

Publications - Faulty Workmanship Claims And Insurance Coverage

Docket No. 98-1639

United States Court of Appeals

for the

Fourth Circuit

LORDS LANDING VILLAGE CONDOMINIUM

COUNCIL OF UNIT OWNERS,

Plaintiff-Appellee,

- v. -

CONTINENTAL INSURANCE COMPANY,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF MARYLAND

(HONORABLE PETER J. MESSITTE, JUDGE)

BRIEF FOR DEFENDANT-APPELLANT

CONTINENTAL INSURANCE COMPANY

Jeffrey R. Schmieler

Saunders & Schmieler

Attorneys for Defendant-Appellant

8737 Colesville Road

Suite L-201

Silver Spring, Maryland 20910

(410) 235-7558

(301) 588-7717

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JURISDICTIONAL STATEMENT

STATEMENT OF SUBJECT MATTER JURISDICTION AND

BASIS OF APPELLATE JURISDICTION

The Federal District Court’s subject matter jurisdiction was based on diversity pursuant to 28 USC § 1332. The lower court entered a final judgment after granting the Appellee’s, Lord’s Landing Village Condominium council of Unit Owner’s

(Lord's Landing's), Cross Motion for Summary Judgment and denying the Appellant's, Continental Insurance Company's (Continental's), Motion for Summary Judgment on April 1, 1998. App. 2342. Appellant filed a Motion to Reconsider on April 13, 1998. App. 2343-57. Appellant noted its appeal on April 29, 1998. Appellant's Motion for Reconsideration on behalf of Continental was denied on September 9, 1998. App. 2485. Appellant noted its Amended Notice of Appeal on September 15, 1998, appealing from the Order denying Continental's Motion for Summary Judgment and granting Lord's Landing's Cross Motion for Summary Judgment and from the Order denying Defendant's Motion for Reconsideration. App. 2486. This Court has appellate jurisdiction pursuant to 28 USC § 1291.

STATEMENT OF THE ISSUES

Issue I - Whether the trial court erred in failing to grant Continental's Motion for Summary Judgment that no indemnity coverage is afforded under the CGL insurance policy for the faulty workmanship claims presented by Lord's Landing.

Issue II - Whether the trial court erred in granting the Cross Motion for Summary Judgment filed by Lord's Landing finding coverage for the faulty workmanship claims asserted and finding that coverage was not excluded by the "business risk" exclusions of the policy.

Issue III - Whether the court erred in denying Continental's Motion for Reconsideration based upon the failure of the District Court to follow the controlling Maryland legal authority that a contractor's liability for repair and replacement costs arising out of a construction project are economic damages not caused by an occurrence or accident and are outside the scope of commercial general liability (CGL) coverage.

STATEMENT OF THE CASE

Appellee Lord's Landing, an association of condominium owners, sued Continental in Maryland state court, seeking to compel Appellant to pay a \$1.1 million judgment it had obtained against Continental's insured, the developer of its condominium complex. In a previous action, a jury had held the developer liable for numerous defects in the complex finding that the developer had breached express and implied warranties and had made misrepresentations of the quality, useful life and characteristics of the individual units and the common elements of the Lord's Landing Condominiums. Continental had issued a commercial general liability insurance policy (CGL) covering the insured developer, Wellington Homes. The policy provided that Continental would pay "those sums that [the developer] becomes legally obligated to pay as damages because of"Property damage" to which this insurance

applies." App. 2759. Under the policy, "Property damage" was covered only if it was caused by an "accident."

Appellant removed the action to the United States District Court for the District of Maryland, based on the party's diversity of citizenship. On July 7, 1995, the District Court granted summary judgment in favor of Continental on the grounds that the damage which occurred as a natural, probable consequence of poor workmanship was not caused by an "accident," as defined by the policy, and thus is not an "occurrence" regardless of whether the work was performed by the contractor (Wellington) or a subcontractor. On August 6, 1996, the Fourth Circuit Court of Appeals, relying upon existing Maryland law, affirmed. App. 861. The Court of Appeals denied a petition for rehearing on September 3, 1996, and issued the mandate on September 11, 1996. App. 2775.

On September 20, 1996, Appellee filed a motion asking the Court of Appeals to recall or stay its mandate based on then recent decision of Sheets v. Brethren Mutual Ins. Co., 342 Md. 634, 679 A.2d 540 (1996), which had been rendered on July 26, 1996. App. 2776-2810.

The Supreme Court granted Appellee's petition for writ of certiorari, vacated the decision of the Court of Appeals, and remanded the case to the Court of Appeals for further consideration in light of Sheets, which clarified its precedents to hold that "an act of negligence constitutes an 'accident,'" under a CGL policy "when a negligent act causes damage that is unforeseen or unexpected by the insured." Sheets, 679 A.2d at 548. App. 1013. Upon further consideration, the Court of Appeals on September 17, 1997, vacated and remanded the case to the District Court for further consideration in light of the Sheets decision to determine the applicability of that case and to consider any other factual or legal arguments that may be relevant. App. 1019.

Upon remand, Continental filed a Motion for Summary Judgment on February 12, 1998, predicated on the grounds that the Sheets decision was neither applicable to nor dispositive of the coverage issue(s) presented, and that there is no coverage under the Continental CGL policy for the judgment for breach of implied and express warranties and misrepresentations of the quality, useful life and characteristics of the individual unit owners and common elements of Lord's Landing Condominiums on the grounds that CGL coverage is not intended to cover normal *business risks* arising from *faulty workmanship* which do not cause property damage to occur. App. 794-95. On February 20, 1998, a Cross Motion for Summary Judgment was filed by Appellee. App. 943. Both Motions were responded and replied to, (App. 947, 1219, 1244, 2296, 2305,) and the Motions were heard by the District Court on March 30, 1998. At the conclusion of the hearing, the Court denied Continental's Motion for Summary Judgment, granted Lord's Landing's Cross Motion for Summary Judgment and

entered a final judgment in favor of Appellee. App. 2637-2751. Appellant's Motion to Reconsider predicated upon the intermediate appellate court's ruling in Lerner Corporation v. Assurance Company of America, 120 Md. App. 525, 707 A.2d 906 (1998), was denied on September 9, 1998. App. 2485.

STATEMENT OF THE FACTS

Appellee obtained a \$1.1 million judgment against Wellington Homes based upon breach of warranty obligations and misrepresentations, omissions or statements that led Plaintiff to believe that the condominium and common elements had a quality, useful life or characteristics which they do not have, which constituted a violation of the Consumer Protection Act. App. 934-35. During the development of the condominium units, Wellington managed and controlled all aspects of the work performed and specified the materials provided at the project. In Phases I and II of development, Wellington, as the developer, specified the quality of work, materials and services in its contract with VRI, the general contractor. App. 1247. During these development phases, Wellington had no subcontractors, VRI did. In August of 1989, Wellington took over the entire project as both the developer and builder to complete Phases III and IV and directly contracted with service providers and materialmen and controlled the specifications of the type of materials, including the type of wood and products, inclusive of the paint, and the quality of work on the project. App. 1731-1803. Numerous defects existed on the project as a result of deficiencies and faulty workmanship, inclusive of the deterioration of the exterior wood surfaces which were painted with two coats of paint, but were not primed, in accordance with Wellington's job specifications. App. 627-630, 425-426, 638-642, 411-420. Continental provided a full defense to its insured in the underlying State court action under a reservation of rights. The State court ruled, as a matter of law, that the tort counts against Continental's insured for negligence and negligent misrepresentation sought economic damages for the repair and replacement of faulty workmanship and applied the "economic loss" rule in dismissing the negligence and negligent misrepresentation counts from the Complaint. App. 2482B.

SUMMARY OF ARGUMENT

I. No indemnity coverage is provided under Continental's CGL policy for a judgment against an insured developer for its breach of implied and express warranties and its misrepresentations as to the quality, useful life or characteristics of the condominium project developed and built by the insured.

- 1) The District Court erred in determining the applicability of Sheets:

a) Sheets involved only a determination of a "duty to defend" not the ultimate "duty to indemnify," and dealt solely with the sufficiency of

allegations of negligent misrepresentation and causally related damages to trigger the "duty to defend," but did not determine the indemnity coverage afforded under the CGL policy predicated upon breach of warranty and violations of the Maryland Consumer Protection Act.

b) Sheets dealt with acts of negligence in the context of whether the resulting damages were "*accidental*" and, therefore, constituted an "*occurrence*," thereby affording coverage under a CGL policy.

c) Sheets never determined whether the insured sustained "*Property damage*" consisting of "*physical injury to tangible property*," noting that the costs for repair and replacement of the faulty facility itself were not property damage, but rather economic loss which is not covered by a CGL policy.

d) Sheets never determined the applicability of the policy exclusion(s) known as the "business risk exclusions" which exclude from coverage the insured's duty to pay for the repair or replacement of defective workmanship.

2) The Court erred in failing to grant Continental's Motion for Summary Judgment that, as a matter of law, no insurance coverage is provided under the CGL policy issued to Wellington Homes for the *faulty workmanship* claims presented by Lord's Landing, in view of the fact that Wellington never became *legally obligated* to pay any sums as damages because of "*Property damage*" caused by an "*occurrence*" which was required under the policy in that:

a) The judgment under the counts of *Breach of Warranty* and *Violations of the Maryland Consumer Protection Act* are claims for *economic losses*, and do not constitute "*Property damage*" under the policy.

b) The causes of action for *Breach of Warranty* and *Violations of the Maryland Consumer*

Protection Act do not constitute an "occurrence" as defined by the terms and provisions of the policy.

c) There is no causal connection between the *Breach of Warranty and Violations of the Consumer Protection Act* causes of action and the alleged "Property damage."

d) The CGL policy's conditions that the damages be "neither expected nor intended from the standpoint of the insured" were not met in that the damages resulting from the breaches of warranties and representations were expected by the assured.

II. The Court erred in granting the Motion for Summary Judgment filed by Lord's Landing finding coverage for the faulty workmanship claims asserted under the CGL policy.

a) The coverage provisions of the Continental CGL policy do not provide coverage for the "*accident of faulty workmanship*," but rather "*faulty workmanship*" which causes an accident.

b) The Policy's exclusion(s) apply to exclude coverage for the judgments rendered in favor of Lord's Landing.

c) A material issue of fact existed which precluded summary judgment being entered in favor of Appellee predicated upon the subcontractors exception to exclusion (1) (*Damage to Your Work*, exclusion), in that Continental maintained that the defective workmanship arose out of the work of its insured, Wellington Homes, and not that of a subcontractor as maintained by Appellee.

III. The Court erred in denying Continental's Motion for Reconsideration based upon the landmark case of Lerner Corporation v. Assurance Company of America, 120 Md. App. 525, 707 A.2d 906 (1998), which decided the very issues for which the above-entitled cause was remanded, i.e. the applicability of Sheets to claims of faulty workmanship against a developer and whether claims of faulty workmanship are covered under a CGL policy. The Lerner decision, which was decided on April 1, 1998, together with the case of Harbor Court Associates, et al., vs. Kiewit Construction Company, et al., 6 F.

Supp.2d 449 (1998), decided on April 24, 1998, are controlling and determinative of the coverage issues presented in the instant case.

ARGUMENT

ISSUE I - The trial court erred in failing to grant Continental's Motion for Summary Judgment that no indemnity coverage is afforded under the CGL insurance policy for the faulty workmanship claims presented by Lord's Landing.

Standard of Review

In reviewing the grant or denial of a summary judgment motion, this Court will review a District Court's grant of summary judgment *de novo*, applying the same standards as the District Court. Summary judgment is proper only when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317 (1986).

In ruling on a Motion for Summary Judgment, a federal court sitting in diversity has a duty to apply the operative state law as would the highest court of the state in which the suit is brought. Liberty Mutual Insurance Company v. Triangle Industries, Inc. 957 F.2d 1153 (4th Cir. 1992). The best evidence to this effect would be a decision by the highest court.Id. The state's intermediate appellate court decisions "constitute the next best indicia of what state law is," and in the absence of an authoritative pronouncement from the state's highest court, the federal courts are obliged to give due regard to decisions of the forum state's intermediate appellate court as an indication of how the state's highest court would decide the issue. Federal Kemper Ins. Co. v. Jones, 777 F. Supp 405 (M.D. Pa. 1991).

Discussion of the Issues

(1) Sheets is neither applicable nor controlling

Sheets determined that in view of the allegation(s) set forth in the complaint of negligent misrepresentation and causally related *loss of use* damages, which the Sheets court viewed with disdain, there was a "duty to defend." Sheets stated that "an act of negligence constituted an 'accident' under a liability insurance policy....when a negligent act causes damages that is unforeseen or unexpected by the insured." Sheets, 679 A.2d at 548. In the instant case, the coverage issue is whether there is ultimate liability indemnity coverage based upon the special jury verdict which found that the assured Defendant, Wellington Homes, was liable for causes of action predicated upon

(1) Breach of Warranty and (2) a Violation of the Maryland Consumer Protection Act. App. 934-35. These issues were never considered by the Sheets court. In the underlying litigation, a full defense on all counts was provided by Continental to its insured under a "reservation of rights." App. 2473-75; 2477-2482B; 2483-84; 1-9.

In the underlying case of Lord's Landing v. Wellington Homes, et al., the trial court, as a matter of law, ***dismissed the negligence count and the negligent misrepresentation count*** on the grounds that the damages being sought were economic damages and not property damages. App. 795. The ruling was never appealed and is the controlling "law of the case." As a consequence of the state court's ruling, no negligent act existed which resulted in "Property damages" caused by an "occurrence" under a Sheets analysis. Additionally, the Sheets court did not determine whether the insured sustained "Property damage," i.e., "Physical injury to Tangible Property," caused by an occurrence, as defined and required under the policy in order for coverage to apply. App. 795. In its analysis, the Sheets court commented on the concept of

"Property damage" and noted that it was conceded "that the money spent to fix the system was economic loss and thus not covered under the policy as property damage." The Sheets court never determined the issue(s) of whether ***faulty workmanship*** claims are covered under a CGL policy, nor the applicability of any of the policy's ***business risk*** exclusions.

(2) No indemnity coverage is provided under Continental's CGL policy for a judgment against the insured developer for its breach of implied and express warranties and its misrepresentations as to the quality, useful life or characteristics of the condominium project developed by the insured.

In order to determine if Continental has a duty to indemnify its insured under its CGL policy, the legal liability of the insured is determinative as the policy provides that Continental will pay for only those sums that the "insured becomes ***legally obligated*** to pay as damages because of 'property damage' to which this insurance applies." App. 2759. (Emphasis added).

An insurance company's duty to defend is separate and distinct from its duty to pay a resulting judgment. Unlike the "duty to defend" issue, the determination as to

whether an insurer has the duty to pay a final judgment against an insured turns on the comparison of the ultimate findings of fact concerning the alleged occurrence against the policy coverage(s). In this case, the jury found in favor of Lord's Landing, based

upon the findings that the insured breached warranty obligations and made misrepresentations, omissions or statements that led Plaintiff to believe the common elements had a quality, useful life or characteristics which they do not have which constituted a violation of the Consumer Protection Act. The jury verdict sheet provides a clear pronouncement of the insured's liability. App. 934.

Property Damage

The Continental policy defines "Property damage" as "*physical injury* to tangible property, including all resulting loss of use of that property." App. 2770. Under Maryland law, the language of a CGL policy which provides coverage for liability for damages on account of "Property damage," caused by or arising out of an

"occurrence," makes "Property damage" as defined by the policy, a condition of an insurance company's liability. While Lord's Landing's loss in the underlying claim resulted from the deterioration of the materials that Wellington designed, specified and installed, such loss is not, as a matter of law, "Property damage" under the Continental CGL policy. The sums for which Wellington Homes was found to be *legally obligated* to pay as damages were for *economic damages* only and do not constitute "Property damage" as was clearly and unalterably adjudicated in the underlying legal action.

Under the great weight of authority, it has been held that CGL policies cover the possibility that the goods, products, or work of the insured, once relinquished or completed, will cause bodily injury or physical injury or damage to property other than to the product or completed work itself, and for which injury or damage the insured might be exposed to liability. The coverage is for tort liability for physical damage to property of others, and not for contractual liability of the insured economic loss suffered because the completed work is not what the damaged person bargained for. This basic concept, which is implicit in the meaning and intendment of the coverage provisions of the standard CGL policy, has been accepted as the unquestioned pronouncement of Maryland law.

The interpretation that the majority of Courts have made regarding the extent of coverage afforded under a CGL policy is premised upon the concept that an insured's contractor's work gives rise to two different types of risk. The *first type of risk* involves the typical situation, where a contractor or developer holds itself out as being capable of completing the bargained-for construction in a workmanlike manner. In these instances, the property owner, as did Lord's Landing in the underlying case, relies upon the *representation(s)* of the developer with respect to the quality of the

goods, services and materials and the useful life of the condominium units purchased and of the common elements of the condominium, and anticipates the receipt of the goods, services and materials warranted. When the developer's work does not measure up to the quality and character of that which was represented, either express or implied warranties and representations of the quality of goods, services and materials are breached, and the dissatisfied customer may recover the costs of *repair or replacement* of the faulty work from the developer as the standard measure of damages for the breach of warranty. This consequence of not performing well is part of every business

venture, and the repair or replacement of faulty goods and work is a business expense, to be borne by the contractor/developer in order to honor the warranty or representation(s) as to the quality of work promised. This is the precise nature of risk presented in the instant case.

The *second type of risk* inherent in a contractor's line of work is the risk of injury to people and physical damage to property of third parties caused by *accidental* injuries to persons or property which can expose the developer to unlimited liability. While the same neglectful craftsmanship can result in both a business expense of repair or replacement and a loss represented by damage to persons or property, the two results are vastly different in relation to sharing the costs of such risks as a matter of insurance underwriting and are vastly different in connection with the coverage afforded under the basic coverage provisions of the standard CGL policy of insurance. (See footnotes 11 and 12.)

The Weedo court initially best articulated the distinction between "business risks" and "occurrence" which give rise to insurable liability. The Weedo analysis remains as valid today as it was when first articulated and serves currently as the

foundation for the modern day "business risk" analysis, notwithstanding the modifications which have taken place in the standard ISO policy since it was first articulated, and has been recently quoted as espousing principles of insurance coverage which are wholly consistent with Maryland law. In Weedo, the Court stated:

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 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 neighbor could suffer a scratched arm or a fatal blow to the skull from the peeling stonework.... injury to persons and damage to other property constitute the risks intended to be covered under the CGL.

Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 405 A.2d 788, 796 (1979).

The judgment obtained by Lord's Landing against Wellington was for breaches of warranty and representations of the quality and character of the property sold measured by the remedial costs related to the repair and replacement of nonconforming

goods and materials, and does not constitute "*physical* injury to tangible property," or "Property damage." On this issue, Courts have held that the coverage afforded by a CGL policy does not include reimbursement to a builder for expenditures required to *correct, repair, or replace* his own *poor workmanship or the workmanship of subcontractors*. They apply the basic Weedo analysis that such costs attendant upon the repair or replacement of faulty workmanship is a part of every business venture and is a business expense to be borne by the insured-contractor in order to satisfy customers. They have held that losses resulting from, or which are measured by, the repair and replacement costs due to faulty workmanship is a *business risk* long excluded by CGL policies, recognizing that it is another form of risk in the insured-contractor's line of work for which coverage is provided, namely, *injury to people and physical damage* to other property caused by the contractor's *negligence* or defective product. In applying the "business risk" concept articulated in Weedo, the courts have

determined that no coverage exists for the type of damages claimed by Lord's Landing against Wellington without regard to the application of the "business risk" exclusions. A CGL policy which provides coverage for "Property damage" caused by an "occurrence" does not cover economic loss resulting from breaches of warranty and misrepresentations due to an insured builder's faulty workmanship in constructing

a condominium project. The reason is that the loss is an *intangible loss* which neither constitutes nor causes "Property damage" caused by an occurrence under the coverage provisions. Tellingly, the Thompson court, held:

Because Thompson's claim arises from economic loss suffered by the Association, and not from damage to property other than the contractor's completed work itself, there was no "property damage" covered by the Thompson's CGL policies.

R.N. Thompson & Associates, Inc. v. Monroe Guarantee Insurance Company and

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Commercial Union Insurance Company, 686 N.E.2d 160 (Ind. 1997).

Occurrence

In Maryland, poor workmanship has never been determined to constitute property damage caused by an "occurrence." The Maryland cases which have addressed the CGL policy's definition of "occurrence"; similar to that of the Continental policy have found that defective workmanship and the claims arising therefrom do not constitute an "occurrence." In Woodfin, the Court recognized that courts uniformly hold that when property damage arising out of the insured's defective workmanship is confined to the insured's work product, the damage is not caused by an "occurrence" within the meaning of a CGL policy. In Woodfin, the developers and general contractors of a large hotel filed a declaratory judgment action against the CGL insurer of the HVAC subcontractor for damages allegedly resulting from the subcontractor's faulty installation of the HVAC system. The court held that the cost of repair and replacement of the HVAC system and the cost associated with tearing out walls, molding, and carpeting in order to repair the HVAC system was not the result of an "occurrence." In Mogavero, a case decided by the United States District Court for the District of Maryland, the court stated that the natural and probable consequences of poor workmanship does not constitute an "occurrence."

In Mogavero, a general contractor's faulty workmanship had to be repaired or replaced. The Court stated that the term "occurrence" does not include the "normal, expected consequences of poor workmanship." Mogavero, 640 F. Supp. at 86.

The Thompson court reviewed the cases from other jurisdictions which had decided the issues and determined that the action against the builder for the defective roofing materials was one for breach of contract arising from faulty workmanship and design and from the use of defective materials. It held that economic losses suffered by the

Association are the natural and ordinary consequences of Thompson's breach of contract. It cited Weedo and DeZutti in declaring, "**Because a typical CGL policy 'does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident,'** the

Association's losses did not arise from an 'occurrence' and are not covered by Thompson's CGL policies." The well-established principle of law that "**a typical CGL policy 'does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident'**" was determined to be "*wholly consistent with Maryland law*" in the Woodfin case. It cited both Vector Constr. Co. and Weedo, in support for its opinion that in order to be covered "damages" must be "Property damage" caused by an "occurrence" under a CGL policy in Maryland and restated the identical principle that "**a CGL policy does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident.**"

As articulated in Woodfin and Thompson and the cited cases, the CGL policy issued by Continental to Wellington, "*does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident.*" Weedo, 405 A.2d at 796. The losses claimed by Lord's Landing in the underlying litigation and which were embodied in the jury award of damages, which establishes the *legal obligation* of Wellington to pay, do not constitute "Property damage" which was the result of an "occurrence," but rather were inextricably a part of the claims which were submitted to the jury which resulted in a judgment against Wellington. Wellington's

legal obligation to pay was predicated upon the breach of implied and expressed warranties and misrepresentation(s) which violated the Consumer Protection Act. Continental's CGL policy does not provide coverage for Lord's Landing's economic losses.

Causal Connection

There is *no causal connection* between the Breach of Warranty and Violations of the Consumer Protection Act causes of action and the alleged property damage claims of Lord's Landing.

The judgment rendered against Continental's insured for breaches of warranties and misrepresentations in the quality, character, and useful life of the condominium project does not constitute "Property damage" *caused by* an "occurrence," but rather misrepresentations which *caused uninsured economic loss*. It is axiomatic black letter law in the State of Maryland and elsewhere that a CGL insurer has no duty to indemnify for a judgment based upon claims that are not covered under the policy. In

Maryland, the question of whether the insurer has a duty to pay a final judgment against

the insured depends upon a comparison of the ultimate liability assessed against the insured predicated upon the actual causes of action which are alleged in the complaint against the insured with the coverages set forth in the policy. This issue was extensively dealt with and decided in this State in Reames. App. 1273.

CGL policies do not provide coverage to a developer who breached warranties or violated consumer protection laws. Accordingly, under the terms and provisions of the Continental CGL policy issued to Wellington Homes, it is clear, as a matter of law, that no coverage for indemnification is provided to Wellington in the instant case and summary judgment should again have been properly entered in favor of Continental in these proceedings.

ISSUE II - The trial court erred in granting the Cross Motion for Summary Judgment and finding that coverage was not excluded by the "business risk" exclusions of the policy.

Standard of Review

The standard for summary judgment as enunciated by this Court in Knowaleviouz v. Local 333 of The International Longshoremen's Association, 942 F.2d 285, 288 (4th Cir. 1991), is as follows:

Summary Judgment is appropriate only when there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. All factual contentions are to be considered in the light most favorable to the non-moving party, who is to be given the benefit of all favorable legal theories invoked by the evidence as considered. Where the facts specifically averred by the non-movant contradict facts specifically averred by the movant, the motion must be denied.

This Court must reverse a grant of summary judgment if it appears from the record that there are unresolved issues of material fact, and, in that regard, all inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Helm v. Western Maryland Ry. Co., 838 F.2d 729 (4th Cir. 1988).

Discussion of the Issues

The Court erred in granting the Motion for Summary Judgment filed by Lord's Landing finding coverage for the faulty workmanship claims asserted under the CGL policy and finding that coverage was not excluded by the "business risks" exclusion of the policy.

The trial court erred in ruling that the coverage provisions of the CGL policy issued by Continental granted coverage for *faulty workmanship* claims and for ruling that the "business risk" exclusions do not effectively exclude coverage. As asserted in Appellant's first argument, the coverage provision(s) of the policy do not provide coverage for the damages assessed against Wellington Homes in that the Continental CGL policy does not cover the "*accident of faulty workmanship*." Additionally, the *business risk exclusion(s)* of the policy apply to exclude coverage for the judgments rendered against Wellington. App. 1244, 836.

The applicable "business risk" exclusions are set forth in the Continental CGL policy as exclusions: (j) *Damage to Property*; (l) *Damage to Your Work*; (m) *Damage to [Impaired Property or] Property Not Physically Injured*; and (n) *Repair, Replacement, or Removal of Products, Work or Impaired Property*. App. 1245. These "business risk" exclusions are intended to exclude from coverage the ordinary contractual risk that a product will fail to live up to its expected performance and will require repair or replacement. Relying on the "business risk" exclusions, the Maryland courts have denied coverage for breach of warranties and faulty workmanship.

The Business Risk Exclusion(s), inclusive of Exclusion (m) of the policy exclude coverage due to the fact that the damages awarded in the underlying litigation do not constitute "property that has been physically injured" within the meaning of the policy. App. 1287. The provisions of exclusion (m) apply to exclude coverage under the policy for the damages awarded for the *repair and replacement costs* of the deteriorated wood products which damages are inextricably bound to the quality of the goods, services and workmanship represented by Wellington rather than constituting property which was physically injured within the meaning of the policy.

Additionally, Lord's Landing was not entitled to a summary judgment on the grounds that exclusion (l), the "*Damage to your work*" exclusion applied to exclude coverage which might otherwise exist.

In opposing the Cross Motion for Summary Judgment, Continental asserted that exclusion (l) *Damage To Your Work* , applied to exclude coverage not only because the faulty workmanship did not constitute "Property damage" caused by an occurrence, but also because it constituted "damage" arising out of and to the *work of the insured* and not a subcontractor. App. 1256.

Although the Appellee made the factual assertions that the work at Lord's Landing was performed by subcontractors and that the "sub contractor exception" to the "Your work" exclusion applied to extend coverage under the CGL policy, such contention was a contested issue of a fact material to the Court's determination of the Cross Motion for Summary Judgment. App. 1245. During phases of the development, commencing from July 1988 and extending to August 1992, Wellington conducted continual on-site inspections for the purpose of noting any deficiencies in the work product and promised to correct the numerous discovered deficiencies observed inclusive of the deficiencies noted in the painting and wood products. App. 2139-2209; 1804-2138. The record reveals that Wellington was an experienced developer and builder which specified the paint to be used and the number of coats to apply, and did not require or specify that a primer be used on the exterior wood surfaces of the Condominium project. App. 1804-2138. Therefore, any and all resultant damage to the exterior wood surfaces which were painted without priming and which occurred as a consequence of the failure to prime the wood prior to the application of the paint, was the "work of" Wellington and no one else. App. 1244-1297. Continental also contended that the work of the subcontractors did not cause the harm or damages to occur, which is a mixed question of fact and law. App. 1251. Additionally, it was Continental's contention that at no time was any of the work on the Lord's Landing performed by "subcontractors" for Wellington Homes, the project developer in Phases I and II and the developer and builder in Phases III and IV. App. 1246-47. In view of the fact that material issue(s) of disputed fact existed, i.e., whether the actual work that allegedly caused the damages was the work of Wellington, as asserted by Appellant, or the subcontractors, as alleged by Appellee, it was reversible error for the trial court to make a factual ruling in favor of the Appellee in determining the applicability of the "subcontractors exception" to the "your work" exclusion of the policy in granting the Appellee's Cross Motion for Summary Judgment, as it was the trial court's duty to make all inferences of fact in favor of Appellant in ruling on Appellee's Motion for Summary Judgment. App. 1256.

Additional factual issues and inferences to be drawn therefrom with respect to the application of the Damage to Property exclusion (j) also were in dispute and required a factual determination. App. 1245. The determination by the court of the factual issue(s) in dispute in favor of Appellee was reversible error as it was the trial Court's duty to make all inferences of fact and inferences drawn therefrom in favor of Appellant, not Appellee, in connection with the Court's ruling on the Cross Motion for Summary Judgment filed by Lord's Landing.

ISSUE III - The court erred in denying Continental's Motion for Reconsideration based upon the failure of the District court to follow the controlling Maryland legal authority that a contractor's liability for *repair and*

replacement costs arising out of a construction project are economic damages not caused by an occurrence or accident and are outside the scope of commercial general liability (CGL) coverage.

Standard of Review

This Court in U.S. v. Little, 52 F.3d 495 (4th Cir. 1995), set forth the rule followed by this circuit when the Court is adjudicating non-federal questions of State law. A Federal Court must apply the law of the state in these cases and the general rule is that a Federal Court must follow the rule of an intermediate appellate court unless there is persuasive data that the state's highest court would decide differently. Little, 52 F.3d at 498 (citing Lynch v. Universal Life Church, 775 F.2d 576, 580 (4th Cir. 1985)). Where an intermediate appellate state court rests its considered judgment upon a rule of law which it announces, that is a datum for ascertaining state law which is not to be disregarded by a federal court. West v American Tel. & Tel. Co., 311 U.S. 223, 85 L.Ed 139, 61 S.Ct 179 (1940). It is the duty of the Federal Appellate Court and the trial court to ascertain and apply state law as enunciated by the state's intermediate appellate court in a case in which such law is controlling and in the absence of a conflicting decision by the state's highest court. Gooding v. Wilson, 405 U.S. 518, 31 L.Ed 2d 408, 92 S.Ct 1103 (1972).

Discussion of the Issues

The Court erred in denying Continental's Motion for Reconsideration based upon

the landmark case of Lerner Corporation v. Assurance Company of America, 120 Md. App. 525, 707 A.2d 906 (1998).

On March 31, 1998, the District Court signed an Order Denying the Motion for Summary Judgment of Defendant Continental, and granting the Cross Motion for Summary Judgment of Lord's Landing as to all issues in this case. App. 2342. The Order of the Court was entered upon the Docket on April 1, 1998. App. 10. On April 2, 1998, the day following the entry of the Order of this Court, the Court of Special Appeals of Maryland filed the landmark case of Lerner Corporation v. Assurance Company of America, 120 Md. App. 525, 707 A.2d 906 (1998), which decided the very issues for which the above-entitled cause was remanded. The decision is controlling Maryland law which is determinative of the issues presented in the instant case. App. 2358-74. In accordance with the holding in Lerner, the Court should have reconsidered its Order of March 31, 1998, in view of the Court's ruling

that Sheets does not alter the long standing Maryland law as articulated in Woodfin, Mogovero, and Century I, and the original findings of the District Court, which were originally affirmed by this Court, that the ***costs of the repair and replacement of faulty construction are not covered under*** the Continental CGL policy, in that the damages for such costs represent ***economic damages*** and do not constitute "Property damage" caused by an "occurrence" under the provisions of the Continental policy.

Factual And Procedural Background

Continental's coverage position that the CGL policy issued to Wellington does not provide indemnity coverage for economic damages measured by the ***repair and replacement*** costs due to faulty workmanship was initially adjudicated to be correct by the District Court. App. 858. The case was thereafter remanded by the Fourth Circuit to the District Court to determine the applicability of Sheets, and if applicable, the extent to which the issues could be determined by summary judgment. The sole issue to have been determined on remand was whether Sheets required the reversal of the initial determination of this court that no coverage is afforded under the Continental CGL policy for the damages awarded in favor of Lord's Landing and against the insured, Wellington. The Lerner case clearly resolves this issue.

In Lerner, the Court of Special Appeals examined a case in which a land developer, and Lerner Corporation, a construction management company (the "insureds"), sought indemnification from various insurance companies for amounts they paid to repair a defect in a building's facade which the developer sold. The Court of

Appeals held that the insurers were not obligated to indemnify the insureds for the costs incurred in repairing the building's facade.

The Court based its holding on an analysis of the standard CGL policy provisions and the Maryland cases that have interpreted such provisions. The policy provisions examined in Lerner are substantively identical to those in the present case. The policies essentially provided that the insurers would be obligated to pay damages for bodily injury or "Property damage" which is "caused by an occurrence," provided the "Property damage" was not expected by the assured.

The insured's in Lerner asserted that the damaged facade was property damage and the "occurrence" was the continuous and repeated exposure to harmful conditions such as the effects of weather and time on faulty workmanship. The Court disagreed, and stated that "if the [insured's] analysis is correct, the CGL policy under such circumstances takes on the characteristics of a performance bond ***or warranty***." Lerner, 707 A.2d at 910 (emphasis added). This language in Lerner is

significant in that it is clear that the Maryland Appellate Court's unmistakable view is that a ***breach of warranty*** claim, such as that which resulted in the assured's legal obligation to pay damages, is not covered under a CGL policy.

The Lerner case clearly stands for the rule of law that damages arising out of, or measured by, the costs of the ***repair or replacement of faulty workmanship*** are not covered under a CGL policy irrespective of the form or nature of the cause of action alleged. Lerner, 707 A.2d at 909. In enunciating this rule of law the Lerner court stated:

We hold that the damages claimed, ***regardless*** of the form of the ***cause of action*** that GSA might have maintained against the Insureds to ***repair the faulty construction*** {of the facade}, were **not covered** by the CGL policies issued to the insureds and that the Insurers were not obligated to indemnify the Insureds for the costs incurred related to the repair of the Building's damaged facade.

Lerner, 707 A.2d at 909 (emphasis added).

Under the clear holding of Lerner, Sheets is readily distinguishable from both the Lerner case and the instant case, and under the clear pronouncement of Lerner, Sheets does not change the pre-existing Maryland Law that damages to the work product itself resulting from ***faulty workmanship*** are not covered under a CGL policy. In support of its opinion, the Court relied upon the analysis which it had made in the Woodfin case and which is set forth in both Century I, and Mogavero, the cases principally relied upon by Continental in these proceedings. App. 2444.

The Lerner court stated:

This interpretation is consistent with this Court's understanding of CGL policies as expressed in both Century I and Woodfin. Century I, 63 Md. App. at 553-54 and Woodfin, 110 Md. App. at 642 (citing Roger Henderson, Insurance Protection for Products Liability and Completed Operations -- What Every Lawyer Should Know, 50 Neb. L. Rev. 415, 441 (1970)) ("coverage...is not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained"). It is also consistent with the federal district court's understanding in Reliance Insurance Co. v. Mogavero, 640 F. Supp. 84 (D. Md. 1986), "that the insurers issued a general liability policy, not a performance bond" ***and with the comment by the Court of Appeals in Sheets that economic loss for repair and replacement of the faulty facility itself is not covered by a CGL***

policy. Finally, our interpretation is consistent with the understanding of CGL policies expressed by commentators such as Henderson, as quoted in Century I, Woodfin and also Robert Franco, *Insurance Coverage for Faulty Workmanship Claims Under Commercial General Liability Policies*, 30 Tort & Ins. L.J. 785 (1995) ("The CGL Policy does not serve as a performance bond, nor does it serve as a warranty of goods and services.

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Lerner, 707 A.2d at 912.

The Court of Special Appeals in the Lerner decision, also quoted with approval from Henderson, which further articulated the important distinction between *the accident of faulty workmanship* and an "*accident*" caused by faulty workmanship, as follows:

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 the property other than to the product or completed work itself, and for which 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 damage to others and not for contractual liability of the assured for economic loss because the product or completed work is not that for which the damaged person bargained.***

Henderson, 15 Neb. L. Rev. 415, 441 (1970) (emphasis added).

The fallacy of the District Court's rationale in maintaining that Sheets required a reversal of the Court's initial ruling is predicated upon the failure to distinguish cases involving *the accident of faulty workmanship*, which is not covered under a CGL policy and an "*accident*" caused by faulty workmanship, for which coverage is provided. The Lerner Court, in distinguishing Sheets, explicitly pointed out the important distinction between the two types of claims in stating:

In determining if there is a covered accident, the Sheets analysis directs our attention to the nature of the damages -- do they represent an expected or foreseen event? If the damages suffered relate to the satisfaction of the contractual bargain, it follows that they are not unforeseen. In other words, and in the context of this case, it should not be unexpected and unforeseen that, if the Building delivered does not meet the contract requirements of the sale, the purchaser will be entitled to correction of the defect. This, we believe, would be the expectation and understanding of the reasonably prudent lay purchaser of a CGL policy. ***On the other hand, if the defect causes unrelated and unexpected personal injury or property damage to something other than the defective object itself, the resulting damages, subject to the terms of the applicable policy, may be covered. For example, if a collapse of the veneer had injured a user of the facility or damaged property other than the veneer itself, these may well be covered.***

Lerner, 707 A.2d at 912 (emphasis added).

The Court indicated that it did not consider the assured's liability to repair the ***faulty workmanship*** as having resulted from an "accident" which should be deemed unexpected or unforeseen. It held that the ***repair or replacement*** damages represent ***economic loss*** which would not trigger a duty to indemnify under a CGL policy.

In accordance with the Court's clear pronouncement and ruling(s) in Lerner, no indemnification coverage is provided under the terms of the CGL policy for damage claims of faulty workmanship.

That no coverage is afforded for faulty workmanship of a developer under the terms of a CGL policy under the principles of law clearly enunciated in Lerner, was reiterated in a recent case of the United States District Court for the District of Maryland in Judge Garbis's Opinion in Harbor Court Associates, et al. v. Kiewit Construction Company, et al., 6 F.Supp.2d 449 (D. Md. 1998). The Court denied coverage to the Developer of the Harbor Court Condominium Complex for major structural defects in the Complex inclusive of the brick veneer which had experienced cracking, distress, buckling, and failure in several locations. The Court noted that the CGL policy, with language substantially similar to the Continental policy, requires that an occurrence caused "property damage *neither expected nor intended from the standpoint of the insured*" and both noted and cited Lerner as having addressed the issue, in the construction context, of what damages are "expected" under the terms of a CGL policy. Therein, the Harbor Court court stated:

After a thorough review of the law in this area, the Court of Special Appeals in Lerner concluded that "if the damages suffered relate to the satisfaction of the *contractual bargain*, it follows that they are *not unforeseen*. In other words, and in the context of this case, it should not be unexpected and unforeseen that, if the Building delivered does not meet the *contract requirements of the sale*, the purchaser will be entitled to correction of the defect.

Harbor Court, 6 F. Supp.2d at 456 (emphasis added).

In the instant case, Wellington failed to construct the condominium units in a workmanlike fashion, and, further, after Wellington allegedly failed to perform, it made certain warranties and made representations and also failed to repair its faulty work. App. 2210-2255. Under well-established Maryland law, as articulated by Maryland's intermediate Appellate Court in Lerner, (which distinguished the Sheets case), and as further articulated by the United States District Court in Harbor Court, (which followed the principles of law enunciated in Lerner, as it was required to do), the Continental CGL policy does not provide coverage for claims of the faulty workmanship of a developer of a condominium project as the damages are economic damages which were not caused by an "occurrence" as required by the policy's provisions.

As asserted in Continental's Motion to Reconsider, the Court of Special Appeals' opinion in Lerner is dispositive of this matter. App. 2473. Lerner is the most recent pronouncement of Maryland law on the coverage issue(s) presented, and its holding that the "*repair or replacement* damages represent *economic loss* and consequently would not trigger a duty to indemnify under a CGL policy" is, most assuredly, controlling substantive state law, which, when coupled with the court's distinguishment of Sheets, had the direct effect of being dispositive of the coverage issue which was pending before the District Court. The clear, unmistakable, and controlling coverage opinion of the Maryland intermediate appellate court mandates the finding that the *repair or replacement* damages arising out of Wellington's contractual relationship with the Appellees for which judgment was granted in favor of Lord's Landing against Wellington Homes in the underlying proceedings are *economic* damages which are **not** covered under the Continental CGL policy.

The Harbor Court decision correctly states that in the context of a construction case, damages for which the developer would be liable because of its contractual obligations to construct the project are "expected" and therefore not covered under a CGL policy. The Court stated:

In the context of the instant case, the word "expected" is construed to refer to

damages for which an insured would be liable in any event, irrespective of fault, because of its contractual obligations to construct its product. Under Lerner, contractors, when they agree to construct a building, expect that they will have to erect the building in a proper manner. They further expect that if they do not do so, they will have to repair any defects in their work so as to deliver" the product they promised to provide.

Harbor Court, 6 F. Supp.2d at 456.

The Harbor Court court noted that all of the work done to construct Harbor Court was either done by the developer or by a subcontractor, and applied Lerner in ruling that "Under Lerner, any defects in any part of the building would be 'expected' by the developer, irrespective of whether the actual physical work was performed by the developer or one of its subcontractors." Harbor Court, 6 F. Supp.2d at 457. It held, "Therefore, with regard to Kiewit-General, the alleged damages to the brick veneer of Harbor Court were not caused by an occurrence," and, "Accordingly, there is no potentiality of coverage for Kiewit -General for the asserted damages, and, consequently no duty to defend. The only damages sought from Kiewit-General are for the cost of repairing Harbor Court itself. Plaintiffs have not alleged in their Complaint that anything other than the building itself has been damaged." Harbor Court, 6 F. Supp.2d at 457.

Therefore, the claims asserted for repair and replacement costs for faulty workmanship are not claims which are covered under a CGL policy because the alleged property damage was not caused by an occurrence.

It is also clear that Lerner court clearly distinguished the Sheets case and found that the only cause of action against the insureds in Lerner was breach of contract and not negligent misrepresentation. According to the Lerner court, even if there was a negligence claim against the insured, there was no "accident" that would give rise to coverage. The Lerner court stated:

We do not believe that [the insureds'] liability to repair the Building's facade resulted from an "accident" but simply from its failure to satisfy its obligation under their contract. Damage to the facade of the Building caused by a latent defect should not be deemed unexpected or

unforeseen. Certainly, the obligation to repair the facade itself is not unexpected or unforeseen under the terms of the sales contract. Therefore, repair or replacement damages represent economic loss and consequently would not trigger a duty to indemnify under a CGL policy.

Lerner, 707 A.2d at 911-12.

The Lerner court also observed that Sheets focused on the "nature of the damages" and found that "[i]f the damages suffered relate to the satisfaction of the contractual bargain, it follows that they are not unforeseen ... it should not be unexpected and unforeseen that, if the Building delivered does not meet the contract requirements of the sale, the purchaser will be entitled to correction of the defect."

Similarly, the damage allegedly caused by Wellington was not the result of an "accident" as defined by the applicable policy and Maryland case law. Rather, the alleged damages arose solely out of the alleged breach of warranty and misrepresentations of the quality and characteristics of the condominium units arising out of the contractual relationship which existed between Wellington and the Appellees. It is clear that Lord's Landing's claims against Wellington for negligence and negligent misrepresentation were dismissed by the trial Court on the grounds that the claims were for economic damages for replacement and repair for faulty workmanship.

Therefore, in accordance with legal dictates of Lerner, the alleged damage which resulted from Wellington's alleged breach of warranty and misrepresentations based upon its *faulty workmanship* and which arose out of its contractual relationship with Lord's Landing, cannot be deemed "unexpected or unforeseen." Moreover, Wellington's alleged failure to repair the damage constituted *economic loss*, coverage for which is not contemplated by the Continental CGL policy. It therefore was error for Judge Messitte to deny Continental's Motion to Reconsider as the most recent pronouncement of Maryland law, as set forth in the Lerner decision, was controlling and determinative of the very issues presented in this case before him.

Moreover, in Maryland, poor workmanship has never been determined to constitute property damage caused by an "occurrence". As set forth in Lerner, Woodfin recognized that courts uniformly hold that when property damage arising out of the insured's defective workmanship is confined to the insured's work product, the

damage is not caused by an "occurrence" within the meaning of a CGL policy. Lerner also pointed out that in Mogavero, a general contractor's faulty

workmanship had to be repaired or replaced. The allegedly defective work was faulty work performed by the named insured. The Court stated that the term "occurrence" does not include the "normal, expected consequences of poor workmanship." Mogavero, 640 F.Supp at 86.

In summary, in accordance with the most recent relevant analysis from the Maryland intermediate appellate court in a case dealing in the construction context, damages arising out of faulty workmanship are not a covered "occurrence." If it were, in accordance with the Lerner analysis, then the CGL policy at issue in this matter would function as a performance bond or warranty rather than a liability policy. Simply put, "poor performance by an insured is a cost of doing business, not a component of the insurance objective of shifting risk." Lerner, 707 A.2d at 912 (citing

Robert Franco, Insurance Coverage for Faulty Workmanship Claims Under Commercial General Liability Policies, 30 Tort & Ins. L.J. 785, 786-87 (1995)).

It is clear that under Lerner, contractors, when they agree to construct a building, expect that they will have to erect the building in a proper manner, and that they further expect that if they do not do so, they will have to repair any defects in their work so as to "deliver" the work product that they promised to provide. Accordingly, as a matter of law, the costs of repair and replacement which arose out of a contractual relationship and which formed the basis of the underlying judgment against the assured, Wellington, were damages which were "expected" by the assured and were not "Property damages" caused by an "occurrence" as required by the Continental CGL policy. These repair and replacement damages, under the clear pronouncement of Lerner, which was the controlling legal authority before the District Court at the time of the ruling on the Motion to Reconsider, were, as a matter of law, not covered under the Continental policy. It was reversible error for the Court not to have so ruled.

In accordance with the holding in Lerner, the Court should have reconsidered its Order of March 31, 1998, in view of the Maryland intermediate appellate court's ruling that Sheets does not alter the long standing Maryland law as articulated in Woodfin, Mogavero, and Century I, that the costs of the repair and replacement of faulty construction not covered under a standard ISO policy in that the damages for such costs do not constitute "Property damage" which was not expected caused by an "occurrence" under the provisions of a CGL policy.

CONCLUSION

The consequential economic damage(s) awarded to Appellee in the state court action do not meet the definition in the insurance contract of "***Property damage***" ***caused by an occurrence*** in that they ***constituted consequential economic*** damages which were

the measure of damages awarded by the jury for the breach of warranties and violation of the Maryland Consumer Protection Act, and not "Property damage" as required for indemnity coverage under the CGL policy provisions.

Nor did the damages awarded by the jury meet the policy coverage requirement that the property damage be *caused by* an "occurrence" as defined in the policy. The breaches of warranty and the violation of the Consumer Protection Act which were made by the insured at the time of the sale of the Condominium units *did not cause* the goods, services, and/or materials to deteriorate causing "**Property damage**" as defined and as required by the terms of the policy, but rather form the basis of a claim for economic damages which resulted from the failure of the goods, services and/or materials to measure up to the quality of the goods, services and/or materials as represented. Moreover, there is no *causal connection* between the Breach of Warranty and violation of the Consumer Protection Act causes of action and the resulting consequential damages awarded by the jury in the underlying action and the "Property damage(s)" for which coverage is otherwise provided under the terms and provisions of the insurance contract. App. 795. These consequential damages were not caused by an "occurrence" under the policy, are not "Property damage" as defined in the policy, and are not damages covered under the CGL policy issued to the insured by Continental.

A CGL policy is only intended to grant coverage for damage to property which has been "physically injured" and which was *caused by an unexpected* happening. The insured's work or products which are defective or which require removal or replacement because they do not measure up to that which was promised, either in an express or implied warranty, or as required by statutory provisions, such as provided for in a consumer protection statute, do not constitute "**Property damage**" which has been *physically injured* because there is no damage to property other than the faulty workmanship itself. CGL coverage is not intended to cover normal *business risks* which do not "accidentally" cause "Property damage" to others to occur.

Additionally, like most policies of commercial general liability insurance, the Continental CGL policy issued to Wellington excludes Wellington's **faulty workmanship** from coverage. The rationale for such exclusions is that the **faulty workmanship** is not an insurable "*fortuitous event*," but a *business risk* to be born by the insured. The purpose of the exclusions in the policy which are referred to as "*business risk exclusions*," is to exclude from coverage damages to the insured's work or product and to remove any obligation of the Insurer to pay for the *repair or replacement* of the insured's own defective work or defective product. To hold otherwise would transform Continental's policy into that of a performance bond, which was clearly not its intent.

The Continental policy's *business risk exclusions* effectively exclude indemnity coverage for Wellington arising out of the jury verdict in favor of Lord's Landing in the underlying litigation. These "business risk" exclusions are intended to exclude from coverage the ordinary contractual risk that a product will fail to live up to its expected performance and will require repair or replacement, and were designed to make the insured responsible for predictable and limited business risks, while protecting the insured against catastrophe. All claims of damage which arose out of the, and during the, operations of Wellington are excluded under exclusion (j) irrespective of whose work was being performed, i.e., whether the work of Wellington, a contractor or a subcontractor. With respect to all claims which are included in the completed operations hazard, they are excluded under exclusion (l) to the extent that the damage arose out of the work of Wellington or any part of it. Lastly, all property damage claims arising out of the faulty workmanship in the instant case are excluded under exclusion (m) irrespective of whether the damage occurred during the operations of Wellington or thereafter, and irrespective of whether the faulty workmanship was performed by Wellington or by anyone on its behalf. Accordingly, under the terms and provisions of the Continental CGL policy issued to Wellington Homes, the "business risk exclusions" effectively exclude coverage for the indemnity of Wellington arising out of the jury verdict in favor of Lord's Landing in the underlying litigation.

It constituted reversible error for the court to have adjudicated the factual issues of material import with respect to the applicability, of the "business risk exclusions," inclusive of the subcontractors exception to the exclusion, in granting summary judgment to Appellee, as it was the trial court's duty to make all inferences of fact and inferences fairly deducible therefrom in favor of Appellant in connection with the adjudication of the Cross Motion for Summary Judgment.

Finally, the Lerner court articulated in its analysis the most recent pronouncement of Maryland law on the coverage afforded under a CGL policy for the faulty workmanship of a developer and in so doing it distinguished Sheets predicated its decision upon its interpretation and application of Maryland law. The Lerner court's ruling that Sheets does not alter the long standing Maryland law as articulated in Woodfin, Mogovero, and Century I, that the *costs of the repair and replacement of faulty construction are not covered under* the Continental CGL policy, in that the damages for such costs represent *economic damages* and do not constitute "Property damage" caused by an "occurrence" under the provisions of a CGL policy, is determinative of the issues presented herein.

Under the clear pronouncement of Maryland law, as enunciated by Lerner and followed by Harbor Court, CGL Insurance policies do not provide coverage to a developer who has breached warranties or who has violated consumer protection laws.

Accordingly, under the terms and provisions of the Continental CGL policy issued to Wellington Homes, it is clear no coverage for indemnification is provided to Wellington in the instant case as a consequence of its breach of implied and express warranties and its misrepresentations of the quality, useful life and characteristics of the individual units and common elements of Lord's Landing Condominiums and Continental is entitled to a judgment as a matter of law.

Lerner makes it clear that the Sheets decision has been distinguished from the coverage issues presented in the instant case, and that Lerner, not Sheets, is dispositive of the coverage issues presented. The initial ruling of the District Court and the Fourth Circuit Court of Appeals was correct. The summary judgment originally entered on behalf of Continental, which provided that there was no coverage under the CGL policy for the judgment rendered in favor of Lord's Landing Condominiums for breach of warranties and for misrepresentations as to the quality, useful life or characteristics of the condominium project developed by Continental's insured, was also correct. This initial ruling ought not to have been disturbed on remand by virtue of the Sheets decision.

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