Advisory

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Connecticut Supreme Court Weighs in on Faulty Workmanship as an Occurrence in the Standard CGL Policy

The next card has been played in the ongoing dispute of whether faulty workmanship is an occurrence under the standard ISO CGL policy. As most readers are aware, faulty workmanship by a contractor is not an occurrence under the law of some states (*e.g.*, New Jersey, Ohio, and Pennsylvania). Whereas the law in other states (*e.g.*, Florida, Texas and Wisconsin) provides that faulty workmanship can be an occurrence. In responding to a certified question from the federal district court in the Northern District of Alabama, the Connecticut Supreme Court has ruled that defective construction work can constitute an "occurrence" under the terms of the standard CGL policy. *Capstone Building Corp. v. American Motorists Ins. Co.*, SC 18886, June 11, 2013.

In this case, the Capstone Plaintiffs, served as general contractor and project developer for the construction of a housing complex at the University of Connecticut. Three years after completion of the project, UConn sent Plaintiffs a letter alleging that, as a result of Plaintiffs' work, there were "defects and deficiencies" in the project, including elevated levels of carbon monoxide. After the Plaintiffs' insurer AMICO rejected the claim under a standard CGL policy, the Plaintiffs and UConn settled their dispute. Subsequently, the Plaintiffs brought suit in Alabama for breach of contract and bad faith.

AMICO argued that because defective construction is deliberate and lacks the element of "fortuity," it does not constitute an "accident," and thus, is not an "occurrence." The Court disagreed, however, and stated that "[a] deliberate act, performed negligently, is an accident if the effect is not the intended or expected result; that is, the result would have been different had the deliberate act been performed correctly." Therefore, because it is the motive of the acting party which determines whether an act is intentional or accidental and, from the viewpoint of Plaintiffs, their negligent work was unintentional, the Court held that their faulty workmanship constituted an "accident," and thus, could constitute an "occurrence."

Even though the Court rejected AMICO's argument that a CGL policy never covers damage to the insured's project, the Court did hold that "property damage" does not include construction deficiencies unless they damage other, non-defective property. Therefore, if there is no damage beyond faulty workmanship or defective work, then there is no "property damage." Moreover, because defective work, without more, is not "property damage," then the repair of the defective work itself cannot constitute "property damage." Thus, there is a difference between "a claim for the costs of repairing or *removing defective work [itself]* - which is not a claim for property damage - and a claim for the costs of repairing *damage* caused by the defective work which is a claim for property damage." Finally, the Court stated that damage that does not cause a "physical, tangible

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alteration to any property" is not "property damage," and in this case, the escaping of carbon monoxide alone does not constitute "property damage."

The Court went on to consider the business risks exclusions and held that some of the damages may be excluded by the "your work" exclusion, but then brought back within coverage by the "subcontractor exception" to that exclusion. Thus, the Plaintiffs will have to prove at the trial court level that the property damage was caused by its subcontractors' defective work, rather than its own.

On the other questions certified to the Court, it held: there is no bad faith cause of action against an insurer for failing to conduct a discretionary investigation; and where underlying global settlements include the resolution of covered and non-covered claims, the insured has the burden to prove that the settlement was reasonable in proportion to the claims that the insurer was obligated to defend.

It is now the law in Connecticut that:

- Allegations of unintended defective construction work by a subcontractor that damages nondefective property may constitute an "occurrence" resulting in "property damage" under certain circumstances.
- Defective work, standing alone, or repairs to defective work do not constitute property damage and, therefore, are not covered under the standard CGL policy.
- Work by a contractor, as opposed to a subcontractor, is excluded from coverage under the business risks exclusions.
- There is no cause of action based on an insurer's failure to conduct a discretionary investigation of claims for coverage.
- In global settlements encompassing multiple claims, the insured has the burden of proving that the settlement is reasonable in proportion to claims that, considered independently, the insurer had a duty to defend.

No doubt, this same dispute will continue to play out in the insurance industry. Will insurers clarify the language in their policies to exclude faulty workmanship from coverage? Will insurers factor coverage for these damages into their pricing? Or, will market forces leave insurers having to simply cover these losses? The big picture reaction is uncertain, but at least the stakeholders have some clarity on how Connecticut law applies to claims of faulty workmanship under the standard CGL policy.

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