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The Tenth Circuit Hands Another Win To Policyholders Seeking To Insure Defective Workmanship By Their Subcontractors

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Your company, an engineering firm, is hired by an agent for coal-fired plants to serve as contractor on projects to build jet bubbling reactors, which eliminate contaminants from the plants' exhaust. Your company, in turn, subcontracts the engineering and construction of the reactors' internal components to another firm. After the contractor's work is done, the plants discover that the components are defective, causing the reactors to deform, crack or even collapse. The agent notifies your company of the problem and asserts that it is liable for the costs of repairing and replacing the defective components, an amount which will run well into the hundreds of millions of dollars. Your company tenders the claim under its commercial general liability ("CGL") policy, which says that it covers amounts your company is legally obligated to pay as damages for property damage caused by an "occurrence." The policy defines "occurrence" to mean an "accident." Clearly, the defective workmanship was not intentional. While the policy excludes coverage for property damage to your company's completed work that arises out of that work, that exclusion does not apply when the work at issue was performed on your company's behalf by a subcontractor. Because the property damage here arose out of the subcontractor's work, coverage seems fairly straightforward, but the insurance company flatly denies the claim. It contends that defective workmanship by your subcontractor is not an "accident" or "occurrence" within the meaning of the policy, even if the property damage was not intentionally caused. Surprisingly, not that long ago, many courts would have sided with the insurance company in denying coverage. CGL policies are generally issued on standardized forms. This standardization over time has resulted in a fairly robust – though often inconsistent – body of law interpreting the intricacies of their various provisions. Even though the standard CGL definition of "occurrence" says nothing about workmanship, a number of courts looked beyond the text of the policy to reason that, as a general principle, CGL policies simply were never intended to function as a "security bond" for defective workmanship. In recent years, that interpretation of CGL policies – always controversial – has fallen sharply out of favor. In *Black & Veatch Corp. v. Aspen Ins. (UK) Ltd.*, a case recently decided by the Tenth Circuit Court of Appeals, the court looked at the above facts and concluded that New York courts – long an adherent to a narrow interpretation of CGL coverage – would find that the property damage arising from the subcontractor's work was a covered "occurrence" under the policy. Black & Veatch (B&V), the policyholder, entered into a settlement obligating it to pay more than $225 million for the costs of repairing the reactors due to defective workmanship by B&V's subcontractor,

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Midwest Towers, Inc. When Aspen, an excess insurer, denied the claim, B&V sued the carrier in federal court in Kansas. On cross motions for summary judgment, the court found that, under applicable New York law, there could be no "occurrence" triggering coverage under the Aspen CGL policy unless the damage occurred to something other than B&V's own work product (which, under the policy, includes work performed by B&V or by subcontractors on its behalf). B&V appealed to the Tenth Circuit. The Tenth Circuit started its analysis with the policy's insuring agreement, which encompasses liability for property damage arising out of an "occurrence," defined as an "accident." It noted that New York authorities have held that "accident" means "unexpected and unintentional." Although an insured may foresee that its subcontractor may construct something deficiently, the court said that "does not render the resulting damages intentional" or "expected." In short, the court found nothing in the insuring agreement that excluded defective workmanship. The court then turned to the policy's "your work" exclusion, which excludes coverage for the property damage to the insured's own completed work that arises out of the work. In particular, the court focused on an exception to that exclusion, commonly referred to in the insurance world as the "subcontractor exception" to the "your work" exclusion. That is, the 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." Aspen argued that the subcontractor exception cannot create coverage for defective workmanship that doesn't exist in the first place. The court flipped Aspen's argument on its head. It focused on a fundamental principle of insurance policy construction – a policy should be interpreted as a whole, with every provision helping to interpret every other provision. The reason for this rule stems from the reality that contracts generally are carefully written by their drafters to achieve an intended result, and so provisions in those contracts should not be read as meaningless throwaways (or "surplusage," in legal parlance). In construing the Aspen CGL policy as a whole, the court observed that, if "occurrence" and "accident" did not include encompass defective workmanship, both the "your work" exclusion and its subcontractor exception would be pointless. "It would be redundant," the court wrote, "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 place." While the dissent argued that the majority was selective in its reading of New York authorities, *Black & Veatch* is significant in that it continues an important trend in the courts in interpreting policies based on what they(?)say, not what they may have been meant to cover. The court noted that there has been "near unanimity" in state supreme court decisions since 2012 that construction defects can be "occurrences" under a reading of CGL policies as a whole. While it remains to be seen whether New York courts will agree with the Tenth Circuit's reading of New York law, this decision is yet another win for policyholders seeking to insure the risk of defective workmanship of their subcontractors.