HUNTON& WILLIAMS

INSURANCE LITIGATION ALERT

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Contacts

McLean Office
1751 Pinnacle Drive, Suite 1700
McLean, VA 22102

Walter J. Andrews
(703) 714-7642
wandrews@hunton.com

Lon A. Berk
(703) 714-7555
lberk@hunton.com

Edward J. Grass
(703) 714-7649
egrass@hunton.com

Paul E. Janaskie
(703) 714-7538
pjanaskie@hunton.com

Washington DC Office
1900 K Street, NW
Washington, DC 20006

Neil K. Gilman
(202) 955-1674
ngilman@hunton.com

John W. Woods
(202) 955-1513
jwoods@hunton.com

Atlanta Office
Bank of America Plaza, Suite 4100
600 Peachtree Street, NE
Atlanta, GA 30308

Lawrence J. Bracken II
(404) 888-4035
lbracken@hunton.com

New York Office
200 Park Avenue
New York, NY 10166

Robert J. Morrow
(212) 309-1275
rmorrow@hunton.com

Charlotte Office
Bank of America Plaza, Suite 3500
101 South Tryon Street
Charlotte, NC 28280

Dana C. Lumsden
(704) 378-4711
dlumsden@hunton.com

Ruth S. Kochenderfer of the firm's McLean office authored this Alert.

Florida Supreme Court Holds that Defective Work Is an Occurrence Under a CGL Policy but Costs for Repairing Defective Work Are not Property Damage

The Florida Supreme Court has held that defective work performed by a subcontractor that damages a general contractor's completed work constitutes "property damage" caused by an "occurrence" under a commercial general liability (CGL) policy. *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, No. SC05-1295 (Fla. Dec. 20, 2007). In a companion decision issued on the same day, the Florida Supreme Court held that the costs of repairing or removing the defective work itself do not constitute "property damage" under a CGL policy. *Auto-Owners Ins. Co. v. Pozzi Window Co.*, No. SC06-779 (Fla. Dec. 20, 2007).

U.S. Fire Ins. Co. v. J.S.U.B., Inc.

Factual and Procedural Background

In *JSUB*, the coverage dispute arose out of a lawsuit against insured general contractors/homebuilders J.S.U.B., Inc., and Logue Enterprises, Inc. (collectively, JSUB), for alleged damage to the foundations, drywall, and other interior portions of homes. The cause of the alleged damage was JSUB's subcontractors' use of poor soil and of improper soil compaction and testing.

JSUB sought coverage for the alleged damage to the homes under a CGL policy issued to JSUB by United States Fire Insurance Company (US Fire). US Fire agreed to cover damage to the homeowners' personal property, but disclaimed a duty to provide coverage for the costs to repair the structural damage to the homes. JSUB repaired the homes and filed a declaratory judgment action against US Fire in Florida state court.

The state trial court held in favor of US Fire on the basis that there was no coverage for faulty workmanship. An intermediate appellate court disagreed and reversed the trial court. Because of a split between intermediate appellate courts on the issue of whether there is coverage for defective construction, the Florida Supreme Court accepted jurisdiction.

Holding and Analysis

The Court held that a claim made against a contractor for damage to a completed project caused by a subcontractor's defective work is an occurrence under a CGL policy.

The Court began by examining the history of the CGL policy. This history revealed that prior to 1986, the standard CGL policy

excluded coverage for an insured's work — the "your work" exclusion — and did not contain an exception for property damage caused by a subcontractor's work. Beginning in 1986, the CGL policy contained such an exception to the "your work" exclusion. The Court noted, however, that this history did not answer the question of whether there is coverage for defective construction under the insuring agreement of a CGL policy.

To answer that question — the "threshold issue" of whether there was an occurrence, the Court first reviewed its prior decision in *Shelby Mutual Insurance Company v. LaMarche*, 390 So.2d 325 (Fla. 1980). *LaMarche* held that there was no coverage for defective work and stated that "the purpose of comprehensive liability insurance coverage is to provide protection for . . . damage caused by the completed product, not for the repair or replacement of that product." The Court explained that "[a]lthough *LaMarche* used broad language regarding the purpose of CGL policies, *LaMarche*'s ultimate determination that there was no coverage for repair or replacement of the contractor's own defective work was based on the policy exclusions, not the insuring provisions." Based on this, the Court reasoned that *LaMarche* did not stand for the proposition that defective work can never constitute an occurrence. The Court concluded that *LaMarche* did not control the case before it.

In the case before it, the Court held that defective construction was an occurrence. The Court reasoned that faulty workmanship and a breach of contract can constitute an occurrence because a CGL policy provides "coverage not only for 'accidental events,' but also injuries or damages neither expected nor intended from the standpoint of the insured." (quoting *State Farm Fire & Cas. Co. v. CTC Development Corp.*, 720 So.2d 1072, 1076 (Fla. 1998)). The Court rejected a definition of an occurrence that "renders damage to the insured's own work as a result of a subcontractor's faulty workmanship as expected, but renders property damage to property of a third party caused by the same faulty workmanship unexpected." The Court stated that whether or not something is an occurrence is not dependent on what property was damaged.

The Court also reasoned that if defective construction was not an occurrence, then there would be no need for the subcontractor exception to the "your work" exclusion.

The Court also rejected US Fire's argument that if defective construction was an occurrence, it would transform a CGL policy into a performance bond. The Court explained that a CGL policy and performance bond protected against different risks. A CGL policy indemnifies an insured for property damage arising after the project's completion, whereas a performance bond guarantees the completion of a project upon a contractor's default.

After finding that defective construction was an occurrence, the Court analyzed whether the occurrence caused property damage. US Fire argued that faulty workmanship that only injures the work product itself was not property damage. The Court disagreed and stated that "defective work that has damaged the otherwise nondefective completed project" is property damage. Notably, the Court recognized that "[i]f there is no damage beyond the faulty workmanship or defective work, there may be no resulting property damage." Because there was structural damage to the completed homes, the Court held that the claim against the general contractor was a claim for property damage.

Auto-Owners Ins. Co. v. Pozzi Window Co.

Factual and Procedural Background

The *Pozzi Window* case arose out of a suit by a homeowner for the defective installation of windows by a subcontractor of a builder. Auto-Owners, the builder's CGL insurer, paid for the damage caused by the leaking windows, but refused to pay for the repair or replacement of the windows. Pozzi, the window manufacturer, settled with the homeowner and builder and then filed suit against Auto-Owners, as the builder's assignee.

A Florida federal district court held that there was coverage for the repair and replacement of the defective windows. On appeal, the United States Court of Appeals for the Eleventh Circuit certified the following question to the Florida Supreme Court:

Does a standard CGL policy with products completed operations hazard coverage . . . issued to a general contractor, cover the general contractor's liability to a third party for the costs of repair or replacement of defective work by its subcontractor?

Holding and Analysis

For reasons similar to those in *JSUB*, the Court held that the defective installation of the windows was an occurrence.

As to whether there was property damage, the Court stated that the "discrete

issue of whether Auto-Owners' policies provide coverage for the repair or replacement of the defective windows is different from the issue we decided in *JSUB*" and that the difference is "dispositive." The difference, in the view of the Court, is "between a claim for the costs of repairing or removing defective work, which is not a claim for 'property damage,' and a claim for the costs of repairing damage caused by the defective work, which is a claim for 'property damage.'" Unlike the structural damage to the homes in *JSUB*, the Court reasoned that the "defective installation of the windows is not itself 'physical injury to tangible property.'" Instead, "'the alleged defect is the equivalent of the 'mere inclusion of a defective component' such as the installation of a defective tire, and no 'property damage' has occurred." (quoting *Travelers Indem. Co. of Am. v. Moore & Assocs., Inc.*, 216 S.W.2d 302, 310 (Tenn. 2007)). Because there was no property damage, the Court answered the certified question in the negative and held that there was no coverage for the repair and replacement costs of the windows.

Implications

In *JSUB* and *Pozzi Window*, the Florida Supreme Court weighed in on the growing national debate over whether defective or faulty workmanship is covered under a CGL policy. In *JSUB*, the Court held that a subcontractor's faulty workmanship that causes damage to other work may constitute property damage caused by an occurrence under a CGL policy issued to a general contractor. In *Pozzi Window*, on the other hand, the Court held that if a subcontractor's faulty workmanship is limited to the subcontractor's own work, there is no property damage and thus no coverage under a general contractor's CGL policy.

After these two decisions, an insurer construing Florida law must carefully review the pleadings and facts to determine if allegations of faulty workmanship trigger coverage under a CGL policy. If the allegations of faulty workmanship are limited to the work itself, then there may be no coverage. If there are allegations that the faulty workmanship damaged other work, there may be coverage for the damage to the other work, but not to the actual work.