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Is There Coverage for Damage Caused by Faulty Construction? The Courts Change Course

Contractors face uncertainty whether claims brought against them for property damage or bodily injury allegedly caused by their faulty workmanship are covered under their standard commercial general liability (CGL) policies.

While the courts have not always been friendly toward contractors, some recent cases have had more favorable outcomes.

Insurers, emboldened by early success in the courts, have frequently argued that no coverage was available because claims alleging faulty workmanship did not constitute an “occurrence” under the standard CGL policy, and therefore, there was no coverage for the resulting bodily injury or property damage.

For example, the Pennsylvania Supreme Court weighed in on the debate in *Kvaerner Metals Division v. Commercial Union Insurance Company*, 589 Pa 317 (2006), finding that claims of faulty construction do not constitute an “occurrence” under the terms of the CGL policy. The court held that Kvaerner’s insurers had no obligation to defend or indemnify it in connection with claims that Kvaerner had breached its contract in connection with the construction of a coke oven battery.

While Kvaerner dealt with claims associated with damage to the contractor’s own work, subsequent decisions by the Pennsylvania Superior Court seemingly expanded that holding to bar coverage not only for damage to the contractor’s work but also for any damage arising from the faulty construction.

For example, in *Millers Capital Insurance Co. v. Gambone Brothers Development Corp.* 941 A.2d 706 (Pa. Super. 2007), the Superior Court relied on the Supreme Court’s statement that faulty workmanship claims did not present the degree of fortuity contemplated by the term “accident” in the definition of occurrence. It thereby extended the reasoning of *Kvaerner* to bar claims for damages caused by all natural and foreseeable acts, including rainfall, which tend to exacerbate the damage, effect or consequences of the faulty workmanship. The court found

that damage to other property caused by water leaks due to construction defects and product failures also were barred as not involving an occurrence.

Recently, courts in general, including Pennsylvania courts, have begun to reject that expanded view. In *Indalex Inc. v. National Union Fire Insurance Company* of Pittsburgh, the Superior Court found that a product manufacturer was entitled to coverage in connection with lawsuits alleging that the windows and doors it manufactured were defectively designed or manufactured, which resulted in water leakage that caused physical damage such as mold and cracked walls.

In so finding, the court limited the holding of *Kvaerner*, *Gambone* and other previous Superior Court authority as barring coverage only to situations "where the underlying claims were for breach of contract and breach of warranty, and the only damages were to the [insured's] work product." Thus, the court found that because the underlying complaints alleged defective products resulting in damage to property other than the policyholder's products, there was an "occurrence."

Even though this rejection of a broad reading of the "faulty construction" argument was made in the context of a product claim, its analysis should be relevant in claims arising from a contractor's work. While the Superior Court has denied rehearing, the insurer may still appeal this result to the Pennsylvania Supreme Court, so this may not be the last work on this issue.

This clarification in Pennsylvania law has been mirrored nationwide, where the clear majority rule is that claims of faulty construction can constitute an occurrence under the terms of the CGL policy. The recent decisions of the West Virginia and Connecticut supreme courts reinforce this trend.

In *Cherrington v. Erie Insurance Property and Casualty Company*, 745 S.E.2d 508, (W.Va. 2013) the West Virginia Supreme Court found that the contractor's CGL policy provided coverage against claims for property damage as a result of defective workmanship performed by subcontractors. In so holding, the West Virginia Supreme Court acknowledged its line of cases finding that defective work did not constitute an occurrence.

After reviewing contrary precedent from other states, the West Virginia Supreme Court changed its course and concluded that "defective workmanship causing bodily injury or property damage is an 'occurrence' under [a CGL policy]." The court found further support for its position in the express language of the contractor's CGL policy, which provided coverage for the acts of the subcontractors while excluding damage to the contractor's work.

Because the defective work in this case was performed by a subcontractor, the court reasoned that "[c]ommon sense dictates that had [the contractor] expected or foreseen the allegedly shoddy workmanship its subcontractors were destined to perform, [the contractor] would not have hired them in the first place."

The Connecticut Supreme Court reached the same result, finding that "defective workmanship can give rise to an 'occurrence' under the [CGL]," explaining that "the mere fact that defective work is in some sense volitional does not preclude it from coverage under the terms of the policy" in *Capstone Building Corporation v. American Motorists Insurance Company*, 67 A.3d 961, (Conn. 2013).

With the addition of Connecticut and West Virginia, 17 state Supreme Courts have held that faulty construction can constitute an occurrence. Moreover, three states have statutes that require policies to cover faulty workmanship.

A great deal of uncertainty exists on this issue and the question of whether coverage is available

will depend on the policy language and exclusions, the underlying facts, including the manner in which they are plead, and the state law that is to be applied to the policy. Nonetheless, these recent cases should be viewed as a welcome development for contractors.

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David Strasser primarily practices in the area of insurance coverage and commercial litigation. Since joining Eckert Seamans in 1998 and prior as an Assistant General Counsel for CBS/Westinghouse Electric Corporation, Dave litigated and managed a wide variety of environmental, toxic tort and product insurance coverage claims and negotiated settlements in these matters. He has extensive experience dealing with foreign and domestic insolvent insurers and is a member of the creditors' committee of a number of insolvent London Market Companies.
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