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Connecticut Supreme Court Chimes in on Insurance Coverage For Construction Defects

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Last June, in *Capstone Building Corporation v. American Motorists Insurance Company*, 308 Conn. 760 (2013), our Supreme Court first considered what has long been a fertile subject of litigation nationwide - whether contractors can look to their comprehensive general liability ("CGL") policies for coverage when owners assert damage claims for alleged defects in construction. This piece briefly explains the holding and discusses who it favors and who it disfavors.

The Court's analysis began with the insuring agreement section of the policy. Typically, this section grants coverage for "property damage" (and bodily injury), but only when caused by an "occurrence," which the policy defines as an "accident." Some jurisdictions conclude there is no coverage under the insuring agreement because defective construction is not an accident, and hence, not an occurrence. They say that fortuity – the lack of volition - is an essential characteristic of an accident, and it is missing with defective construction, which is foreseeable. Had the Connecticut Court accepted this reasoning, there would be no coverage under any circumstances for defective construction or even the damage defective construction caused other, non-defective property – the most pro-insurer position imaginable. To the insurers' chagrin, the Court rejected this position, citing decisions in which it held that an accident is an event an insured does not intend even though it may have performed the defect-producing act deliberately. Contractors, it concluded, rarely intend to create defective results, and even if those results are foreseeable, insurance policies are meant to cover foreseeable risks.

The Court then turned to the definition of "property damage" – as pertinent here, physical injury to tangible property, including all resulting loss of use of that property. One of the issues here is whether the insuring agreement covers damage to the contractor's own work. Rejecting the pro-insurer position some other courts have taken, the Connecticut Court held that the policy could cover damage to the contractor's own work, just as it covers damage to other property. The decision goes on, however, to all but eliminate this potential coverage by also holding that if the claimed damage to the contractor's work is the result of the contractor's shoddy workmanship or his installation of defective materials, then this is not property damage within the meaning of a CGL policy, because the work (the property) has not been physically injured; it came that way. That is to say that the building component in issue was not altered, and in the Court's view, to have property damage within the meaning of the policy, there must be some alteration of what was built after it was built.

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The Court then turned to the policy's "Damage To Your Work" exclusion, first reminding the reader that exclusions operate to eliminate coverage the insuring agreement granted. As to the "Damage To Your Work" exclusion, the Court concluded that it clearly and unambiguously withdrew whatever coverage the insuring agreement provides for "property damage to the insured contractor's work, arising out of that or any part of that work and included in the 'products-completed operations hazard." At first blush, this would appear to be a devastating blow to contractors and owners, because the Court also held that their work in many cases is the entire building or project, including those portions built perfectly that were subsequently damaged due to other, defective portions. This means that when an owner sues the contractor for defective construction, whether the loss experienced is the cost to correct the defect or the cost to repair the damage the defect caused to non-defective portions of the building, the loss is not covered by a CGL policy.

From the contractor/owner perspective, another aspect of the exclusion eliminates much of this bleakness. The "Damage To Your Work" exclusion contains a coverage restoring exception. The exclusion does not apply – and the coverage the insuring agreement provided is restored - if the property damage was caused by a subcontractor. The Court acknowledged this exception, finding its language to be clear and unambiguous. Since today's general contractors and construction managers do little or no work with their own forces, this restoration is favorable to them.

The bottom line is that in Connecticut, there is no longer any question: the contractor's CGL insurer is not on the hook for defective construction itself, a result that favors insurers and disfavors contractors and owners. Nonetheless, contractors and owners were in jeopardy of losing coverage even for the damage the contractor's defective work caused to the contractor's non-defective work, coverage other states allow. The cause was the Connecticut Court's conclusion that the contractor's work for purposes of the "Damage To Your Work" exclusion is the entire project. The Court's literal reading of the subcontractor exception removed that jeopardy and for all intents and purposes restored coverage for at least those instances where the damage was caused by the subcontractor's faulty work.

All in all, though, *Capstone* is more of a victory for insurers largely sustaining their position that defective construction itself is the contractor's business risk – a risk they have no intention of insuring.

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