



## Legislatures Address Coverage For Defective Construction

Lawmakers step in amid growing dissatisfaction with court rulings

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Disputes between policyholders and their insurers are nothing new. Construction contractors in particular are well-acustomed to debating the finer points of insurance coverage with their general liability carriers. Even the most careful contractor has probably encountered a situation where a project owner claims the work was improperly performed, necessitating fixing the work itself (e.g., faulty siding on a home); repairing damages that resulted from the faulty work (water infiltration inside of the home due to the faulty siding); or some combination of the two. Whether the policyholder is entitled to insurance coverage for these types of claims has been a hotly contested issue in the insurance and construction industries for, at least, the past 20 years.

State judiciaries have played an active role in shaping the scope of insurance coverage for claims of faulty workmanship. Hundreds of reported cases nationwide analyze the nuances of general liability coverage in this context. Whether such claims constitute an “occurrence,” typically defined as an “accident,” has been pondered by courts in all but two states (Idaho and New Mexico).

This firm has written on these trends in the past for this publication, in articles titled “Coverage for Defective Construction Claims Debatable” (March 2007) and “Defective Construction Often An Insurance Issue” (March 2011).

For many years, the question of whether

defective construction and resulting damages constitute a covered “occurrence” was solely the province of state judiciaries. Since May 2010, however, four state legislatures—Colorado, Arkansas, South Carolina and Hawaii—have joined the fray. The result is new legislation aimed at overturning case law that went too far in restricting coverage for defective construction claims.

### Colorado Leads

Colorado’s legislature led the pack in passing pro-policyholder legislation. In response to *General Security Indemnity Co. v. Mountain States Casualty Co.*, 205 P.3d 529 (Colo. App. Ct. 2009), a decision in which the appellate court ruled that neither faulty workmanship nor consequential damages flowing from it constituted an “occurrence,” the legislature passed Colorado Revised Statutes § 13-20-808.

The legislative findings preceding the statute make it clear that the court got it wrong: “The decision of the Colorado court of appeals in [*Mountain States*] does not properly consider a construction professional’s reasonable expectation that an insurer would defend the construction professional against an action or notice of claim [involving defective construction].”

The statute therefore provides that: “In interpreting a liability insurance policy issued to a construction professional, a court shall



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presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured. . . .”

Arkansas was the next state to tackle the issue of insurance coverage for defective construction claims. In 2008, Arkansas’ Supreme Court issued *Essex Insurance Co. v. Holder*, in which it held that “faulty workmanship is not an accident,” 261 S.W.3d 456, 460 (Ark. 2008). Arkansas Code § 23-79-155, which was passed in March of this year, attempts to resolve the uncertainty caused by that decision. According to the legislative findings, the purpose of the statute is “to allow an insurance consumer to safely purchase commercial liability insurance coverage at a fair price to insure against the risk of property damage . . . resulting from faulty workmanship.” The statute’s key subsection provides: “(a) A commercial general liability insurance policy offered for sale in this state shall contain a definition of ‘occurrence’ that includes: . . .

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(2) Property damage or bodily injury resulting from faulty workmanship.”

### South Carolina Reversal

This past May, South Carolina joined Colorado and Arkansas in legislatively addressing whether claims springing from defective construction constitute an “occurrence.” South Carolina courts have struggled with this issue since 2005, when the Supreme Court issued *L-J Inc. v. Bituminous Fire & Marine Insurance Co.*, 621 S.E.2d 33 (S.C. 2005).

There, the court held that there was no “occurrence” and thus no coverage for a claim for damage to the faulty work itself. The decision, however, left open the possibility of coverage for claims of faulty workmanship that cause damage to third-party property. In *Auto-Owners Insurance Co. Inc. v. Newman*, 684 S.E.2d 541 (S.C. 2009), the court came down in favor of the policyholder on that issue. However, the *Newman* case was not long for this world, and the next year the court reversed course in *Crossman Communities of North Carolina Inc. v. Harleysville Mutual Insurance Co.*, 2011 WL 93716 (S.C. Jan. 7, 2011), stating that damages resulting from faulty workmanship were the “natural and probable cause” of that work. The legislature responded quickly, and on May 17, 2011, the governor signed section 38-61-70 into law, which provides:

“(B) Commercial general liability insur-

ance policies shall contain or be deemed to contain a definition of ‘occurrence’ that includes...(2) property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself.”

### Creating ‘Uncertainty’

Hawaii is the most recent state to enact legislation aimed at the occurrence issue. Hawaii’s appellate court came down hard on construction contractors when it decided for the insurer in *Group Builders Inc. v. Admiral Insurance Co.*, 231 P.3d 67 (Haw. Ct. App. 2010). The court ruled in that case that any claims resulting from faulty workmanship, whether based in tort or contract, did not qualify as an “occurrence.”

The legislature took up the policyholder’s cause and passed Hawaii Revised Statute § 431:1. According to the legislative findings, the *Group Builders* case created “uncertainty in the construction industry,” and ran against construction professionals’ “reasonable, good-faith understanding that bodily injury or property damage resulting from construction defects would be covered under the insurance policy.” The statute provides: “For purposes of a liability insurance policy that covers occurrences of damage or injury during the policy period and that insures a construction professional for liability arising from construction-related work, the meaning of the term ‘occurrence’ shall be

construed in accordance with the law as it existed at the time that the insurance policy was issued.”

Unlike the clear language of the Colorado, Arkansas and South Carolina law, the language of the Hawaii statute will likely be subject to more intense judicial scrutiny.

In general, the promulgation of legislation aimed at insurance coverage for defective construction is a step in the right direction. Policyholders and insurers alike benefit from having a clear understanding of what general liability insurance covers when construction projects go awry. States, too, have a significant interest in protecting policyholders who may otherwise suffer catastrophic business losses when insurance coverage falls through. In this respect, Colorado’s law is among the clearest and strongest pro-policyholder approach to the issue.

Arkansas and South Carolina also took a clear position, with both state’s laws effectively precluding insurers from arguing no coverage when faulty workmanship causes damage to third-party property. Hawaii’s law is less than clear, however, and policyholders in that state will likely have a difficult time obtaining coverage even under policies issued prior to the *Group Builders* decision.

The practical effect of the laws outlined here remains to be seen. What is certain, however, is that legislative involvement will likely continue well into this decade. ■