

# Construction Defect Claims Are Occurrences

By James A. Johnson

“You can guard against the high percentage of risk but you can’t guard against risk itself.”

## Introduction

One of the most litigated issues in insurance law is whether construction defect claims constitute “occurrences” under the Commercial General Liability (CGL) policy. This article answers the question in the affirmative and explains the nascent majority view.

Keep in mind that today we are all involved in a multijurisdictional practice. A New York lawyer may find himself or herself in New Jersey, Michigan, Texas or any court outside New York State. Moreover, in the insurance context, both plaintiff and defendant counsel will need to know the law of the jurisdiction that will be applied by the court in deciding the insurance coverage dispute. Attorneys who reread this article will have an advance starting point.

Currently the majority view is that construction defects constitute “occurrences” with the Supreme Courts of Tennessee,<sup>1</sup> Indiana,<sup>2</sup> Florida,<sup>3</sup> Alaska,<sup>4</sup> Wisconsin,<sup>5</sup> South Dakota,<sup>6</sup> Mississippi,<sup>7</sup> Georgia,<sup>8</sup> Texas,<sup>9</sup> South Carolina,<sup>10</sup> Minnesota<sup>11</sup> and Kansas.<sup>12</sup> These states all find in favor of policyholders. Moreover, Colorado,<sup>13</sup> Arkansas,<sup>14</sup> Hawaii<sup>15</sup> and South Carolina<sup>16</sup> have passed statutes that essentially mandate that construction defects are “occurrences.”

## Analysis

In determining if construction defects are “occurrences,” the analysis should focus on whether the faulty workmanship and resulting damage was expected or intended by the insured. If the faulty workmanship and resulting damage were unexpected and unintended by the contractor, it follows that the resulting construction defects and any related property damage were caused by an “occurrence.” An “*occurrence*” as set out in the Insurance Services Office (ISO) standard for policy is defined as: *An accident, including continuous or repeated exposure to substantially the same general harmful conditions.*<sup>17</sup>

The rules of insurance policy interpretation dictate that construction defects are “occurrences.” Under the rules of insurance interpretation, such as *contra proferentem*, the reasonable expectations doctrine together with construing the policy as a whole, there is no question that construction defects are “occurrences.” All of the policy provisions should be analyzed, including the business risk exclusions to determine if the policy covers the claim at issue. Contractors do not intend for their workmanship to be faulty or defective. Nor do they generally expect that their work will result in property damage. Thus, when

construction work is done defectively it generally is an “accident.” If construction defects were not “occurrences” the business risk exclusions, which purport to exclude coverage for certain risks inherent in doing business, would be superfluous. *The drafters of the Commercial General Liability policy did not intend to provide illusory coverage to contractors.* And, contractors who purchase CGL insurance expect that liability claims will be covered under CGL policies they purchase. This expectation is reasonable because contractors are in the construction business.

Insurance companies maintain that allowing coverage for construction defects convert CGL policies into performance bonds because such claims are reasonably foreseeable and therefore not “accidents.” This counsel maintains that permitting recovery for construction defect claims does not convert the Commercial General Liability into performance bonds. Performance bonds are issued to the owner to ensure that the construction will be completed. CGL policies insure the contractor against third party claims and lawsuits. Thus, performance bonds and liability insurance provide financial security to different entities and requires a separate and independent analysis of the facts.

In applying the expected or intended language the majority of courts have adopted the *subjective test*.<sup>18</sup> These courts have reached their conclusions by applying the definition of “occurrence” to the facts of the case. And, then determined it was undisputed that the insured did not expect or intend to do the work defectively or cause the resulting damage.

## Additional Case Law

**CONNECTICUT**—*Royal Indemn Co. v. Sonoco/Northeastern, Inc.*, 183 F. Supp. 2d 526, 533 (D. Conn. 2002)—determining intent for the intentionality exclusion requires the court to apply a subjective standard.

**MASSACHUSETTS**—*Quincy Mut. Fire Ins., Co. v. Abernathy*, 469 NE 2d 797, 800 (Mass. 1984)—an injury is nonaccidental only where the result was actually, not constructively, intended.

**NEW HAMPSHIRE**—*High Country Assoc. v. New Hampshire Ins. Co.*, 648 A.2d 474, 478 (N.H. 1994)—property damage to condominium units caused by defective workmanship is an “occurrence” within the meaning of the CGL policy.

**MICHIGAN**—*Arco Indus. Corp v American Motorists Ins. Co.*, 531 NW 2d 168,179 (Mich. 1995), overruled on other

grounds by *Frankenmuth Mut. Ins. Co. v. Masters*, 595 NW 2d 832 (Mich. 1999)—trial court should have adopted a subjective standard.

**OHIO**—*Erie Ins. Exchange v. Colony Dev. Corp.*, 736 NE 2d 941, 947 (Ohio App. 1999)—property damage caused by contractor’s negligence in constructing and designing a condominium complex reasonably falls within the policy’s definition of property damage caused by an occurrence, i.e., an accident.

**WEST VIRGINIA**—*Farmers & Mech. Mut. Ins. Co. of W. Virginia v. Cook*, 557 S.E. 2d 801, 807 (W. VA. 2001)—courts must use a subjective rather than objective standard for determining the insured’s intent.

**LOUISIANA**—*Great American Ins. Co. v. Gaspard*, 608 So. 2d 981, 985 (La. 1992)—the subjective intent of the insured is the key and not what the average or ordinary reasonable person would expect or intend; *Williams v. City of Baton Rouge*, 731 So. 2d 240, 253 (La. 1999)—the subjective intent of the insured will determine whether an act is intentional.

**ALABAMA**—*U.S.F & G Co. v. Armstrong*, 479 So. 2d 1164, 1167 (Ala. 1985)—the legal standard to determine whether the injury was either expected or intended is a purely subjective standard.

## Conclusion

When you apply the rules of policy interpretation such as *contra proferentem*, the reasonable expectations doctrine together with construing the policy in its entirety, the ineluctable conclusion is that construction defects are occurrences. Contractors do not expect or intend to do their work defectively. *Moreover, construction defects must be “occurrences” in order for business risk exclusions to have any purpose. Also, the subcontractor exception would be superfluous.*

In the final analysis, the test should be *subjective* whether the damage was actually expected or intended by the insured and not whether the damage was reasonably foreseeable. Thus, if construction defects were not “occurrences” under CGL policies such coverage would be illusory. Therefore, construing CGL policies as a whole leads inexorably to the conclusion that construction defects are “occurrences.”

## Endnotes

1. *Travelers Indem. Co. v. Moore & Associates, Inc.*, 216 SW 2d 887, 894-95 S.D. 2002)—defective installation of windows causing water penetration constitutes property damage for purposes of the CGL.
2. *Sheehan Const. Co., Inc v. Continental Cas. Co.*, 935 NE 2d 160 (Ind. 2010), modified on other grounds, 2010 WL5135322 (Ind. 2010)—

if faulty workmanship is unexpected and without intention or design and not foreseeable from the viewpoint of the insured, then it is an accident within the meaning of a CGL policy.

3. *United States Fire Ins. Co. v. J.S.U.B.*, 979 So. 2d 871, 883 (Fla. 2007)—defective soil work done by subcontractor that caused damage to homes was an occurrence under CGL policies.
4. *Fejes v. Alaska Ins. Co.*, 984 P 2d 519, 523 (Alaska 1999)—improper or faulty workmanship constitutes an accident.
5. *American Family Mut. Ins. Co.*, 673 NW 2d 65, 70 (Wis. 2004)—settlement of soil after building was completed that caused the building’s foundation to sink was property damage caused by an occurrence within the meaning of the CGL policies general grant of coverage.
6. *Corner Construction Co. v. U.S. Fid. & Guar. Co.*, 638 NW 2d 887, 894-95 (S.D. 2002)—construction defects resulting in ventilation problems constituted an accident and such damage is covered by the policy at issue.
7. *Architex Assn. Inc. v. Scottsdale Ins. Co.*, 27 So. 3d 1148, 1162 (Miss. 2004)—the term “occurrence” cannot be construed in such a manner as to preclude coverage for unexpected or unintended property damage resulting from negligent acts or conduct of a subcontractor, unless otherwise excluded or the insured breaches its duties after loss.
8. *American Empire Surplus Lines Ins. v. Hathaway Dev. Co.*, 707 SE 2d 369, 372 (Ga. 2011)—an occurrence can arise where faulty workmanship causes unforeseen or unexpected damage to other property.
9. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 SW 3d 1, 9 (Tex. 2007)—no basis exists in the definition of “occurrence” to distinguish between damage to the insured’s work and damage to a third party’s property from an occurrence as defined in the CGL policy.
10. *Auto Owners Ins. Co. v. Newman*, 684 SE 2d 541 (S.C. 2009)—defectively installed stucco resulted in a covered occurrence.
11. *Wanzele Const., Inc. v. Employers Ins. of Wausau*, 679 NW 2d 322 (Minn. 2004).
12. *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P. 3d 486, 493 (Kan. 2006).
13. *Colo. Rev. Stat. § 13-20-808* (2010).
14. *Ark. Code Ann. § 23-79-155* (2011).
15. *Haw. Rev. Stat. § 431-1* (2011).
16. *S.C. Code Ann. § 38-61-70* (2011).
17. *Insurance Service Office 2004 form for Commercial Liability Policies—ISO is an insurance industry organization that prepares and disseminates standard form policies.*
18. *Royal Indem. Co. v. Sonoco/Northeastern, Inc.*, 183 F. Supp. 2d 526, 533 (D. Conn. 2002)—determining intent for the intentionality exclusion requires the court to apply a subjective standard.

**James A. Johnson (johnsonjajmf@yahoo.com) of James A. Johnson, Esq. in Southfield, Michigan is a trial lawyer and an active member of the Michigan, Massachusetts, Texas and Federal Court Bars. Mr. Johnson is an accomplished attorney and concentrates on insurance coverage under the Commercial General Liability policy. He can be reached at [www.JamesAJohnsonEsq.com](http://www.JamesAJohnsonEsq.com).**

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