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PA Superior Court Confirms CGL Coverage

By John M. McNulty and Donald R. McMinn

On Dec. 3, 2013, Pennsylvania's intermediate appellate court confirmed the availability of commercial general liability ("CGL") coverage for manufacturers facing product liability claims that allege damages to persons and property other than the manufacturers' products, even where the underlying actions giving rise to the coverage dispute may involve claims that plead a contract theory, not just those seeking recovery in tort. *Indalex, Inc. v. Nat. Union Fire Ins. Co. of Pittsburgh, Pa.*, --- A.3d ---, No. 612 WDA 2012, 2013 WL 6237312 (Pa. Super. Ct. Dec. 3, 2013).

The *Indalex* decision clarifies the limits stated by Pennsylvania's highest court in *Kvaerner Metals v. Commercial Union*, the 2006 Pennsylvania Supreme Court decision denying coverage for contractual faulty workmanship claims on grounds that damage to a manufacturer's own product does not qualify as an "occurrence" under a CGL policy. In holding that contract and tort claims for damages to products other than an insured's own product qualified as "occurrences," the Pennsylvania Superior Court in *Indalex* took a step toward recognizing that coverage assessments for these claims should turn on the applicability, *vel non*, of the standardized CGL policy's three business risk exclusions, not on whether the theory of recovery for underlying property damage claims is stated in contract (in which case no "occurrence" and no coverage) or tort (in which case an "occurrence" and possible coverage).

Background

Comprehensive general liability policies typically provide coverage for "occurrences" that result in property damage, bodily injury, or both. Policyholders and insurers have been litigating whether property damage arising from faulty workmanship claims can constitute an "occurrence" triggering possible coverage.

The majority view holds that construction defects attributable to faulty workmanship can be accidental, *i.e.*, unintended, regardless of whether the underlying suit seeks recovery in tort or in contract and that, therefore, they can be "occurrences" for coverage purposes. *See, e.g., Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 16 (Tex. 2007) ("The proper inquiry is whether an 'occurrence' has caused 'property damage,' not whether the ultimate remedy for that claim lies in contract or in tort."); *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004) (stating that policy language, not whether a claim sounds in contract or tort, determines if a claim is covered).

Where courts apply the majority view, the coverage dispute often shifts from the definition of "occurrence" to the policy's business risk exclusions, with insurers arguing that the exclusions preclude coverage for what insurers contend are the policyholder's efforts to convert an insurance policy into a performance bond. *See, e.g., Travelers Indem. Co. of Am. v. Moore & Assoc., Inc.*, 216 S.W.3d 302, 309 (Tenn. 2007) ("[T]he recognition that damages may result from an 'occurrence' is only the first step in determining whether damages are afforded coverage under a CGL. Coverage for damages granted under the 'insuring agreement' may be precluded by an 'exclusion.'"). The business risk exclusions in a standard CGL policy preclude coverage for certain property damage to the insured's own "product," own "work," and for property damage to "impaired property" or property that has not been physically injured (the sistership exclusion). *See generally* Donald R. McMinn, Latex Products Liability Litigation: Commercial General Liability Coverage, *Mealey's Litigation Report*, May 1997 (discussing CGL policy business risk exclusions and noting that the own-product exclusion seeks to prevent an insured from recovering damages the product does to itself).

The Pennsylvania Supreme Court in *Kvaerner Metals v. Commercial Union* appeared to adopt the minority view of "occurrence," holding that property damage from faulty workmanship is not a qualifying "occurrence," albeit in a situation in which the claimed property damage had happened to the policyholder's product. *See Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. 2006). Kvaerner had sought coverage in connection with a lawsuit by Bethlehem Steel Corporation that alleged breach of contract claims based on Kvaerner's provision of a defective coke oven battery. Kvaerner's insurer, National Union, denied coverage on the grounds that damage to the faulty battery did not qualify as either an "occurrence" or an "accident." The Pennsylvania Supreme Court agreed, holding that contract-based faulty workmanship claims for defective products do not present the necessary "degree of fortuity" required to be considered "accidents" that establish an "occurrence." *Id.* at 899.

The court reasoned that "[t]o hold otherwise would be to convert a policy for insurance into a performance bond." *Id.* Having categorically determined that

John M. McNulty is an associate and **Donald R. McMinn**, a member of this newsletter's Board of Editors, is a partner at Hollingsworth LLP in Washington, DC.

such claims were not "occurrences," the *Kvaerner* court did not need to address any further coverage arguments and also expressly declined to consider whether business risk exclusions precluded coverage. *Id*. at 900. Insurers took notice of *Kvaerner*, and subsequent lower courts in Pennsylvania responded to insurers' arguments that claims for faulty workmanship based on damages to the insured's work product, when stated in contract, categorically were not "occurrences" — despite the absence of any express policy provision clearly stating an exclusion for underlying claims proceeding upon a contract, rather than tort, theory of recovery. *See Erie Ins. Exch. v. Abbott Furnace Co.*, 972 A.2d 1232 (Pa. Super. Ct. 2009); *Millers Capital Ins. Co. v. Gambone Bros. Dev. Co.*, 941 A.2d 706 (Pa. Super. Ct. 2007).

Indalex v. National Union

Against the backdrop of *Kvaerner* came a lawsuit by two insureds, Indalex Inc. and Harland Clarke Holdings Corp. (collectively "Indalex"), seeking coverage for contract and tort claims by homeowners who alleged that Indalex's faulty windows and doors allowed water leakage that caused physical damage to other parts of the homeowners' houses and bodily injury from exposure to moldy walls. *See Indalex, Inc. v. Nat. Union Fire Ins. Co. of Pittsburgh, Pa.*, No. GD-06-21147 (Pa. C.P. Allegheny County. Mar. 7, 2012). The National Union policy at issue covered bodily injury and property damage caused by an "occurrence," defined as "an accident, including continuous or repeated exposure to conditions, which result in Bodily Injury or Property Damage neither expected nor intended from the standpoint of the Insured." National Union denied coverage and moved for summary judgment on grounds that, under Pennsylvania law, there was no "occurrence" triggering coverage. The trial court agreed, holding that the Pennsylvania Supreme Court's decision in *Kvaerner* barred coverage for any faulty workmanship claims due to the lack of an "occurrence," regardless of whether the harm was due to defective windows or to property in which the windows were installed. *Id*. at 22.

On appeal, the Pennsylvania Superior Court assessed whether National Union had a duty to defend, and evaluated the precedent of *Kvaerner* and its Pennsylvania Superior Court progeny, *Abbott* and *Gambone*. *See Indalex*, 2013 WL 6237312. As an initial matter, the court emphasized that CGL policies are contracts that must be construed according to their terms (in distinction to categorical statements about what policies do or do not cover). *Id*. at *2 (applying the language of the policy, with construction in favor of the insured only where the policy is ambiguous).

After noting that the underlying claims stated causes of action in both tort and contract, the *Indalex* court refused to find in *Kvaerner* a general principle that CGL policies do not cover contract actions, and specifically rejected an invitation to apply Pennsylvania's "gist of the action" doctrine, which examines whether the "gist" of a cause of action is more properly considered to lie either in contract or tort for purposes of precluding plaintiffs from recovering in tort for ordinary breach of contract claims. *See id*. at *6-*8; *see also Abbott*, 972 A.2d at 1238 (precluding coverage under the gist of the action doctrine because plaintiff's claims were solely contract based and contractual claims were not covered under *Kvaerner*). The *Indalex* court also observed that alleged faulty workmanship in *Kvaerner* and *Gambone* related directly to the insured's work product, whereas claims in *Indalex* involved "active malfunctions" that caused damage to property other than Indalex's windows and doors. *Indalex*, 2013 WL 6237312 at *6.

Instead of finding an unstated "contract claim" exclusion, the *Indalex* court concluded that claims based on the alleged "active malfunctions" that resulted in injury to individuals and damage to property other than Indalex's own products (*e.g.*, mold-related health issues and mold damage to house structures) qualified as "occurrences" because they "were arguably not expected." *Id*. at *6. The court properly recognized that an "occurrence" analysis should evaluate whether the claimed bodily injury or property damage was fortuitous — and not whether the policyholder happened to be sued in contract or tort.

In so doing, the *Indalex* decision edges Pennsylvania toward the majority "occurrences" analysis used in most jurisdictions. *See, e.g., U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 878 (Fla. 2007) (noting that the "occurrences" analysis turns on whether the damage was expected or intended from the standpoint of the insured).

Indalex is a reminder that the lens for squaring cases addressing CGL coverage for allegedly faulty products is through a case-by-case evaluation of fortuity followed by the application of business risk exclusions, rather than a categorical holding — unsupported by policy language — that contract claims are never "occurrences." *See, e.g., Am. Girl, Inc.*, 673 N.W.2d at 78 (if "losses actionable in contract are never CGL 'occurrences' for purposes of the initial coverage grant, then the business risk exclusions are entirely unnecessary").

Conclusion

The *Indalex* decision marks a significant development in the ongoing battle to define what constitutes an "occurrence" in CGL policies. The trial court's ruling indicated Pennsylvania might become a jurisdiction uniquely hostile to CGL policyholders, with a blanket rule precluding coverage for any allegation of faulty workmanship within the underlying complaint. By reversing the trial court's categorical coverage bar for faulty workmanship claims, *Indalex* clarifies that contract and tort claims alleging damages to products other than the insured's product may indeed be "occurrences" and that the appropriate line between covered and uncovered claims should be drawn with reference to the business risk exclusions.

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