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Issue Alert

CONSTRUCTION DEFECTS: ARE THEY EVEN AN OCCURRENCE?

We just moved into our new condo development. Everything was fine until a few weeks after we moved in. Without warning, the new hardwood floor buckled, with the middle two four-inch-wide planks pushing up on their sides to form a small barrier in the middle of the floor of our living room. As it turns out, other members of our homeowners' association were experiencing the similar problem. We had just experienced a CD – construction defect.

Construction Defect – Defined

The term "construction defect," or "CD," is a very broad term that has a variety of meanings, including in some cases "faulty workmanship" or "faulty work." For the purposes of addressing how construction defect litigation is to be handled, several states have enacted statutes that define what constitutes a construction defect. With an eye toward limiting or at least controlling litigation, several states have "right to repair" statutes, which mandate (among other things) that the builder/contractor must be given the opportunity to repair certain defects *before* the owner can proceed with construction defect litigation.

In general, whether it is a matter of perception or reality, a construction defect usually begins when the owner(s) of property believe something about the property they have purchased is not right – and demand that it be corrected.

Are Construction Defects Covered by Insurance?

Our answer to this is a very definite "it depends." While this type of answer tends to erode our clients' or customers' confidence, the very nature of the question points to the problem – without sufficient facts, it is virtually impossible to give an accurate opinion as to how coverage applies to a hypothetical construction defect claim.

The ISO Commercial General Liability Policy

Let's presume our coverage question is relative to the 2001 or later edition of the ISO CGL "occurrence" policy.

Insuring Agreement

The CGL policy starts with a promise – the insuring agreement – which requires the insurer to pay for damages because of bodily injury or property damage which is caused by an occurrence. It is widely accepted by courts that a claim must fall within the insuring agreement for coverage to apply – and that the burden is usually on the policyholder to demonstrate the claim is within the promise.

The implications of this extraordinarily important notion are at the heart of the construction defects and liability insurance predicament. If the claim for damages does not fall within the insuring agreement, *the CGL policy provides no coverage*. Exclusions and exceptions to exclusions only apply to claims that are otherwise covered. Put another way, exclusions are relevant only if the insuring agreement is triggered.

Property Damage

Property damage usually requires physical injury to tangible property, including the loss of use of such property, as well as loss of use of tangible property not physically injured. Are construction defects considered to be property damage?

Consider a claim by members of a homeowners' association in which they allege the railings on all of the balconies are too low and built too close to the sliding glass doors. While the railings may need to be fixed, it is difficult to make a credible case that physical injury to tangible property has taken place. Thus, no property damage and no coverage for this construction defect.

The Weedo Case

In the oft-cited New Jersey case of *Weedo v. Stone-E-Brick, Inc.,* the Court made a distinction between repairing defective work and repairing damage caused by that defective work. In denying insurance coverage, the *Weedo* Court concluded that "the policy in question does not cover an accident of faulty work but rather faulty workmanship which causes an accident." Although the *Weedo* Court's explanations of how the CGL policy should apply to faulty workmanship claims was based on a review of the *entire policy, including its exclusions*, the so-called "Weedo principle" was later expanded to apply in a broader context.

Not an Occurrence

Evolution of the *Weedo* Principle was such that many courts found faulty workmanship *could not be accidental* – and thus was not an occurrence. The result of this reasoning is that most construction defect claims (except for that part of the claim that results in damage to other than the work) do not fall within the CGL insuring agreement and *thus are not covered by insurance*. This school of thought is exemplified by the South Carolina case of *L-J, Inc. v. Bituminous Fire & Marine Ins. Co*. The *L-J* Court noted:

> We agree that faulty workmanship, standing alone, does not constitute an "accident" and cannot therefore be an "occurrence." …faulty workmanship alone is not covered but faulty workmanship that causes an accident is covered.

It is noteworthy that the above interpretation has not contemplated any of the policy exclusions – only the insuring agreement, which they conclude does not include construction defect claims – unless the claim is for damage to third party property that is separate and distinct from the work itself.

Although the *Weedo* Principle as articulated in the *L-J* Court's ruling seems to be today's majority view, all courts do not follow it. In the case of *Travelers v. Moore & Associates*, the Tennessee Supreme Court stated:

> Travelers' argues this language [*Weedo*] stands for the proposition that damages to work of the insured arising from faulty workmanship can never be the result of an "occurrence" as defined by the policy. We disagree. Travelers' argument fails to recognize that the analysis in both *Vernon Williams* and *Weedo* is based upon "exclusions" in the respective CGLs rather than the "insuring agreement." However, recognition that damages that may result from an "occurrence" is only the first step in determining whether damages are afforded coverage under a CGL. Coverage for damages granted under the "insuring agreement" may be precluded by an "exclusion." Therefore, our acknowledgement that damages arising from faulty workmanship may be the result of an occurrence does not convert the CGL into a performance bond.

The above case simply requires the insurer to apply the exclusions (and their exceptions) *before generalizing* as to how the CGL applies to a construction defect claim.

Conclusion

To understand the coverage provided by the CGL policy for construction defects, it is important to first have an appreciation for legal battles currently being waged by some insurers to convince courts that construction defects that do not damage the property of third parties can never be an "occurrence" or "property damage" in the CGL insuring agreement. For more on the exclusions and exceptions that might apply to construction defects, please read part 2 of this article titled "Construction Defects: The Impact of Exclusions and Their Exceptions."

Editor's Note:

Colemont has access to many markets that continue to write contractors who may face exposure to CD litigation. Please contact your Colemont broker to discuss the specific markets most appropriate to your client's needs.

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