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Construction Defects: Are They “Occurrences”?

Chris French

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ABSTRACT

A frequently litigated issue in recent years in the area of insurance law is whether construction defects are “occurrences” under Commercial General Liability (“CGL”) insurance policies. The courts have been divided both in deciding this issue and in their approaches to analyzing it. This article addresses how the issue should be analyzed and concludes that construction defects are “occurrences.”

The relevant rules of insurance policy interpretation dictate that construction defects are “occurrences.” Policy language should be interpreted so as to fulfill the reasonable expectations of the policyholder when the policy is construed as a whole with all ambiguities in the policy language resolved in favor of the policyholder. “Occurrence” is defined in CGL policies as an “accident,” including continuous or repeated exposure to harmful conditions. The term “accident” itself, however, is undefined. The common law provides that an “accident” is an event or happening that unexpectedly and unintentionally results in injury or property damage. Thus, in determining whether construction defects are “occurrences,” the analysis should focus on whether the faulty workmanship and resulting damage was expected or intended by the contractor/policyholder. If the faulty workmanship and resulting damage was unexpected and unintended by the contractor, as is typically the case, then the resulting construction defects, and any related property damage, were caused by an “occurrence.”

Such a result is consistent with contractors’ reasonable expectations regarding the coverage they think they are purchasing under CGL policies. Contractors reasonably expect that when they purchase CGL insurance to cover their business liabilities, they will receive coverage for liability claims relating to property damage arising out of their business activities. Such claims are often the result of alleged construction defects. Thus, if construction defects were not “occurrences” under CGL policies, then CGL policies would unfairly and impermissibly provide illusory coverage to contractors.

Finally, if construction defects were not “occurrences,” then the “business risk” exclusions found in CGL policies, which purport to exclude coverage for certain risks

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inherent in doing business, would be superfluous. Thus, construing CGL policies as a whole also leads to the conclusion that construction defects are “occurrences.”

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INTRODUCTION

One of the most litigated issues in the area of insurance law in recent years is whether construction defects constitute “occurrences” under Commercial General Liability (“CGL”) policies.¹ “Occurrence” is defined under standard form CGL policies, which are currently used by most insurers, as follows:

[A]n accident, including continuous or repeated exposure to substantially the same general harmful conditions.²

Notably, the term “accident” is not defined.

To put the issue of whether construction defects are “occurrences” in context, imagine the following scenario which plays out across America on a daily basis: A contractor, who has CGL insurance, uses a subcontractor to install or replace a roof on a person’s house. Six months later, water starts leaking through the roof and causes damage to the walls and interior of the house. The homeowner sues the contractor, who then turns to its CGL insurer to cover the claim. The insurer denies coverage for the claim on the basis that the defective roof installation allegedly does not constitute an “occurrence” under the policy.

In essence, the insurer’s argument is that construction defects, such as the defective roof in the above example, are not “occurrences” because claims related to faulty workmanship are reasonably foreseeable, and thus they are not “accidents.” Insurers also argue that allowing coverage for construction defects would convert CGL policies into performance bonds or a guaranty regarding the quality of work performed, which is not the purpose of liability insurance.

The contractor’s response to such arguments, in the roofing example, is that the contractor did not intend to install the roof defectively; thus, the defective work was done accidentally and should be covered. The contractor would also argue that it expected the CGL policy to cover claims asserted against it and its business. Indeed, if construction defect claims are not covered, then why would a contractor even buy CGL insurance?

This article addresses this issue and answers the question of whether construction defects are “occurrences” under CGL policies. In short, the answer is “yes,” construction defects are “occurrences.” As an initial matter, allowing recovery for construction defect claims would not convert CGL policies into performance bonds. Performance bonds and insurance provide financial security to different entities. Performance bonds are issued to assure the owner of the property that the construction work will be completed, while CGL policies insure the contractor

1. See *infra* note 78 and accompanying text.

2. INS. SERVS. OFFICE, INC., FORM NO. CG 00 01 12 04, COMMERCIAL GENERAL LIABILITY COVERAGE FORM § V(13), at 14 (2004), *reprinted in* DONALD S. MALECKI & ARTHUR L. FLITNER, COMMERCIAL GENERAL LIABILITY app. I (8th ed. 2005).

against third party claims and lawsuits.³ Whether a performance bond or an insurance policy covers a claim requires a separate, independent analysis of the facts and the language in each agreement at issue, and it is possible that one, both, or neither of them would cover the claim. They are simply different agreements.

Under the rules of insurance policy interpretation, such as *contra proferentem*, the “reasonable expectations” doctrine, and construing the policy as a whole, there should be little debate that construction defects are “occurrences.” “Occurrences” are accidents, “including continuous or repeated exposure” to harmful conditions, that unexpectedly and unintentionally result in injury or damage.⁴ Because the term “accident” is not defined in CGL policies, any ambiguities in its meaning when applied to construction defect claims should be construed in favor of the policyholder/contractor under the doctrine of *contra proferentem*.⁵ Contractors generally do not intend their workmanship to be faulty or defective. Nor do they generally expect that their work will result in property damage. Thus, when construction work is done defectively, it generally is an “accident.”

In addition, contractors who purchase CGL insurance do so with the expectation that liability claims asserted against them, most commonly for construction defects, will be covered under the CGL policies they purchase. This expectation is reasonable because contractors are in the construction business; consequently, their liabilities typically relate to their construction work.

Moreover, when CGL policies are construed as a whole, one also is led to the conclusion that construction defects are “occurrences.” If construction defects were not “occurrences,” then the “business risk” exclusions, which purport to exclude coverage for certain risks inherent in doing business, would be superfluous.⁶ Consequently, in order for the “business risk” exclusions to have any purpose or meaning in the context of a policyholder in the construction business, construction defects must constitute “occurrences” so long as the construction defects are not expected or intended by the policyholder. Thus, the determination of whether any particular construction defect claim is covered under a CGL policy ultimately should turn on the application of the specific facts of the claim to the language in the “business risk” exclusions, not on an analysis of whether construction defects are “occurrences.”

This article analyzes the issue of whether construction defects are “occurrences” in four parts. Part I discusses the relevant policy language, such as the definitions of “occurrence” and “property damage,” as well as the “business risk” exclusions contained in CGL policies. Part II addresses the principles of insurance policy interpretation relevant to the determination of whether construction defects are “occurrences.” Part III discusses the courts’ treatment of the issue and the various

3. See *infra* notes 172-175 and accompanying text.

4. INS. SERVS. OFFICE, INC., *supra* note 2.

5. See discussion *infra* Part II.A.

6. See *infra* note 121 and accompanying text.

approaches that courts have taken in resolving the issue. Part IV sets forth the author's views regarding how courts should be resolving the issue. The article then concludes with a summary of the reasons why construction defects are "occurrences."

I. THE RELEVANT POLICY LANGUAGE

A. *The Insuring Agreement*

Under the Insurance Services Office, Inc.'s ("ISO")⁷ current standard form CGL policy, the basic insuring agreement language is as follows:

COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

- a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. . . .

. . . .

- b. This insurance applies to "bodily injury" and "property damage" only if:
 - (1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"⁸

B. *The Fortuity Doctrine and the Definition of "Occurrence"*

The use of the term "occurrence" in CGL policies actually has its origins in the fortuity doctrine, which first appeared in the property insurance context and essentially provides that insurance only covers "fortuitous" losses.⁹ Quoting *Webster's Third New International Dictionary*, the Supreme Court of North Carolina has explained that a loss is fortuitous if it "occur[s] by chance without evident causal need or relation or without deliberate intention." The court further described a fortuitous event as an event that is "not certain to occur."¹⁰

7. ISO is an influential organization within the insurance industry that promulgates standard form insurance policies, including CGL policies that insurers across the country use to conduct their business. *See* U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871, 879 n.6 (Fla. 2007). In particular, the organization develops its own standard forms and makes them available with state insurance regulators. *See* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 772 (1993). Being comprised of about 1400 insurers of property and casualty, ISO "is the almost exclusive source of support services in this country for CGL insurance." *Id.* As a result, "most CGL insurance written in the United States is written on [ISO] forms." *Id.*

8. INS. SERVS. OFFICE, INC., *supra* note 2, § I(1)(a), (b)(1), at 1.

9. *See, e.g.,* *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d 545, 548 (N.C. 1973).

10. *Avis*, 195 S.E.2d at 548.

Other courts have described “fortuity” as the “loss of property or possession, ‘by some unexpected acts’”;¹¹ “an event dependent on chance”;¹² “[h]appening by accident or chance; unplanned”;¹³ and “a casualty.”¹⁴

The original Restatement of Contracts defines “fortuity” in the insurance context as follows:

A fortuitous event . . . is an event which so far as the parties to the contract are aware, is dependent on chance. It may be beyond the power of any human being to bring the event to pass; it may be within the control of third persons; it may even be a past event, as the loss of a vessel, provided that the fact is unknown to the parties.¹⁵

The fortuity doctrine subsequently made its way into liability policies when it began being included in the definition of “occurrence.” For many years, “occurrence” was defined in ISO’s standard form CGL policies as follows:

[A]n accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage *neither expected nor intended from the standpoint of the insured*¹⁶

The current version of ISO’s standard form CGL policy defines “occurrence” as:

[A]n accident, including continuous or repeated exposure to substantially the same general harmful conditions.¹⁷

11. *Klockner Stadler Hurter Ltd. v. Ins. Co. of the State of Pa.*, 780 F. Supp. 148, 157 (S.D.N.Y. 1991) (quoting *London & Provincial Leather Processes, Ltd. v. Hudson*, [1939] K.B. 724 at 730 (Eng.)).

12. *Formosa Plastics Corp. v. Sturge*, 684 F. Supp. 359, 367 (S.D.N.Y. 1987), *aff’d*, 848 F.2d 390 (2d Cir. 1988); *see also* *Ins. Co. of N. Am. v. U.S. Gypsum Co.*, 870 F.2d 148, 151 (4th Cir. 1989); *Intermetal Mexicana, S.A. v. Ins. Co. of N. Am.*, 866 F.2d 71, 77 (3d Cir. 1989); *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 193 (D. Conn. 1984).

13. *Nw. Mut. Life Ins. Co. v. Linard*, 498 F.2d 556, 563 (2d Cir. 1974) (quoting *THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE* 518 (William Morris ed., 1970)).

14. *Buckeye Cellulose Corp. v. Atl. Mut. Ins. Co.*, 643 F. Supp. 1030, 1042 (S.D.N.Y. 1986).

15. *RESTATEMENT OF CONTRACTS* § 291 cmt. a (1932); *see also* *Compagnie des Bauxites de Guinee v. Ins. Co. of N. Am.*, 724 F.2d 369, 372 (3d Cir. 1983); *Mattis v. State Farm Fire & Cas. Co.*, 454 N.E.2d 1156, 1164 (Ill. App. Ct. 1983).

16. *INS. SERVS. OFFICE, INC., GENERAL INSURING AGREEMENT* 1 (1973) (emphasis added), *reprinted in* *MALECKI & FLITNER*, *supra* note 2, at app. A.

17. *INS. SERVS. OFFICE, INC.*, *supra* note 2.

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The “expected or intended” language that was contained in the old definition of “occurrence” has been moved to the exclusions section of the policies:

This insurance does not apply to . . . “[b]odily injury” or “property damage” expected or intended from the standpoint of the insured.¹⁸

Thus, depending on the year the policy was issued, the “expected or intended” language may appear in the exclusions section of the policy or in the definition of “occurrence.”

C. The Definition of “Property Damage”

“Property damage” is defined in standard form CGL policies as follows:

- a. Physical injury to tangible property, including all resulting loss of use of that property. . . . ; or
- b. Loss of use of tangible property that is not physically injured.¹⁹

D. The “Business Risk” Exclusions

Under ISO’s 1973 CGL policy form, there were three exclusions commonly referred to as the “business risk” exclusions, which purport to eliminate coverage for risks inherent in doing business and were worded as follows:

This [insurance] does not apply . . . :

. . . .

- (n) to property damage to the named insured’s products arising out of such products or any part of such products;
- (o) to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith;
- (p) to damages claimed for the withdrawal, inspection, repair, replacement, or loss of use of the named insured’s products or work completed by or for the named insured or of any property of which such products or work form a part, if such products, work or property are withdrawn from the market or from use because of any known or suspected defect or deficiency therein²⁰

18. *Id.* § I(2)(a), at 2.

19. *Id.* § V(17)(a)-(b), at 14-15.

20. INS. SERVS. OFFICE, INC., FORM NO. GL 00 02 01 73, COMPREHENSIVE GENERAL LIABILITY INSURANCE § I(n)-(p), at 2 (1973), *reprinted in* MALECKI & FLITNER, *supra* note 2, at app. A.

Since 1973, the “business risk” exclusions have been redrafted to narrow the scope of the exclusions.²¹ Beginning in 1976, policyholders could purchase what was referred to as a Broad Form Property Endorsement that replaced, among other exclusions, Exclusion (o) with an exclusion that expanded coverage.²²

In 1986, the “business risk” exclusions were revised again to incorporate the Broad Form Property Endorsement into the policy itself, clarify the language in the business risk exclusions, and add an exception for work done by subcontractors.²³ Since 1986, the business risk exclusions have been worded as follows:

This insurance does not apply to:

....

k. Damage to Your Product

“Property damage” to “your product” arising out of it or any part of it.

l. Damage to Your Work

“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.

m. Damage to Impaired Property or Property Not Physically Injured

“Property damage” to “impaired property” or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in “your product” or “your work”; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to “your product” or “your work” after it has been put to its intended use.²⁴

According to one commentator, the subcontractor exception was added because

the insurance and policyholder communities agreed that the CGL policy should provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor rather than the policyholder itself. This resulted both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of

21. See 21 ERIC MILLS HOLMES, HOLMES’ APPLEMAN ON INSURANCE 2D § 132.9[B], at 148-50 (2002).

22. See *id.*

23. See *id.* § 132.9[C]-[D], at 150-53; see also INS. SERVS. OFFICE, INC., *supra* note 2, § I(2)(j)-(l), (n), at 4-5.

24. INS. SERVS. OFFICE, INC., *supra* note 2, § I(2)(k)-(m)(2), at 5; see also INS. SERVS. OFFICE, INC., FORM NO. CG 00 01 07 98, COMMERCIAL GENERAL LIABILITY COVERAGE FORM § I(2)(k)-(m)(2) (1998), as reprinted in HOLMES, *supra* note 21, § 132.9[A], at 145-46.

insurers that the CGL was a more attractive product that could be better sold if it contained this coverage.²⁵

ISO itself, through a July 15, 1986 circular, stated that the 1986 revisions to the “business risk” exclusions were intended to incorporate the 1976 Broad Form Property Endorsement and to make it clear that the policy “cover[ed] damage caused by faulty workmanship to other parts of work in progress; and damage to, or caused by, a subcontractor’s work after the insured’s operations are completed.”²⁶

II. PRINCIPLES OF INSURANCE POLICY INTERPRETATION RELEVANT TO THE DETERMINATION OF WHETHER CONSTRUCTION DEFECTS ARE “OCCURRENCES”

When courts are asked to interpret and apply policy language, such as the definition of “occurrence” and the “expected or intended” language, three well-established rules of policy interpretation emerge as particularly relevant to the analysis: (1) *contra proferentem*, (2) the doctrine of “reasonable expectations,” and (3) construction of the policy as a whole.

A. The Doctrine of *Contra Proferentem*

It is hornbook insurance law that because insurers are the drafters of policy language, the doctrine of *contra proferentem* applies, which means any ambiguities in the policy language should be construed against the insurers and in favor of coverage.²⁷ The test under many states’ laws for determining whether policy

25. 2 JEFFREY W. STEMPEL, STEMPEL ON INSURANCE CONTRACTS § 14.13[D], at 14-224.8 (3d ed. Supp. 2007).

26. U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871, 879 (Fla. 2007) (alteration in original) (quoting INS. SERVS. OFFICE, INC., CIRCULAR NO. 6L-86-204, COMMERCIAL GENERAL LIABILITY PROGRAM INSTRUCTIONS (1986)).

27. See, e.g., 1 ELIZABETH K. AINSLIE ET AL., BUSINESS INSURANCE LAW AND PRACTICE GUIDE § 2.02[1], at 2-37 to -39 (2009); 13 JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 7401, at 197 (1976); 4 ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE § 16.04, at 16-20, § 16.06, at 16-27 (2009); 1 BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 1.03[b][1], at 30-32 (15th ed. Supp. 2011); 2 STEVEN PLITT ET AL., COUCH ON INSURANCE 3D § 22:14, at 22-67 to -70 (rev. ed. 2010); JEFFREY W. STEMPEL, INTERPRETATION OF INSURANCE CONTRACTS § 5.1, at 173 (1994); David B. Goodwin, *Disputing Insurance Coverage Disputes*, 43 STAN. L. REV. 779, 795 (1991) (book review); see also *New Castle County v. Nat’l Union Fire Ins. Co. of Pittsburgh*, 243 F.3d 744, 750 (3d Cir. 2001) (“When policy language is ambiguous, . . . under Delaware law this Court must apply the doctrine of *contra proferentem*. That is, ambiguous language must be construed against the drafter and in conformance with the reasonable expectations of the insured.”); *Kunin v. Benefit Trust Life Ins. Co.*, 910 F.2d 534, 538-39 (9th Cir. 1990) (“According to the law of California and, indeed, every other state as well as the District of Columbia, ambiguities in insurance contracts must be construed against the insurer.” (footnote omitted)); *Keller v. Safeco Ins.*

Co. of Am., 877 S.W.2d 90, 92 (Ark. 1994) (“If there is a reasonable construction that may be given to the contract that would justify recovery, it is the duty of the court to adopt it.”); Crane v. State Farm Fire & Cas. Co., 485 P.2d 1129, 1130 (Cal. 1971) (“Any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer.”); Hecla Mining Co. v. N.H. Ins. Co., 811 P.2d 1083, 1092 (Colo. 1991) (finding the term “sudden” to be ambiguous, and construing the phrase “sudden and accidental” against the insurer to mean “unexpected and unintended”); Ceci v. Nat’l Indem. Co., 622 A.2d 545, 548-51 (Conn. 1993) (finding “family member” ambiguous and defining it to favor the insured); Cody v. Remington Elec. Shavers, 427 A.2d 810, 812 (Conn. 1980) (“[A]mbiguities in contract documents are resolved against the party responsible for its drafting.”); Phillips Home Builders, Inc. v. Travelers Ins. Co., 700 A.2d 127, 129 (Del. 1997) (“If there is an ambiguity, however, the contract language is construed most strongly against the insurance company that drafted it.” (internal quotation marks omitted)); Qwest Commc’ns Int’l Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, 821 A.2d 323, 328 (Del. Ch. 2002) (“To the extent an ambiguity does exist, the doctrine of *contra preferentum* requires that the language be construed most strongly against the insurance company that drafted it.”); Crawford v. Prudential Ins. Co. of Am., 783 P.2d 900, 904 (Kan. 1989) (“Since an insurer prepares its own contracts, it has a duty to make the meaning clear, and if it fails to do so, the insurer, and not the insured, must suffer.”); RPM Pizza, Inc. v. Auto. Cas. Ins. Co., 601 So. 2d 1366, 1369 (La. 1992) (“[A]ny ambiguity must be construed against the insurance company and in favor of the reasonable construction that affords coverage.”); Me. Drilling & Blasting, Inc. v. Ins. Co. of N. Am., 665 A.2d 671, 673 (Me. 1995) (“A liability insurance policy must be construed to resolve all ambiguities in favor of coverage.”); Am. Bumper & Mfg. Co. v. Hartford Fire Ins. Co., 550 N.W.2d 475, 480 (Mich. 1996) (“[I]n construing insurance contracts, any ambiguities are strictly construed against the insurer to maximize coverage.”); Weaver v. Royal Ins. Co. of Am., 674 A.2d 975, 977 (N.H. 1996) (“If the policy language is ambiguous or where conflicting interpretations exist, we construe the policy in favor of providing coverage to the insured.”); Allen v. Metro. Life Ins. Co., 208 A.2d 638, 644 (N.J. 1965) (“[P]olicies should be construed liberally in their favor to the end that coverage is afforded to the full extent that any fair interpretation will allow.” (internal quotation marks omitted)); Ohio Cas. Ins. Co. v. Flanagan, 210 A.2d 221, 226 (N.J. 1965) (“If the controlling language will support two meanings, one favorable to the insurer, and the other favorable to the insured, the interpretation sustaining coverage must be applied.” (internal quotation marks omitted)); State v. Home Indem. Co., 486 N.E.2d 827, 829 (N.Y. 1985) (“If . . . the language in the insurance contract is ambiguous and susceptible of two reasonable interpretations, the parties may submit extrinsic evidence as an aid in construction, and the resolution of the ambiguity is for the trier of fact.”); DeBerry v. Am. Motorists Ins. Co., 236 S.E.2d 380, 382 (N.C. Ct. App. 1977) (“[A]ny ambiguity or uncertainty as to the meaning of terms in a policy should be resolved against the insurer since it selected the language used.”); Kief Farmers Coop. Elevator Co. v. Farmland Mut. Ins. Co., 534 N.W.2d 28, 32 (N.D. 1995) (explaining that in construing policies, a court must “balance the equities in favor of providing coverage to the insured”); Gomolka v. State Auto. Mut. Ins. Co., 436 N.E.2d 1347, 1348-49 (Ohio 1982) (“[P]olicies of insurance, which are in language selected by the insurer and which are reasonably open to different interpretations, will be construed most favorably for the insured.” (alteration in original) (internal quotation marks omitted)); Sec. Fin. Co. v. Aetna Ins. Co., 269 N.E.2d 592, 594 (Ohio 1971) (“[I]n construing provisions of insurance policies a court must resolve any doubts arising from the language used in favor of the insured and . . . if the words used in the policy bear more than one reasonable meaning, they should be interpreted liberally in favor of the insured.” (internal quotation marks

language is ambiguous is whether the provisions at issue are reasonably or fairly susceptible to different interpretations or meanings.²⁸ Where the controversy

omitted)); *Cohen v. Erie Indem. Co.*, 432 A.2d 596, 599 (Pa. Super. Ct. 1981) (concluding, in the face of conflicting authorities, that the clause at issue was ambiguous regarding whether coverage extended to the particular facts at hand, and that such ambiguity alone required resolving the issue in favor of the insured driver); *Shelley v. Nationwide Mut. Ins. Co.*, 245 A.2d 674, 675-76 (Pa. Super. Ct. 1968) ("It is well established that an insurance policy will be construed most strongly against the insurer who has prepared it . . ."); *Nat'l Union Fire Ins. Co. of Pittsburgh v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex. 1991) ("[I]f a contract of insurance is susceptible of more than one reasonable interpretation, [the court] must resolve the uncertainty by adopting the construction that most favors the insured."); *Garneau v. Curtis & Bedell, Inc.*, 610 A.2d 132, 134 (Vt. 1992) ("In determining whether the insurer has a duty to indemnify, any ambiguity in the insurance contract will be resolved in favor of the insured."); *Peerless Ins. Co. v. Wells*, 580 A.2d 485, 487 (Vt. 1990) ("[A]ny ambiguity in policy language should be resolved in favor of the insured . . ."); *Murray v. W. Pac. Ins. Co.*, 472 P.2d 611, 615 (Wash. Ct. App. 1970) ("[T]he well recognized rule that exclusionary clauses in insurance policies are construed most strongly against the insurer.").

28. See *APPLEMAN & APPLEMAN*, *supra* note 27, § 7403, at 312-13 (explaining that the insurer has the burden of establishing that the insurer's interpretation is the only fair interpretation of the contract); *LONG*, *supra* note 27, § 16.06, at 16-35 ("Generally, a term or clause will be found ambiguous if it is subject to two or more reasonable constructions."); see also *New Castle County v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 243 F.3d 744, 750 (3d Cir. 2001) ("The settled test for ambiguity is whether the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings." (internal quotation marks omitted)); *W. Heritage Ins. Co. v. Magic Years Learning Ctrs. & Child Care, Inc.*, 45 F.3d 85, 88 (5th Cir. 1995) (noting that under Texas law, "the court must enforce the policy as written if it can be given only one reasonable construction"); *Vargas v. Ins. Co. of N. Am.*, 651 F.2d 838, 839-40 (2d Cir. 1981) (stating that New York law places a heavy burden on the insurer to prove that the policyholder's interpretation is unreasonable, that the policy is "susceptible" to the insurer's interpretation, and the insurer's interpretation is the only one that could "fairly be placed" on the policy (internal quotation marks omitted)); *Desai v. Farmers Ins. Exch.*, 55 Cal. Rptr. 2d 276, 280 (Cal. Ct. App. 1996) (explaining that policy language is ambiguous if it is susceptible to two or more meanings); *Shepard v. Calfarm Life Ins. Co.*, 7 Cal. Rptr. 2d 428, 432-33 (Cal. Ct. App. 1992) (explaining that "a policy provision is ambiguous when it is capable of two or more constructions, both of which are reasonable," and the burden of proving one reasonable construction falls to the insurer (internal quotation marks omitted)); *Phillips Home Builders, Inc. v. Travelers Ins. Co.*, 700 A.2d 127, 130 (Del. 1997) ("Convolved or confusing terms are the problem of the insurer . . . not the insured." (internal quotation marks omitted)); *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 476 (N.H. 1994) ("If the language of the policy reasonably may be interpreted more than one way and one interpretation favors coverage, an ambiguity exists in the policy that will be construed in favor of the insured and against the insurer."); *Salem Grp. v. Oliver*, 607 A.2d 138, 139 (N.J. 1992) ("When a policy fairly supports an interpretation favorable to both the insured and the insurer, the policy should be interpreted in favor of the insured."); *Harris, Jolliff & Michel, Inc. v. Motorists Mut. Ins. Co.*, 255 N.E.2d 302, 307 (Ohio Ct. App. 1970) ("Where an ambiguity exists that meaning must be assigned which is most favorable to the insured and

involves a phrase that insurance companies have failed to define and has generated many lawsuits with varying results, common sense dictates that the policy language must be ambiguous.²⁹

Further, because exclusions purport to limit coverage that otherwise is provided, they are to be narrowly construed and the insurer has the burden of proving they are applicable.³⁰ Indeed, numerous courts have held that exclusions will not be

which excludes the least.”); *Bartlett v. Amica Mut. Ins. Co.*, 593 A.2d 45, 47 (R.I. 1991) (noting ambiguity if a clause has “more than one reasonable meaning”); *Goldstein v. Occidental Life Ins. Co. of Cal.*, 273 A.2d 318, 321 (R.I. 1971) (“The test to be applied by a court in determining the meaning of ambiguous terms in an insurance contract is not what the insurer intended by its words, but what the ordinary reader and purchaser applying for insurance would have understood them to mean.”); *H.D. Bonner v. United Servs. Auto. Ass’n*, 841 S.W.2d 504, 506 (Tex. Ct. App. 1992) (“The court must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties’ intent.”).

29. See, e.g., *New Castle County v. Nat’l Union Fire Ins. Co. of Pittsburgh*, 243 F.3d 744, 756 (3d Cir. 2001) (finding ambiguity where the contested phrase was not defined and had been interpreted differently by various courts); *Sec. Ins. Co. of Hartford v. Investors Diversified Ltd.*, 407 So. 2d 314, 316 (Fla. Dist. Ct. App. 1981) (“The insurance company contends that the language is not ambiguous, but we cannot agree and offer as proof of *that* pudding the fact that the Supreme Court of California and the Fifth Circuit in New Orleans have arrived at opposite conclusions from a study of essentially the same language.”); *Crawford v. Prudential Ins. Co. of Am.*, 783 P.2d 900, 908 (Kan. 1989) (“[T]he reported cases are in conflict, the trial judge and the Court of Appeals reached different conclusions and the justices of this court do not agree Under such circumstances, the clause is, by definition, ambiguous and must be interpreted in favor of the insured.”); *Allstate Ins. Co. v. Hartford Accident & Indem. Co.*, 311 S.W.2d 41, 47 (Mo. Ct. App. 1958) (“Since we assume that *all* courts adopt a reasonable construction, the conflict is of itself indicative that the word as so used is susceptible of at least two reasonable interpretations, one of which extends the coverage to the situation at hand.”); *George H. Olmsted & Co. v. Metro. Life Ins. Co.*, 161 N.E. 276, 277 (Ohio 1928) (surveying cases where courts have differed in their interpretation of the same language in insurance contracts and concluding that the language in this case is ambiguous); *Cohen v. Erie Indem. Co.*, 432 A.2d 596, 599 (Pa. Super. Ct. 1981) (“The mere fact that . . . [courts differ on the construction of the provision] itself creates the inescapable conclusion that the provision in issue is susceptible to more than one interpretation.”); AINSLIE ET AL., *supra* note 27, § 2.02[1], at 2-38; LONG, *supra* note 27, § 16.06, at 16-36; STEMPER, *supra* note 27, § 5.8, at 201-02; Charles C. Marvel, Annotation, *Division of Opinion Among Judges on Same Court or Among Other Courts or Jurisdictions Considering Same Question, as Evidence that Particular Clause of Insurance Policy is Ambiguous*, 4 A.L.R.4TH 1253, 1255 (1981).

30. See, e.g., *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 313 (Minn. 1995) (explaining that the insurer has the burden to “prove the applicability of an exclusion as an affirmative defense”), *overruled on other grounds by* *Bahr v. Boise Cascade Corp.*, 766 N.W.2d 910 (Minn. 2009); *Cont’l Ins. Co. v. Louis Marx & Co.*, 415 N.E.2d 315, 317 (Ohio 1980) (explaining that the insurer has the burden of proving a defense based on exclusion); *Brown v. Snohomish Cnty. Physicians Corp.*, 845 P.2d 334, 340 (Wash. 1993) (explaining

interpreted and applied in such a way as to swallow the basic coverages provided under a policy.³¹

So how does *contra proferentem* apply in the context of determining whether construction defects are “occurrences”? As discussed above, an ambiguous insurance policy provision is one that has more than one reasonable meaning.³² Here, the key term “accident” is not defined, and the courts have struggled to determine what the test should be with respect to whether an injury or damage is “expected or intended.”³³ Thus, when one attempts to determine whether construction defects are “occurrences,” it becomes apparent that the term is ambiguous when applied in many instances. Consequently, it should be construed against insurers in such cases.³⁴

B. The “Reasonable Expectations” Doctrine

Another staple of insurance policy interpretation is that a policy should be interpreted in such a way as to fulfill the “reasonable expectations” of the policyholder.³⁵ A seminal article regarding the “reasonable expectations” doctrine

that once the insured has made a *prima facie* case that there is coverage, the burden shifts to the insurer to prove an exclusionary provision applies); AINSIE ET AL., *supra* note 27, § 2.02[1], at 2-39; APPLEMAN & APPLEMAN, *supra* note 27, § 7405, at 340; PLITT ET AL., *supra* note 27, § 22:31, at 22-133.

31. See *Tews Funeral Home, Inc. v. Ohio Cas. Ins. Co.*, 832 F.2d 1037, 1045 (7th Cir. 1987) (concluding that a policy excluding acts explicitly covered in a prior section of the policy should be construed against the insurer); *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 390 (D. Del. 2002) (explaining that construing ambiguities against the insurer reduces the insurer’s incentive to draft “provisions [that] purport to give coverage while other clauses take that very coverage away”); *Titan Indem. Co. v. Newton*, 39 F. Supp. 2d 1336, 1348 (N.D. Ala. 1999) (finding some coverage even though “[t]he limitations of [the] policy completely swallow[ed] up the insuring provisions”); *Bailer v. Erie Ins. Exch.*, 687 A.2d 1375, 1380 (Md. 1997) (“If the exclusion totally swallows the insuring provision, the provisions are completely contradictory. That is the grossest form of ambiguity, and [the insurer], unquestionably, would be obliged to defend and indemnify.”).

32. See *supra* note 28 and accompanying text.

33. See *infra* Part II.D.

34. See *supra* notes 27, 29 and accompanying text.

35. See AINSIE ET AL., *supra* note 27, § 2.02[1], at 2-40; ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 6.3(a)(3), at 633-34 (1988); LONG, *supra* note 27, § 16.07, at 16-39; OSTRAGER & NEWMAN, *supra* note 27, § 1.03[b][2][B], at 42-53 (identifying courts in forty-two states that have expressed support for, or applied a form of, the reasonable expectations doctrine); PLITT ET AL., *supra* note 27, § 22:11, at 22-41; STEMPEL, *supra* note 27, § 11.1, at 312; see also *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1264 (Cal. 1990) (explaining that ambiguous coverage clauses of insurance policies are to be interpreted “broadly, protecting the objectively reasonable expectations of the insured”); *Roland v. Ga. Farm Bureau Mut. Ins. Co.*, 462 S.E.2d 623, 625 (Ga. 1995) (“A contract of insurance should be strictly construed against the insurer and read in favor of coverage in accordance with the reasonable expectations of the insured.”); *A.B.C. Builders, Inc. v. Am. Mut. Ins. Co.*, 661 A.2d 1187, 1190 (N.H. 1995) (“[T]he policy language must be so clear as to create

was written by then Professor Robert Keeton more than forty years ago.³⁶ In his subsequent treatise, then Judge Keeton summarized the doctrine as follows:

In general, courts will protect the reasonable expectations of applicants, insureds, and intended beneficiaries regarding the coverage afforded by insurance contracts even though a careful examination of the policy provisions indicates that such expectations are contrary to the expressed intention of the insurer.³⁷

no ambiguity which might affect the insured's reasonable expectations." (internal quotation marks omitted); Fed. Ins. Co. v. Century Fed. Sav. & Loan Ass'n, 824 P.2d 302, 308 (N.M. 1992) (explaining that the court will "give[] effect to the insured's reasonable expectations" in construing policy language); Mills v. Agrichem. Aviation, Inc., 250 N.W.2d 663, 671-73 (N.D. 1977) (explaining that the doctrine of reasonable expectations is properly invoked to discern the intentions of the parties and impose liability on the insurer); Nat'l Mut. Ins. Co. v. McMahon & Sons, Inc., 356 S.E.2d 488, 495-96 (W. Va. 1987) (explaining that a court will apply the reasonable expectations doctrine to construe the policy in a manner that "a reasonable person standing in the shoes of the insured would expect the language to mean[.] . . . even though painstaking study of the policy provisions would have negated those expectations" (internal quotation marks omitted), *overruled on other grounds by* Potesta v. U.S. Fid. & Guar. Co., 504 S.E.2d 135 (W. Va. 1998)).

36. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 966-77 (1970).

37. KEETON & WIDISS, *supra* note 35, § 6.3(a)(3), at 633. For commentary regarding the reasonable expectations doctrine, see Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151, 1168-98 (1981) (outlining justifications for, and limitations of, the reasonable expectations doctrine); Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 825-26, 839-46 (1990) (providing a detailed historical account of the doctrine and asserting that the doctrine is principled and can be applied within justiciable guidelines); Robert H. Jerry, II, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21, 35-41 (1998) (discussing the doctrine as conceptualized by Keeton); William A. Mayhew, *Reasonable Expectations: Seeking a Principled Application*, 13 PEPP. L. REV. 267, 287-96 (1986) (formulating standards for applying the doctrine); Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 374-92 (1986) (arguing for refinements to the doctrine in response to the fading appeal that the doctrine holds for courts and commentators and contending that courts should "discard their unfortunate tendency to speak the platitudes of reasonable expectations without undertaking a careful and systematic analysis"). While there is relatively broad acceptance of the doctrine, judicial interpretation and application of the doctrine is variable. See Jeffrey W. Stempel, *Unmet Expectations: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of Judicial Role*, 5 CONN. INS. L.J. 181, 182-84, 191-95 (1998) (describing judicial approaches and noting both liberal and narrow approaches among the numerous states that have adopted the doctrine); Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L.J. 729, 731-32 (2000) (exploring judicial responses and proposing that a "middle ground" approach has developed); Laurie Kindel Fett, Note, *The Reasonable Expectations Doctrine: An Alternative to Bending and Stretching Traditional Tools of Contract Interpretation*, 18 WM. MITCHELL L. REV. 1113, 1124-33 (1992) (exploring the doctrine under Minnesota law); Scott B. Krider, Comment, *The*

As Professor Francis Mootz more recently commented, the reasonable expectations doctrine provides that “even when the policy language unambiguously precludes coverage, under certain circumstances, courts will hold that coverage exists.”³⁸

Stated differently, the policyholder should receive in coverage what it can objectively and reasonably expect to receive even if the insurer can point to some policy language that supports the insurer’s position that the claim at issue should not be covered. Thus, for example, a policyholder in the construction business can reasonably expect it will receive coverage under a CGL policy for construction liability claims when it buys a CGL policy for purposes of insuring itself against liability claims.

So what does this mean in the context of whether construction defects are “occurrences”? As is discussed below in Part IV, a policyholder can reasonably expect to receive coverage for construction defects so long as it did not “expect or intend” its work to be defective and cause damage. In other words, courts should not permit insurers to agree to cover property damage unexpectedly and unintentionally caused by a contractor or its subcontractor, but then, when a claim is presented, deny coverage based on the argument that all work done by a contractor or its subcontractor, whether defective or of high quality, is intentional and thus, it and any related property damage are not covered. To do so would render the liability coverage provided to contractors under the policy illusory, which is impermissible.³⁹

Reconstruction of Insurance Contracts Under the Doctrine of Reasonable Expectations, 18 J. MARSHALL L. REV. 155, 157, 173-76 (1984) (arguing that regulatory efforts address the underlying problems in the insurance industry in a manner superior to judicial use of reasonable expectations); William Mark Lashner, Note, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*, 57 N.Y.U. L. REV. 1175, 1208 (1982) (proposing a rule that “any provision which undercuts the bargained-for insurance coverage must . . . be[] specifically explained to the insured” to be enforceable); Stephen J. Ware, Comment, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1475-87 (1989) (providing a “law and economics” critique of the doctrine).

38. Francis J. Mootz III, *Insurance Coverage of Employment Discrimination Claims*, 52 U. MIAMI L. REV. 1, 22 (1997).

39. See, e.g., *Bowersox Truck Sales & Serv., Inc. v. Harco Nat’l Ins. Co.*, 209 F.3d 273, 278-79 (3d Cir. 2000) (rejecting the insurer’s interpretation of the policy’s two-year limitation period where that interpretation would have rendered coverage illusory); *Harris v. Gulf Ins. Co.*, 297 F. Supp. 2d 1220, 1226 (N.D. Cal. 2003) (rejecting the insurer’s interpretation of the exclusion in the policy because it “would render the coverage provided by the policy illusory”); *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 398 (D. Del. 2002) (rejecting a director and officer insurer’s interpretation of the policy’s deliberate fraud exclusion where, if applied, “there would be little or nothing left to that coverage” because “[n]o insured would expect such limited coverage from a policy that purports to cover all types of securities fraud claims”); *Atofina Petrochems., Inc. v. Cont’l Cas. Co.*, 185 S.W.3d 440, 444 (Tex. 2005) (rejecting an insurer’s interpretation of additional insured endorsement because doing so “would render coverage under the endorsement largely illusory”); see also *supra* note 31 and accompanying text.

C. Construction of the Policy as a Whole

The third policy interpretation principle applicable to the issue of whether construction defects are “occurrences” provides that, if possible, the policy should be interpreted in a way that reconciles the various provisions of the policy and attempts to give effect to all of the policy’s provisions.⁴⁰ In essence, this principle means courts should attempt to interpret all of the policy’s provisions in a way that is consistent with the general purpose of the policy as a whole. In the context of construction defects, this means that the definition of “occurrence” should not be read in isolation in determining whether a claim is covered. To the contrary, courts should first look to the insuring language in the policy that incorporates the definition of “occurrence,” as well as the rest of the policy provisions, including the “business risk” exclusions, to determine whether the policy covers the claim at issue.

As is discussed in Part IV, the fact that “business risk” exclusions are even provided for in CGL policies, including the subcontractor exception contained therein,⁴¹ should be considered when determining whether construction defects are intended to be covered. Thus, when analyzing whether there is coverage for a claim, courts should not examine just a portion of the policy, such as the definition of “occurrence.” Instead, the insurance policy should be read as a whole—keeping in mind that the basic purpose of insurance is to protect the policyholder from losses or liabilities in exchange for the payment of a premium. To do otherwise would make the insurance illusory.⁴²

40. See, e.g., GA. CODE ANN. § 13-2-2(4) (2010) (providing that contracts should be interpreted as a whole); *Rothenberg v. Lincoln Farm Camp, Inc.*, 755 F.2d 1017, 1019 (2d Cir. 1985) (applying New York law and finding “an interpretation that gives a reasonable and effective meaning to all the terms of a contract is generally preferred to one that leaves a part unreasonable or of no effect”); *Fireman’s Fund Ins. Co. v. Allstate Ins. Co.*, 286 Cal. Rptr. 146, 155-56 (Cal. Ct. App. 1991) (“In short, an insurance contract is to be construed in a manner which gives meaning to all its provisions in a natural, reasonable, and practical manner, having reference to the risk and subject matter and to the purposes of the entire contract.” (quoting *State Farm Mut. Auto. Ins. Co. v. Crane*, 266 Cal. Rptr. 422, 424-25 (Cal. Ct. App. 1990))); *State Farm*, 266 Cal. Rptr. at 424-25 (citing *Barrett v. Farmers Ins. Grp.*, 220 Cal. Rptr. 135, 137 (Cal. Ct. App. 1985) to determine that “an insurance contract is to be construed in a manner which gives meaning to all its provisions in a natural, reasonable, and practical manner”); *Barrett*, 220 Cal. Rptr. at 137 (construing an insurance contract to give meaning to all its provisions); *Weiss v. Bituminous Cas. Corp.*, 319 N.E.2d 491, 495 (Ill. 1974) (explaining that the provisions of an insurance policy should be interpreted in the context of the entire policy); *Welborn v. Ill. Nat’l Cas. Co.*, 106 N.E.2d 142, 143 (Ill. App. Ct. 1952) (“[T]he court should determine the intention [of the parties] from the whole agreement, and endeavor to give a meaning to all provisions, so far as possible, which will render them consistent and operative.”).

41. *INS. SERVS. OFFICE, INC.*, *supra* note 2, § I(2)(1), at 5 (“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.”).

42. See *supra* notes 31, 39 and accompanying text.

D. Issues Related to What Exactly Must Be “Expected or Intended”

In analyzing whether construction defects are “accidents,” the first thing one must keep in mind is that the “expected or intended” language contained in CGL policies, whether located in the definition of “occurrence” or in the exclusions section of the policy, is an exclusion.⁴³ Thus, it should be narrowly construed⁴⁴ and all ambiguities regarding its interpretation and application should be resolved in favor of the policyholder.⁴⁵ Further, the insurer has the burden of proving the policyholder expected or intended the damage at issue.⁴⁶

1. Objective v. Subjective Standard

In applying the “expected or intended” language, one must examine the policyholder’s state of mind to determine whether the property damage was caused by an accident or whether the policyholder expected or intended to cause the damage at issue. Courts do not agree if the test should be whether the policyholder subjectively expected or intended to cause the damage at issue, or objectively should have expected or intended to cause the damage at issue.⁴⁷ The majority of courts to address the issue, however, have adopted a subjective standard.⁴⁸

43. See, e.g., *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1205 (2d Cir. 1995) (explaining that the insurer has the burden of proof regarding “the exclusionary effect of policy language,” regardless of where the exclusionary language is located in the policy); *Upjohn Co. v. Aetna Cas. & Sur. Co.*, No. 4:88-CV-124, 1994 WL 1029337, at *9 (W.D. Mich. July 22, 1994) (“[A]lthough the neither expected nor intended language appears in the occurrence clause, it essentially operates as an exclusion.”); *Clemco Indus. v. Commercial Union Ins. Co.*, 665 F. Supp. 816, 820-21 (N.D. Cal. 1987) (determining that the “expected or intended” language is an exclusionary clause, and thus requires a narrow interpretation to provide the insured the greatest protection); *Nat’l Farmers Union Prop. & Cas. Ins. Co. v. Kovash*, 452 N.W.2d 307, 311 n.3 (N.D. 1990) (“A determination of coverage under the ‘expected or intended’ language in the definition of an occurrence generally involves the same determination as coverage under an exclusion for intentional acts.” (citing James L. Rigelhaupt, Jr., Annotation, *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 A.L.R.4TH 957, 971 (1984))).

44. See *supra* note 30 and accompanying text.

45. See *supra* note 27 and accompanying text.

46. See *United Rental Equip. Co. v. Aetna Life & Cas. Ins. Co.*, 376 A.2d 1183, 1187 (N.J. 1977) (“When an insurance carrier puts in issue its coverage of a loss under a contract of insurance by relying on an exclusionary clause, it bears a substantial burden of demonstrating that the loss falls outside the scope of coverage.”); see also *supra* note 30 and accompanying text.

47. Compare *Coregis Ins. Co. v. Elizabeth Township*, No. 205cv582, 2007 WL 1005599, at *4 (W.D. Pa. Mar. 30, 2007) (“To determine whether an insured intended the harm, courts apply a subjective standard.”), and *Royal Indem. Co. v. Sonoco/Ne., Inc.*, 183 F. Supp. 2d 526, 533-34 (D. Conn. 2002) (determining intent for the intentionality exclusion

There are a number of variations of the objective standard. Under one variation, the question is whether a “reasonable” person would have expected the injury at issue.⁴⁹ Under another variation, the question is whether the policyholder knew or

“requires the Court to apply a subjective standard”), and *U.S. Fid. & Guar. Co. v. Armstrong*, 479 So. 2d 1164, 1167 (Ala. 1985) (“[T]he legal standard to determine whether the injury was either expected or intended . . . is a purely subjective standard.”), and *Fire Ins. Exch. v. Berray*, 694 P.2d 191, 194 (Ariz. 1984) (explaining that the court looks “from the standpoint of the insured” to determine whether the insured “expected or intended” to cause injury), and *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 861 (Cal. Ct. App. 1993) (rejecting the objective “should have known” meaning of “expect” and instead adopting the word’s “plain meaning”), and *State Farm Mut. Auto. Ins. Co. v. McMillan*, 925 P.2d 785, 794 (Colo. 1996) (rejecting the insurer’s “objective viewpoint” argument and addressing the issue from the viewpoint of the insured), and *Williams v. City of Baton Rouge*, 98-1981, pp. 19-20 (La. 4/13/99); 731 So. 2d 240, 253 (“The subjective intent of the insured . . . will determine whether an act is intentional.” (internal quotation mark omitted)), and *Great Am. Ins. Co. v. Gaspard*, 608 So. 2d 981, 985 (La. 1992) (“[T]he subjective intent of the insured is the key and not what the average or ordinary reasonable person would expect or intend.”), and *Quincy Mut. Fire Ins. Co. v. Abernathy*, 469 N.E.2d 797, 800 (Mass. 1984) (“Our cases have concluded that an injury is nonaccidental only where the result was actually, not constructively, intended . . .”), and *Patrons-Oxford Mut. Ins. Co. v. Dodge*, 426 A.2d 888, 892 (Me. 1981) (adopting a subjective standard and recognizing it as the majority standard), and *Arco Indus. Corp. v. Am. Motorists Ins. Co.*, 531 N.W.2d 168, 179 (Mich. 1995) (concluding that the court of appeals should have adopted a subjective standard), *overruled on other grounds by Frankenmuth Mut. Ins. Co. v. Masters*, 595 N.W.2d 832 (Mich. 1999), and *Espinete v. Horvath*, 597 A.2d 307, 309 (Vt. 1991) (upholding a subjective standard and rejecting use of an objective standard with respect to “inherently dangerous activity” where such activity was not explicitly excluded by the insurance policy), and *Queen City Farms, Inc. v. Cent. Nat’l Ins. Co. of Omaha*, 882 P.2d 703, 714 (Wash. 1994) (holding that a subjective standard applies where a policy is silent and ambiguous on whether the standard should be objective or subjective), *modified by* 891 P.2d 718 (Wash. 1995), and *Farmers & Mechs. Mut. Ins. Co. of W. Va. v. Cook*, 557 S.E.2d 801, 807 (W. Va. 2001) (“[C]ourts must use a subjective rather than objective standard for determining the policyholder’s intent.”), *with* *Auto-Owners Ins. Co. v. Jensen*, 667 F.2d 714, 717 n.2 (8th Cir. 1981) (using an objective standard to determine if damages were “expected”), and *City of Carter Lake v. Aetna Cas. & Sur. Co.*, 604 F.2d 1052, 1058-59 (8th Cir. 1979) (using an objective standard of “knew or show have known” in determining if a result was “expected”), and *In re Tex. E. Transmission Corp.*, 870 F. Supp. 1293, 1321 (E.D. Pa. 1992) (“Texas law determines an insured’s intention ‘objectively’ and not ‘subjectively.’”), and *W. Cas. & Sur. Co. v. Waisanen*, 653 F. Supp. 825, 830 (W.D.S.D. 1987) (using a range of foreseeability to “inject[] varying degrees of objectivity into the test”). See also OSTRAGER & NEWMAN, *supra* note 27, § 8.03[c], at 658-64).

48. See cases cited in support of a subjective standard *supra* note 47.

49. See, e.g., *Auto-Owners Ins. Co. v. Jensen*, 667 F.2d 714, 717 n.2 (8th Cir. 1981) (“[I]n determining whether the damages were expected under the terms of the policy the appropriate standard to be applied is an objective one, i.e., whether a reasonable man in the position of the insured would have expected the damage to occur.”); *City of Carter Lake v. Aetna Cas. & Sur. Co.*, 604 F.2d 1052, 1059 (8th Cir. 1979) (asking, for purposes of

should have known that there was a “substantial probability” its actions would result in the injury at issue.⁵⁰ “Substantial probability” has been defined as whether “a reasonably prudent man” would be aware the adverse “results are highly likely to occur.”⁵¹

An obvious criticism of the objective standards is that they are not based on the policy language, which speaks in terms of whether the policyholder “expected or intended” the damage, not whether a “reasonable person” should have expected it.⁵² Further, a “should have known” standard could eliminate coverage for many negligence claims simply because many accidents are reasonably foreseeable. In the words of then New York Supreme Court Justice Benjamin Cardozo, “[t]o restrict insurance to cases where liability is incurred without fault of the insured would reduce indemnity to a shadow.”⁵³ Or, in the words of the Second Circuit, “to exclude all losses or damages which might in some way have been *expected* by the insured, could expand the field of exclusion until virtually no recovery could be had on insurance.”⁵⁴

determining coverage, “[i]f the insured knew or should have known that there was a substantial probability that certain results would follow his acts or omissions”); *In re Tex. E. Transmission Corp.*, 870 F. Supp. 1293, 1321 (E.D. Pa. 1992) (applying Texas law and explaining that the objective standard focuses on “what the insured knew or *should have known*”); *W. Cas. & Sur. Co. v. Waisanen*, 653 F. Supp. 825, 830 (W.D.S.D. 1987) (applying a spectrum of foreseeability); *see also* OSTRAGER & NEWMAN, *supra* note 27, § 8.03[c], at 658-64.

50. *See* OSTRAGER & NEWMAN, *supra* note 27, § 8.03[c], at 658.

51. *City of Carter Lake*, 604 F.2d at 1059 n.4; *see also* *King v. Hartford Life & Accident Ins. Co.*, 414 F.3d 994, 1002 (8th Cir. 2005) (distinguishing between standards of “reasonably foreseeable” and “substantial probability” and expressing, “the latter requires not only that a reasonably prudent person would be alerted to the possibility of results occurring, but that such a reasonable person would be forewarned that the results are ‘highly likely to occur’” (quoting *City of Carter Lake*, 604 F.2d at 1059 n.4)).

52. *See* *Aetna Cas. & Sur. Co. v. Dichtl*, 398 N.E.2d 582, 588 (Ill. App. Ct. 1980) (rejecting insurance company’s argument to read in a “reasonableness standard,” noting that if the insurer, who drafted the policy language, “wanted an objective standard to apply, it could have drafted its policy accordingly”); *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 278-79 (Ky. 1991) (“Policies do not define ‘expected’ and ‘intended’ but those are common words and they clearly indicate subjective awareness.”); *United Servs. Auto. Ass’n v. Elitzky*, 517 A.2d 982, 991 (Pa. Super. Ct. 1986), (explaining that the common meaning of “expected” “connote[s] an element of conscious awareness on the part of the insured”).

53. *Messersmith v. Am. Fid. Co.*, 133 N.E. 432, 432 (N.Y. 1921). Such a view would also violate the principle that an insured’s reasonable expectations should be protected. *See* *United Servs.*, 517 A.2d at 991 (“We do not believe that a layman would reasonably expect that as a result of the inclusion of such a phrase [i.e., “expected”] in his insurance contract he might not be insured for negligent acts. These are the very acts which insurance is purchased against.”).

54. *City of Johnstown v. Bankers Standard Ins. Co.*, 877 F.2d 1146, 1150 (2d Cir. 1989); *see also* *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 735 n.6 (Minn. 1997)

Consequently, for reasons such as these, the majority view is that a subjective standard should be applied.⁵⁵ Under this approach, the actual intent of the policyholder is examined rather than what some fictitious “reasonable person” knew or should have foreseen. Thus, coverage is only precluded where the insurer can prove the policyholder actually expected or intended to cause the damage at issue.⁵⁶

2. The Resulting Damage, Not the *Causative* Act, Must Be Expected or Intended

In most instances, the policyholder intends to engage in the conduct, such as the construction work, that gives rise to the damage. Thus, what exactly must the policyholder expect or intend before the claim is excluded from coverage? Most jurisdictions follow the rule that the damage must be expected or intended, not merely the act itself, before coverage is lost for the claim.⁵⁷ With that said, in some contexts, courts have interpreted this standard to mean that if some injury or damage is expected or intended, then coverage is precluded even if the injury or damage at issue is different than what the policyholder expected or intended.⁵⁸

(rejecting a “purely objective test” as inconsistent with the prior interpretations of the term “unexpected” and as “undermin[ing] coverage for injuries caused by simple negligence, a result we sought to avoid in prior cases”).

55. See *supra* notes 47-48 and accompanying text.

56. See *supra* notes 30, 48 and accompanying text.

57. See, e.g., *Allstate Ins. Co. v. Sparks*, 493 A.2d 1110, 1112 (Md. Ct. Spec. App. 1985) (explaining that the intentional injury exclusion applied only where the insured intended both an act causing damage and the results of that act); *Hanover Ins. Co. v. Talhouni*, 604 N.E.2d 689, 690-91 (Mass. 1992) (“The focus in these cases is whether the insured ‘intended’ the injury, not whether the insured ‘intended’ the act.”); *White v. Smith*, 440 S.W.2d 497, 508 (Mo. Ct. App. 1969) (explaining that, although some damages are foreseeable, “damages not intentionally inflicted but resulting from an insured’s negligence . . . may be caused by accident and within the coverage afforded by a liability insurance policy” (internal quotation marks omitted)); *Cont’l Cas. Co. v. Rapid-Am. Corp.*, 609 N.E.2d 506, 510 (N.Y. 1993) (“Resulting damage can be unintended even though the act leading to the damage was intentional. A person may engage in behavior that involves a calculated risk without expecting that an accident will occur.” (citations omitted)); *Grand River Lime Co. v. Ohio Cas. Ins. Co.*, 289 N.E.2d 360, 365 (Ohio Ct. App. 1972) (recognizing that the term “occurrence” is broader than the term “accident” and may encompass a fully intended action that resulted in unintended damage); *Vt. Mut. Ins. Co. v. Singleton*, 446 S.E.2d 417, 420-21 (S.C. 1994) (explaining that an intentional injury exclusion did not bar coverage where the insured had not intended the injury resulting from his voluntary act).

58. See *Lopez ex rel. Lopez v. Am. Family Mut. Ins. Co.*, 148 P.3d 438, 439 (Colo. App. 2006) (explaining that the intentional act exclusion applies “‘whenever *some* injury is intended, even though the injury that actually results differs in character or degree from the injury actually intended” (emphasis added) (quoting *Am. Family Mut. Ins. Co. v. Johnson*, 816 P.2d 952, 955 (Colo. 1991))); *Butler v. Behaeghe*, 548 P.2d 934, 939 (Colo. App. 1976) (holding in an assault case that where the insured “intentionally struck the plaintiff, he must be deemed to have intended the ordinary consequences of his voluntary actions”); *Ga. Farm Bureau Mut. Ins. Co. v. Purvis*, 444 S.E.2d 109, 110 (Ga. Ct. App. 1994) (concluding that an

Other courts have held, however, that coverage is not precluded if the policyholder expected an injury or damage that was different or significantly less severe than what actually occurred.⁵⁹ This is the sounder approach because a policyholder should not be required to forfeit coverage for a claim if the policyholder did not intend to cause significant damage, but it occurs nonetheless.

In the context of corporate policyholders, determining who must expect or intend the injury or damage is a more complex issue. Corporations act through people. Thus, whose knowledge or expectation should dictate whether the corporation expected or intended the injury or harm? In many instances, an employee of the corporation may have expected or intended the injury or damage, but the management or executives of the corporation had no knowledge of the employee's actions, and therefore, they did not expect or intend any harm.

For example, consider a situation in which a seasonal, hourly employee of a roofing subcontractor, unbeknownst to the corporation's management, intentionally fails to install ice shield on a roof because he forgot to put the ice shield on his truck that day and he did not want to drive back to the shop to retrieve it. Subsequently, during a harsh winter, ice dams form on the roof and water infiltrates the house, causing substantial damage. Did the corporation expect or intend to cause the damage in light of the fact that its employee knowingly failed to install the ice shield? In other contexts, courts have answered questions like this in the negative because the knowledge or intent of the corporation's management should be considered instead of the seasonal employee's knowledge or intent.⁶⁰

intentional act exclusion is applicable where “the insured acts with the intent or expectation that . . . injury occur, *even if the actual, resulting injury is different either in kind or magnitude from that intended or expected*” (omission in original) (quoting *Stein v. Mass. Bay Ins. Co.*, 324 S.E.2d 510, 511-12 (Ga. Ct. App. 1985)); *State Farm Fire & Cas. Co. v. Johnson*, 466 N.W.2d 287, 289 (Mich. Ct. App. 1990) (“Once intended harm is established, the fact of an unintended injury is irrelevant.”); *Farmers Mut. Ins. Co. of Neb. v. Kment*, 658 N.W.2d 662, 668 (Neb. 2003) (“In order for the intentional or expected injury exclusion in a liability insurance policy to apply, the insurer must show that the insured acted with the specific intent to cause harm to a third party, but does not have to show that the insured intended the specific injury that occurred.”); *see also* 1 LONG, *supra* note 27, § 1.08[2][b][ii], at 1-82 to -83; OSTRAGER & NEWMAN, *supra* note 27, § 8.03[d], at 664-65; Rigelhaupt, *supra* note 43, at 990-91.

59. *See, e.g.,* *Yount v. Maisano*, 627 So. 2d 148, 152 (La. 1993) (“[W]hen minor injury is intended, and a substantially greater or more severe injury results, whether by choice, coincidence, accident, or whatever, coverage for the more severe injury is not barred.” (quoting *Breland v. Schilling*, 550 So. 2d 609, 614 (La. 1989))); *United Servs. Auto. Ass’n v. Elitzky*, 517 A.2d 982, 988 (Pa. Super. Ct. 1986) (“Our interpretation affords maximum coverage to insured persons as coverage is precluded only for harm of the same general type as that which they set out to inflict.”).

60. *See, e.g.,* *Olin Corp. v. Ins. Co. of N. Am.*, 762 F. Supp. 548, 564 (S.D.N.Y. 1991) (concluding that, in determining whether the corporation expected or intended the harm, the dispositive facts were “what [the policyholder’s] executives knew, when they knew it, and what conclusions they drew from their knowledge”), *aff’d*, 966 F.2d 718 (2d

III. COURTS' DETERMINATIONS OF WHETHER CONSTRUCTION DEFECTS ARE "OCCURRENCES"

A. *The Weedo Case*

A seminal case regarding the issue of whether construction defects are covered under CGL policies is the New Jersey Supreme Court's 1979 opinion in *Weedo v. Stone-E-Brick, Inc.*⁶¹ In *Weedo*, a subcontractor was hired to pour a concrete floor on a veranda and apply stucco to the exterior of a home.⁶² Soon after the job was completed, cracks in the stucco appeared and "other signs of faulty workmanship" manifested such that the homeowner had to replace the stucco.⁶³ The homeowner sued the contractor, and the contractor tendered the claim to its CGL insurer.⁶⁴ The insurer denied coverage on the basis that CGL policies allegedly do not cover claims for faulty workmanship.⁶⁵

The CGL policy at issue stated that the insurer agreed to pay "on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of . . . bodily injury . . . or *property damage to which this insurance applies*, caused by an occurrence . . ."⁶⁶ The policy also contained the 1973 standard form "business risk" exclusions, including Exclusions (n) and (o):

This insurance does not apply

(n) to property damage to the named insured's products arising out of such products or any part of such products;

(o) to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.⁶⁷

In rejecting the subcontractor's claim for coverage, the court reasoned:

Regardless of the existence of express warranties, the insured's provision of stucco and stone "generally carries with it an implied warranty of merchantability and often an implied warranty of fitness for a particular purpose." . . . Where the work performed by the insured-contractor is faulty,

Cir. 1992); *Bituminous Cas. Corp. v. Kenway Contracting, Inc.*, 240 S.W.3d 663, 639 (Ky. 2007) (explaining that coverage analysis involves determining the intentions and expectations of corporate officers, not lower level employees).

61. 405 A.2d 788 (N.J. 1979).

62. *Id.* at 789.

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.* at 790 (internal quotation marks omitted).

67. *Id.* at 791-92 (internal quotation marks omitted).

either express or implied warranties, or both, are breached. As a matter of contract law the customer did not obtain that for which he bargained. . . . [A] principal justification for imposing warranties by operation of law on contractors is that these parties are often “in a better position to prevent the occurrence of major problems” in the course of constructing a home than is the homeowner. . . . The consequence of not performing well is part of every business venture; the replacement or repair of faulty goods and works is a business expense, to be borne by the insured-contractor in order to satisfy customers.⁶⁸

To support its decision, the court cited to and relied on a 1971 law review article by then Nebraska law school professor, Roger C. Henderson, regarding the changes made in 1966 to the standard CGL policy form with respect to the “business risk” exclusions for products liability and completed operations.⁶⁹ In particular, the court quoted the portion of the article in which Professor Henderson opined:

“The risk intended to be insured is the possibility that the goods, products or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable.”⁷⁰

The court also pointed to the “business risk” exclusions in the policy at issue in the case and stated that:

given the precise and limited form of damages which form the basis of the claims against the insured, either exclusion is, or both are, applicable to exclude coverage. In short, the indemnity sought is not for “property damage to which this insurance applies.”⁷¹

There are several notable points regarding the court’s analysis in *Weedo*. One, the court did not quote the definition of “occurrence” in the policy at issue and failed to analyze whether the faulty stucco work constituted an “occurrence.”⁷² Two, the court did not quote the definition of “property damage” in the policy at issue and failed to analyze whether the faulty stucco work was “property damage” or caused

68. *Id.* at 790-91 (citations omitted).

69. *See id.* (citing Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 418, 441 (1971)).

70. *Id.* at 791 (quoting Henderson, *supra* note 69, at 441).

71. *Id.* at 792 (quoting George H. Tinker, *Comprehensive General Liability Insurance—Perspective and Overview*, 25 FED’N INS. COUNS. Q. 217, 233 (1975)).

72. *See id.* at 790 n.2 (explaining that the court would not address whether, in light of the policy’s stated exclusions, coverage extended to the claims at issue, because the insurer had already conceded that “but for the exclusions in the policy, coverage would obtain”).

“property damage.”⁷³ Three, Professor Henderson’s law review article, on which the court relied, also did not analyze or address the issues of whether construction defects constitute “occurrences” or “property damage.”⁷⁴ Instead, Professor Henderson’s article focused on the “business risk” exclusions contained in the 1966 CGL policy form, then offered the professor’s own unsupported conclusions regarding the intent of the exclusions.⁷⁵ Four, the “business risk” exclusions at issue in the case were redrafted in 1986 to provide much narrower reductions in coverage. Thus, Professor Henderson’s 1971 law review article is of little value in understanding or applying the “business risk” exclusions that are at issue today.⁷⁶

Following the 1986 changes to the “business risk” exclusions, one would expect that the *Weedo* decision and Professor Henderson’s 1971 law review article would have become obsolete because they address “business risk” exclusions that are no longer used. Nonetheless, as is discussed below, the *Weedo* decision and Professor Henderson’s article continue to surface from time to time, particularly in decisions where the court misapprehends the issue before it.⁷⁷

B. *The Case Law Since Weedo*

In recent years, courts have split in their holdings regarding whether construction defects constitute “occurrences.”⁷⁸ Currently, the majority rule is that construction

73. *See id.* at 790.

74. *See* Henderson, *supra* note 69.

75. *See id.* at 438-41.

76. *See* discussion *supra* Part I.D.

77. *See, e.g.,* Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co., 908 A.2d 888, 889 n.10 (Pa. 2006).

78. *Compare* French v. Assurance Co. of Am., 448 F.3d 693, 706 (4th Cir. 2006) (applying Maryland law and holding that “a standard 1986 commercial general liability policy form . . . provides liability coverage for the cost to remedy unexpected and unintended property damage to the contractor’s otherwise nondefective work-product caused by the subcontractor’s defective workmanship”), *and* Great Am. Ins. Co. v. Woodside Homes Corp., 448 F. Supp. 2d 1275, 1283 (D. Utah 2006) (applying Utah law and declaring that, among the various approaches to the issue at hand, “the better-reasoned approach, and the approach that is most consistent with Utah law, views faulty subcontractor work as an occurrence from the standpoint of the insured”), *and* Fejes v. Alaska Ins. Co., 984 P.2d 519, 522-23 (Alaska 1999) (standing for the general proposition that improper or faulty workmanship constitutes an accident), *and* Auto-Owners Ins. Co. v. Pozzi Window Co., 984 So. 2d 1241, 1249 (Fla. 2008) (concluding that a policy provided coverage for costs to repair damage to windows caused by a subcontractor’s defective installation), *and* U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871, 883 (Fla. 2007) (concluding defective soil work done by a subcontractor that caused damage to homes was an “occurrence” under CGL policies), *and* Am. Empire Surplus Lines Ins. Co. v. Hathaway Dev. Co., 707 S.E.2d 369, 372 (Ga. 2011) (“[A]n occurrence can arise where faulty workmanship causes unforeseen or unexpected damage to other property.”), *and* U.S. Fid. & Guar. Co. v. Wilkin Insulation Co., 578 N.E.2d 926, 932 (Ill. 1991) (concluding that damage to a building caused by installation

of asbestos was a covered “occurrence”), *and* *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486, 493 (Kan. 2006) (“[D]amage occurring as a result of faulty or negligent workmanship constitutes an occurrence as long as the insured did not intend for the damage to occur.” (internal quotation mark omitted)), *and* *Joe Banks Drywall & Acoustics, Inc. v. Transcon. Ins. Co.*, 32,743, p. 4 (La. App. 2 Cir. 3/1/2000); 753 So. 2d 980, 983 (standing for the general proposition that improper or faulty workmanship constitutes an “occurrence” within the meaning of a general commercial liability policy), *and* *Architex Ass’n v. Scottsdale Ins. Co.*, 2008-CA-01353-SCT (¶ 33) (Miss. 2010), 27 So. 3d 1148, 1162 (“[T]he term ‘occurrence’ cannot be construed in such a manner as to preclude coverage for unexpected or unintended ‘property damage’ resulting from negligent acts or conduct of a subcontractor, unless otherwise excluded or the insured breaches its duties after loss.”), *and* *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 478 (N.H. 1994) (finding that property damage to condominium units caused by defective workmanship was an “occurrence” within the meaning of the CGL policy), *and* *Erie Ins. Exch. v. Colony Dev. Corp.*, 736 N.E.2d 941, 947 (Ohio Ct. App. 1999) (“[W]e find that the [insured’s] allegations of property damage caused by [the contractor’s] negligence in constructing and designing the condominium complex reasonably fall within the policy’s definition of property damage caused by an occurrence,—i.e., an accident.”), *and* *Corner Constr. Co. v. U.S. Fid. & Guar. Co.*, 2002 SD 5, ¶ 29, 638 N.W.2d 887, 894-85 (affirming the lower court’s ruling that construction defects resulting in ventilation problems constituted an accident and that such damage was covered by the policy at issue), *and* *Travelers Indem. Co. of Am. v. Moore & Assocs., Inc.*, 216 S.W.3d 302, 310 (Tenn. 2007) (“[D]efective installation [of windows] resulted in water penetration . . . [and] constitute[d] ‘property damage’ for purposes of the CGL.”), *and* *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 9 (Tex. 2007) (concluding that damage to the insured’s work, as well as damage to a third party’s property, can result from an occurrence as defined in the CGL policy, but that no basis exists in the definition of “occurrence” to distinguish between the two), *and* *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶ 5, 268 Wis. 2d 16, 26, 673 N.W.2d 65, 70 (holding that excessive settlement of soil, which occurred after the building was completed, and which caused the building’s foundation to sink, was “‘property damage’ caused by an ‘occurrence’ within the meaning of the CGL policies’ general grant of coverage”), *with* *Burlington Ins. Co. v. Oceanic Design & Constr., Inc.*, 383 F.3d 940, 948 (9th Cir. 2004) (applying Hawaii law and explaining that “[g]eneral liability policies . . . are not designated to provide contractors and developers with coverage against claims their work is inferior or defective” (internal quotation marks omitted)), *and* *Lenning v. Commercial Union Ins. Co.*, 260 F.3d 574, 583 (6th Cir. 2001) (applying Kentucky law and declaring “there is no ‘occurrence’ to the extent that [a] complaint alleges property damage arising out of defective or faulty craftsmanship”), *and* *J.Z.G. Res., Inc. v. King*, 987 F.2d 98, 103 (2d Cir. 1993) (applying New York law for the proposition that “mere faulty workmanship, standing alone, cannot constitute an occurrence” (internal quotation marks omitted)), *and* *U.S. Fid. & Guar. Corp. v. Advance Roofing & Supply Co.*, 788 P.2d 1227, 1233 (Ariz. Ct. App. 1989) (“[M]ere faulty workmanship, standing alone, cannot constitute an occurrence as defined in the policy, nor would the cost of repairing the defect constitute property damages.”), *and* *Gen. Sec. Indem. Co. of Ariz. v. Mountain States Mut. Cas. Co.*, 205 P.3d 529, 535 (Colo. App. 2009) (“[C]laims of poor workmanship, standing alone, are not occurrences that trigger coverage under CGL policies similar to those at issue here.”), *and* *State Farm Fire & Cas. Co. v. Tillerson*, 777 N.E.2d 986, 991 (Ill. App. Ct. 2002) (“Where the defect is no more than the natural and ordinary consequences of faulty workmanship, it is not caused by an accident.”), *and* *Pursell Constr., Inc. v. Hawkeye-Sec. Ins. Co.*, 596 N.W.2d 67, 71 (Iowa 1999)

defects constitute “occurrences,” with the Supreme Courts of the States of Alaska,⁷⁹ Florida,⁸⁰ Georgia,⁸¹ Indiana,⁸² Kansas,⁸³ Minnesota,⁸⁴ Mississippi,⁸⁵ South

(“[D]efective workmanship standing alone, that is, resulting in damages only to the work product itself, is not an occurrence under a CGL policy.”), *and* *Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 578 (Neb. 2004) (“[A]lthough 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.”), *and* *ACUITY v. Burd & Smith Constr., Inc.*, 2006 ND 187, ¶¶ 23, 27, 29, 721 N.W.2d 33, 40, 42 (concluding that damages to a roof that a contractor was replacing were excluded from coverage because to hold otherwise would convert the policy into a performance bond, but damages resulting from a defective roof to the apartment interior was covered under the policy), *and* *Heile v. Herrmann*, 736 N.E.2d 566, 568 (Ohio Ct. App. 1999) (concluding that faulty workmanship is not an “accident” and therefore not an “occurrence”), *and* *Oak Crest Constr. Co. v. Austin Mut. Ins. Co.*, 998 P.2d 1254, 1257 (Or. 2000) (“[T]here can be no ‘accident,’ within the meaning of a commercial liability policy, when the resulting damage is merely a breach of contract.”), *and* *Kvaerner Metals Div.*, 908 A.2d at 899 (“[T]he definition of ‘accident’ required to establish an ‘occurrence’ under the policies cannot be satisfied by claims based upon faulty workmanship.”), *and* *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 621 S.E.2d 33, 37 (S.C. 2005) (finding that “faulty workmanship does not constitute an ‘occurrence’”), *and* *Corder v. William W. Smith Excavating Co.*, 556 S.E.2d 77, 83 (W. Va. 2001) (“[C]ommercial general liability policies are not designed to cover poor workmanship.”).

79. *Fejes v. Alaska Ins. Co.*, 984 P.2d 519, 525 (Alaska 1999) (“[A]n insured *has* coverage for his completed work when the damage arises out of work performed by someone other than the named insured, such as a subcontractor . . .” (omission in original) (quoting *Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648, 652 (9th Cir. 1988))).

80. *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 888 (Fla. 2007) (concluding that the “subcontractors’ defective soil preparation,” which caused damage to homes, was an “occurrence” under CGL policies).

81. *Am. Empire Surplus Lines Ins. Co. v. Hathaway Dev. Co.*, 707 S.E.2d 369, 372 (Ga. 2011) (“[A]n occurrence can arise where faulty workmanship causes unforeseen or unexpected damage to other property.”).

82. *Sheehan Constr. Co. v. Cont’l Cas. Co.*, 935 N.E.2d 160, 171-72 (Ind. 2010) (concluding that the subcontractors’ defective work was a covered “occurrence”), *modified on other grounds*, 938 N.E.2d 685.

83. *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486, 493, 495 (Kan. 2006) (agreeing with the appellate court that the “damage occurring as a result of faulty or negligent workmanship constitutes an occurrence as long as the insured did not intend for the damage to occur” (quoting *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 104 P.3d 997, 1002 (Kan. Ct. App. 2005))).

84. *Wanzek Constr., Inc. v. Emp’rs Ins. of Wausau*, 679 N.W.2d 322, 325-27 (Minn. 2004) (acknowledging earlier decisions based upon Professor Henderson’s 1971 law review article were incorrectly decided because the “business risk” exclusions were changed in 1986).

85. *Architex Ass’n v. Scottsdale Ins. Co.*, 2008-CA-01353-SCT (¶ 33) (Miss. 2010), 27 So. 3d 1148, 1162 (concluding that “the term ‘occurrence’ cannot be construed in such a manner as to preclude coverage for unexpected or unintended ‘property damage’ resulting

Carolina,⁸⁶ South Dakota,⁸⁷ Tennessee,⁸⁸ Texas,⁸⁹ and Wisconsin⁹⁰ all finding in favor of policyholders on the issue.⁹¹ A minority of state supreme courts have held that, under the facts of the cases presented to them, construction defects were not covered by CGL policies.⁹²

Generally, the decisions fall under one or more of the following five schools of thought: (1) construction defects are “occurrences” so long as the damage was not expected or intended by the policyholder,⁹³ (2) construction defects are “occurrences”

from negligent acts or conduct of a subcontractor, unless otherwise excluded or the insured breaches its duties after loss”).

86. Auto Owners Ins. Co. v. Newman, 684 S.E.2d 541, 545-46 (S.C. 2009) (finding defectively installed stucco resulted in a covered occurrence), *adhered to*, Crossman Cmities. of N.C., Inc. v. Harleysville Mut. Ins. Co., No. 26909, 2011 WL 3667598 (S.C. Aug. 22, 2011) (publication forthcoming); *see also* Act of May 17, 2011, No. 26, § 1, 2011 S.C. Acts 88, 88-89 (to be codified at S.C. CODE ANN. § 38-61-70) (providing that CGL “policies shall contain or be deemed to contain a definition of ‘occurrence’ that includes . . . property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself”).

87. Corner Constr. Co. v. U.S. Fid. & Guar. Co., 2002 SD 5, ¶ 29, 638 N.W.2d 887, 894-95 (concluding that construction defects resulting in ventilation problems constituted an “accident” and such damage is covered by the policy at issue).

88. Travelers Indem. Co. of Am. v. Moore & Assocs., Inc., 216 S.W.3d 302, 310 (Tenn. 2007) (concluding that the defective installation of windows causing alleged water damage “constitute[s] ‘property damage’ for purposes of the CGL”).

89. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 9 (Tex. 2007) (explaining that damage to the insured’s work as well as damage to a third party’s property can result from an “occurrence” as defined in commercial general liability policy; no basis exists in the definition of “occurrence” to distinguish between the two).

90. Am. Family Mut. Ins. Co. v. Am. Girl, Inc., 2004 WI 2, ¶ 5, 268 Wis. 2d 16, 26, 673 N.W.2d 65, 70 (holding that excessive settlement of soil, which caused the building’s foundation to sink, was “‘property damage’ caused by an ‘occurrence’ within the meaning of the CGL policies’ general grant of coverage”).

91. Several states have preemptively passed statutes essentially mandating that construction defects are “occurrences.” *See* ARK. CODE ANN. § 23-79-155(a) (Supp. 2011); COLO. REV. STAT. § 13-20-808(3) (2010); Act of May 17, 2011, No. 26, § 1, 2011 S.C. Acts at 88-89.

92. *See, e.g.,* Essex Ins. Co. v. Holder, 261 S.W.3d 456, 460 (Ark. 2008) (concluding that damages due to faulty workmanship are “foreseeable” and therefore, not covered), *superseded by statute*, H.R. 1439, 88th Gen. Assemb., Reg. Sess. § 2 (Ark. 2011) (enacted) (codified at ARK. CODE ANN. § 23-79-155(a) (Supp. 2011)); Cincinnati Ins. Co. v. Motorists Mut. Ins. Co., 306 S.W.3d 69, 76 (Ky. 2010) (explaining that construction defects are not fortuitous events); Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co., 908 A.2d 888, 899 (Pa. 2006) (“[T]he definition of ‘accident’ required to establish an ‘occurrence’ under the policies cannot be satisfied by claims based upon faulty workmanship.”); Corder v. William W. Smith Excavating Co., 556 S.E.2d 77, 83 (W. Va. 2001) (“[C]ommercial general liability policies are not designed to cover poor workmanship.”).

93. *See* cases cited *supra* notes 79-90 and cases cited *infra* note 122.

to the extent property other than the work performed by the policyholder is damaged,⁹⁴ (3) construction defects are not “occurrences” because they are not “accidents,”⁹⁵ (4) construction defects are not “occurrences” because to hold otherwise would transform insurance into surety or performance bonds,⁹⁶ and (5) construction defects are not “occurrences” because they are due to intentional acts from which the resulting damage is a foreseeable consequence.⁹⁷

1. Courts Holding Construction Defects Are “Occurrences”

As noted above, the majority rule currently is that construction defects constitute “occurrences.”⁹⁸ In recent years, numerous cases favoring policyholders have been decided.⁹⁹ The courts have reached these decisions by applying the definition of “occurrence” contained in CGL policies to the facts at issue and determining it was undisputed that the policyholder did not expect or intend to do the work defectively or cause the resulting damage.¹⁰⁰ The Supreme Court of Florida’s decision in *United States Fire Insurance Co. v. J.S.U.B., Inc.*¹⁰¹ is a leading example of the courts’ reasoning on this issue.

In *J.S.U.B.*, the policyholder was a contractor that built several houses in Florida.¹⁰² After the houses were finished and the homeowners took possession of them, the homeowners discovered that there was damage to the houses’ foundations, drywall, and other interior parts.¹⁰³ The parties agreed that the “subcontractors’ use of poor soil and improper soil compaction and testing” caused the damage to the houses.¹⁰⁴ The homeowners sued the contractor/policyholder asserting claims for “breach of contract, breach of warranty, negligence, strict liability, and violation of the Florida Building Code.”¹⁰⁵

The CGL policy at issue contained the standard form definitions of “occurrence” and “property damage” discussed in Part I of this article.¹⁰⁶ Consequently, the term “accident” contained in the definition of “occurrence” was undefined.¹⁰⁷

94. See cases cited *infra* note 145.

95. See cases cited *infra* note 146.

96. See cases cited *infra* note 175.

97. See cases cited *infra* note 187.

98. See cases cited *supra* notes 79-91 and cases cited *infra* note 122.

99. See cases cited *supra* notes 79-91 and cases cited *infra* note 122.

100. See cases cited *supra* notes 79-91 and cases cited *infra* note 122.

101. 979 So. 2d 871 (Fla. 2007).

102. *Id.* at 875.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.* at 883.

Although the insurer agreed to cover the personal property of the homeowners that was damaged due to the defective construction work, the insurer argued that faulty workmanship itself “can never be an ‘accident’ because it results in reasonably foreseeable damages.”¹⁰⁸ The insurer also argued that “a breach of contract can never result in an ‘accident,’”¹⁰⁹ and that allowing recovery under insurance policies for defective construction work would convert “the policies into performance bonds.”¹¹⁰ Finally, the insurer argued that it would be against public policy to allow recovery under insurance policies for construction defects because of the “moral hazard” that such a precedent would create (i.e., policyholders would have no incentive to perform their work competently).¹¹¹

The Supreme Court of Florida rejected all of the insurer’s arguments and held there was coverage for the claims.¹¹² In doing so, the court first rejected the notion that the determination of whether the policyholder “expected or intended” the damage is based on whether the damage was objectively foreseeable, stating as follows:

The policy . . . in this case define[s] an “occurrence” as an “accident” but leave[s] “accident” undefined. Thus, under [prior Florida precedent], these policies provide coverage not only for “accidental events,” but also injuries or damage neither expected nor intended from the standpoint of the insured. . . . We expressly rejected the use of the concept of “natural and probable consequences” or “foreseeability” in insurance contract interpretation¹¹³

Second, the court rejected the argument that damages resulting from a breach of contract cannot be an accident:

“[T]here is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL’s initial grant of coverage. ‘Occurrence’ is not defined by reference to the legal category of the claim. The term ‘tort’ does not appear in the CGL policy.”¹¹⁴

108. *Id.* at 876, 883.

109. *Id.* at 884.

110. *Id.* at 887.

111. *Id.* at 890.

112. *Id.* at 883-85 (rejecting the argument that it is reasonably foreseeable and, thus, never an “accident,” for a subcontractor’s defective work to damage the contractor’s own); *id.* at 887 (rejecting the argument that interpreting “occurrence” as including a subcontractor’s faulty work would turn CGL policies into performance bonds); *id.* at 889 (rejecting the argument that a subcontractor’s faulty work renders a whole project damaged from the beginning so that “property damage” never actually occurs in construction defect cases).

113. *French*, 979 So. 2d at 883 (citations omitted) (internal quotation marks omitted).

114. *Id.* at 884 (quoting *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶ 41,

Third, the court rejected the argument that allowing the policyholder to recover under its insurance policy would convert the insurance policy into a performance bond:

[W]e reject [the insurer's] contention that construing the term "occurrence" to include a subcontractor's defective work converts the policies into performance bonds. The purpose of a performance bond is to guarantee the completion of the contract upon default by the contractor. Thus, unlike an insurance policy, a performance bond benefits the owner of a project rather than the contractor. Further, a surety, unlike a liability insurer, is entitled to indemnification from the contractor.¹¹⁵

Fourth, the court rejected the theoretical public policy argument that allowing insurance recoveries for construction defects would create a "moral hazard":

In reaching this conclusion, we discern no public policy reason for precluding coverage. A subcontractor's defective work that is neither intended nor expected from the standpoint of the insured is not the type of intentional wrongful act that we have held was uninsurable as a matter of public policy. Even if a "moral hazard" argument could be made regarding the contractor's own work, the argument is not applicable for the subcontractors' work "[I]t is as a practical matter very difficult for the general contractor to control the quality of the subcontractor work. Only if the contractor has a supervisor at the elbow of each subcontractor at all times can quality control be relatively assured—but this would be prohibitively expensive."¹¹⁶

Fifth, the court rejected the argument that only property that has been damaged separately from the defective work itself is recoverable "property damage":

[J]ust like the definition of the term "occurrence," the definition of "property damage" in the CGL policies does not differentiate between damage to the contractor's work and damage to other property.¹¹⁷

[W]e reject a definition of "occurrence" that renders damage to the insured's own work as a result of a subcontractor's faulty workmanship expected, but renders damage to property of a third party caused by the same faulty workmanship unexpected.¹¹⁸

268 Wis. 2d 16, 40, 673 N.W.2d 65, 77).

115. *Id.* 887-88 (citations omitted) (internal quotation marks omitted).

116. *Id.* at 890 (citation omitted) (quoting *STEMPEL*, *supra* note 25).

117. *Id.* at 889.

118. *Id.* at 885.

Sixth, the court considered the *Weedo v. Stone-E-Brick, Inc.*¹¹⁹ decision and noted that the “business risk” exclusions at issue in that case were the pre-1986 “business risk” exclusions; thus, the case was of no precedential value.¹²⁰

Finally, the court noted that the “business risk” exclusions themselves prove that construction defects are understood to constitute “occurrences”:

“If . . . losses actionable in contract are never CGL “occurrences” for purposes of the initial coverage grant, then the business risk exclusions are entirely unnecessary. . . . Why would the insurance industry exclude damage to the insured’s own work or product if the damage could never be considered to have arisen from a covered “occurrence” in the first place?”¹²¹

Numerous other courts have adopted the *J.S.U.B.* court’s analysis or reached similar decisions prior to when *J.S.U.B.* was decided such that the Supreme Court of Florida’s holding in *J.S.U.B.* now represents the majority rule.¹²²

119. 405 A.2d 788 (N.J. 1979).

120. *J.S.U.B.*, 979 So. 2d at 881-83.

121. *Id.* at 886-87 (first omission in original) (quoting *Am. Family Mut. Ins. Co. v. Am. Girl Inc.*, 2004 WI 2, ¶ 47, 268 Wis. 2d 16, 43, 673 N.W.2d 65, 78).

122. *See, e.g.*, *Great Am. Ins. Co. v. Woodside Homes Corp.*, 448 F. Supp. 2d 1275, 1283 (D. Utah 2006) (applying Utah law and declaring that, among the various approaches to the issue at hand, “the better-reasoned approach, and the approach that is most consistent with Utah law, views faulty subcontractor work as an occurrence from the standpoint of the insured”); *Fejes v. Alaska Ins. Co.*, 984 P.2d 519, 522-23 (Alaska 1999) (standing for the general proposition that improper or faulty workmanship constitutes an accident); *Auto-Owners Ins. Co. v. Pozzi Window Co.*, 984 So. 2d 1241, 1249 (Fla. 2008) (concluding that a policy provided coverage for costs to repair damage to windows caused by a subcontractor’s defective installation); *Am. Empire Surplus Lines Ins. Co. v. Hathaway Dev. Co.*, 707 S.E.2d 369, 372 (Ga. 2011) (“[A]n occurrence can arise where faulty workmanship causes unforeseen or unexpected damage to other property.”); *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486, 493 (Kan. 2006) (“[D]amage occurring as a result of faulty or negligent workmanship constitutes an occurrence as long as the insured did not intend for the damage to occur.” (internal quotation marks omitted)); *Joe Banks Drywall & Acoustics, Inc. v. Transcon. Ins. Co.*, 32,743, p. 4 (La. App. 2 Cir. 3/1/00); 753 So. 2d 980, 983 (standing for the general proposition that improper or faulty workmanship constitutes an “occurrence” within the meaning of a general commercial liability policy); *Architex Ass’n v. Scottsdale Ins. Co.*, 2008-CA-01353-SCT (¶ 33) (Miss. 2010), 27 So. 3d 1148, 1162 (“[T]he term ‘occurrence’ cannot be construed in such a manner as to preclude coverage for unexpected or unintended ‘property damage’ resulting from negligent acts or conduct of a subcontractor, unless otherwise excluded or the insured breaches its duties after loss.”); *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 478 (N.H. 1994) (finding that property damage to condominium units caused by defective workmanship was an “occurrence” within the meaning of the CGL policy); *Erie Ins. Exch. v. Colony Dev. Corp.*, 736 N.E.2d 941, 947 (Ohio Ct. App. 1999) (“[W]e find that the [insured’s] allegations of property damage caused by [the contractor’s] negligence in constructing and designing the condominium complex

2. Courts Holding Construction Defects Are “Occurrences” if Property Other than the Work at Issue Was Damaged

A number of courts have held that construction defects are “occurrences” only if property other than the work at issue was damaged. The Fourth Circuit’s decision in *French v. Assurance Co. of America*¹²³ is an example of this line of thought.

In *French*, homeowners contracted with the policyholder for the construction of a home in Virginia.¹²⁴ The policyholder hired a subcontractor to install synthetic stucco onto the home’s exterior.¹²⁵ Almost five years later, extensive water damage resulted from the defective stucco installation.¹²⁶ The homeowners spent over \$500,000 to correct the defective construction and to fix the resulting damage to the other parts of their home.¹²⁷ The homeowners, as assignees of the contractor’s rights under the policy, sued the contractor’s CGL insurer.¹²⁸

The insurer denied coverage, arguing that the property damage was “expected or intended.”¹²⁹ The CGL policies at issue contained the standard form definitions of “occurrence” and “property damage” discussed in Part I of this article.¹³⁰

In analyzing the coverage issues, the court divided the homeowner’s property damage claim into two categories.¹³¹ The first category included the defectively

reasonably fall within the policy’s definition of property damage caused by an occurrence,—*i.e.*, an accident.”); *Corner Constr. Co. v. U.S. Fid. & Guar. Co.*, 2002 SD 5, ¶ 29, 638 N.W.2d 887, 894-95 (affirming the lower court’s ruling that construction defects resulting in ventilation problems constituted an accident and that such damage was covered by the policy at issue); *Travelers Indem. Co. of Am. v. Moore & Assocs. Inc.*, 216 S.W.3d 302, 310 (Tenn. 2007) (“[D]efective installation [of windows] resulted in water penetration . . . [and] constitute[d] ‘property damage’ for purposes of the CGL.”); *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 9 (Tex. 2007) (concluding that damage to the insured’s work, as well as damage to a third party’s property, can result from an occurrence as defined in the CGL policy, but that no basis exists in the definition of “occurrence” to distinguish between the two); *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶ 5, 268 Wis. 2d 16, 26, 673 N.W.2d 65, 70 (holding that excessive settlement of soil, which occurred after the building was completed, and which caused the building’s foundation to sink, was “‘property damage’ caused by an ‘occurrence’ within the meaning of the CGL policies’ general grant of coverage”).

123. 448 F.3d 693 (4th Cir. 2006).

124. *Id.* at 696.

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.* at 699.

129. *Id.* at 704.

130. *Id.* at 697.

131. *See id.* at 703.

installed stucco exterior.¹³² The second category included the other parts of the house damaged by water as a result of the defectively installed stucco exterior.¹³³

With respect to the first category of damages, the court held that the defectively installed stucco did not constitute an “accident” and, therefore, was not an “occurrence.”¹³⁴ In reaching this conclusion, the court applied Maryland law and relied on Maryland precedent.¹³⁵ The court explained its reasoning:

“[T]he obligation to repair the facade itself is not unexpected or unforeseen under the terms of the sales contract. Therefore, the repair or replacement damages represent economic loss and consequently would not trigger a duty to indemnify under a CGL policy.”¹³⁶

In reaching its decision, the court failed to explain, however, why the defectively installed stucco allegedly did not constitute “property damage,” or why the defective stucco installation was not an accident from the perspective of the contractor/policyholder, who did not expect its subcontractor to apply the stucco deficiently.¹³⁷ Instead, the court created a straw man argument that a contractor should expect that it will have to remedy faulty work done by its subcontractor,¹³⁸ which is no different than saying a negligent driver who hits someone should expect that, as the driver, he or she will be required to compensate the victim. Although the driver may expect that he or she will have liability under such circumstances, that expectation does not mean he or she expected or intended to cause the injury, which is the issue that must be decided under an “occurrence” analysis.

With respect to the damage to other parts of the house, the court inconsistently held that such damage was due to an “accident,” and as a result, was an “occurrence” under the CGL policy.¹³⁹ In doing so, the court noted, “there does not appear even to be an allegation that [the contractor] either expected or intended that its subcontractor . . . would defectively install the [stucco] exterior on the . . . home.”¹⁴⁰ Further, the court emphasized that the other parts of the house would not have been damaged but for the moisture intrusion caused by the defectively installed stucco.¹⁴¹

132. *See id.*

133. *See id.*

134. *Id.*

135. *Id.* (citing *Lerner Corp. v. Assurance Co. of Am.*, 707 A.2d 906, 912-13 (Md. Ct. Spec. App. 1998)).

136. *Id.* at 703 (alteration in original) (quoting *Lerner*, 707 A.2d at 911-12).

137. *See id.* at 703-04.

138. *See id.* at 703.

139. *See id.* at 704.

140. *Id.*

141. *Id.* at 704-05.

In reaching its decision, the court pointed to the insurer's admission that if a portion of the defectively installed stucco had fallen onto a car, or onto home furniture, then the CGL policy would have provided coverage:

In this same vein, it is illogical to contend that had the defective [stucco] exterior on the . . . home failed and caused damage to the flooring inside the home or to the structural members of the house, neither of which was defective at completion of construction and certification for occupancy, coverage would not have been provided¹⁴²

Finally, the court noted that allowing coverage for the costs to fix the other damaged parts of the house gave effect to the subcontractor exception found in the "business risk" exclusions discussed in Part I of this article:

"If the policy's exclusion for damage to the insured's work contains a proviso stating that the exclusion is inapplicable if the work was performed on the insured's behalf by a subcontractor, it would not be justifiable to deny coverage to the insured, based upon the absence of an occurrence, for damages owed because of property damage to the insured's work caused by the subcontractor's work. Reading the policy as a whole, it is clear that the intent of the policy was to cover the risk to the insured created by the insured's use of a subcontractor. Moreover, if coverage were never available for damage to the insured's work because of a subcontractor's mistake, on the theory that there was no occurrence even under those circumstances, the foregoing subcontractor proviso to the exclusion for damage to the insured's work would be meaningless, and if possible, policies should not be interpreted to render policy provisions meaningless."¹⁴³

In sum, the Fourth Circuit held that, under Maryland law, although insurance coverage is not available to a general contractor in order to fix faulty workmanship done by a subcontractor, insurance does cover the cost of fixing "unexpected and unintended property damage to the contractor's otherwise nondefective work-product caused by the subcontractor's defective workmanship."¹⁴⁴ Although it is not based on a correct analysis of what the policyholder must expect or intend before coverage is precluded with respect to the faulty workmanship itself (i.e., that the work intentionally was done deficiently), a number of other courts have reached decisions similar to the Fourth Circuit's in the *French* case and allowed recovery for damaged property other than the faulty workmanship itself.¹⁴⁵

142. *Id.* at 705.

143. *Id.* at 705-06 (quoting *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 104 P.3d 997, 1003 (Kan. Ct. App. 2005)).

144. *Id.* at 706.

145. *See, e.g., Lexicon, Inc. v. ACE Am. Ins. Co.*, 634 F.3d 423, 427 (8th Cir. 2011)

3. Courts Holding Construction Defects Are Not “Occurrences” Because They Are Not “Accidents”

A handful of courts have adopted the view that construction defects cannot be “accidents” and thus, they cannot be viewed as “occurrences” under the terms of CGL policies.¹⁴⁶ An example of such a case is the Pennsylvania Supreme Court’s

(explaining that “collateral damage” resulting from construction defects is considered an “occurrence”); Pa. Nat’l Mut. Cas. Ins. Co. v. Parkshore Dev. Corp., 403 F. App’x 770, 772 (3d Cir. 2010) (“[C]onstruction defects resulting in consequential damage to the property itself could qualify as an ‘occurrence.’”); Stanley Martin Cos. v. Ohio Cas. Grp., 313 F. App’x 609, 614 (4th Cir. 2009) (concluding that any damage a subcontractor’s defective work caused to non-defective work constituted an occurrence); Mid-Continent Cas. Co. v. JHP Dev., Inc., 557 F.3d 207, 218 (5th Cir. 2009) (applying Texas law and holding that the exclusion “bars coverage only for property damage to parts of a property that were themselves the subjects of defective work, and not for damage to parts of a property that were the subjects of only nondefective work by the insured and were damaged as a result of defective work by the insured on other parts of the property”); OneBeacon Ins. Co. v. Metro Ready-Mix, Inc., 242 F. App’x 936, 940 (4th Cir. 2007) (applying Maryland law and holding that “coverage exists only to remedy unexpected and unintended property damage to the contractor’s otherwise nondefective work-product caused by the . . . defective workmanship” (internal quotation marks omitted)); U.S. Fid. & Guar. Co. v. Wilkin Insulation Co., 578 N.E.2d 926, 932 (Ill. 1991) (concluding that damage to a building caused by the installation of asbestos in the building was a covered “occurrence”); Auto-Owners Ins. Co. v. Home Pride Cos., 684 N.W.2d 571, 577 (Neb. 2004) (“[A]lthough faulty workmanship, *standing alone*, is not an occurrence under a CGL policy, an accident caused by faulty workmanship is a covered occurrence.”); High Country Assocs. v. N.H. Ins. Co., 648 A.2d 474, 477-78 (N.H. 1994) (explaining that faulty work in and of itself does not constitute an “occurrence” due to foreseeability, but damage resulting as a consequence of faulty work is covered under the policy); ACUITY v. Burd & Smith Constr., Inc., 2006 ND 187, ¶¶ 23, 27, 29, 721 N.W.2d 33, 40, 42 (concluding that damages to a roof that a contractor was replacing were excluded from coverage because to hold otherwise would convert the policy into a performance bond, but damages resulting from the defective roof to the interior of the apartment was covered under the policy); Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co., No. 26909, 2011 WL 93716, at *9 (S.C. Jan. 7, 2011) (explaining that faulty work itself is not an “occurrence” but damage resulting from faulty work may be an “occurrence”), *withdrawn on reh’g*, No. 26909, 2011 WL 3667598 (S.C. Aug. 22, 2011) (publication forthcoming); *see also* Act of May 17, 2011, No. 26, § 1, 2011 S.C. Acts 88, 88-89 (to be codified at S.C. CODE ANN. § 38-61-70) (providing that CGL “policies shall contain or be deemed to contain a definition of ‘occurrence’ that includes . . . property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself”).

146. *See, e.g.,* Lyerla v. Amco Ins. Co., 536 F.3d 684, 689 (7th Cir. 2008) (noting how Illinois law recognizes that “damage to a construction project resulting from construction defects is not an ‘accident’ or ‘occurrence’ because it represents the natural and ordinary consequence of faulty construction”); Hathaway Dev. Co. v. Ill. Union Ins. Co., 274 F. App’x 787, 791 (11th Cir. 2008) (noting that the subcontractors’ faulty work was “an injury accidentally caused by intentional acts” (internal quotation marks omitted)); OneBeacon Ins. Co. v. Metro Ready-Mix, Inc., 242 F. App’x 936, 940 (4th Cir. 2007) (“[W]hen there is no

decision in *Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Insurance Co.*¹⁴⁷

In *Kvaerner*, a manufacturing company entered into a contract to construct a coke oven battery for a steel company.¹⁴⁸ The coke oven battery allegedly had numerous problems that the manufacturer failed to remedy, resulting in a lawsuit.¹⁴⁹ The coke oven battery manufacturer notified its insurer of the lawsuit and sought coverage under its CGL policies.¹⁵⁰ The insurer denied coverage.¹⁵¹

The CGL policies at issue contained the standard form definitions of “occurrence” and “property damage” discussed in Part I of this article.¹⁵² In denying coverage, the insurer argued that:

(1) the Policies only permitted coverage for allegations of “property damage” caused by an “occurrence,” which was defined by the Policies as an accident, and [the steel company] had not alleged that the [coke oven] Battery was

property damage to otherwise nondefective parts of [a] building, there is no ‘accident’ or ‘occurrence.’ In other words, coverage exists only to remedy unexpected and unintended property damage to the contractor’s otherwise nondefective work-product caused by the . . . defective workmanship.” (citation omitted) (internal quotation marks omitted)); *Essex Ins. Co. v. Holder*, 261 S.W.3d 456, 460 (Ark. 2007) (“Faulty workmanship is not an accident; instead, it is a foreseeable occurrence, and performance bonds exist in the marketplace to insure the contractor against claims for the cost of repair or replacement of faulty work.”); *Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 577 (Neb. 2004) (“[A]lthough faulty workmanship, *standing alone*, is not an occurrence under a CGL policy, an accident caused by faulty workmanship is a covered occurrence.”); *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 477-78 (N.H. 1994) (explaining that faulty work in and of itself does not constitute an “occurrence” due to foreseeability, but damage resulting as a consequence of faulty work is covered under the policy); *ACUITY v. Burd & Smith Constr., Inc.*, 2006 ND 187, ¶¶ 23, 27, 29, 721 N.W.2d 33, 40, 42 (concluding that damages to a roof that a contractor was replacing were excluded from coverage because to hold otherwise would convert the policy into a performance bond, but damages resulting from the defective roof to the interior of apartment was covered under policy); *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 899 (Pa. 2006) (“We hold that the definition of ‘accident’ required to establish an ‘occurrence’ under the policies cannot be satisfied by claims based upon faulty workmanship. Such claims simply do not present the degree of fortuity contemplated by the ordinary definition of ‘accident’ or its common judicial construction in this context.”); *Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co.*, No. 26909, 2011 WL 93716, at *8 (S.C. Jan. 7, 2011) (holding that the policy at issue does not provide coverage for faulty workmanship because faulty workmanship fails the “fortuity component” of the definition of “accident”), *withdrawn on reh’g*, No. 26909, 2011 WL 3667598 (S.C. Aug. 22, 2011) (publication forthcoming).

147. 908 A.2d 888 (Pa. 2006).

148. *Id.* at 890-91.

149. *Id.* at 891.

150. *Id.* at 891-92.

151. *Id.* at 892.

152. *See id.* at 897.

damaged by such an occurrence, and (2) even if [the steel company] alleged property damage caused by an occurrence, such damages were excluded under various “business risk/work product” exclusions in the Policies.¹⁵³

The court agreed with the insurer’s first argument.¹⁵⁴ Because “accident” was not defined in the policy, the court looked to *Webster’s* dictionary to understand the meaning of the term and then concluded that faulty workmanship is not an “accident”:

Words of common usage in an insurance policy are construed according to their natural, plain, and ordinary sense. We may consult the dictionary definition of a word to determine its ordinary usage. Webster’s II New College Dictionary 6 (2001) defines “accident” as “[a]n unexpected and undesirable event,” or “something that occurs unexpectedly or unintentionally.” The key term in the ordinary definition of “accident” is “unexpected.” This implies a degree of fortuity that is not present in a claim for faulty workmanship.¹⁵⁵

In reaching its decision, the court cited and relied on Professor Henderson’s 1971 law review article dealing with the 1966 business risk exclusions.¹⁵⁶ Those exclusions, however, had not been used in CGL policies for over two decades and were not at issue in the case. Thus, the court did not actually address the business risk exclusions that were at issue in its decision.¹⁵⁷

The court also did not address the relevant issue under an “occurrence” analysis—whether the coke battery manufacturer expected or intended to manufacture a defective piece of equipment. In short, the court’s decision is conclusory and essentially devoid of reasoning. Nonetheless, several other courts have reached similar conclusions.¹⁵⁸

4. Courts Holding Construction Defects Are Not “Occurrences” Because To Hold Otherwise Would Transform Insurance into Surety or Performance Bonds

Some courts have been persuaded that the distinction between CGL policies and surety or performance bonds leads to the conclusion that construction defects are not

153. *Id.* at 892.

154. *Id.* at 899.

155. *Id.* at 897-98 (alteration in original) (citations omitted).

156. *Id.* at 899 n.10 (Henderson, *supra* note 70, at 441).

157. *Id.* The court also incorrectly concluded that a finding of coverage would convert the policy into a performance bond. *Id.* at 899.

158. See cases cited *supra* note 146.

covered under CGL policies.¹⁵⁹ An example of such a case can be found in *Essex Insurance Co. v. Holder*,¹⁶⁰ decided by the Arkansas Supreme Court.

In *Holder*, homeowners contracted with a building contractor to construct a new home.¹⁶¹ Although the decision does not discuss in detail the construction defects at issue, the homeowners sued the contractor for “breach of contract, breach of an express warranty, breach of implied warranties, and negligence.”¹⁶²

The policyholder/contractor asserted that because the term “accident” is undefined in the CGL policy, it should be liberally interpreted in its favor, thus covering the construction defects.¹⁶³ The court rejected this argument and ruled in favor of the insurer.¹⁶⁴

Although the court acknowledged that several other jurisdictions have found that the use of the undefined term “accident” in CGL policies is ambiguous, the court stated that an insurance policy is not ambiguous simply because the term “accident” is undefined in it.¹⁶⁵ The court then explained that the term “accident” is “an event that takes place without one’s foresight or expectation—an event that proceeds from an unknown cause, and therefore not expected.”¹⁶⁶

After defining an “accident” as an unforeseen event or an event with an unknown cause, the *Holder* court examined a federal district court case in which the court concluded that construction defects are not “accidents”:

[T]he contractor’s obligation to repair or replace its subcontractor’s defective workmanship could not be deemed unexpected on the part of the contractor, and therefore, failed to constitute an “event” for which coverage existed under the policy.¹⁶⁷

The *Holder* court also reasoned that allowing insurance to cover construction defects would purportedly convert insurance policies into performance bonds:

“The purpose of a CGL policy is to protect an insured from bearing financial responsibility for unexpected and accidental damage to people or property. It is not intended to substitute for a contractor’s performance bond, the purpose of which is to insure the contractor against claims for the cost of repair or

159. See, e.g., *Essex Ins. Co. v. Holder*, 261 S.W.3d 456, 459-60 (Ark. 2007); *Kvaerner*, 908 A.2d at 899.

160. 261 S.W.3d 456 (Ark. 2007).

161. *Id.* at 457.

162. *Id.*

163. *Id.* at 458.

164. *Id.*

165. *Id.* at 460.

166. *Id.* at 458 (quoting *Cont’l Ins. Co. v. Hodges*, 534 S.W.2d 764, 765 (Ark. 1976)).

167. *Id.* at 459 (discussing *Nabholz Constr. Corp. v. St. Paul Fire & Marine Ins. Co.*, 354 F. Supp. 2d 917 (E.D. Ark. 2005)).

replacement of faulty work. [Contractor] might have elected to purchase a performance bond to protect it from a known business risk that its subcontractor would not perform its contractual duties. That [the contractor] has no remedy for its subcontractor's default under its CGL policy is neither troublesome nor unexpected given the nature of the risk involved."¹⁶⁸

In many respects, the *Holder* decision suffers from the same analytical defects as the *Kvaerner*¹⁶⁹ decision. Both courts incorrectly framed the issue as whether it was foreseeable that the contractor would be liable for defective workmanship.¹⁷⁰ That is not the correct issue to be decided under an "occurrence" analysis. Of course it is foreseeable that one will be liable for the damages one causes. The correct issue to analyze is whether the damage resulting from the accident was actually expected or intended by the contractor, not whether it was foreseeable that the contractor would be liable for the resulting damages.

Both courts also incorrectly stated that allowing insurance recoveries for faulty workmanship would convert CGL insurance policies into performance bonds.¹⁷¹ Performance bonds protect the owner of the property and ensure that the work will be done timely.¹⁷² Insurance, on the other hand, protects the contractor against liabilities imposed on the contractor by third parties, such as the property owner.¹⁷³ Further, whether a performance bond would also cover the loss is not relevant to an analysis of the policy's language and whether the policy covers the loss. The two types of agreements contain different language and protect different entities. As such, they are as similar as apples and oranges.¹⁷⁴

Nonetheless, like the court in *Holder*, several other courts have mistakenly pointed to the distinction between CGL policies and performance bonds as a basis for holding that construction defects are not "occurrences."¹⁷⁵

168. *Id.* (alterations in original) (quoting *Nabholz Constr. Corp. v. St. Paul Fire & Marine Ins. Co.*, 354 F. Supp. 2d 917, 922 (E.D. Ark. 2005)).

169. *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. 2006).

170. *See id.* at 897-98; *Holder*, 261 S.W.3d at 458.

171. *See Kvaerner*, 908 A.2d at 899; *Holder*, 261 S.W.3d at 459.

172. *See, e.g.*, *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 887 (Fla. 2007).

173. *Id.*

174. Perhaps for such reasons, the Arkansas state legislature on March 23, 2011 effectively nullified the precedential value of the *Holder* decision by requiring insurers to sell CGL policies that define "occurrence" to include "[p]roperty damage or bodily injury resulting from faulty workmanship." *See* ARK. CODE ANN. § 23-79-155(a)(2) (2011).

175. *See, e.g.*, *United Fire & Cas. Co. v. Boulder Plaza Residential, LLC*, 633 F.3d 951, 959 (10th Cir. 2011) (explaining that to hold that construction defects are "occurrences" would "transform . . . [a] commercial general liability policy into a performance bond"); *Lexicon, Inc. v. ACE Am. Ins. Co.*, 634 F.3d 423, 426 (8th Cir. 2011) ("[P]erformance bonds exist in the marketplace to insure the contractor against claims for the cost of repair or replacement of faulty work . . ." (internal quotation marks omitted)); *Breezewood of*

5. Courts Holding Construction Defects Are Not “Occurrences” Because the Damages Are the Foreseeable Consequences of Intentional Acts

The Eighth Circuit’s decision in *Lexicon, Inc. v. ACE American Insurance Co.* is an example of a court holding that construction defects are not “occurrences” because liability for faulty workmanship is the foreseeable consequence of intentional acts.¹⁷⁶ In *Lexicon*, a contractor used a subcontractor to construct several silos.¹⁷⁷ Due to faulty welds, one of the silos collapsed and damaged nearby equipment.¹⁷⁸ When the silo’s owner asserted a claim against the contractor, the contractor’s insurers refused to pay for the damage.¹⁷⁹

The CGL policies at issue contained the standard form definitions of “occurrence” and “property damage” discussed in Part I of this article, which, of course, means the term “accident” contained in the definition of “occurrence” was not defined.¹⁸⁰

In its decision, the Eighth Circuit addressed two principal arguments advanced by the insurers against a finding of liability: (1) it was foreseeable that the faulty

Wilmington Condos Homeowners’ Ass’n v. Amerisure Mut. Ins. Co., 335 F. App’x 268, 271-72 (4th Cir. 2009) (remarking that construction defects are the kind of business risks that are the purpose of performance bonds); Mid-Continent Cas. Co. v. JHP Dev., Inc., 557 F.3d 207, 212 (5th Cir. 2009) (“Damage to an insured’s own work resulting from his faulty workmanship on it is usually covered by a performance bond, not a commercial general liability policy.” (internal quotation marks omitted)); Pursell Constr., Inc. v. Hawkeye-Sec. Ins. Co., 596 N.W.2d 67, 70-71 (Iowa 1999) (explaining that an insured’s “defective workmanship, standing alone, is not an occurrence” because “[t]he fortuity implied by reference to accident or exposure is not what is commonly meant by a failure of workmanship” and “[i]f the policy is construed as protecting a contractor against mere faulty or defective workmanship, the insurer becomes a guarantor of the insured’s performance of the contract, and the policy takes on the attributes of a performance bond” (internal quotation marks omitted)); AUCITY v. Burd & Smith Constr., Inc., 2006 ND 187, ¶¶ 23, 27, 29, 721 N.W.2d 33, 40, 42 (concluding that damages to a roof that a contractor was replacing were excluded from coverage because to hold otherwise would convert the policy into a performance bond, but damages resulting from the defective roof to the interior of the apartment was covered under the policy); *Kvaerner*, 908 A.2d at 899 (“We hold that the definition of ‘accident’ required to establish an ‘occurrence’ under the policies cannot be satisfied by claims based upon faulty workmanship. . . . To hold otherwise would be to convert a policy for insurance into a performance bond.”); Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co., No. 26909, 2011 WL 93716, at *10 (S.C. Jan. 7, 2011) (explaining that the policy at issue does not provide coverage for faulty workmanship and noting that to hold otherwise would convert it into a performance bond), *withdrawn on reh’g*, No. 26909, 2011 WL 3667598 (S.C. Aug. 22, 2011) (publication forthcoming).

176. 643 F.3d 423, 426 (8th Cir. 2011).

177. *Id.* at 424.

178. *Id.* at 425.

179. *Id.*

180. *See id.*

welds would damage the silo; and (2) “foreseeable risks are never an ‘accident’ or ‘occurrence’ for purposes of a CGL policy”¹⁸¹

In addressing these arguments, the Eighth Circuit, applying Arkansas law, focused on whether it was foreseeable that faulty construction work would damage the silo and lead to additional property damage.¹⁸² The court held that “it was foreseeable that faulty subcontractor work would damage the silo, but not foreseeable that faulty subcontractor work would cause millions of dollars in collateral damage.”¹⁸³ Consequently, the court denied coverage for the damage that it deemed foreseeable.¹⁸⁴ The insurers were held responsible for the collateral damage that the silo collapse caused, but not for the damage to the silo itself.¹⁸⁵

The Eighth Circuit got it partly right in *Lexicon*. The court was correct to allow recovery for the additional property damage caused by the defective welds. When properly framed, however, the issue regarding the faulty welds themselves should have been resolved by determining whether the policyholder actually expected or intended to construct faulty welds, not whether it was foreseeable that they were faulty or that faulty welds would cause damage. In fairness to the Eighth Circuit, however, it was effectively precluded from reaching a different result under Arkansas law due to the Arkansas Supreme Court’s decision in *Essex Insurance Co. v. Holder*¹⁸⁶ discussed above. Thus, the *Lexicon* decision was incorrectly decided for essentially the same reasons the *Holder* decision was incorrectly decided.

Despite its analytical flaws, there are a handful of other decisions that have also improperly applied a “foreseeable consequence” rationale in their decision-making.¹⁸⁷

181. *Id.* at 426.

182. *Id.*

183. *Id.* at 427.

184. *Id.* (citing *Essex Ins. Co. v. Holder*, 261 S.W.3d 456, 460 (Ark. 2007)).

185. *Lexicon*, 634 F.3d at 427 (citing *Advanced Envtl. Recycling Techs. Inc. v. Am. Int’l Specialty Lines Ins. Co.*, 399 F. App’x 869, 873 (5th Cir. 2010)).

186. 261 S.W.3d 456 (Ark. 2007).

187. See e.g., *Lyerla v. Amco Ins. Co.*, 536 F.3d 684, 689 (7th Cir. 2008) (applying noting how Illinois law recognizes that “damage to a construction project resulting from construction defects is not an ‘accident’ or ‘occurrence’ because it represents the natural and ordinary consequence of faulty construction”); *Hathaway Dev. Co. v. Ill. Union Ins. Co.*, 274 F. App’x 787, 791 (11th Cir. 2008) (noting that the subcontractors’ faulty work “was an injury accidentally caused by intentional acts” (internal quotation marks omitted)); *OneBeacon Ins. Co. v. Metro Ready-Mix, Inc.*, 242 F. App’x 936, 940 (4th Cir. 2007) (“[W]hen there is no property damage to otherwise nondefective parts of [a] building, there is no ‘accident’ or ‘occurrence.’ In other words, coverage exists only to remedy unexpected and unintended property damage to the contractor’s otherwise nondefective work-product caused by the . . . defective workmanship.” (citation omitted) (internal quotation marks omitted)); *Holder*, 261 S.W.3d at 460 (“Faulty workmanship is not an accident; instead, it is a foreseeable occurrence, and performance bonds exist in the marketplace to insure the contractor against claims for the cost of repair or replacement of faulty work.”); Pursell

IV. HOW COURTS SHOULD BE ADDRESSING THE ISSUE OF WHETHER CONSTRUCTION DEFECTS ARE "OCCURRENCES"

A. Public Policy and the "Moral Hazard" Problem

As noted above when discussing *United States Fire Insurance Co. v. J.S.U.B., Inc.*, the "moral hazard" problem is one of the theoretical bases cited for the proposition that CGL policies do not cover construction defects.¹⁸⁸ The basic theory posits that a policyholder/contractor effectively would have little incentive to perform its work well if it were covered for the damages it caused to third parties.¹⁸⁹

Constr., Inc. v. Hawkeye-Sec. Ins. Co., 596 N.W.2d 67, 70-71 (Iowa 1999) (explaining that an insured's defective workmanship standing alone is not a covered "occurrence" because "[t]he fortuity implied by reference to accident or exposure is not what is commonly meant by a failure of workmanship" and "[i]f the policy is construed as protecting a contractor against mere faulty or defective workmanship, the insurer becomes a guarantor of the insured's performance of the contract, and the policy takes on the attributes of a performance bond" (internal quotation marks omitted)); *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 477-78 (N.H. 1994) (explaining that faulty work in and of itself does not constitute an "occurrence" due to foreseeability, but damage resulting as a consequence of faulty work is covered under the policy); *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 899 (Pa. 2007) ("We hold that the definition of 'accident' required to establish an 'occurrence' under the policies cannot be satisfied by claims based upon faulty workmanship. Such claims simply do not present the degree of fortuity contemplated by the ordinary definition of 'accident' or its common judicial construction in this context."); *Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co.*, No. 26909, 2011 WL 93716, at *8 (S.C. Jan. 7, 2011) (holding that the policy at issue does not provide coverage for faulty workmanship because faulty workmanship fails the "fortuity component" of the definition of "accident"), *withdrawn on reh'g*, No. 26909, 2011 WL 3667598 (S.C. Aug. 22, 2011) (publication forthcoming).

188. See, e.g., *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 890 (Fla. 2007).

189. See *W. Cas. & Sur. Co. v. W. World Ins. Co.*, 769 F.2d 381, 385 (7th Cir. 1985) (Easterbrook, J., delivering the opinion of the court) (describing the moral hazard problem by stating that "[o]nce a person has insurance, he will take more risks than before because he bears less of the cost of his conduct"). Numerous other commentators also have addressed the moral hazard problem. See, e.g., Scott E. Harrington, *Prices and Profits in the Liability Insurance Market*, in *LIABILITY: PERSPECTIVES AND POLICY* 42, 47 (Robert E. Litan & Clifford Winston eds., 1988) ("Moral hazard is the tendency for the presence and characteristics of insurance coverage to produce inefficient changes in buyers' loss prevention activities, including carelessness and fraud . . ."); ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, *UNDERSTANDING INSURANCE LAW* § 10[c][2], at 11 (4th ed. 2007) ("[T]he existence of insurance can have the perverse effect of increasing the probability of loss. . . . This phenomenon is called *moral hazard*."); George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 *YALE L.J.* 1521, 1547 (1987) ("Moral hazard refers to the effect of the existence of insurance itself on the level of insurance claims made by the insured. . . . *Ex ante* moral hazard is the reduction in precautions taken by the insured to prevent the loss, because of the existence of insurance."); Gary T. Schwartz, *The Ethics and the Economics of Tort Liability Insurance*, 75 *CORNELL L. REV.* 313, 338 n.117 (1990)

Examples of courts pointing to “moral hazard” concerns when denying coverage for insurance claims are most commonly found in the first party insurance context, such as a beneficiary who attempts to recover under a life insurance policy after murdering the named insured.¹⁹⁰ Similarly, courts often enforce an insurer’s decision not to cover a property loss where the policyholder intentionally destroyed the insured property.¹⁹¹ The “moral hazard” concern underlying such decisions is more understandable in the first party context because the policyholder is arguably being encouraged to create the losses in order to recover insurance proceeds.

The same logic does not apply, however, in the construction defect context. In addition to taking pride in a job well done, a contractor is incentivized to do its work well, despite the existence of liability insurance, in order to get paid for the work, obtain future work, and avoid claims and litigation. If the work is not done right, the contractor will not be paid; nor will the contractor be hired again. Further, even if the contractor is able to eventually recover from its insurer, very few litigants would describe litigation as a pleasant or valuable use of their time, particularly while they are trying to run a profitable construction business.

Moreover, proponents of the “moral hazard” theory do not point to any empirical evidence that a contractor actually reviews his or her insurance policy to determine whether the insurance will cover the resulting damage before proceeding to do a job

(“‘Moral hazard’ is sometimes distinguished from ‘morale hazard,’ the former referring to deliberate acts like arson, the latter to the mere relaxation of the defendant’s discipline of carefulness.” (citing C. ARTHUR WILLIAMS, JR. & RICHARD M. HEINS, RISK MANAGEMENT AND INSURANCE 217 (4th ed. 1981))).

190. See, e.g., *New Eng. Mut. Life Ins. Co. v. Null*, 605 F.2d 421, 424 (8th Cir. 1979) (“[T]he accepted rule that a life insurance policy is void *ab initio* when it is shown that the beneficiary thereof procured the policy with a present intention to murder the insured.”); *Commercial Travelers Mut. Accident Ass’n v. Witte*, 406 S.W.2d 145, 149 (Ky. Ct. App. 1966) (explaining that a beneficiary cannot recover life insurance proceeds if he murders the insured); 1B APPLEMAN & APPLEMAN, *supra* note 27, § 481, at 308 (“It has uniformly been held that a beneficiary under a contract of personal insurance who murders the insured cannot recover the policy benefits.”).

191. See, e.g., 12 APPLEMAN & APPLEMAN, *supra* note 27, § 7031, at 147 (“[A]rson by the insured will prevent him from recovering.”); JERRY & RICHMOND, *supra* note 189, § 63A, at 441 (“If the insured intentionally causes damage to her own property, the loss is not covered. . . . Insureds should not receive coverage for destroying their own property. Otherwise, insureds would have an incentive in many instances to destroy their property and collect the proceeds.”); see also *U.S. Fire Ins. Co. v. Beltmann N. Am. Co.*, 695 F. Supp. 941, 948 (N.D. Ill. 1988) (“A fire insurance policy issued to any one, which purported to insure his property against his own willful and intentional burning of the same, would manifestly be condemned by all courts as contrary to a sound public policy” (quoting *Checkley v. Ill. Cent. R.R. Co.*, 100 N.E. 942, 944 (Ill. 1913))). One commentator refers to this problem as the “barn burning defense,” stating that “the insured who intentionally burns his own barn is not entitled to collect the insurance on it!” 1 WARREN FREEDMAN, FREEDMAN’S RICHARDS ON THE LAW OF INSURANCE § 1:13, at 48-49 (6th ed. 1990).

sloppily. In short, “moral hazard” arguments in the context of construction defect claims are based solely on theory, not empirical evidence.

On the other hand, there are other more tangible public policies favoring insurance recoveries for construction defects. For example, public policy favors compensating innocent victims.¹⁹² Thus, in situations where a homeowner would go uncompensated in the absence of the contractor’s insurance (e.g., the contractor is insolvent or judgment proof), public policy favors allowing the homeowner to recover insurance proceeds regardless of whether the contractor could have or should have done the work right in the first place.

Another competing public policy is the enforcement of contracts, such as insurance policies, in accordance with their express terms.¹⁹³ Indeed, as one court correctly noted in the context of analyzing whether insurance should be allowed to cover intentional torts, “[t]here is more than one public policy. One such policy is that an insurance company which accepts a premium for covering all liability for damages should honor its obligation.”¹⁹⁴ Because insurers draft the language contained in their policies, they do not need courts to resort to “public policy” arguments to help the insurers avoid coverage for the types of claims the insurers do not want to insure. The insurers can simply state in the insurance policy, in clear terms, the specific types of claims that are not covered.¹⁹⁵ If the insurer fails to do that, then public policy favors enforcing the terms of the policy in favor of coverage.

Courts that have rejected insurers’ “moral hazard” public policy arguments in other third party liability contexts have analyzed the issue similarly. For example, some courts have questioned whether the inference that insurance stimulates

192. See, e.g., *Yousuf v. Cohlma*, 718 F. Supp. 2d 1279, 1288 (N.D. Okla. 2010) (explaining that compensating a wrongdoer’s innocent victims outweighs the concern that the wrongdoer would unjustly benefit); *St. Paul Fire & Marine Ins. Co. v. Jacobson*, 826 F. Supp. 155, 164-65 (E.D. Va. 1993) (concluding that compensating innocent victims, where an insurance policy does not explicitly exclude coverage of intentional acts, outweighs public policy of not permitting coverage of intentional action); *Grinnell Mut. Reins. Co. v. Jungling*, 654 N.W.2d 530, 541 (Iowa 2002) (“Compensating . . . innocent victims . . . outweighs the concern that [the wrongdoer] will unjustly benefit from coverage.”); *Vigilant Ins. Co. v. Kambly*, 319 N.W.2d 382, 385 (Mich. Ct. App. 1982) (“[T]here is great public interest in protecting the interests of the injured party.”).

193. *Sch. Dist. for the City of Royal Oak v. Cont’l Cas. Co.*, 912 F.2d 844, 848-49 (6th Cir. 1990) (explaining that public policy favors enforcing the terms of insurance policies and “common sense suggests that the prospect of escalating insurance costs and the trauma of litigation, to say nothing of the risk of uninsurable punitive damages, would normally neutralize any stimulative tendency the insurance might have”); *Nw. Nat’l. Cas. Co. v. McNulty*, 307 F.2d 432, 444 (5th Cir. 1962) (Gwin, J., concurring) (noting the public policy favoring the enforcement of contracts); *Union Camp Corp. v. Cont’l Cas. Co.*, 452 F. Supp. 565, 568 (S.D. Ga. 1978) (“Exercise of the freedom of contract is not lightly to be interfered with. It is only in clear cases that contracts will be held void as against public policy.”).

194. *Creech v. Aetna Cas. & Sur. Co.*, 516 So. 2d 1168, 1174 (La. Ct. App. 1987).

195. See cases cited *infra* note 198.

undesirable behavior can overcome “the competing public policies which favor freedom of contract and the enforcement of insurance contracts according to their terms.”¹⁹⁶ Other courts have pointed to the insurance industry’s own ability to discourage undesirable behavior.¹⁹⁷ Such courts have noted that insurance companies are capable of policing their own policyholders and that insurance companies, as drafters of the policy language, have ample motivation to prevent policyholders from recovering for allegedly deliberate losses if they so desire.¹⁹⁸

In sum, the courts that have rejected “moral hazard” public policy based arguments have done so for three primary reasons. First, they have noted the lack of empirical evidence to support the assumption that insurance promotes bad behavior.¹⁹⁹ Second, they have noted the competing public policies that favor the enforcement of an insurer’s agreement to provide coverage under its policies and the need to compensate victims.²⁰⁰ Third, they emphasize that insurers can, themselves,

196. *Indep. Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 495 N.W.2d 863, 868 (Minn. Ct. App. 1993) (citing *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1010 n.1 (Fla. 1989) (Ehrlich, C.J., dissenting)), *aff’d*, 515 N.W.2d 576 (Minn. 1994); *see also Royal Oak*, 912 F.2d at 849.

197. *See, e.g., Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 509 So. 2d 945, 948 (Fla. Dist. Ct. App. 1987) (“[T]he marketplace itself will discourage wrongful acts of discrimination.”), *vacated*, 549 So. 2d 1005 (Fla. 1989); *Indep. Sch. Dist.*, 495 N.W.2d at 867 (“[C]ommon sense suggests that the prospect of escalating insurance costs and the trauma of litigation, to say nothing of the risk of uninsurable punitive damages, would normally neutralize any stimulative tendency the insurance might have.” (quoting *Royal Oak*, 912 F.2d at 848)).

198. *See, e.g., Royal Oak*, 912 F.2d at 849 (“Had the company wished to exclude coverage for intentional religious discrimination in employment, it could and should have said so.”); *Union Camp*, 452 F. Supp. at 568 (“Continental and other insurers which have issued policies containing such clauses have not up to now conceived that they were violating public policy by writing insurance policies insuring against losses resulting from discriminatory employment practices.”); *Ranger*, 509 So. 2d at 947 (citing *Union Camp*, 452 F. Supp. at 567-68); *Univ. of Ill. v. Cont’l Cas. Co.*, 599 N.E.2d 1338, 1350-51 (Ill. App. Ct. 1992) (“[T]he insurer is an informed contracting party with no inferiority in bargaining position and should not be allowed to escape from the contract it freely entered into. . . . This court will not rewrite . . . policy to create an exclusion.”); *Indep. Sch. Dist.*, 495 N.W.2d at 868 (“The carrier is, of course, free to expressly provide an exclusion for such conduct in the future.”).

199. *See, e.g., Ranger*, 509 So. 2d at 947 (“The proposition that insurance taken out by an employer to protect against liability under Title VII will encourage violations of the Act is . . . speculative and erroneous.” (internal quotation marks omitted)).

200. *See St. Paul Fire & Marine Ins. Co. v. Jacobson*, 826 F. Supp. 155, 164-65 (E.D. Va. 1993) (finding that public policy does not forbid patients from being compensated by doctor’s professional liability policy for doctor’s intentional insemination of them with his own sperm), *aff’d*, 48 F.3d 778 (4th Cir. 1995); *St. Paul Fire & Marine Ins. Co. v. Asbury*, 720 P.2d 540, 542 (Ariz. Ct. App. 1986) (holding that Arizona public policy favors compensating injured persons and victims of doctor’s sexual abuse can be compensated through his professional liability policy); *St. Paul Fire & Marine Ins. Co. v. Shernow*, 610

exclude coverage for specific types of claims, as they have done with the “business risk” exclusions.²⁰¹ Insurers draft the policies; thus, they should not be permitted to avoid their contractual obligations by appealing to vague public policy concerns, such as the “moral hazard” problem, with the expectation that the courts will do for them what they failed to do for themselves when drafting the policies.

B. *Applying the Rules of Policy Interpretation to the Issue*

When one applies the relevant rules of insurance policy interpretation to the issue of whether construction defects constitute “occurrences,” the inescapable conclusion is that construction defects are “occurrences” unless the insurer can prove the policyholder actually expected or intended to do the construction work defectively and cause damage. The term “accident” is not defined in standard form CGL policies. As has been discussed above, courts have held that an “accident” essentially is an event that unexpectedly and unintentionally gives rise to injury or damage.²⁰² Contractors generally do not expect or intend to do their work defectively. Further, under the doctrine of *contra proferentem*, to the extent there is any ambiguity in the

A.2d 1281, 1285-86 (Conn. 1992) (finding that public policy does not prohibit indemnity for compensatory damages flowing from dentist’s intentional sexual assault of patient); *Hudson v. State Farm Mut. Ins. Co.*, 569 A.2d 1168, 1171-72 (Del. 1990) (refusing to void coverage for intentional wrongdoing under an automobile policy, despite the public policy exclusion because of the competing public policy behind the state motor vehicle financial responsibility law); *Vigilant Ins. Co. v. Kambly*, 319 N.W.2d 382, 385 (Mich. Ct. App. 1982) (allowing insurance recovery for a physician’s sexual assault of his patient because “[i]t is not the insured who will benefit, but the innocent victim who will be provided compensation for her injuries”); *Indep. Sch. Dist.*, 495 N.W.2d at 868 (citing *Ranger*, 549 So. 2d at 1010 n.1 (Ehrlich, C.J., dissenting)); *S.S. v. State Farm Fire & Cas. Co.*, 808 S.W.2d 668, 671 (Tex. Ct. App. 1991) (concluding that a homeowner’s insurance policy provides coverage for the transmission of a sexually transmitted disease by relying on the analogous context of automobile insurance in which public policy favors the compensation of tort victims).

201. See, e.g., *Royal Oak*, 912 F.2d at 849 (“Had the company wished to exclude coverage for intentional religious discrimination in employment, it could and should have said so.”); *Ranger*, 509 So. 2d at 947 (“Continental and other insurers which have issued policies containing such clauses have not up to now conceived that they were violating public policy by writing insurance policies insuring against losses resulting from discriminatory employment practices.”) (quoting *Union Camp*, 452 F. Supp. at 568); *Univ. of Ill.*, 599 N.E.2d at 1350-51 (“[T]he insurer is an informed contracting party with no inferiority in bargaining position and should not be allowed to escape from the contract it freely entered into. . . . This court will not rewrite . . . policy to create an exclusion.”); *Indep. Sch. Dist.*, 495 N.W.2d at 868 (“The carrier is, of course, free to expressly provide an exclusion for such conduct in the future.”).

202. See, e.g., *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 883 (Fla. 2007).

meaning of “accident,” the courts must resolve those ambiguities in favor of the policyholder.²⁰³

In addition, the “reasonable expectations” doctrine dictates that construction defects are “occurrences.”²⁰⁴ The reason a contractor buys CGL insurance is to protect itself against claims relating to its construction business. Thus, a contractor reasonably expects that it will be covered for construction defect claims brought against it because those are among the most common types of claims asserted against contractors. To hold otherwise would render the coverage provided under CGL policies largely illusory for contractors.

Further, when one construes CGL policies as a whole, instead of in parts, construction defects must be “occurrences” in order for the “business risk” exclusions to have any purpose. What would be the point of the “business risk” exclusions if construction defects were not “occurrences” in the first instance? There would be no need to exclude coverage for “defects” in “your work” or have a subcontractor exception to such an exclusion if construction defects were not covered “occurrences” under the basic insuring agreement language.²⁰⁵

Moreover, under the definition of “occurrence” and the “expected or intended” exclusion contained in standard form CGL policies, property damage caused by the policyholder is covered unless the damage is “expected or intended” by the policyholder.²⁰⁶ Contrary to some courts’ holdings,²⁰⁷ the policy language does not state that property damage is *not* covered if it is the reasonably foreseeable consequence of the policyholder’s actions. Thus, whether the damage is reasonably foreseeable should not be part of the analysis because such a test lacks a basis in the “expected or intended” language or definition of “occurrence” found in CGL policies. The test is subjective, not objective, and the issue is whether the damage was actually “expected or intended” by the policyholder, not whether the damage was reasonably foreseeable.²⁰⁸

In the same vein, the question of whether a contractor reasonably expects to be held liable for its negligence also should not be part of the analysis. Of course contractors, like everyone else, expect to be held liable if their negligence causes injuries or damage. Indeed, that is the reason people buy insurance. Insurance is intended to cover the policyholder’s liabilities for injuries and damages that result from the policyholder’s negligence. If reasonably foreseeable property damage and liabilities were not covered by CGL policies, then insurance for liabilities would become largely illusory in many situations because it is often reasonably foreseeable

203. See discussion *supra* Part II.A.

204. See discussion *supra* Part II.B.

205. See, e.g., *J.S.U.B.*, 979 So. 2d at 886-87; *INS. SERVS. OFFICE, INC.*, *supra* note 2, § I(2)(1) at 5.

206. See discussion *supra* Parts I.A, II.D.2.

207. See cases cited *supra* note 187.

208. See discussion *supra* Part II.D.2.

that negligent actions will lead to accidents, property damage, and ultimately liability.²⁰⁹

In sum, there should be little debate that construction defects are “occurrences” under CGL policies unless the contractor expected or intended to do the work defectively and cause damage. Thus, in most cases, the analysis regarding whether construction defect claims are covered under CGL policies should focus on whether the “business risk” exclusions apply to the claim.

CONCLUSION

After years of misunderstanding the issue, many courts, such as the Supreme Court of Florida in *United States Fire Insurance Co. v. J.S.U.B., Inc.*,²¹⁰ are finally starting to understand the issue of whether construction defects are “occurrences,” and they are getting the analysis right.²¹¹ Construction defects are “occurrences” under standard form CGL policies.

In determining whether there is an “occurrence” in the context of construction defects, the analysis should focus on whether there was an “accident” that gave rise to property damage. Although the term “accident” is undefined in CGL policies, courts have generally defined it to mean a happening or an event that unexpectedly and unintentionally gives rise to an injury or property damage.²¹² Thus, unless the insurer can prove that the policyholder/contractor expected or intended its workmanship to be defective and cause property damage, the faulty workmanship was accidental and thus, an “occurrence.”

Such a conclusion is consistent with the rules of insurance policy interpretation. Those rules provide that policy language should be interpreted in such a way as to give effect to all of the provisions in a policy and to fulfill the reasonable expectations of the policyholder regarding the scope of coverage it has purchased, with any ambiguities in the policy language being resolved in favor of coverage. Contractors who purchase CGL insurance to cover their businesses (i.e., construction) reasonably expect that they will receive coverage for third-party liability claims related to their businesses (i.e., construction defect claims), especially when one considers that the policies contain “business risk” exclusions that specify the particular types of work-related claims that are not covered. If construction defect claims were not “occurrences” in the first instance, then why would policies contain “business risk” exclusions or the subcontractor exception to such exclusions? Finally, if construction defects were not “occurrences,” then the coverage provided to contractors under CGL policies largely would become illusory because the vast majority of claims asserted

209. See *supra* notes 53-54 and accompanying text.

210. 979 So. 2d 871 (Fla. 2007).

211. See cases cited *supra* notes 79-90, 122.

212. E.g., *Fejes v. Alaska Ins. Co., Inc.*, 984 P.2d 519, 523 (Alaska 1999).

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against contractors would not be covered. Such a result would be unfair and should not be permitted.