Dramatic Changes on the Horizon for CGL Coverage Law

by Robert Horkovich and Scott Turner

Recent changes in national case law suggest that a major shift is under way for CGL coverage of property damage to an insured contractor's own work. Contractors of all tiers, property and project owners and developers, risk managers, and concerned others should watch this development closely.

For many years, perhaps as many as 50% of the U.S. jurisdictions that considered the point completely barred CGL coverage for property damage to an insured contractor's own work under one theory or another, such as by holding that defective construction cannot satisfy the "occurrence," "property damage" or "legally obligated" requirements in the CGL policy insuring agreement. Courts and commentators sometimes lump these theories together under the banner of "business risk doctrine," as they are motivated by the underlying and mistaken belief that to allow such coverage would encourage negligent construction practices. (Of course, this begs the question, "Why are lawyers, doctors and design professionals deemed trustworthy of insurance for their mistakes, while contractors are not?" There's a musty whiff of old school class prejudice in the air here.)

That position starkly contradicted the ISO policy drafters' original intent for the modern CGL and the policy language, which carefully delineates between many such business risks that the drafters intended to insure and those they deemed uninsurable, usually because of moral hazard. Originally, this partial—but very substantial—coverage for property damage to the policyholder's own work was known as "broad form coverage," as it was first available by an endorsement of that name. Since 1985, that coverage was drafted into the body of the standard CGL forms, but the name for this aspect of CGL coverage lingers on. An example of this coverage is the current "your work Exclusion, exclusion l," which begins by excluding coverage for any property damage to the policyholder's completed work. But it then carves out a significant exception for property damage either caused by the work of the policyholder's subcontractors or that was experienced by work performed by subcontractors. Of course, most general contractors perform most, if not all, of their work through subcontractors, so this subcontractor exception largely voids the exclusion. Other aspects of broad form coverage allow coverage for many instances of property damage to a policyholders' on-going work by way of limitations and qualifications to standard exclusions j.(5) and j.(6).

So, there is a great deal of coverage that was always intended to be covered by the policy drafters, and for which construction industry policyholders have paid billions of dollar over the last four decades. Sadly, the courts in the many business risk doctrine jurisdictions have wrongly nullified this coverage, affecting an enormous unearned transfer of wealth from the construction industry to the insurance industry.

Over the last several years, however, previously undecided states have gone pro-coverage, and formerly anti-coverage states are switching sides. In this year alone, the influential Second Circuit of the U.S. Court of Appeals and the supreme courts of Connecticut, West Virginia and Georgia have all turned away from the business risk doctrine and upheld one or more aspects of broad form coverage. The Second Circuit did so applying Connecticut law, but on a basis that suggests it will take the same pro-coverage position in the next New York case it hears. That would force the New York state courts to seriously re-examine their position and probably follow suit. Even Alabama, a bastion of the business risk doctrine, signaled its awareness of the trend and its willingness to reconsider its historically anti-coverage stance this September. In several other states, the legislatures have intervened to correct their courts' mistake.

If your company is located in, or does business in, a business risk doctrine state, that state's position is now subject to switching overnight to recognizing and upholding broad form coverage. You should hedge your bets accordingly. But how?

First, educate yourself as to the nuances of broad form coverage and the considerable body of law surrounding its enforcement as developed in the many pro-coverage states.

Second, while awaiting the change, don't sell off or impair your broad form coverage for a modestly lower premium, such as by accepting endorsements CG 22 94 10 01 or CG 22 95 10 01 which eliminate or weaken

the subcontractor exception in the your work exclusion.

Third, the change in the law will probably apply retroactively, so today's coverage claim will fall under tomorrow's new coverage law. Until that change arrives, preserve coverage for your current claims by tendering now despite the bad current law, receiving a denial of coverage from the insurance company, negotiating an agreement with them to toll the statute of limitations on the claim, and settling the claim with your own money (just as you have been doing). This way, if or when the change comes, you will have preserved a strong claim for reimbursement.

Finally, prepare for the enormous changes the new law will usher in. Construction claims handling is revolutionized when broad form coverage is recognized and applied. Insurance companies—sometimes scores of them—must be included in the already crowded, multi-lateral, settlement negotiations. Become aware of how such claims are being handled in the traditionally pro-coverage states. Locate and use construction coverage litigation counsel who are experts at pursuing broad form coverage and have established credibility on point with the insurance companies.

Robert M. Horkovich *is managing partner and shareholder in the New York office of Anderson Kill. He is a trial lawyer who has obtaining more $5 billion in settlements and judgments for policyholders from insurance companies.*

Scott C. Turner *is of counsel in Anderson Kill's Washington, D.C., and Ventura, California, offices. He is a construction insurance attorney with over 20 years of experience securing insurance recoveries for property losses and in securing defense and indemnification for liability resulting from construction disputes and defects.*

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