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Defective Construction CGL Coverage: The Subcontractor Exception

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DEFECTIVE CONSTRUCTION CGL COVERAGE: THE SUBCONTRACTOR EXCEPTION

*Christian H. Robertson II**

In the construction industry, commercial general liability (CGL) insurance is the standard policy for managing property damage risks. Historically, CGL policies do not cover an insured’s own defective construction because the insured controls its own work and can reasonably foresee the damage that may result from defective work. But what about the defective work of an insured’s subcontractor? Practical considerations limit an insured’s effective control of every aspect of a subcontractor’s work, and this limitation complicates the insured’s ability to foresee future risks. In 1986, the increasing involvement of subcontractors led general contractors to insist upon protection from subcontractor work risks in CGL policies. The insurance industry agreed upon and created the subcontractor exception. Insurers, however, have claimed that CGL policies exclude coverage for any defective work, including the work of a subcontractor.

This Note discusses court decisions rejecting the categorical denial of coverage for any defective work and how courts have found coverage exists where a subcontractor’s defective work is beyond the insured’s effective control and not foreseeable. Over the past 15 years, 23 state supreme courts have ruled that CGL policies cover the defective workmanship of an insured’s subcontractor. To illustrate the trend toward coverage, the Note summarizes a recent Ohio appellate court decision as a case study of the issue.

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INTRODUCTION

In 2008, Ohio Northern University (“ONU”) entered a deal with a general contractor, Charles Construction Services, Inc. (“Charles Construction”), for the construction of a 57,000 square-foot luxury hotel and conference center.¹ After completion, ONU found water leaks in and moisture damage to the interior and exterior walls of the property.² ONU investigated the leaks and discovered structural defects that required total removal and replacement of the brick façade.³ In 2012, ONU sued Charles Construction for, among other things, breach of contract and sought to recover damages for defective construction.⁴ Charles Construction responded by bringing a third-party lawsuit against its subcontractors, alleging they were responsible for the defective work.⁵

In 2013, a year into the lawsuit, Charles Construction’s insurer, Cincinnati Insurance Company (“Cincinnati Insurance”), entered the case. Cincinnati Insurance sought a declaratory judgment against Charles Construction. Specifically, Cincinnati Insurance asked the court to find that it did not owe Charles Construction a duty to defend and indemnify it under the agreed upon commercial general liability (“CGL”) policy.⁶ In bringing this claim, Cincinnati Insurance relied on a broad interpretation of the Ohio Supreme Court’s 2012 ruling in *Westfield Ins. Co. v. Custom Agri Systems, Inc.*, where the court held:

1. See *Ohio N. Univ. v. Charles Constr. Servs., Inc.*, 2017-Ohio-258, 77 N.E.3d 538, ¶ 2 (3d Dist.).

2. See *id.* ¶ 3.

3. See *id.*

4. See *id.* ¶ 4.

5. See *id.*

6. *Id.*

[C]laims of defective construction or workmanship brought by a property owner are not claims for “property damage” caused by an “occurrence” under a commercial general liability policy.⁷

In *Ohio N. Univ. v. Charles Constr. Servs., Inc.*, Charles Construction and ONU joined and sued to compel Cincinnati Insurance’s coverage. They sought to distinguish the *Custom Agri* case by showing that the defective work on its property was the product of the insured’s *subcontractor* and not the insured general contractor itself.⁸ The issue at trial was whether ONU’s claims against Charles Construction for its subcontractors’ defective construction fell within the insurance policy issued by Cincinnati Insurance.⁹ ONU and Charles Construction argued that the *Custom Agri* opinion only denies CGL coverage from including an insured’s *own* defective work, not that of its subcontractors.¹⁰ Against ONU and Charles Construction’s arguments, the trial court adopted the insurer’s broad interpretation of *Custom Agri* and granted the insurer’s motion for summary judgment.¹¹ ONU and Charles Construction appealed the decision.

The *Ohio Northern* case represents the commonly reoccurring issue between insurers and contractors: whether CGL insurance covers defective construction. Generally speaking, contractors seek coverage for unintentional defective workmanship, while insurers resist insuring “business risks” within the contractor’s control.¹² The debate historically centered around the insured contractor’s own defective work. Although experts like Professor Christopher French advocate for broader coverage for one’s own faulty workmanship, many state courts remain reluctant to adopt such an expansive interpretation.¹³ Courts, however, have begun to recognize an exception to the traditional rule of categorically denying CGL coverage for defective workmanship: the subcontractor exception.

This Note addresses the question of whether an insured’s CGL policy covers defective construction claims when its subcontractors performed the faulty workmanship. By analyzing policies and trending judicial interpretations across the country, the Note asserts that courts should presume coverage, unless the insurer shows that the insured had sufficient control of the process that resulted in the defective work or that the policy clearly excludes the specific coverage without exception. Although the Note surveys court interpretations on a state-by-state basis, it uses the ongoing

7. See *id.* ¶ 6 (citing *Westfield Ins. Co. v. Custom Agri Systems, Inc.*, 133 Ohio St.3d 476, 2012–Ohio–4712, 979 N.E.2d 269, ¶ 21).

8. See *id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. See Robert J. Franco, *Insurance Coverage for Faulty Workmanship Claims under Commercial General Liability Policies*, 30 TORT & INS. L.J. 785 (1994).

13. See generally Christopher C. French, *Revisiting Construction Defects as “Occurrences” under CGL Insurance Policies*, 19 U. PA. J. BUS. L. 101 (2016).

Ohio Northern case as a current and illustrative case study of the identified trend.

Split into five parts, this Note begins with the fundamental rules and concepts of policy interpretation and ends with their application in courts nationwide. Part I sets forth the background of CGL policies. Part II discusses the canons of insurance policy interpretation applied by courts. Part III presents the relevant provisions within the standard CGL policy. Part IV establishes the courts' traditional denial of CGL coverage for an insured's own defective work. Part V presents the new, majority trend covering defective work under the subcontractor exception. The Note concludes with a suggested model framework for CGL coverage of an insured's subcontractor's defective work.

I. CGL BACKGROUND

CGL is a standard insurance policy in the construction industry.¹⁴ Seeking coverage for various projects, contractors throughout the country purchase CGL policies in an attempt to manage the bundle of risks inherent in their work.¹⁵ Insurers, however, limit coverage to insurable risks.¹⁶ Principally, insurable risks involve fortuitous loss.¹⁷ Unlike insurable risks, CGL policies do not cover risks resulting from poor business judgment, also known as business risks. One rationale for this distinction stems from the insurance carrier's ability to set premiums based on the statistical probability of fortuitous losses outside of the insured's control.¹⁸ "[T]o have predictable and affordable insurance rates, the insurers' assumptions of risk are usually limited to those beyond the 'effective control' of the insured."¹⁹ Capturing business risk concerns in CGL policies, however, has been an ongoing process, refined over many years. No organization has set the industry standard to a greater degree than the Insurance Services Office, Inc. ("ISO").

ISO is an insurance organization "that drafts many standard forms used by insurers, including the main ISO CGL. . . form."²⁰ The ISO CGL form has become the industry standard and, although individual policies might include technical variations, the primary CGL provisions are largely the same across the country.²¹

Originally, the ISO CGL forms excluded business risks from coverage with broad provisions such as ISO's 1973 CGL policy provision "(o)",

14. See generally Lee H. Shidlofsky, *Deconstructing CGL Insurance Coverage Issues in Construction Cases*, 9 J. AM. COLL. CONSTR. LAW. 2 (2015).

15. See generally French, *supra* note 13.

16. See generally Franco, *supra* note 12.

17. *Id.*

18. *Id.*

19. *Id.* at 786.

20. Shidlofsky, *supra* note 14, at 75.

21. *Id.*

which denied coverage for “property damage to the work performed by or on behalf of the named insured out of the work or any portion thereof”²² This exclusion implicitly included the work of subcontractors. ISO, however, revised the business risk exclusions several times after 1973.²³ In 1976, ISO established the Broad Form Property Damage Endorsement.²⁴ This provision allowed contractors to replace the previous business risk exclusions like provision (o) by purchasing endorsements with narrower exceptions—effectively broadening their coverage.²⁵

The last major revision to the ISO CGL form came in 1986.²⁶ This revision is the most relevant for policy interpretation today.²⁷ According to many practitioners, the success of the Broad Form Property Damage Endorsement resulted in the insurance industry’s willingness to expand coverage in exchange for higher premiums.²⁸ Moreover, because subcontractors became increasingly integral to the construction industry, insured general contractors sought protection for subcontractor work outside their effective control.²⁹ This change manifested itself in the subcontractor exception—a key provision that has broadened coverage for insured contractors and is a central issue in cases like *Ohio Northern*.³⁰ The provision reads as follows:

This 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.³¹

On its face, this provision appears to clearly remove claims of faulty workmanship caused by a subcontractor from any coverage exclusion. The history of this provision, however, clearly indicates the intent of policyholders and of insurers to provide coverage for subcontractor work in exchange for higher premiums. This history is not the end of the story. Context, gained from the rest of the policy and from the unique facts of each case, is necessary to fully understand the extent of this important exception.

22. French, *supra* note 13, at 107 (citing INS. SERVS. OFFICE, INC., COMMERCIAL GENERAL LIABILITY COVERAGE FORM, No. CG 00 01 12 07 (2006)).

23. See Shidlofsky, *supra* note 14, at 8-9.

24. See French, *supra* note 13, at 107.

25. See *id.*

26. See generally *id.*

27. See generally Franco, *supra* note 12.

28. 9A LEE R. RUSS ET AL., COUCH ON INSURANCE § 129:18 (3d ed. 2005).

29. See generally *id.*

30. See *Ohio N. Univ. v. Charles Constr. Servs., Inc.*, 2017-Ohio-258, 77 N.E.3d 538 (3d Dist.).

31. INS. SERVS. OFFICE, INC., COMMERCIAL GENERAL LIABILITY COVERAGE FORM, No. CG 00 01 12 07 (2006).

II. CANONS OF INSURANCE POLICY INTERPRETATION

Insurance policies are contracts by nature.³² Accordingly, canons of contract construction—to the extent recognized by various jurisdictions—guide courts’ interpretation of policy provisions.³³ Theoretically, insurers and contractors can bargain for terms within the policy contract. Practically speaking, however, insurance policies like CGL are generally form contracts (ISO CGL standard forms) that are boilerplate or “take it or leave” contracts.³⁴ As a general rule, courts will start with the expressed policy language limited to the “four corners” of the policy.³⁵ If—and in many jurisdictions, only if—the policy fails to define a term and the term is susceptible to more than one reasonable interpretation, the court will look beyond the four corners of the policy to determine the parties’ intentions.³⁶

A. Interpreting Expressed Terms

1. Intent of the Parties

When interpreting a contract, courts must give effect to the intent of the parties.³⁷ As a basic principle of contract law, a contract is only enforceable if the parties mutually assent to the agreement. For instance, under a CGL policy, it is likely that the contractor intends to pay a premium in exchange for insurance coverage, while the insurer likely intends to provide insurance to a specific extent. The extent of the insurer’s intent to cover is generally reflected by clear language in the policy. If the language is ambiguous, a presiding court must look elsewhere to determine the parties’ intent. Nevertheless, effectuating the parties’ intent must always be the primary objective.³⁸

2. Plain and Ordinary Meaning Principle

To give meaning to the parties’ intent, the courts start with the plain and ordinary meaning of the policy language.³⁹ Courts should give words their plain meaning, unless the policy specifically defines the word or context gleaned from a reading of the whole policy gives credence to a different interpretation.⁴⁰ Dictionaries are often an acceptable source for

32. See 43 Am. Jur. 2d Insurance § 269.

33. See RUSS ET AL., *supra* note 28, at § 22:14.

34. See 108 ERIC M. LARSSON, AM. JUR. PROOF OF FACTS 351 § 8 (3d ed. 2009).

35. See 2 STEVEN PLITT, ET AL., COUCH ON INSURANCE 3D § 21:1, at 21-6 (2016).

36. See *id.*

37. See *id.*

38. See *id.*

39. See ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS § 6:2 (6th ed. 2017).

40. See *id.*

establishing the meaning of word not defined in the policy.⁴¹ Dictionaries, however, are not always reliable sources for ascertaining the parties' intent.⁴²

Custom might persuade the court to reject adopting a dictionary's definition. For example, when a term of art is apparent from the trade usage, a court should presume that the parties intended the term to have the customary meaning within the trade rather than a technical dictionary meaning.⁴³ Accordingly, when interpreting CGL policy terms, courts should give its language the meaning expressly defined or commonly understood in the trade before searching elsewhere for the plain and ordinary meaning.

3. Whole Policy Principle

Context is another necessary element considered in the interpretation of a policy. The whole policy principal requires courts to interpret a particular term in a manner consistent with the whole policy rather than interpreting the term in isolation.⁴⁴ The purpose of the whole policy principle is to eliminate absurd results—results that would render a provision meaningless or materially alter the provision's meaning.⁴⁵

By interpreting terms with the whole policy in mind, courts harmonize potentially inconsistent provisions. Insurers generally have greater bargaining power when drafting insurance policy provisions than policyholders.⁴⁶ If provisions are truly inconsistent, courts should give priority to terms whereby bargaining power was relatively closer. In CGL policies,

41. See, e.g., *Founders Ins. Co. v. Munoz*, 237 Ill. 2d 424, 436, 930 N.E.2d 999, 1005 (2010) (stating that “[w]here a term in an insurance policy is not defined, we afford that term its plain, ordinary and popular meaning, i.e., we look to its dictionary definition”); see also *Markel Ins. Co. v. Muzyka*, 293 S.W.3d 380, 386-87 (Tex. App. 2009).

42. See *Sanders v. Wallace*, 884 S.W.2d 300, 303 (Mo. Ct. App. E.D. 1994).

43. See *Lakehead Pipe Line Co., Inc. v. American Home Assurance Co.*, 981 F. Supp. 1205, 1211 (D. Minn. 1997); see also *Omni Berkshire Corp. v. Wells Fargo Bank, N.A.*, 307 F. Supp. 2d 534, 540 (S.D.N.Y. 2004) (stating that “[i]f the language of a contract is ambiguous, the court may look to extrinsic evidence of the parties' intent. Extrinsic evidence may include evidence of trade usage . . . when a trade usage is widespread, there is a presumption that the parties intended its incorporation by implication, unless the contract language negates it”).

44. See *Windt, Insurance Claims & Disputes: Representation of Insurance Companies & Insureds* 6th § 6:2 (2017).

45. See *Penthouse Owners Ass'n, Inc. v. Certain Underwriters at Lloyds, London*, 612 F.3d 383, 387 (5th Cir. 2010) (holding that “[w]e can acknowledge that some of the language of this [d]eductible . . . may be misleading; but only if read in virtual isolation. When the Deductible is read in its proper context of the policy as a whole, and with the common understanding of how deductibles operate in insurance policies, any ambiguity about the effect of this language on the scope of coverage vanishes”); see also *Blum v. 1st Auto & Cas. Ins. Co.*, 2010 WI 78, 326 Wis. 2d 729, 786 N.W.2d 78, 83-84 (2010) (finding that an insurance policy must “be read as a whole” and not “made ambiguous by isolating a small part from the context of the whole”).

46. See Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 963 (1970).

endorsements for broadened coverage should receive superior weight over standard boilerplate terms.⁴⁷ One of the reasons for the greater significance of endorsements is the higher premium paid for greater coverage under the compromise in 1986.⁴⁸ As a result, endorsements and their derivatives incorporated into the standard form—like the subcontractor exception—should receive greater weight when truly inconsistent with other provisions.⁴⁹

B. *Looking Beyond the “Four Corners”*

1. *Contra Proferentem*

As previously mentioned, CGL policies, like ISO CGL standard forms, are generally not negotiated but rather take it or leave contracts.⁵⁰ Boilerplate standard CGL forms are not necessarily a bad thing. For example, they facilitate standardization across the industry.⁵¹ They do, however, create a negotiation power disparity between the drafting insurer and the contractor. For this reason, courts assume the insurers that drafted the CGLs had the comparative advantage to define terms without ambiguity. This principle is known as *contra proferentem*.

Contra proferentem construes contract ambiguities in the light most favorable to the non-drafting party, which in the case of CGL insurance policies, is usually the contractor.⁵² For insurance policy interpretation, it “means any ambiguities in the policy language are construed against the insurers and in favor of coverage.”⁵³ According to Professor Christopher French, reoccurring litigation of a policy’s terms that concern coverage of construction defects “suggests the policy language must be ambiguous”; therefore, courts should apply *contra proferentem* in favor of contractors.⁵⁴ Courts, however, rarely deem CGL provisions ambiguous.⁵⁵ Although

47. See, e.g., *Adams v. Explorer Ins. Co.*, 107 Cal. App. 4th 438, 452 (2d Dist. 2003) (finding that “[a]n endorsement is an amendment of or modification of an existing policy of insurance. It is not a separate contract of insurance Endorsements on an insurance policy form a part of the insurance contract, and the policy of insurance with the endorsements and riders thereon must be construed together as a whole”); see also *Ayers v. C & D Gen. Contractors*, 237 F. Supp. 2d 764, 771 (W.D. Ky. 2002) (holding that “[e]ndorsements affixed to an insurance policy are to be read with and harmonized with the provisions of the policy; in the event of any conflict between the endorsement and the policy, the endorsement prevails Here, the endorsement does not provide that it applies to one part of the policy. Rather, it is provided as an endorsement to the ‘Workers Compensation and Employers Liability Insurance Policy’ ”).

48. See French, *supra* note 13, at 107.

49. See *id.*

50. See LARSSON, *supra* note 34, § 8.

51. See generally Franco, *supra* note 12.

52. See PLITT, *supra* note 35, § 21:1, at 21-5.

53. French, *supra* note 13, at 109.

54. *Id.* at 110.

55. See generally *infra* Figures 1-2 and notes 188-91.

some courts occasionally deem a term ambiguous, they often do so for the purpose of denying a motion for summary judgment rather than for the issuance of a final ruling.⁵⁶ *Contra proferentem* should, nevertheless, guide a court's interpretation of the policy ambiguities.

2. Reasonable Expectations Principle

Like *contra proferentem*, the reasonable expectations principle emerged from the onerous boilerplate characteristics of insurance policies.⁵⁷ Professor Robert Keeton established this famous principle in response to the growing concern that policyholders—like contractors—faced a comparative disadvantage in not only establishing terms but also in fully understanding the extent of their coverage.⁵⁸ Because policyholders are relatively less insurance-savvy than their industry counterparts, as a policy matter, courts should limit policy interpretation to the reasonable expectations of the parties apparent on the policy's face.⁵⁹ Likewise, rather than strictly following technical provisions embedded within the policy that excludes CGL coverage, courts should honor the reasonable expectations of coverage that contractors have when they read that “[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.”⁶⁰

III. CGL POLICY PROVISIONS

The ISO CGL form, as discussed in Parts I and II, has become the standard form used by insurers and contractors throughout the construction industry.⁶¹ Although the subcontractor exception provision language has become largely uniform, its interpretation has not—that is, until recently.⁶²

Part III presents excerpts of the standard ISO CGL form provisions relevant to the issue of whether a contract covers an insured's subcontractor's defective work. CGL language generally establishes coverage through the following flow: *first*, the policy covers bodily injury and property damage caused by an occurrence—that is, an accident; *second*, exclusions deny coverage for specific damage or conduct; and *third*, exceptions to exclusions restore coverage.⁶³ If an insured's claim is an occurrence

56. See, e.g., *Ohio N. Univ. v. Charles Constr. Servs., Inc.*, 2017-Ohio-258, 77 N.E.3d 538, ¶ 41 (3d Dist.).

57. See Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

58. See generally *id.*

59. See *id.*

60. INS. SERVS. OFFICE, INC., *supra* note 31, at 5.

61. See Shidlofsky, *supra* note 14.

62. See *infra* Figures 1-2 and notes 188-91.

63. See generally INS. SERVS. OFFICE, INC., *supra* note 31. (The listed sections are standard provisions within general CGL form policies. The pertinent parts included identify the policy's coverage, its exclusions from coverage, and exceptions to those exclusions.)

and either (1) not excluded or (2) excluded but restored by an exclusion's exception, then the policy should cover it.

The standard CGL policy provides for coverages and definitions, in pertinent part, as follows:

SECTION I – COVERAGES⁶⁴

COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages. However, we will have no duty to defend the insured against any “suit” seeking damages for “bodily injury” or “property damage” to which this insurance does not apply. We may, at our discretion, investigate any “occurrence” and settle any claim or “suit” that may result.

b. This insurance applies to “bodily injury” and “property damage” only if:

(1) The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory”;

(2) The “bodily injury” or “property damage” occurs during the policy period;

* * *

SECTION V – DEFINITIONS

* * *

13. “Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

* * *

17. “Property damage” means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it.

64. *Id.*

The majority of disputes over CGL coverage arise from competing interpretations of what constitutes an “occurrence,” a term essentially means an “accident.” The first question a court must answer is whether the bodily injury or property damage resulted from an accidental occurrence. As discussed in Part I, insurers seek to limit coverage to insurable risks and to exclude business risks.⁶⁵ The term “accident” arises from the fundamental insurance principle of fortuity—discussed more in Part IV.⁶⁶ Although CGL policies generally leave the word “accident” undefined, most courts define it as an event that is “unexpected or unintended.”⁶⁷

Regarding the exclusion for losses related to business risks, the standard CGL policy provides, in pertinent part, as follows:

22. “Your work”:

a. Means:

- (1) Work or operations performed by you or on your behalf; and
- (2) Materials, parts or equipment furnished in connection with such work or operations.

b. Includes:

- (1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your work”, and
- (2) The providing of or failure to provide warnings or instructions.

* * *

SECTION I, PART 2 – EXCLUSIONS⁶⁸

This insurance does not apply to:

a. Expected Or Intended Injury

“Bodily injury” or “property damage” expected or intended from the standpoint of the insured. This exclusion does not apply to “bodily injury” resulting from the use of reasonable force to protect persons or property.

* * *

j. Damage To Property

“Property damage” to:

65. See Franco, *supra* note 12.

66. Shidlofsky, *supra* note 14.

67. See e.g., Westfield Insurance Company v. Custom Agri Systems, Inc., 133 Ohio St.3d 476, 2012-Ohio-4712, 979 N.E.2d 269, ¶ 13 (defining an accident as an “unexpected and unintended” consequence).

68. See generally INS. SERVS. OFFICE, INC., *supra* note 31.

- (1) Property you own, rent, or occupy, including any costs or expenses incurred by you, or any other person, organization or entity, for repair, replacement, enhancement, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another's property;
- (2) Premises you sell, give away or abandon, if the "property damage" arises out of any part of those premises;
- (3) Property loaned to you;
- (4) Personal property in the care, custody or control of the insured;
- (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations; or
- (6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

The second part of Section I, illustrated above, provides the business risk exclusions incorporated from the pre-1973 ISO CGL form.⁶⁹ The theme common to the exclusions centers around effective control.⁷⁰ This is apparent in exclusion "(a)." If a general contractor intends or individually expects a consequence, it is within her effective control to avoid, and therefore, it is not an accident. Exclusions "(j)(5)" and "(j)(6)" have been highly litigated.⁷¹ Exclusion "(j)(5)" is particularly significant to the issue of covering the work of an insured's subcontractor. The language specifically excludes coverage for the work of an insured's subcontractor while *working* on the job. It is noteworthy, however, that the drafters wrote the "(j)(5)" exclusion in the present tense (e.g., "working") instead of the past tense used in exclusion "(j)(6)" (e.g., "performed"). Courts have interpreted this distinction to limit the scope of the "(j)(5)" exclusion of subcontractor defective work to that which occurs while working on the project and not that which occurs *after* completion of the work.⁷²

69. See Franco, *supra* note 12.

70. See PLITT, *supra* note 35.

71. Transportation Ins. Co. v. Piedmont Const. Group, LLC., 301 Ga. App. 17, 686 S.E.2d 824 (2009) (finding that determining that particular part of a property upon which the insured's subcontractor was working applied only to the room in which he was working at the time the fire was started, rather than the entire building that was being renovated at the time of the fire); see also Mid-Continent Cas. Co. v. JHP Development, Inc., 557 F.3d 207, 211 (5th Cir. 2009).

72. See Ohio N. Univ. v. Charles Constr. Servs., Inc., 2017-Ohio-258, 77 N.E.3d 538, ¶ 37 (3d Dist.).

The standard CGL policy provision that follows is of particular importance:

I. Damage To Your Work⁷³

“Property damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard”. *This 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* (emphasis added).

* * *

SECTION V – DEFINITIONS⁷⁴

* * *

16. “Products-completed operations hazard”:

a. Includes all “bodily injury” and “property damage” occurring away from premises you own or rent and arising out of “your product” or “your work” except:

(1) Products that are still in your physical possession; or

(2) Work that has not yet been completed or abandoned. However, “your work” will be deemed completed at the earliest of the following times:

(a) When all of the work called for in your contract has been completed.

(b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.

(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project. Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed.

In no part of the modern ISO CGL form is the 1986 endorsement so apparent as it is in the last sentence of exclusion “(1).” There it states the following: “This exclusion does not apply if . . . performed on your behalf by a subcontractor.”⁷⁵ This provision has become known as the “subcontractor exception.”⁷⁶ Although courts have historically been reluctant to

73. See INS. SERVS. OFFICE, INC., *supra* note 31, at 5 (emphasis added).

74. See *id.*

75. INS. SERVS. OFFICE, INC., *supra* note 31, at 5.

76. See *infra* Figures 1-2 and notes 188-91.

give it full effect—research indicates—and this Note argues—that many courts across the country have overcome that reluctance.⁷⁷

IV. COURTS DENYING CGL COVERAGE TO INSURED'S OWN DEFECTIVE WORK

Practitioners and academics have historically focused litigation and debate on the issue of CGL policy coverage of an insured's own defective work, placing less focus on the subcontractor exception.⁷⁸ Like the analysis applied to the subcontractor exception, the threshold question for coverage of an insured's own defective work remains to be whether the defective work constitutes an "occurrence" under CGL policies. Unlike the subcontractor scenario, however, contractors refute the validity of the effective control argument and focus on the unintentional and unexpected nature behind their defective work.⁷⁹

A. Arguments for Coverage and Professor French's Critique

Few experts have argued for the expanded coverage of CGL policies to include coverage of an insured's own defective work more than Professor Christopher French.⁸⁰ In his article, *Revisiting Construction Defects as "Occurrences" under CGL Policies*, French claims coverage analysis should presume that a contractor did not intend or expect the defective results of his or her work and, instead, should focus more on the business risk exclusions expressed in the policy.⁸¹ Distinct from the subcontractor exception analysis, French supports his assertion with three arguments: (1) the subjective standard of an insured's intent or expectations; (2) the errant citation to the *Weedo* precedent; and (3) the assumption error under the "moral hazard" argument.⁸²

To answer the threshold "occurrence" question, the court must determine whether the defective work was an accident.⁸³ As French claims, contractors do not intend for their product to be defective.⁸⁴ On the other hand, an insurer would likely counter that a contractor should reasonably expect defective results when his or her execution or the material used is sub-standard. Reasonableness, French argues, is irrelevant to the analysis of accidental defective work.⁸⁵ Specifically, French points to the language in ISO CGL Section I, exclusion "(a)," which states that "insurance does not apply to . . . 'property damage' expected or intended *from the stand-*

77. *Id.*

78. *See* French, *supra* note 13; Shidlofsky, *supra* note 14.

79. French, *supra* note 13.

80. *See id.*

81. *See id.* at 104.

82. *Id.*

83. *See* INS. SERVS. OFFICE, INC., *supra* note 31, at 14.

84. *See* French, *supra* note 13, at 143.

85. *See id.* at 144.

point of the insured.”⁸⁶ The language clearly indicates, as French claims, that the court should apply a subjective standard in determining whether the defective work was expected or intended and, therefore, not accidental.⁸⁷

Additionally, as French explains, one of the most errant citations courts use is that of the 1979 case *Weedo v. Stone-E-Brick, Inc.*⁸⁸ In *Weedo*, the New Jersey Supreme Court held that the cracks found in concrete poured by the subcontractor were not covered under the general contractor’s CGL policy.⁸⁹ Because the *Weedo* court supported its decision by referencing pre-1973 ISO CGL revision forms and performed no analysis regarding either property damage or occurrence, French claims that the holding no longer applies and is erroneous as a citation.⁹⁰ As French highlights, moreover, New Jersey recently completely overturned *Weedo* in its 2016 decision, *Cypress Point Condominium Ass’n v. Adria Towers, L.L.C.*⁹¹ There, the court found that a “your work” exclusion in a developer’s CGL policy did not preclude coverage of the rain-water damage caused by subcontractor’s faulty workmanship.⁹² French contends that the analysis under *Weedo*—as perpetuated by a minority of states—is obsolete, as several subsequent revisions to the ISO CGL policy incorporate new terms.⁹³

Insurers often cite the moral hazard public policy argument as grounds for denying coverage. The argument essentially claims that a court’s endorsement of broad coverage of faulty workmanship will create a moral hazard that removes a contractor’s incentive to perform their work competently.⁹⁴ French criticizes the moral hazard position and argues that it lacks empirical evidence and that it wrongfully assumes contractors have insufficient incentives to perform well (other than insurance benefits).⁹⁵ For instance, French notes reputational risks that could arise from poor quality work as well as simple payment considerations that incentivize competent work performance, insurance benefits notwithstanding.⁹⁶ Per-

86. INS. SERVS. OFFICE, INC., *supra* note 31, at 2 (emphasis added).

87. *See* French, *supra* note 13, at 115-16 (discussing the majority rule).

88. *See e.g.*, U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871, 879 (Fla. 2007) (rejecting the insurer’s citation of *Weedo* as persuasive precedent, the Florida Supreme Court found that the policy covered the insured’s subcontractor’s defective work).

89. *See Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979).

90. French, *supra* note 13, at 119 (citing *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979)).

91. French, *supra* note 13, at 119-20 (citing *Cypress Point Condo. Ass’n v. Adria Towers, L.L.C.*, 143 A.3d 273 (N.J. 2016)).

92. *See Cypress Point Condo. Ass’n v. Adria Towers, L.L.C.*, 143 A.3d 273, 289 (N.J. 2016).

93. *See* French, *supra* note 13, at 119.

94. *Id.* at 130 (citing U.S. Fire Ins. Co. v. J.S.U.B., Inc. 979 So. 2d 871, 890 (Fla. 2007)).

95. *Id.* at 141.

96. *Id.*

haps most poignant in his critique of the moral hazard argument is his recognition of the unappealing nature of the litigation that would have to ensue before a court found coverage.⁹⁷ “[E]ven if the contractor were able to eventually recover from his insurer as a result of litigation, very few litigants would describe litigation as a pleasant or valuable use of their time, particularly while they are trying to run a profitable construction business.”⁹⁸

French concludes that courts should presume that all faulty workmanship—even that of the insured—constitutes an occurrence covered, unless either the insurer proves otherwise or the policy specifically excludes coverage.⁹⁹ Although French acknowledges the majority trend (e.g., coverage for an insured’s subcontractor’s defective work), French’s broader claim that CGL policies should cover an insured’s own defective work is far less accepted.¹⁰⁰

B. *Arguments against Covering One’s Own Defective Work*

Professor French’s claim seeking a broad policy interpretation to cover one’s own defective work relies upon case law in which the contractor is further removed from the work (e.g., when its subcontractor does the work).¹⁰¹ Although courts have become more willing to find coverage for an insured’s subcontractor—as this Note asserts and Professor French acknowledges¹⁰²—they do so because they can reconcile finding coverage with the doctrine of fortuity, essential to insurance common law.¹⁰³ Unlike the work of an insured’s subcontractor, the insured’s own work is not fortuitous and is more subject to moral hazard concerns.¹⁰⁴

Under insurance law, the doctrine of fortuity limits liability coverage to fortuitous or accidental events.¹⁰⁵ It is inherent to liability coverage that claims are fortuitous and not intentional.¹⁰⁶ The doctrine of fortuity protects against nefarious claims brought by intentional conduct or business risks within the control of the insured as discussed in Part I.¹⁰⁷ Determining an insured claimants’ intent behind the property damage arising from the work has been a highly debated issue. Although Professor French claims that coverage analysis need go no further than the subjective intent

97. *Id.*

98. *Id.*

99. *See id.* at 142-43.

100. *See infra* Figures 1-2 and notes 188-91.

101. *Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, 306 S.W.3d 69, 74 (Ky. 2010) (finding that the defective work of an insured was not covered because it was not fortuitous); French, *supra* note 13.

102. *Compare* French, *supra* note 13, *with infra* Figures 1-2 and notes 188-191.

103. *See infra* Figures 1-2 and notes 188-91.

104. *See Cincinnati Ins. Co.*, 306 S.W.3d at 74-76.

105. ERIC MILLS HOLMES, HOLMES’ APPLEMAN ON INSURANCE § 116.1B (2d. 2000).

106. *Id.*

107. *See Franco, supra* note 12.

of the insured, courts have extended the analysis to cover what the insured controls.¹⁰⁸ In essence, if the insured has effective control of the work, then its faulty workmanship is not fortuitous.¹⁰⁹

In *Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, the Kentucky Supreme Court denied an insured homebuilder CGL coverage for property damage resulting from its own defective construction.¹¹⁰ Central to its decision was its analysis under the doctrine of fortuity.¹¹¹ To be fortuitous and receive coverage, the court held that the conduct must be accidental and beyond the control of the insured.¹¹² Because an insured claimant will likely always claim that it did not intend the work to be defective, the analysis must extend to work that it effectively controlled.¹¹³ The court noted, “It is abundantly clear, therefore, that the issue of control is encompassed in the fortuity doctrine.”¹¹⁴ The Kentucky Supreme Court found that the homebuilder’s direct control over the defective work—albeit mixed with the work of its subcontractor—indicated that the defect was not accidental and, therefore, not covered.¹¹⁵

Like the doctrine of fortuity, the moral hazard argument remains problematic when the defective work is the insured’s own.¹¹⁶ The support Professor French cites in his counter to the moral hazard argument actually limits its analysis to cases where the insured’s subcontractor performed the faulty work, not the insured itself.¹¹⁷ In *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, the Florida Supreme Court rejected the insurer’s moral hazard argument specifically because insureds cannot effectively control subcontractors at every step of the process:¹¹⁸

Even if a “moral hazard” argument could be made regarding the contractor’s own work, the argument is not applicable for the subcontractors’ work . . . “[I]t is as a practical matter very difficult for the general contractor to control the quality of the subcontractor work. Only if the contractor has a supervisor at the elbow of each subcontractor at all times can quality control be relatively assured—but this would be prohibitively expensive.”¹¹⁹

While the *J.S.U.B.* court remained reluctant to reject the moral hazard argument for an insured’s own defective work, it was convinced that the

108. See French, *supra* note 13; see also *Cincinnati Ins. Co.*, 306 S.W.3d at 74.

109. See *Cincinnati Ins. Co.*, 306 S.W.3d at 74.

110. *Id.*

111. *Id.* at 75–76 (evaluating the applicability of the fortuity doctrine in detail).

112. *Id.* at 74–76

113. *Id.*

114. *Id.* at 76.

115. *Id.*

116. See generally *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 890 (Fla. 2007) (“Even if a ‘moral hazard’ argument could be made regarding the contractor’s own work, the argument is not applicable for the subcontractors’ work.”).

117. Compare French, *supra* note 13, with *J.S.U.B., Inc.*, 979 So. 2d at 879.

118. *J.S.U.B., Inc.*, 979 So. 2d at 890.

119. *Id.*

practical difficulties an insured has with monitoring every move its subcontractor makes render the moral hazard argument irrelevant in the subcontractor context.¹²⁰ In cases of an insured's own defective work, however, the moral hazard argument still carries weight.¹²¹

*C. Traditional Broad Interpretation of CGL Coverage and
Ohio's Custom Agri Decision*

Traditionally, defective construction cases limited CGL coverage analysis to situations where the insured sought coverage for its own faulty workmanship.¹²² Some courts broadly concluded that no defective construction claim constituted an "occurrence" necessary to trigger CGL coverage, even though the cases centered around an insured's own defective work.¹²³ The Ohio Supreme Court's decision in *Westfield Ins. Co. v. Custom Agri Systems, Inc.* provides a good example of a court's broad interpretation of coverage.¹²⁴

The diversity suit in *Custom Agri* arose from damages alleged by a property owner to the steel grain bin that it contracted a general contractor to build.¹²⁵ After the property owner withheld payments, the general contractor filed a third-party complaint against the subcontractor who constructed the bin, Custom Agri Systems, Inc.¹²⁶ Custom Agri Systems then sued its own insurer, Westfield Insurance Co., seeking defense and indemnification for its work.¹²⁷ Moving for declaratory judgment, Westfield Insurance claimed that the defective construction claim did not constitute an occurrence under the CGL policy and, alternatively, that the policy expressly excluded such coverage.¹²⁸ The federal district court granted the insurer's motion because of the policy exclusion rather than the absence of any occurrence.¹²⁹ It "assumed that Custom [Agri System's] policy covered defective construction and went on to find that the exclusion removed such claims from coverage."¹³⁰

On appeal, the Sixth Circuit certified two questions to the Ohio Supreme Court because it had not yet decided the extent of CGL coverage

120. *Id.*

121. *Id.*

122. *See Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, 306 S.W.3d 69, 74 (Ky. 2010); *see also Westfield Ins. Co., v. Custom Agri Sys., Inc.*, 133 Ohio St.3d 476, 2012-Ohio-4712, 979 N.E.2d 269.

123. *See Cincinnati Ins. Co.*, 306 S.W.3d at 75; *see also Custom Agri Sys., Inc.*, 133 Ohio St.3d 476.

124. *Custom Agri Sys., Inc.*, 133 Ohio St.3d 476.

125. *Id.*

126. *Id.* ¶ 2.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

for defective construction in Ohio. Accordingly, the Ohio Supreme Court analyzed the CGL policy under a two-prong test:

(1) Are claims of defective construction/workmanship brought by a property owner claims for “property damage” caused by an “occurrence” under a commercial general liability policy?

(2) And, if so, does the contractual liability exclusion in the commercial general liability policy preclude coverage for claims for defective construction/workmanship?¹³¹

In *Westfield Ins. Co. v. Custom Agri Systems, Inc.*, the Ohio Supreme Court found that an insured’s own work does not constitute an “occurrence” necessary to trigger CGL coverage. Its analysis focused primarily on Custom Agri System’s effective control over its defective work.¹³² It opined that the defective results of one’s own defective work is not fortuitous or accidental because it is a business risk controlled by the insured.¹³³ Ohio law had already distinguished defective construction from consequential damages resulting therefrom in review of CGL policies. Unlike consequential damages that are further removed from the contractor’s operations, defective construction in a contractor’s own work is sufficiently under her control and, therefore, not fortuitous.¹³⁴ The key questions, according to the court, were “whether the contractor *controlled* the process leading to the damages and whether the damages were anticipated.”¹³⁵ Because Custom Agri System’s claim “against which Westfield [was] being asked to defend and indemnify Custom [Agri System’s] relate[d] to Custom [Agri System’s] work itself,” the court found that it had sufficient control over its own work to anticipate claims of defective construction.¹³⁶

To answer the Sixth Circuit’s first question, the Ohio Supreme Court broadly stated that claims of faulty workmanship “are not claims for ‘property damage’ caused by an ‘occurrence’ under a [CGL] policy.”¹³⁷ Having answered the first question, the Ohio Supreme Court declined to answer the second question concerning the coverage exclusions and exceptions in the policy.¹³⁸

In Justice Paul Pfeifer’s dissenting opinion, he disagreed with the majority’s sweeping conclusion and stated that it was overly broad.¹³⁹ Because there might be cases where defective construction is truly accidental,

131. See *Ohio N. Univ. v. Charles Constr. Servs., Inc.*, 2017-Ohio-258, 77 N.E.3d 538, ¶ 37 (3d Dist.) (discussing the certified questions under *Custom Agri Sys., Inc.*, 133 Ohio St.3d 476, ¶ 6).

132. *Id.*

133. *Id.* ¶ 10 (citing *Heile v. Hermann*, 136 Ohio App.3d 351, 354, 736 N.E.2d 566 (5th Dist. 1999)).

134. See *id.*

135. *Id.* ¶ 13 (citing *Cincinnati Ins. Co.*, 306 S.W.3d at 87) (emphasis added).

136. *Id.*

137. *Id.* ¶ 19.

138. *Id.*

139. *Id.* ¶ 35 (Pfeifer, J., dissenting).

he cautioned that the majority's ruling "forecloses too many other potential cases."¹⁴⁰ One potential case Justice Pfeifer noted is the defective work of a subcontractor.¹⁴¹ Instead of denying coverage at the threshold "occurrence" analysis, Justice Pfeifer opined that courts should shift their focus to the exclusions and exceptions contained within the policy.¹⁴² He contended that it would be absurd to broadly deny coverage for defective construction when CGL policies expressly exclude or expressly except certain types of faulty workmanship.¹⁴³ "[I]t would be nonsensical for the policy to include such a[n] [exclusionary] provision if [defective construction] could never be caused by an 'occurrence' in the first place."¹⁴⁴

Courts remain reluctant to extend CGL coverage to an insured's own defective work.¹⁴⁵ Although experts like Professor French have challenged this traditional convention, courts tend to find an insured's own faulty workmanship sufficiently under its control and reasonably anticipated to deny it coverage as an "occurrence."¹⁴⁶ As in *Custom Agri*, some courts adopt this reasoning but fail to distinguish it from claims of defective work outside the contractor's effective control.¹⁴⁷ Many other courts, however, have identified Justice Pfeifer's potential cases where CGL policies cover defective construction—arising under the subcontractor exception.¹⁴⁸

V. COURTS DISTINGUISHING COVERAGE FOR INSURED'S SUBCONTRACTORS' DEFECTIVE WORK

A. Courts Honor 1986 Subcontractor Exception Endorsement

Over the past decade, many states have begun to recognize the ISO CGL policy revision as evidence of the validity of the subcontractor exception.¹⁴⁹ In 2010, the Indiana Supreme Court reversed its precedent denying coverage for defective construction by finding that a subcontractor's

140. *Id.* ¶ 27 (Pfeifer, J., dissenting).

141. *See generally id.* ¶ 26 (Pfeifer, J., dissenting) (citing *Greystone Constr., Inc. v. Natl. Fire & Marine Ins. Co.*, 661 F.3d 1272, 1276 (10th Cir. 2011) (holding that "property damage caused by a subcontractor's faulty workmanship is an 'occurrence' for purposes of a commercial general liability (CGL) insurance policy . . . because damage to property caused by poor workmanship is generally neither expected nor intended. . . ."))

142. *Id.* ¶ 32 (Pfeifer, J., dissenting).

143. *See id.*

144. *Id.* ¶ 34 (Pfeifer, J., dissenting) (quoting *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 281 Kan. 844, 856 (2006)).

145. *See, e.g., id.* ¶ 30 (Pfeifer, J., dissenting).

146. *Compare* French, *supra* note 13, with *Custom Agri Systems, Inc.*, 133 Ohio St.3d ¶ 29.

147. *Custom Agri Systems, Inc.*, 133 Ohio St.3d at 487.

148. *See generally id.*

149. *See generally infra* Figure 1.

faulty installation of windows constituted an occurrence sufficiently covered by the general contractor's CGL policy.¹⁵⁰

In *Sheehan Constr. Co., Inc. v. Continental Cas. Co.*, the court recounted the five major revisions to the standard form CGL policies dating back to 1940 and the impact each had on policy interpretation.¹⁵¹ Before the 1976 revision, the court found that the "on behalf of" language found in the "your work exclusion" (comparable to today's "(j)(5)" and "(j)(6)" exclusions)¹⁵² sufficiently excluded the coverage of a subcontractor's faulty workmanship. The court highlighted the general contractors' growing dissatisfaction with the policy exclusion stemming from their increased hiring of subcontractors.¹⁵³ According to the court, this dissatisfaction resulted in policy endorsements and provisions that explicitly excepted subcontractor work from exclusions.¹⁵⁴ The industry's creation of the 1976 Broad Form Property Damage Endorsement and its subsequent 1986 addition of the subcontractor exception provision in ISO CGL exclusion "(l)" made significant changes.¹⁵⁵ These changes "eliminated the 'on behalf of' language" and "extended to the insured's completed work when the damage arose out of work performed by a subcontractor."¹⁵⁶

Having discussed the significant CGL form revisions, the *Sheehan* court interpreted the policy history as conferring broad coverage over an insured's subcontractor's work.¹⁵⁷ Although an insurer might still deny coverage when the insured intends or expects its subcontractor's work to be defective, "we start with the assumption . . . [that] the resulting damage . . . [was] unforeseeable."¹⁵⁸ Essentially, courts should presume subcontractor coverage unless they find that the insured could foresee (e.g., they intended or expected) the defective work would result.¹⁵⁹ The court found that this presumption necessarily followed from the 1986 addition of the subcontractor exception history and from the absurd consequence that would result from a categorical denial of subcontractor coverage under the ISO CGL form exclusion "(l)." Citing Clifford Shapiro's article, *The Good, the Bad, and the Ugly: New State Supreme Court Decisions Address Whether an Inadvertent Construction Defect is an "Occurrence" Under CGL Policies*, the court noted:

A court need only ask why the CGL policy includes an exclusion for property damages to . . . that of [an insured's] subcontractors to understand that it would be nonsensical for the policy to include such a provision if this kind of

150. *Sheehan Constr. Co., v. Cont'l. Cas., Co.*, 935 N.E.2d 160 (Ind. 2010).

151. *Id.* at 163.

152. Commercial Gen. Liab. Coverage, Form No. CG 00 01 12 07 (2006).

153. *Sheehan Constr. Co.*, 935 N.E.2d at 163.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.* at 170.

159. *Id.*

property damage could never be caused by an “occurrence” in the first place.¹⁶⁰

In other words, concluding that a subcontractor’s defective work never constitutes an occurrence would render the expressed subcontractor exception provision meaningless. Consistent with the whole policy interpretation canon, the *Sheehan* court’s presumption of subcontractor coverage harmonizes the “your work” exclusion with the subcontractor exception provisions.¹⁶¹ Knowing the purpose behind the 1986 revision, the court held that the CGL policy covered the insured’s subcontractor’s defective work.¹⁶²

B. *Establishing Occurrence Based on Effective Control and Lack of Foreseeability*

A salient rationale for the creation of the 1986 subcontractor exception was to insure an aspect of projects that the insured contractor could not completely control: subcontractor work.¹⁶³ “General contractors needed coverage for property damage that arose from the work of their subcontractors, a risk they could not control by the exercise of general supervision and coordination.”¹⁶⁴ Numerous courts have recognized this displacement of control as a sufficient justification for finding an insured’s CGL policy coverage for its subcontractor’s work.¹⁶⁵

The Florida Supreme Court’s decision in *J.S.U.B.*—discussed in Part IV—was one of the first to expressly apply this “control” analysis.¹⁶⁶ In response to a homebuilder’s insurance claim for the property damage that resulted from its subcontractor, the court interpreted the CGL policy as providing coverage—the insured could not control every step of its subcontractor’s work.¹⁶⁷ Because the insured lacked effective control—unable to have a “supervisor at the elbow of each subcontractor at all times”—the court rejected the claim that the rule against insuring an insured’s defective work should extend to that of its subcontractors.¹⁶⁸

In addition to control, claims for a subcontractor’s faulty workmanship mitigates, if not eliminates, foreseeability concerns that courts encounter

160. *Id.* at 171 (quoting Clifford J. Shapiro, *The Good, the Bad, and the Ugly: New State Supreme Court Decisions Address Whether an Inadvertent Construction Defect is an “Occurrence” Under CGL Policies*, 25 CONSTR. LAW., Summer 2005, at 9, 12).

161. *See generally* *Sheehan Constr. Co.*, 935 N.E.2d at 163.

162. *Id.* at 172.

163. *See* James Duffy O’Connor, *What Every Court Should Know About Insurance Coverage for Defective Construction*, 5 J. AM. C. CONSTR. L., no. 1.

164. *Id.* at 5.

165. *See infra* Figures 1–2 and notes 187–89.

166. *J.S.U.B., Inc.*, 979 So. 2d at 879.

167. *Id.*

168. *See id.*

when interpreting CGL coverage.¹⁶⁹ In *Cherrington v. Erie Ins. Prop. and Cas. Co.*, the West Virginia Supreme Court held that a CGL policy covered the defective work of an insured's subcontractor because it could not be expected or be foreseen.¹⁷⁰ The *Cherrington* court seemingly created a presumption that an insured would neither expect nor foresee the faulty workmanship of its subcontractor without contradictory evidence.¹⁷¹ The court stated:

Common sense dictates that had [the insured] expected or foreseen the allegedly shoddy workmanship its subcontractors were destined to perform, [the insured] would not have hired them in the first place. Nor can it be said that [the insured] deliberately intended or even desired the deleterious consequences that were occasioned by its subcontractors' substandard craftsmanship. To find otherwise would suggest that [the insured] deliberately sabotaged the very same construction project it worked so diligently to obtain at the risk of jeopardizing its professional name and business reputation in the process.¹⁷²

The state supreme court opinions of *J.S.U.B.* and *Cherrington* capture the unique traits required by the subcontractor exception that distinguish cases covered by it from general claims for an insured's own work: control and the lack of foreseeability.¹⁷³ These traits directly answer the "key issues" articulated by the supreme courts of Kentucky and Ohio: whether the contractor controlled the process leading to the damages and whether the damages were anticipated.¹⁷⁴ Accordingly, courts across the country have begun to find that CGL policies cover defective subcontractor work that may have been beyond the control of, and unforeseen by, insureds.¹⁷⁵

C. Distinguishing Precedent and Extending Coverage

Over the past fifteen years, state supreme courts have increasingly reversed or clarified prior decisions rejecting or limiting CGL coverage for subcontractor work.¹⁷⁶ The Iowa Supreme Court's 2016 decision in *Nat'l Sur. Corp. v. Westlake Inv., LLC*—overturning its previous denied coverage opinion—illustrates this trend. The *Westlake* court grappled with the issue of CGL coverage for water and moisture damage to a developer's apartment complex caused by the insured's subcontractors.¹⁷⁷ In addition

169. See generally *Cherrington v. Erie Ins. Prop. and Cas. Co.*, 231 W.Va. 470, 482 (W.Va. 2013).

170. *Id.*

171. *Id.*

172. *Cherrington*, 231 W.Va. at 482.

173. *Id.*; *J.S.U.B., Inc.*, 979 So. 2d at 890.

174. See *Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, 306 S.W.3d 69, 74 (Ky. 2010); *Westfield Ins. Co., v. Custom Agri Sys., Inc.*, 133 Ohio St.3d 476, 2012-Ohio-4712, 979 N.E.2d 269, ¶ 32.

175. See *infra* Figure 1 and notes 188-89.

176. *Id.*

177. *Nat'l Sur. Corp. v. Westlake Inv., LLC*, 880 N.W.2d 724, 742 (Iowa 2016).

to the standard dispute over the policy's definition of "occurrence," the court had to decide whether the definitions provided in the jury instructions were proper.¹⁷⁸ Among the jury instructions in question, a sentence in instruction number 21 was of particular significance:

Defective construction performed by an insured is not covered by the policy; however, defective construction work performed by subcontractors may be an "occurrence" under the policy.¹⁷⁹

After the court provided the jury with the instruction 21, it returned a verdict supporting the insured's claim for CGL coverage.¹⁸⁰ The insurer appealed pursuant to the then-controlling Iowa precedent under *Pursell Construction v. Hawkeye-Security Insurance*, which broadly stated that CGL policies do not cover faulty workmanship.¹⁸¹ After the court of appeals affirmed the trial court's verdict and post-trial rulings, the case went to the Iowa Supreme Court.¹⁸²

The Iowa Supreme Court affirmed, finding that the CGL policy did not preclude coverage for defective work performed by an insured's subcontractor.¹⁸³ It distinguished its decision in *Pursell* from the *Westlake* decision by pointing out that the claim in the former was for the insured's *own* defective work.¹⁸⁴ Unlike *Pursell*, the insured's claim in *Westlake* sought coverage for the faulty workmanship performed by its subcontractors.¹⁸⁵ Inherent in the distinction, the court noted, is the element of control.¹⁸⁶ Since general contractors lack effective control over all aspects of the subcontractor's work, losses they incur from a subcontractor's defective work are more fortuitous than losses from their own work.¹⁸⁷ Coupled with the subcontractor exception under ISO CGL exclusion "(1)," the *Westlake* court distinguished the *Pursell* precedent and concluded:

[W]e interpret the insuring agreement in the modern standard-form CGL policy as providing coverage for property damage arising out of defective work performed by an insured's subcontractor unless the resulting property damage is specifically precluded from coverage by an exclusion or endorsement.¹⁸⁸

Cases like *Westlake* exemplify the trend towards coverage under the subcontractor exception and provide a blueprint for state supreme courts

178. *Id.* at 728.

179. *Id.*

180. *Id.*

181. *Id.* at 736-37 (citing *Pursell Construction v. Hawkeye-Security Insurance*, 596 N.W.2d 67 (Iowa 1999)).

182. *Id.* at 730.

183. *Id.* at 744.

184. *Id.* at 737 (citing *Pursell Constr. v. Hawkeye-Sec. Ins.*, 596 N.W.2d 67 (Iowa 1999) (emphasis added)).

185. *Id.*

186. *Id.* at 741.

187. *See id.*

188. *Id.* at 740.

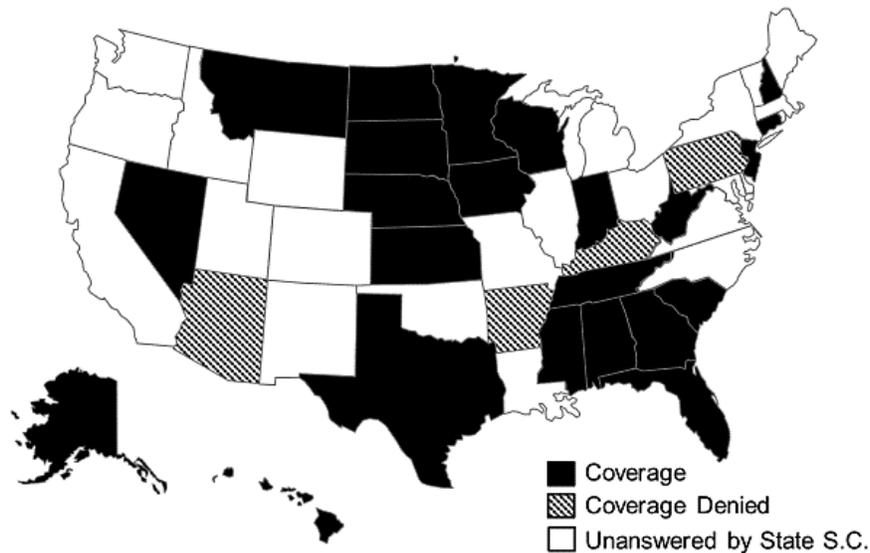
(e.g., Kentucky and Ohio) to distinguish cases dealing with subcontractor work from precedents broadly denying coverage for any defective work.

D. Trending Coverage for the Subcontractor Exception

Like *Westlake*, many other state supreme courts and legislatures have adopted the trend of finding CGL coverage for the defective work of an insured's subcontractor.¹⁸⁹ As of May 2017, twenty-three state supreme courts found coverage under the subcontractor exception while only four expressly rejected it.¹⁹⁰ Figure 1 illustrates which state supreme courts have found coverage to apply, those which have not, and those that have yet to directly decide the issue.¹⁹¹ Figure 2 adds the two state legislatures that promulgated statutes expressly providing coverage—without subsequent state court analysis denying the subcontractor exception¹⁹²—under the subcontractor exception.¹⁹³ Figure 2 also depicts the five federal court decisions—interpreting state law—that found coverage for insured's subcontractor's faulty workmanship.¹⁹⁴

FIGURE 1.^{195,196}

State Supreme Court Precedents Finding Coverage for Subcontractor Defective Construction



189. See *infra* Figure 1 and notes 188-89.

190. See *id.*

191. See *id.*

192. See *Columbia Ins. Group, Inc. v. Cenark Project Mgmt. Servs., Inc.*, 491 S.W.3d 135, 145 (Ark. 2016) (Danielson, J., dissenting) (interpreting Ark. Code Ann. § 23-79-155(a) as not requiring coverage for subcontractor defective work).

193. See Figure 2 and notes 190-91.

194. *Id.*

195. Twenty-three state supreme courts have distinguished the “your-work” exclusion from subcontractor defective work. *See* *Town & Country Prop., LLC v. Amerisure Ins. Co.*, 111 So.3d 699, 710 (Ala. 2011) (finding that in CGL insurance policies with a ‘your-work’ exclusion and a ‘subcontractor exception’, an insured contractor is not covered for property damage while coverage is restored for the subcontractor); *Fejes v. Alaska Ins.*, 984 P.2d 519, 522-23 (Alaska 1999) (finding that exclusions to broad form endorsement did not preclude coverage for losses caused by the insured contractor’s subcontractors); *Capstone Bldg. Corp. v. Am. Motorists Ins.*, 67 A.3d 961, 981 (Conn. 2013) (finding that an insurance policy excludes coverage for property damage caused by an insured contractor’s work, not by a subcontractor’s defective work); *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871, 888 (Fla. 2007) (finding that a “subcontractors’ defective soil preparation, which general contractor did not intend or expect, was an occurrence under CGL policy”); *Am. Empire Surplus Lines Ins. v. Hathaway Dev. Co.*, 707 S.E.2d 369, 372 (Ga. 2011) (finding that a “[p]lumbing subcontractor’s acts of faulty workmanship on three projects, which caused damage to neighboring property being built by the general contractor, constituted ‘occurrences,’ within meaning of subcontractor’s CGL insurance policy”); *Sentinel Ins. v. First Ins. Co. of Haw.*, 875 P.2d 894, 904 (Haw. 1994) (finding that a subcontractor’s defects may be covered by a CGL policy); *Sheehan Constr. Co., Inc. v. Continental Cas. Co.*, 935 N.E.2d 160, 160-61 (Ind. 2010) (finding that a “contractor’s CGL policies could provide coverage for subcontractors’ faulty workmanship”); *Nat’l Sur. Corp. v. Westlake Inv., LLC*, 880 N.W.2d 724, 744 (Iowa 2016) (finding that “defective workmanship by an insured’s subcontractor may constitute an ‘occurrence’ covered by a modern standard-form CGL policy”); *Lee Builders, Inc. v. Farm Bureau Mut. Ins.*, 137 P.3d 486, 493 (Kan. 2006) (holding that unforeseen and unintended resulting from an insured’s subcontractor work was caused by an occurrence); *Wanzek Const., Inc. v. Emp’rs Ins. of Wausau*, 679 N.W.2d 322, 325-27 (Minn. 2004) (finding that the exclusion for damage to ‘your work’ within a CGL contract is inapplicable if a subcontractor performed the work on behalf of an insured general contractor); *Architex Ass’n v. Scottsdale Ins.*, 27 So. 3d 1148, 1162 (Miss. 2010) (finding that “[u]nder [the] CGL policy, the term ‘occurrence’ cannot be construed in such a manner as to preclude coverage for unexpected or unintended ‘property damage’ resulting from work ‘performed on [Architex’s] behalf by a subcontractor”); *Revelation Indus., Inc. v. St. Paul Fire & Marine Ins.*, 206 P.3d 919, 922 (Mont. 2009) (finding that “the policy provides coverage for this subcontractor-caused damage” where the insured knew that the product was manufactured by the sub-contractor); *Auto-Owners Ins. v. Home Pride Cos.*, 684 N.W.2d 571, 578 (Neb. 2004) (finding that “although a standard CGL policy does not provide coverage for faulty workmanship that damages only the resulting work product, if faulty workmanship causes bodily injury or property damage to something other than the insured’s work product, an unintended and unexpected event has occurred, and coverage exists”); *McKellar Dev. v. N. Ins.*, 837 P.2d 858, 860 (Nev. 1992) (finding that “the elimination of the [BFPD completed operations hazard] phrase ‘or on behalf of’ indicates that the work of subcontractors was intended to be covered by the policies”); *Concord Gen. Mut. Ins. v. Green & Co. Bldg. and Dev. Corp.*, 8 A.3d 24 (N.H. 2010) (distinguishing a contractor’s claim for CGL coverage of its own defective construction from the CGL coverage where the insured’s subcontractor performed the defective construction) (citing *Essex Ins. Co. v. Holder*, 261 S.W.3d 456 (2008)); *Cypress Point Condo. Ass’n, Inc. v. Adria Towers, LLC.*, 143 A.3d 273 (N.J. 2016) (finding that damage caused by subcontractor’s faulty workmanship was covered under developer’s CGL policy under the ‘your work’ umbrella); *K&L Homes, Inc. v. Am. Family Mut. Ins.*, 829 N.W. 2d 724, 726 (N.D. 2013) (finding that the term ‘occurrence’ in the contractor’s CGL policy covers the subcontractor’s faulty workmanship); *Auto Owners Ins. Co., Inc., v. Newman*, 684 S.E.2d 541, 542 (S.C. 2009) (finding that a policy exclusion effectively barred coverage for damage to the defective workmanship itself, prohibiting recovery for the incidental cost of replacing the defective work); *Corner Constr. Co. v. U.S. Fid. & Guar. Co.*, 638 N.W.2d 887, 888 (S.D. 2002) (finding that the CGL policy did not exclude coverage for a general contractor’s liability for property damage; subcontractor’s faulty workmanship was an ‘accident’ resulting in property damage); *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 2 (Tex. 2007) (finding that the subcontractor excep-

Among the 17 states where the subcontractor exception issue remains unanswered by the state supreme court, federal court, or the state legislature, states like Ohio have acknowledged these trends in their own case law.¹⁹⁸

E. *Ohio Appellate Court Acknowledges Trend in Ohio Northern Case*

After the Ohio trial court in *Ohio Northern* concluded the insured's CGL policy did not cover the subcontractor's defective work.¹⁹⁹ In *Ohio N. Univ. v. Charles Const. Servs., Inc.*, the Ohio Court of Appeals, Third District, held that "at the very minimum" there existed an ambiguity in the CGL policy regarding its coverage for "property damage" caused by a subcontractor's defective workmanship.²⁰⁰ Therefore, because a genuine issue of material fact existed, the court vacated the trial court's summary judgment award and remanded the case for further proceedings.²⁰¹

In deciding that "at the very minimum" there was an ambiguity, the court discussed in detail its inclination to find that the CGL policy *did* cover the faulty work of Charles Construction's subcontractors.²⁰² The Third District started by analyzing the Ohio Supreme Court precedent set in the *Custom Agri* decision.²⁰³ To determine the threshold occurrence question, the appellate court applied the effective control test—recognized in *Custom Agri*—of whether the contractor *controlled* the process

faulty workmanship, exclusive of the faulty workmanship itself"). *See also* Westfield Ins. Co. v. Custom Agri. Sys., Inc., 133 Ohio St.3d 476, 2012-Ohio-4712, 979 N.E.2d 269; French v. Assurance Co. of Am., 448 F.3d 693, 705 (4th Cir. 2006) (Finding "under Maryland law, coverage exists under the 1986 ISO CGL Policies for the costs to remedy the damage to the nondefective structure and walls of the Frenches' home, unlike that of the district court and the position of the Insurance Defendants, gives effect to the subcontractor exception to the '[y]our [w]ork' exclusion in these policies"); Breezewood of Wilmington Conds. Homeowners' Ass'n v. Amerisure Mut. Ins., 335 Fed. Appx. 268, 278 (4th Cir. 2009) (stating that under North Carolina law the "denied coverage was proper inasmuch as the alleged water damage 'arises out of' the [general contractor's] work within the meaning of the 'your work' exclusion and is not alleged to have been performed by a subcontractor"); Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins., 864 F.2d 648, 654-55 (9th Cir. 1988) (finding that under Oregon law the completed operations hazard exclusion in endorsement for broad form property damage liability coverage did not apply to subcontractors, and the products exclusion did not apply); Dewitt Constr., Inc. v. Charter Oak Fire Ins., 307 F.3d 1127, 1138-39 (9th Cir. 2002) (holding that the subcontractor's cost of removing and destroying non-defective work of other subcontractors to remedy its own defective construction was covered by the insured subcontractor's CGL policy); Stanley Martin Cos. v. Ohio Cas. Grp., 313 Fed. App'x. 609 (4th Cir. 2009) (finding that "any damage subcontractor's defective work caused to insured's non-defective work constituted an 'occurrence' under commercial general liability insurance policy, under Virginia law").

198. *See* Ohio N. Univ. v. Charles Constr. Servs., Inc., 2017-Ohio-258, 77 N.E.3d 538, ¶ 37 (3d Dist.).

199. *See id.*

200. *Id.* ¶ 40.

201. *See id.* ¶¶ 29-30.

202. *See id.* ¶ 41 (emphasis added).

203. *See id.* ¶ 10.

leading to the damages or whether it should have anticipated them.²⁰⁴ The Third District Court found it persuasive that, unlike *Custom Agri*, Charles Construction sought coverage for the defective work of its subcontractors, not of its own. Nevertheless, the court declined to rule on this issue.²⁰⁵

The court then dissected the CGL policy.²⁰⁶ The following provisions were of particular interest:

SECTION I – COVERAGE²⁰⁷

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages. However, we will have no duty to defend the insured against any “suit” seeking damages for “bodily injury” or “property damage” to which this insurance does not apply.

b. This insurance applies to “bodily injury” and “property damage” only if:

(1) The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory;”

* * *

SECTION V – DEFINITIONS²⁰⁸

* * *

16. “Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

* * *

SECTION I – EXCLUSIONS²⁰⁹

* * *

This insurance does not apply to:

* * *

j. Damage to Property

“Property damage” to:

* * *

204. *See id.* (citing *Custom Agri Sys., Inc.*, 133 Ohio St.3d 476, 2012-Ohio-4712, 979 N.E.2d 269) (emphasis added).

205. *See id.*

206. *See id.* ¶¶ 27-40.

207. *See* INS. SERVS. OFFICE, INC., *supra* note 31.

208. *Id.*

209. *Id.*

(5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the “property damage” arises out of those operations.

(6) That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.

* * *

Paragraph (6) of this exclusion does not apply to “property damage” included in the “products-completed operations hazard.”

* * *

I. Damage to Your Work:

“Property damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard.”

*This 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 (emphasis added).*²¹⁰

The court first determined that, under Sections 1 and 16, the CGL policy covers “property damage” caused by “an occurrence.”²¹¹ Because the court must review an entire contract to fully determine the effects of its provisions, it moved to the policy coverage exclusions.²¹² While Section “(j)(5)” appears to exclude coverage of defective work by both contractors and subcontractors, the court interpreted the provision’s use of the present tense (i.e., “working”) as meaning that it only applied to work in progress.²¹³ ONU’s claim, however, arose after project completion.²¹⁴

Next, the court noted that a paragraph that followed exclusion “(j)(6)” created an exception to the exclusion that “restores [CGL] coverage if the ‘property damage’ is included in the ‘products-completed operations hazard.’ ”²¹⁵ Because ONU’s claim arose after project completion, the court suggested that the products-completed operations coverage applies.²¹⁶

Finally, the court indicated that exclusion “(l)” contained an exception when the defective work was performed on the contractor’s behalf or *by a subcontractor*.²¹⁷ Accordingly, Charles Construction’s claim that its sub-

210. *See id.* ¶¶ 20-36 (citing INS. SERVS. OFFICE, INC., *supra* note 31, at 1-2, 5) (emphasis added).

211. *See id.* ¶ 41.

212. *See id.*

213. *Id.* ¶¶ 29-30.

214. *See id.* ¶ 25.

215. *Id.* ¶ 30 (citing INS. SERVS. OFFICE, INC., *supra* note 31, at 5).

216. *Id.* ¶ 32.

217. *Id.* ¶ 31.

contractor performed the defective work seemed to operate as an exception to coverage exclusion.²¹⁸

After reviewing the policy, the court cited the national trend toward inclusion of a subcontractor's defective work within the term "occurrence" to trigger coverage.²¹⁹ Specifically, the court cited other state supreme court decisions in Iowa, Indiana, and West Virginia.²²⁰

In the end, the Ohio Court of Appeals, Third District, did not decide the coverage issue or adopt the neighboring jurisdictions' persuasive decisions.²²¹ Instead, it found that the totality of the evidence created, at minimum, an ambiguity as to whether the parties contracted for "property damage" caused by subcontractor work, making it necessary to vacate the summary judgment and remand for further proceedings.²²²

In April 2017, Cincinnati Insurance filed a petition to the Ohio Supreme Court, seeking review and reversal of the Third District's decision.²²³ As of December 2017, the Ohio Supreme Court has accepted the appeal for review.²²⁴

CONCLUSION

Courts across the country have overwhelmingly interpreted the ISO CGL standard form as providing coverage for the defective work performed by an insured's subcontractor. After the 1986 ISO CGL form revision, courts have recognized the exceptional nature of property damage resulting from subcontractors' work. The plain and ordinary meaning of the subcontractor exception under exclusion "(I)" clearly distinguishes cases of an insured's own defective work from that of its subcontractors. Because the insured cannot realistically supervise each subcontractor at all times, it lacks effective control and is fortuitous. Accordingly, courts have determined that property damage resulting from such subcontractor work is beyond the insured's effective control and foreseeability.

Under the prevailing case law and under the terms of the standard ISO CGL form, courts should review questions about CGL coverage of a subcontractor's defective work as follows: *first*, courts should presume CGL coverage for defective work performed by the insured's subcontractor unless the policy clearly excludes the specific coverage without exception; *second*, that presumption might be overcome if evidence shows that the

218. *See id.*

219. *See id.* ¶ 37.

220. *See id.* (citing Nat'l Sur. Corp. v. Westlake Inv. LLC, 880 N.W.2d 724, 742 (Iowa 2016); Sheehan Constr. Co., Inc. v. Cont'l Cas. Co., 935 N.E.2d 160, 170 (Ind. 2010); and Cherrington v. Erie Ins. Prop. and Cas. Co., 745 S.E.2d 508, 519 (W. Va. 2013)).

221. *See id.*

222. *Id.* ¶ 41.

223. *See* Notice of Appeal in re: Ohio N. Univ., Case No. 2017-0514 (Filed Apr. 17, 2017).

224. *See* 12/6/2017 Case Announcements, 2017-Ohio-8842.

insured had sufficient control of the work that resulted in defective construction. Factors such as the level of the insured's direct involvement in conducting the work at issue and the amount of material provided directly by the insured are potentially indicative of sufficient control.

Cases like *Ohio Northern* provide a clear example of how the subcontractor exception has changed the analysis. These cases provide courts, such as the Ohio Supreme Court, with the opportunity adopt the majority trend.