

1-1-2006

Construction Defect Litigation: Courts' Fragmented Rationales regarding Coverage for Contractor's Faulty Workmanship

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Recommended Citation

11 Suffolk J. Trial & App. Advoc. 119 (2006)

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CONSTRUCTION DEFECT LITIGATION: COURTS' FRAGMENTED RATIONALES REGARDING COVERAGE FOR CONTRACTOR'S FAULTY WORKMANSHIP

In Boston, Massachusetts, the Central Artery Tunnel Project, also known as the "Big Dig," is considered an engineering marvel. Designers and contractors encountered many challenges including adverse soil conditions, confined work spaces, and proximity to office towers and historical buildings, while trying to construct an underground expressway beneath an elevated highway. After fourteen years of construction, an estimated cost of 14.6 billion dollars, and hundreds of leaks in the tunnel walls, accusations of construction defects naturally arose. Construction defect claims are no stranger to public construction contracts. Different courts and jurisdictions have taken varied approaches regarding faulty workmanship coverage under a Commercial General Liability ("CGL") policy.¹ The Big Dig contractors and subcontractors should be concerned with their potential liability under a CGL policy because courts have failed to supply a universal interpretation of liability under these policies. How can they truly understand what their CGL policy coverage encompasses when widespread disagreement exists among the courts?

I. INTRODUCTION

Some contractors confronted with a claim of faulty workmanship by their customers are shocked to discover that there is no coverage for faulty

¹ *Southwest Metalsmiths, Inc. v. Lumbermens Mut. Cas. Co.*, 85 F.App'x 552, 554 (9th Cir. 2004) (noting at least four possible interpretations of an "occurrence" under a Commercial General Liability ("CGL") policy). After a review of case law from numerous jurisdictions, the court in *Southwest Metalsmiths* stated:

There are, at the very least, four possible interpretations of the term "occurrence" under a CGL policy: (1) accidents that include the faulty work of the insured as long as the work causes some collateral damage to tangible property; (2) accidents that include the faulty work of the insured in the form of faulty installation standing alone; (3) accidents that include the faulty work of the subcontractor that are unforeseen; and (4) accidents that do not include faulty workmanship by the subcontractor.

workmanship under their CGL policy.² Such a discovery leaves many experienced builders wondering why they even purchased the insurance policy.³ How can a contractor understand what the limits of his coverage are under his CGL policy when there is widespread disagreement among the courts?⁴

Insurance coverage disputes regarding construction defects are a rapidly growing area of controversy in the insurance industry.⁵ Courts have interpreted policy coverage language differently; therefore, parties often attempt to present precedent from other jurisdictions that support their position.⁶ Consequently, this has resulted in additional litigation.⁷

Over the past fifteen years, litigation involving defects in construction has exploded.⁸ The enormous cost of this litigation has impacted homeowners, contractors, insurance companies and state legislatures, among others.⁹ Accordingly, inferior quality construction resulted in a financial burden on society, as well as complex and expensive insurance coverage litigation.¹⁰

A Commercial General Liability policy covers the liability exposures of a business that are not specifically excluded under that policy.¹¹ The range of coverage encompasses product liability, completed opera-

² See Randy J. Maniloff, *Construction Defect Coverage in Flux: No Hope for Bob the Builder – Three Recent Supreme Court Decisions and Three Different Approaches – Has Kvaerner’s Foundation Been Cracked?*, 18-43 MEALEY’S LITIG. REP. INS. 17 (2004) (describing builders surprise regarding the limits of coverage under their CGL policy).

³ See *id.* at 17 (discussing builders confusion and surprise regarding the extent of coverage under their CGL policy).

⁴ See *id.* (noting disagreement exists among courts resulting in contractors confusion regarding construction defect coverage). Compare *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004), with *Auto-Owners Ins. Co. v. Home Pride Companies, Inc.*, 684 N.W.2d 571 (Neb. 2004), and *L-J Inc. v. Bituminous Fire and Marine Ins. Co.*, 621 S.E.2d 33 (S.C. 2005). See also *infra* notes 98-109 and accompanying text (discussing three courts’ varied reasoning in reaching same conclusion).

⁵ See Maniloff, *supra* note 2, at 17 (discussing increase of construction defect claims).

⁶ See *id.* (discussing courts’ differing interpretation of policy language results in further litigation).

⁷ See *id.* (recognizing growth of construction defect litigation).

⁸ Jeffrey W. Stempel, *Injury to Building Caused by Negligent Soil Analysis May Constitute Occurrence under CGL that is Not Precluded by Business Risk Exclusions or Similar Limitations on Coverage; Recent Court Decisions*, 71 J. RISK & INS. No. 2, at 334 (2004) (noting recent boom of construction defect litigation).

⁹ *Id.* (acknowledging increase of construction defect litigation’s effects on many parties).

¹⁰ See *id.* (discussing construction defect litigation’s societal costs).

¹¹ Insurance Information Institute, *Glossary of Insurance Terms*, <http://www.iii.org/media/glossary/> (last visited Nov. 20, 2005) (stating industry definition of CGL insurance).

tions, premises and operations, and independent contractors.¹² Disagreement exists, however, among lawyers, policyholders and courts regarding the *extent* of insurance coverage available to contractors under a CGL policy.¹³

A central question in the disagreement regarding coverage is whether a construction defect is considered “property damage” and an “occurrence,” as defined in a CGL policy, terms essential to the trigger of policy coverage.¹⁴ The CGL policy defines “occurrence,” a condition precedent of policy coverage, as “an accident,” and the definition of “occurrence” includes “property damage” which is not expected or intended by the insured.¹⁵

This note will explore construction defect cases, specifically examining three recent state supreme court decisions that demonstrate jurisdictions’ various rationales regarding CGL coverage.¹⁶ Part II will provide a brief overview of the relevant history of Commercial General Liability

¹² Allen Financial Insurance Group, *Insurance Definitions*, at http://www.eqgroup.com/insurance_definitions.htm (last visited Nov. 22, 2005) (outlining coverage areas of CGL insurance). Commercial General Liability can be written as a monoline policy or as part of a commercial package. *Id.* “CGL” means the “commercial general liability forms which have replaced the earlier ‘comprehensive’ general liability forms.” *Id.* The CGL form provides broad coverage and is available in two variations, “occurrence,” and “claims made” coverage. *Id.*

¹³ See Maniloff, *supra* note 2, at 17 (acknowledging construction defect claim controversies are common). As a result of increased court decisions on the topic of faulty work, there has been increased disagreement over what is and what is not covered on an insurance policy. *Id.*

¹⁴ See, e.g., *American Family Mut. Ins. Co.*, 673 N.W.2d 65; *Auto-Owners Ins. Co.*, 684 N.W.2d 571; *L-J Inc.*, 621 S.E.2d 33 (examining whether construction defect constitutes an “occurrence” under CGL policy). See also Alison Hightower & Katrina J. Lee, *So How Do You Define “Accident”?*, IN THE LAW, Vol. 01, No. 5 at 151 (discussing “accident” not defined in insurance policies). Insurance policies typically:

restrict coverage to ‘damages caused by an occurrence neither expected nor intended from the standpoint of the insured.’ ‘Occurrence’ in turn is defined as ‘an accident,’ though accident is not defined. The rationale for limiting coverage to ‘accidents’ is that insurance should cover negligence, but not intentional misconduct.

Id.

¹⁵ MATTHEW BENDER & CO., INC., 1-1 APPLEMAN ON INSURANCE § 1.15 (2d ed. 2005) (discussing casualty insurance and risk transfer generally). “Property damage” is defined as “physical injury to tangible property, including all resulting loss of use of that property...[and] loss of use of tangible property that is not physically injured.” *Travelers Indemnity Co. v. Miller Bldg. Corp.*, 97 F.App’x 431, 434 (4th Cir. 2004) (summarizing definition of “property damage”).

¹⁶ See *American Family Mut. Ins. Co.*, 673 N.W.2d 65; *Auto-Owners Ins. Co.*, 684 N.W.2d 571; *L-J Inc.*, 621 S.E.2d 33; see also *infra* notes 50-95 and accompanying text (examining three recent decisions involving construction defect litigation).

insurance and the CGL policy.¹⁷ Part III will focus on three recent state supreme court decisions involving construction defect actions in Wisconsin, South Carolina and Nebraska which examined the meaning of an “occurrence.”¹⁸ Part IV will compare the court’s differing approaches in reaching their conclusions, particularly involving exceptions and exclusions in the CGL policy.¹⁹ Part V will conclude that it is time for the United States Supreme Court to decide the relevant standard to be applied in construction defect litigation cases.²⁰

II. HISTORY AND CHARACTERISTICS OF THE “CGL” POLICY WITH RESPECT TO CONSTRUCTION DEFECT CLAIMS

In general, liability insurance is commonly referred to as third-party insurance because the insurer, on the insured’s behalf, is obligated to pay directly a third-party claimant who is injured by conduct of the insured.²¹ Accordingly, the insurer’s duty to pay does not run directly to the insured.²² Fundamentally, the insurer indemnifies its insured for any liability the insured may have to the injured party by reimbursing the injured party on behalf of the insured.²³ Determining whether or not coverage exists under the CGL policy involves a two-step process: first, the insured must show that the policy covers his loss; second, in order to avoid coverage, the insurer must show specific policy language that excludes the insured’s loss.²⁴

The purpose of a general liability policy is to safeguard the insured from liability for personal injury or property damage to a third party that

¹⁷ See *infra* notes 21-49 and accompanying text (discussing GCL insurance and policy generally).

¹⁸ See *infra* notes 50-95 and accompanying text (examining three recent decisions involving construction defect litigation). In examining what constitutes an “occurrence,” three recent state supreme court decisions have utilized three separate approaches to arrive at two different conclusions. See *supra* note 2, at 17.

¹⁹ See *infra* notes 96-119 and accompanying text (comparing three recent state supreme court decisions involving construction defect litigation).

²⁰ See *infra* notes 120-121 and accompanying text (considering future of construction defect litigation).

²¹ MATTHEW BENDER & CO., INC., APPLEMAN ON INSURANCE § 3.3 (2d ed. 2004) (describing third-party indemnity insurance generally).

²² *Id.* (describing insurer’s duty to pay does not run directly to insured).

²³ See *id.* (comparing insured’s “indirect” loss and third party’s “direct” loss). The insured party acts as a channel for the transfer of insurance proceeds from the liability insurer to the injured third party. *Id.* Using the “Big Dig” as an illustrative example, suppose a nearby office tower was damaged due to the negligence of a contractor, during the excavation of soil adjacent to the tower. The owner of the office tower sued the contractor, who purchased CGL insurance. In this scenario, the contractor’s insurer would potentially reimburse the injured party on behalf of the contractor, the insured.

²⁴ McDonald v. State Farm Fire and Cas. Co., 837 P.2d 1000, 1003-04 (Wash. 1992) (setting forth two-step process for determining existence of coverage).

could be caused by the insured's products or services.²⁵ A common misconception, especially among those with insurance coverage, is that the purpose of liability insurance is to provide for the repair or replacement of the insured's poorly constructed product, or to perform the service correctly.²⁶ Coverage is excluded in these circumstances because a contractor or subcontractor would receive duplicate payment.²⁷ These duplicate payments would include a payment from the customer to a contractor for work completed, and another payment from the insurance company to repair or replace the deficiencies in its poorly constructed product.²⁸ Another policy reason that liability insurance is not for the repair or replacement of a faulty product or service is that the responsibility and obligation of the contractor or subcontractor to perform the project in a workmanlike fashion would be diminished.²⁹ Essentially, the contractor or subcontractor's incentive to provide a quality product would be eliminated.³⁰

Furthermore, liability coverage is "not a replacement for a warranty or a guaranty of the performance to be given to the insured's customer."³¹

²⁵ See *id.* (describing liability insurance policy's intent); see also *Hobson Constr. Co. v. Great Am. Ins. Co.*, 322 S.E.2d 632, 635 (N.C. Ct. App. 1984) (stating definition of property damage in a typical CGL policy). In a typical CGL policy, property damage is defined as:

- (1) Physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or
- (2) Loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Hobson Constr. Co., 322 S.E.2d at 635 (citation omitted).

²⁶ See *MATTHEW BENDER & CO., INC.*, *supra* note 21 (discussing purpose of liability policies generally); see also *Centex Homes Corp. v. Prestressed Sys., Inc.*, 444 So.2d 66, 67 (Fla. 1984) (emphasizing scope of purpose of liability insurance). The Florida Supreme Court pointed out the deeply rooted principal that the purpose of liability insurance is to "provide protection for personal injury or property damage caused by the product only and not for the replacement or repair of the product." *Centex Homes Corp.*, 444 So.2d at 67.

²⁷ *Centex Homes Corp.*, 444 So.2d at 67 (noting policy reasons for purpose of liability insurance not for repair or replacement); see also *LaMarche v. Shelby Mut. Ins. Co.*, 390 So. 2d 325, 326 (Fla. 1980) (finding duplicate payment to contractors not intent of parties or policy language).

²⁸ *Centex Homes Corp.*, 444 So.2d at 67 (outlining duplicate payments to contractors if policy for repair or replacement).

²⁹ See *Centex Homes Corp.*, 444 So.2d at 67-68 (noting existence of insurance for repair or replacement would eliminate obligation to initially perform in workmanlike manner).

³⁰ See *id.* (pointing to consequence of elimination of obligation and incentive to perform in a workmanlike manner and produce a quality product).

³¹ See *MATTHEW BENDER & CO., INC.*, *supra* note 21 (noting liability insurance not the same as a warranty or performance guaranty); see also *Travelers Indemnity Co.*, 97 F.App'x. at 434 (stressing liability insurance policies do not intend to act as a performance bond). Travelers insurance policy provided coverage for "those sums that the insured be-

For example, in *Travelers Indemnity Co. v. Miller Building Corp.*³², the United States Court of Appeals for the Fourth Circuit concluded that the building owner's claim against the builder for recovery for the cost to correct the builder's faulty workmanship was not within the scope of the insurance policy because faulty workmanship is not considered "property damage."³³ To be considered "property damage," the property must have been undamaged previously.³⁴ Comparatively, defective construction was never undamaged.³⁵

Coverage disputes involving construction defects are often further complicated because some contractors do not have a full understanding of the coverage of a CGL policy.³⁶ In general, CGL insurance includes coverage for "damage caused by a contractors faulty work," not for the expense for repair or replacement of the actual faulty work.³⁷ That the CGL policy does not cover the repair or replacement of faulty work often is surprising to contractors as these costs are often the most significant exposures and expenses at issue in construction disputes.³⁸

In the United States, CGL insurance policies traditionally are "occurrence" based, as opposed to other liability policies, such as Directors and Officers and Professional Liability, which are "claims-made".³⁹

comes legally obligated to pay as damages because of . . . 'property damage,'" so long as the "'property damage' is caused by an 'occurrence.'" *Travelers Indemnity Co.*, 97 F.App'x. at 434. In particular, discussing the "work product" exclusion in CGL policies:

Since the quality of the insured's work is a 'business risk' which is solely within his own control, liability insurance generally does not provide coverage for claims arising out of the failure of the insured's product or work to meet the quality or specifications for which the insured may be liable as a matter of contract.

Western World Ins. Co. v. Carrington, 369 S.E.2d 128, 130 (N.C. Ct. App. 1988) (discussing "work product" exclusion in standard CGL policies).

³² *Travelers Indemnity Co.*, 97 F.App'x. at 434.

³³ *Id.* (stressing intent of liability insurance policies not to act as a performance bond).

³⁴ *Id.* at 433 (establishing property damage definition involves property previously undamaged). See *supra* note 15 and accompanying text (stating definition of "property damage").

³⁵ *Travelers Indemnity Co.*, 97 F.App'x. at 433 (explaining defective construction never undamaged). The *Travelers* court concluded, however, that damage to separate tangible property, such as carpet, caused by the defective construction of windows and doors, does fall within the CGL policies definition of "property damage". *Id.* at 434.

³⁶ RANDY MANILOFF, *Insurance Coverage: Hot Topics*, Morgan Stanley, Insurance – Property & Casualty, Sept. 9, 2004, at 6 (discussing growth trend of construction defect litigation).

³⁷ *Id.* (noting purpose for CGL coverage).

³⁸ *Id.* (acknowledging contractors surprise that CGL policies do not cover repair or replacement of faulty work).

³⁹ MATTHEW BENDER & CO., INC., *supra* note 21 (comparing "occurrence" versus "claims-made" triggers of coverage). See also *supra* note 12 and accompanying text (naming two variations of CGL coverage); Tracy Alan Saxe, *What Every Lawyer, Risk Manager Should Know About Coverage*, CONN. LAW TRIB., April 19, 2004, at 5 (clarifying "occur-

Through the “occurrence” based CGL policy, the insurer is obligated to pay or defend claims, whenever they are made, resulting from an incident that occurred during the policy time period.⁴⁰ The insurer is obliged to defend and indemnify claims if an “occurrence” based liability policy was in force when the alleged bodily injury or property damage occurred.⁴¹

The CGL insurer has two major duties to the insured, the duty to indemnify for settlements and judgments within the coverage granted, and the duty to provide defense for the policyholder.⁴² In every state, insurers have a duty to provide defense if the complaint against the insured even suggests facts which could potentially bring the claim within the policy’s coverage grant.⁴³ All claims or suits alleging that the insured caused property damage or bodily injury, even those encompassing certain intentional acts, lead to the possibility that the insurer will incur defense costs.⁴⁴ The duty to defend feature of the CGL policy is exceptionally significant to policyholders challenged with circumstances such as “product liability [including asbestos], environmental, construction defects, intellectual prop-

rence” versus “claims-made” liability policy differences). A “claims-made” policy “pays claims presented to the insurer during the term of the policy or within a specific term after its expiration,” limiting insurers’ exposure to unknown future liabilities. Insurance Information Institute, *Glossary of Insurance Terms*, <http://www.iii.org/media/glossary/> (last visited Nov. 20, 2005). In contrast, an “occurrence” policy “pays claims arising out of incidents that occur during the policy term, even if they are filed many years later.” *Id.*

⁴⁰ *Hartford v. Fire Ins. Co. v. California*, 509 U.S. 764, 771 (1993) (discussing particular insurers preference for “claims-made” trigger versus traditional “occurrence” trigger). Despite the standard comprehensive general liability “occurrence” based policy, industry changes denote a recent increase in the utilization of “claims-made” policies. *Id.* In contrast to the “occurrence” trigger, the “claims-made” trigger requires the insurer to pay or defend only claims made during the policy period. MATTHEW BENDER & CO., INC., *supra* note 21; *see Saxe, supra* note 39, at 5 (clarifying “occurrence” versus “claims-made” liability policy differences).

⁴¹ *See Saxe, supra* note 39, at 5 (discussing insurers obligation to defend and indemnify). Although there are applicable statute of limitations varying from two to six years for many claims, significant exposure claims such as construction defects could have a very long tail. *See id.*

⁴² *See Saxe, supra* note 39, at 5 (maintaining duty to defend has an extremely broad trigger).

⁴³ *Id.* (describing insurers’ duty to defend policyholder); *see also Travelers Indemnity Co.*, 97 F.App’x. at 433 (elaborating on insurer’s duty to defend under North Carolina law); *Waste Mgmt. of Carolinas, Inc. v. Peerless Ins. Co.*, 340 S.E.2d 374, 377 (N.C. 1986) (noting insurer’s duty to defend insured generally broader than its obligation to pay damages); *Duke Univ. v. St. Paul Fire & Marine Ins. Co.*, 386 S.E.2d 762, 764 (N.C. Ct. App. 1990) (asserting plaintiff not required to establish ultimate liability, rather only to show facts of claim within coverage of policy). The insurance companies’ duty to provide defense for the insured does not turn on the companies’ eventual liability to pay. *See Saxe, supra* note 39, at 5 (describing insurer’s duty to defend).

⁴⁴ *See Saxe, supra* note 39, at 5 (proscribing CGL policy is litigation insurance).

erty or any other potentially covered claim” where defense costs may considerably exceed policy limits.⁴⁵

Although coverage is generally narrow, construction defect claims are a financial drain on insurers.⁴⁶ Construction defect claims are particularly costly because of CGL coverage’s broad “duty to defend” the insured, and because litigation typically involves multiple parties.⁴⁷ To avoid these enormous defense costs and waste of financial resources, insurance companies often contribute to settlements regardless of whether their insured is actually liable or whether the policy clearly provides coverage.⁴⁸ In the examination of construction defect controversies, most not resolved through settlement, it is evident that complex and expensive insurance coverage litigation impacts multiple stakeholders, including policyholders, insurers, lawyers, the court system and society.⁴⁹

III. RECENT SUPREME COURT DECISIONS INVOLVING CONSTRUCTION DEFECTS

Since 2004, the supreme courts of Wisconsin, Nebraska, and South Carolina have each addressed questions of coverage under a CGL policy regarding claims of faulty workmanship.⁵⁰

A. *American Family Mutual Insurance Co. v. American Girl, Inc.*

In *American Family Mutual Insurance Co. v. American Girl, Inc.*,⁵¹ a soil engineering subcontractor provided faulty advice to a general contractor regarding site-preparation in the construction of a warehouse.⁵² This error resulted in extreme soil settlement and a sinking foundation, causing the structure to crack and cave-in, and the warehouse to ultimately

⁴⁵ Saxe, *supra* note 39, at 5 (noting duty to pay costs of defense usually unlimited as long as limit not exhausted towards settlement or judgment).

⁴⁶ MANILOFF, *supra* note 36, at 6 (noting major expense of construction defect litigation).

⁴⁷ MANILOFF, *supra* note 36, at 6 (discussing broad duty to defend insured exacerbates litigation costs). For example, defense costs quickly multiply if a general contractor, who is sued by a homeowner, then brings in to the lawsuit all the subcontractors involved in the construction. *Id.*

⁴⁸ See MANILOFF, *supra* note 36, at 6 (recognizing plaintiffs, judges and mediators often leverage potential of sizeable defense costs by pressuring insurance companies to contribute to settlements even when questionable liability or coverage).

⁴⁹ See *supra* notes 5-9 and accompanying text (noting financial burden of construction defect litigation impacts multiple parties).

⁵⁰ See generally, *American Family Mut. Ins. Co.*, 673 N.W.2d 65; *Auto-Owners Ins. Co.*, 684 N.W.2d 571; *L-J Inc.*, 621 S.E.2d 33 (examining whether construction defect constitutes an “occurrence” under CGL policy).

⁵¹ 673 N.W.2d 65 (Wis. 2004).

⁵² *Id.* at 69 (describing faulty construction circumstances of warehouse structure).

be demolished.⁵³ As the general contractor was potentially liable to the owner of the warehouse under certain contractual warranties, it notified its insurance company of the loss.⁵⁴

The dispute between the defendants, contractor and the building owner, and the plaintiff insurer, was whether the particular construction defect claim was for “property damage” caused by an “occurrence” within the standard CGL insurance policy’s grant of coverage.⁵⁵ In early 2004, the Supreme Court of Wisconsin concluded that the sinking, buckling and cracking of the warehouse satisfied the definition of “property damage.”⁵⁶ Further, in holding that the “property damage” was caused by an “occurrence” as defined in the CGL policy which triggers coverage, the court recognized that the damage was not intentional or expected, but rather accidental.⁵⁷

The Supreme Court of Wisconsin concluded that breach of contract liability is not unequivocally excluded, reversing the court of appeals decision that the CGL policy’s “contractual liability” exclusion excluded coverage.⁵⁸ The court held that in this particular instance, the “contractual liability” exclusion did not apply because there was no hold harmless or indemnification agreement involved.⁵⁹ Although the CGL policy does not commonly cover contract claims arising out of the insured’s defective work or product, the court noted that the absence of coverage is a result of the business risk exclusion, also known as the “your work” exclusion, not because a breach of contract can never constitute an “occurrence.”⁶⁰

⁵³ *Id.* (describing consequences of faulty construction resulted in demolition of warehouse structure).

⁵⁴ *Id.* at 70 (explaining general contractors’ notification of warehouse loss to its liability insurer).

⁵⁵ *Id.* at 69-70 (addressing issues including meaning of “property damage” and “occurrence”).

⁵⁶ *American Family Mut. Ins. Co.*, 673 N.W.2d at 70 (holding claim within “property damage” definition of “physical injury to tangible property”).

⁵⁷ *Id.* at 70 (holding claim within “occurrence” definition). The building damage caused by settlement of the soil, which was a result of faulty site-preparation advice by the subcontractor, met the definition of an “occurrence” in the CGL policy, defined as “an accident, including continuous or repeated exposure to substantially the same general harmful condition.” *Id.*

⁵⁸ *Id.* (explaining “contractual liability” exclusion “excludes coverage for liability that arises because the insured has contractually assumed the liability of another”).

⁵⁹ *Id.* (holding “contractual liability” exclusion did not apply because absence of relevant hold harmless or indemnification agreement).

⁶⁰ *Id.* at 76 (explaining CGL policy generally does not provide coverage for construction defect claims as a result of the business risk exclusion). Also known as the “your work” exclusion, the rationale of the business risk exclusion is commonly explained as follows:

The insured, as a source of goods or services, may be liable as a matter of contract law to make good on products or work which is defective or otherwise unsuitable because it is lacking in some capacity. This may even extend to an obligation to

The parties did not dispute that the negligent work of the engineering subcontractor caused the soil settlement and resulting property damage to the building.⁶¹ In examining the CGL policy exclusions, the court recognized the subcontractor exception to the “your work” exclusion.⁶² The “your work” exclusion in the CGL policy provides specifically:

This insurance does not apply to . . . “Property damage” to “your work” arising out of it or any part of it and included in the products-completed operations hazard. This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.⁶³

In summary, the Wisconsin Supreme Court ruled that although breach of contract is considered an “occurrence” causing “property damage,” coverage is excluded by the “your work” exclusion if the property damage is to the insured’s own work.⁶⁴ The exclusion, however, does not apply if the property damage is caused by the work of a subcontractor.⁶⁵ Other state supreme courts, particularly Nebraska which issued its opinion later in 2004, have followed differing rationales regarding the “subcontractor exception” to the “your work” exclusion.⁶⁶

completely replace or rebuild the deficient product or work. This liability, however, is not what the coverages in questions are designed to protect against. The coverage is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damage person bargained.

Weedo v. Stone-E-Brick Inc., 405 A.2d 788, 791 (N.J. 1979) quoting Dean Henderson, *Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1971).

⁶¹ *American Family Mut. Ins. Co.*, 673 N.W.2d at 76 (noting fact subcontractors’ negligent work caused soil settlement and resulting building damage).

⁶² *Id.* at 82 (recognizing exception to “your work” exclusion in CGL policy).

⁶³ *Id.* (describing CGL policies “your work” exclusion and subcontractor exception to exclusion). The subcontractor exception was instituted in the 1986 revision of the CGL policy form. *Id.* Before 1986, the policy excluded coverage for damage caused to construction projects by subcontractor negligence. *Id.* See also *Kalchthaler v. Keller Constr. Co.*, 591 N.W.2d 169, 170 (Wis. Ct. App. 1999) (stating exception to exclusion restores coverage for damage to completed work caused by subcontractor work).

⁶⁴ *American Family Mut. Ins. Co.*, 673 N.W.2d at 82; see also *Maniloff*, *supra* note 2, at 17 (summarizing *American Family* rule that a breach of contract constitutes an “occurrence” causing “property damage,” even to work of insured). The coverage for “property damage” to the insured’s own work, however, is excluded by the “your work” exclusion. *Id.* The “your work” exclusion, however, does not apply if the “property damage” is caused by work of subcontractor’s. *Id.*

⁶⁵ See *supra* note 64 and accompanying text (summarizing *American Family* rule).

⁶⁶ Compare *American Family Mut. Ins. Co.*, 673 N.W.2d 65 with *Auto Owners Ins. Co.*, 684 N.W.2d 571.

B. Auto-Owners Insurance Company v. Home Pride Companies, Inc.

In *Auto-Owners Insurance Company v. Home Pride Companies, Inc.*,⁶⁷ Appletree Apartments, Inc. (“Appletree”) contracted with JT Builders, Inc. to install shingles on Appletree’s apartment buildings.⁶⁸ J.T. Builders, Inc. subcontracted the work to Home Pride Companies, Inc. (“Home Pride”), who then entered into a subcontract with Ron Hansen Construction to install the shingles.⁶⁹ Appletree discovered problems with the roof and filed suit against Home Pride and other parties, claiming they failed to “install the shingles in a workmanlike manner and that such faulty workmanship caused substantial and material damage to the roof structures and buildings.”⁷⁰ Home Pride claimed coverage under its CGL policy from its insurer, Auto-Owners Insurance Company (“Auto-Owners”).⁷¹ Auto-Owners brought a declaratory judgment action to determine its obligations to Home Pride.⁷²

The issue on appeal was whether a standard CGL insurance policy covers an insured contractor for the faulty workmanship of a hired subcontractor.⁷³ The Supreme Court of Nebraska concluded coverage exists, however, the “subcontractor exception” to the “your work” exclusion was not the reason for coverage.⁷⁴ The *Auto-Owners* Court stated that the sub-

⁶⁷ 684 N.W.2d 571 (2004).

⁶⁸ *Id.* (explaining factual background of owner, contractor and subcontractor relationship).

⁶⁹ *Id.*

⁷⁰ *Id.* (describing suit against Home Pride as failure to install shingles in workmanlike fashion leading to structural damage).

⁷¹ *Id.* at 574 (summarizing Home Pride’s claim for coverage under its CGL policy). Auto-Owners claimed the CGL policy did not provide coverage because the faulty workmanship of a subcontractor is not an “occurrence” under the policy. *Id.* In contrast, Home Pride insisted coverage existed on the basis of the “subcontractor exception” to the “your work” exclusion. *Id.* at 575.

⁷² *Auto Owners Ins. Co.*, 684 N.W.2d at 574 (noting procedural history of case). The district court concluded the policy issued to the insured did not cover the insured’s claim as the alleged property damage was not caused by an “occurrence”. *Id.* Summary judgment was granted in favor of the insurance company. *Id.*

⁷³ *Id.* at 575 (addressing issue on appeal of whether contractor is covered under CGL policy for faulty workmanship of its subcontractor). On appeal to the Supreme Court of Nebraska, the trial court decision was reversed, and the case was remanded to the district court for judgment in the contractor’s favor. *Id.* at 580.

⁷⁴ *Id.* at 575-76 (contending subcontractor exception “merely an exception to an exclusion and, therefore, incapable of providing coverage”); see also *Hawkeye Security Ins. Co. v. Davis*, 6 S.W.3d 419, 427 (Mo. Ct. App. 1999) (explaining exclusion provisions in an insurance policy); *Lassiter Const. v. American States Ins.*, 699 So.2d 768, 770 (Fla. Dist. Ct. App. 1997) (discussing subcontractor exclusion alone cannot create coverage where no coverage exists elsewhere on policy). Exclusion provisions that state certain causes of loss or consequences of a particular insured event are not covered by the insurance policy, do not grant coverage. *Hawkeye Security Ins. Co.*, 6 S.W.3d at 427. Rather, the exclusion provision restricts the “obligation of indemnity undertaken by the policy.” *Id.*

contractor exception within the “your work” exclusion (aka. Exclusion 1) is not applicable “until two conditions precedent are met: (1) There is an initial grant of coverage and (2) exclusion “1” operates to preclude coverage.”⁷⁵

First addressing whether there was “property damage” caused by an “occurrence,” the court concluded there was “property damage” because there was physical injury to tangible property.⁷⁶ Although the court held that faulty workmanship by itself is not covered under a CGL policy because it is not an accidental event, the court qualified that the damage beyond the contractors own product, which was an unintended and unexpected consequence of the alleged faulty workmanship, is a covered occurrence.⁷⁷ Applying this rule, the court concluded that the CGL policy provides an initial grant of coverage.⁷⁸ In considering the policy exclusions,

⁷⁵ *Auto-Owners Ins. Co.*, 684 N.W.2d at 576 (describing conditions precedent for subcontractor exception to “your work” exclusion to apply); see also *L-J, Inc. v. Bituminous Fire and Marine Ins. Co.*, No. 25854, 2004 S.C. Lexis 190, *11-12 (confirming an exclusion limits coverage rather than provides coverage); *Kalchthaler*, 591 N.W.2d at 173-74 (noting “exclusions can only subtract from coverage”).

⁷⁶ *Auto-Owners Ins. Co.*, 684 N.W.2d at 576 (concluding allegations constituted “property damage” under CGL policy). Appletree alleged the shingles were breaking and falling off the roofs, resulting in substantial and material damage to the roof and buildings. *Id.* Because these allegations stated a cause for physical injury to tangible property, under the CGL policy, this constituted “property damage”. *Id.* See also *American Family Mut. Ins. Co.*, 673 N.W.2d at 70 (holding claim within “property damage” definition of “physical injury to tangible property”); *Kalchthaler*, 591 N.W.2d at 173 (concluding water entering through leaky windows wrecking drapes and walls constitutes “property damage”); *Maryland Cas. Co. v. Reeder*, 270 Cal. Rptr. 719, 723 (Cal. Ct. App. 1990) (asserting inferior materials or workmanship alone does not constitute “property damage,” however resulting physical injury or lost use of tangible property does).

⁷⁷ *Auto-Owners Ins. Co.*, 684 N.W.2d at 577 (noting coverage exists for consequences of faulty workmanship). The *Auto-Owners* court summarized “although a standard CGL policy does not provide coverage for faulty workmanship that damages only the resulting work product, if faulty workmanship causes bodily injury or property damage to something other than the insured’s work product, an unintended and unexpected event has occurred, and coverage exists.” *Id.* at 578. See also *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 478 (N.H. 1994) (interpreting “accident” in “occurrence” definition to mean unexpected and unintended circumstances); *L-J, Inc.*, 567 S.E.2d at 493-94, *rev’d*, 621 S.E.2d 33 (S.C. 2005) (noting under CGL policy, the “property damage,” not the construction activity that caused the property damage, cannot be expected or intended); *Radenbaugh v. Farm Bureau Gen. Ins. Co.*, 610 N.W.2d 272, 279-80 (Mich. 2001) (indicating “accident” exists within meaning of CGL policy when insured’s defective workmanship results in damage to property of others); *Kalchthaler*, 591 N.W.2d at 173-74 (concluding water entering through leaky windows wrecking drapes and walls constitutes “property damage”).

⁷⁸ *Auto-Owners Ins. Co.*, 684 N.W.2d at 578-79 (noting underlying complaint alleged contractors negligently installed shingles, causing shingles to fall off). The further allegation that the faulty workmanship caused the roofs and buildings to sustain significant damage, is an “unintended and unexpected consequence of the contractors’ faulty workmanship and goes beyond damages to the contractors’ own work product.” *Id.* Therefore, the court concluded the complaint alleged an “occurrence” within the meaning of the CGL policy. *Id.* at 579.

the court held that the “your work” exclusion was not applicable because the damages alleged were beyond the cost of basic repair and replacement of the contractors’ work.⁷⁹ The court concluded that Auto-Owners had a duty to defend Home Pride and an obligation to provide coverage to the extent Home Pride was liable for the resulting damage to the roofs and buildings.⁸⁰ The Supreme Court of South Carolina followed a similar rationale in a decision in fall 2005.⁸¹

C. L-J, Inc. v. Bituminous Fire and Marine Insurance Company

In *L-J, Inc. v. Bituminous Fire and Marine Insurance Company*,⁸² the Supreme Court of South Carolina addressed the issue of whether damage caused by the faulty workmanship of the contractor, L-J, Inc., and its subcontractors, on a road project is covered under L-J Inc.’s CGL policy.⁸³

⁷⁹ *Id.* at 579 (recognizing burden of proof to demonstrate whether an exclusionary clause of CGL applies is on insurer); *see also* *Farmers Mut. Ins. Co. v. Kment*, 658 N.W.2d 662, 667-668 (Neb. 2003) (discussing Nebraska standard that insurer has burden to prove exclusionary clause applicable). The “your work,” also known as “business risk” exclusions intent is to prevent liability policies from insuring an insured’s own faulty workmanship; which is considered a normal inherent business risk. *Auto-Owners Ins. Co.*, 684 N.W.2d at 579 (reiterating general purpose of “your work” exclusion); *see also American Family Mut. Ins. Co.*, 673 N.W.2d at 65 (noting “business risk” exclusion purpose is preventing CGL insurance from being protection from claims based on poor business operations); *Knutson Const. Co. v. St. Paul Fire & Marine Ins.*, 396 N.W.2d 229, 233 (Minn. 1986) (stressing principle CGL insurer’s limit their assumption of risk to that beyond insured’s control); *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788, 796 (1979) (noting absence of coverage for an accident of faulty workmanship, however, existence of coverage for faulty workmanship which causes an accident). The reasoning for the “your work” exclusion is to discourage sloppy work by making contractors pay for the losses resulting from their own defective work, and precludes liability insurance from turning into a performance bond. *Auto-Owners Ins. Co.*, 684 N.W.2d at 579; *see also Knutson Const. Co.* 396 N.W.2d at 233 (noting to impose risk on CGL insurer such that policy acts like a performance bond would make cost of insurance prohibitive); *Weedo*, 405 A.2d 788, 791 (discussing contractor bears risk of his failure and resulting contractual liability as he controls quality of goods and services provided). The court concluded that because the roof structures and building experienced substantial damage, the “your work” exclusion was inapplicable. *Auto-Owners Ins. Co.*, 684 N.W.2d at 579-80; *see also Maniloff, supra* note 2, at 17 (summarizing holding that “your” work exclusion not applicable).

⁸⁰ *Auto-Owners Ins. Co.*, 684 N.W.2d at 580 (reversing judgment against Home Pride and instructing district court to enter judgment in favor of Home Pride consistent with opinion).

⁸¹ *Compare L-J, Inc.*, 621 S.E.2d 33, with *Auto-Owners Ins. Co.*, 684 N.W.2d 571.

⁸² 621 S.E.2d 33 (S.C. 2005).

⁸³ *Id.* at 34 (noting coverage issues addressed was whether damages caused by faulty workmanship of contractor). In August 2004, the Supreme Court of South Carolina reversed the appeals court decision in favor of the construction company. *L-J, Inc. v. Bituminous Fire and Marine Ins. Co.*, No. 25854, 2004 S.C. LEXIS 190, *2 (S.C. 2004), *substituted opinion at, opinion withdrawn by*, 621 S.E.2d 33 (S.C. 2005). In September 2005, the Supreme Court of South Carolina withdrew its prior opinion and substituted it with a new opinion, still reversing the Court of Appeals decision. *L-J, Inc.*, 621 S.E.2d 33, 34.

A developer hired L-J, Inc., to perform site development work and to construct roads for a subdivision.⁸⁴ The developer later sued the contractor when the road substantially deteriorated.⁸⁵ The deterioration included “alligator cracking,” a term used to describe the severe cracking in asphalt that has the characteristics of alligator skin.⁸⁶ L-J, Inc. agreed to pay the developer in settlement negotiations, and when L-J, Inc. sought indemnity from its numerous insurers, Bituminous, one of these insurers, refused to indemnify them.⁸⁷

The Supreme Court of South Carolina held that the court of appeals was mistaken in finding that the deterioration of the road constituted an “occurrence” under the CGL policy.⁸⁸ The South Carolina Supreme Court reasoned that the negligent acts by the insured during the stages of design, preparation and construction were examples of faulty workmanship that caused damage to the road system alone, and therefore did not fall under

⁸⁴ *L-J, Inc.*, 621 S.E.2d at 34 (summarizing circumstances surrounding faulty workmanship claim under contractors CGL policy).

⁸⁵ *Id.* (explaining developers suit against contractor). Four years after completion of the work, which was performed primarily by subcontractors, the road had deteriorated to the extent that the developer sued the contractor for breach of contract, breach of warranty, and negligence. *Id.*

⁸⁶ *Id.* at 36 (describing deterioration of road system).

⁸⁷ *Id.* at 34 (summarizing settlement details of underlying lawsuit). In settlement of the lawsuit, the contractor agreed to pay the developer \$750,000, and subsequently sought indemnity from Bituminous as well as three other insurers that had issued CGL policies for the particular project. *Id.* Only Bituminous refused to pay its portion of the indemnification. *Id.* The contractor and the three other insurers brought a declaratory judgment action seeking Bituminous’ contribution. *Id.* In determining Bituminous owed the other insurers a contribution, the Charleston Circuit Court special master concluded the damage to the roadway system was covered under the CGL policy. *Id.* The court of appeals subsequently affirmed the special master’s decision that “the damage constituted an “occurrence,” and the “expected or intended” and “your work” exclusions did not apply to work performed by subcontractors.” *Id.* The Supreme Court of South Carolina granted certiorari and reversed the court of appeals decision. *Id.* The court allowed a rehearing, withdrawing the prior opinion, and again reversed the court of appeals decision. *Id.*

⁸⁸ *Id.* at 34-35 (reversing court of appeals decision). Although numerous other jurisdictions have decided the issue of “whether property damage to the work product alone, caused by faulty workmanship, constitutes an occurrence,” the issue of whether faulty workmanship constitutes an occurrence was a matter of first impression for South Carolina. *Id.* The majority of other jurisdictions have ruled that faulty workmanship by itself, resulting in damage to the work product alone, is not an “occurrence” under the CGL policy. *See, e.g.,* *Amerisure, Inc. v. Wurster Constr. Co., Inc.*, 818 N.E.2d 998, 1004 (Ind. Ct. App. 2004) (finding faulty workmanship not an accident and therefore not an “occurrence”); *Heile v. Herrmann*, 736 N.E. 2d 566, 568 (Ohio Ct. App. 1999) (concluding faulty workmanship not an “occurrence” when damage is solely to work product). However, in prior decisions, the Supreme Court of South Carolina has held that it is not the intent of the CGL policy to cover economic loss that results from faulty workmanship. *Century Indem. Co. v. Golden Hills Builders, Inc.*, 561 S.E.2d 355, 359 (S.C. 2002) (noting insurer has no duty to defend insured in situation where faulty workmanship by insured’s subcontractor results in losses).

the CGL policy's definition of an "occurrence".⁸⁹ Reasoning there was not any alleged property damage beyond the contractor's defective performance; the court concluded the CGL policy did not cover Bituminous' contract liability for a claim for money damages for compensation for this substandard work.⁹⁰

The Supreme Court of South Carolina filed its opinion for *L-J, Inc.* in August 2004; however, this opinion was subsequently withdrawn and substituted with a second opinion, filed in September 2005.⁹¹ In the first opinion, the Supreme Court of South Carolina discussed the "subcontractor exception" to the "your work" exclusion.⁹² Further, the court reversed the court of appeals finding that an exception to an exclusion can restore coverage.⁹³ Specifically, the court noted that "in stating that the exception to the exclusion 'restores' coverage, the court of appeals overlooks existing law, which states that 'an exclusion does not provide coverage but limits coverage.'"⁹⁴ However, the Supreme Court of South Carolina's second opinion, which replaced its first opinion, notably did not address these exclusions.⁹⁵

⁸⁹ *L-J, Inc.*, 621 S.E.2d at 35 (holding damage to roadway system did not constitute an occurrence). According to the deposition testimony, the several negligent acts by the insured during the states of design, preparation and construction, which resulted in the premature deterioration of the roads, were the only "occurrences;" however, the Supreme Court of South Carolina held the damage to the road systems did not constitute an occurrence. *Id.* at 36. The *L-J, Inc.* court discussed the distinction between a faulty workmanship claim and a claim for work product damage resulting from third party negligence. *Id.*; see also *High Country Assocs. v. New Hampshire Ins. Co.*, 648 A.2d 474, 477 (N.H. 1994) (distinguishing claim for faulty workmanship versus claim for damage to work product caused by third parties negligence). Particularly, the liability policy may "provide coverage in cases where faulty workmanship causes a third party bodily injury or damage to the other property, not in cases where faulty workmanship damages the work product alone. *L.J., Inc.*, 621 S.E.2d at 36 n.4.

⁹⁰ *L.J., Inc.*, 621 S.E.2d at 36 (concluding insurance policy does not cover liability for claim of money damages for compensation for defective performance). The Supreme Court of South Carolina stressed that the purpose of the CGL policy was not to guarantee the contractors work, characteristic of a performance bond. *Id.* at 36-37. Rather, the purpose of an insurance policy is to insure against accidents. *Id.*; see also *State Farm Fire and Cas. Co. v. Tillerson*, 777 N.E.2d 986 (Ill. App. Ct. 2001) (rationalizing courts would transform CGL policies into performance bonds if they found policy covered faulty workmanship).

⁹¹ *L-J, Inc. v. Bituminous Fire and Marine Ins. Co.*, No. 25854, 2004 S.C. LEXIS 190 (S.C. 2004), *substituted opinion at, opinion withdrawn by*, 621 S.E.2d 33 (S.C. 2005) (explaining sequence of opinions).

⁹² *L-J, Inc.*, 2004 S.C. LEXIS at *12-*13, *substituted opinion at, opinion withdrawn by*, 621 S.E.2d 33 (S.C. 2005) (comparing Supreme Court of Carolina's new opinion with withdrawn opinion).

⁹³ *Id.* (reversing court of appeals' decision that an exception to an exclusion can restore coverage).

⁹⁴ *Id.* (describing rationale of withdrawn opinions reversal of court of appeals determination that an exception to an exclusion can "restore" coverage).

⁹⁵ See generally, *L-J, Inc.*, 621 S.E.2d 33.

IV. ANALYSIS OF RECENT STATE SUPREME COURT DECISIONS

In CGL policy coverage disputes regarding construction defects, the central issue normally involves whether an insured's faulty workmanship constitutes an "occurrence."⁹⁶ The determination of whether the damage was caused by an "occurrence," commonly defined as an "accident," is a question courts have long wrestled with, and insurer and policyholder counsel and courts have considerably varied.⁹⁷ Given the differing rationales among courts, uncertainty exists surrounding the extent of construction defect coverage available under a CGL policy.⁹⁸

In construction defect coverage disputes such as those in *American Family*, *Auto-Owners*, and *L-J, Inc.*, courts generally do not provide coverage for damage as a result of the insured's own faulty workmanship under the CGL policy.⁹⁹ Although the courts in these three cases eventually reached the same conclusion as to whether the CGL policy covers damage to an insured's work, the three courts differed in how they reached this conclusion.¹⁰⁰ Particularly, the courts took one of two extremely different approaches.¹⁰¹ In *American Family*, the Supreme Court of Wisconsin concluded that damage to the insured's own work qualified as an "occurrence," however, as a result of the "your work" exclusion, the damage was excluded from coverage.¹⁰² The *Auto Owners* and *L-J, Inc.* Courts concluded that damage to the insured's own work is excluded from coverage

⁹⁶ See *supra* notes 50-95 and accompanying text (discussing three state supreme court decisions involving whether an insured's faulty workmanship constitutes an "occurrence").

⁹⁷ See *supra* notes 4-14 and accompanying text (discussing jurisdictional variation on what constitutes an "occurrence"). What constitutes an "accident" has confused courts since the 1800's. See Maniloff, *supra* note 2, at 17 (discussing judge's historical struggle with question of what constitutes an "accident"). The *Auto-Owners* court noted that a few courts in the country have considered unintentional damage resulting from faulty workmanship constituted an accident; compared to a majority of courts that have concluded faulty workmanship alone is not covered under the CGL policy, because an accident requires fortuity. See Maniloff, *supra* note 2, at 17.

⁹⁸ See *supra* notes 4-14 and accompanying text (discussing general uncertainty of coverage surrounding faulty workmanship claims under CGL policy).

⁹⁹ See *supra* notes 50-95 and accompanying text (summarizing facts and holdings of three cases). The purpose of CGL coverage is "for tort liability for physical damages to others and not for contractual liability for the insured for economic loss because the product or completed work is not that for which the damages person bargained." Henderson, *Insurance Protection for Products Liability and Completed Operations What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1971).

¹⁰⁰ See *supra* notes 50-95 and accompanying text (summarizing facts and holdings of three cases).

¹⁰¹ See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 50-95 and accompanying text (summarizing facts and holdings of three cases).

¹⁰² See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 51-66 and accompanying text (summarizing facts and holding of *American Family*).

from the beginning because it is not caused by an “occurrence.”¹⁰³ The courts, therefore, did not need to address the “your work” exclusion.¹⁰⁴ Nonetheless, the court in *Auto-Owners*, and the first opinion of the *L-J, Inc.* court which was subsequently withdrawn, considered the “your work” exclusion.¹⁰⁵

The disparity in the courts’ approaches involved particularly the “subcontractor exception” to the “your work” exclusion.¹⁰⁶ The court in *American Family* utilized the “subcontractor exception” to bring back coverage for otherwise excluded property damage under the “your work” exclusion.¹⁰⁷ If the *Auto Owners* and *L-J, Inc.* courts had been faced with the facts of *American Family*, however, it is apparent that these two courts would not have restored coverage through the “subcontractor exception.”¹⁰⁸ The *Auto-Owners* court concluded the “subcontractor exception” to the “your work” exclusion (Exclusion 1) cannot provide coverage, unless “(1) [t]here is an initial grant of coverage and (2) exclusion “1” operates to preclude coverage.”¹⁰⁹ Therefore, if *American Family* were to be decided under the rationale of the *Auto-Owners* and the *L-J, Inc.* courts, it is likely that the court would conclude there was no coverage to restore by the “subcontractor exception” because faulty workmanship to the insured’s own work is not a covered “occurrence” in the first place.¹¹⁰ If the *American Family* court had affirmed the appellate ruling concluding that a general contractor could not obtain liability coverage for a subcontractor’s

¹⁰³ See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 67-95 and accompanying text (summarizing facts and holding of *Auto-Owners* and *L-J, Inc.*).

¹⁰⁴ See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 67-95 and accompanying text (summarizing facts and holding of *Auto-Owners* and *L-J, Inc.*).

¹⁰⁵ See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 67-95 and accompanying text (summarizing facts and holding of *Auto-Owners* and *L-J, Inc.*).

¹⁰⁶ See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 50-95 and accompanying text (summarizing facts and holding of three cases).

¹⁰⁷ See Maniloff, *supra* note 2, at 17 (explaining *American Family* court recognized coverage through the “subcontractor exception” to the “your work” exclusion); see *supra* notes 51-66 and accompanying text (summarizing facts and holding of *American Family*). The court in *American Family* concluded the “your work” exclusion does not apply if the property damage is caused by the work of a subcontractor. See *supra* note 64 and accompanying text (summarizing *American Family* rule).

¹⁰⁸ See Maniloff, *supra* note 2, at 17 (discussing three courts differing reasoning in reaching same conclusion); see *supra* notes 50-95 and accompanying text (summarizing facts and holding of three cases).

¹⁰⁹ See *supra* note 75 and accompanying text (describing applicable conditions precedent for subcontractor exception to “your work” exclusion).

¹¹⁰ See Maniloff, *supra* note 2, at 17 (discussing three courts different reasoning in reaching same conclusion); see *supra* notes 50-95 and accompanying text (summarizing facts and holding of three cases).

faulty work, CGL policies arguably would have been rendered worthless in Wisconsin.¹¹¹

Although important policy reasons dictate that liability insurance should not cover repair or replacement of a contractor's poorly constructed product, the *American Family* ruling blurs the line between a CGL policy and a performance bond by allowing coverage for construction defects caused by the work of a subcontractor.¹¹² Allowing the CGL policy to cover construction defects is a significant victory for both building contractors and subcontractors.¹¹³ This ruling has widespread effects, particularly to insurance companies which have a duty to defend their insured's while the question of coverage is investigated.¹¹⁴

The Supreme Court of South Carolina's reversal of the appeals court's decision in *L-J, Inc.* could potentially have widespread effects on other courts and jurisdictions.¹¹⁵ For example, Pennsylvania's Superior Court recently relied on the South Carolina Court of Appeals decision in *L-J, Inc.*¹¹⁶ The Pennsylvania Supreme Court has granted an appeal in this particular case, which will further define the law of CGL coverage.¹¹⁷ In light of the conflicting case law and frequency of litigation in this area, the U.S. Court of Appeals for the Fifth Circuit recently certified three questions to the Texas Supreme Court, including whether construction defects constitute an "occurrence" under a CGL policy.¹¹⁸

Given the difference in courts' rationales throughout the country, it is time for the United States Supreme Court to consider this issue so that

¹¹¹ See *supra* notes 51-66 and accompanying text (summarizing facts and holding of *American Family*).

¹¹² See *supra* notes 25-35 and accompanying text (discussing policy reasons and purpose of CGL policy).

¹¹³ See *supra* notes 41-48 and accompanying text (discussing defense and indemnification aspects of CGL policy).

¹¹⁴ See *supra* notes 41-48 and accompanying text (discussing defense and indemnification aspects of CGL policy).

¹¹⁵ See Maniloff, *supra* note 2, at 17 (discussing courts decision in *L-J, Inc.*).

¹¹⁶ *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commer. Union Ins. Co.*, 825 A.2d 641 (Pa. Super. Ct. 2003), *appeal granted* by 848 A.2d 925 (Pa. 2004); see Maniloff, *supra* note 2, at 17 (noting *Kvaerner Metals* court relied heavily on South Carolina's Court of Appeals decision in *L-J, Inc.*).

¹¹⁷ See *supra* note 116 and accompanying text (noting *Kvaerner Metals* court reliance on courts rationale in *L-J, Inc.*).

¹¹⁸ *Lamar Homes, Inc. v. Mid Continent Cas. Co.*, 428 F.3d 193 (5th Cir. 2005). In October 2005, the appeals court held that:

Given the frequency this issue is litigated and the copious amount of conflicting caselaw on both sides regarding whether construction errors causing damage to the subject of the contract constitute an 'occurrence' causing 'property damage' under a CGL policy, we believe that this is an issue that the Texas Supreme Court should consider resolving.

contractors will be able to better understand what their CGL policy covers.¹¹⁹ The Supreme Court should follow the decisions of many jurisdictions by holding that faulty workmanship, standing alone, does not constitute an “occurrence,” and should clearly explain the proper rationale, hampering the blurred line between CGL policies and performance bonds. Contractors should not be permitted to rely on a CGL policy to cover faulty workmanship.

V. CONCLUSION

Considering the confusion in the courts and various jurisdictions, contractors must naturally question the extent of coverage offered under their CGL policy.¹²⁰ For example, the contractors involved in the “Big Dig” likely regard their CGL coverage as vital liability protection. Not surprisingly, many of these contractors would be shocked if they discovered they did not have coverage for faulty workmanship under their CGL policy. Although some industry experts have suggested that a uniform approach to construction defect coverage will never exist, considering the dramatic consequences to the industry of the coverage, would it not be better for the United States Supreme Court to put an end to the fragmentation of authority?¹²¹

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¹¹⁹ See *supra* notes 50-95 and accompanying text (discussing three recent state supreme court decisions varying rationales).

¹²⁰ See *supra* notes 2-4 and accompanying text (discussing shock of contractors upon discovery of extent of coverage under CGL policy); Jeremy Harrell, *Supreme Court Ruling Hailed As Victory For Builders*, THE DAILY REPORTER (MILWAUKEE, WI), Jan. 13, 2004, available at LEXIS, Dolan Media Newswires (discussing *American Family* decision as important legal victory for building contractors).

¹²¹ See Maniloff, *supra* note 2, at 17 (suggesting uniform approach to construction defect coverage not possible). Similar to the fragmentation of authority regarding the pollution exclusion litigation, Randy Maniloff has suggested that a uniform approach to coverage for construction defect litigation is also not foreseeable. *Id.*

