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An "Occurrence" By Any Other Name:

The Ongoing Trend Toward Affording Coverage Under CGL Policies for Consequential Damage Arising from Defective Work

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PRACTICAL POLICYHOLDER ADVICE

Policyholders may take added comfort from a strong recent trend in favor of finding that consequential damage arising from an insured's defective work, or that of a subcontractor, is an "occurrence" that may trigger coverage under CGL policies, thus preventing insurers from denying coverage immediately on this basis. Policyholders should be cautious, however, that insurers may increasingly rely on exclusions in a CGL policy to deny coverage—and thus should give added attention to any exclusions or exceptions in their CGL policies when submitting claims for coverage arising from third-party lawsuits related to defective work.

Policyholders often rely on Commercial General Liability (CGL) polices to insure against losses that may result from work that later turns out to be negligent or defective. Many courts, however, have historically limited coverage under such policies, holding that an insured's own defective work is not an "occurrence" triggering coverage under a CGL policy. But in three recent decisions from different jurisdictions, courts have held that an insured's own defective work—or the work of a subcontractor—may constitute an "occurrence" triggering coverage, to the extent that consequential damage to third parties results from the defective or negligent work.

In *Decker Plastics, Inc. v. West Bend Mutual Insurance Company*, No. 15-2851 (8th Cir.) the insured, Decker Plastics, manufactured plastic bags without an ultraviolet inhibitor, thus causing the bags to deteriorate in sunlight. Decker had sold the bags to a third party, Al's, that had unwittingly filled the defective bags with landscaping materials and sold them to its customers. When the bags deteriorated, small shreds of plastic commingled with the landscaping materials, and Decker was sued to recover Al's expenses in cleaning up spilled materials from customer sites and cleaning up its own premises. Decker sought coverage from West Bend under its CGL policy.

In a per curiam opinion, the Eighth Circuit, applying Iowa law, held that the deterioration of the bags was a covered "occurrence" under Decker's CGL policy. While the Court recognized the Iowa Supreme Court's prior ruling that an insured's defective workmanship, standing alone, is not itself an occurrence, it declined to end the inquiry there. Rather, the Court held, there was a *separate* "occurrence" that took place when the result of that workmanship caused injury to Al's and its customers.

Similarly, in *Cypress Point Condominium Association, Inc. v. Adria Towers, LLC*, No. A-13/14-15; 076348 (N.J.), condominium owners sued the developers of their condominium complex after the owners experienced problems such as water leaks and intrusion resulting from defective workmanship by a subcontractor. The owners claimed consequential damage to steel supports, sheetrock, insulation, and interior structures. The developers, in turn, sought coverage from their insurer.

In a highly significant ruling that many practitioners viewed as a departure from its prior decisions, the New Jersey Supreme Court, applying New Jersey law, held that the water intrusion constituted an "occurrence" under the developer's CGL policy. Noting what it deemed to be a "strong recent trend" in favor of finding an "occurrence" when defective workmanship results in consequential damage, the Court held that an "occurrence" could be found whenever an accident resulted in unintended and unexpected harm caused by negligent conduct. The Court recognized that its prior opinions had been interpreted to exclude coverage under CGL policies, but distinguished those opinions as relying on *exclusions* from coverage, and therefore not bearing on what constitutes an "occurrence" triggering CGL coverage. As a practical matter, however, the *Cypress Point* decision represents a marked change in approach from the prior New Jersey case law.

The *Cypress Point* decision also illustrates that, even when the consequential damage of an insured's own negligent work constitutes an "occurrence" within the meaning of a CGL policy, coverage may not always be assured, in that insurers may rely on exclusions to deny coverage—and are increasingly likely to do so. The insurer in *Cypress Point* asserted that it was entitled to deny coverage under a "your work" exclusion, which applied to "property damage to work performed by or on behalf of the named insured." (In Decker Plastics, the Eighth Circuit also noted the presence of a "Your Product" exclusion that was potentially applicable, but remanded for the district court to address its applicability in the first instance.)

In another significant aspect of the *Cypress Point* decision, the New Jersey Supreme Court held that the "Your Work" exclusion did *not* apply, because of an exception narrowing the application of that exclusion when damage arises from work "performed on your behalf by a subcontractor." The Court noted that finding coverage in this instance was consistent with a general evolution in insurance law favoring subcontractor exceptions, as reflected by the inclusion of the subcontractor exception in the 1986 iteration of the CGL form.

These cases are evidence of what the *Cypress Point* decision recognized as a strong recent trend toward finding coverage under CGL policies for the consequential damage of defective workmanship. Indeed, more than 20 state high courts have ruled, consistent with *Cypress Point*, that a general contractor's CGL policy provides coverage for damage caused by a subcontractor's defective work. A third case, however, illustrates that these holdings may be limited to the *unpredictable* impact of defective workmanship on third parties.

In *Mesa Underwriters Specialty Insurance Co. v. Ronald L. Myers*, No. 3:14-CV-2201 (N.D. Ohio), Myers was hired to perform roofing work, including patching a bad roof, for a business. The sealant that Myers applied, however, did not harden as quickly as he had anticipated—resulting not only in damage to the structure whose roof he had attempted to repair, but also the sealant running off into Lake Erie, thus requiring environmental remediation. Myers sought defense coverage for a subsequent lawsuit, and Mesa brought a declaratory judgment action seeking a ruling that the CGL policy did not afford any coverage to the insured.

Judge Carr of the U.S. District Court for the Northern District of Ohio, applying Ohio law, held that the failure to use an appropriate sealant was *not* itself an "occurrence" within the meaning of a CGL policy, and, as a result, the CGL policy did not cover damage relating to the removal of the roof and repair of property damage resulting from leaks. Nevertheless, Judge Carr held that the sealant's runoff from the roof, and its discharge into Lake Erie, was a *separate* "occurrence" causing consequential damage that could trigger coverage. Judge Carr differentiated the two types of damage by noting that the property damage was the predictable result of negligent work, whereas the consequential damage, such as environmental remediation, was a fortuitous and unpredictable result—precisely the type of claim for which CGL policies were intended.

Further illustrating the heightened importance of exclusions, however, Judge Carr ultimately held that the insurer could properly deny coverage pursuant to the "Total Pollution Exclusion" in the policy, and thus concluded that coverage did not apply for either type of damage.

In conclusion, because these recent cases evince a strong trend toward finding an “occurrence” sufficient to potentially trigger coverage under CGL policies for the consequential damage of an insured’s defective work (or that of the insured’s subcontractor), insurers will have to defend such actions until the facts permit them to attempt to assert exclusions or exceptions to limit coverage. No longer will insurers be able to avoid their defense obligations by asserting, immediately in response to a claim, that there was no “occurrence,” or that the insured cannot satisfy the preliminary requirements for pursuing both defense coverage and indemnity under a CGL policy.

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