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WHEN IS A MISTAKE AN 'ACCIDENT'?

By Jason R. Potter, Esq.

Commercial General Liability (CGL) policies, like all insurance products, are intended to protect the insured from unexpected claims or suits by third parties. A CGL policy covers bodily injury, property, personal and advertising liability, products and completed operations and fire liability unless they are excluded by a specific endorsement. CGL coverage can provide important protections to a business owner for a variety of losses, but they are most ubiquitous in the construction setting.

Perhaps no issue is as litigated and disputed within the CGL context as whether faulty construction work comes within a typical CGL policy's initial grant of coverage. Pundits, professors and law professionals have all offered starkly differing views, but recent cases appear to be coalescing in favor of coverage, albeit for a specifically delineated subset of damages. This article will briefly summarize the positions and arguments in favor and in opposition to such coverage and offer a glimpse of what the future may hold. This article is limited to analyzing the CGL's initial grant of coverage and does not delve into how, if at all, the policy's 20 or so exclusions would affect that grant.

The case for CGL coverage

CGL insurance was first developed in 1941 as a way to purchase separately insured risks in one, unified policy. The Insurance Services Office, Inc. last modified the current standard form CGL policy in 1986. Its initial grant of coverage provides: "We will pay those sums that the insured becomes obligated to pay as damages because of 'bodily injury' or 'property damages' to which this insurance applies." It clarifies that "This insurance applies to 'bodily injury' and 'property damage' only if: 1. The 'property damage' is caused by an 'occurrence' that takes place in the 'coverage territory' [and] 2. The 'bodily injury' or 'property damage' occurs during the policy period." It defines "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The term "accident," however, is undefined. That lack of definition bears responsibility for much of the current dispute.

Consider the following example. A university contracted with a general contractor (GC) to build a new hotel on its campus. GC has a CGL policy. GC subcontracted most of the work to subcontractors. After construction was complete, the university discovered extensive water damage from hidden leaks, as well as other structural problems, all of which, it contended, arose from defective workmanship. The repair cost was estimated at $6 million.

The university sued the GC for the defective construction, and the GC turned to its CGL carrier for a defense of the case and indemnity for any judgment rendered against it. The CGL carrier argued there was no coverage because no accident (and thus no occurrence) had taken place. The court agreed with the insurer, leaving the GC with the $6 million repair bill.

In this scenario, if the GC is relatively solvent, it will file suit against its subcontractor or subcontractors seeking some or all of those repair costs. If the subcontractor has no insurance coverage and no surety performance bond, the GC and/or the subcontractors will bear the risk of loss. If, however, the GC and/or the subcontractors has insufficient capital or credit, then some or all of the repair costs will be passed onto the owner. Regardless of who bears that cost, all of the parties are likely to complain that they believe the GC's CGL carrier should bear such a burden because, for contractors, defective workmanship is by far the largest claim risk they face. In fact, for that reason, they are likely to say that CGL policies are purchased specifically to protect against such risks. Who is right? It will come as no surprise that the answer depends on whom you ask, or, in this case, what court you ask.

Courts' treatment of CGL coverage for faulty workmanship

Courts throughout the country hold disparate views regarding whether defective construction is an occurrence within the confines of a CGL policy's initial grant of coverage. By definition, an occurrence must be an accident; thereby raising the question as to whether the failure to properly construct something is an "accident." As courts have repeatedly demonstrated, the answer to that question is not an easy one.

PERHAPS NO ISSUE IS AS LITIGATED AND DISPUTED WITHIN THE CGL CONTEXT AS WHETHER FAULTY CONSTRUCTION WORK COMES WITHIN A TYPICAL CGL POLICY'S INITIAL GRANT OF COVERAGE

A minority of jurisdictions holds that defective construction is not an accident. Pointing to the everyday meaning of the term accident, these courts say that construction defects are not unexpected, because, they argue, it is foreseeable that a contractor that does faulty work would cause damages for which it would be obligated to pay the costs of repair. Because an accident must be, by its nature, unexpected, defective construction is no accident.

These jurisdictions often state that if a CGL policy provided coverage for defective workmanship, it would be converted into a warranty or guaranty of the contractor's performance, which is more properly the province of a surety performance bond, whose sole purpose is to guaranty the contractor's performance on the construction project. Courts in Ohio, Arkansas, Kentucky, and Pennsylvania adhere to this view and typically deny CGL coverage for construction defects, regardless of the types of damages caused by the defective work.

The majority position says that construction defects may be accidents, and thus occurrences that are eligible for CGL coverage. They are accidental because the contractor performing the work does not intend for the resulting damages to occur. Further, they argue, if CGL policies did not cover construction defects, no contractor would ever purchase them because they would provide no coverage for

their single largest category of claim risk – construction defects. These majority -view jurisdictions often look at whether the damages were intended, expected or foreseeable. The focus, therefore, is on whether the results (the damages resulting from the defective work) would have been expected or foreseeable had the contractor performed correctly. If so, then it was not an accident for purposes of the CGL policy; if not, then it was.

Granting coverage for construction defects does not render as insured all such damages, however. Within these majority -view jurisdictions, there is a further split of authority as to whether the CGL policy covers only damages to a third party's work or whether it also covers the repair and/or replacement cost of the defective work itself.

Most hold that a construction defect may be an occurrence (*i.e.*, an "accident") but only to the extent that the faulty work damaged property other than the insured's defective work. These jurisdictions, which include Oregon, Illinois, Iowa, South Carolina, and Nebraska, believe that faulty workmanship itself is not an accident because the damages (the defective work) were within the insured's control. They further justify their position on policy grounds, believing that the ultimate liability for such defective work should fall on the party that performed it, not the insurance carrier.

Other courts say that there is no basis for distinguishing between damages to the work itself and damages to other property. As the Supreme Court of Florida stated, "the definition of 'property damage' in the CGL policies does not differentiate between damage to the [insured] contractor's work and damage to other property. [W]e reject a definition of occurrence that renders damage to the insured's own work as a result of a subcontractor's faulty workmanship expected, but renders damage to property of a third party caused by the same workmanship unexpected." These jurisdictions, which include Florida, Kansas, Minnesota, Tennessee, Texas, and Wisconsin, find property damage to the work itself, as well as damage to the work of third parties, to be an occurrence that triggers CGL coverage.

What does the future hold?

In 2004, the Supreme Court of Nebraska stated, "the majority of courts have determined that faulty workmanship is not an accident and, therefore, not an occurrence." [*Auto-Owners Insurance Co. v. Home Pride Companies, Inc.*, 268 Neb. 528 (2004).] Since that case, however, courts in Florida, Kansas, Iowa, New Jersey, Georgia, West Virginia, Montana, Missouri, South Dakota, Tennessee, and South Carolina have reversed that majority, and it appears that a strong consensus has emerged that construction defects are occurrences that come within the initial grant of CGL coverage. The Ohio Supreme Court stemmed the unanimity of these authorities favoring coverage with its 2018 opinion in *Ohio Northern University v. Charles Construction Services, Inc.*, from which the above example was taken.

Despite *Ohio Northern*, the clear trend favors initial coverage for defective workmanship. And, at least four state legislatures (Colorado, Hawaii, South Carolina, and Arkansas) have enacted statutes that define occurrences in the CGL context to include construction defects. Although such decisions are state-specific, they often rely on policy interpretations from other jurisdictions, a fact which suggests the majority view may continue to grow with support from new jurisdictions that have yet to consider the matter.

What does all this mean for the insurance industry and its insureds? This greater trend toward uniformity in construction defect coverage should provide optimism in the goal toward greater understanding and therefore fewer disputes among all parties (and fewer lawsuits against carriers) regarding the question of CGL coverage of damages arising from faulty construction.

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