Florida Court Finds Coverage For Faulty Subcontractor Work Under CGL Policy

BY DONNA M. GREENSPAN

The Florida Supreme Court added several new wrinkles to an ongoing debate over the question of whether a general contractor's commercial general liability insurance policies cover damage caused by the faulty workmanship of a subcontractor.

Courts across the country have reached different conclusions on similar facts and nearly identical policy language. In *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, the Florida Supreme Court has found coverage for faulty subcontractor work where other courts have not.

Even after the 2007 *J.S.U.B.* decision, however, courts in other states have ruled that CGL policies do not cover defective construction.

Typical facts considered by all these courts are:

- A general contractor builds a house and delivers the completed project to the homeowner.
- Later on, damages appear in the home's foundations, drywall and other interior portions.
- It is undisputed that a subcontractor's faulty workmanship caused the home's structural damage.
- The homeowner sues the insured contractor, who seeks coverage under a CGL policy for the subcontractor's defective work.

THE CGL POLICY

Whether the contractor will prevail on a coverage action against the insurer depends in large part on the applicable choice of law.

The difference among jurisdictions stems primarily from the threshold disagreement of whether faulty workmanship can trigger coverage under the insuring agreement of the CGL policy.

A standard CGL policy provides coverage for sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" caused by an "occurrence" within the coverage territory during the policy period.

The CGL policy defines "property damage" as "physical injury to tangible property, including all resulting loss of use of that property."

The CGL policy defines an "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions," but does not provide a definition for the term "accident."

CGL policies also contain "products-completed operations hazard" coverage for which additional premium is charged. The products-completed operations hazard includes "all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work' except…[w]ork that has not yet been completed or abandoned."

Some courts reject the notion that faulty workmanship or defective construction can be an "occurrence" resulting in "property damage." Other courts disagree and, after finding that an "occurrence" and "property damage" trigger the CGL policy's insuring agreement, continue the analysis to determine if the policy's exclusions nevertheless preclude coverage.

In 1986, the Insurance Services Office revised the standard CGL form significantly. The post-1986 CGL policy has three exclusions, "j(5)," "j(6)" and "l", sometimes known as the "business risk" exclusions, which are pertinent to the question of whether the policy excludes coverage for faulty workmanship.

Exclusion j(5) eliminates coverage for "that particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations."

Exclusion j(6)—the "faulty workmanship" exclusion—precludes coverage for "that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." There is an exception to exclusion j(6), however, for "'property damage' included in the 'products-completed operations hazard.'"

On the other hand, exclusion l—the "Your Work" exclusion—precludes coverage for "'property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard,'" except for work performed on the insured's behalf by a subcontractor.

More recently, the ISO has issued an endorsement that may be included in the CGL to eliminate the subcontractor exception to the "Your Work" exclusion.

FLORIDA ENTERS THE FRAY

In *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, the Florida Supreme Court concluded that because the CGL policy does not define "accident," the term includes not only "accidental events," but also faulty workmanship that is "neither expected nor intended" from the standpoint of the insured.

The *J.S.U.B.* court also held that defective work that damages an otherwise non-defective part of the project has caused "physical injury to tangible property" and thus "property damage" under the policy.

The *J.S.U.B.* court found that the post-1986 CGL policy exclusions do not preclude coverage for damage to a completed project caused by a subcontractor's faulty workmanship. The court noted that the faulty workmanship exclusion j(6) does not apply to property damage included in the "products-completed operations hazard," and the "Your Work" exclusion (l) contains an express exception for subcontractor work.

Accordingly, the Florida Supreme Court held in *J.S.U.B.* that a post-1986 CGL policy with products completed-operations hazard coverage, issued to a general contractor, provides coverage for a claim made against the contractor for damage to the completed project caused by a subcontractor's defective work, provided there is no specific exclusion that otherwise precludes coverage.

The Florida Supreme Court has instructed, however, that "property damage" under the CGL policy does not include the faulty work itself. In *Auto-Owners Ins. Co. v. Pozzi Window Co.*, (Fla. 2008), the homebuilder's insurer paid for damage to personal property caused by leaking windows on a multimillion-dollar home, but refused to pay the cost of repair or replacement of the windows themselves.

The *Pozzi* court found that a claim for the repair or replacement of windows that were defective both prior to installation and as installed is merely an uncovered claim to replace a "defective component" in the project. Conversely, a claim for the repair or replacement of windows that were not initially defective but were damaged by defective installation is a claim for physical injury to tangible property, thus constituting "property damage."

THE DEBATE CONTINUES

The Florida Supreme Court's pronouncements have not been the last word in the national debate.

In *Westfield Ins. Co. v. Sheehan Const. Co.* (S.D. Ind. 2008), the contractor cited *J.S.U.B.* in seeking coverage under a post-1986 CGL policy. Applying Indiana law, however, the district court rejected the contractor's argument that damage to the otherwise non-defective parts of the homes constituted "property damage."

The court also found that water penetration arising from the subcontractors' failure to properly seal the houses was the "natural and ordinary consequence of the defects," and thus was not an "accident" constituting an "occurrence."

The Seventh Circuit, applying Illinois law in *Lyerla v. AMCO Ins. Co.* (7th Cir. 2008), likewise found that the CGL policy did not cover the insured's defective construction. However, the court left open the possibility that Illinois law might view faulty workmanship as an "occurrence" if it resulted in damage to property other than the cost of repair or replacement of the faulty work itself.

The *Lyerla* court cited *J.S.U.B.* for its recognition of the "analytical inconsistency of treating faulty work that damages third-party property as an 'occurrence,' but treating faulty work that damages the insured's work as foreseeable and, hence, not accidental." The 7th Circuit also cited *J.S.U.B.* for its observation that CGL policies themselves do not distinguish between tort and contract claims.

Courts across the country are still deciding the question of whether CGL policies cover damage caused by faulty workmanship. The impact of *J.S.U.B* will depend heavily on the facts giving rise to the alleged "property damage," as well as the particular jurisdiction's definition of an "accident" constituting an "occurrence."

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