

## INSURING THE RISK OF CONSTRUCTION DEFECTS IN COLORADO: THE TENTH CIRCUIT'S *GREYSTONE* DECISION

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### ABSTRACT

Whether commercial general liability insurance policies cover claims for construction defects has been the subject of debate for many years in Colorado and across the United States. When a division of the Colorado Court of Appeals ruled in 2009 that negligent work could not give rise to a covered “occurrence” under the pertinent policy language, the state legislature responded with a statute rejecting this view. Disputes continued in the courts until late 2011, however, when the Tenth Circuit reviewed a diversity case and predicted that the Colorado Supreme Court would hold that standard liability policies do in fact cover unforeseen damage to property arising from faulty workmanship. This Article examines the history of construction liability insurance policies, the interpretation of such policies in Colorado, and the Tenth Circuit’s holding in *Greystone Construction, Inc. v. National Fire & Marine Insurance Co.*

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## INTRODUCTION

With its decision in *Greystone Construction, Inc. v. National Fire & Marine Insurance Co.*,<sup>1</sup> the United States Court of Appeals for the Tenth Circuit has greatly clarified the law of construction insurance in the State of Colorado. The opinion, announced in late 2011, followed years of fighting between policyholders and carriers in Colorado's state courts, federal courts, and legislature. Underlying all of these battles was a fundamental dispute over whether builders' liability insurance policies could cover property damage and construction defect claims arising from negligent work. Although this war is certainly not over, the Tenth Circuit's decision represents a significant victory for policyholders.

## I. HISTORY

*A. ISO Policies of the 1960s, 1970s, and 1980s*

The institution of insurance is at least as old as the earliest records of human civilization in Greece, Rome, and China.<sup>2</sup> Modern concepts of business insurance date back to the Middle Ages, when traders sought a means to offset the risk of hazardous maritime travel and other threats to their property.<sup>3</sup> In the late nineteenth century, however, a new form of risk emerged: the civil judgment. As the Industrial Revolution brought about trains, automobiles, and other new technologies wonderfully suited to people hurting themselves, businesses sought to insure against the risk that a court would order them to compensate third parties for bodily injury or property damage.<sup>4</sup> This desire begat the modern commercial general liability (CGL) insurance policy.<sup>5</sup>

Until the 1930s, each insurance company drafted its own unique policy language to cover potential liabilities, "resulting in little uniformity and a great deal of confusion and litigation."<sup>6</sup> These concerns prompted the various carriers to create an independent service agency to develop standardized language for all general liability policies.<sup>7</sup> This agency, now known as the Insurance Services Office, Inc. (ISO), published its first standardized liability policy in 1940 and has updated its policy forms periodically since then.<sup>8</sup>

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1. 661 F.3d 1272, 1282 (10th Cir. 2011).

2. See DAVID P. LEONARD, *THE NEW WIGMORE: A TREATISE ON EVIDENCE: SELECTED RULES OF LIMITED ADMISSIBILITY* § 6.3.1, at 756 (Aspen Law & Business rev. ed. 2002).

3. *Id.* at 756–57.

4. *Id.* at 758–59; see also Kenneth S. Abraham, *The Rise and Fall of Commercial Liability Insurance*, 87 VA. L. REV. 85, 87–88 (2001); James A. Robertson, *How Umbrella Policies Started Part 1: Early Liability Coverage*, INT'L RISK MGMT. INST., INC. (Mar. 2000), <http://www.irmi.com/expert/articles/2000/robertson03.aspx>.

5. Abraham, *supra* note 4, at 89.

6. SCOTT C. TURNER, *INSURANCE COVERAGE OF CONSTRUCTION DISPUTES* § 1:5 (2012).

7. *Id.*

8. *Id.*

Today, a few basic ISO forms define the scope of liability coverage available for nearly all businesses throughout the United States, regardless of what type of work the business may do.<sup>9</sup> Although there would be obvious advantages to creating specialized policies tailored to individual industries, this approach would present challenges as well: whenever a carrier seeks to adopt new policy language, it must first obtain approval from the government of each state where the policy would have effect, educate its employees on the meaning and application of the new language, and calculate premiums based on predictions of how courts may interpret the policy in future disputes.<sup>10</sup> Given these administrative hurdles, most insurers opt to use the standard, tested language.<sup>11</sup> As one commentator has noted, however, this results in a situation where “much the same policy is issued to an earthmoving and excavating contractor as to a wholesale bakery.”<sup>12</sup>

The very first ISO liability policies were written to cover legal obligations arising out of injury or damage “caused by an accident.”<sup>13</sup> Questions emerged, however, over whether an “accident” included harm that took place over an extended period of time. To address such questions, the ISO amended its standard policy language in 1966 to state that the carrier must pay all “sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ . . . caused by an ‘occurrence’ that takes place in the ‘coverage territory.’”<sup>14</sup> The policy in turn defined “occurrence” to be “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”<sup>15</sup> The 1973 revision defined “occurrence” in a similar manner but added an element of fortuity, deeming an “occurrence” to be “an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.”<sup>16</sup>

Beginning with the 1986 revision, ISO policies have defined an “occurrence” as “an accident including continuous or repeated exposure to substantially the same general harmful conditions,” moving the “nei-

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9. *Id.*

10. *Id.* As Turner notes, the McCarren Act, 15 U.S.C. §§ 1011–1015 (2012), delegates the regulation of insurance policies to the states and territories, effectively requiring the ISO to obtain the approval of fifty-three separate governments before adopting new language. See TURNER, *supra* note 6.

11. For a further discussion of the forces encouraging standardization of insurance policies, see 1 ERIC MILLS HOLMES & MARK S. RHODES, HOLMES’S APPLEMAN ON INSURANCE §§ 2.1–2.2, at 189–202 (2d ed. 1996).

12. TURNER, *supra* note 6.

13. *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65, 74 (Wis. 2004) (quoting 16 HOLMES & RHODES, *supra* note 11, § 117.3, at 240).

14. *Id.* (alteration in original) (quoting CGL policy) (internal quotation marks omitted).

15. *Id.* at 75–76 (quoting CGL policy) (internal quotation marks omitted).

16. Clifford J. Shapiro & Neil B. Posner, *It Was an Accident: Inadvertent Construction Defects Are an “Occurrence” Under Commercial General Liability Insurance Policies*, 3 J. INS. COVERAGE, Autumn 2000, at 55, 59 (quoting 1973 revision of CGL policy).

ther expected nor intended” language to the exclusions section of the policy.<sup>17</sup> The policies have never defined the word “accident,” prompting courts to look to common usage and dictionary definitions, which generally describe an accident as being something that happens by chance or from an unknown or unexpected cause.<sup>18</sup>

As the policy language evolved, insured builders sought coverage for the cost of repairing property that had sustained damage due to inadvertent defects in their workmanship. Although the 1966 and 1973 ISO policies excluded coverage for damage to the “work” or “product” of the named insured, some argued that such exclusions were inapplicable to property damage included within the “Products–Completed Operations Hazard” or similarly titled provisions, which the policies defined to comprise property damage arising out of work that had been completed or abandoned.<sup>19</sup> Few courts of the era were persuaded, however.<sup>20</sup> A 1971 law review article opined that the “business risk” exclusions of the contemporary CGL policies were evidence that the ISO drafters had not intended to cover the possibility that the policyholder might not perform contractual obligations.

The products hazard and completed operations provisions are not intended to cover damage to the insured’s products or work project out of which an accident arises. 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 eco-

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17. TURNER, *supra* note 6, § 6:53 (quoting post-1986 policies).

18. *Id.* § 6:54. Turner suggests that, because “accident” is subject to many possible meanings, it is an ambiguous term that courts should interpret in whatever manner maximizes coverage for the insured. *See id.* § 6:53. The Wisconsin Supreme Court, meanwhile, has cited two applicable definitions of this word:

The dictionary definition of “accident” is: “an event or condition occurring by chance or arising from unknown or remote causes.” Black’s Law Dictionary defines “accident” as follows: “The word ‘accident,’ in accident policies, means an event which takes place without one’s foresight or expectation. A result, though unexpected, is not an accident; the means or cause must be accidental.”

*Am. Girl, Inc.*, 673 N.W.2d at 76 (citations omitted).

19. *See* Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 419–24 (1971).

20. *See, e.g.*, *Bibel Bros., Inc. v. United States Fidelity & Guar. Co.*, 522 F.2d 1207, 1211 (8th Cir. 1975); *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229, 235 (Minn. 1986); *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788, 792 (N.J. 1979).

nomic loss because the product or completed work is not that for which the damaged person bargained.<sup>21</sup>

The Supreme Court of New Jersey quoted this article in a 1979 case, *Weedo v. Stone-E-Brick, Inc.*,<sup>22</sup> in which the court concluded that an insurance carrier had no duty to defend allegations that an insured contractor was liable for replacing defective stucco and roofing materials.<sup>23</sup> The court then offered its own example to guide future litigants.

An illustration of this fundamental point may serve to mark the boundaries between “business risks” and occurrences giving rise to insurable liability. When a craftsman applies stucco to an exterior wall of a home in a faulty manner and discoloration, peeling and chipping result, the poorly-performed work will perforce have to be replaced or repaired by the tradesman or by a surety. On the other hand, should the stucco peel and fall from the wall, and thereby cause injury to the homeowner or his neighbor standing below or to a passing automobile, an occurrence of harm arises which is the proper subject of risk-sharing as provided by the type of policy before us in this case. The happenstance and extent of the latter liability is entirely unpredictable the [sic] neighbor could suffer a scratched arm or a fatal blow to the skull from the peeling stonework. Whether the liability of the businessman is predicated upon warranty theory or, preferably and more accurately, upon tort concepts, injury to persons and damage to other property constitute the risks intended to be covered under the CGL.<sup>24</sup>

Notably, it does not appear that the plaintiffs in *Weedo* alleged that the defects in the stucco and roofing products led to any water intrusion or property damage within the home, so the court never reached the question of whether the policy would have covered damage to nondefective components of a builder’s work.<sup>25</sup>

In any event, though the reasoning of *Weedo* and similar cases may have correctly interpreted the CGL policies of the time, it also suggested that builders had little means of protecting themselves against liability for subcontractor errors or other construction defects. Any modern business wants to insure against potential liability, and this gap in available coverage presented a problem, both for the builders and the affected property owners.<sup>26</sup> The ISO addressed this problem in 1976 by offering a

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21. Henderson, *supra* note 19, at 441 (footnote omitted).

22. 405 A.2d 788, 791 (N.J. 1979).

23. *Id.*

24. *Id.* at 791–92.

25. *Id.* at 789.

26. See Abraham, *supra* note 4, at 85 (“The idea that businesses can insure against liability is so axiomatic that it has very nearly become a form of legal reasoning itself.”). The moral question of whether society should allow tortfeasors to insure against civil liability is beyond the scope of this Article, but one should not overlook that liability coverage exists both for the benefit of the insured and also “for the protection of the innocent tort victim who suffers personal injury or property dam-

new product, the “Broad Form Property Damage” endorsement.<sup>27</sup> For an additional premium, a builder could add this endorsement to its policy and obtain coverage for liability arising from damage to the builder’s completed work that resulted from a subcontractor’s errors.<sup>28</sup> Ten years later, the ISO incorporated this language directly into its standard CGL policy by narrowing the exclusion applicable to property damage within the Products–Completed Operations Hazard.<sup>29</sup> Policies written in 1986 and later, including those at issue in *Greystone*, expressly stated that the exclusion for damage to an insured’s completed work does not apply “if the damaged work or the work out of which the damage arises was performed on [the named insured’s] behalf by a subcontractor.”<sup>30</sup>

Following publication of the 1986 revision, industry commentators offered a new example of how the ISO drafters intended the contemporary CGL policy to apply in negligent construction cases.

The named insured is a general contractor who has built an apartment house with the services of numerous subcontractors. After the building is completed and put to its intended use, a defect in the building’s wiring (put in by a subcontractor) causes the building, including work of the general contractor and other subcontractors, to sustain substantial fire damage. The named insured is sued by the building’s owner. Although the named insured’s policy excludes damage to “your work” arising out of it or any part of it, the second part of [the exclusion] makes it clear that the exclusion does not apply to the claim. That is because the *work out of which the damage arose was performed on the named insured’s behalf by a subcontractor. . . .* Thus, barring the application of some other exclusion or adverse policy condition, the loss should be covered, including the part out of which the damage arose.<sup>31</sup>

Nevertheless, disputes continued. Despite selling these new policies to builders, some carriers balked at paying claims relating to subcontractors’ defective work. Unable to convince courts that the new, more limited policy exclusions should bar coverage for defective work, these carriers shifted their strategy to the threshold question of whether defective work constituted an “occurrence” in the first place.<sup>32</sup> A number of courts agreed, holding that there was no occurrence when faulty workmanship

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age for which the insured is liable.” *Friedland v. Travelers Indem. Co.*, 105 P.3d 639, 646 (Colo. 2005). If an insolvent builder damages a home, for example, the homeowner’s only recourse may be to pursue the builder’s insurance policy.

27. *See Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 12 (Tex. 2007).

28. *Id.*

29. *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65, 83 (Wis. 2004).

30. *Id.* at 82.

31. *O’Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99, 105 (Minn. Ct. App. 1996), *abrogated on other grounds by Gordon v. Microsoft Corp.*, 645 N.W.2d 393 (Minn. 2002) (quoting The Nat’l Underwriter Co., *Public Liability: Exclusions*, FIRE, CASUALTY & SURETY BULLETINS, Sept. 1993, at Aa 16–17) (internal quotation marks omitted).

32. *See Shapiro & Posner, supra* note 16, at 56.

damaged only itself and did not inflict any harm on the property of a third party.<sup>33</sup> Other courts reached the opposite conclusion and ruled that accidental damage to an insured's own product could indeed constitute a covered occurrence.<sup>34</sup> These conflicting decisions presented a situation that was, in the words of one court, an "intellectual mess."<sup>35</sup>

*B. Meanwhile, in Colorado . . .*

Interpretation of an insurance policy is, like interpretation of any contract, a matter of state law.<sup>36</sup> Thus, even when considering identical language in standard policies, courts in different states may reach different results. The opinion of *Worsham Construction Co. v. Reliance Insurance Co.*<sup>37</sup> illustrates this. In *Worsham*, a builder sought coverage under its CGL policy for the cost of repairing construction defects in an office building.<sup>38</sup> Reversing a grant of summary judgment for the carrier, the Colorado Court of Appeals expressly rejected the business risk analysis of *Weedo* and instead focused on the language of the policy, which the court found to be ambiguous.<sup>39</sup> One section of the policy excluded coverage for contractual liability but then stated that "this exclusion does not apply to a warranty of fitness or quality of the named insured's products or a warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner."<sup>40</sup> This language, the court noted, seemed to contemplate coverage for property damage resulting from a breach of the builder's duty to perform its work in a non-negligent manner.<sup>41</sup> Although the carrier argued that other sections of the policy excluded "property damages to the named insured's products arising out of such products or any part of such products" as well as "property damage to work performed by the named insured arising out of such work or any portion thereof," the court concluded that these exclusions conflicted with the former language and created an ambiguity that, under Colorado law, had to be resolved in favor of the insured.<sup>42</sup>

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33. See, e.g., *J.Z.G. Resources, Inc. v. King*, 987 F.2d 98, 102–03 (2d Cir. 1993); *Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 577 (Neb. 2004).

34. E.g., *Fejes v. Alaska Ins. Co.*, 984 P.2d 519, 523 (Alaska 1999); *Sheets v. Brethren Mut. Ins. Co.*, 679 A.2d 540, 551 (Md. 1996); *High Country Assocs. v. New Hampshire Ins. Co.*, 648 A.2d 474, 478 (N.H. 1994).

35. Edwin L. Doernberger & Theresa A. Guerin, *Construction Defects as an "Occurrence"*: *State Legislatures Weigh In*, COVERAGE, Nov./Dec. 2011, 18, 19 (quoting *Crossmann Comtys. of North Carolina, Inc. v. Harleysville Mut. Ins. Co.*, No. 26909, 2011 WL 93716 at \*3 (S.C. Jan. 7, 2011), *modified on reh'g*, 717 S.E.2d 589 (S.C. 2011)). The original opinion that contained this pithy quote has since been withdrawn, but it remains an apt description.

36. E.g., *Houston Gen. Ins. Co. v. Am. Fence Co.*, 115 F.3d 805, 806 (10th Cir. 1997).

37. 687 P.2d 988, 991 (Colo. App. 1984).

38. *Id.* at 990.

39. *Id.* at 990–91.

40. *Id.* at 990.

41. *Id.* at 991.

42. *Id.* at 990–91.

Subsequent rulings in Colorado adhered to the reasoning of *Worsham* when deciding the applicability of these business risk exclusions to construction damages.<sup>43</sup> Some carriers countered with the argument that the exclusions section of a policy could never expand their obligations, under the theory that “an exception to an exclusion can never amount to a grant of coverage but by nature, can only limit coverage.”<sup>44</sup> In *Simon v. Shelter General Insurance Co.*, the Colorado Supreme Court justices acknowledged “the technical merits” of this argument, but they were not persuaded.<sup>45</sup> The justices reiterated that insurance policies had to be read as a whole and considered from the perspective of persons of ordinary intelligence, not from the perspective of legal or insurance experts.<sup>46</sup>

With regard to whether damage from construction defects should be treated as an occurrence under Colorado law, two lines of cases developed. Beginning with the Colorado Supreme Court’s 1991 decision in *Hecla Mining Co. v. New Hampshire Insurance Co.*,<sup>47</sup> one line of cases focused on “the knowledge and intent of the insured.”<sup>48</sup> If the result of the insured’s actions was not expected or intended, it would be covered as an accident.<sup>49</sup> Quoting the Second Circuit, the *Hecla* court explained:

In general, what make injuries or damages expected or intended rather than accidental are the knowledge and intent of the insured. It is not enough that an insured was warned that damages might ensue from its actions, or that, once warned, an insured decided to take a calculated risk and proceed as before. Recovery will be barred only if the insured intended the damages, or if it can be said that the damages were, in a broader sense, “intended” by the insured because the insured knew that the damages would flow directly and immediately from its intentional act.<sup>50</sup>

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43. See, e.g., *Simon v. Shelter Gen. Ins. Co.*, 842 P.2d 236, 242 (Colo. 1992); *Colard v. Am. Family Mut. Ins. Co.*, 709 P.2d 11, 14 (Colo. App. 1985). But see *Union Ins. Co. v. Kjeldgaard*, 820 P.2d 1183, 1187 (Colo. App. 1991) (noting that absent ambiguity, policy excluded coverage for damage to insured’s work).

44. *Simon*, 842 P.2d at 240.

45. *Id.*

46. *Id.*

47. 811 P.2d 1083 (Colo. 1991).

48. *Id.* at 1088 (quoting *City of Johnstown v. Bankers Standard Ins. Co.*, 877 F.2d 1146, 1150 (2d Cir.1989)).

49. *Id.*

50. *Id.* (quoting *City of Johnstown*, 877 F.2d at 1150) (internal quotation marks omitted). Some courts have employed the analogy of a speeding driver to explain this distinction. See, e.g., *Merced Mut. Ins. Co. v. Mendez*, 261 Cal. Rptr. 273, 279–80 (Ct. App. 1989). A driver who is late for an appointment may intentionally drive too fast and negligently cause a collision. His insurance will still cover the damage because although the act of speeding was intentional, the damage was an unintended accident. This contrasts with the scenario in which a driver deliberately runs over his hated rival in a crosswalk. In the latter case, there is no coverage because the injury was the intended result.



The Colorado Court of Appeals relied on *Hecla* in 2005 when it decided *Hoang v. Monterra Homes (Powderhorn) LLC*.<sup>51</sup> The *Monterra Homes* case arose after several homeowners had sued their builder, Monterra, in state court over construction defects.<sup>52</sup> Shortly before trial, Monterra's insurance carrier commenced a separate action in federal court seeking a declaration that its policies would not cover any of the damages that the homeowners were seeking.<sup>53</sup> The jury in the state court action eventually returned a verdict in the homeowners' favor, at which point the homeowners served the carrier with a writ of garnishment from the state court.<sup>54</sup> The federal court then stayed the carrier's declaratory judgment action because it concluded that it would be improper to grant declaratory relief in relation to an ongoing state court garnishment suit.<sup>55</sup> Recently, the Tenth Circuit affirmed a similar order from a Kansas district court, and it appears unlikely that many federal judges in this circuit will choose to grant declaratory relief concerning insurance lawsuits that are actively pending in the state courts.<sup>56</sup>

After the federal court declined to rule on the coverage issues in *Monterra Homes*, the state trial court considered the evidence and found that the property damage in question had in fact resulted from an occurrence.<sup>57</sup> The Colorado Court of Appeals affirmed:

Here, the trial court found that Monterra may have known, based on the soil reports and other engineering reports, that there was a substantial *risk* that damages would occur, but the evidence did not show that Monterra actually intended or expected the damages. . . .

Insurers maintain that, by focusing on the result rather than on the knowledge and intent of the insured, the trial court applied an erroneous legal standard in determining that there was an "occurrence" under the policies. A review of the court's order, however, demonstrates that the trial court properly focused its inquiry on Monterra's knowledge, actions, and intentions.<sup>58</sup>

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51. 129 P.3d 1028, 1034 (Colo. App. 2005), *rev'd sub nom.* *Hoang v. Assurance Co. of Am.*, 149 P.3d 798 (Colo. 2007).

52. *Id.* at 1032, 1034.

53. *Id.* at 1032.

54. *Id.*

55. Order, No. 01-CV-2439 (D. Colo. Sept. 12, 2002) (copy of minute order on file with author).

56. *See* *Mid-Continent Cas. Co. v. Vill. at Deer Creek Homeowners Ass'n*, 685 F.3d 977, 986 (10th Cir. 2012). Whether to grant relief under the Federal Declaratory Judgment Act, 28 U.S.C. § 2201 (2012), is discretionary. *See* *Wilton v. Seven Falls Co.*, 515 U.S. 277, 282 (1995). In addition to the *Monterra Homes* litigation, the United States District Court for the District of Colorado has declined to grant declaratory relief in at least two other unpublished rulings involving garnishments over construction defect judgments. *See* Order Granting Defendants Motion to Stay, No. 04CV-1924REBOES, 2005 WL 2359125, at \*1 (D. Colo. Sept. 26, 2005); Order, No. 02-CV-0366-WDM-BNB (D. Colo. Nov. 20, 2002).

57. *Monterra Homes*, 129 P.3d at 1034.

58. *Id.*

The court went on to hold that the policy covered portions of the judgment but that certain exclusions limited coverage.<sup>59</sup>

Both the homeowners and the insurers petitioned for a writ of certiorari, the former challenging whether any exclusions applied and the latter arguing that the builder's faulty workmanship did not constitute an occurrence.<sup>60</sup> The Colorado Supreme Court granted certiorari on the narrow issue of whether an exclusion voided insurance coverage for property damage occurring when a claimant's predecessor in interest owned the property, but it denied the remainder of the petition and cross-petition.<sup>61</sup> Such a denial is not necessarily an endorsement of the court of appeals's decision,<sup>62</sup> though the supreme court's subsequent discussion of the nature and timing of an occurrence necessary to trigger coverage suggests that the justices likely agreed with the lower courts' determination that Monterra's accidental errors did indeed constitute an occurrence.<sup>63</sup>

A second line of cases emerged with the opinions in *Union Insurance Co. v. Hottenstein*<sup>64</sup> and *McGowan v. State Farm Fire & Casualty Co.*<sup>65</sup> In *Hottenstein*, a homeowner obtained an arbitration award against a remodeling contractor for various sums, including the costs necessary to complete the contractor's work, fix various defects, pay for lost use, and repair damage to an existing roof.<sup>66</sup> The contractor's carrier agreed to pay for the roof damage but refused to cover the remaining amounts, contending that these were breach-of-contract damages that its policy did not cover.<sup>67</sup> In a 2003 opinion, the Colorado Court of Appeals affirmed summary judgment for the carrier.<sup>68</sup> The court noted that the ambiguous "exception to the contract exclusion" found in *Simon (and Worsham)* was not present in the policy, and it rejected the homeowner's efforts to re-characterize her breach-of-contract judgment as one for negligence.<sup>69</sup> The court further held that, based on decisions from the Eighth Circuit and the Iowa Supreme Court, a contractor's breach of its construction contract was not an accident that could constitute a covered occurrence under the contractor's CGL policy.<sup>70</sup>

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59. *Id.* at 1039.

60. Plaintiffs and Defendant's Joint Reply Brief at 1, 10, *Hoang v. Assurance Co. of Am.*, 149 P.3d 198, 800 (Colo. 2007) (No. 05SC389), 2006 WL 2618808, at \*1, \*10.

61. *Hoang v. Assurance Co. of Am.*, No. 05SC389, 2006 WL 1586645, at \*1 (Colo. Mar. 20, 2006).

62. See COLO. APP. R. 35(f) ("Denial of certiorari by the Supreme Court shall not necessarily be taken as approval of any opinion of the Court of Appeals.").

63. See *Hoang*, 149 P.3d at 802.

64. 83 P.3d 1196 (Colo. App. 2003).

65. 100 P.3d 521 (Colo. App. 2004).

66. *Hottenstein*, 83 P.3d at 1198.

67. *Id.* at 1201.

68. *Id.* at 1198.

69. *Id.* at 1201.

70. *Id.* (citing *Pace Constr. Co. v. U.S. Fid. & Guar. Ins. Co.*, 934 F.2d 177, 179–80 (8th Cir. 1991); *Yegge v. Integrity Mut. Ins. Co.*, 534 N.W.2d 100, 102–03 (Iowa 1995)).

*McGowan*, announced several months later, described similar facts. A husband and wife hired a contractor to build a house but noticed a number of serious defects during construction.<sup>71</sup> They eventually fired the contractor and obtained a default judgment for breach of contract, negligence, and other claims, and they attempted to collect on their judgment from the contractor's insurance carrier.<sup>72</sup> The trial court found that the couple had alleged "property damage" resulting from an "occurrence" as the terms appeared in the relevant CGL policy, but that the policy's exclusions barred coverage.<sup>73</sup> The Colorado Court of Appeals affirmed. Relying indirectly on Tenth Circuit precedent, the court observed that "[c]omprehensive general liability policies normally exclude coverage for faulty workmanship based on the rationale that poor workmanship is considered a business risk to be borne by the policyholder, rather than a 'fortuitous event' entitling the insured to coverage."<sup>74</sup> The court further noted that CGL policies "are not intended to be the equivalent of performance bonds."<sup>75</sup> Turning to the specifics of the case, the court held that the policy unambiguously excluded coverage for damage to the contractor's work unless it fell within the exception for completed operations.<sup>76</sup> Because the contractor had been fired in the midst of the project and much of the damage reflected the cost of finishing the contractor's work, the "completed operations" exception did not apply, and the exclusion controlled.<sup>77</sup> The Colorado Supreme Court denied a petition for certiorari.<sup>78</sup>

Despite the very different outcomes, the lines of cases represented by *Monterra Homes* and *McGowan* can be reconciled. The property damage in *Monterra Homes* was an unexpected result of the insured de-

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71. *McGowan v. State Farm Fire & Cas. Co.*, 100 P.3d 521, 522 (Colo. App. 2004).

72. *Id.* at 522–23.

73. *Id.* at 523.

74. *Id.* at 525 (citing 9 LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* § 129:11, at 129–31 (3d ed. 1995) (citing *Bangert Bros. Constr. Co. v. Americas Ins. Co.*, 888 F. Supp. 1069 (D. Colo. 1995), *aff'd*, 1995 WL 539479, at \*6 (10th Cir. Sept. 11, 1995)). It is not clear if the court's use of the adjective "comprehensive" in place of "commercial" was deliberate. The first ISO policies bore the name of "Comprehensive General Liability" insurance; beginning with the 1986 revisions, the drafters kept the CGL initials but changed the name to "Commercial General Liability" insurance. See Abraham, *supra* note 4, at 89.

75. *McGowan*, 100 P.3d at 525 (citing *Union Ins. Co. v. Hottenstein*, 83 P.3d 1196, 1202–03 (Colo. App. 2003); *Kvaerner Metals Div. v. Commercial Union Ins. Co.*, 825 A.2d 641, 655 (Pa. Super. Ct. 2003)). A performance bond is an agreement by a third party to guarantee the completion of a construction contract upon the default of the general contractor. BLACK'S LAW DICTIONARY 1253 (9th ed. 2009).

76. *McGowan*, 100 P.3d at 525. Had the contractor abandoned the job instead of being terminated, the result may have been different. See *Thomas v. Nautilus Ins. Co.*, No. CV 11-40-M-DWM-JCL, 2011 WL 4369519, at \*10 (D. Mont. Aug. 24, 2011), *report and recommendation adopted*, No. CV 11-40-M-DWM-JCL, 2011 WL 4369496, at \*2 (D. Mont. Sept. 19, 2011).

77. *McGowan*, 100 P.3d at 525–26. The insurance industry does offer another product—builder's risk insurance—that provides first-party coverage for certain forms of property damage arising prior to the completion or abandonment of a project, and prudent construction professionals may wish to purchase both forms of coverage.

78. *McGowan v. State Farm Fire & Cas. Co.*, No. 04SC354, 2004 WL 2377173, at \*1 (Colo. Oct. 25, 2004).

veloper's negligence that appeared well after the completion of the project. By contrast, the unfinished work in *McGowan* was neither a traditional form of property damage nor anything that would typically be considered an accident. Although the appellate panel in *McGowan* suggested that negligent work should never be considered an occurrence, and that courts should interpret CGL policies to avoid overlap with performance bonds, these comments were merely dicta; the holding of the case was based on unambiguous exclusions for damage to the insured's incomplete work. Thus, these cases gave insured builders and their creditors little reason to fear that Colorado courts would refuse to enforce CGL insurance policies in future construction disputes. The situation changed in 2009, however, when the Colorado Court of Appeals announced *General Security Indemnity Co. v. Mountain States Mutual Casualty Co.*<sup>79</sup>

*C. The General Security Case and Colorado House Bill 10-1394*

*General Security* arose from a large construction defect suit between a homeowners association and a builder.<sup>80</sup> The builder asserted third-party claims seeking indemnity from its subcontractors, and one of these subcontractors in turn filed a complaint against its own subcontractors (the sub-subcontractors).<sup>81</sup> After the original plaintiff and defendant settled, this subcontractor's insurer, General Security Indemnity Company of Arizona (GSINDA), filed a separate action seeking contribution of defense costs and other relief from the sub-subcontractors' insurers.<sup>82</sup> In a series of rulings, the trial court determined that the property damage alleged by the homeowners association had not been caused by an occurrence, and it therefore dismissed GSINDA's claims.<sup>83</sup>

GSINDA appealed to the Colorado Court of Appeals, which affirmed.<sup>84</sup> The judges acknowledged that another division of their court had concluded that defective workmanship was an occurrence when deciding *Monterra Homes*, but they declined to follow this holding.<sup>85</sup> Instead, they criticized the *Monterra Homes* division for failing to consider case law from other states and follow what they characterized as the "majority rule."<sup>86</sup> According to the *General Security* division, a majority of jurisdictions had held "that claims of poor workmanship, standing

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79. 205 P.3d 529 (Colo. App. 2009), *superseded by* COLO. REV. STAT. § 13-20-808 (2012), as recognized in *TCD, Inc. v. Am. Family Mut. Ins. Co.*, 296 P.3d 255 (Colo. App. 2012).

80. *Id.* at 531.

81. *Id.*

82. *Id.*

83. *Id.* at 532.

84. *Id.* at 538.

85. *Id.* at 536.

86. *Id.* How *General Security* selected its majority is unclear; the opinion identified five jurisdictions as defining the "majority" yet listed six jurisdictions as representing the "minority." The court's primary basis for this statement appeared to be an editorial written by an insurance industry commentator who claimed to have collected cases from other states denying coverage, but the court did not name the author's cases nor provide any further explanation of its dubious arithmetic. *See id.* at 535.

alone, are not occurrences that trigger coverage under CGL policies.”<sup>87</sup> Although the division acknowledged that “a corollary to the majority rule is that an ‘accident’ and ‘occurrence’ are present when consequential property damage has been inflicted upon a third party as a result of the insured’s activity,” the judges found this corollary inapplicable to the facts of the case.<sup>88</sup> The judges likewise declined to follow *Hecla*, concluding that it was not binding because the Colorado Supreme Court had considered a slightly different definition of “occurrence” in that case.<sup>89</sup>

On its face, the *General Security* decision seemed to invite certiorari review by the Colorado Supreme Court under the criteria of the applicable state rule: the case decided a significant question of law in a manner probably not in accord with the rationale of *Hecla* and similar supreme court decisions, and it presented a conflict with *Monterra Homes* and other divisions of the court of appeals.<sup>90</sup> Nevertheless, GSINDA chose not to petition for review.

It is easy to speculate why GSINDA may have made this choice. Some commentators have suggested that a dispute between two insurance companies, continuing after the original claimant and the insured defendants have settled, presents a “poor forum for determining significant insurance coverage questions.”<sup>91</sup> This theory seems plausible, given that an adversarial, common law system depends on parties aggressively defending their own interests. In a dispute between two insurance carriers at the appellate level, the system may fail insofar as a carrier may face “the prospect of winning the coverage battle but losing the war if an insured turns the insurer’s winning coverage arguments against that insurer in a different case.”<sup>92</sup> In other words, GSINDA may have decided that a published opinion stating that carriers have no duty to pay con-

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87. *Id.*

88. *Id.*

89. *Id.* at 537. Whether this was a valid basis for departing from binding precedent is likewise dubious. As discussed above, the pre-1986 policy considered in *Hecla* included the language “neither expected nor intended from the standpoint of the insured” as part of the definition of an “occurrence,” whereas post-1986 policies moved this language to the exclusions. See TURNER, *supra* note 6, § 9:1 (quoting the pre-1986 policy) (internal quotation mark omitted). Although this change may have the procedural effect of shifting the burden of proof to the carrier, *see id.*, it does little to suggest that the concept of accident considered in *Hecla* has been superseded. On the contrary, commentators have noted that “the industry still equates an occurrence with the insured neither expecting nor intending the injury or damage.” Harmon S. Graves et al., *Shoddy Work, Negligent Construction, and Reconciling the Irreconcilable Under the CGL Policies*, 38 COLO. LAW., Nov. 2009, at 43, 46 & n. 48 (citing *The Nat’l Underwriter Co., Public Liability: CGL Coverage Form—Coverage A; Bodily Injury and Property Damage Liability*, FIRE, CASUALTY & SURETY BULLETINS, July 2008, at A.3-4).

90. Colorado appellate rules provide that the character of reasons for granting certiorari include, *inter alia*, situations where the court of appeals has “decided a question of substance in a way probably not in accord with applicable decisions of the Supreme Court,” and situations where a division of the court of appeals has rendered a “decision . . . in conflict with another [division of said court].” COLO. APP. R. 49.

91. Graves et al., *supra* note 89, at 44.

92. *Id.* at 44 n.2.

struction defect claims would be worth more in the long run than whatever damages it might have recovered from the sub-subcontractors' insurers had it convinced the supreme court to reverse the *General Security* holding.

In any event, the *General Security* ruling soon received criticism from both sides of the coverage universe. Representatives of policyholders complained that the decision departed from established Colorado precedent, went against the intent of the ISO drafters, rendered portions of the CGL policy superfluous, and created uncertainty as to what construction damages were covered.<sup>93</sup> Lobbyists for the insurance industry, in turn, testified that *General Security* and related cases "took it too far," came as a "shock" to the industry, and were "not the way courts have ruled in other jurisdictions."<sup>94</sup>

Although GSINDA was content to let the published decision stand without further review, Colorado's legislators were not. In the following session, the Colorado General Assembly passed House Bill 10-1394, which unequivocally rejected the "majority rule" that had enamored the court in *General Security*.<sup>95</sup> The legislators declared that "[t]he interpretation of insurance policies issued to construction professionals is of vital importance to the economic and social welfare of the citizens of Colorado," and stated:

(I) The policy of Colorado favors the interpretation of insurance coverage broadly for the insured.

(II) The long-standing and continuing policy of Colorado favors a broad interpretation of an insurer's duty to defend the insured under liability insurance policies and that this duty is a first-party benefit to and claim on behalf of the insured.

(III) The decision of the Colorado court of appeals in *General Security Indemnity Company of Arizona v. Mountain States Mutual Casualty Company* does not properly consider a construction professional's reasonable expectation that an insurer would defend the construction professional against an action or notice of claim [for construction defects].<sup>96</sup>

The bill, eventually codified at section 13-20-808 of the Colorado Revised Statutes, took effect in May 2010 and applied to "insurance policies currently in existence or issued on or after the effective date of this

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93. *Id.* at 47.

94. Ronald M. Sandgrund & Scott F. Sullan, *H.B. 10-1394: New Law Governing Insurance Coverage for Construction Defect Claims*, 39 COLO. LAW., Aug. 2010, at 89, 90 (quoting *House Testimony on H.B. 10-1394 Before the H. Comm. on Bus. Affairs & Labor*, 67th Gen. Assemb., 2d Reg. Sess. 21:2-11 (2010)).

95. See H.B. 10-1394, 67th Gen. Assemb., 2d Reg. Sess. (Colo. 2010) (codified at COLO. REV. STAT. §§ 13-20-808, 10-4-110.4).

96. H.B. 10-1394 § 1 (citation omitted).

act.”<sup>97</sup> Since then, several other states have followed suit, enacting similar legislation.<sup>98</sup> Before the bill became law, however, several state and federal courts in Colorado relied on the *General Security* holding to deny coverage to insured builders. One such case was *Greystone Construction, Inc. v. National Fire & Marine Insurance Co.*<sup>99</sup>

## II. THE GREYSTONE LITIGATION

### A. Background and Procedural Posture

*Greystone* arose out of two state court cases in which homeowners had sued their builders for construction defects, including foundation movement that caused extensive damage to the homes’ living areas.<sup>100</sup> In both cases, the homebuilders had used subcontractors to perform most, if not all, of their work.<sup>101</sup> American Family Mutual Insurance Company (American Family) had insured the builders during the time of construction and shortly thereafter, and National Fire & Marine Insurance Company (National Fire) had issued policies covering later dates.<sup>102</sup> In both cases, American Family had tendered a defense to the homebuilders subject to a reservation of rights.<sup>103</sup> National Fire denied owing the homebuilders any defense under its policies, and American Family eventually paid to settle both cases.<sup>104</sup>

American Family and the homebuilders subsequently sued National Fire in the United States District Court for the District of Colorado. They alleged jurisdiction based on diversity of citizenship and asserted claims for declaratory relief, contribution or equitable subrogation, breach of contract, bad faith breach of contract, and violation of the Colorado Consumer Protection Act.<sup>105</sup> The court bifurcated the issue of policy interpretation, and the parties filed cross-motions for summary judgment seeking a determination of whether the underlying cases had alleged an occurrence that fell within the coverage provisions of the policies.<sup>106</sup> Relying heavily on *General Security*, the district court ruled that there was no occurrence to trigger coverage under National Fire’s policies because the

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97. *Id.* § 3.

98. See Doernberger & Guerin, *supra* note 35, at 20–22; accord ARK. CODE ANN. § 23-79-155 (2011); HAW. REV. STAT. § 431:1-217 (2011); S.C. CODE ANN. § 38-61-70 (2011).

99. *Greystone Constr., Inc. v. Nat’l Fire & Marine Ins. Co.*, 649 F. Supp. 2d 1213, 1219 (D. Colo. 2009).

100. *Greystone Constr., Inc. v. Nat’l Fire & Marine Ins. Co.*, 661 F.3d 1272, 1276 (10th Cir. 2011), *vacated*, 661 F.3d 1272 (10th Cir. 2011).

101. *Id.*

102. *Id.*

103. *Id.*

104. *Greystone*, 649 F. Supp. 2d at 1215.

105. Complaint and Jury Demand at 2, 6–10, *Greystone*, 649 F. Supp. 2d at 1213 (No. 07-cv-00066-MSK-CBS), 2007 WL 703348, at \*2, \*6–10.

106. *Greystone*, 649 F. Supp. 2d at 1215–16.

underlying complaints had not alleged property damage to anything other than the insureds' own work.<sup>107</sup>

### *B. Appeal to the Tenth Circuit*

Following the district court's ruling, American Family and the homebuilders appealed to the Tenth Circuit. Because the Colorado state courts had not issued a clear ruling on the subject, the Tenth Circuit certified a question to the Colorado Supreme Court: "Is damage to non-defective portions of a structure caused by conditions resulting from a subcontractor's defective work product a covered 'occurrence' under Colorado law?"<sup>108</sup> The Supreme Court declined to consider the issue.<sup>109</sup>

House Bill 10-1394 passed in the midst of the appeal, and the Tenth Circuit permitted additional briefing on the new statute before announcing its final decision in November 2011.<sup>110</sup>

#### 1. The Policies

To start its discussion, the court noted that the National Fire policies at issue were all versions of the post-1986 CGL policy, which contained the same material language:

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have [no] duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply . . . .

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is *caused by an "occurrence"* that takes place in the "coverage territory";

(2) The "bodily injury" or "property damage" occurs during the policy period . . . .<sup>111</sup>

The court also noted that the policies contained various business risk exclusions, including the "your work" exclusion that barred coverage for

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107. *Id.* at 1219–20.

108. Certification of Question of State Law at 1, *Greystone*, 661 F.3d at 1276 (No. 09-1412), 2010 WL 5776109, at \*1.

109. *See Greystone*, 661 F.3d at 1277.

110. *See id.*

111. *Id.* at 1277–78 (footnote omitted) (quoting CGL policy) (internal quotation marks omitted). Although it did not affect the holding, the court appears to have misquoted a portion of the policy.



“[p]roperty damage” to “*your work*” arising out of it or any part of it and included in the “products–completed operations hazard.”

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 sub-contractor.<sup>112</sup>

The policies defined an “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions” but contained no definition of “accident.”<sup>113</sup>

## 2. Applicability of Section 13-20-808

The *Greystone* court first asked, “Does § 13-20-808, which defines the term ‘accident’ for purposes of Colorado insurance law, apply retroactively to this case?”<sup>114</sup> The court acknowledged that, if the statute applied, it “would settle this appeal.”<sup>115</sup>

Considering the text of the statute, the court observed that the Colorado legislature had expressly rejected *General Security* and established a definition of “accident” that required courts interpreting CGL policies to “presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, *is an accident unless the property damage is intended and expected by the insured.*”<sup>116</sup>

The court also noted that the statute’s enabling act provided that it applied to all insurance policies “currently in existence” at the time the statute took effect, but the court questioned how to interpret this language in the context of an occurrence policy.<sup>117</sup> Such policies typically apply for a specified period of time and provide coverage for any damage that occurs during that period, even if a claim is not made until years later. “In this way, an occurrence policy does not expire, but, rather, continues in effect after the policy period ends.”<sup>118</sup> After reviewing Colorado law regarding retroactive application of statutes, the Tenth Circuit determined that despite the legislature’s directive, there was no clear intent to apply the statute to policies where the policy period had expired.<sup>119</sup> The court therefore declined to apply section 13-20-808 to the *Greystone* dispute.

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112. *Id.* at 1278 (footnotes omitted) (quoting CGL policy) (internal quotation marks omitted).

113. *Id.* (emphasis omitted) (quoting CGL policy) (internal quotation marks omitted).

114. *Id.*

115. *Id.* at 1279.

116. *Id.* (citing COLO. REV. STAT. § 13-20-808(3) (2012)).

117. *Id.* at 1280.

118. *Vill. Homes of Colo., Inc. v. Travelers Cas. & Sur. Co.*, 148 P.3d 293, 296 (Colo. App. 2006).

119. *Greystone*, 661 F.3d at 1280.

### 3. Whether the Builders' Negligence Created an "Occurrence"

Having decided that the new statute was inapplicable, the Tenth Circuit then considered whether property damage arising from poor workmanship could give rise to an occurrence under existing state law and the policy language.<sup>120</sup>

The court acknowledged that there was no consensus among federal and state courts on this issue, and it began its analysis by looking to the Colorado Court of Appeals's most recent decision on the subject, *General Security*, which had concluded that "a claim for damages arising from poor workmanship, standing alone, does not allege an accident that constitutes a covered occurrence."<sup>121</sup> The Tenth Circuit panel noted that it found this interpretation to be persuasive, but it also recognized that federal courts are not bound by the rulings of intermediate state courts when there is convincing evidence that the state's highest court would decide otherwise.<sup>122</sup> The judges then made their key decision: notwithstanding their own agreement with much of *General Security*'s reasoning, they "predict[ed that] the Colorado Supreme Court would construe the term 'occurrence,' as contained in standard-form CGL policies, to encompass unforeseeable damage to nondefective property arising from faulty workmanship."<sup>123</sup>

In reaching this conclusion, the Tenth Circuit first examined the approaches taken by other jurisdictions as to whether damage caused by faulty workmanship constitutes an occurrence under a standard CGL policy.<sup>124</sup> The court noted that the *General Security* opinion, despite its statements to the contrary, had not actually followed the majority view; in reality, most federal and state courts had found an occurrence under similar circumstances, and the more "recent trend . . . interprets the term 'occurrence' to encompass unanticipated damage to nondefective property resulting from poor workmanship."<sup>125</sup> The court rejected the argument that damage arising from defective construction can never be a covered "occurrence," because this view "creates a fundamental inconsistency with the logic of CGL policies" insofar as it renders other policy provisions, such as the your work exclusion, superfluous.<sup>126</sup>

Next, the Tenth Circuit held that "injuries flowing from improper or faulty workmanship constitute an occurrence so long as the resulting damage is to nondefective property, and is caused without expectation or

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120. *Id.* at 1281.

121. *Id.* (quoting *General Sec. Indem. Co. v. Mountain States Mut. Cas. Co.*, 205 P.3d 529, 534 (Colo. App. 2009)).

122. *Id.* at 1281–82 (citing *United Fire & Cas. Co. v. Boulder Plaza Residential, LLC*, 633 F.3d 951, 957 (10th Cir. 2011) (declining to follow *General Security* on other grounds)).

123. *Id.* at 1282.

124. *Id.* at 1282–83.

125. *Id.*

126. *Id.* at 1283.

foresight.”<sup>127</sup> The court rejected *General Security*’s definition of “accident” as requiring “an element of ‘fortuity,’” calling this “an overly narrow view of CGL-policy language” that would be “inconsistent with the inherent structure of CGL policies.”<sup>128</sup> The court examined prior Colorado appellate law in *McGowan*, *Hottenstein*, and *Monterra Homes* and found that “fortuity is not the sole prerequisite to finding an accident under a CGL policy. To the contrary, an *unanticipated* or *unforeseeable* injury to person or property—even in the absence of true fortuity—may be an accident and, therefore, a covered occurrence.”<sup>129</sup> The court also relied on the Colorado Supreme Court’s decision in *Hecla*, which had concluded that under similar policy language, “damages were covered because the term ‘occurrence’ excludes from coverage only ‘those damages that the insured *knew would flow directly and immediately from its intentional act.*”<sup>130</sup>

To bolster its ruling, the Tenth Circuit also considered the history and evolution of CGL policies and noted how the current policy language arose from the desire “to provide general contractors with at least some insurance coverage for damage caused by the faulty workmanship of their subcontractors.”<sup>131</sup> The court found that the subcontractor exception that the ISO added to the your work exclusion in 1986 was particularly instructive.<sup>132</sup> This language “specifically contemplated coverage for property damage caused by a subcontractor’s defective performance.”<sup>133</sup> The court observed that insurance carriers can remove this language from future policies or add a specific endorsement limiting coverage if they decide that they no longer wish to insure such losses.<sup>134</sup>

By contrast, *General Security*’s approach of not allowing coverage where a subcontractor causes the damage to nondefective property “renders the ‘your work’ exclusion a phantom” in light of the subcontractor exception included in the standard-form CGL policies.<sup>135</sup> The court acknowledged the importance of the exclusions in CGL policies to limit the initial broad grant of coverage and recognized that the exceptions, in turn, narrow the exclusions’ scope to restore coverage under the original grant.<sup>136</sup> Under the logic of *General Security*, the Tenth Circuit conclud-

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127. *Id.* at 1284.

128. *Id.*

129. *Id.* at 1284–85.

130. *Id.* at 1285 (quoting *Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083, 1088 (Colo. 1991)).

131. *Id.*

132. *See id.* at 1288.

133. *Id.* (quoting *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 12 (Tex. 2007)) (internal quotation mark omitted).

134. *Id.* (noting that the ISO now publishes an optional endorsement eliminating the subcontractor exception from coverage).

135. *Id.* at 1289.

136. *Id.* (citing David Dekker, et al., *The Expansion of Insurance Coverage for Defective Construction*, 28 CONSTRUCTION LAW. 19, 19–20 (2008)).

ed that “the ‘your work’ exclusion and the subcontractor exception are illusory if damages to the contractor’s nondefective work product—whether caused by poor workmanship or otherwise—are not covered in the first place.”<sup>137</sup> By rejecting this interpretation, the Tenth Circuit judges thus gave effect to the your work exclusion, which, in their view, could only apply if the “physical injury caused by poor workmanship—whether to some part of the work itself or third-party property—may be an occurrence under standard CGL policies.”<sup>138</sup>

The Tenth Circuit also observed that “interpreting a CGL policy so as to provide coverage for a subcontractor’s faulty workmanship does not transform the policy into a performance bond.”<sup>139</sup> The court noted that a CGL policy has different traits and protects other parties, and that, ultimately, “even if the CGL policy does share some characteristics of a performance bond, that alone is an insufficient reason to ignore the plain language and intent of the policy.”<sup>140</sup>

The court declined to consider whether any exclusions might alternatively bar coverage, remanding the case to the district court to decide this question and any other issues.<sup>141</sup>

#### 4. Defective and Nondefective Property

Although the central holding of *Greystone* correctly interpreted the intent of the ISO drafters, the court’s conclusion that only damage to nondefective property presents an occurrence is curious. The express language of a standard CGL policy does not make this distinction, but the Tenth Circuit nevertheless held that “CGL policies *implicitly* distinguish between damage to nondefective work product and damage to defective work product.”<sup>142</sup> The court based this conclusion on the premise that the “obligation to repair defective work is neither unexpected nor unforeseen under the terms of the construction contract or the CGL policies,”<sup>143</sup> and “the recognition that the faulty workmanship, standing alone, is not caused by an accident—but that damage to *other* property caused by the faulty workmanship (including both the nondefective work product of the contractor and third-party property) *is* the result of an accident.”<sup>144</sup> In *Greystone*, this meant that the damage to the homes was covered, but that damage to the exterior drainage and structural systems was not, because these repairs represented “an economic loss that does

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137. *Id.*

138. *Id.*

139. *Id.* at 1288.

140. *Id.* at 1288–89.

141. *Id.* at 1290.

142. *Id.* at 1286 (emphasis added).

143. *Id.* at 1286 (noting that this reasoning is also in line with the Fourth Circuit’s holding in *French v. Assurance Co. of Am.*, 448 F.3d 693, 703 (4th Cir. 2006)).

144. *Id.* at 1287.

not trigger a duty to defend under the CGL policies.”<sup>145</sup> The court noted that its ruling was thus largely consistent with *General Security*’s “corollary rule,” which had recognized that “injury to third-party property may be covered” under a CGL policy.<sup>146</sup>

Some have suggested that this portion of the *Greystone* opinion is an “ancillary holding” that conflicts with the underlying logic of the case.<sup>147</sup> Regardless of its reasoning, this aspect of the case leaves several questions unanswered, not the least of which is whether the court meant to establish a subjective test for coverage that takes into account the knowledge and intent of the insured, or whether the court contemplated an objective analysis limited to the components of property involved. For example, an insured builder seeking coverage for a subcontractor’s defective work might argue that *Greystone* adopts the foreseeability test of *Hecla*, and that the cost of repairing such work is not foreseeable under the *Hecla* standard unless the builder actually knew of the subcontractor’s errors.<sup>148</sup> In response, the carrier might argue that the builder’s knowledge is irrelevant because the implicit exclusion for damage to defective property recognized in *Greystone* is independent of such facts.<sup>149</sup> How the courts will resolve questions like this remains to be seen.

### III. THE EFFECT OF *GREYSTONE* ON FUTURE CASES

Although federal court decisions are generally not binding on state tribunals, the Colorado Supreme Court’s reluctance to revisit this issue means that *Greystone* will likely define the law of construction insurance in Colorado for the immediate future.<sup>150</sup> The Colorado Court of Appeals has, in fact, already relied on *Greystone* in two published decisions.

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145. *Id.* (citing *French*, 448 F.3d at 703).

146. *Id.* at 1287 (citing Gen. Sec. Indem. Co. of Ariz. v. Mountain States Mut. Cas. Co., 205 P.3d 529, 535 (Colo. App. 2009)).

147. See Ronald M. Sandgrund, *Greystone and Insurance Coverage for “Get to” and “Rip and Tear” Expenses*, 41 COLO. LAW. 69, 71 (2012).

148. *Greystone Constr., Inc. v. Nat’l Fire & Marine Ins. Co.*, 661 F.3d 1272, 1286 (10th Cir. 2004); see also *Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083, 1088 (Colo. 1991) (noting that the fact that an insured was warned of possible damage or decided to take a calculated risk does not mean that there was no accidental occurrence under CGL policy).

149. See *Greystone*, 661 F.3d at 1286–87.

150. As discussed above, the Colorado Supreme Court has denied petitions for certiorari review of what constitutes an occurrence in at least three construction cases over the last decade: *Greystone*, *Hoang*, and *McGowan*. See *Greystone*, 661 F.3d at 1277; *Hoang v. Assurance Co. of Am.*, No. 05SC389, 2006 WL 1586645, at \*1 (Colo. Mar. 20, 2006); *McGowan v. State Farm Fire & Cas. Co.*, No. 04SC354, 2004 WL 2377173, at \*1 (Colo. Oct. 25, 2004). Recently, the court denied a fourth petition in the *TCD* case discussed below, in which the plaintiff had argued that the Colorado Court of Appeals improperly relied on *General Security* to conclude that allegations of construction defects did not suggest an occurrence that triggered a carrier’s duty to defend. *TCD, Inc. v. Am. Fam. Mutual Ins. Co.*, No. 12SC351, 2013 WL 673985, at \*1 (Colo. Feb. 25, 2013). At the time of this writing, a fifth petition relating to this issue is pending in the *Colorado Pool* case, also discussed below. Petition for Certiorari, *Colorado Pool Sys., Inc. v. Scottsdale Ins. Co.*, No. 2012SC1000 (on file with author).

In *TCD, Inc. v. American Family Mutual Insurance Co.*,<sup>151</sup> the court of appeals reviewed an order granting summary judgment to a carrier that had argued that it had no duty to defend a contractor accused of installing a defective roof.<sup>152</sup> The court expressly noted that section 13-20-808 had superseded *General Security*, but it declined to apply the statute to the policies in question because their coverage periods had ended prior to the statute's enactment, and the court found no legislative intent to apply the statute retroactively.<sup>153</sup> The court observed that the "corollary rule" from *General Security* was similar to the conclusion from *Greystone* that "an 'accident' and 'occurrence' are present when consequential property damage has been inflicted upon a third party as a result of the insured's activity."<sup>154</sup> The court determined that this rule did not apply, however, because the parties had not alleged any consequential damage to any third party or to any nondefective property, and it therefore affirmed the judgment.<sup>155</sup>

Several months later, another division of the court of appeals announced *Colorado Pool Systems, Inc. v. Scottsdale Insurance Co.*,<sup>156</sup> in which a carrier had refused to defend or indemnify a contractor accused of installing rebar too close to the surface of a concrete swimming pool.<sup>157</sup> The division in *Colorado Pool* took a different view of section 13-20-808 and recognized that the state legislature had indeed intended to apply the statute retroactively, noting that its enabling act expressly provided that the law "applies to all insurance policies *currently in existence* or issued on or after the effective date of this act,"<sup>158</sup> and that the statute itself provided that its purpose was to "to guide *pending* actions, on policies that *have been* issued."<sup>159</sup> Nevertheless, the court concluded that application of the statute to policies created before passage of section 13-20-808 would violate the Colorado constitution's prohibition of retrospective laws that impair vested rights, create new obligations, impose new duties, or attach new disabilities to transactions that have already occurred.<sup>160</sup>

Having concluded that section 13-20-808 did not apply, the court then considered how to interpret the policy under Colorado common law. The contractor argued that *Hoang* should control, whereas the carrier

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151. 296 P.3d 255, *cert. denied*, No. 12SC351, 2013 WL 673985 (Colo. Feb. 25, 2013).

152. *Id.* ¶¶ 1–2.

153. *See id.* ¶¶ 23–24, 26.

154. *Id.* ¶¶ 16–17 (emphasis omitted) (quoting *Gen. Sec. Indem. Co. of Ariz. v. Mountain States Mut. Cas. Co.*, 205 P.3d 529, 535 (Colo. App. 2009)) (internal quotation marks omitted).

155. *Id.* ¶ 17.

156. 2012 COA 178.

157. *Id.* ¶ 2, 9.

158. *Id.* ¶ 31 (quoting 2010 Colo. Sess. Laws 1128).

159. *Id.* ¶ 31.

160. *Id.* ¶ 34 (citing COLO. CONST. art. II, § 11; *In re Estate of DeWitt*, 54 P.3d 849, 854 (Colo. 2002)).

relied on *General Security*.<sup>161</sup> The court held that neither of these decisions had properly considered all of the policy terms, and that the proper test for coverage was that defined by the Tenth Circuit in *Greystone*.<sup>162</sup> The court discussed the *Greystone* holding in detail and recognized that “injuries flowing from improper or faulty workmanship constitute an ‘occurrence’ so long as the resulting damage is to nondefective property, and is caused without expectation or foresight,” regardless of whether the resulting damage is to the insured’s own work or to the work of a third party.<sup>163</sup> Applying the *Greystone* test to the facts of the case, the court held that the contractor’s policy did not cover the cost of replacing the defective pool itself, but that the policy did cover the cost of repairing other property that had been damaged during the course of replacing the pool.<sup>164</sup> The trial court had therefore erred by granting summary judgment.

*Colorado Pool* is significant for two main reasons. First, by explicitly identifying *Greystone* as the correct test for determining CGL policy coverage, the Colorado Court of Appeals has effectively made the federal *Greystone* opinion binding on state trial courts.<sup>165</sup> Second, the opinion interprets *Greystone* to require carriers to indemnify the cost of repairing what some commentators have called “rip and tear” expenses: the cost of ripping and tearing out undamaged property in order to access the insured’s defective work.<sup>166</sup> In *Colorado Pool*, the court found that this damage included the cost of removing a pool deck, sidewalk, retaining wall, and electric conduits; none of these components was initially damaged or defective, but each stood in the way of the pool materials that the contractor was legally obligated to replace, and each became damaged in the course of the ensuing repairs.<sup>167</sup> This is a noteworthy analytical shift, insofar as it arguably extends coverage to some intentional property damage necessary to correct an unintentional defect.<sup>168</sup>

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161. *Id.* ¶ 42.

162. *Id.* ¶ 43.

163. *Id.* ¶ 45 (quoting *Greystone Constr., Inc. v. Nat’l Fire & Marine Ins. Co.*, 661 F.3d 1272, 1284 (10th Cir. 2004)) (internal quotation marks omitted).

164. *Id.* ¶¶ 45, 48.

165. See COLO. APP. R. 35(f) (mandating that published opinions of the Colorado Court of Appeals “shall be followed as precedent by the trial judges of the state of Colorado”).

166. See, e.g., Sandgrund, *supra* note 147, at 73; R. Stephen Rawls, *Do CGL Policies Cover “Rip and Tear” Expenses?*, IRMI ONLINE (Mar. 2011), [www.irmi.com/expert/articles/2011/rawls03-liability-insurance-coverage-law.aspx](http://www.irmi.com/expert/articles/2011/rawls03-liability-insurance-coverage-law.aspx).

167. *Colorado Pool*, 2012 COA 178, ¶ 48.

168. Cases such as this may invite tedious distinctions as courts try to distinguish whether certain elements of property damage result from the alleged occurrence itself or from the repair of said occurrence. Compare *Dewitt Constr. Inc. v. Charter Oak Fire Ins. Co.*, 307 F.3d 1127, 1134 (9th Cir. 2002) (holding that CGL policy covered cost of demolishing nondefective work during repair of defective property), with *Desert Mountain Props. Ltd. P’ship. v. Liberty Mut. Fire Ins. Co.*, 236 P.3d 421, 441–42 (Ariz. Ct. App. 2010) (holding that there was no coverage for “get to” expenses associated with repair of defect), *aff’d*, 250 P.3d 196 (Ariz. 2011); see also Sandgrund, *supra* note 147, at 73 & nn.41–42 (collecting cases). Some courts have sidestepped this question by relying on the policies’ alternate definition of “property damage,” which includes loss of use of property that has

## CONCLUSION

In a diversity action such as *Greystone*, federal courts apply the substantive law of the forum state.<sup>169</sup> It has thus been said that “[t]here is no federal general common law.”<sup>170</sup> Nevertheless, in the course of applying state insurance law, the judges of the Tenth Circuit have historically tended to favor a strict view of fortuity and business risk principles.<sup>171</sup> The *Greystone* decision may therefore have surprised observers who expected the panel to rule for the carrier.

*Greystone* should not have come as a surprise. Although the case gave the Tenth Circuit discretion to predict how the Colorado Supreme Court would decide certain coverage issues, it ultimately required little more than a traditional application of contract principles to effectuate the intent of the parties. Implementing that analysis, the Tenth Circuit recognized that ISO drafters intended for builders’ CGL insurance policies to cover liability for property damage caused by defective work. It is oft said but bears repeating: if the insurance industry wants to eliminate coverage for defective construction, it can easily do so.<sup>172</sup> It has not. On the contrary, when given the opportunity, its drafters have elected to expand coverage for construction defects, first by creating the Broad Form Property Damage endorsement in 1976 and later by incorporating the broad form language into all standard CGL policies in 1986. Although some opportunistic lawyers have argued that allowing CGL policies to cover negligent workmanship improperly converts insurance policies into performance bonds, any such similarity is not the work of activist judges. As one court succinctly stated, “[w]e have not made the policy closer to a performance bond for general contractors, the insurance industry has.”<sup>173</sup>

The fact that the insurance industry has made this choice likely reflects simple principles of supply and demand: so long as builders are willing to pay premiums for protection from liability for defective work, insurance companies will be willing to sell them an appropriate product. The system only breaks down when a carrier collects a builder’s premi-

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not been physically injured. See Rawls, *supra* note 166 (discussing Clear, LLC v. Am. & Foreign Ins. Co., No. 3:07-cv-00110JWS, 2008 WL 818978 (D. Alaska Mar. 24, 2008)). The U.S. District Court for the District of Western Oklahoma recently applied this approach in a case with similar facts to *Colorado Pool* when it found coverage under a concrete supplier’s policy for repairs to nondefective components of a bridge that had to be ripped out in the course of replacing substandard concrete. See *Employers Mut. Cas. Co. v. Grayson*, No. CIV-07-917-C, 2008 WL 2278593, at \*6 (W.D. Okla. May 30, 2008).

169. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

170. *Id.*

171. See, e.g., *Adair Group, Inc. v. St. Paul Fire & Marine Ins. Co.*, 477 F.3d 1186, 1187–88 (10th Cir. 2007); *Bangert Bros. Constr. Co. v. Americas Ins. Co.*, No. 94-1412, 1995 WL 539479, at \*5–6 (10th Cir. Sept. 11, 1995).

172. See *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 12 (Tex. 2007) (noting that the ISO recently published an optional endorsement eliminating the subcontractor exception to the “your-work” exclusion for builders who do not wish to purchase such coverage).

173. *Kalchthaler v. Keller Constr. Co.*, 591 N.W.2d 169, 174 (Wis. Ct. App. 1999).



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ums but refuses to honor the policy when the builder files a large claim.<sup>174</sup> The Tenth Circuit's decision in *Greystone* makes clear that Colorado law does not permit this, and that builders and homeowners can expect Colorado state and federal courts to enforce CGL provisions that cover property damage resulting from construction defects.

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174. See Abraham, *supra* note 4, at 103 (discussing the economics of insurance and noting that policyholders “now speak facetiously about an implied ‘big claim’ exclusion in CGL policies, referring to the perceived tendency of commercial insurers to deny any substantial claim by asserting what policyholders regard as questionable policy defenses”).