

November 11, 2011

Colorado Construction Defect Law Not Retroactive—But Court Finds Occurrence

In the first appellate ruling on the 2010 Construction Defect (CD) law, a federal court has held that the expansive legislation applies only to insurance policies in force or issued after the effective date of the law.

The case involved a house constructed in 2001 and insurance policies issued during 2001–2006. The insureds sought to have the 2010 law applied to the coverage dispute. First, the federal court refused to give the law any retroactive effect, determining that the reference to policies “in existence” meant unexpired policies and not all those for which coverage can still be obtained. Second, the court diverged from state court precedent on the meaning of occurrence, ruling that property damage to non-defective work caused by the faulty workmanship of subcontractors can constitute an occurrence under a GL policy.

Since such damage to other work is generally not expected or intended, the fortuity element is satisfied. In contrast, the court ruled that property damage to the defective work itself can be expected or intended, and thus constitutes economic loss not covered by the policy. *Greystone Construction Inc. v. National Fire Marine Ins. Co.*, No. 09-1412 (Nov. 1, 2011). A few additional points:

- This case was a “duty to defend” case, and that entailed a broader view of the insurance policy. However, the legal holdings will influence indemnity and defense obligations in other coverage litigation.
- Exclusions in pre-2010 policies still apply, although many claims that once failed on occurrence grounds will now test those exclusions. If insurers were using a “Your Work” exclusion without the subcontractor exception (such as ISO BP 14 19 01 10) or a Designated Work Exclusion listing the particular project, for example, the end result would likely be “no coverage.”
- The Colorado Supreme Court has not ruled on the CD occurrence or retroactivity questions, although a Colorado appellate court recently issued a narrow interpretation of occurrence. Under the 2009 *General Security* case, damage from faulty workmanship is not considered an accident or occurrence. This decision is still good law, although the *Greystone* holding will now be argued in coverage cases and could lead more courts to find an occurrence.
- On the retroactivity question, two of three lower state courts considering the issue came to the same conclusion as the federal court. Since state rulings take precedence over federal in matters of state law and insurance policy interpretation, insurers need to watch how state appellate panels decide the issue.

Implications: The decision has no direct impact on current contractor business that is subject to the new law. For those pre-2010 policies with “anti-Montrose” language or exclusions not permitted by the new law, insurers can be reasonably comfortable that those coverage provisions will be enforced and applied under old law rather than the new statute. The same is true for insurers using broader form language. However,

the latest ruling does add to the growing body of conflicting law on the meaning of occurrence. Courts will now look to General Security, Greystone and earlier decisions—with their mixed views of occurrence—for guidance. Ultimately, the federal decision will prompt more legal challenges and probably some unfavorable outcomes.

Other States: The Colorado law, as well as the 2011 Arkansas CD law, do not contain specific language on retroactivity. However, the 2011 South Carolina CD law, S. 431, does state that the broader occurrence definition applies retroactively. At present, we are not aware of any legislation pending on the issue in other states, but could well see new proposals in 2012.

Gen Re underwriters monitor CD coverage products and legal developments, both of which seem to emerge on a regular basis. If you would like to explore implications and options for your contractor book of business in Colorado or elsewhere, please contact your Gen Re account executive.

Gen Re's General Liability and Commercial Umbrella Teams

Gen Re—A Berkshire Hathaway Company

The information we have provided is offered as general information and should not be relied upon as advice, representation or counsel. Legal conclusions will vary depending on applicable local and national laws, individual policy terms and conditions and exclusions. This analysis is separate from and does not affect any positions we may take or have taken on any claims, past or future, under any reinsurance or insurance agreement or other contract. You should consult with appropriate professionals, including your own legal counsel, before relying upon any information we provide.