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CONNECTICUT SUPREME COURT: CGL POLICY CAN COVER CONSTRUCTION DEFECTS

By [Martin A. Onorato](#)

Connecticut has become the latest state to declare itself in the national debate over whether, and to what extent, general liability insurance covers damage caused by construction defects. This discussion goes to the essence of insurance as a risk transfer mechanism, focusing on whether defective workmanship is akin to a fortuitous accident that might be entitled to coverage or more like a foreseeable business risk. In a Supreme Court decision released last week, Connecticut has joined a nationwide trend toward a more expansive reading of liability insurance that covers damage caused by defective construction work in some instances. The Court rejected the insurance company's argument that general liability policies never cover damages caused by defects in the insured's project. Specifically, the Court held that a construction defect that damages another part of a project can constitute an "occurrence" causing "property damage" and avoid the "your work" exclusion. The Supreme Court's decision is here: [Capstone Bldg. Corp. v. American Motorists Ins. Co.](#)

The decision arose out of defective construction at the University of Connecticut's Hilltop student housing complex. UConn hired Capstone as its general contractor and procured the project's general liability insurance under an owner-controlled insurance program (OCIP), which covered Capstone as a named insured. The CGL policy was the standardized 1986 ISO form used in the construction business throughout the country. After completion, UConn discovered that a number of building code violations and other construction defects had produced excess carbon monoxide from hot water heater leaks and inadequate ventilation. The estimated cost of remediation was substantial. UConn brought a \$25 million claim against Capstone, which in turn sought coverage from the OCIP carrier. The insurer denied coverage and refused to defend Capstone after concluding that the

AT THE PODIUM

[Jonathan R. Hausner](#) taught the Construction Administration class with Maureen McDonough, director of Program Administration of Harvard University, at the New England Chapter of the Construction Management Association of America. The class helps to prepare candidates for their certification exam.

[Peter Strniste](#) recently presented with Donald Shubert, president of the Connecticut Construction Industries Association, a program at the Connecticut Surety Association's Spring Meeting. The presentation explored the Supreme Court's recent decision in *State of Connecticut v. Lombardo Bros. Mason Contractors, Inc.*, holding that statutes of limitations do not apply to the State of Connecticut.

[Ryan M. Burns](#) delivered a presentation at the Construction Law Annual Update program at the offices of the Connecticut Bar Association. His

claims were not covered by the OCIP.

Capstone sued the insurance company for coverage in the U.S. District Court in Alabama. The District Court sought guidance from Connecticut's highest state court on several questions of Connecticut law involved in the case, including the question of a general liability insurer's obligation to provide coverage for construction defects. This was an issue of first impression for the Connecticut Supreme Court, which noted differing treatment of this issue among the jurisdictions. The Court ultimately sided with the jurisdictions interpreting general liability policies as including some coverage for damage caused by construction defects.

The Connecticut Supreme Court's analysis touched on key definitions found in standard general liability insurance policies. Generally, liability insurance covers "occurrences," which by definition must be accidental in nature. Capstone's insurance company argued that defects resulting from the negligent acts of contractors are not accidental, in that they are the product of a deliberate act by a contractor, and that they lack the "fortuitous" element that is fundamental to insurance. The Court disagreed, noting that faulty workmanship may be considered accidental to the extent that the consequences of the insured's conduct are unexpected or unintended. A deliberate act, performed negligently, is still an accident.

Turning to another important definition in the policy, the Court noted that the OCIP policy was drafted to cover "property damage," which is generally understood to involve physical damage to tangible property. The Court held that "property damage" includes damage to nondefective work that had been physically damaged by the defective work but does not include damage to the defective work itself. Thus, "property damage" of the type covered by a liability policy might include water damage to drywall caused by a leaking pipe joint that was poorly installed, but it excludes the costs of the leaking pipe itself. Similarly, the Court found, building code violations and poor quality control were also specifically mentioned by the Court as not covered, unless they cause damage to other parts of the building. Also of note, the Court concluded that the presence of excess carbon monoxide does not constitute "property damage," absent actual physical damage to property.

In reaching its conclusion, the Court was also required to address the policy's "your work" exclusion and the "subcontractor exception" thereto. The exclusion states that the policy does not cover damage to an insured contractor's own work. In this case, the entire Hilltop project was Capstone's own work and, therefore, was excluded from coverage under the OCIP; however, the "subcontractor exception" to the exclusion restores coverage where property damage is caused by the defective work of one of the insured contractor's

presentation, "Developments in Bonding and Surety Law," was part of a CLE program of the CBA's Construction Section.

[Martin A. Onorato](#) and [Gregory R. Faulkner](#) are attending NACUA's 53rd annual conference in Philadelphia, PA, held on June 19-21. The National Association of College and University Attorneys meets annually to discuss legal issues of importance to attorneys representing educational institutions.

[Joseph A. Barra](#) will present at the ACG of Massachusetts Construction Law Series on June 25, 2013, addressing the business factors and legal risks to consider when deciding whether Building Information Modeling (BIM) should be used on a particular project.

[Dennis C. Cavanaugh](#) and [Todd R. Regan](#) will speak at the 38th Annual Meeting of the Surety & Fidelity Claims Institute in Cambridge, MD, on June 28, 2013.

CONNECTICUT LEGISLATURE PASSES TAX AMNESTY

The program offers a 75 percent reduction of interest and waiver of penalties to those who participate. Nonfilers are subject to a mandatory 25 percent penalty.

Both chambers of the Connecticut General

subcontractors. Thus, the Supreme Court advised the District Court in Alabama that coverage may be available to the extent that Capstone can show that the defect was part of its subcontractor's work, and work that cannot be attributed to a subcontractor remains excluded from coverage.

Finally, the insurance company sought to persuade the Court that allowing coverage would unfairly transform liability insurance into a performance bond. The differences between insurance and bonds are, of course, considerable. Broadly speaking, insurance is a contract of indemnity while a bond is a form of guaranty that the contractor will perform its contractual obligations. Insurance is generally underwritten based on actuarial risk evaluations while bonds are underwritten based on the contractor's ability and financial strength. And liability insurers may seek to recover losses from third parties, but not generally from the insured, whereas a surety's expectation is that the bonded contractor will indemnify the surety against any bond losses. In *Capstone*, the Court recognized some similarities in coverage between liability insurance and performance bonds, but it was satisfied that the overlap was limited, that it did not alter the fundamentally different purposes of insurance and bonding, and that it did not compel the Court to reach a different conclusion.

This case is a major development in construction risk management and is likely to have significant ramifications in contract drafting, claims handling, and dispute resolution involving building projects in Connecticut.

For more information on the *Capstone* case or on this subject, contact Martin A. Onorato at monorato@rc.com or Dennis Cavanaugh at dcavanaugh@rc.com.

Assembly passed legislation, originally proposed by Governor Dannel Malloy, authorizing the Department of Revenue Services (DRS) to implement a tax amnesty program expected to raise \$35 million. Provided that it is signed into law by the governor, this initiative will represent the fifth time that Connecticut has implemented a tax amnesty program [Click here for more details.](#)

Please contact [Scott E. Sebastian](#) for assistance with any tax issues.

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