Recent Third Circuit Decision Provides Insight into Pennsylvania's Approach to CGL Coverage for Faulty Construction Claims

Despite substantial uniformity in language among commercial general liability ("CGL") policies, the extent of coverage can vary depending upon which state's law applies. One contested issue among the states is whether CGL policies should extend coverage for property damage caused by faulty construction, and what the extent of any such coverage should be. This article discusses a recent opinion reflecting the current status of Pennsylvania law with respect to CGL coverage for faulty construction claims, and briefly touches on the policy behind Pennsylvania's existing approach.

A recent Third Circuit decision applying Pennsylvania law, *Specialty Surfaces International, Inc. v. Continental Casualty Co.*, addressed the scope of an insurer's duty to defend and indemnify a contractor for faulty workmanship claims under a CGL policy.[1] In *Specialty Surfaces*, the source of the defective construction allegations stemmed from a project to install synthetic turf fields and drainage systems for four schools in the Shasta Union High School District ("Shasta").[2] Empire and Associates, Inc. ("Empire") was hired as a subcontractor to provide and install synthetic turf fields manufactured by Specialty Surfaces, Inc., ("Specialty Surfaces") as well as to install drainage systems. Empire and Specialty Surfaces, working together as "Sprinturf," provided an eight-year warranty for each of the fields.[3]

According to Shasta, within a year after the project commenced, the synthetic turf systems showed signs of defects in materials and workmanship.[4] Shasta alleged that the subdrain systems failed in each of the fields, resulting in a series of events that created unstable playing surfaces. Shasta also alleged that the synthetic turf material was weak enough to be torn by hand. Shasta alleged property damage to the turf, the subdrain system, the liner, and the subgrade.[5] As a result, Shasta filed suit against Specialty Surfaces, claiming breach of warranty.[6] Because Continental Casualty did not have a duty to defend based on the allegations in the original complaint,[7] Shasta subsequently amended its complaint to add a negligence claim against Empire.[8]

Upon receiving notice of Shasta's original complaint, Specialty Surfaces notified Continental Casualty of the lawsuit and requested coverage under its CGL policy.

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[1] 609 F.3d 223 (3d Cir. 2010).
[2] *Id.* at 227.
[3] *Id.*
[4] *Id.* at 228.
[5] *See id.*
[6] *Id.*
[7] *Id.* at 238.
[8] *Id.* at 227-28. (Specialty Surfaces is a Pennsylvania corporation and Empire is a California corporation that is a wholly owned subsidiary of Specialty Surfaces. After describing the facts, the court referred to the entities collectively as Specialty Surfaces, which this article will also do.)

Continental Casualty refused, maintaining that faulty workmanship is not an "occurrence" causing "property damage" as required by the policy.[9] After Shasta filed its amended complaint adding a claim for negligence, Continental Casualty agreed to defend Specialty Surfaces subject to a reservation of rights.[10] When Continental Casualty imposed limitations on its coverage, the issue went to court, with Specialty Surfaces asserting that Continental Casualty was required to provide coverage as of the date of the first complaint. Continental Casualty countered that it had no obligation to provide coverage at any time.[11] The District Court held in favor of Continental Casualty and the Court of Appeals subsequently affirmed.[12]

The Court of Appeals held that the CGL policy did not provide coverage for the claims alleged in this case, focusing its analysis on the application of the term "occurrence." The court concluded that under Pennsylvania law, to qualify as an "occurrence," there must be a "fortuitous event" resulting in property damage.[13] The court proclaimed, "[f]aulty workmanship, even when cast as a negligence claim, does not constitute such an event."[14]

Further, the court held that any foreseeable damage resulting from faulty workmanship is not sufficiently fortuitous to be considered an occurrence.[15] The court denied Specialty Surfaces' claim that water damage to the subgrade must be covered because it was outside the "work product" of the insured. In denying this argument, the court focused on whether the damage was caused by an "accident," or whether the damage was a foreseeable result of faulty workmanship. Because the damage was a foreseeable result of faulty workmanship, it was not an "occurrence" under the policy, despite the fact that the damage occurred to property that was outside of the contractor's scope of work.[16]

Specialty Surfaces conforms to Pennsylvania precedent regarding the meaning of "occurrences" in CGL policies.[17] In prior recent cases, Pennsylvania courts have limited

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[9] *Id.* (The policy in question defined "property damage" as "[p]hysical injury to tangible property, including all resulting loss of use of that property." "Occurrence" was defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions.")
[10] *Id.* at 229.
[11] *Id.*
[12] *Id.* at 229, 237.
[13] *Id.* at 231.
[14] *Id.*
[15] *Id.* at 239.
[16] *Id.*
[17] *Specialty Surfaces* has also been cited with approval in *National Fire Insurance Co. of Hartford v. Robinson Fan Holdings, Inc.*, No. 10-1054, 2011 WL 1327435 (W.D. Pa. Apr. 7, 2011). The *National Fire* court, applying Pennsylvania law, held that an "occurrence" does not include claims of faulty workmanship. The court suggested that

insurers' duties to defend in faulty workmanship cases. For example, in *Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Insurance Co.,* the Pennsylvania Supreme Court looked to the language of the policy, which defined an "occurrence" as being an "accident," meaning that it is "unexpected."[18] As such, an "occurrence" "implies a degree of fortuity that is not present in a claim for faulty workmanship."[19] Based on this definition, the *Kvaerner* court held that the faulty workmanship of Kvaerner's subcontractor was not an "occurrence" for purposes of triggering coverage.

Additionally, in *Millers Capital Insurance v. Gambone Bros. Development Co*., the Pennsylvania Superior Court held "natural and foreseeable" events that exacerbate damages caused by faulty workmanship cannot be considered to be an "occurrence."[20] In *Millers*, the underlying action involved a claim for faulty construction resulting in severe water leaks, which damaged home interiors.[21] Because rainfall was a "natural and foreseeable" act that would tend to exacerbate the existing faulty construction, the court held that the water damage was not sufficiently fortuitous to be considered an "occurrence."[22]

In part, Pennsylvania decisions on this issue are influenced by the business risk doctrine.[23] This doctrine, credited to a 1970 law review article by Roger C. Henderson, was cited with approval by the Pennsylvania Supreme Court in *Kvaerner*.[24] The theory posits that those covered by CGL policies must not look to insurance to cover business risks within their control.[25] In other words, the insured party should not receive coverage for a risk that it could have avoided.[26] The *Kvaerner* court explained its support for this view, stating that the CGL policy is not intended to act as a "performance bond" for a contractor's work.[27]

Pennsylvania case law distinguishes between providing coverage when a product malfunctions, as opposed to flawed workmanship, which will not trigger coverage.

[18] 908 A.2d 888, 897-98 (Pa. 2006).

[19] *Id.*

[20] 941 A.2d 706, 713 (Pa. Super. Ct. 2008).

[21] *Id.* at 715.

[22] *Id.*

[23] James Duffy O'Connor, *What Every Court Should Know About Insurance Coverage for Defective Construction*, 5 Am. C. Constr. L.J. 1 (2011).

[24] *Kvaerner*, 908 A.2d at 899, n.10; *see also id.*

[25] O'Connor, *supra* note 23.

[26] Katherine J. Solon, Case Note, *Contracts—Beating Them at Their Own Game: The Business Risk Doctrine and the Broadening Coverage of Commercial General Liability Insurance*—Thommes v. Milwaukee Insurance Co., 30 Wm. Mitchell L. Rev. 673, 678 (2003).

[27] *Kvaerner*, 908 A.2d at 899.

Pennsylvania's approach is not replicated in many states.[28] The views expressed in *Kvaerner* have been rejected in some cases as overly limiting liability coverage, as well as being based on an outdated version of the CGL policy, among other reasons.[29] The result of policy disagreements such as these is that the extent of CGL coverage for faulty workmanship will vary depending upon which state's law applies.

The business risk doctrine is just one issue that pulls states in divergent directions with respect to the scope of coverage under CGL policies. This varied landscape highlights the importance of becoming familiar with the particular state law that may apply to an insurance policy for any given construction project. For Pennsylvania law, *Specialty Surfaces* offers an informative snapshot of Pennsylvania's jurisprudence on this issue.

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[28] *See, e.g., United States Fire Ins. Co. v. J.S.U.B.*, 979 So. 2d 871, 887-88 (Fla. 2007) (rejecting argument that interpreting the term "occurrence" to include a subcontractor's defective work would convert the policy into a "performance bond"); *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1, 20 (Tex. 2007) (holding that unintended construction defects may be considered an "accident" or "occurrence" under a CGL policy).

[29] O'Connor, *supra* note 23.