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A recent decision by a Hawaii court may have you rethinking your General Liability (CGL) and/or Professional Liability (PL) policies. It's crucial to be aware of what exactly is covered under each policy and the importance of maintaining both types of insurance.

Hawaii Appellate Court Confirms That a Construction Defect Claim Does Not Constitute an Occurrence Under a Commercial General Liability Policy

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A Hawaii appellate court recently confirmed that a construction defect claim does not constitute an “occurrence” under a Commercial General Liability (CGL) policy. Specifically, the appellate court in Group Builders, Inc. v. Admiral Ins. Co., 123 Hawaii 142, 231 P3d 67 (2010) held that faulty construction work by a subcontractor on a hotel construction project did not constitute an occurrence under a CGL policy.

In August 1999, Hilton Hotels Corporation, the parent company of the Hilton Hawaiian Village, LLC (collectively “Hilton”), retained Hawaiian Dredging as the general contractor for the construction of a new

hotel tower known as the “Kalia Tower” (the “Tower”) as part of the Hilton Hawaiian Village in Waikiki, Honolulu, Hawaii. Hawaiian Dredging retained Group Builders to install an exterior insulation finishing system and sealant, spray-applied fireproofing, building insulation, and metal wall framing on the Tower.

In May 2001, after construction of the Tower had been completed, Hilton opened the Tower guest rooms to the public. In mid-2002, extensive mold growth was discovered in the Tower guest rooms. In July 2002, Hilton closed the Tower guest rooms for remediation. An investigation revealed numerous defects in the design and construction of the Tower which contributed to or caused the mold growth.

In 2003, Hilton filed suit against numerous defendants involved in the design and construction of the Tower including Group Builders. In its Complaint against Group Builders, Hilton alleged five causes of action: (1) breach of contract; (2) breach of the covenant of good faith and fair dealing; (3) negligence; (4) breach of express and implied warranties; and (5) negligent misrepresentation.

Group Builders’ CGL coverage was provided by the following insurers:

- Tradewind: October 1, 1999 to October 1, 2000;
- Admiral Insurance Co. (“Admiral”): October 1, 2000 to December 1, 2000; and
- After December 1, 2000, Group Builders maintained several insurance policies with Zurich American Insurance Co. (“Zurich”), and Fireman’s Fund Insurance Co. of Hawaii, Inc. (“Fireman’s Fund”).

After Group Builders notified Admiral of the lawsuit, Admiral refused to defend, indemnify, or otherwise provided insurance coverage to Group Builders for the claims asserted in Hilton's lawsuit. Hilton settled its claims with Group Builders, Tradewind, Zurich, and Fireman's Fund. In connection with the settlement, Group Builders assigned its claims against Admiral to Tradewind.

In December 2005, Tradewind and other CGL insurer entities (collectively the "Plaintiffs") filed a Complaint against Admiral for its refusal to defend, indemnify, or otherwise provide insurance coverage to Group Builders for the claims asserted in Hilton's lawsuit. In June 2008, Admiral filed a "Motion for Partial Summary Judgment Re: No Duty to Indemnify". The circuit court granted Admiral's Motion. The circuit court held that "because there is no genuine issue of material fact that any property damage as a result of an occurrence took place at Kalia Tower Project during the Admiral Policy period, which is required for coverage under Admiral's Policy, Admiral's [Motion] is granted."

The Plaintiffs filed an Interlocutory Appeal of the Order granting Admiral's Motion for Partial Summary Judgment, and Stay of the proceedings pending the appeal. The Plaintiffs argued that the circuit court erroneously concluded that there was no evidence of property damage caused by an occurrence during Admiral's policy period.

The appeals court noted that Admiral's CGL policy obligates Admiral to pay "those sums that the insured [Group Builders] becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." The appeals court further noted that the mold damage and resulting loss of use of the Tower qualified as "property damage" under Admiral's CGL policy. However, the appeals court stated that the issue is whether the "property damage" to the Tower was caused by an "occurrence" during the Admiral policy period. In Hilton's Complaint, Hilton identified the primary causes and contributing factors of the mold damage and Tower closure as: "material defects in the design and construction" of the Tower. The appeals court stated that the issue is whether alleged faulty construction

work, giving rise to contractual claims, constitutes an "occurrence" under a CGL policy.

Admiral's CGL policy defines "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The appeals court held that construction defect claims do not constitute an "occurrence" under a CGL policy. Accordingly, breach of contract claims based on allegations of poor work performance, and tort-based claims, derivatives of this type of breach of contract claim, are also not covered under CGL policies.

In affirming the circuit court, the appellate court cited to WDC Venture v. Hartford Accident & Indemnity Co., 938 F.Supp. 671 (D. Hawaii 1996) which provides that the Plaintiff's tort and contract claims that arise from the contractual relationship, are outside the scope of the CGL policy. The circuit court also reasoned that permitting contractual claims under a CGL policy would violate public policy since it would not make sense for a policy to cover a willful and wanton breach of contract claim, as doing so would render the contract meaningless and "invite such misbehavior."

Additionally, the appellate court cited to Burlington Insurance Co. v. Oceanic Design & Construction Inc., 383 F.3d 940, 943 (9th Cir. 2004) which provides that a homeowners' allegations of negligence against a contractor "cannot be read to constitute an occurrence under Hawaii law."

The circuit court observed that "[a]llowing recovery for disputes between parties in a contractual relationship over the quality of work performed would convert this CGL policy into a professional liability policy or a performance bond."

The circuit court further reasoned that because the allegations were ancillary to the breach of contract claim, they could not "state a separate independent cause of action for negligence."

In addressing the issue, the appellate court noted that the Hawaii Supreme Court has held that where an underlying complaint alleges an intentional breach

of contract, there is no occurrence that triggers an insurer's duty to defend under a standard CGL policy. The Hawaii Supreme Court has further stated tort recovery is not allowed in the absence of conduct that (1) violates a duty that is independently recognized by principles of tort law and (2) transcends the breach of contract. The Hawaii Supreme Court has also cautioned of the need to examine carefully a complaint to "ensure that plaintiffs could not, through artful pleading, bootstrap the availability of insurance coverage under an insured defendant's policy by purporting to state a claim for negligence based on facts that, in reality, reflected manifestly intentional, rather than negligent conduct."

In applying these principles, the appellate court concluded that the line of federal cases applying Hawaii law follow the "majority position" that claims of poor workmanship, standing alone, are not occurrences that trigger coverage under CGL policies. In contrast, a minority of jurisdictions has held that the damage resulting from faulty workmanship is an accident, and thus, a covered occurrence, so long as the insured did not intend the resulting damage.

The appellate court's decision is a significant victory for CGL carriers allowing CGL carriers to reject coverage for claims for defective construction. However, the decision is negative for design professionals who may be one of the few parties in a lawsuit who are perceived to have "deep pockets" only because the design professional has insurance coverage.

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