PUBLICATIONS

The "Occurrence" Battle: Whether CGL Policies Cover Property Damage Arising out Of Subcontractor's Defective Work

ABC SEMI Member Newsletter
11.19.2019

If you haven't noticed, there is a war going on in the construction industry. Contractors' insurers are financing a national war against property damage coverage–coverage that their underwriters have been promising (and providing in their insurance products) since 1973. The primary focus of this war is whether a subcontractor's defective work that damages a portion of a project is an "occurrence" and thus covered under the general contractor's Commercial General Liability ("CGL") policy.

Standard CGL insurance policies provide in the initial insuring agreement coverage for damages the policyholder is legally obligated to pay because of property damage or bodily injury caused by an "occurrence." CGL policies define "occurrence" as an "accident" but do not define that term. The Courts supplied the definition of "accident" – the unexpected, unforeseen, unintended consequence of the insured's actions. In short, then, CGL polices provide coverage against accidental property damage. Viewed in this light, it makes sense a carrier would deny a claim when the insured contractor deliberately used substandard materials and engaged in shoddy workmanship, knowing the work product was defective. In these "fly-by-night" contractor cases, there clearly has been no "accident" because the insured deliberately engaged in faulty workmanship and the resulting property damage was, or should have been, foreseeable and expected.

Construction defects, however, normally arise when a contractor intends to perform the work correctly, but unknowingly or mistakenly performs the work improperly. The property damage that results from these mistakes is therefore neither intended nor expected by the contractor performing the work. The majority of Supreme Courts in the country which have

Related People

Eric J. Flessland
Shareholder

Related Services

Construction

Construction Litigation

reviewed the issue hold that property damage arising out of construction defects should be considered 'accidental' and qualify as an 'occurrence' under the CGL insurance policy. Understand, this conclusion does not mean that the CGL insurance policy provides coverage for all property damage arising out of construction
defects. It means only that the ultimate coverage determination should base on careful application of the policy exclusions.

Exclusion l in the standard CGL policy is one such provision that is the focus of the on-going coverage battle. The “Damage To Your Work” exclusion has two components: (1) an exclusion eliminating coverage for property damage to your completed work, and (2) an exception which restores coverage for damage to the insured's own work that arise out of the work of a subcontractor. When reviewing the Subcontractor Exception to the Your Work exclusion, the majority of courts have ruled accidental property damage arising out of a subcontractor’s work is covered, even if the damage is to the policy holder’s work. These courts reach this conclusion by applying the express language of the CGL policy. The Insurance Services Office, which writes the standard CGL policies, says that is precisely how the liability policy should be interpreted and enforced.

Unfortunately, the Michigan Court of Appeals adopted a rule based on “public policy” rather than the policy language, and in doing so destroyed coverage most general contractors believe they purchased. In *Hawkeye-Security Ins v Vector Construction Co*, 185 Mich App 369 (1990), the Michigan Court of Appeals ruled faulty work, causing damage only to the insured’s work itself, and not to third-party property, is not an accident, within the definition of occurrence, but rather the failure of the contractor to complete the work in a workmanlike manner as bargained-for in the construction contract. In other words, remedying defective work is a business risk the contractor assumes, and therefore property damage arising out of defective work is not an accident within the CGL insuring agreement.

By superimposing the Business Risk Doctrine onto the definition of “occurrence” in the initial grant of coverage in the insuring agreement, the Michigan Court of Appeals rendered the exclusions and exceptions to those exclusions meaningless. If property damage arising out of a subcontractor’s work does not constitute an occurrence, then Exclusion l – and the exception to the exclusion – are superfluous. The Subcontractor Exception to Exclusion (l) narrowed the scope of the "business risk doctrine" to allow an insured coverage for property damage to its own work where that property damage arises out of work performed by the insured's subcontractor. In that way, an insured general contractor retains the risk for the exposure it controls, property damage for its own selfperformed defective work. However, the insured purchased coverage for risks beyond its control which produced property damage – the work of subcontractors and suppliers.

Until recently, the Michigan Supreme Court has not taken a position on the issue. However, the Court now can join the majority of jurisdictions that enforce the CGL policy as written, and to correct the misguided interpretation espoused by the Michigan Court of Appeals. In *Skanska USA Building Inc. v. M.A.P. Mechanical Contractors, Inc., and Amerisure Insurance Company*, the general contractor received an adverse coverage ruling in the Court of Appeals, and applied for Leave to Appeal to the

Michigan Supreme Court. Skanska seeks to overturn the Court of Appeals' "public policy" interpretation of contract language. Numerous trade associations and two prominent general contractors filed a "Friend of the Court" brief, urging the Supreme Court to grant leave to appeal, andto adopt the correct interpretation rule based on the express language of the CGL policy. On October 18, 2019, the Supreme Court granted leave. Oral arguments are expected in late spring 2020, and a decision should be issued in early summer. In the interim, insurance associations are expected to file "Friend of the Court" briefs opposing the
common-sense policy based interpretation.

The battle lines have been drawn, and the importance of this issue to the construction industry is obvious. Hopefully the Michigan Supreme Court issues a decision based on the CGL language, and rules (1) defective workmanship may constitute an "occurrence" under the CGL insuring agreement, (2) damages caused by faulty workmanship are "property damage" as defined by the CGL, and (3) damages to the insured contractor's work resulting from the faulty workmanship of a subcontractor are not excluded from coverage.

Eric J. Flessland
313.983.6901
flesslae@butzel.com