Connecticut Law Tribune
MARCH 7, 2011
VOL. 37, NO. 10 • $10.00
An ALM Publication
CTLAWTRIBUNE.COM

Defective Construction Often An Insurance Issue

Courts divided over whether CGL policies cover property damage

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Imagine the following scenario: you are a general contractor hired to construct a condominium complex. Your role is supervisory, since you enter into contracts for each aspect of the work with subcontractors. Unfortunately, as is so often the case on construction projects, mistakes are made—the flashing around the windows is installed backwards.

Several months after the project is completed, a rainstorm soaks the area and water pours in through the windows, destroying millions of dollars worth of property. The owner sues you for damages. You tender the claim to your comprehensive general liability (CGL) carrier—this is what you purchased insurance for, right?—and quickly get a denial: "Defective construction is not covered under your CGL policy."

The insurer's position in this hypothetical situation is common, albeit misguided. For years, insurers have argued that defective construction does not satisfy the CGL insuring agreement (the key policy provision outlining coverage) because there is no accident and, therefore, no "occurrence." It is true that CGL policies do not cover the cost of repairing or replacing defective work itself (in our example, the flashing). However, the general contractor should not have to shoulder the cost of all of the repair work. This sort of unforeseen accident is precisely what CGL policies are meant to cover.

Since 2005, at least 20 jurisdictions have issued pro-policyholder decisions in the realm of defective construction as an "occurrence." Three states in particular (Mississippi, Indiana and Georgia) have held that coverage is not automatically precluded when defective work is at issue. Of course, there are still some jurisdictions that take the minority approach: in the past five years, the highest courts in South Carolina and Pennsylvania, along with the appellate-level court in Hawaii, have gone the other way, leaving policyholders to face such claims on their own.

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The Indiana Supreme Court took a pro-policyholder approach in *Sheehan Construction Co. v. Continental Casualty Co.*, 935 N.E.2d 160 (Ind. 2010), the first case decided by Indiana's highest court on this issue since 1980. Much like the hypothetical situation above, Sheehan served as general contractor on a project where window flashing and caulking was improperly installed by a subcontractor. The trial court determined that there was "no property damage other than to the structural components of the homes themselves," and that, therefore, there was no "occurrence" or "property damage." The Supreme Court reversed, stating: "We align ourselves with those jurisdictions adopting the view that improper or faulty workmanship does constitute an accident [i.e., an 'occurrence'] so long as the resulting damage is an event that occurs without expectation or foresight." Thus, the determination of whether there has been an "occurrence" is a question of fact depending on the intent (or lack thereof) of the parties.

At the other end of the spectrum, South Carolina's high court recently ruled in *Crossman Communities of North Carolina Inc. v. Harleysville Mutual Insurance Co.*, 2011 W.L. 93716 (S.C. Jan. 7, 2011) that damages that are the natural consequence of defective construction cannot constitute an "occurrence."

Crossman was the developer of a series of condo projects in Myrtle Beach. Various homeowners filed suit against Crossman,

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alleging that the condos were defectively constructed and that resulting water infiltration led to decay and deterioration of the buildings. Crossman settled the case for approximately $16.8 million and then sought coverage from its CGL insurer.

The state Supreme Court overruled a pro-policyholder decision it had issued less than a year earlier and held that "where the damage to the insured's property is no more than the natural and probable cause of faulty workmanship such that the two cannot be distinguished," there is no occurrence. Crossman was not entitled to coverage, the court held, because the decay of the condos was the "natural" consequence of its deficient work.

Mystery In Connecticut

Connecticut law on the issue remains somewhat of a mystery. In 2007, this firm published an article in the *Law Tribune* titled "Coverage for Defective Construction Claims Debatable," in which the authors discussed the notable absence of Connecticut appellate law.

Four years later, there has been little judicial commentary on the issue. Last year the district court issued an unpublished opinion in the case of *Scottsdale Insurance Co. v. R.I. Pools Inc.,* 2010 W.L. 3827948 (D. Conn. Sept. 22, 2010) which failed to add any clarity to the courts' jurisprudence.

The case stemmed from suits brought by 19 homeowners against R.I. Pools for the alleged defective construction of the concrete walls and floors of their pools. The district court found no coverage for the policyholder: although the complaints against R.I. Pools alleged losses to appurtenant structures and surrounding landscaping (on top of the losses to the defective pools themselves), the damages were deemed not "the result of an 'accident' that occurred as the result of faulty workmanship."

This decision is out of step with Connecticut's only other judicial pronouncement on this topic, *Times Fiber Communications Inc. v. Travelers Indemnity Co.*, 2005 W.L. 589821 (Conn. Super. Ct. Feb. 2, 2005), which suggested that a policyholder would be entitled to coverage for consequential damages to non-defective work. Given this apparent conflict, it is unclear what a Connecticut court will do when it next faces a policyholder seeking insurance for defective construction.

Until recently, case law has been the only source of guidance in determining coverage for defective construction. However, in 2010, the Colorado legislature passed a statute in direct response to an appellate court's pro-insurer decision. The statute provides: "In interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured. " Colorado Revised Statutes § 13-20-808.

In light of this new law, insureds should be on the look-out for pending legislation that might affect their insurance coverage.

Nationwide, the majority of courts are finding in favor of coverage when damages caused by defective construction were not intended by the insured. Colorado's statute may mark the beginning of a new era of legislative involvement in this ongoing debate.

Regardless of the present state of the law, policyholders throughout the country should not take "no" for an answer when it comes to seeking coverage for damages arising from defective construction. Policyholders are entitled to the coverage they purchased and should be protected from claims of accidental damage stemming from defective work. ■