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Practice Groups:

Insurance Coverage

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Alabama Supreme Court Clarifies Position on Construction Coverage Question:

Damage to Contractor's Work Resulting from Faulty Workmanship Does Constitute "Property Damage" Caused by an "Occurrence" under Standard CGL Policy

By Frederic J. Giordano and Robert F. Pawlowski

In an important decision for policyholders in the construction business, the Supreme Court of Alabama recently clarified that Alabama law is in accord with the growing majority of jurisdictions finding coverage for property damage arising out of defective workmanship. Adding precision to its prior holdings and citing with approval various out-of-state authority, the Alabama high court confirmed that the definition of "occurrence" does not exclude property damage caused by faulty workmanship and that damage to other parts of a structure caused by defective workmanship constitutes "property damage" 'caused by' or 'arising out of' an 'occurrence.'" *Owners Insurance Company v. Jim Carr Homebuilder, LLC*, ---So.3d---, 2014 WL 1270629 *6 (Ala. March 28, 2014) ("*Carr*").

In *Carr*, Thomas and Pat Johnson ("Homeowners") contracted with Jim Carr Homebuilder, LLC ("JCH") to construct a new house on Lay Lake in Wilsonville, Alabama, and paid approximately \$1.2 million. Within a year of moving in, the Homeowners noticed leaking through the roof, walls, and floors, causing water damage to those and other areas of the house. Upon notification by the Homeowners, JCH attempted to remedy the defects. Dissatisfied with the repairs, the Homeowners sued JCH for breach of contract, fraud, and negligence and wantonness. JCH's liability insurance company, Owners Insurance Company ("Owners"), defended the suit, which the trial court stayed after the parties agreed to arbitrate, under a reservation of rights. The Homeowners won an arbitration award of \$600,000.

Simultaneously, Owners filed a declaratory judgment action seeking a "no coverage" ruling. The trial court granted JCH's motion for summary judgment declaring the arbitration award covered by the Owners policy. After initially reversing the trial court's ruling, the Alabama Supreme Court subsequently withdrew and superseded that ruling with its opinion of March 28. The ruling has two primary components.

First, the Court rejected Owners argument that the property damage and bodily injury at issue was not the result of an "occurrence" under the Owners policy. Owners relied upon a prior Alabama Supreme Court case stating that "we may conclude that faulty workmanship itself is not an occurrence" in arguing that there was no occurrence here. See *Town and Country Prop., L.L.C. v. Amerisure Ins. Co.*, 111 So. 3d 699, 706 (Ala. 2011). The Court found this to be an overstatement and, therefore, thought "it prudent to restate that principle in more precise terms—faulty workmanship itself is not 'property damage' 'caused by' or 'arising out of' an 'occurrence.'" *Carr* at *6.

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The policy defined “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” According to Owners, the only scenario where faulty workmanship might result in an “occurrence” is where such “workmanship results in property damage to real or personal property that is *not* part of that construction or repair project.” According to the Court, “Owners asks the term ‘occurrence’ to do too much.” *Carr* at *5. The Court continued: “If some portion of the Owners policy seeks to affect coverage by references to the nature or location of the property damaged, it is not the provision of the policy for coverage of occurrences. The policy simply does not define ‘occurrence’ by reference to such criteria.” *Id.*, citing *Lamar Homes v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007). Thus, the definition of “occurrence” did not, in and of itself, exclude the alleged property damage.

Second, the Court considered Owners’ argument that the “your work” exclusion in the policy precluded coverage. That exclusion stated: “This insurance does not apply to...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.’*” (the Court’s emphasis). The Court rejected this argument as well. “As the emphasized passage makes clear, in order for the ‘Your Work’ exclusion to apply, the damage not only must be to ‘your work,’ but also must be ‘included’ in the ‘products-completed operations hazard.’” *Carr* at *7. Since it was not, the exclusion did not apply. The Court further agreed with the Homeowners argument that, if true, Owners’ argument that the “home and every component of the home is the ‘work’ of JCH” and thus excluded, would render Owners “guilty of issuing illusory coverage.” *Id.*¹

Although the decision in *Carr* does not necessarily create new precedent in Alabama, it eliminates uncertainty as to whether and when coverage exists under Alabama law for property damage caused by defective workmanship under standard-type commercial general liability (“CGL”) insurance policies. Although application in any particular case may be fact-sensitive, and various exclusions contained in a CGL policy may nonetheless bar coverage, Alabama now more clearly sides with the majority of states holding that the definition of “occurrence” does not exclude property damage caused by faulty workmanship, and that damage to other parts of a structure caused by defective workmanship constitutes “property damage” under such policies. Policyholders facing construction-related claims under policies governed by Alabama law should understand the rules to assess how to maximize their insurance recovery.

Authors:

Frederic J. Giordano

frederic.giordano@klgates.com

+1.973.848.4035

Robert F. Pawlowski

robert.pawlowski@klgates.com

+1.973.848.4032

¹ The policy in *Carr* did not have the “subcontractor exception” to the “your work” exclusion found in many liability policies. See e.g., ISO Commercial General Liability Coverage Form CG 00 01 04 13 (“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.”).

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