

THE TENTH CIRCUIT'S PREDICTION: NEW YORK STATE LIKELY TO FOLLOW TREND RECOGNIZING DAMAGES CAUSED BY SUBCONTRACTOR'S FAULTY WORK IS A COVERED "OCCURRENCE"

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The United States Court of Appeals, Tenth Circuit recently issued a favorable decision for policyholders finding property damage arising from a subcontractor's faulty work arose from an accidental "occurrence" under New York law. In *Black & Veatch Corp. v. Aspen Ins. (UK) Ltd.*, [1] a 2–1 Tenth Circuit panel agreed with Black & Veatch Corp. ("B&V") that its excess policy — which contained a New York choice-of-law provision — covered claims for property damage to a third party caused by its subcontractor's faulty work. [2] The Tenth Circuit reversed the district court's ruling that B&V's subcontractor's faulty work caused damage to only B&V's own work and, therefore, was not a covered "occurrence." [3] The Tenth Circuit concluded the New York Court of Appeals would likely find the subcontractor's faulty work was an accidental "occurrence," following the growing trend of other state high courts that have addressed this coverage issue under commercial general liability ("CGL") policies. [4] Policyholders — whose policies are governed by New York law — should take notice and consider the implications of this decision on whether New York will soon join the majority view that faulty workmanship by a subcontractor can be an occurrence under CGL policies.

In 2005, B&V, a Kansas engineering firm, entered into contracts with American Electrical Power Service Corporation ("AEP") to engineer several jet bubbling reactors ("JBRs") — which eliminate contaminants from the exhaust emitted by coal-fueled power plants — at four coal-fire power plants in Ohio and Indiana. [5] B&V subcontracted the work for the JBRs' internal components. [6] Deficiencies in the subcontractor's work caused the JBRs' internal components to deform, crack, and sometimes collapse. [7] Subsequently, AEP notified B&V of the damaged JBRs arising from its subcontractor's faulty work. [8] AEP and B&V settled the dispute, and B&V agreed to pay more than \$225 million in repair and replacement costs for its subcontractor's defective internal components. [9]

After recovering \$3.5 million from its primary insurer, B&V submitted coverage claims to Aspen Insurance Ltd. ("Aspen") under its excess CGL policy (the "Policy"), which provided \$25 million of limits per occurrence. [10] Aspen denied coverage on the grounds that damage arising from and confined to B&V's own work was not an "occurrence." [11] In 2012, B&V filed suit against Aspen in the U.S. District Court for the District of Kansas for breach of contract and declaratory judgment as to B&V's rights under the Policy. [12] Aspen cross-moved for partial summary judgment on the coverage issue. [13] The district court granted Aspen's motion, holding property damage arising from the construction defects were not covered "occurrences" under the Policy because only

B&V's own work product — the JBRs — was damaged by its subcontractor's faulty workmanship. [14] B&V appealed. [15]

The issue before the Tenth Circuit was whether the New York Court of Appeals would find that the Policy covers a portion of B&V's payments to AEP to repair and replace the damaged JBRs. [16] The Tenth Circuit predicted the Court of Appeals would decide that the damages to the JBRs constitute an "occurrence" that triggers coverage under the Policy and, therefore, vacated the district court's summary judgment decision. [17] The Tenth Circuit's reasoning was based on, but not limited to, the Policy's language, New York's rule against surplusage, and the trend among state supreme courts. [18]

First, the Tenth Circuit held the subcontractor's shoddy work constituted an "occurrence," as that term is defined in the Policy, because it was accidental and harmed a third party's property. The Tenth Circuit considered the Policy's (1) basic insuring agreement defining the general scope of coverage and key terms, (2) exclusions from coverage, and (3) exceptions to the exclusions. [19] The Policy's basic insuring agreement held that Aspen would pay on behalf of B&V sums in excess of the liability limit provided by other insurance policies which B&V would "become legally obligated to pay as damages for . . . 'Bodily Injury' or 'Property Damage' . . . caused by an 'Occurrence.'" [20] An "Occurrence" was defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions, that resulted in 'Bodily Injury' or 'Property Damage' that was not expected or not intended by the 'Insured'." [21] "Property Damage" was defined as "physical injury to tangible property of a 'Third Party', including all resulting loss of use of that property of a 'Third Party'" [22] The Policy also defined "Third Party" as "any company, entity, or human being other than an 'Insured' or other than a subsidiary, owned or controlled company or entity of an 'Insured'." [23]

The Tenth Circuit concluded the Policy covers damages arising from an "occurrence," which includes an accident causing damage to the property of a third party — even though the term "accident" is not defined under the Policy. [24] The Tenth Circuit reasoned B&V did not intend or expect its subcontractor to damage the JBRs. [25] Because the JBRs' construction defects were unintentional, they constituted an accidental "occurrence." [26] Next, the Tenth Circuit considered Aspen's argument that damage to a third party did not occur since the Policy designated AEP as an additional insured, and the JBRs belonged to AEP. [27] Disagreeing, the Court found that "when AEP claimed damages against B&V, the separation of insureds clause rendered AEP a third party with respect to its claims for property damage against B&V." [28] Thus, the damages involved physical harm to the property of a third party.

In further support of the ruling that it is a covered "occurrence," the Tenth Circuit noted that Aspen's interpretation of "occurrence" would render several Policy provisions "surplusage," in violation of New York general principles of contract interpretation. [29] The Policy included a "Your Work" exclusion that prohibited coverage for property damage to B&V's own *completed* work. [30] The "subcontractor exception" to the "Your Work" exclusion, however, provided that the exclusion did 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." [31] The Policy further contained "Endorsement 4," which excluded coverage for property damage to "*that particular part* of real property" on which B&V or its subcontractor were actively working. [32]

Aspen's interpretation of "occurrence" excluded accidental damage to B&V's own work resulting from a subcontractor's faulty workmanship. [33] The Tenth Circuit found that the Policy's "Your Work" exclusion and "subcontractor exception" would lose their meaning under Aspen's definition of "occurrence" because "it would be

redundant to say the Policy does not cover property damage to B&V's own work (as stated in the 'Your Work' exclusion) if the definition of 'occurrence' categorically and preemptively precludes coverage for such damages in the first instance." [34] The Tenth Circuit further explained "there would there would be no reason for the Policy to state that it covers damages to [B&V]'s work when 'the damaged work . . . was performed . . . by a subcontractor' if the basic insuring agreement does not encompass these damages." [35] The Tenth Circuit further held Aspen's interpretation of an "occurrence" would also render part of "Endorsement 4" meaningless if faulty workmanship resulting in damage to B&V's own work could never trigger coverage as an "occurrence." [36] In essence, if the Policy could never cover damage to the B&V's work in the first instance, then there would be no reason for "Endorsement 4" to exclude coverage only for damage to a "particular part" of the JBRs. [37]

General contractors should take note of the Tenth Circuit's policyholder-friendly decision in *Black & Veatch Corp.*, which provides guidance to insureds with policies governed by New York law. Although New York's highest court has not addressed whether construction defects caused by a subcontractor's defective work constitutes a covered "occurrence" under CGL policies, the Tenth Circuit came to a significant conclusion while interpreting New York law. Policyholders should keep an eye on whether New York "joins the clear trend" among other states' interpretation of CGL coverage.

[1] 882 F.3d 952 (10th Cir. 2018).

[2] *Id.* at 971.

[3] *Id.* at 957.

[4] *Id.* at 957.

[5] *Id.* at 954.

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.* at 955–56.

[11] *Id.* at 956.

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.* at 956–57.

[18] *Id.* at 956–57, 962.

[19] *Id.* at 958.

[20] *Id.* at 955.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id.* at 965.

[25] *Id.* at 962–63.

[26] *Id.*

[27] *Id.* at 963.

[28] *Id.* at 964.

[29] *Id.*

[30] *Id.* at 955.

[31] *Id.* at 956.

[32] *Id.* at 955 (emphasis in the original).

[33] *Id.* at 964.

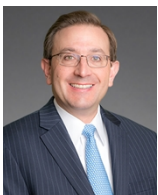
[34] *Id.*

[35] *Id.*

[36] *Id.* at 965.

[37] *Id.*

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