A common question in construction law is whether commercial general liability (“CGL”) insurance policies cover construction defects/faulty workmanship. Typical CGL policy language states that the insurer will provide coverage for damages because of “bodily injury” or “property damage” caused by an “occurrence” that takes place in the “coverage territory.” States vary in their interpretation of the term “occurrence” in the context of construction defects. Nebraska and Iowa courts have found that construction defects are not “occurrences,” and thus not covered by CGL insurance unless the “property damage” is to property other than the insured’s work. Below is a more detailed breakdown of how Nebraska and Iowa analyze this issue.

**Nebraska**

The Nebraska Supreme Court stated its position on this issue in *Auto-Owners Ins. Co. v. Home Pride Companies, Inc.*, 684 N.W.2d 571 (Neb. 2004) (“[A]lthough 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.”).

In *Auto-Owners*, the insured contractor hired a subcontractor to perform a shingle installation project. Sometime later, the consumer discovered that the shingles were installed incorrectly, which allegedly caused damage to the roof structure and building. The consumer sued, and after the contractor made a claim, the insurer instituted a declaratory judgment action to determine whether the CGL provided coverage for the construction defects of a subcontractor. The district court granted summary judgment in favor of the insurer. On appeal, the Supreme Court reversed.

The Nebraska Supreme Court began its analysis by determining if there was an initial grant of coverage—was there “property damage” caused by an “occurrence?” The CGL policy defined “property damage” as “physical injury to tangible property, including all resulting loss of use of that property” as well as “loss of use of tangible property that is not physically injured.” The court determined that the damage to the roof structure and building was clearly “property damage,” and next turned to the issue of whether the incidence should be deemed an “occurrence.”

The CGL policy defined “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” Though the term “accident” was not defined in the policy, the Nebraska Supreme Court previously held that “an accident within the meaning of liability insurance contracts includes any event which takes place without the
foresight or expectation of the person acted upon or affected thereby.” *Farr v. Designer Phosphate & Premix Internat.*, 570 N.W.2d 320, 325 (Neb. 1997); see also *City of Kimball v. St. Paul Fire & Marine Ins. Co.*, 206 N.W.2d 632, 634 (Neb. 1973) (“The word ‘accident’ as used in liability insurance is a more comprehensive term than ‘negligence’ and in its common signification the word means an unexpected happening without intention.”). Thus, the court turned its focus to consider whether a construction defect is an “accident.”

The court found that because a construction defect is not a fortuitous event, it does not fit within the accepted definitions of “accident,” therefore, standing alone, construction defects are not covered under a standard CGL policy. The court’s determination included an important distinction, however. The court stated that if a construction defect *causes* an accident, then the event will be deemed an “occurrence.” Essentially, if the construction defect causes an unexpected and unintended result, it is deemed an accident, which falls within the scope of an “occurrence,” thus, coverage should be provided. In *Auto-Owners*, the plaintiff alleged damage to the roof structure and building. The court reasoned that while damage to the shingles (the work product) could be expected as a business risk (thus, not an accident), damage to the roof and building were not expected nor intended. Therefore, the defective work to the shingles caused an accident, which permits the incident to be classified as an “occurrence” under the CGL policy.

After finding initial coverage, the court analyzed the possible exclusions provided in the CGL policy. The policy stated that coverage does not apply to “damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of . . . your work.” The court found the “Your Work Exclusion” inapplicable because there was no damage to the insured’s work product (the shingles). Because this exclusion did not apply, the court did not have to consider the “Subcontractor Exception” to the exclusion, which stated that the “Your Work Exclusion” of coverage does not apply if damages arise from work which was performed on the insured’s behalf by a subcontractor. Importantly, the court clarified that the “Subcontractor Exception” is merely an exception to the “Your Work Exclusion” and does not grant coverage simply because work is done by a subcontractor. Thus, whether a construction defect is performed by a subcontractor or a contractor directly is immaterial—the same accident/occurrence analysis applies.

Likewise, the Court determined that the “Impaired Property” exclusion did not apply because property is not “impaired” unless it can be restored by the “repair, replacement, adjustment or removal of . . . your work.” Thus, because the insured’s work was not at issue (the damage was to the roof structure and building, not the shingles), the exclusion was found inapplicable.

The holding in *Auto-Owners* received negative treatment from other jurisdictions (those holding that a construction defect standing alone is an “occurrence,” including Texas and Florida cited *supra*), but remains authoritative in Nebraska. There are no significant cases on this issue in Nebraska since the decision in *Auto-Owners*. It should be noted, however, that in *Fireman’s Fund v. Structural Sys. Tech., Inc.*, 426 F. Supp. 2d 1009, 1025 (Dist. Neb. 2006), the district court appears to have over-generalized the *Auto-Owners* holding. The court in *Fireman’s Fund*
asserted that “a standard commercial general liability policy will cover an insured contractor for the faulty workmanship of a contractor that it hired.” This seems to conflict with the framework used in *Auto Owners* and the fact that the court in *Auto Owners* clearly states that “Subcontractor Exception” is merely an exception to an exclusion and, therefore, incapable of providing coverage. Basically, the fact that a subcontractor performs the faulty workmanship is not sufficient to grant coverage, and there will not be coverage if the only damage is to the work product, even if performed by a subcontractor.

The framework below should serve as a practical guide for determining CGL coverage of a construction defect case in Nebraska. One potential issues not discussed in *Auto-Owners* is where to draw the line between damage to the insured’s work product and “other property.” *Auto-Owners* seemed to take a narrow approach by distinguishing between shingles on a roof and the roof and building itself. Iowa appears to use a less precise approach as seen below.

**Nebraska Analytical Framework**

1. **Is there an “occurrence?”**
   a. An occurrence is an “accident;” see accepted definitions from case law:
      i. “An accident within the meaning of liability insurance contracts includes any event which takes place without the foresight or expectation of the person acted upon or affected thereby.” *Farr v. Designer Phosphate & Premix Int'l, Inc.*, 570 N.W.2d 320, 325 (Neb. 1997).

*Construction defects of one’s own work product are not an accident, but if the defect causes damage to other property, then this is an accident. *Auto-Owners Ins. Co. v. Home Pride Companies, Inc.*, 684 N.W.2d 571 (Neb. 2004).*

2. If there is not an occurrence, then there is no coverage and none of the exclusions are necessary to apply.

3. If there is an occurrence, the “Your Work” and “Impairment” Exclusions will not bar coverage for damage to other property.

4. Because neither exclusion will bar coverage, the “Subcontractor Exception” to the exclusions will not come into play.
   a. Therefore, the fact that a subcontractor performs the construction defect is irrelevant when determining CGL coverage; the “occurrence” analysis is the same whether the contractors or subcontractors performed the work; the focus of the analysis is on the type of damage arising as a result of the defect—whether to the work product itself or other property, not who caused the damage.
The Iowa Supreme Court stated its position on this issue in *Pursell Const., Inc. v. Hawkeye-Sec. Ins. Co.*, 596 N.W.2d 67 (Iowa 1999) (“We agree with the majority rule and now join those jurisdictions that hold that defective workmanship standing alone, that is, resulting in damages only to the work product itself, is not an occurrence under a CGL policy.”).

In *Pursell*, a developer hired a contractor to build the basements, footings, sidewalks, and driveways for two houses located in a floodplain. A city ordinance required the lowest levels of the houses to be elevated above the floodplain. Following the project’s completion, an inspection revealed that the lower levels were not above the floodplain, thus, the houses could not legally be occupied, rented or sold until the violation was cured. The developer hired different contractors to raise the lower levels above the floodplain, and sued the original contractor for the cost of fixing the defects, as well as costs for other necessary modifications to the houses that the original contractor did not directly work on (such as “new duct work”). The original contractor brought a declaratory judgment action against its insurer to determine coverage under its CGL insurance policy.

The language in the CGL policy here is identical to the policy examined in *Auto-Owners* in Nebraska. The court also used the same framework as in *Auto-Owners*: “[I]t appears our framework of analysis for determining coverage may involve three steps. First, we look to the insuring agreement. If there is coverage, we look next to the exclusions. Last, if any exclusion applies, we then consider whether [there] is an exception to the exclusion.” The CGL policy provided that an “occurrence” is an “accident . . . .” thus, the court looked to accepted definitions of the term “accident” for guidance. In *Cent. Bearings Co. v. Wolverine Ins. Co.*, 179 N.W.2d 443, 448 (Iowa 1970), the Iowa Supreme Court recognized that “the word ‘accident’, as used in insurance policies, has frequently been defined as . . . an undesigned, sudden, and unexpected event, usually of an afflictive or unfortunate character, and often accompanied by a manifestation of force . . . .” The *Cent. Bearings* court further stated that “giving to the word the meaning which a man of average understanding would, we think it clearly implies a misfortune with concomitant damage to a victim, and not the negligence which eventually results in that misfortune.”

After looking at how other jurisdictions approach this issue, the Iowa Supreme Court determined, “the better reasoned authorities hold that mere faulty workmanship, standing alone, cannot constitute an occurrence as defined in the policy, nor would the cost of repairing the defect constitute property damages.” Applying this rationale, the court concluded that that damages sought by the developer were “limited to the very property upon which [the contractor] performed the work,” thus, the damages were not an “occurrence.”

Although *Pursell* and *Auto-Owners* follow a similar framework, the two courts arguably made conflicting final determinations. In *Auto-Owners*, the court determined that damage to the roof structure and building was separate from damage to the work product itself (the shingles) because the defects of the work product caused the separate roof and building damage. But in *Pursell*, the court found that all damages were part of the work product even though it appears
the defect in the lower levels caused damage to other property, such as the ducts. This sub-issue was raised in W.C. Stewart Const., Inc. v. Cincinnati Ins. Co., 770 N.W.2d 850 (Iowa Ct. App. 2009). In W.C. Stewart, after a subcontractor performed grading services, the developer noticed movement in the building’s foundation as well as cracking in the walls. The subcontractor argued that the defective grading services caused an unintended result, therefore, the CGL should provide coverage. The Iowa Court of Appeals disagreed, stating:

[Subcontractor] argues that because [Developer’s] counterclaim asserted damages to property other than [Subcontractor’s] work product, Pursell is not controlling. [Subcontractor] reads Pursell too narrowly. The faulty workmanship in Pursell required re-installation of plumbing and duct work with which Pursell had not been involved, just as the faulty workmanship by [Subcontractor] required reconstruction of walls [Subcontractor] had not built.

This quote seems to affirm the difference in Iowa and Nebraska. This result may be linked to the different accepted definitions of “accident” in the context of liability insurance in each state. While Nebraska definitions focus on the result being “unforeseen” and “unexpected,” the Iowa definition states that an accident is “not the negligence which eventually results in that misfortune.” As a result, it seems that Nebraska cases are more likely to provide CGL coverage because the term “accident” is read to include unexpected results to construction defects. In Iowa, it appears that “accident” is interpreted narrowly, excluding unexpected results if they arise from a construction defect. This distinction makes it less likely that a court in Iowa will determine CGL coverage exists if a construction defect occurs. Further, a search of Iowa case law revealed no cases where a court ruled that a CGL provided coverage when a construction defect was involved in any way.

Iowa Analytical Framework

1. Is there an “occurrence?”
   a. An occurrence is an “accident;” see accepted definitions from case law:
      i. “The word ‘accident’, as used in insurance policies, has frequently been defined as . . . an undesigned, sudden, and unexpected event, usually of an afflictive or unfortunate character, and often accompanied by a manifestation of force . . . .” *Cent. Bearings Co. v. Wolverine Ins. Co.*, 179 N.W.2d 443, 448 (Iowa 1970).
      *Damages to “the very property upon which [the contractor] performed the work,” even if unrelated to the contractor’s specific work product, is not an “accident.” See Pursell Const., Inc. v. Hawkeye-Sec. Ins. Co., 596 N.W.2d 67 (Iowa 1999); W.C. Stewart Const., Inc. v. Cincinnati Ins. Co., 770 N.W.2d 850 (Iowa Ct. App. 2009).

2. If there is not an occurrence, then there is no coverage and none of the exclusions are necessary to apply.

3. If there is an occurrence, the “Your Work” and “Impairment” Exclusions will not bar coverage for damage to other property.
4. Because neither exclusion will bar coverage, the “Subcontractor Exception” to the exclusion will not come into play.

* Defective work itself, regardless of who performs the work, is not an occurrence that is covered under a CGL policy. *Cont'l W. Ins. Co. v. Jerry's Homes, Inc.*, 713 N.W.2d 247 (Iowa Ct. App. 2006).

Moving forward, there are two issues to keep an eye on. First, it is important to track how courts define the term “accident” in the context of liability insurance contracts. Because “occurrence” is defined as an “accident” in CGL policies, but “accident” remains undefined in CGL policies, case law definitions are immensely persuasive to courts. Also, though *Auto-Owners* and *Pursell* provide significant guidance, it will be interesting to see how lower courts apply this framework in unique facts patterns. The two state supreme court decisions suggest that Nebraska is more willing to find coverage, while Iowa is more restrictive. Second, at the time of their decisions, both *Auto-Owners* and *Pursell* state that they are following the “majority view” on this issue. Recently, however, the trend is for courts to find CGL coverage for construction defects. If the majority shifts, it will be interesting to see whether Nebraska and/or Iowa follow the trend.

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