Interpreting Insurance Policies – When Courts Take Shortcuts

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When a witness or deponent is being asked as to their understanding of a letter, email or other document, it is not uncommon to hear the objection "the document speaks for itself." I will admit that I take this too literally, but this objection (which usually means objecting counsel doesn't want to discuss the document) reminds me of the old joke:

"What time does your watch say?"
"It doesn't say anything; you have to look at it."

Any documents, in particular insurance policies, don't say anything – you do have to read them. The point, of course, is that the actual words used (when read closely) usually determine the coverage provided and excluded by the policy.

In interpreting insurance policy wording, courts are fond of making very clear that figuring out what the wording means is their business – and their business alone. Statements like "the interpretation of an insurance policy is a question of law for the courts to decide" are a testament to this unequivocal assertion of their authority. Some courts even go as far as to explain how they go about their work "Our primary goal in interpreting a policy, as with any contract, is to ascertain the parties' intent as manifested by the policy's terms." 401 Fourth Street v. Investor's Insurance Co., 879 A2d 166 (Pa 2005).

Our Court System Unlike many in the insurance and risk business, I do not consider our civil courts to be out of control or badly in need of repair. Despite sensational reports, plaintiffs do not always receive huge awards for the smallest of injuries. Likewise, judges do not automatically side with policyholders in all matters of coverage dispute.

In my opinion, our courts ultimately get it right much more often than they get it wrong, and get it right for the correct reasons. It is from this perspective that I offer the following observations.

Defective Construction Over the past few years, a disturbing trend has developed as to how some courts decide whether Commercial General Liability insurance applies to defective construction or defective work claims.

Framing the Question In some, but certainly not all instances, insurers have successfully denied coverage for defective work claims with some novel arguments, all of which have a common underlying strategy – direct the court's focus away from considering the wording of the *entire* CGL policy. Rather, the insurers attempt to reduce the coverage dispute to one question – is it the intent of the CGL policy to pay for "faulty workmanship?"

In other words, if insurers can, at the outset, convince the courts that such claims were never intended to by covered and thus fall outside of the CGL insuring agreement, there is no need for

the courts to grapple with all of those messy property damage exclusions and their exceptions - rendering the policy exclusions and exceptions to those exclusions superfluous.

Disregarding Policy Wording While the CGL does not and should not provide coverage for claims that do not come within its insuring agreement, what is troubling here is the vague assertions and broad platitudes put forth by insurers that are embraced by the courts as sufficient legal interpretation of coverage. Typical contentions by insurers that defective work claims are *never covered* include the "business risk doctrine" or the CGL is not a "performance bond." Even a superficial reading of the CGL reveals that these contentions are not based on actual policy wording. While such considerations may be valuable in determining the meaning of certain policy terms, particularly exclusions to coverage, such sweeping doctrines are not in themselves exclusions to coverage and should not be treated as such as by the courts.

Faulty Workmanship not an Occurrence This problem is well illustrated by one of the more prominent cases – L-J, Inc. v. Bituminous Fire & Marine Ins. Cas. Co., 621 S.E.2d 33 (S.C. 2005) – in which the South Carolina Supreme Court overturned both the trial and appellate courts' finding of coverage, instead concluding that "faulty workmanship can never constitute an 'occurrence' under the CGL."

In this case, L-J, Inc. contracted to build roads for a real estate developer. L-J, Inc. engaged subcontractors to perform the road work, including compaction of the road bed. The subcontractor's compaction work was done improperly, resulting in deterioration of the road. The developer (owner) brought an action against L-J, Inc. for the cost to repair the cracked and deteriorated road.

The South Carolina Supreme Court in their 2005 decision found that property damage to the road *did* occur as the result of the subcontractors' negligence in compaction of the road bed.

Despite a finding of negligence, the court held that faulty workmanship cannot be an "occurrence" as defined under a CGL policy as faulty workmanship is not something that typically is caused by an "accident." In court's view, any other finding would convert the CGL into a performance bond.

In a footnote (number [4]), the court did conclude the policy *may provide coverage* in cases where faulty workmanship causes property damage *to other property*, not in cases where faulty workmanship damages the work product alone.

Even though the South Carolina Appellate Court found coverage for L-J, Inc. due to the subcontractor exception to the Your Work exclusion, the Supreme Court did not consider any exclusion or exception. Instead, the Supreme Court concluded that faulty workmanship cannot be accidental and therefore not an occurrence – no coverage existed and the court declined to read any further into the policy.

Faulty Workmanship as an Accident While it is certainly possible that faulty workmanship may be intentional, such as a contractor who *chooses* to cut corners and *knowingly* produces shoddy work, to presume that faulty workmanship *cannot ever* be accidental stains common sense.

As any "do it yourself" homeowner knows, projects can go terribly wrong - despite the best of intentions. It seems obvious that inadvertent errors combined with a lack of skill or competence is often at the root of faulty workmanship.

Damage to Property of Others The CGL policy *definition* of property damage is not limited to the *property of others*. Restrictions to whose property the CGL will respond when damaged are found in the CGL policy's *property damage policy exclusions*, not in the basic insuring agreement as the L-J, Inc. Court found.

The footnote that states faulty workmanship which damages third party property may be covered by the CGL is very curious indeed. The court seems to suggest that damage to the work itself is never accidental, but the same incident *becomes* accidental if the damage happens to extend to other property. This is roughly analogous to saying that if I damage my car by negligently colliding with another vehicle, it is only an accident if the other vehicle is damaged.

Coverage Explanation – From 1971 A slightly different approach to no coverage for faulty workmanship can be found in the Supreme Court of Pennsylvania 2006 case of Kaverner Metals et al v. Commercial Union et al.

The Supreme Court of Pennsylvania similarly decided that the definition of accident (and thus "occurrence") cannot be satisfied by claims based upon faulty workmanship. The oft quoted law review article by Roger C. Henderson entitled Insurance Protection for Products Liability Completed Operations; What Every Lawyer Should Know, 50 Neb. L. Rev 415, 441 (1971) appears to be the prime basis (in addition to L-J, Inc. among other cases) for the court's understanding of the application and limitations of CGL policies.

While Mr. Henderson's law review article is no doubt very insightful, it should not be relied upon in lieu of actually reading the policy. Possibly more importantly, Mr. Henderson's commentary was based on a review of the 1966 edition of the Comprehensive General Liability policy, which bears little resemble to today's CGL policy. The 1966 edition of the CGL policy was much more limited in scope and did not contain the subcontractor's exception to the Your Work exclusion that is a crucial element of coverage in today's CGL.

Nonetheless, law clerks seem to dust off Mr. Henderson's article every time the phrase "faulty workmanship" appears, even though a closer look should reveal that the article is not only dated, but may be irrelevant to the case at bar considering it pertains to entirely different policy wording.

Of course, there are other similar arguments made by insurers as to why faulty workmanship does not fall within the CGL insuring agreement, such as the CGL policy does not cover property damage that results from a breach of contract. The underlying reasoning is basically the same – a breach of contract is not accidental and therefore not an occurrence. As noted above, failing to correctly perform a contract may very well be inadvertent and accidental – the broad brush shortcut doesn't fit here, either.

The "breach of contract" argument has an additional wrinkle, however. Insurers have argued that the CGL policy provides coverage only for liability imposed in tort and that liability based on contract is not covered – despite the fact that today's CGL makes no such distinction in its insuring agreement.

The California Supreme Court in Vandenberg v. Centennial Ins. Co., 21 Cal. 4th 815, 982 P.2d. 229 (1999) overruled previous cases and found "legally obligate to pay as damages" refers to *any obligation* which is binding and enforceable under the law, whether by contract or tort liability. Nonetheless, some insurers continuously attempt to dismiss faulty workmanship claims based on the tort versus contract distinction.

Conclusion Insurer's attempts to divert the court's attention away from the reading the *entire policy* so the insurer may more expediently deny faulty workmanship claims has met with a growing amount of success. If courts continue to settle for analytical shortcuts in their interpretations of the CGL policy, such as relying on 36 year old treatises that are commenting on entirely different CGL policies or on broad generalizations of intent that may not be reflected in the policy, a spate of poorly reasoned decisions will likely follow.

It is time to put into perspective Mr. Henderson's treatise; it is also time to critically examine the broad, vague and sweeping generalizations of coverage intent urged by insurers. There is no substitute for *reading the entire policy* to understand the intent of the parties, regardless of how tedious it may be. Ultimately, such an analysis may find no coverage for faulty workmanship claims under the CGL – not necessarily because there is not an accident or there is no property damage or the property damage results from a breach of contract, but because the property damage is *excluded by the policy.* Denying coverage for the right reasons is far preferable to denying coverage for the wrong reasons. Shortcuts taken in coverage interpretation and construction are likely to leave the next policyholder without the coverage they purchased because a prior decision, incorrectly decided, is now broadly applied to a different set of facts.

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