

New York's Approach to Faulty Work and the Term “Occurrence” in Commercial General Liability Insurance Policies

Richard M. Hauser Jr.

Follow this and additional works at: <https://scholarship.law.stjohns.edu/lawreview>

This Note is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact selbyc@stjohns.edu.

NEW YORK’S APPROACH TO FAULTY WORK AND THE TERM “OCCURRENCE” IN COMMERCIAL GENERAL LIABILITY INSURANCE POLICIES

RICHARD M. HAUSER JR.[†]

INTRODUCTION

Imagine the following scenario: A large power plant hires a global construction firm to produce eight reactors designed to remove toxic pollutants from exhaust that the plant releases into the atmosphere. The reactors are large and extremely complicated pieces of machinery, so the construction company subcontracts the manufacturing and installation of their internal components to multiple different subcontractors. Shortly after the power plant puts three of the reactors into operation, plant supervisors discover cracking and fracturing in the reactors caused by a defect in an internal gas riser manufactured by a subcontractor. The damage to those reactors is so severe that they must be completely replaced. And while the plant has not begun operating the other five reactors, the construction company already installed the same faulty gas riser in them. Workers cannot replace the faulty gas risers in the tight confines of the reactors without damaging them.

The construction company incurs over \$200 million in costs repairing the reactors for the power plant. Luckily, they procured commercial general liability (“CGL”) insurance to cover their work on the reactors before they began the project. A payout within the limits of the policy would indemnify them for a great deal of the repair costs. But the insurance company refuses to pay, claiming that the damage to the reactors is not covered under the CGL policy. First, they insist that the damage to the reactors is not a coverable occurrence as defined in the policy because it was caused by the subcontractor’s faulty work, and faulty work is foreseeable. Second, they argue that even if it was

[†] Richard M. Hauser Jr. is a graduate of St. John’s University School of Law, Class of 2020.

an “occurrence,” the damage is not coverable under the policy because it occurred to the work that was the subject of the construction contract and not to the property of a third party as defined in the policy.

This exact factual scenario is the subject of *Black & Veatch Corp. v. Aspen Insurance (U.K.) Ltd.*¹ There, the Tenth Circuit held that under New York law, faulty subcontractor work can be a coverable occurrence under a standard form CGL policy, and the faulty gas riser installation at issue was such an occurrence.² The court also found that the damage to the reactors was property damage as defined in the CGL policy, and therefore the company was entitled to indemnification for the cost of repairing that damage.³ If this decision is indicative of how the New York Court of Appeals would rule, then New York will join the “overwhelming trend” of state supreme courts that recognize faulty work as an occurrence.⁴

CGL coverage for faulty subcontractor work is important for two reasons. First, denying contractors indemnification for damages caused by faulty subcontractor work would force them to “ha[ve] a supervisor at the elbow of each subcontractor at all times,” which would be “prohibitively expensive” unless they passed that cost onto their customers.⁵ Second, unsophisticated consumers may expect the CGL policies they purchase with hard-earned money to cover faulty work by their subcontractors, only to get burned when that very contingency occurs. While a multinational engineering firm like Black & Veatch may have in-house counsel to peruse insurance contracts, the neighborhood contractor has neither the sophistication nor the bargaining power to negotiate for provisions in the insurer’s form contract.

Even if faulty work is considered a coverable occurrence, yet another issue arises: Should that coverage include indemnification for the cost of repairing and replacing the faulty work itself, or merely for damage to other property caused by that faulty work? The court in *Black & Veatch Corp.* did not have occasion to answer this question because the policy at issue defined cov-

¹ 882 F.3d 952, 954–56 (10th Cir. 2018), *cert. denied*, 139 S. Ct. 151 (2018).

² *Id.* at 971.

³ *Id.* at 963–64.

⁴ *Id.* at 971.

⁵ *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 890 (Fla. 2007) (quoting 2 JEFFREY W. STEMPEL, *STEMPEL ON INSURANCE CONTRACTS* § 14.13[D], at 14-224.8 (3d ed. Supp. 2007)).

erable property damage as damage to the property of a third party.⁶ The court concluded that the reactors belonged to the power plant, which was a third party under the terms of the policy.⁷ Therefore, all of the damage was coverable under the policy, including the cost of repairing and replacing the reactors that had been assembled with the faulty gas risers but had not yet been put into operation.⁸ Nonetheless, this question is an important one because contractors who expect to be indemnified for damage caused to other property by faulty subcontractor work may also expect to be indemnified for the cost of repairing and replacing the faulty work itself, since both result from the accidental error of a subcontractor. While a majority of states recognize faulty work as an occurrence, only a handful of those states consider the cost of repairing and replacing the faulty work itself to be coverable property damage under standard form CGL policies.⁹

In October of 2018, the Supreme Court of Ohio held that faulty subcontractor work was not a coverable occurrence under standard form CGL policies in an extraordinary “spurning”¹⁰ of the national trend.¹¹ As this Note discusses below, the Supreme Court of Ohio’s holding was based on precedent that applied a flawed understanding of CGL policies to the issue of faulty work. Fortunately, the New York Court of Appeals is not bound by similar precedent.¹²

In the face of urgency created by the Supreme Court of Ohio’s decision, this Note argues that the New York Court of Appeals should hold that faulty work is a coverable occurrence under standard form CGL policies, and the cost of repairing and replacing the faulty work itself is coverable “property damage.” Part I of this Note defines standard form CGL policy language, such as “occurrence,” “property damage,” and “accident.” Part I also explores relevant exclusions that limit coverage and the

⁶ *Id.*

⁷ *Black & Veatch Corp.*, 882 F.3d at 963–64.

⁸ *See id.*

⁹ *See* Christopher C. French, *Revisiting Construction Defects as “Occurrences” Under CGL Insurance Policies*, 19 U. PA. J. BUS. L. 101, 126, 128–29 (2016).

¹⁰ Jeff Sistrunk, *Ohio Justices Say Bad Subcontractor Work Not an “Accident,”* LAW360 (Oct. 9, 2018), <https://www.law360.com/articles/1090223> [<https://perma.cc/VXD5-XVZD>].

¹¹ *Ohio N. Univ. v. Charles Constr. Servs., Inc.*, 155 Ohio St. 3d 197, 2018-Ohio-4057, 120 N.E.3d 762, at ¶ 3.

¹² *See infra* Part II.

exceptions to those exclusions. Part II discusses New York law with respect to CGL policies, starting with a brief analysis of the doctrines of policy interpretation, followed by an analysis of the leading New York intermediate appellate court case, which holds that faulty work is not an occurrence. Part II then contrasts that case with the *Black & Veatch Corp.* holding.

Part III discusses a scholarly approach to CGL policy interpretation referenced by the court in *Black & Veatch Corp.* The thesis is that faulty work should always be considered an occurrence unless it is subjectively expected or intended by the insured. Part III then discusses cases from other states' highest courts that apply a similar subjective standard and contrasts those cases with the Supreme Court of Ohio's recent decision in *Ohio Northern University*, which applied a more objective standard. Part IV discusses an issue not raised in *Black & Veatch Corp.*—namely, whether the cost of repairing and replacing the faulty work itself is coverable property damage under standard form CGL policies.

Finally, Part V makes the case that the New York Court of Appeals should hold that faulty subcontractor work is a coverable occurrence under standard form CGL policies. First, Part V concludes that the *Black & Veatch Corp.* court correctly distinguished the leading New York intermediate appellate court case based on its facts and a major difference in the CGL policy at issue. Second, Part V argues that the New York Court of Appeals should adopt a subjective standard rather than an objective standard like the one applied by the Supreme Court of Ohio. Last, Part V contends that the New York Court of Appeals should also hold that the cost of repairing and replacing the faulty work itself is included in the definition of coverable “property damage” under standard form CGL policies.

I. STANDARD FORM CGL POLICY LANGUAGE

The standard form CGL policy issued by the Insurance Services Office (“ISO”)¹³ since 2013¹⁴ employs a three-part structure:

¹³ The Insurance Services Office is the primary developer of standard CGL policy forms for state insurance regulators in the United States. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 772 (1993) (“[The] ISO develops standard policy forms and files or lodges them with each State’s insurance regulators; most CGL insurance written in the United States is written on these forms.”). The standard form policy can then be tailored to the needs of the insurer or insured by way of “endorsements” that amend the policy language. *Black & Veatch Corp.*, 882 F.3d at 958 (“[The] ISO

(a) the basic insuring agreement determines initial coverage, (b) the various exclusions narrow the scope of coverage, and (c) the various exceptions to those exclusions restore coverage.¹⁵

A. *Initial Coverage Under CGL Policies and Definitions of Relevant Policy Language*

The standard form policy provides the following basic insuring agreement language:

SECTION I—COVERAGES

COVERAGE A—BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

- a. We will pay those sums that the insured becomes legally obligated to pay as damages because of . . . “property damage” to which this insurance applies. . . .
- b. This insurance applies to . . . “property damage” only if:
 - (1) The . . . “property damage” is caused by an “occurrence” that takes place in the “coverage territory”¹⁶

Under the basic agreement, “the insurer agrees to pay those sums that the insured becomes *legally obligated* to pay as *damages* because of . . . *property damage* . . . caused by an *occurrence* that takes place in the *coverage territory*.”¹⁷ This essentially imposes a dual requirement for coverage. There must be: (1) property damage, and (2) an occurrence.

maintains a large portfolio of ‘endorsements,’ language that can be used to amend a standard CGL policy to suit the needs of the insured or insurer” (citation omitted).

¹⁴ The ISO has instituted several major revisions in the standard form CGL policies it has issued since 1940. *Black & Veatch Corp.*, 882 F.3d at 959–60. The most recent was in 2013. See Laurie Infantino, *ISO Form Changes Commercial General Liability*, INSURANCE THOUGHT LEADERSHIP (Mar. 19, 2013), <https://www.insurancethoughtleadership.com/iso-form-changes-commercial-general-liability/> [https://perma.cc/EBM3-YZNV]. This Note discusses the most relevant changes for faulty work jurisprudence. See *infra* Section I.B.

¹⁵ *Black & Veatch Corp.*, 882 F.3d at 958 (“The basic insuring agreement is then subject to exclusions, which narrow the scope of coverage. The exclusions are then subject to exceptions, which restore coverage—but only to the extent coverage was initially included in the basic insuring agreement.”).

¹⁶ Ins. Servs. Off., Inc., Form No. CG 00 02 04 13, Commercial General Liability Coverage Form (2013) [hereinafter Coverage Form (2013)], reprinted in DONALD S. MALECKI ET AL., COMMERCIAL GENERAL LIABILITY COVERAGE GUIDE 549, 549 (12th ed. 2017).

¹⁷ MALECKI ET AL., *supra* note 16, at 1.

There are two kinds of “property damage.” The first is “[p]hysical injury to tangible property, including all resulting loss of use of that property.”¹⁸ For this kind of property damage, “[a]ll such loss of use shall be deemed to occur at the time of the physical injury that caused it.”¹⁹ The second is “[l]oss of use of tangible property that is not physically injured.”²⁰ For the second kind of property damage, “[a]ll such loss of use shall be deemed to occur at the time of the ‘occurrence’ that caused it.”²¹ Notably, neither kind distinguishes between tangible property that is the subject of the insured’s own work and tangible property that is owned by a third party—both simply encompass tangible property.²² Moreover, both kinds encompass loss of use of tangible property, differentiated by its cause; the former covers loss of use caused by physical injury, while the latter covers loss of use that is simply caused by an “occurrence.”

An “[o]ccurrence,” the second requirement for coverage, is defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”²³ Modern standard form CGL policies do not define the term accident, but exclude “‘[b]odily injury’ or ‘property damage’ expected or intended from the standpoint of the insured” from coverage.²⁴

¹⁸ Coverage Form (2013), *supra* note 16, at 565.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² See French, *supra* note 9, at 105 (“Notably, the definition does not make a distinction between property that is created by the contractor/policyholder (i.e., the contractor’s workmanship) and separate property owned by a third party . . .”).

²³ Coverage Form (2013), *supra* note 16, at 564.

²⁴ *Id.* at 549. The definition of “occurrence” in modern CGL forms differs from the definition given in the 1973 ISO form, which defined “occurrence” as “an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage *neither expected nor intended from the standpoint of the insured.*” Ins. Servs. Off., Inc., Form No. GL 00 02 01 73, Comprehensive General Liability Insurance Coverage Form (1973) [hereinafter Coverage Form (1973)], reprinted in MALECKI ET AL., *supra* note 16, at 489 (emphasis added); see also French, *supra* note 9, at 105–06. The “expected or intended” language was moved to the exclusions section in the ISO’s 1986 policy revision, but the change was not intended to affect the requirement that an “occurrence” must be fortuitous. MALECKI ET AL., *supra* note 16, at 7 (“Despite the change in the wording of the occurrence definition, the effect is intended to be the same as in the 1973 policy. Thus, whether it can be said that bodily injury or property damage is *caused by an occurrence* still hinges on fortuity.”). The “continuous or repeated exposure” language means that the definition of occurrence is not limited to a single event but encompasses gradual exposure. *Id.* at 404 (“[T]he phrase ‘continuous or repeated exposure’ eliminates the necessity of proving the exact moment at which damage is sustained.”).

The effect of this language is to provide coverage for “property damage” the insured did not expect or intend to be caused by their actions, whether their actions alone were intentional or not.

B. The Business Risk Exclusions from Coverage Under CGL Policies

The initial coverage provided under the basic insuring agreement is then limited by several exclusions. Traditionally, insurers do not cover “business risk[s],” such as liability for the insured’s breach of implied or express contractual warranties that the insured’s work will be performed according to particular specifications.²⁵ Numerous kinds of business risks are excluded from coverage under standard form CGL policies.²⁶ The most relevant exclusion in the contracting context is “Exclusion L,” or the “Your Work”²⁷ exclusion, which provides that the insurance does not apply to:

l. Damage To Your Work

“Property damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard.”

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.²⁸

A brief discussion of the history and development of the “Your Work” exclusion in ISO policies is instructive as to its meaning. The 1973 ISO policy excluded coverage for “property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof.”²⁹ The language “or on behalf of the named insured” served to exclude coverage for damage to the insured’s own work even if it was caused by someone working on behalf of the insured—that is, a subcontractor. This provision in the 1973 policy reflected that property damage to the insured’s own work caused by faulty work was an inherent risk in the

²⁵ MALECKI ET AL., *supra* note 16, at 384.

²⁶ *Id.*

²⁷ *Black & Veatch Corp. v. Aspen Ins. (U.K.) Ltd.*, 882 F.3d 952, 958 (10th Cir. 2018) (“For consistency, we refer to this provision as the ‘Your Work’ exclusion.”), *cert. denied*, 139 S. Ct. 151 (2018).

²⁸ Coverage Form (2013), *supra* note 16, at 553.

²⁹ Coverage Form (1973), *supra* note 24, at 492.

construction business and thereby was excluded from coverage, even if the faulty work was performed by a subcontractor.³⁰

Contractors began to subcontract work more often, and by 1976, the ISO responded to pressure from the industry by removing the phrase “or on behalf of” from the “Your Work” exclusion, thereby restoring coverage for damage to the insured’s own work caused by a subcontractor.³¹ In 1986, the ISO clarified the “Your Work” exclusion by adding language that explicitly excepted subcontractor work.³² The effect of this language is to designate the insured and the subcontractor as separate entities under the “Your Work” exclusion, and provide that the insured will not be held liable for the subcontractor’s faulty work.³³

³⁰ *Black & Veatch Corp.*, 882 F.3d at 959 (“[S]ubcontractor-caused damage was considered a risk inherent to the construction business and explicitly excluded from coverage in CGL policies.”).

³¹ STEVEN PLITT ET AL., 9A COUCH ON INSURANCE § 129:19 (3d ed. 2019) (“[M]any general contractors were not satisfied with the lack of coverage In 1976, the insurance industry responded by the introduction of the Broad Form Property Damage Endorsement, which extended coverage to insureds for property damage caused by the work of their subcontractors.” (citing *Am. Fam. Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶¶ 67–68, 268 Wis. 2d 16, 673 N.W.2d 65)). See also *Black & Veatch Corp.*, 882 F.3d at 959 (“In response, the 1976 standard-form CGL policy eliminated the phrase ‘or on behalf of’ from the ‘Your Work’ exclusion. The policy thus broadened coverage by no longer excluding damages arising from faulty subcontractor work.”).

³² PLITT ET AL., *supra* note 31 (“The subcontractor exception to . . . ‘your work’ was added directly to the body of the policy in 1986.” (citing *Am. Fam. Mut. Ins. Co.*, 2004 WI 2, ¶¶ 67–68)). See also *Black & Veatch Corp.*, 882 F.3d at 959 (“In 1986, the ISO attempted to clear up this confusion by expressly stating in the standard-form CGL policy that the ‘Your Work’ exclusion does not apply ‘if the damaged work . . . was performed . . . by a subcontractor.’” (alterations in original)). The ISO explicitly stated in a contemporaneous circular that the revision to the “Your Work” exclusion was intended to provide coverage for “damage to, or caused by, a subcontractor’s work.” *Id.* (emphasis omitted) (quoting *Commercial General Liability Program Instructions Pamphlet Furnished*, CIRCULAR NO. GL-86-204 (Ins. Servs. Office, Inc., New York, N.Y.), July 15, 1986); see also *Cypress Point Condo. Ass’n v. Adria Towers, L.L.C.*, 143 A.3d 273, 282 (N.J. 2016) (citing *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 879 (Fla. 2007)).

³³ MALECKI ET AL., *supra* note 16, at 76–77.

II. NEW YORK LAW

A. *Doctrines of Policy Interpretation*³⁴

New York courts apply three doctrines of policy interpretation: (1) *contra proferentem*,³⁵ (2) the reasonable expectations doctrine,³⁶ and (3) a doctrine requiring that courts construe the policy as a whole.³⁷

1. *Contra Proferentem*

The doctrine of *contra proferentem* provides that any ambiguities in the policy language should be interpreted “in favor of coverage” and “against the insurers,” even if both parties offer “reasonable interpretations” of the ambiguous language.³⁸ The rationale for this doctrine is that the insurer is in the best position to resolve ambiguities in the policy language because the insurer creates the policy.³⁹

2. Reasonable Expectations Doctrine

The reasonable expectations doctrine provides that the “objectively reasonable expectations” of the consumer in purchasing insurance must be protected, even if the policy provisions “negate[] those expectations.”⁴⁰ The rationale for this doctrine is similar to the rationale for *contra proferentem*. Purchasers of insurance are unlikely to have the level of sophistication necessary to interpret ambiguities in the policy; therefore, the insurer is obligated to make sure the policy coverage meets the purchaser’s

³⁴ These are universal policies of insurance contract interpretation applied by courts around the country. *See* French, *supra* note 9, at 109 (“When courts are asked to interpret and apply policy language, such as the definitions of ‘occurrence’ and ‘property damage,’ there are three well-established rules of policy interpretation that are particularly relevant: (1) *contra proferentem*, (2) the ‘reasonable expectations’ doctrine, and (3) construction of the policy as a whole.”).

³⁵ 1 ROBERT D. GOODMAN & STEVE VACCARO, *NEW APPLEMAN NEW YORK INSURANCE LAW* § 15.02 n.6 (2d ed. 2020) (collecting New York intermediate appellate court cases and federal district court cases applying New York law).

³⁶ *Id.* nn.3–4 (collecting cases).

³⁷ *See Black & Veatch Corp.*, 882 F.3d at 960–61.

³⁸ French, *supra* note 9, at 109 (citing RESTATEMENT (SECOND) OF CONTRACTS § 206 (AM. L. INST. 1981)).

³⁹ *See id.* at 109–10, 109 n.20.

⁴⁰ Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

expectations when purchasing the policy, and any misinterpretations are weighed against the insurer.⁴¹

3. Construing the Policy as a Whole

Finally, courts construe insurance policies such that all of the policy language is afforded a “fair meaning,” and “no provision” is left “without force or effect.”⁴² In other words, no provision of the policy should be read in isolation, and coverage should be interpreted by reading all of the policy provisions together.⁴³

B. New York Cases Interpreting “Occurrence”

1. *George A. Fuller Co. v. United States Fidelity Guaranty Co.*: The Leading New York Case on Faulty Work Coverage

The New York Court of Appeals has not yet decided whether faulty work is an occurrence under standard form CGL policies.⁴⁴ The leading intermediate appellate court case is *George A. Fuller Co. v. United States Fidelity and Guaranty Co.*,⁴⁵ decided by the New York Appellate Division, First Department, in 1994.⁴⁶ There, the court held that a contractor was not entitled to indemnification for liability incurred due to faulty work.⁴⁷

In *Fuller*, a building owner hired the George A. Fuller Company (“Fuller”) to manage the construction of a mixed commercial and residential building in Manhattan.⁴⁸ The contractor retained a subcontractor to install wood flooring, an aluminum wall, and a

⁴¹ *Id.* at 969.

⁴² *Black & Veatch Corp.*, 882 F.3d at 960–61 (quoting Roman Cath. Diocese of Brooklyn v. Nat'l Union Fire Ins. Co. of Pittsburgh, 21 N.Y.3d 139, 148 (N.Y. 2013)).

⁴³ French, *supra* note 9, at 112.

⁴⁴ See *Black & Veatch Corp.*, 882 F.3d at 956–57.

⁴⁵ This Note regards *Fuller* as the leading Appellate Division case for three reasons. First, Aspen's lawyers in *Black & Veatch* “rel[ie]d heavily” on *Fuller*. *Id.* at 957. Second, the court itself pointed out that the other relevant appellate cases offered by Aspen either relied solely on *Fuller*, cited to other cases that relied on *Fuller*, or cited as persuasive *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979), a New Jersey Supreme Court case that was “effectively overturned” in *Cypress Point Condominium Ass'n v. Adria Towers, L.L.C.*, 143 A.3d 273 (N.J. 2016). *Black & Veatch Corp.*, 882 F.3d at 969–70. Third, other scholars have treated *Fuller* as the leading Appellate Division case as well. See, e.g., Qifu Li, Note, *What America Can Learn from Canada's Progressive Decision in Commercial General Liability Policy Coverage Litigation over Construction Defects*, 23 CARDOZO J. INT'L & COMPAR. L. 165, 166 (2014) (citing *Fuller* for the proposition that “New York's case law holds that construction defects are not occurrences within CGL policies”).

⁴⁶ 200 A.D.2d 255, 255 (1st Dep't 1994).

⁴⁷ *Id.* at 261–62.

⁴⁸ *Id.* at 257.

water system that complied with the city code.⁴⁹ Fuller procured a CGL policy for the project through United States Fidelity and Guaranty Company (“USF&G”).⁵⁰ The policy insured Fuller for “‘property damage’ . . . caused by an ‘occurrence,’ which [the policy] defined as ‘an accident, including continuous or repeated exposure to substantially the same general harmful conditions.’”⁵¹ The policy further excluded two kinds of damage: (1) property damage to “[t]hat 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”; and, (2) property damage to “[t]hat particular part of any property that must be restored, repaired or replaced because ‘your work’ was incorrectly performed on it,” where “your work” was defined as “[w]ork or operations performed by you or on your behalf.”⁵² Therefore, the question arose as to whether the latter exclusion precluded coverage for damage to the contracted work caused by the contractor’s own negligent construction.

The subcontractor’s negligent installation caused the wood flooring to buckle and allowed “water infiltration into the building” through the aluminum wall.⁵³ As a result of the water damage, the water metering system had to be repaired.⁵⁴ The building owner sued Fuller on various counts, and Fuller sought indemnification from USF&G, who ultimately denied coverage for the claim on the grounds that the damage was not an “occurrence” as defined in the policy.⁵⁵ Fuller sought a declaration that USF&G was liable to defend Fuller in the underlying suit per the terms of the contract.⁵⁶ The lower court granted Fuller’s cross motion for summary judgement, finding the water infiltration was continuous exposure to a generally harmful condition, which tracked the definition for occurrence under the policy.⁵⁷

The Appellate Division reversed.⁵⁸ The court found Fuller’s faulty work was not an accident resulting in “continuous or re-

⁴⁹ *See id.*

⁵⁰ *Id.* at 256–57.

⁵¹ *Id.*

⁵² *Id.* at 257 (alterations in original).

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 257–58.

⁵⁶ *Id.* at 258.

⁵⁷ *Id.*

⁵⁸ *Id.* at 261–62.

peated exposure to substantially the same general harmful conditions” because it was the result of “intentional cost-saving or negligent acts” which only affected the building owner’s “economic interest in the building.”⁵⁹ The court insisted that Fuller’s “contract default” was not an accident simply because Fuller alleged negligence.⁶⁰ Therefore, the court found no occurrence under the policy.⁶¹

Nonetheless, the court found that even if Fuller’s faulty work were an occurrence, the policy expressly excluded from coverage damage to the contractor’s work.⁶² The court maintained that the CGL policy issued by USF&G “d[id] not insure against faulty workmanship in the work product itself but rather faulty workmanship in the work product which creates a legal liability by causing bodily injury or property damage to something other than the work product.”⁶³ In the court’s view, the CGL policy “was never intended to insure Fuller’s work product or Fuller’s compliance . . . with its contractual obligations,” and to hold otherwise “would transform USF&G into a surety for the performance of Fuller’s work.”⁶⁴ Therefore, the court held that Fuller was not entitled to indemnification.⁶⁵

2. *Black & Veatch Corp.*: Refusing to Extend *Fuller*

In *Black & Veatch Corp.*, the lawyers for Aspen Insurance “relie[d] heavily” on *Fuller*, arguing that the Appellate Division’s refusal to extend CGL coverage beyond faulty workmanship in the work product which causes property damage to something other than the work product necessarily precluded faulty work from being a coverable occurrence under New York law.⁶⁶ Nonetheless, the court distinguished *Fuller* based on differences in the CGL policy at issue and the facts of the case.⁶⁷

The contractor Black & Veatch (“B&V”) purchased the CGL policy at issue through Aspen Insurance (“Aspen”).⁶⁸ The policy

⁵⁹ *Id.* at 259.

⁶⁰ *Id.* at 259–60.

⁶¹ *Id.* at 259.

⁶² *Id.* at 260.

⁶³ *Id.* at 259.

⁶⁴ *Id.* at 260.

⁶⁵ *Id.* at 261–62.

⁶⁶ *Black & Veatch Corp. v. Aspen Ins. (U.K.) Ltd.*, 882 F.3d 952, 967–68 (10th Cir. 2018), *cert. denied*, 139 S. Ct. 151 (2018).

⁶⁷ *Id.* at 967–69.

⁶⁸ *Id.* at 955.

provided coverage for “‘Property Damage’ . . . caused by an ‘Occurrence.’”⁶⁹ The contractor Black & Veatch (“B&V”) purchased the CGL policy at issue through Aspen Insurance (“Aspen”). The policy contained the following definitions:

- Occurrence: “an accident, including continuous or repeated exposure to substantially the same general harmful conditions, that results in . . . ‘Property Damage’ that is not expected or not intended by the ‘Insured.’”
- Property Damage: “physical injury to tangible property of a ‘Third Party,’ including all resulting loss of use of that property of a ‘Third Party’”
- Third Party: “any . . . entity . . . other than an ‘Insured.’”⁷⁰

Additionally, the policy defined an “Insured” as “any entity listed as a ‘Named Insured’ or designated as an ‘Additional Insured.’”⁷¹ The policy further excluded coverage for “‘Property Damage’ to ‘Your Work,’” where “‘Your Work’ is defined as ‘work operations performed by you or on your behalf’ by a subcontractor.”⁷² Finally, the policy included an exception to that exclusion, providing that the exclusion “does not apply if the damaged work or the work out of which the damage arises was *performed on [B&V’s] behalf by a subcontractor.*”⁷³ The question thus arose as to whether that exception to the exclusion allowed coverage for the subcontractor’s faulty work.

The court found that B&V was entitled to indemnification for four main reasons. First, the damage to the reactors was an occurrence under the policy and qualified as coverable property damage.⁷⁴ Second, the subcontractor exception to the “Your Work” exclusion was added by the ISO specifically to preserve coverage for faulty work performed by subcontractors.⁷⁵ Third, the overwhelming trend of state supreme courts around the country was to hold that faulty work can constitute an occurrence, and that contractors are covered for unexpected damage caused by subcontractor work.⁷⁶ Fourth, *Fuller* did not compel a conclusion

⁶⁹ *Id.* (alteration in original).

⁷⁰ *Id.* (citations omitted).

⁷¹ *Id.* at 963.

⁷² *Id.* at 955.

⁷³ *Id.* at 956 (alteration in original).

⁷⁴ *Id.* at 965.

⁷⁵ *Id.* at 959–60.

⁷⁶ *Id.* at 966 (citing French, *supra* note 9, at 122–23).

in favor of the insurance provider because it was distinguishable on its facts.⁷⁷

As to the first reason, the court found that the damage to the reactors was an occurrence under the policy because it was caused by an accident.⁷⁸ B&V neither expected nor intended for their subcontractors to perform faulty work, nor did they engage in reckless cost-cutting like the contractor in *Fuller*.⁷⁹ The court rejected Aspen's argument and concluded that the damage was coverable "property damage" under the policy because the plant owner was a third party, not an additional insured under the policy.⁸⁰ The court concluded instead that the plant owner was an additional insured only for liability "arising out of operations performed by the Named Insured," but the subcontractor who performed the work at issue was not a named insured under the policy.⁸¹

The court bolstered its finding that faulty subcontractor work was an occurrence under the policy by concluding that the definition of occurrence would not make sense when construed along with the business risk exclusions unless the definition included faulty work.⁸² The court found that reading the definition of occurrence to exclude the damage to B&V's work product would render the "Your Work" exclusion and the subcontractor exception to that exclusion superfluous, in violation of New York law.⁸³ According to the court's reasoning, the provision excluding coverage for damage to the insured's own work necessarily implied that those damages were not "categorically and preemptively preclude[d]" by "the definition of 'occurrence'"; otherwise, the exclusion would be surplusage.⁸⁴ Moreover, the policy would not provide an exception to the "Your Work" exclusion for work performed by a subcontractor unless faulty work was a coverable occurrence under the policy to begin with.⁸⁵ For these reasons, the court rejected Aspen's argument that the subcontractor ex-

⁷⁷ *Id.* at 968–69.

⁷⁸ *Id.* at 962–63.

⁷⁹ *Id.*

⁸⁰ *Id.* at 963–64.

⁸¹ *Id.* at 963.

⁸² *Id.* at 964–65.

⁸³ *Id.* at 964 ("CGL policies [must] be construed 'in a way that affords a fair meaning to all of the language . . . in the contract and leaves no provision without force and effect.'" (second alteration in original) (quoting *Roman Cath. Diocese of Brooklyn v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 21 N.Y.3d 139, 148 (N.Y. 2013))).

⁸⁴ *Id.*

⁸⁵ *Id.*

ception impermissibly creates coverage for damage that is not a coverable occurrence under the basic insuring agreement, and held that the damage to the reactors was an occurrence.⁸⁶

As noted above, the court held that *Fuller* did not compel a conclusion in favor of the insurance provider because it was distinguishable on its facts,⁸⁷ despite the rule that federal courts applying state law should defer to intermediate appellate courts when no high court decision has been made.⁸⁸ The court found that the *Fuller* rationale did not apply to the damage for which B&V sought indemnification, because Aspen presented no evidence that B&V had sought to cut corners by accepting excessively low subcontractor bids or by using inferior materials.⁸⁹ The contractor in *Fuller* was not entitled to indemnification because “a CGL policy covers damages only when they were ‘unexpected and unintentional,’ ”⁹⁰ and Fuller’s attempt at “reckless cost-saving” so “increased the likelihood” of faulty subcontractor work as to make it expected.⁹¹ In contrast, the court held that B&V’s damages were accidental: while B&V may have taken a “calculated risk” in hiring a subcontractor to manufacture the internal parts, that risk alone simply did not amount to an expectation or intention that the subcontractor’s work would be faulty.⁹² Therefore, the faulty subcontractor work was an occurrence under the policy.

Moreover, the *Black & Veatch Corp.* court found that *Fuller* did not even address “whether damages caused by a subcontractor are covered by a CGL policy that expressly provides coverage for damages to an insured’s work arising from a subcontractor’s faulty workmanship,” because the policy in *Fuller* did not include a subcontractor exception.⁹³ The policy in *Fuller* simply excluded coverage for damage to the insured’s own work product, full stop, “regardless of whether the contractor or its subcontractor caused the damages.”⁹⁴ Even if the damages at issue in *Fuller* had been caused by an occurrence under the policy, they would have been

⁸⁶ *Id.* at 965.

⁸⁷ *Id.* at 968–69.

⁸⁸ *Id.* at 967.

⁸⁹ *Id.* at 968–69.

⁹⁰ *Id.* at 962 (quoting *Cont’l Cas. Co. v. Rapid-Am. Corp.*, 80 N.Y.2d 640, 649 (N.Y. 1993)).

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 968.

⁹⁴ *Id.*

excluded from coverage by the “Your Work” exclusion. Therefore, the court declined to extend *Fuller*'s holding to say that “the damages at issue [in *Black & Veatch Corp.*] can never be an occurrence.”⁹⁵

III. USING A SUBJECTIVE OR OBJECTIVE STANDARD TO DETERMINE WHETHER A POLICYHOLDER EXPECTED OR INTENDED FAULTY WORK

Because the definition of “occurrence” is contingent on there being an accident that is not expected or intended from the standpoint of the insured, a relevant question is whether expectation or intention is a purely subjective standard. The court in *Black & Veatch Corp.* applied a purely subjective standard, relying heavily on arguments made by Professor Christopher C. French in an article regarding CGL coverage for defective work.⁹⁶ However, the Supreme Court of Ohio applied a more objective standard in *Ohio Northern University*, which was dispositive in the court's decision that faulty work is not a coverable occurrence.

A. *The Subjective Standard Argued for by Professor Christopher C. French*

Professor French argues that defective work should be a coverable occurrence, whether it is caused by a subcontractor or the general contractor on a project.⁹⁷ French's argument goes a

⁹⁵ *Id.* (emphasis added).

⁹⁶ See *id.* at 959–60 (citing French, *supra* note 9, at 107–08). The court's analysis of New York law seems to suggest that New York applies a purely subjective standard. The court cited *Continental Casualty Co. v. Rapid-American Corp.*, 80 N.Y.2d 640, 649 (1993), for the proposition that CGL policies “are to be construed as barring coverage ‘only when the insured intended the damages.’” *Black & Veatch Corp.*, 882 F.3d at 960 (emphasis omitted). The court went on to state that “[a] policyholder might take a ‘calculated risk’—such as hiring a subcontractor—without ‘expecting’ damages to occur.” *Id.* at 962. Nonetheless, it would serve the New York Court of Appeals well to clarify exactly whether the standard it applies is purely subjective.

⁹⁷ See French, *supra* note 9, at 143 (“[T]he inescapable conclusion is that construction defects are occurrences unless the insurer can prove the policyholder actually expected or intended to do the construction work at issue defectively and expected or intended that it would cause damage.”); see also Christian H. Robertson II, Note, *Defective Construction CGL Coverage: The Subcontractor Exception*, 7 MICH. BUS. & ENTREPRENEURIAL L. REV. 159, 174 (2017) (“French concludes that courts should presume that all faulty workmanship—even that of the insured—constitutes an occurrence covered, unless either the insurer proves otherwise or the policy specifically excludes coverage.”).

step further than the view adopted by the majority of state courts, which only indemnify contractors for defective work performed by a subcontractor.⁹⁸ French proposes a simple methodology for analyzing CGL insurance policies: “[I]n most cases, whether the damage associated with the defective workmanship is actually covered by CGL insurance should be determined based on an analysis of whether any of the business risk exclusions apply.”⁹⁹

French’s argument hinges on the notion that the standard for determining whether faulty work is accidental should be completely subjective, in the sense that insurers cannot deny coverage unless they prove that the insured subjectively expected or intended the damage.¹⁰⁰ French argues that the subjective standard is baked into the language of a standard form CGL policy, which states that the injury or damage is excluded from coverage if it was “expected or intended *from the standpoint of the insured*.”¹⁰¹ The exclusion for expectation or intention neither imposes a reasonableness standard nor a standard that relies on probability or likelihood, but suggests a subjective standard focused on the insured party’s perspective.¹⁰² From there, French makes the supposition that construction defects are rarely expected or intended from the insured’s standpoint, whether they can be attributed to the subcontractor’s work or not, and therefore they should not be categorically excluded from coverage.¹⁰³

While many courts have applied a subjective standard, none have gone as far as French. Most find that faulty work is an oc-

⁹⁸ See Robertson, *supra* note 97.

⁹⁹ French, *supra* note 9, at 144–45.

¹⁰⁰ See *id.* at 115–17. French’s argument features two additional points that do not merit discussion here, namely that: (1) state courts which find no occurrence often rely on older cases like *Weedo*, which are outdated because they were decided before the ISO instituted major changes in CGL insurance policies; and (2) the “moral hazard” argument, which insurance companies employ to argue that CGL coverage for the insured’s own faulty work lessens incentives for contractors to reduce their probability of error, is weakened by other, more powerful incentives that do not implicate insurance indemnification. *Id.* at 119, 141; see also Robertson, *supra* note 97, at 172–74.

¹⁰¹ French, *supra* note 9, at 116.

¹⁰² *Id.*

¹⁰³ *Id.* at 143 (“[T]he inescapable conclusion is that construction defects are occurrences unless the insurer can prove the policyholder actually expected or intended to do the construction work at issue defectively and expected or intended that it would cause damage.”). French draws an analogy to car insurance, which consumers purchase to indemnify themselves from the foreseeable result of their own negligent driving, and poses the question: “If construction defect claims, the most common claims asserted against contractors, were not covered by CGL insurance, then why would or should a contractor even buy CGL insurance?” *Id.* at 104.

currence only when it was performed by a subcontractor and decline to extend that holding to faulty work performed by the insured. For example, in *National Surety Corp. v. Westlake Investments, L.L.C.*, the Iowa Supreme Court held that a modern CGL policy covered property damage arising out of defective subcontractor work.¹⁰⁴ The court reviewed a jury verdict that the petitioners claimed was the result of improper jury instruction; the trial judge had instructed the jury that “[d]efective construction work performed by an insured is not covered by the policy; however, defective construction work performed by subcontractors may be an ‘occurrence’ under the policy.”¹⁰⁵ The court held that the jury instruction was not improper because the policy at issue contemplated coverage for defective subcontractor work.¹⁰⁶ The court applied a subjective standard for the same reasons suggested by French: the policy provided coverage for an accident “from the standpoint of the insured.”¹⁰⁷ The court made clear that the standard is purely subjective, finding that defective subcontractor work would not be an accident only if it were the “natural and expected result of the insured’s actions,” or “highly probable whether the insured was negligent or not.”¹⁰⁸

Likewise, in *Cypress Point Condominium Ass’n v. Adria Towers, L.L.C.*, the Supreme Court of New Jersey held that a subcontractor’s faulty work was an occurrence under a standard form CGL policy.¹⁰⁹ Like the court in *National Surety*, the Supreme Court of New Jersey found that whether damages were an accident depended on whether they were expected or intended.¹¹⁰

¹⁰⁴ 880 N.W.2d 724, 740 (Iowa 2016) (“Accordingly, we interpret the insuring agreement in the modern standard-form CGL policy as providing coverage for property damage arising out of defective work performed by an insured’s subcontractor unless the resulting property damage is specifically precluded from coverage by an exclusion or endorsement.”).

¹⁰⁵ *Id.* at 734.

¹⁰⁶ *Id.* at 736.

¹⁰⁷ *Id.* (“Considered from the standpoint of the insured, ‘a deliberate act, performed negligently, is an accident if the effect is not the intended or expected result; that is, the result would have been different had the deliberate act been performed correctly.’” (quoting *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 8 (Tex. 2007))).

¹⁰⁸ *Id.* The court cited *United Fire & Casualty Co. v. Shelly Funeral Home, Inc.*, 642 N.W.2d 648, 652, 654 (Iowa 2002), as an example, in which the court concluded that damage caused by the insured’s negligent supervision of their employee still constituted an occurrence because the insured did not know its omission to act would result in the harmful consequences. *Nat’l Surety Corp.*, 880 N.W.2d at 735.

¹⁰⁹ 143 A.3d 273, 288 (N.J. 2016).

¹¹⁰ *Id.* at 287.

However, unlike the court in *National Surety*, the Supreme Court of New Jersey was less clear about whether that standard was purely subjective. The court cited to *Travelers Indemnity Co. of America v. Moore & Associates, Inc.*, in which the Supreme Court of Tennessee held that expectation or intention is determined from the perspective of the insured,¹¹¹ but the court concluded that it needed to determine whether the “poor workmanship was foreseeable.”¹¹² The court’s appeal to foreseeability, without qualifying whether foreseeability is determined from the perspective of the insured, suggests that it was not applying a subjective standard as pure as that applied by the courts in *National Surety* and *Black & Veatch Corp.*

Nonetheless, the court did not seem to rely on the foreseeability analysis in reaching the conclusion that the defective work was an occurrence. Instead, the court rejected the insurance company’s argument that the alleged damage resulting from breach of contract could not give rise to a coverable occurrence.¹¹³ The court found that breach of contract claims were barred from CGL coverage because of the business risk exclusions, not because such claims were not initially covered as an occurrence.¹¹⁴

B. *Applying an Objective Standard for Determining Whether Damages Are Accidental*

One alternative to French’s subjective standard is to apply an objective standard that determines whether faulty work damages are accidental based on the amount of control the contractor had over the subcontractor’s work.¹¹⁵ In *Westfield Insurance Co. v. Custom Agri Systems, Inc.*, the Supreme Court of Ohio appeared to forecast a control test by suggesting that the general contractor’s control over the process is relevant to coverage for faulty work.¹¹⁶ While the court ultimately denied coverage for the

¹¹¹ *Id.*; see *Travelers Indem. Co. of Am. v. Moore & Assocs., Inc.*, 216 S.W.3d 302, 308 (Tenn. 2007).

¹¹² *Cypress Point Condo. Ass’n*, 143 A.3d at 287.

¹¹³ *Id.* at 287–88.

¹¹⁴ *Id.*

¹¹⁵ See, e.g., Robertson, *supra* note 97, at 189–90 (“First, courts should presume CGL coverage for defective work performed by the insured’s subcontractor unless the policy clearly excludes the specific coverage without exception; second, that presumption might be overcome if evidence shows that the insured had sufficient control of the work that resulted in defective construction.” (emphasis omitted)).

¹¹⁶ 133 Ohio St. 3d 476, 2012-Ohio-4712, 979 N.E.2d 269, at ¶ 13 (“The key issues are whether the contractor controlled the process leading to the damages and whether the damages were anticipated.” (emphasis omitted) (citation omitted)).

faulty work of a general contractor in that case, at least one commentator debated whether the court would explicitly apply the control test in a later case involving faulty subcontractor work on the basis that subcontractor work cannot be controlled by the general contractor.¹¹⁷

However, in October of 2018, the Supreme Court of Ohio reached a final decision in *Ohio Northern University*, holding that faulty subcontractor work is not a coverable occurrence under standard form CGL policies because it “cannot be deemed fortuitous.”¹¹⁸ Although the court was bound by their previous decision in *Custom Agri*, it did not appear to interpret *Custom Agri* as creating a control test; instead, it interpreted the earlier case to hold that faulty work is not a coverable occurrence because it is never fortuitous.¹¹⁹ The court then applied that holding to the faulty subcontractor work at issue, and determined that faulty work is not a coverable occurrence whether it is caused by a subcontractor or not, because it is not fortuitous.¹²⁰ In essence, the court appeared to hold that even where a contractor has little to no control over the quality of its subcontractor’s work, faulty work by a subcontractor is foreseeable enough to never qualify as a coverable “occurrence.”

IV. WHETHER THE COST OF REPAIRING AND REPLACING THE DEFECTIVE WORK ITSELF IS COVERABLE PROPERTY DAMAGE

The majority of courts hold that the cost of repairing or replacing defective work alone is not coverable property damage under standard form CGL policies absent damage to other property.¹²¹ For example, in *Capstone Building Corp. v. American*

¹¹⁷ See Robertson, *supra* note 97, at 186–87.

¹¹⁸ Ohio N. Univ. v. Charles Constr. Servs., Inc., 155 Ohio St. 3d 197, 2018-Ohio-4057, 120 N.E.3d 762, at ¶ 3.

¹¹⁹ *Id.* ¶¶ 17–18 (noting that “[i]nherent in the plain meaning of ‘accident’ is the doctrine of fortuity,” and “claims for faulty workmanship, such as the one in the present case, are not fortuitous in the context of a CGL policy like the one here” (quoting *Custom Agri*, 133 Ohio St. 3d 476, 2012-Ohio-4712, 979 N.E.2d 269, at ¶¶ 13–14)).

¹²⁰ *Ohio N. Univ.*, 155 Ohio St. 3d 197, 2018-Ohio-4057, 120 N.E.3d 762, at ¶ 27.

¹²¹ French, *supra* note 9, at 128–29 (“Many courts have held that construction defects can be occurrences, but only to the extent that property other than the defective work itself was damaged. This is becoming the majority position of the state supreme courts that have addressed the issue . . .”). Note that, like the issue as to whether faulty work is an “occurrence,” this issue is one of initial coverage—the claimed damage may be initially coverable within the definition of property

Motorists Insurance Co., the Supreme Court of Connecticut held that the cost of repairing and replacing defective work alone did not constitute coverable property damage under a standard form CGL policy.¹²² The plaintiffs sought indemnification for liabilities incurred by water damage and other collateral damage to the third party's property, as well as "defective work, standing alone, including building and fire safety code violations."¹²³ The court found that the damage to the property not involved in the work was coverable property damage, but declined to extend the definition of property damage to the defective work alone.¹²⁴

The court focused on the term "physical injury" in the definition of property damage, and concluded that the term presupposed that the work was not defective or defectively installed prior to delivery, but was injured after delivery or installation by faulty work.¹²⁵ Therefore, the court held that the cost of repairing and replacing defective work was not coverable property damage because the work was defective from its inception, rather than as a result of some physical injury that altered the once-nondefective product.¹²⁶

V. ARGUMENT

A. Black & Veatch Corp. *Correctly Distinguished Fuller*

The *Black & Veatch Corp.* court correctly distinguished *Fuller* on two distinct bases. First, the court placed appropriate emphasis on the fact that Fuller undertook bad faith cost-cutting, while

damage, but the particular policy at issue may ultimately exclude the property damage from coverage in one of the business risk exclusions, such as the "Your Work" exclusion. *Capstone Bldg. Corp. v. Am. Motorists Ins. Co.*, 67 A.3d 961, 976 (Conn. 2013) ("Although a contractor's work will often be excluded from coverage pursuant to contractual exclusions in a commercial general liability policy, this distinction is not found in the plain language of the insuring agreement's initial grant of coverage.").

¹²² 67 A.3d at 969 (holding that "defective work standing alone or repairs to that defective work do not constitute property damage and, therefore, are not covered under the particular insurance policy in the present case").

¹²³ *Id.* at 976.

¹²⁴ *Id.* at 979.

¹²⁵ *Id.* at 980.

¹²⁶ *Id.* at 982 (noting that "'physical injury' unambiguously connotes damage to tangible property causing an alteration in appearance, shape, color or in other material dimension" (quoting *Traveler's Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 481, 502 (Ill. 2001))).

Black & Veatch did not.¹²⁷ Second, the court identified a provision in the CGL policy at issue in *Fuller* that expressly excluded coverage for damages to the insured's own work, whether that damage resulted from an occurrence or not.¹²⁸ The court correctly found that the ISO no longer includes that provision in their CGL policies, and that provision was absent from the policy at issue in *Black & Veatch Corp.*¹²⁹

1. *Fuller* Involved Bad-Faith Cost Cutting

The *Black & Veatch Corp.* court correctly held that *Fuller* is distinguishable because the contractor in that case undertook bad faith cost-cutting. The *Fuller* court did not claim that faulty work lacks the fortuity required to constitute an accident, as other scholars and courts have claimed.¹³⁰ Rather, the *Fuller* court made clear that the particular faulty work at issue was not fortuitous enough to constitute an occurrence because it resulted from reckless cost-cutting measures.¹³¹ In other words, *Fuller* was more than merely negligent for failing to expect faulty work by its subcontractors; *Fuller* knew its subcontractors were inferior but hired them anyway to save money.¹³² That fact was enough to dissuade the *Fuller* court from ordering USF&G to indemnify *Fuller*,¹³³ even if *Fuller* did not expect or intend subcontractor error on a purely subjective level. In contrast, *Aspen* did not allege any cost-cutting by Black & Veatch,¹³⁴ let alone recklessness. Black & Veatch had no reason to expect that their subcontractor's work would be faulty beyond the notion that faulty work is always a remote possibility.

¹²⁷ *Black & Veatch Corp. v. Aspen Ins. (U.K.) Ltd.*, 882 F.3d 952, 968–69 (10th Cir. 2018).

¹²⁸ *Id.* at 968.

¹²⁹ *Id.* at 969, 971.

¹³⁰ Compare PLITT ET AL., *supra* note 31, § 129:4 (collecting cases to support the proposition that “[a] claim for faulty workmanship, in and of itself, is not an occurrence under a commercial general liability policy because a failure of workmanship does not involve the fortuity required to constitute an accident”), with *George A. Fuller Co. v. U.S. Fid. and Guar. Co.*, 200 A.D.2d 255, 259 (1st Dep’t 1994) (finding that the property damage resulted from “intentional cost-saving or negligent acts”).

¹³¹ *George A. Fuller Co.*, 200 A.D.2d at 259. Unfortunately, there are no trial court documents to show precisely what those cost cutting measures were.

¹³² *Id.*

¹³³ *See id.*

¹³⁴ *Black & Veatch Corp.*, 882 F.3d at 968–69.

Admittedly, the factual distinction would be much clearer if the *Fuller* court had specified exactly what kind of cost-cutting measures Fuller employed. Nonetheless, the *Black & Veatch Corp.* court fairly posited that reckless cost-cutting is risky, bad-faith behavior sufficiently culpable to stand in for expectation or intention, whereas subcontracting work on a large and complex piece of machinery, without more, does not create an expectation or intention that a subcontractor will perform faulty work.

2. The Policy in *Fuller* Was Different from the Policy in *Black & Veatch Corp.*

The *Black & Veatch Corp.* court was also correct in finding that the CGL policy at issue in *Fuller* was markedly different from the one in *Black & Veatch Corp.* The policy in *Fuller* barred coverage via an exclusion that is no longer part of the standard form policy issued by the ISO.¹³⁵ Even if the *Fuller* court had decided that the damage at issue was caused by an occurrence despite Fuller's bad faith cost-cutting, the policy expressly excluded coverage for damage caused to the insured's own work. In contrast, while the policy in *Black & Veatch Corp.* also excluded damage to the insured's own work, it excepted from that exclusion damage to the insured's own work caused by the work of a subcontractor.

Therefore, the *Fuller* court's holding that the policy "d[id] not insure against faulty workmanship in the work product itself but rather faulty workmanship in the work product which create[d] a legal liability by causing bodily injury or property damage to something other than the work product"¹³⁶ made sense only as applied to that particular CGL policy. Modern CGL policies like the one B&V purchased only exclude coverage for faulty work performed by the insured general contractor, and not for faulty work performed by their subcontractor.

Moreover, even under an outdated *Fuller* policy, the exclusion for faulty work has no bearing on whether faulty work is an "occurrence" in the first place.¹³⁷ That is decided only on the basis of whether the resulting damages were expected or intended from the standpoint of the insured. If faulty work were

¹³⁵ See discussion *supra* Part I.

¹³⁶ *George A. Fuller Co.*, 200 A.D.2d at 259.

¹³⁷ See *Black & Veatch Corp.*, 882 F.3d at 958 ("[A] CGL policy starts with a broad grant of coverage for damages arising from an 'occurrence.' Exclusions narrow the scope of coverage.").

never an occurrence, it would not be necessary for the policy to exclude it from the initial grant of coverage for occurrences that cause property damage. As the court stated in *Black & Veatch Corp.*, “*Fuller* does not stand for the proposition that damages caused by a subcontractor’s faulty workmanship can never constitute an ‘occurrence’ under a CGL policy.”¹³⁸

The policy in *Fuller* was a completely different CGL policy than either the policy in *Black & Veatch Corp.* or any modern standard form CGL policy. Indeed, the *Black & Veatch Corp.* court emphasized this fact, and found that *Fuller* relied on two intermediate appellate court cases that were decided before the ISO originated the subcontractor exception and expressly declared that it was intended to preserve coverage for property damage caused by subcontractor work.¹³⁹

Because *Fuller* is distinguishable, the New York Court of Appeals would not contradict Appellate Division precedent by holding that faulty subcontractor work is an occurrence under standard form CGL policies. Therefore, New York’s legal environment is ripe for such a holding.

B. *The New York Court of Appeals Should Apply a Purely Subjective Standard*

The New York Court of Appeals should apply a purely subjective standard to determine whether a contractor expected or intended faulty work for three reasons. First, New York law does not preclude the use of a subjective standard. Second, Professor French’s approach to policy interpretation applying a purely subjective standard best comports with the doctrines of insurance policy interpretation. Third, the Supreme Court of Ohio’s decision applying an objective standard is based on flawed precedent.

1. New York Law Does Not Preclude a Subjective Standard

The court in *Black & Veatch Corp.* appeared to conclude that New York law applies a purely subjective standard to determine whether an accident was expected or intended.¹⁴⁰ But Aspen did

¹³⁸ *Id.* at 957.

¹³⁹ *Id.* at 968; *see also* discussion *supra* Section II.B.1.

¹⁴⁰ *Black & Veatch Corp.*, 882 F.3d at 960 (“The New York Court of Appeals has held that damages are accidental so long as they are ‘unexpected and unintentional.’ These terms are to be construed as barring coverage ‘only when the insured *intended* the damages.’ The fact that an insured might have foreseen the possibility that its subcontractor would build a defective product does not render the resulting damages

not argue that B&V expected or intended the faulty subcontractor work, nor did B&V engage in bad faith cost-cutting like the contractor in *Fuller*.¹⁴¹ Thus, the court did not have occasion to rule on whether the standard is purely subjective. Nonetheless, a future New York Court of Appeals decision could easily apply a subjective standard to the definition of accident and determine that subcontractor work is a coverable occurrence under standard form CGL policies, as the court did in *National Surety Corp.*¹⁴² In fact, *National Surety Corp.*'s limit on coverage for instances where the resulting damage was highly probable, regardless of whether the contractor was negligent, coincides with *Fuller*'s finding that bad-faith cost cutting estops the contractor from later seeking coverage for faulty subcontractor work. Bad-faith cost cutting is the very kind of behavior that makes damages caused by faulty subcontractor work highly probable, whether the general contractor adequately supervises the subcontractor or not.¹⁴³

Additionally, the New York Court of Appeals can use the same reasoning as the court in *Cypress Point Condominium Ass'n* to cast aside the *Fuller* court's notion that subcontractor error results merely in an uncoverable breach of contract rather than a coverable accident. The definition of "occurrence" does not distinguish between tort or breach of contract actions at least for the purpose of initial coverage, notwithstanding any exclusions from coverage later in the policy. Other courts have applied the same reasoning.¹⁴⁴

intentional . . ." (citations omitted)). The court further maintained that a person may engage in behavior that involves a calculated risk without expecting that an accident will occur; "[i]n fact, people often seek insurance for just such circumstances." *Id.* at 962 (citation omitted).

¹⁴¹ *Id.* at 968.

¹⁴² 880 N.W.2d 724, 740 (Iowa 2016).

¹⁴³ In *United Fire & Casualty Co.*, the case offered by the court in *National Surety Corp.* for the proposition that negligent supervision does not create an expectation or intention of bodily injury without some affirmative act, the court found that "the term 'expected' in such an exclusion denotes knowledge by the 'actor' that certain consequences will flow from the intentional actions." 642 N.W.2d 648, 653 (Iowa 2002). In a case such as *Fuller*, the contractor's intentional act is cost cutting.

¹⁴⁴ See, e.g., *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 884 (Fla. 2007) ("[T]here is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL's initial grant of coverage. 'Occurrence' is not defined by reference to the legal category of the claim." (alteration in original) (quoting *Am. Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2, ¶ 41, 268 Wis. 2d 16, 673 N.W.2d 65)).

2. French's Approach to CGL Policy Interpretation Best Comports with the Doctrines of Insurance Policy Interpretation¹⁴⁵ and Saves Litigation Costs

Ultimately, French's argument in favor of assuming defective work was accidental regardless of whether it was caused by the work of a contractor or a subcontractor best comports with the doctrines of insurance policy interpretation: (1) *contra proferentem*, (2) the reasonable expectations doctrine, and (3) construing the policy as a whole.

First and most importantly, French's approach makes the most sense based on the language of the policy when it is read as a whole. The very existence of the business risk exclusion for damage to the insured's own work—and the exception to that exclusion for damage to the insured's own work caused by faulty subcontractor work—would be completely unnecessary if those damages did not pass the threshold occurrence test to begin with. To avoid rendering the business risk exclusions and their exceptions mere surplusage, those provisions must be given their full effect.

Second, to the extent that the policy's "accident" language is ambiguous, the doctrine of *contra proferentem* supports finding coverage in favor of the insured. Not only is the insurer in the best position to avoid confusion over the extent of coverage because it drafts the policy, but also the insurer can more easily telegraph the limits of coverage by drafting them into the business risk exclusions, rather than hoping that the courts will interpret ambiguous terms like "occurrence" in its favor.

Third, construing CGL policies to indemnify contractors for faulty subcontractor work better comports with the reasonable expectations doctrine. Contractors purchasing CGL insurance policies surely purchase them with the expectation that they will be indemnified for liability incurred by accidental negligence, which includes faulty subcontractor work. Otherwise, the CGL policies would not have the risk-shifting effect sought by contractors.

Finally, by assuming that faulty work was accidental and moving directly to the business risk exclusions to determine if there is coverage, French's approach saves litigation costs otherwise spent on determining difficult fact issues like "objective intent" or "sufficient control." For these reasons, the New York

¹⁴⁵ See discussion *supra* Sections II.A, III.A.

Court of Appeals should conclude that faulty work is an “occurrence” for the purpose of standard form CGL policies, unless the insurer can show intent or bad-faith cost cutting, and the Court should look to the business risk exclusions to limit coverage.

3. The Supreme Court of Ohio’s Decision in *Ohio Northern University* Is Based on Flawed Precedent

The Supreme Court of Ohio’s decision in *Ohio Northern University* followed the precedent set in *Custom Agri*, a case in which the court misinterpreted CGL policy language. There, the court based its decision to apply the doctrine of fortuity when analyzing CGL policies on language from a lower court decision.¹⁴⁶ The court quoted *JTO, Inc. v. State Automobile Mutual Insurance Co.* for the proposition that faulty work claims are not covered unless they cause consequential damage, because faulty work is not fortuitous, and coverage should instead be determined by analyzing the amount of control the contractor had over the project and “whether the damages were anticipated.”¹⁴⁷ The quoted language went on to state that there is generally no coverage for damages to the insured’s own work and that the intent of the policies is to exclude coverage for business risks.¹⁴⁸

The quoted language misinterpreted CGL policy language. Claims for damages to the insured’s own work—rather than for “consequential” damages to other property—caused by faulty work are denied coverage because damage to the insured’s own work is expressly excluded from coverage in the business risk exclusions, and *not* because faulty work fails to pass the occurrence threshold. Indeed, for those policies to cover *consequential* damages caused by faulty work, they would first need to conclude that such faulty work was an accidental occurrence. Therefore, the Supreme Court of Ohio should have overruled *Custom Agri* because it was based on a flawed interpretation of CGL policy language.

¹⁴⁶ *Westfield Ins. v. Custom Agri Sys., Inc.*, 133 Ohio St. 3d 476, 2012-Ohio-4712, 979 N.E.2d 269, at ¶ 13.

¹⁴⁷ *Id.* (“The key issues are whether the contractor controlled the process leading to the damages and whether the damages were anticipated.” (emphasis omitted) (quoting *JTO, Inc. v. State Auto. Mut. Ins. Co.*, 194 Ohio App. 3d 319, 2011-Ohio-1452, 956 N.E.2d 328, at ¶ 32)).

¹⁴⁸ *Id.* (quoting *JTO, Inc.*, 194 Ohio App. 3d 319, 2011-Ohio-1452, 956 N.E.2d 328, at ¶ 33).

The Court also cited as persuasive the Kentucky Supreme Court's decision in *Cincinnati Insurance Co. v. Motorists Mutual Insurance Co.*,¹⁴⁹ a decision that was "laden with errors and poor reasoning."¹⁵⁰ There, the court seemed to contradict itself by concluding that even though an unintended loss is fortuitous, and it is rare for a contractor to intend to damage their own work product, defective workmanship is not an accidental occurrence.¹⁵¹ The court reasoned that the opposite holding would cause CGL policies to become performance bonds by allowing any claim of faulty workmanship to be a coverable occurrence unless the insurer could prove the contractor's error was intentional.¹⁵² As Professor French points out in his critique of the holding, that is the very purpose of insurance policies—to indemnify the policy holder for their unintentional negligence, regardless of their fault.¹⁵³ Therefore, *Ohio Northern University* relies on case law which fundamentally misunderstands CGL insurance policies.

The Ohio Supreme Court's decision further reveals the perils of applying objective standards like foreseeability or control to CGL insurance policies: they virtually bar claims based on faulty work, because contractors always have control over their own work, and it is always foreseeable to some extent that faulty work will lead to damages. In essence, a control test is impossible to implement while preserving any kind of coverage for faulty work claims—even those for property damage to third-party property. Such a holding is fatal to coverage under a policy that contractors pay into with the specific intention of shifting the risk of liability for their own negligence onto the insurer.

The Supreme Court of Ohio should have concluded that faulty work passes the occurrence threshold unless it is subjectively expected or intended from the standpoint of the insured, but that faulty work is excluded from coverage under the business risk exclusions unless the faulty work was performed by a

¹⁴⁹ 306 S.W.3d 69 (Ky. 2010).

¹⁵⁰ French, *supra* note 9, at 138.

¹⁵¹ *Cincinnati Ins. Co.*, 306 S.W.3d at 74–75; *see also* French, *supra* note 9, at 139.

¹⁵² *Cincinnati Ins. Co.*, 306 S.W.3d at 75; *see also* French, *supra* note 9, at 139 (“[T]he court then mistakenly concluded that construction defects cannot be occurrences because that would mean that any time construction work is unintentionally done poorly by a subcontractor, and the defective work causes damage, there would be coverage unless an exclusion in the policy otherwise eliminates coverage.”).

¹⁵³ French, *supra* note 9, at 139 (arguing that “one of the primary reasons why people and businesses buy insurance” is “to protect themselves against liability for injuries unintentionally caused by their negligence”).

subcontractor. This would have allowed the court to preserve the overall result of its holding in *Custom Agri* by excluding the general contractor's faulty work from coverage based on the business risk exclusions, rather than declaring that faulty work can never pass the occurrence threshold. Then, the court could have allowed coverage in *Ohio Northern University* because subcontractor work is an exception to the "Your Work" exclusion.

C. *The New York Court of Appeals Should Also Hold that the Cost of Repairing and Replacing Faulty Work Is Coverable "Property Damage" Under CGL Policies*

The New York Court of Appeals should also hold that the cost of repairing and replacing defective subcontractor work meets the threshold for coverable "property damage" under CGL policies. The *Capstone Building Corp.* court's reasoning for precluding the defective work itself from coverage "neglects the 'loss of use' language in the second definition of property damage."¹⁵⁴ Modern standard form CGL policies cover two kinds of property damage: (1) "physical injury to tangible property, *including all resulting loss of use of that property,*" and (2) "loss of use of tangible property that is *not physically injured.*"¹⁵⁵ The first loss of use *results* from some physical injury and therefore requires some physical alteration, as the court concluded in *Capstone Building Corp.*

However, the second loss of use does not result from physical injury and is therefore not contingent on some kind of physical alteration. This second loss of use coverage can be thought to cover any loss of use of property that results from the property being defective at its inception. This scenario does not presuppose that the owner had been using the property before defective subcontractor work rendered the property unusable by way of physical injury. Instead, the owner had expected the property to be usable and the property was unusable because of some defect, such as the defective installation of some part before the property was put into use. In other words, the defective work itself is the coverable property damage. Therefore, if the property owner comes after the insured for the costs they incurred repairing or replacing the defective work, or for the loss of income they incurred waiting for the defective work to be repaired or replaced, the loss

¹⁵⁴ Li, *supra* note 45, at 180–81.

¹⁵⁵ Coverage Form (2013), *supra* note 16, at 565; *see also supra* Section I.A.

of use coverage is intended to indemnify the insured for that liability.

Like the issue of whether faulty work can be considered an "occurrence," whether the faulty work itself can be considered "property damage" is a threshold for initial coverage that can be limited by the business risk exclusions.¹⁵⁶ Therefore, nothing precludes the New York Court of Appeals from interpreting "property damage" to encompass the defective work itself and limiting coverage for such damages under the business risk exclusions. Importantly, this would still retain coverage for the cost of repairing and replacing defective work itself when the work was done by a subcontractor.

Such a holding would better comport with the doctrines of insurance policy interpretation. First, to the extent that the "property damage" language is ambiguous, it should be construed in favor of the insured under the doctrine of *contra proferentum*. Second, if a contractor expects to be indemnified for faulty work caused by a contractor because such faulty work is truly accidental, it makes sense that they would expect to be indemnified for the cost of repairing and replacing the faulty work, which is no less a part of the accident.¹⁵⁷ Therefore, the reasonable expectations doctrine supports finding that the cost of repairing and replacing the faulty work itself is covered under the policy. Third, reading the policy as a whole, the cost of repairing and replacing the faulty work itself is a matter of initial coverage so long as the damages were not expected or intended; therefore, it should only be excluded if the business risk exclusions so provide.

CONCLUSION

The New York Court of Appeals should hold that faulty work is an "occurrence" under standard form CGL policies. Unlike the

¹⁵⁶ See French, *supra* note 9, at 105.

¹⁵⁷ See *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 885 (Fla. 2007) ("[W]e reject a definition of 'occurrence' that renders damage to the insured's own work as a result of a subcontractor's faulty workmanship expected, but renders damage to property of a third party caused by the same faulty workmanship unexpected."); see also French, *supra* note 9, at 134 ("In sum, the courts holding defective work itself cannot be viewed as property damage have not offered a satisfying explanation why non-defective work that has been damaged and needs to be repaired or replaced because of defective workmanship constitutes property damage but the defective work itself that also needs to be repaired or replaced does not constitute property damage. In both instances, the property is unusable or damaged in its current state.").

Supreme Court of Ohio, the New York Court of Appeals is not bound by past precedent to preclude liability for damages caused by faulty work from coverage under standard form CGL policies. As to the scope of coverage, the New York Court of Appeals should construe the term “accident” as wholly subjective and find that faulty work is an occurrence so long as it is not expected or intended from the standpoint of the insured. The Court should then conclude that the business risk exclusions limit this broader form of initial coverage for “occurrences,” and that the “Your Work” exclusion in particular limits such coverage for damages to the insured’s own work caused by faulty work unless that faulty work was performed by a subcontractor. Finally, the Court should conclude that the cost of repairing and replacing the faulty work itself falls within the definition of “property damage” under standard form CGL policies. Like the business risk exclusions, the Court should make clear that insurers and policy holders are free to negotiate an exclusion that limits coverage for the cost of repairing and replacing the faulty work itself, whether or not it causes damage to other property, but that such damages are not precluded from initial coverage under the policy.