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Full circle on insurance coverage for construction defect claims

The Colorado General Assembly's 2010 session capped a turbulent 18 months for construction professionals and their insurers, an issue affecting liability for construction defects in commercial, residential and mixed-use buildings throughout the state. The turmoil surrounded the question of whether commercial general liability insurance policies issued to contractors, subcontractors and other construction professionals covered claims for construction defects, an issue on which courts throughout the country continue to disagree. The controversy centered around two common terms in CGL policies: "accident" and "occurrence" – specifically, whether a defective workmanship claim, standing alone, is an "accident" constituting a covered "occurrence." If the answer is yes, then defense, settlements and judgments against the construction professional are covered; if the answer is no, they are not. In Colorado this controversy wound its way through state trial courts, the Colorado Court of Appeals and federal courts before being resolved by the General Assembly.

■ **The (unsettled) law before 2009.** In 2002, owners obtained a defective workmanship judgment against their builder and sued to recover from the builder's CGL insurer. The trial court ruled that the defective workmanship was an "accident" constituting an "occurrence" under the builder's insurance policy and the insurer appealed to the Colorado Court of Appeals. In 2005, the Court of Appeals issued its opinion in *Hoang v. Monterra,* holding that faulty workmanship claims were covered by CGL policies and that the proper focus in arriving at this conclusion was the construction professional's "knowledge and intent." While this case involved residential construction defects, the holding applied equally to commercial and mixed-use projects.

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As of February 2005, the *Monterra* holding obliged lower courts deciding similar cases to hold that CGL policies covered faulty workmanship claims. But the *Monterra* case did not conclusively resolve the issue. In the years following *Monterra,* a significant rift developed on this issue among states throughout the country. Here, the Colorado Court of Appeals has 22 judges but a "panel" of only three judges is assigned to each case and one panel does not always follow the next. That is what happened in 2009.

■ **General Security and its aftermath.** In February 2009, a different panel of the Court of Appeals dealt a significant blow to construction professionals seeking insurance coverage in construction defect cases. In 2003, a builder was sued for construction defects and in turn sued its subcontractors and their CGL insurers, who in turn sued their sub-subcontractors and CGL insurers. This resulted in a dispute between a CGL insurer for a subcontractor and a CGL insurer for a sub-subcontractor as to whether the sub-subcontractor's alleged faulty workmanship was an "occurrence" under its policy. The trial court ruled that it was not an "occurrence" and the subcontractor's insurer appealed to the Colorado Court of Appeals. In the ensuing opinion in *General Security Indemnity Co. of Arizona v. Mountain States Mutual Casualty Co.,* the Colorado Court of Appeals declined to follow *Monterra* and held that "a claim for damages arising from poor workmanship, standing alone, does not allege an accident that constitutes a covered occurrence, regardless of the underlying legal theory pled."

The *General Security* ruling prompted a wave of alarm among construction professionals who rely on CGL policies for defense and indemnification, and owners who rely on CGL policies to fund repairs. Because *General Security* involved two insurers, many observers believed the decision was the result of the insurance company fox guarding the coverage henhouse.

In the aftermath of this decision, a Colorado federal court followed *General Security* in *Greystone Construction Company, Inc. v. National Fire & Marine Ins. Co.,* holding that a CGL insurer owed no duty to defend faulty workmanship claims. Based on the *General Security* and *Greystone* cases, insurers began disputing and denying coverage for construction defect claims.

■ **House Bill 10-1394 to the rescue.** In response to these developments, the Colorado General Assembly introduced HB10-1394, which reinstated Colorado law as it existed before *General Security.* The bill essentially dictates to courts the manner in which typical CGL policies are to be construed. Specifically, HB10-1394 mandates that:

1. Courts, when construing a typical CGL policy, should find that work of construction professionals that results in property damage is an "accident," and is therefore a covered "occurrence."

2. Insurers may disclaim coverage for construction defect liability if the insurer can show that a) a policy exclusion or limitation eliminates such coverage; and b) that no exception to the exclusion revives such coverage.

3. HB10-1394 does not require insurers to provide particular coverage to a construction professional and, going forward, insurers may still disclaim coverage for construction defects.

HB10-1394 sparked considerable controversy. While being debated in the General Assembly, the bill received strong and vocal support from both construction professional groups and owner groups – typical legislative foes who worked in tandem to see HB10-1394 passed. The bill was aggressively opposed by the insurance industry, which won several concessions in amendments to the bill.

The matter was resolved for now when Gov. Ritter signed HB10-1394 into law this year on May 21. In the wake of its passage, construction professionals and owners generally agree that the bill restored a fair and predictable coverage scheme that already existed in Colorado before *General Security* muddied the issue in 2009. But insurers insist HB10-1394 goes too far, turning CGL policies into a guarantee of the quality of work and forcing insurers to defend claims that were never envisioned. Some insurers have hinted at challenging HB10-1394 as unconstitutional; other insurers have proclaimed their intent to leave the Colorado market. Time will tell…

While the issue may plague courts and legislators in the future, it is settled for now. ▲