INSURANCE COVERAGE FOR DEFECTIVE CONSTRUCTION: LITIGATION, LEGISLATION AND REACTION

By Barbara A. Reeves Neal, Esq.

If you have ever remodeled or built a house, you can begin to understand a significant issue that has generated both litigation and legislation arising out of defective construction: Do comprehensive general liability ("CGL") policies provide coverage for construction defects?

Contractors typically purchase performance bonds to cover their work, but these bonds generally have higher premiums than liability policies. While it is not surprising that consumers would prefer the availability of the lower-priced coverage if provided by CGL policies, the cost of those policies may increase if courts and legislatures mandate constructive defect coverage under CGL policies.

A CGL policy covers potential liability for property damage caused by an "occurrence," typically defined as an "accident," including gradual accidental harm. In construction defect coverage, courts across the country have handed down opinions with varying interpretations of the "occurrence" issue, with most being divided on the issue as to whether coverage is available for construction defects.

One approach takes the position that defective construction work—and resulting damage—is not covered under liability insurance policies because neither was the result of an "accident" (i.e., an "occurrence"). Pennsylvania, New Jersey, New York, Arizona, Ohio and Kentucky courts, among others, have adopted this position, while courts in Colorado and Hawaii were split within the state. The analysis is that construction defects are the natural consequence of performing (substandard) work and liability policies do not protect against foreseeable business risks. They conclude that CGL policies are not performance bonds and liability insurers did not sign up to be guarantors of a contractor's work.

Other jurisdictions, including Florida, Wisconsin, and Alabama, among others, have held that faulty or defective workmanship is considered an "accident" and therefore an "occurrence," or that even if the defective construction work itself is not an "occurrence," the resulting damage is covered because it was fortuitous and unintended. ("Your substandard work may not have been an accident, but the resulting mess was.")

Some state legislatures have gotten involved further in this battleground and passed legislation that confirms faulty work does constitute an "accident," or an "occurrence," under CGL policies. In 2010 and 2011, Colorado, Arkansas, South Carolina and Hawaii passed statutes defining construction defect claims for damages from faulty workmanship as "occurrences" (The statutes vary significantly from each other. Read the specific language of the statute if you are in one of these states.), but the anticipated groundswell of legislation into other states has not emerged, save for a bill introduced in New Jersey at the end of 2013.

Not to be outdone by the legislature, courts have responded by examining other exclusions and reaching conflicting results. The South Carolina Supreme Court held last summer that two exclusions ("completed operations" and "withdrawn work") in the standard form CGL policy remove coverage that the legislature had attempted to restore when it passed legislation overruling a previous decision of the court. (*Bennett & Bennett Construction v. Auto Owners Insurance Co.*, 405 S.C. 1, 747 S.E.2d 426 (2013)).

On the other hand, last month the Texas Supreme Court upheld coverage, holding that the contractor's agreement to perform in a workmanlike manner was not an assumption of liability beyond its obligations under general law and thus did not trigger the contractual liability exclusion. (*Ewing Construction Co. v. Amerisure Insur. Co.*, _____ S.W.3d ___, WL 185035 (2014)).

Taken together, the *Ewing and Bennett* decisions are a reminder that there is a myriad of other issues, and exclusions, that frequently arise in construction defect coverage cases and may be very influential in opening up another battle front over the scope of insurance coverage for construction defects.

Insurance solutions for construction defect claims are of interest to anyone who represents or deals with contractors. Increasingly, carriers are offering construction defect endorsements that could clarify coverage across jurisdictions; the question that remains is at what cost to the contractors and to the end consumers. ■

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