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Gambone Rolls On – Third Circuit: No Coverage For Consequential Damages of Faulty Workmanship

Insureds Don't Got a Friend in Pennsylvania

April 14, 2009

For the past fifteen months talk in Pennsylvania insurance coverage circles has been dominated by one word – *Gambone*. Everywhere you turn the discussion has been about this Superior Court decision and its effect on construction defect claims. The case has been as inescapable as *Law & Order* reruns.

Today the Third Circuit Court of Appeals issued a Precedential opinion in *Nationwide Mutual Ins. Co. v. CPB International, Inc.* that addressed *Gambone* (most Third Circuit decisions are non-precedential). The *CPB International* court swiftly concluded, following the Pennsylvania Supreme Court's decision in *Kvaerner,* and the Superior Court's in *Gambone*, that faulty workmanship does not constitute an "occurrence" -- and neither do consequential damages flowing therefrom. What's more, the Third Circuit's decision expands *Gambone* beyond the construction defect context.

In *Nationwide Mutual Ins. Co. v. CPB International, Inc.,* the Third Circuit addressed coverage for CPB, an importer and wholesaler of chondroitin, a nutritional supplement made from animal cartilage. CPB had been a Rexall vendor. *CPB International* at 3.

Rexall ordered chondroitin from CPB. A dispute arose and Rexall did not pay for certain product. CPB filed suit against Rexall for breach of contract and demanded payment. Rexall filed an answer and counterclaim, alleging that the chondroitin that was shipped to it was deficient, of improper composition, and unusable for its intended purpose, and that the delivery of the material constituted a material breach of contract. *CPB International* at 3-4.

Rexall sought return of its initial $760,000 payment and consequential damages in an amount exceeding $1,195,465 for the shipment of the allegedly defective chondroitin. Rexall did not discover that the chondroitin was of improper composition until after it had already combined it with glucosamine and other ingredients to form the nutritional tablets. The tablets, which were mixed with ingredients valued at more than $991,015, were allegedly useless and without value. *CPB International* at 4.
CPB tendered the underlying claim to Nationwide pursuant to a CGL policy. Nationwide assumed defense of the action under a reservation of rights and filed a coverage action.

CPB conceded that Rexall's claim that it provided defective chondroitin, without more, would not trigger coverage. However, CPB argued that, because Rexall's action alleged consequential damages, it came within the ambit of the policy. The Third Circuit (affirming the District Court) thought otherwise:

> That argument is unpersuasive. The precise holding of *Kvaerner* is limited to claims that "aver[] only property damage from poor workmanship to the work product itself," 908 A.2d at 900, but the foundation of that holding is that claims for faulty workmanship "simply do not present the degree of fortuity contemplated by the ordinary definition of 'accident' or its common judicial construction in

> this context." *Id.* at 899. In other words, it is largely within the insured's control whether it supplies the agreed-upon product, and the fact that contractual liability flows from the failure to provide that product is too foreseeable to be considered an accident. *See id*. Here, though the delivery of defective chondroitin is not considered an accident, *see id*., CPB argues that Rexall's use of that product should be considered one. That distinction is inapposite. It is certainly foreseeable that the product CPB sold would be used for the purpose for which it was sold. Otherwise, Rexall would lack a claim for consequential damages. * * * Thus, "the degree of fortuity" here is no different than that involved in *Kvaerner*, 908 A.2d at 898.

CPB International at 8.

Of note, the *CPB International* court needed only to look as far as *Kvaerner* to conclude that consequential damages flowing from faulty workmanship are not caused by an "occurrence." The court cited to *Gambone* solely to bolster its conclusion: "The Superior Court of Pennsylvania, when confronted with an argument similar to the one that CPB makes here, reached the same conclusion. *See Millers Capital Ins. Co. v. Gambone Bros. Dev. Co.*, 941 A.2d 706 (Pa. Super. Ct. 2008)." *CPB International* at 9.

The *CPB Internatonal* court also held that an underlying claim alleging breach of contract would not trigger coverage under a CGL policy because allegations that are based in contract do not arise from covered "occurrences." *CPB International* at 11. Lastly, the court concluded that, even if the underlying claim alleged an "occurrence," the contractual liability exclusion barred coverage.

A copy of the Third Circuit's April 14 decision in *Nationwide Mutual Ins. Co. v. CPB International, Inc.* can be accessed here:

http://www.ca3.uscourts.gov/opinarch/074772p.pdf

Let me know if you have any questions.

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