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CGL Coverage and the Myth of *L-J v. Bituminous Fire & Marine Ins. Company*

By: Gerald M. Finkel & William R. Padget

Introduction

Recently, the South Carolina Supreme Court issued a controversial decision in *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 2004 S.C. LEXIS 190, Op. No 25854, (August 9, 2004). This decision has been heralded by the Insurance Defense Bar as severely limiting the scope of coverage of a commercial general liability policy or "CGL" policy. But does it, and is *L-J* such a dramatic change in South Carolina insurance law? Likely not.

The essential holding of *L-J* was that faulty workmanship is not covered under a CGL policy where there is no "occurrence;" and that rain and traffic on an exposed roadway is not such an "occurrence," which is defined as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions" under the standard CGL policy. This makes sense, rain and traffic on an exposed road is not an "accident," but rather a condition for which the roadway should have been designed to accommodate, nor is water on the surface of the roadway unexpected. *L-J* is not a revolution as some perceive it to be, but a logical and reasonable interpretation of the CGL policy language which is a firmly embedded principle of South Carolina law. In *Gambrell v. Travelers Ins. Co.*, 280 S.C. 69, 310 S.E.2d 814 (S.C. 1983), the Honorable Justice Ness in a unanimous opinion stated:

Insurance policies are subject to general rules of contract construction. We must enforce, not write, contracts of insurance and we must give policy language its plain, ordinary and popular meaning. We should not torture the meaning of policy language in order to extend or defeat coverage that was never intended by the parties.

Id. at 71, 310 S.E.2d at 816. (citations

omitted). The decision in *L-J* is nothing more than an extension of this principle.

The Decisions

The *L-J* decision stems from litigation over the development of the Dunes West Subdivision in Mount Pleasant. In 1989, Dunes West Joint Venture contracted with Eagle Creek Construction Company, Inc., a subsidiary of L-J, Inc. to develop the site and construct the roads for the subdivision. The contractor then hired several subcontractors to perform various tasks to complete this project. These subcontractors had completed all work by 1990. By 1994, the road surfaces had deteriorated and failed. The developer then sued the contractor for breach of contract, breach of warranty, and negligence. The contractor then filed a third party complaint against several project designers and subcontractors engaged to work on the project.

In 1997, the contractor settled with the developer and agreed to pay \$750,000. The contractor requested that its four insurers during the applicable time period indemnify it for the settlement amount. Bituminous refused to indemnify the contractor, while the other three insurers contributed to the settlement amount. The contractor and the three contributing insurers then brought a declaratory judgment action seeking payment from Bituminous to the settlement fund. This action was referred to a special master, who determined that the damage to the roadway was an "occurrence" under the Bituminous CGL policy. Further, the Master found the failure of the road did not constitute damage that a Contractor "expected or intended" to be excluded from coverage. The Master ordered Bituminous to contribute its pro rata share of the loss to the settlement amount.

Bituminous appealed, arguing that there was not an "occurrence" as defined

by the policy and that the Master erred in finding that policy exclusions were inapplicable. The Court of Appeals found "[u]nder the clear language of the policy, the repeated exposure to water is an 'accident' and therefore an 'occurrence.'" *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 350 S.C. 549, 555, 567 S.E.2d 489, 492 (S.C. Ct. App. 2002). The Court of Appeals further found that the business risk doctrine did not preclude coverage. As defined by the Court of Appeals "[t]he business risk doctrine is the expression of a public policy applied to the insurance coverage provided under commercial general liability policies. Reduced to its simplest terms, the risk that an insured's product will not meet contractual standards is a business risk not covered by a general liability policy." *Id.* The Court of Appeals agreed that "faulty workmanship, standing alone, does not constitute an 'accident' and cannot therefore be an 'occurrence'" but found that the Contractor's/subcontractor's defective work led to other damages, "namely, the failure of the road surfaces." *Id.* at 556-57, 567 S.E.2d at 493. Having found an "occurrence" the Court of Appeals went on to the exclusions.

First, the Court of Appeals noted that the "your work" exclusion initially appeared to exclude coverage. However, the Court found that there was an exception to this exclusion. The "your work" 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." *Id.* at 558, 567 S.E.2d at 494. The Court found that "this clear and unambiguous policy language restores coverage." *Id.* Applying the clear language of the policy the Court concluded "that the exception at issue was intended to narrow the Business Risk Doctrine." *Id.* Ultimately, the Court of Appeals affirmed the Master's finding that there was an "occur-



rence" under the policy and that no exception applied to bar coverage.

The Supreme Court of South Carolina granted certiorari and reversed the decision. The Supreme Court found that all of the contributing factors to the roadway failure were "examples of faulty workmanship causing damage to the roadway system only, which does not fall within the contractual definition of 'occurrence' under Bituminous's CGL policy." *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 2004 S.C. LEXIS 190, at *7, Op. No. 25854, (August 9, 2004). The supreme court relied on a 1984 court of appeals decision, *C.D. Walters Const. Co., Inc. v. Fireman's Ins. Co.*, 281 S.C. 593, 316 S.E.2d 709 (S.C. Ct. App. 1984), whereupon the Court noted:

The risk intended to be insured is the possibility that the goods, products or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable. The insured, as a source of goods or services, may be liable as a matter of contract law to make good on products or work which is defective or otherwise unsuitable because it is lacking in some capacity. This may even extend to an obligation to completely replace or rebuild the deficient product or work. **This liability, however, is not what the coverages in question are designed to protect against. The coverage is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained.**

L-J (Sup. Ct) at *8-*9 (emphasis added by supreme court)(citing Henderson, *Insurance Protection for Products Liability and Completed Operations—What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1971)). The Supreme Court found "the damage was caused by [(1)]the Contractor's negligently designed drainage system [that was unable] to han-

dle the water runoff and [(2) the Contractor's]failure to properly compact the road's subgrade." *Id.* at *10. Because of these factual predicates the Supreme Court held "the Contractor may not shift this economic loss to its CGL providers," but rather "must bear the loss as a consequence of the business risk it assumed upon submitting its bid to construct the roadway system." *Id.* at *9-*10.

But the Supreme Court did not stop there and went on to discuss the effect of the "Your Work" exclusion. The Court wrote "[n]evertheless, we write further to reverse the court of appeals' determination that an exception to an exclusion 'restores' coverage." *Id.* at *11. The Bituminous CGL policy contained language that excludes coverage for "your work." But there is an exception to the exclusion which reads: "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." Since it was undisputed the work was performed on behalf of the contractor by subcontractors the Supreme Court found the "exception to the exclusion applies, rendering the exclusion inapplicable." *Id.* at *12. The Court then mysteriously writes "[i]n stating that the exception to the exclusion 'restores' coverage, the court of appeals overlooks existing law, which states that 'an exclusion does not provide coverage but limits coverage.'" *Id.* at *12-*13 (citing *Engineered Products, Inc. v. Aetna Casualty & Surety Co.*, 295 S.C. 375, 378-79, 368 S.E.2d 674, 675-76 (S.C. Ct. App. 1988)). The Court continued "[t]herefore, we conclude that the exception renders the 'your work' exclusion inapplicable." *Id.* at *13. Based on this reasoning, the Supreme Court reversed the Court of Appeals' decision and concluded the damage to the roadway system was not covered under the policy.

Reliance on Business Risk is "Risky Business"

The Supreme Court's essential finding in *L-J* was proper, and not just because they have the final say. There is no plausible way to characterize rain and traffic on an exposed roadway as an "accident." Webster's defines accident as "an unex-

pected usually sudden event that occurs without intent or volition although sometimes through carelessness, unawareness, ignorance, or a combination of causes and that produces an unfortunate result." Giving "accident" its plain, popular, and ordinary meaning, it simply can't be said that rain and traffic is unexpected on an exposed roadway. Thus, since there was no "occurrence" under the policy, a finding of no coverage is the proper result.

However, the Supreme Court's reliance on the Business Risk doctrine and its discussion of the "Your work" exclusion has produced great confusion amongst members of the Bar. First, it could be interpreted that *L-J* reinforces the validity of the Business Risk doctrine in South Carolina. This notion could be dangerous if employed at the wrong stage of coverage analysis. In *L-J* the Supreme Court utilized the Business Risk doctrine in answering the initial question, whether there was an "occurrence" under the policy that triggered coverage. Such use is proper when making this determination of whether an "accident" has occurred. But the utility of the Business Risk doctrine in evaluating the effect of the "Your work" exception has been vitiated by a 1986 change in the standard CGL policy language.

The development of the "Your work" or "work product" exclusion warrants a brief discussion of the historical development of CGL policies. Originally, CGL meant "Comprehensive General Liability" policy and covered a much broader spectrum of liability. But in the later half of the 20th Century the modern "Commercial General Liability" policy began to take shape and the numerous exclusions that are common today began showing up in these policies. Prior to 1973, the "Your work" exclusion, though routinely found in CGL policies, was not effective in precluding coverage for this type of property damage. The exclusionary language was often found to be ambiguous because it did not clearly define what insured's work was not covered. It was unclear whether coverage would be excluded only for damage to the defective product or for all damage to the entire project of the insured. In construing policy

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language narrowly against insurers, the courts typically allowed insureds to recover repair costs associated with damage to other parts of the insured's project caused by the defective work of the insured. Because insurers were displeased with coverage in such circumstances the standard CGL policy language was revised in 1973. The language was changed to eliminate coverage in cases where the insured's defective work damaged another part of the insured's project, even where the defective work was performed by an insured's subcontractor. See JOHN F. DOBBYN, *INSURANCE LAW* 45-46 (4th ed. West 2003).

Subsequently, courts typically upheld the new exclusionary language finding no coverage in these circumstances. *E.g. Western Emp. Ins. Co. v. Arciero & Sons*, 146 Cal. App. 3d 1027 (2nd App. Div. 1983). In response to demands from insureds for more coverage, insurers developed and sold many broad form endorsements to CGL policies of this era which restored coverage for work done on your behalf by others, namely subcontractors. Due to the popularity of these endorsements insurers again revised the standard CGL policy language in 1986. This most recent version of the standard CGL policy language contains much of the same language as the broad form endorsement, so as to cover work performed on your behalf by subcontractors. See DOBBYN, *supra* at 48. It was this most recent CGL policy language that was at issue in *L-J*. A point aptly noted by the Court of Appeals:

[responding to the demands of insureds], the industry chose to add the new exception to the business risk exclusion in 1986. We may not ignore that language when interpreting case law decided before and after the addition. To do so would render the new language superfluous. We realize that under our holding a general contractor who contracts all the work to subcontractors, remaining on the job in a merely supervisory capacity, can insure complete coverage for faulty workmanship. However, it is not our holding that creates this result: it is

the addition of the new language to the policy. We have not made the policy closer to a performance bond for general contractors, the insurance industry has.

L-J, 350 S.C. at 558-59, 567 S.E.2d at 494 (citing *Kalchthaler v. Keller Constr. Co.*, 224 Wis. 2d 387, 591 N.W.2d 169 (Wis. Ct. App. 1999)).

Given this history utilizing the Business Risk doctrine at a later stage of coverage analysis may be improper and would be contrary to the plain, ordinary, and popular meaning of the added language, and the expectations of the parties to the insurance agreement. Thus, while a finding of no coverage is proper under the circumstances in *L-J*, there are circumstances whereupon the Business risk doctrine could be improperly employed.

For instance, instead of exposure to ordinary rain and traffic, suppose the roadway in question deteriorated because a dam, constructed by a contractor's subcontractor, of a nearby retention pond burst and flooded the roadway causing its destruction. Despite the fact that the construction contract called for a design to withstand weather conditions, this loss may be covered under the contractor's policy. The first step in the analysis is to determine if there is an "occurrence." Here, the failure of the dam *could* be construed to be an "accident" triggering coverage. For policy purposes, the failure of the dam is the unexpected event that may constitute an "occurrence."

The second step in the analysis is to see if the event is somehow excluded from coverage. Here, if faulty work by a subcontractor was found to have contributed to this loss, the exception to the "Your work" exclusion would apply, and coverage would be maintained. The fact that the contract called for a system that would withstand weather conditions would be of no consequence, as the Business Risk doctrine has been rendered irrelevant by the 1986 standard CGL language change. Thus, it is imperative to employ the Business Risk doctrine at the proper stage of coverage analysis. So long as there is an "accident, including continuous or repeated exposure to substantially the same

general harmful conditions," it is irrelevant that the cause of the accident is the result of an insured's subcontractor's faulty work.

It is important to remember interpretive insurance law is simply a branch of contract law, and parties are free to contract for whatever coverage to which they agree, so long as it is not contrary to public policy. While courts should be cognizant that liability insurance is not a performance bond, they should also be giving CGL policies their plain, ordinary, and popular meaning when determining coverage.

Does "Your work" work?

As stated earlier, the Supreme Court did not stop with its finding of no "occurrence" and continued in dictum with a discussion of the "your work" exclusion. A great deal of confusion has arisen over the following discussion of the "your work" exclusion: "[i]n stating that the exception to the exclusion 'restores' coverage, the court of appeals overlooks existing law, which states that 'an exclusion does not provide coverage but limits coverage.'" *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 2004 S.C. LEXIS 190, at *12-*13, Op. No 25854 (S.C. August 9, 2004) (citing *Engineered Products, Inc. v. Aetna Casualty & Surety Co.*, 368 S.E.2d 674, 675-76 (S.C. Ct. App. 1988)).

Many have misconstrued this to mean that the subcontractor exception to the "your work" exclusion is inoperable, meaning the CGL excludes coverage for all of the insured's work. This is a misinterpretation that fails to recognize the plain, ordinary, and popular meaning of the language of the policy. As pointed out by the Court of Appeals, such an interpretation would render the 1986 policy language change "superfluous." *L.J.*, 350 S.C. at 559, 567 S.E.2d at 494; see also *Thommes v. Milwaukee Mut. Ins. Co.*, 622 N.W.2d 155, 159 (Minn. Ct. App. 2001) (noting the "express [subcontractor] exception to an exclusion can limit the scope of the business risk doctrine"). In stating the exception to the exclusion does not "restore" coverage, the Supreme Court was indicating that where there was no "occurrence" triggering coverage, the sub-



contractor exception to the exclusion does not create coverage where it did not exist in the first instance.

Charts A & B illustrate the difference. In *L-J*, the supreme court was making clear that "Chart B" is an improper interpretation, not that "Chart A" was impossible. To state that "Chart A" is not the proper operation of the CGL policy language fails to give the plain, ordinary, and popular meaning to the CGL policy amendments in 1986. In fact, such an interpretation fails to give any meaning to the policy amendment. Further, if "Chart A" is not the state of the law, the question contractors should be asking their insurers is: "If subcontractor work is not covered under my CGL policy, then why do insurers audit my subcontractors and increase my policy premium if they are uninsured?" The only reasonable interpretation of the exception to the exclusion is illustrated by "Chart A." Again, to do otherwise fails to give the language its plain, ordinary, and popular meaning.

So, where does this leave us for CGL policy coverage and what is an "occurrence"? Well, its not rain and traffic on an exposed roadway. But, in *Boggs v. Aetna Casualty & Surety Co.*, 272 S.C. 460, 252 S.E.2d 565 (S.C. 1979), a unanimous Supreme Court had no trouble finding a contractor's negligent placement of a house on a lot, which resulted in seepage of water into the home constituted an "occurrence" under very similar CGL policy language of the time. *Id.* at 567 (noting "occurrence" at the time was defined as "an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury or property damage neither expected nor intended from the standpoint of the insured"). The court discussed the meaning of "occurrence" as follows:

Aetna seeks to construe the word "occurrence" as an accident referable to a sudden happening. This construction is erroneous. The phrase "injurious exposure to conditions" incorporated in the policy definition of "occurrence" indicates an occurrence need not be sudden but may be produced over a period of time.

Id. The court concluded the "negligent location of the house on the lot which created the exposure to a condition which resulted in property damage constituted an 'occurrence.'" *Id.* Also, the S.C. Supreme Court has found CGL coverage appropriate in other circumstances. See *Century Indem. Co. v. Golden Hills Builders, Inc.*, 348 S.C. 559, 561 S.E.2d 355 (S.C. 2002)(indicating CGL coverage appropriate where defective stucco siding allowed penetration of water into substrate of home when job is completed by contractor and damage occurs during the policy period); *Joe Harden Builders, Inc. v. Aetna Casualty & Surety Co.*, 326 S.C. 231, 486 S.E.2d 89 (S.C. 1997) (holding CGL coverage appropriate for contractor whose subcontractor misaligned concrete columns and floor slabs resulting in damage to exterior veneer brick wall). So the line distinguishing covered events from noncovered events must lie somewhere between rain on an exposed roadway and seepage of water into a home. This leaves us right where we have always been, closely reading the language of CGL policies looking for "occurrences" which may trigger coverage.

Further, as indicated by the Supreme Court, when such occurrences cause bodily injury or property damage to another, coverage is triggered. The Supreme Court gave the example of a bicyclist riding down the road and being injured as a result of the cracking in the roadway. *L-J*, 2004 S.C. LEXIS 190, at *9-*10. But we would suggest that coverage remains broader than that. In the Court of Appeals decision, Chief Judge Hearn dissented, arguing coverage was not proper because there was no occurrence triggering coverage. *L.J.*, 350 S.C. at 562, 567 S.E.2d at 496 (Hearn C.J. dissenting). This dissent likely served as the foundation for the Supreme Court's ruling. In her dissent, Judge Hearn felt compelled to distinguish a notable circumstance. She wrote:


For this reason, I believe *Kalchthaler v. Keller Construction Co.*, 224 Wis. 2d 387, 591 N.W.2d 169 (Wis. Ct. App. 1999) is distinguishable. In that case, the court found coverage when leaky windows damaged the drapery

and wallpaper of the completed building; thus, the damages extended beyond the scope of the contractor's original work.

Id. at 496 n.19 (Hearn C.J. dissenting). This would indicate that coverage is still appropriate in a variety of circumstances.

This suggests the line between coverage and no coverage is a blurred one at best warranting careful evaluation. A knee jerk declination of coverage due to a construction defect is dangerous and inadvisable. Insurers are required to determine their duty to defend based solely on the allegations of the plaintiff's complaint. *Isle of Palms Pest Control v. Monticello Ins. Co.*, 319 S.C. 12, 459 S.E.2d 318 (S.C. Ct. App. 1994). In the wake of *L-J*, insurers would be well advised to carefully evaluate coverage issues prior to denying coverage because property damage or bodily injury to another triggers CGL policy coverage.

Final Thoughts

In sum, the *L-J* decision is not the revolution many believe it to be. The Supreme Court's holding that rain and traffic on an exposed roadway does not constitute an occurrence is not revolutionary. Rather, it is a decision in line with embedded principles of South Carolina law that courts will enforce insurance policies as they read, not write them for their own. While *L-J* may mark the end of a trend in expanding the scope of coverage of CGL policies, it is not the death knell to CGL coverage as some may suggest. In the meantime, South Carolina lawyers have the pleasure of continuing to decipher the plain, ordinary, and popular meaning attributed to phrases such as "accident, including continuous or repeated exposure to substantially the same general harmful conditions" to determine the scope of CGL coverage. 

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