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Faulty Workmanship By State Legislatures: The Next Stage For Construction Defect Coverage

For Policyholders: Arkan-saw the Way

The only legal situation that has grown larger than the number of decisions addressing whether faulty workmanship is an "occurrence" is Barry Bonds's head. Courts and commentators have written volumes over the past two decades addressing a singular issue – Is faulty workmanship an "occurrence," *i.e.*, an accident? The cases are legion and the for and against arguments are well-known by everyone involved. The issue is getting tiresome to discuss – except, of course, when done in the context of plugging "General Liability Insurance Coverage: Key Issues In Every State" (Oxford University Press 2011), which examines the "occurrence" question on a fifty-state basis -- in detail I might add -- from pages 221 to 245.

While Pennsylvania's answer to the question whether faulty workmanship is an accident is best-known for being found in *Kvaerner* and *Gambone*, the Pennsylvania high court examined what is an accident nearly a half-century ago:

What is an accident? Everyone knows what an accident is until the word comes up in court. Then it becomes a mysterious phenomenon, and, in order to resolve the enigma, witnesses are summoned, experts testify, lawyers argue, treatises are consulted and even when a conclave of twelve world-knowledgeable individuals agree as to whether a certain set of facts made out an accident, the question may not yet be settled and it must be reheard in an appellate court.

Brenneman v. St. Paul Fire & Marine Ins. Co., 192 A.2d 745, 747 (Pa. 1963).

The Pennsylvania Supreme Court's decision in *Brenneman* has nothing to do with coverage for construction defects. But you would be hard-pressed to find a better description than that of the state of construction defect coverage over the past twenty or so years (and especially the past ten).

Simply put, there just isn't much more that can be said about these decisions. But, alas, a solution is now at hand to this running-out-of-things-to-talk-about situation. Replace the discussion of *courts* addressing whether faulty workmanship is an "occurrence" with that of *state legislatures* addressing whether faulty workmanship is an "occurrence." With at

least four state legislatures getting involved in the question whether faulty workmanship is an "occurrence," this appears to be the next stage for this area of coverage law.

Legislative involvement in CD coverage kicked-off in May 2010 when the Colorado General Assembly enacted "An Act Concerning Commercial Liability Insurance Policies Issued to Construction Professionals" (H.B. 10–1394) (C.R.S.A. § 13-20-808). The Colorado Act addresses several issues relevant to coverage for construction defects, most notably declaring that: "In interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage, *including damage to the work itself* or other work, is an *accident* unless the property damage is intended and expected by the insured." *Id.* at § 3 (emphasis added). In other words, the Colorado legislature did what courts all across the country have been doing in construction defect coverage cases – it decided whether an insured's own work that is faulty qualifies as having been caused by an accident, *i.e.*, an "occurrence." The Colorado General Assembly concluded that it did.

I addressed the Colorado Act in the *Mealey's Insurance* Top 10 Coverage Cases of 2010 article and stated that it was a significant development in the CD coverage arena because of its uniqueness and that it begged the question whether other states would follow Colorado's lead and legislate whether an insured's own faulty workmanship qualifies as having been caused by an "occurrence." Well, at least three more have. [Forgive me. But my predictions come true so infrequently that when one does I try to make a point of it.]

So far in 2011, legislatures in Hawaii (SB1192), South Carolina (H. 3449) and Arkansas have introduced legislation that affirmatively states that an insured's own faulty workmanship qualifies as having been caused by an "occurrence." Arkansas's is no longer just a bill, having become law in March 2011 (followed by an ISO change in the definition of "occurrence" to accommodate it). But Hawaii's and South Carolina's bills are still just sittin' on their capitals' hills.

At issue in all of this legislation are attempts by states to legislate around court decisions that limited coverage for construction defects because they concluded that an insured's own faulty workmanship does not qualify as having been caused by an "occurrence." That's their purpose at heart, to declare that an insured's own work that is faulty qualifies as having been caused by an "occurrence." Although the Colorado law and Hawaii and South Carolina bills certainly have much more to say on the subject, a discussion of which is beyond the scope of this issue of *Binding Authority*. In general, and among other things, they also expand an insurer's duty to defend CD cases and limit the permissible scope of "loss in progress" exclusions.

Interestingly, despite the battle royale over the "occurrence" issue – both in courtrooms and now state houses -- a CGL policy does not provide coverage for the cost to repair or replace an insured's own work that is faulty – no matter what the answer is to the question whether faulty workmanship is an "occurrence." After all, even if an insured succeeds in establishing that faulty workmanship to its own work qualifies as an

"occurrence," coverage would still be precluded by the policy's "your work" exclusion. And none of the state legislation changes this. Indeed, the new Arkansas law specifically states: "This section is not intended to restrict or limit the nature or types of exclusions from coverage that an insurer may include in a commercial general liability insurance policy." Arkansas Code 23-79-155(b). Colorado's law also states that nothing "[r]equires coverage for damage to an insured's own work unless otherwise provided in the insurance policy; or [c]reates insurance coverage that is not included in the insurance policy." *Id.* at § 3(a), (b).

So if a CGL policy does not provide coverage, under any circumstances, for the cost to repair or replace an insured's own work that is faulty, then why is so much time and money being spent in litigation and legislative houses over the "occurrence" issue? Because, while damage to the insured's own completed work product is not covered, the rationale a court employs to reach this conclusion – no "occurrence" or the "your work" exclusion -- can make a world of difference. This is because the "your work" exclusion also contains what is commonly referred to as the "subcontractor exception," which restores coverage for "property damage" to the insured's own work, that would otherwise be excluded by the "your work" exclusion, if the cause of the damage to the insured's work was the operations of the insured's subcontractor.

However, many courts hold that, if damage to an insured's defective workmanship is not covered, because it does not qualify as an "occurrence," then the insured has not satisfied the requirements of the insuring agreement. As a result of the insured's failure to satisfy the insuring agreement, coverage is excluded and the court's analysis ends there, without any need for the court to address the potential applicability of policy exclusions.

In other words, by resting its decision on the insured's failure to satisfy the insuring agreement, it becomes unnecessary for the court to reach the "your work" exclusion. Translation—policyholders are therefore denied the opportunity to invoke the "subcontractor exception" to such exclusion to restore coverage for damage to their own work that was caused by the operations of a subcontractor. In its simplest terms, the "occurrence" battle that is taking place in both courtrooms and state houses is all about whether the "subcontractor exception" to the "your work" exclusion comes into play.

The most significant aspect of this new legislative avenue for finding coverage for construction defects is this. Once the "occurrence" issue has been decided in a particular state, via the judicial route, it is difficult to change the outcome, especially if the issue has been decided by the state's highest court. And even if it remains an open issue with the highest court, the right case still needs to come along, not to mention that the judicial system is not known for its speediness. But the legislative route – especially for insureds who did not find success in the judicial branch and have exhausted their viable options -- would offer insureds the proverbial second bite at the apple, and a speedier one at that. Further, while lobbying judges has significant restrictions -- being limited to skillful advocacy, in public and under very precise conditions -- lobbying legislators is a whole different kettle of fish. And construction trade associations are no strangers to legislative hallways.

Please let me know if you have any questions.

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