Ohio Rejects the Majority Trend and Finds No Liability Coverage for a Subcontractor's Faulty Work

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In *Ohio N. Univ. v. Charles Constr. Servs.,* 2018 Ohio LEXIS 2375 (No. 2017-0514, October 9, 2018), the Supreme Court of Ohio was recently called upon to determine if a general contractor's Commercial General Liability (CGL) insurance policy provided coverage for defective work completed by its subcontractor. Rejecting the majority trend, the court held that, because the subcontractor's faulty work was not an "occurrence" caused by an accident – *i.e.* a fortuitous event – within the meaning of the contractor's CGL policy, the insurer did not have to defend or indemnify the contractor with respect to the plaintiff's claims.

As stated in the decision, three years after the general contractor, Charles Construction Services (CCS), contracted with Ohio Northern University (ONU) to build a luxury hotel and conference center on its campus, ONU discovered extensive water damage to the building that had been caused by hidden leaks. In the course of ONU's investigation, it also discovered other serious structural defects. ONU sued CCS for the $6 million in damages it sustained as a result of the defective work. After CCS requested that its CGL insurer provide a defense and indemnify it for any damages sought by ONU, its insurer filed a declaratory judgment action, asserting that it did not have a duty to defend or indemnify CCS.

In the declaratory judgment action and on appeal, the insurer argued that claims arising from defective workmanship were not covered by its policy because, as defined in the policy, such claims are not considered an "occurrence." Both ONU and CCS asserted that the products-completed operations-hazard (PCOH) and subcontractor specific policy terms required coverage.

In determining whether there was coverage for property damage caused by the subcontractor's defective work, the Supreme Court began its analysis by examining a 2012 Ohio Supreme Court case that focused on the definition of the term "occurrence" in CGL policies. *See Westfield Ins. Co. v. Custom Agri Sys., Inc.,* 979 N.E.2d 269 (Ohio, 2012). In *Custom Agri,* the court held that a claim for property damage caused by a contractor's own faulty workmanship was not considered an "occurrence" under the terms of the CGL policy at issue. The *Custom Agri* court rationalized its decision by concluding that an "occurrence" must involve an accident and, although the term "accident" was not defined in the policy, an "accident" requires fortuity. Because faulty work involves a business risk and not a fortuitous event, the *Custom Agri* court held that the insurer's CGL policy did not have to cover the claim. Although some of the defective work involved in *Custom Agri* was performed by subcontractors, the Supreme Court did not address the PCOH and subcontractor-specific policy terms in that case.

To analyze whether the PCOH and subcontractor clauses at issue in *Charles Constr.* changed the *Custom Agri* holding and required coverage, the court turned its attention to the applicable policy language. Like in *Custom Agri,* the *Charles Constr.* court found that an "occurrence" is required in order to trigger coverage and application of the PCOH and subcontractor clauses. The CGL policy defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Since the term "accident" was not defined in the CGL policy, the court relied on the *Custom Agri* decision, which held that defective workmanship is not accidental because it is not unexpected or fortuitous. Rather, faulty work is an ordinary business risk that insurance is not intended to protect.

ONU and CCS argued that the inclusion of subcontractor-specific terms and the PCOH clause in the CGL policy evidenced the parties' intention that the policy cover the damages caused to ONU's building. The court disagreed. Although the court found that the CGL policy allowed for coverage for property damage caused to the contractor's work if such work was included in the PCOH and was

completed by a subcontractor, it found that the PCOH and subcontractor provisions had no effect because there was no "occurrence." The court stressed that an "occurrence" is necessary to trigger coverage.

The court recognized that its decision is contrary to the trend embraced by courts throughout the nation, which have found coverage under CGL policies when construction defects are caused by subcontractors and lead to property damage. However, the *Charles Constr.* court was adamant that its decision was based on the plain and ordinary meaning of the CGL policy's terms and its precedent that does not consider faulty workmanship an occurrence. Despite its ruling, the court suggested that if the Ohio General Assembly is dissatisfied with the result, it can enact legislation dictating that the term "occurrence" in CGL policies include property damage resulting from faulty workmanship.

This decision illustrates a few key points that the subrogation professional should keep in mind when handling construction defect claims. First, carefully consider whether the property damages were caused to the work itself or were consequential in nature. For instance, if a new building sustains water damage due to faulty plumbing that was installed by the original contractor or his subcontractor, then there is likely no occurrence under the CGL policy, at least in Ohio. If, however, the work involved an addition to an existing building and defective plumbing in the addition caused damages to the existing structure, then there is probably coverage. Second, bear in mind that work performed by a subcontractor will be analyzed differently than work performed by the CGL policyholder in a majority of jurisdictions. However, like in Ohio, there are exceptions. Third, if an area of law is unsettled in the governing jurisdiction, don't assume that courts in that jurisdiction will adopt the majority position. Courts reach unpredictable results every day. Finally, policy endorsements and exclusions must be interpreted to harmonize the endorsements and exclusions with the general terms of the policy. Like in *Charles Const.*, just because a policyholder purchased additional coverage, this fact does not mean that such coverage will be afforded if other policy terms are not satisfied.