IN THE SUPERIOR COURT OF PENNSYLVANIA
DOCKET NO. 1420 EDA 2007

MILLERS CAPITAL INSURANCE COMPANY

Plaintiff/Appellee,

v.

GAMBONE BROTHERS DEVELOPMENT CO., INC., CONTINENTAL REALTY CO., WHITPAIN ASSOCIATES, L.P., MARGERY AND THOMAS CAPUTO

Defendants/Appellants,

MILLERS CAPITAL INSURANCE COMPANY

Plaintiff/Appellee,

v.

GAMBONE BROTHERS DEVELOPMENT COMPANY, GAMBONE BROTHERS CONSTRUCTION COMPANY, GAMBONE BROTHERS ORGANIZATION, INC., GAMBONE BROTHERS ENTERPRISES, INC., GAMBONE DEVELOPMENT COMPANY, GAMBONE CONSTRUCTION COMPANY, CONTINENTAL REALTY COMPANY, CHRISTOPHER AND AMY COLOIAN, SCOTT AND LAURA DILLMAN, MARK LEVY AND MAUREEN FITZGERALD, AND GEORGE AND ELIZABETH SEES

Defendants/Appellants.

BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS SUBMITTED IN SUPPORT OF APPELLANTS

Appeal from Orders of the Court of Common Pleas of Montgomery County, Pennsylvania, Civil Division, No. 05-26385, dated May 1, 2007

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Dated: August 13, 2007

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INTEREST OF *AMICUS CURIAE*

United Policyholders was founded in 1991 and is a non-profit organization dedicated to educating the public on insurance issues and consumer rights. It protects the interests and presents the positions of policyholders through participation as *amicus curiae* in insurance coverage cases throughout the country. The organization is tax-exempt under Internal Revenue Code § 501(c)(3) and is funded by donations and grants from individuals, businesses and foundations.

In addition to serving as a resource for insurance claims by disaster victims and commercial insureds, United Policyholders actively monitors legal and marketplace developments affecting the interests of all policyholders. United Policyholders receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues.

A diverse range of policyholders and policyholder advocates communicate on a regular basis with United Policyholders. This allows United Policyholders to submit important and topical information to courts throughout the country via the submission of *amicus* briefs. United Policyholders participates as *amicus curiae* in cases that involve insurance principles that are likely to affect large segments of the public. United Policyholders' growing reputation as a source of useful information for appellate courts was confirmed when its *amicus curiae* brief was cited in the United States Supreme Court's opinion in Humana v. Forsyth, 525 U.S. 299 (1999), and its arguments were adopted by the California Supreme Court in Vandenberg v. Superior Court, 88 Cal. Rptr.2d 366 (Cal. 1999). In Vandenberg, the court rejected the line of California cases that gave birth to the erroneous notion that commercial general liability ("CGL") insurance policies do not cover liabilities arising from breach of contract. See discussion infra at 23-24.

STATEMENT OF JURISDICTION

Amicus Curiae United Policyholders adopts and incorporates by reference Appellants' Statement of Jurisdiction.

STANDARD OF REVIEW

Amicus Curiae United Policyholders adopts and incorporates by reference Appellants' statement concerning the appropriate Standard of Review.

ORDERS IN QUESTION

The Orders in question were entered on May 1, 2007. They are included in the Reproduced Record (1a - 4a) and provide as follows:

A. Coloian Order

> AND NOW, this 1st day of May, 2007, upon consideration of Plaintiff Millers Capital Insurance Company's Motion for Partial Summary Judgment, including its Briefs and supporting exhibits and any opposition thereto, for a Declaration that the Claims in the Coloian Action, do not constitute "occurrences" under Millers Capital Insurance Policies, IT IS HEREBY ORDERED AND DECREED that Plaintiff's Motion for Partial Summary Judgment is GRANTED.
>
> IT IS FURTHER ORDERED AND DECREED that the underlying claims that are the subject of the Final Arbitration Award against Gambone Brothers Development Company in *Coloian, et al. v. Gambone Bros. Development Co.*, et al., Chester County Court of Common Pleas, Case No. 03-09386, do not constitute "occurrences" as that term is defined in Insurance Policies Nos., 648507, 616739, and 628468 issued by Millers Capital Insurance Company.
>
> IT IS FURTHER ORDERED AND DECREED that under the terms of these policies, Millers Capital Insurance Company had no duty to indemnify Gambone Brothers Development Company against any part of the Final Arbitration Award.

B. Caputo Order

> AND NOW, this 1st day of May, 2007, upon consideration of the Motion for Partial Summary Judgment on Policy Interpretation of Defendants Gambone Brothers Development Company and Whitpain Associates, supporting brief and exhibits, and Plaintiff Milles [sic] Capital Insurance Company's opposition thereto, and upon consideration of Plaintiff Millers Capital Insurance Company's Cross-Motion for Partial Summary Judgment for a Declaration that it has No Duty

to Defend the Caputo Claim, its brief and supporting exhibits, and any opposition thereto, it is HEREBY ORDERED AND DECREED as follows:

1. The Motion for Partial Summary Judgment on Policy Interpretation of Defendants Gambone Brothers Development Company and Whitpain Associates is DENIED;

2. Millers Capital Insurance Company's Cross-Motion for Partial Summary Judgment is GRANTED and it is FURTHER ORDERED AND DECREED that the underlying Caputo claim against Gambone Brothers Development Company, Whitpain Associates and Continental Realty Company, pending in the Montgomery County Court of Common Pleas, Case No. 04-26061, does not arise out of an "occurrence" as that term is defined in Insurance Policies Nos. 648507, 616739, and 628468 issued by Millers Capital Insurance Company. It is FURTHER ORDERED AND DECREED that under the terms of these policies, Millers Capital Insurance Company had no duty to defend or indemnify Gambone Brothers Development Company, Whitpain Associates or Continental Realty Company in connection with the underlying Caputo claim.

QUESTIONS FOR REVIEW

Amicus Curiae United Policyholders adopts and incorporates by reference Appellants' statement of the questions for review by this Court.

STATEMENT OF THE CASE

Amicus Curiae United Policyholders adopts and incorporates by reference Appellants' statement of the case.

SUMMARY OF ARGUMENT

The trial court committed reversible error in entering summary judgment in favor of appellee, Millers Capital Insurance Company ("Millers"). First, the trial court failed to ascertain the intent of the parties as manifested in the language of their insurance policies, which must be read in their entirety. The trial court also failed to consider the evidence of custom and usage in the insurance industry and the policyholders' reasonable expectation of coverage as mandated by Pennsylvania law. Following these fundamental rules governing the interpretation and construction of insurance policies, leads inescapably to the conclusion that the underlying claims of faulty workmanship constitute an "occurrence" covered under the applicable insurance policies.

Second, the trial court misapplied the Supreme Court's recent decision in Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Insurance Co., 589 Pa. 317, 908 A.2d 888 (2006). Contrary to the conclusion reached below, the Supreme Court did not hold that a claim for faulty workmanship can never constitute covered "occurrence." Where, as here, faulty workmanship results in injury or damage to something other than the work product alone, there is a covered "occurrence."

Thus, for these reasons, *amicus curiae*, United Policyholders, supports the appeal of Appellants and respectfully requests this Court to reverse the summary judgment Orders entered by the trial court.

ARGUMENT

A. The Trial Court Committed Reversible Error By Failing To Apply Pennsylvania Law Governing The Interpretation And Construction Of Insurance Policies

In ruling that "claims for breach of contract and breach of warranty for faulty construction do not constitute 'occurrences' necessary to trigger coverage under the applicable Millers insurance policies" (10a), the trial court erred by failing to apply long-established Pennsylvania law governing the interpretation and construction of insurance policies.

The goal underlying a court's interpretation of an insurance policy is "to ascertain the intent of the parties as manifested by the language of the written instrument." Madison Constr. Co. v. Harleysville Mut. Ins. Co., 557 Pa. 595, 606, 735 A.2d 100, 106 (1999). Indeed, the "polestar" in ascertaining the intent of the parties, "is the language of the insurance policy." Id. In this regard, "an insurance policy must be read in its entirety, and its words are to be given their plain and proper meanings." Monti v. Rockwood Ins. Co., 303 Pa. Super. 473, 475, 450 A.2d 24, 25 (1982) (citations omitted); see also Mutual of Omaha Ins. Co. v. Bosses, 428 Pa. 250, 254, 237 A.2d 218, 220 (1968) (treating provisions of an insurance policy as "meaningless surplusage" violates the "cardinal principle of interpretation that an insurance policy must be construed in such a manner as to give effect to all of its provisions") (citation omitted); Sykes v. Nationwide Mut. Ins. Co., 413 Pa. 640, 643, 198 A.2d 844, 848 (1964) ("in interpreting a contract, effect must be given to all provisions in the contract") (citation omitted). Contractual terms are ambiguous, and must be construed in favor of the insured, "if they are subject to more than one reasonable interpretation when applied to a particular set of facts." Madison Construction Co., 557 Pa. at 606, 735 A.2d at 106 (citation omitted).

Equally important, "custom in the industry or usage in the trade is always relevant and admissible in construing commercial contracts and does not depend on any obvious ambiguity in the words of the contract." Sunbeam Corp. v. Liberty Mut. Ins. Co., 566 Pa. 494, 501, 781 A.2d 1189, 1193 (2001). The consideration of custom or usage evidence concerning the special meaning accorded insurance policy language does not violate the parol evidence rule; "the parol evidence rule does not apply in its ordinary strictness where the existence of a custom or usage to explain the meaning of a writing is concerned." Id.

Finally, any interpretation of an insurance policy must accord with the policyholder's reasonable expectation of coverage. Tonkovic v. State Farm Mut. Auto. Ins. Co., 513 Pa. 445, 456-57, 521 A.2d 920, 926 (1987). As held by the Supreme Court, "regardless of the ambiguity or lack thereof, inherent in a given set of insurance documents...the public has a right to expect that they will receive something of comparable value in return for the premium paid." Id.

The trial court failed to apply these fundamental rules governing the interpretation and construction of insurance policies.

First, the trial court focused improperly on a single provision -- the "occurrence" definition -- to the exclusion of all other policy provisions, in determining whether a claim arising from faulty workmanship constitutes an "occurrence" covered under a commercial general liability ("CGL") insurance policy. Interpretation of the CGL policies at issue, in their entirety, leads unquestionably to the conclusion that the underlying claims for faulty workmanship gave rise to a covered "occurrence."

Second, the trial court failed to consider custom and usage in the insurance industry, as it relates to the coverage afforded by CGL insurance policies for claims arising from faulty workmanship. Consideration of that evidence, including the insurance industry's promulgation

of specific policy language dealing with the faulty work of policyholders and their subcontractors, again demonstrates that the underlying claims for faulty workmanship constitute a covered "occurrence."

Third, the trial court failed to interpret the CGL insurance policies in accordance with the policyholders' reasonable expectation of coverage. Here, the policyholders, like contractors throughout the country, paid significant, additional premiums for protection from liabilities arising out of the work of their subcontractors, and the trial court vitiated that insurance without any consideration of the policyholders' reasonable expectation of coverage.

When these rules governing the interpretation and construction of insurance policies are applied properly, it is plainly evident that the CGL insurance policies at issue in this case cover the underlying claims for faulty workmanship.

1. When Read In Their Entirety, As Required, The CGL Insurance Policies At Issue In This Case Unquestionably Cover The Underlying Claims For Faulty Workmanship

Notwithstanding Pennsylvania law dictating that the "polestar" of insurance policy interpretation is the language of the insurance policy, which must be read in its entirety, the trial court disregarded virtually all of the relevant language of the CGL policies and focused its interpretation on a single provision -- the "occurrence" definition. By interpreting the "occurrence" definition in a vacuum, without consideration of all of the policy terms bearing on the coverage provided under CGL policies for claims of faulty workmanship, the trial court committed a clear error of law mandating reversal of the two summary judgment orders entered below.

When the CGL policies at issue are read in their entirety and effect is given to all policy provisions, it is plainly evident that a claim for faulty workmanship does constitute an

"occurrence" covered under CGL insurance policies, unless an express exclusion bars such coverage. The Insuring Agreement of the CGL policies at issue in this case provide that the insurer "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." (407a).

The CGL policies provide further that,

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;"

(407a). The term "occurrence" is defined as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions." (428a).

Specific coverage for liabilities arising out of a policyholder's "work" is found in the "Products-completed operations hazard." "A completed operations hazard provision insures a general contractor against certain risks that occur after a construction project is finished and is in the owner's control." Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co., 864 F.2d 648, 649 (9th Cir. 1988). The "Products-completed operations hazard" is defined to include "all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work.'" (428a; emphasis added). The phrase "your work" is defined as follows:

"Your work"

a. Means:

(1) Work or operations performed by you or on your behalf; and

(2) Materials, parts or equipment furnished in connection with such work or operations.

b. Includes:

(1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of 'your work"; and

(2) The providing of or failure to provide warnings or instructions.

(430a).

Thus, when the "Products-completed operations hazard" is read in conjunction with the Insuring Agreement of the CGL policies, there is insurance for all bodily injury and property damage arising out of work performed by the insured or anyone acting on the insured's behalf, including any warranties or representations concerning the insured's work. The plain meaning of the operative policy language of the CGL policies completely contravenes the trial court's conclusion that the underlying claims of property damage arising from faulty workmanship did not constitute a covered "occurrence."

To be sure, the CGL policies at issue also contain various exclusions that limit coverage for liabilities arising out of the policyholder's "work" and "products." Those exclusions, (commonly referred to as the "business risk" exclusions), however, contain certain exceptions that are applicable in these circumstances.

Notwithstanding the specific language of the "business risk" exclusions and their corresponding exceptions, however, the very existence of those exclusions serves as further proof that a claim arising out of faulty workmanship constitutes an "occurrence" covered under CGL insurance policies. As this Court has held, "[e]xclusions, by their very nature, are designed to operate to deny coverage that otherwise would be provided under the definition of an occurrence." Donegal Mut. Ins. Co. v. Baumhammers, 893 A.2d 797, 819 (Pa. Super. 2006). There would be no need for these "business risk" exclusions unless a claim for faulty workmanship constituted a covered "occurrence" in the first instance.

The Wisconsin Supreme Court acknowledged this same principle in the specific context of the "business risk" exclusions:

> If, as [the insurer] contends, losses actionable in contract are never CGL "occurrences" for purposes of the initial coverage grant, then the business risk exclusions are entirely unnecessary. The business risk exclusions eliminate coverage for liability for property damage to the insured's own work or product-liability that is typically actionable between the parties pursuant to the terms of their contract, not in tort. If the insuring agreement never confers coverage for this type of liability as an original definitional matter, then there is no need to specifically exclude it. Why would the insurance industry exclude damage to the insured's own work or product if the damage could never be considered to have arisen from a covered "occurrence" in the first place?

American Family Mut. Ins. Co. v. American Girl, Inc., 673 N.W.2d 65, 78 (Wis. 2004) (emphasis added).[1] The question posed by the Wisconsin Supreme Court in the final sentence of the above referenced quote from American Family is rhetorical and the answer is compelled by Pennsylvania law; the insurance industry promulgated the "business risk" exclusions because claims arising out of faulty work and products otherwise constitute a covered "occurrence." Baumhammers, 893 A.2d at 819. When the trial court failed to consider the import of the "business risk" exclusions and their corresponding exceptions, it failed to apply Pennsylvania law which requires the reading of insurance policies in their entirety. See, e.g., Monti, 303 Pa. Super. at 475, 450 A.2d at 25.

Furthermore, the trial court misstated Pennsylvania law when it declared, "policy exclusions are considered only [i]f an insured first meet[s] its burden of showing that a claim falls within the policy's affirmative grant of coverage." (10a). In support of that proposition, the trial court relied on General Accident Insurance Co. of America v. Allen, 547 Pa. 693, 692 A.2d 1089 (1997), and Sclabassi v. Nationwide Mutual Insurance Co., 789 A.2d 699 (Pa. Super.

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[1] Although the Pennsylvania Supreme Court disagreed with the ultimate holding in American Family, see Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Insurance Co., 589 Pa. 317, 335 n.9, 908 A.2d 888, 899 (2006), the relevance of exclusions recognized by the American Family court is entirely consistent with Pennsylvania law. See Baumhammers, 893 A.2d at 819.

2001), appeal denied, 568 Pa. 722, 797 A.2d 915 (2002). Yet, neither the Allen nor Sclabassi courts reached the holding ascribed to them by the trial court below. The trial court's reliance on Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Insurance Co., 589 Pa. 317, 908 A.2d 888 (2006), in support of its refusal to interpret the CGL policies in their entirety (including the "business risk" exclusions) is equally misplaced. (11a). In Kvaerner, the Supreme Court held simply that in the absence of a covered "occurrence" a court need not consider whether coverage for a given loss is also precluded by insurance policy exclusions. Kvaerner, 589 Pa. at 336, 908 A.2d at 900. The Kvaerner court never addressed the issue of whether insurance policies must be interpreted in their entirety, which has long been the rule in Pennsylvania.

Turning to the language of the relevant "business risk" exclusions, there is an express exclusion for "Damage to Your Work" (Exclusion l.) that provides, in full, as follows:

> l. Damage to Your Work
>
> "Property 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 subcontractor.**

(413a; emphasis added). As reflected in the highlighted portion of Exclusion l., property damage to the policyholder's "work" falls outside of the "Damage to Your Work" exclusion and remains covered if, as in this case, "the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." Here, the underlying complaints allege expressly that the work performed by subcontractors contributed to the damage sustained by the underlying plaintiffs. (See, e.g., 295-96a) ("the materials and workmanship provided and supplied by other defendants and various subcontractors contributed to the damage to Plaintiffs' homes....").

Indeed, all of the work that may have caused the underlying water damage was performed by subcontractors. See Appellants' Brief at 8-9 (citing 1328a-1388a).

The trial court's conclusion that the underlying faulty workmanship claims do not constitute a covered "occurrence" is belied further by Exclusion j. ("Damage to Property") and the express exceptions to that exclusion. Exclusion j. provides, in pertinent part, as follows:

> j. Damage to Property
>
> "Property damage" to:
>
> * * *
>
> (2) Premises you sell, give away or abandon, if the "property damage" arises out of any part of those premises;
>
> * * *
>
> (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations; or
>
> (6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.
>
> * * *
>
> **Paragraph (2) of this exclusion does not apply if the premises are "your work" and were never occupied, rented or held for rental by you.**
>
> Paragraphs (3), (4), (5) and (6) of this exclusion do not apply to liability assumed under a sidetrack agreement.
>
> **Paragraph (6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard."**

(685-86a; emphasis added).

As an initial matter, paragraphs (5) and (6) of Exclusion j. are carefully crafted to apply only to that "particular part of property" that is being worked on or which must be restored,

repaired or replaced because of faulty work. To the extent that faulty work damages property other than that "particular part of property," the exclusions are inapplicable.[2]

Additionally, the exceptions to paragraphs (2), (5) and (6) are applicable. In accordance with the exception to paragraph (2) of Exclusion j., the exclusion is not applicable if the premises at issue are "your work" and "were never occupied, rented or held for rental by you." The homes at issue here certainly qualify as the policyholders' "work"[3] and there is no allegation that those homes were ever occupied, rented or held for rental by the policyholders. Thus, the underlying allegations fall squarely within the exception to paragraph (2) of Exclusion j. and are, therefore, covered.

Moreover, paragraph (5) of Exclusion j. is inapplicable because the alleged damage occurred after the homes were sold and, therefore, after the policyholders and their subcontractors ceased "performing operations." (295a).

Finally, paragraph (6) of Exclusion j. is also inapplicable because the alleged property damage arising from the policyholders' "work" is included in the "Products-completed operations hazard," and, therefore, falls within the express exception to the exclusion. Again, the "Products-completed operations hazard" applies to "all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work.'" (428a).

The foregoing analysis of the language of the CGL policies (the "polestar" of insurance policy interpretation) serves as a powerful illustration that the underlying claims for faulty

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[2] See discussion infra at 19 for a fuller discussion of the "that particular part of property" phrase.

[3] The phrase "Your Work" is defined to include, "work or operations performed by you or on your behalf." (430a).

workmanship constitute covered "occurrences." The failure of the trial court to analyze this policy language was a clear of error of law.

The trial court's further conclusion that breach of contract and breach of warranty claims cannot constitute an "occurrence" covered under the applicable CGL policies (10a), is equally controverted by the language of the CGL policies. As discussed above, "all bodily injury and property damage" arising out of the policyholders' "work" is insured in accordance with "Products-completed operations hazard." (428a-429a). The phrase "your work" is defined explicitly to include "warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of 'your work.'" (430a). Thus, the CGL policies at issue expressly insure all "bodily injury" or "property damage" arising out of breach of warranty. Indeed, this Court has acknowledged that a CGL policy provides coverage for property damage arising out of a breach of warranty. See Ryan Homes, Inc. v. Home Indem. Co., 436 Pa. Super. 342, 349, 647 A.2d 939, 942 (1994) ("So if the insured's breach of an implied warranty results in damage to property *other* then the insured's work or product which is excluded by exceptions..., the policy would provide coverage.") (quoting Dodson v. St. Paul Ins. Co., 812 P.2d 372, 378 (Ok. 1991)) (emphasis and alteration in original).

The applicable CGL policies also contain various exclusions for claims (with applicable exceptions) arising from contract. The inclusion of those exclusions for claims arising out of contract demonstrates that such claims can give rise to a covered "occurrence." See Baumhammers, 393 A.2d at 819.

For example, the CGL policies at issue here contain a "contractual liability" exclusion that purports to bar coverage for "'bodily injury' or 'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement."

(408a-409g). This exclusion for "contractual liability," however, is inapplicable to: (1) liability that the insured would have in the absence of the contract and (2) liability assumed in an "insured contract."[4] (Id.). Again, there would be no need for this "contractual liability" exclusion unless liabilities arising out of contracts were covered in the first instance. See Baumhammers, 893 A.2d at 819.

The CGL policies also contain a so-called "impaired property" exclusion that provides as follows:

> m. Damage to Impaired Property or Property Not Physically Injured
>
> "Property damage" to "impaired property" or property that has not been physically injured, arising out of:
>
> (1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or
>
> (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.
>
> This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.[5]

(413a). The fact that there is a specific exclusion for certain property damage that arises from a "delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms," establishes that a liability arising from a delay or failure to perform a contract does constitute a covered "occurrence." If not, there would be no need for the exclusion.

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[4] The phrase "insured contract" is defined to include, "[t]hat part of another contract or agreement pertaining to your business...under which you assume the tort liability of another party to pay for 'bodily injury' or 'property damage' to a third person or organization." (426a).

[5] The "impaired property" exclusion is inapplicable because the property that was damaged is neither (1) "impaired property" nor (2) property not physically injured.

In all, the trial court erred when it failed to interpret the CGL policies in their entirety as required under Pennsylvania law. Rather than focusing exclusively on the "occurrence" definition, the trial court should have considered all of the provisions of the CGL policies, including those provisions that deal specifically with liabilities arising out of faulty work. When the CGL policies are interpreted in their entirety, as required, it is readily apparent that property damage arising out of a faulty workmanship claim does constitute a covered "occurrence," and the trial court erred when it concluded otherwise.

2. The Evidence Of The Custom And Usage In The Insurance Industry Proves That CGL Insurance Policies Were Designed Intentionally To Cover Claims For Faulty Workmanship

As discussed in the preceding section, CGL insurance policies contain various "business risk" exclusions and well-defined exceptions to those exclusions. Those "business risk" exclusions and corresponding exceptions are the product of drafting, refinement and explanation by the insurance industry over the course of many years. When this historical evidence of custom and usage in the insurance industry is considered, the fact that CGL insurance policies cover claims arising from faulty workmanship becomes even more inescapable.

The Supreme Court recently addressed the appropriate consideration of this precise type of custom and usage evidence:

> In the law of contracts, custom in the industry or usage in the trade is always relevant and admissible in construing commercial contracts and does not depend on any obvious ambiguity in the words of the contract. If words have a special meaning or usage in a particular industry, then members of that industry are presumed to use the words in that special way, whatever the words mean in common usage and regardless of whether there appears to be any ambiguity in the words.
>
> > [T]he parol evidence rule does not apply in its ordinary strictness where the existence of a custom or usage to explain the meaning of words in a writing is concerned. Where terms are used in a contract which are known and understood by a particular class of

> persons in a certain special or peculiar sense, evidence to that effect is admissible for the purpose of applying the instrument to its proper subject matter.... [I]n the absence of an express provision to the contrary, custom or usage, once established, is considered a part of a contract and binding on the parties though not mentioned therein, the presumption being that they knew of and contracted with reference to it.

Resolution Trust Corp. v. Urban Redevelopment Auth'y, 536 Pa. 219, 638 A.2d 972, 975-76 (1994). This is consistent with the Restatement (Second) of Contracts § 202(5), rules in aid of construction, which states: "Wherever reasonable, the manifestations of intention of the parties to a promise or agreement are interpreted as consistent with each other and with any relevant course of performance, course of dealing, or usage of trade." Comment d to Restatement (Second) of Contracts § 220 is apropos:

> There is no requirement that an ambiguity be shown before usage can be shown, and no prohibition against showing that language or conduct have a different meaning in the light of usage from the meaning they might have apart from the usage. The normal effect of a usage on a written contract is to vary its meaning from the meaning it would otherwise have.

Sunbeam Corp. v. Liberty Mut. Ins. Co., 566 Pa. 494, 501-02, 781 A.2d 1189, 1193 (2001) (alterations in original) (emphasis added).

In Sunbeam, the Court found reversible error when the courts below failed to consider the import of a 1970 insurance industry memorandum explaining the "sudden and accidental" exception to a pollution exclusion. Sunbeam, 566 Pa. at 502-04, 781 A.2d at 1193-95. The Supreme Court explained that, notwithstanding this Court's previous interpretation of the common meaning of the phrase "sudden and accidental," it was error to refuse consideration of that phrase's "special usage in the trade." Id. The trial court below committed a similar reversible error when it failed to consider the drafting history of the relevant insurance policy provisions at issue in this case, along with the insurance industry's explanations of those provisions.

The CGL insurance policies at issue in this case are the product of standard forms drafted by the insurance industry. Today, CGL insurance in the United States is written on standard forms developed by the Insurance Services Office ("ISO"[6]). Hartford Fire Ins. Co. v. California, 509 U.S. 764, 772 (1993); see also Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Ins. Co., 825 A.2d 641, 648 n.6 (Pa. Super. 2003), rev'd on other grounds, 589 Pa. 317, 908 A.2d 888 (2006) ("Kvaerner") ("The language of the CGL policies at issue in this case is in most instances identical to the language used in CGL policies throughout the U.S.").

The current form of the CGL insurance policy was promulgated in 1986. American Family, 673 N.W.2d at 74. The "business risk" exclusions for damage arising from a policyholder's "work" and "products" were included in the CGL insurance policy as early as 1973. See C. Shapiro, Further Reflections-Inadvertent Construction Defects Are An "Occurrence" Under Commercial General Liability Policies, 686 PCI/Lit 73 (2003) (included in the Reproduced Record at 783a-803a). Those exclusions provided, at that time, as follows:

> This insurance does not apply to
>
> (n) property damage to the named insured's products arising out of such products or any part of such products;
>
> (o) property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof; or out of materials, parts or equipment furnished in connections therewith.

Id. at 785a.

Beginning in 1976, policyholders could purchase, for additional premium, an endorsement to the 1973 CGL policy known as the Broad Form Property Damage Endorsement.

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[6] ISO is "an association of approximately 1,400 domestic property and casualty insurers... [and] is the almost exclusive source of support services in this country for CGL insurance. ISO develops standard policy forms and files or lodges them with each State's insurance regulators; most CGL insurance written in the United States is written on these forms." Hartford Fire Ins. Co. v. California, 509 U.S. 764, 772 (1993) (citations omitted).

(Id. at 785a). The Broad Form Property Damage Endorsement effectively narrowed the scope of the property to which the exclusions applied. Id. at 786. Exclusion (o) of the 1973 CGL policy was deleted and replaced with several other exclusions that broadened the coverage that had been provided under the 1973 CGL policy. Id. With respect to the property to which the exclusions were applicable, the Broad Form Property Damage Endorsement added exclusions d(i), (ii) and (iii). Those exclusions provided as follows:

> (d) To that particular part of any property...
>
> (i) upon which operations are being performed by or on behalf of the named insured at the time of the property damage arising out of such operations; or
>
> (ii) out of which any property damage arises, or,
>
> (iii) the restoration, repair or replacement of which has been made or is necessary by reason of faulty workmanship thereon by or on behalf of the insured.

Id. at 786a.

Importantly, each of the new exclusions applied only "[t]o that particular part of any property." Id. Thus, the exclusion "was carefully crafted not to eliminate insurance coverage for damage to other property caused by defective work." Id.

The Broad Form Property Damage Endorsement was also designed to broaden coverage for property damage arising from the work of subcontractors. (Id. at 786a). In addition to replacing the old exclusion (o), with exclusions d(i), (ii) and (iii), the Broad Form Property Damage Endorsement also included the following exclusion that stated, in pertinent part, as follows:

> This insurance does not apply:
>
> With respect to the completed operations hazard and with respect to any classification stated in the policy or in the company's manual as

> "including completed operations," to property damage to work performed by the named insured arising out of such work or any portion thereof, or out of such materials, parts or equipment furnished in connection therewith.

(Emphasis added). By limiting the ambit of the provision to "property damage to work performed by the named insured" via deleting the phrase "on behalf of the Named insured," the insurance industry intended to extend coverage for claims arising out of work performed by subcontractors. See Maryland Cas. Co. v. Reeder, 270 Cal. Rptr. 719, 724-25 (Cal. Ct. App. 1990); see also Fireguard, 864 F.2d at 650 ("The phrase 'on behalf of' refers to the work of subcontractors."); Corner Constr. Co. v. United States Fidelity and Guaranty Co., 638 N.W.2d 887, 892-93 (S.D. 2002) ("The deliberate omission of the phrase [on behalf of] lends credence to the position that the coverage exclusion in the completed operations hazard provision was only to apply to work performed by the named insured and not to subcontractors"); Fejes v. Alaska Ins. Co., 984 P.2d 519, 525 (Alaska 1999) ("The effect of this deletion is to provide coverage as to work performed for the named insured by subcontractors.").

Indeed, the insurance industry's contemporaneous explanations of the Broad Form Property Damage Endorsement state expressly that it was intended to restore coverage for damage arising from the work of subcontractors. For example, ISO explained that the Broad Form Property Damage Endorsement was intended to: "'exclud[e] only damages caused by the named insured to his own work. Thus,... [t]he insured would have coverage for damage to his work arising out of a subcontractor's work [and] [t]he insured would have coverage for damage to a subcontractor's work arising out of the subcontractor's work.'" Fireguard, 864 F.2d at 652

(emphasis added; alteration in original) (quoting ISO circular[7]); Fejes, 984 P.2d at 525 (same); Reeder, 270 Cal. Rptr. at 725 (same).

A Fire Casualty & Surety Bulletin ("FC&S Bulletin")[8] published by the National Underwriters Association in August 1982 also explained the important broadening of coverage offered by the Broad Form Property Damage Endorsement:

> According to the FC&S bulletin the work performed exclusion as it appears in the broad form endorsement "eliminates coverage for property damage to work performed by the named insured if the property damage arises out of the named insured's work or any portion of it. Thus, an insured *has* coverage for his completed work when the damage arises out of work performed by someone other than the named insured, such as a subcontractor.... The usual Completed Operations coverage (no Broad Form Property Damage endorsement attached) flatly excludes property damage to work performed by *or on behalf* of the named insured arising out of the work. Under the usual coverage, then, the insured has no insurance whatsoever for damage to a subcontractor's work or for damage to his own work for damage resulting from a subcontractor's work. Therein lie the advantages of Broad Form Property Damage coverage including Completed Operations. Consequently, if an insured does not anticipate using subcontractors, the value of purchasing Broad Form Property Damage coverage *with Competed Operations* is questionable, in view of the additional premium required for it."

Fireguard, 864 F.2d at 652 (quoting FC&S Bulletin (August 1982)) (italics in original; underscore added); Reeder, 270 Cal. Rptr. at 725 (same); Corner Constr., 638 N.W.2d at 893 (same); Fejes, 984 P.2d at 525 (same).

Appellate courts throughout the country have relied on these insurance industry explanations in finding coverage for damage arising out of the work of subcontractors. See, e.g., Fireguard, 864 F.2d at 650 ("The language of the policy and the insurance industry's

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[7] ISO "circulars explain the intent, purpose, and effect of the standard form provisions." Fireguard, 864 F.2d at 652. The Pennsylvania Supreme Court relied on a similar insurance industry circular in Sunbeam. See Sunbeam, 566 Pa. at 503, 781 A.2d at 1194.

[8] FC&S Bulletins are used by insurance agents and brokers to interpret standard form insurance policy provisions. Reeder, 270 Cal. Rptr. at 725.

interpretation of these exclusions show that [the insurers] intended to cover losses caused by the work of subcontractors."). The California court of appeal held similarly:

> Like the Ninth Circuit, in the absence of unambiguous policy terms we are not inclined to restrict the risks for which businesses may obtain insurance and insurers may collect premiums. Moreover, as the Fireguard opinion points out, rather than any ambiguity, here there is compelling evidence from the insurance industry itself that the endorsement [the insurer] issued was drafted as a means of covering the very risk [the insurer] seeks to avoid. Accordingly, like the court in Fireguard, we find the broad form endorsement provides coverage for damage claims growing out of services provided by subcontractors retained during development of the condominium project.

Reeder, 270 Cal. Rptr. at 726 (emphasis added).

The provisions of the Broad Form Property Damage Endorsement were thereafter incorporated into the body of the 1986 CGL policy. Corner Constr., 638 N.W.2d at 891 ("In 1986, this CGL policy was amended, essentially incorporating the [Broad Form Property Damage] endorsement section VI(A)(3) into the basic policy as exclusion [l.]"). As discussed, above (supra at 12), Exclusion j. of 1986 CGL policy expressly retained the "that particular part of any property" phraseology set forth in exclusion d(i), (ii) and (iii) of the Broad Form Property Damage Endorsement and has an exception that provides explicitly that the exclusion does not apply "if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." (413a).

The trial court erred when it failed to consider this evidence of custom and usage in the insurance industry, as reflected in the industry's refinement of the "business risks" exclusions over time and the industry's own explanations of coverage. Certainly, this court, in undertaking its *de novo* interpretation of the CGL policies, see 401 Fourth Street v. Investors Ins. Co., 583 Pa. 445, 453, 879 A.2d 166, 170 (2005), should consider this evidence of custom and usage in the insurance industry. When the CGL policies at issue are interpreted properly in light of this

evidence of custom and usage, it is manifestly clear that the underlying claims for faulty workmanship constitute a covered "occurrence," and the trial court's contrary conclusion must be reversed.

3. The Trial Court Failed To Interpret The CGL Insurance Policies In Accordance With The Policyholders' Reasonable Expectation Of Coverage

As made clear by the Supreme Court, the policyholder's reasonable expectation of coverage is the "focal point" of the insurance transaction. Tonkovic, 513 Pa. at 456, 521 A.2d at 926. This is especially so in a case involving liability insurance, like this one:

> If a party purchases liability insurance, that party has a reasonable expectation that it will be provided indemnification for liability imposed upon it. Although the exact scope of the protection purchased may require reference to the policy, and it may not be reasonable to expect complete freedom from liability simply because insurance has been purchased, any inclusion of provisions or interpretation of such provisions that seems to insulate the insurer from liability or to otherwise reduce the scope of coverage, which the policy as a whole purports to extend, would have to be viewed with great skepticism, lest the very nature of the contractual relationship become an illusion.

J.H. France Refractories Co. v. Allstate Ins. Co., 396 Pa. Super. 185, 195, 578 A.2d 468, 473 (1990), aff'd in rel. part, 534 Pa. 29, 626 A.2d 502 (1993) (emphasis added). More specifically, policyholders purchasing CGL insurance have a reasonable expectation of coverage for liabilities arising out of faulty workmanship claims, without regard to whether the underlying claims are pled on a theory of breach of contract or tort. As held by the California Supreme Court, "a reasonable layperson, cognizant that he or she is purchasing a 'general liability' insurance policy, would not conclude such coverage term only refers to liability pled in tort, and thus entirely excludes liability pled on a theory of breach of contract." Vandenberg v. Superior Court, 88 Cal. Rptr.2d 366, 384 (Cal. 1999).

This reasonable expectation of coverage is consistent with the understanding expressed in insurance treatises:

> "[W]hether a particular claim falls within the coverage afforded by a liability policy is not affected by the form of the legal proceeding. Accordingly, the legal theory asserted by the claimant is immaterial to the determination of whether the risk is covered." (9 Couch, Insurance (3d ed. 1997) § 126:3, p. 126-8.) Insurance commentators explain: "The expression 'legally obligated' connotes legal responsibility that is *broad* in scope. It is directed at civil liability ... [which] can arise from either unintentional (negligent) or intentional tort, under common law, statute, or contract." (Malecki & Flitner, Commercial General Liability (6th ed. 1997) p. 6, italics added.") "The coverage agreement [which] embraces 'all sums which the insured shall become legally obligated to pay as damages ...' ... is intentionally broad enough to include the insured's obligation to pay damages for breach of contract as well as for tort, within limitations imposed by other terms of the coverage agreement (e.g. bodily injury and property damage as defined, caused by an occurrence) and by the exclusions...." (Tinker, *Comprehensive General Liability Insurance-Perspective and Overview* (1975) 25 Fed. Ins. Counsel Q. 217, 265.)

Vandenberg, 88 Cal. Rptr.2d at 384 (alterations and emphasis in original).

Beyond this general understanding of CGL insurance, the Appellants also proffered sworn testimony of the Chief Financial Officer for Gambone Development Co. and its insurance agent. Both individuals testified to their reasonable expectation of coverage for the property damage arising from the underlying claims of faulty workmanship. (1474a-1476a; 1480a-1483a).

Procuring insurance coverage for faulty workmanship claims does not come without cost. As discussed above, policyholders pay additional premium for "Product-completed operations" coverage, including coverage for damage resulting from a subcontractor's work. See discussion supra at 21 (quoting Reeder, 270 Cal. Rptr. at 725 ["consequently, if an insured does not anticipate using subcontractors the value of purchasing Broad Form Property Damage coverage *with Completed Operations* is questionable, in view of the additional premium required for it"]. Without question, the Appellants paid substantial, additional premiums for their products and

completed operations coverage, including coverage for damage resulting from the work of subcontractors. (See Appellants' Brief at 14; citing Reproduced Record at 725a-726a; 742a-743a). Having purchased "Products-completed operations" coverage, including coverage for damage resulting from the work of subcontractors, the Appellants (and all similarly situated policyholders) have "a reasonable expectation that [they] will be provided indemnification for liability imposed upon it." J.H. France, 396 Pa. Super. at 195, 578 A.2d at 473.

Notwithstanding this governing rule of insurance policy interpretation, the trial court gave no credence to the policyholders' reasonable expectation of coverage for claims arising from alleged faulty workmanship. The trial court erred when it vitiated that insurance coverage without any consideration of the Appellants' reasonable expectations of coverage.

B. The Trial Court Misapplied The Pennsylvania Supreme Court's Decision In Kvaerner

The trial court misapplied Kvaerner in holding that, "the *Kvaerner* case firmly establishes that claims for faulty workmanship do not constitute an 'occurrence' within the meaning of a general liability policy." (11a; citing Kvaerner, 908 A.2d at 899).

The Supreme Court's opinion in Kvaerner was careful to distinguish between faulty workmanship standing alone and faulty workmanship that results in injury or damage to other property. Kvaerner, 908 A.2d at 898-99. Indeed, the Kvaerner Court quoted approvingly from a prior opinion of this Court, as follows: "[p]rovisions of a general liability policy provide coverage ... if the insured work or product actively malfunctions, causing injury to an individual or damage to another's property." Kvaerner, 908 A.2d at 898 (quoting Snyder Heating v. Pennsylvania Manufacturers' Ass'n Ins. Co., 715 A.2d 483, 485-86 (Pa. Super. 1998)). The Kvaerner Court also cited approvingly to another decision wherein the South Carolina Supreme Court stated that, "a CGL policy may provide coverage where faulty workmanship caused bodily

injury or damage to another property, but not in cases were the faulty workmanship damages the work product alone." Kvaerner, 908 A.2d at 898-99 (citing L.J., Inc. v. Bituminous Fire and Marine Ins. Co., Inc., 621 S.E.2d 33, 36 n.4 (S.C. 2005)) (emphasis added).

The L.J., Inc. court found the analysis by the Supreme Court of New Hampshire helpful in distinguishing between a claim for faulty workmanship standing alone versus a claim for damage to the work product caused by the negligence of a third party. L.J., Inc., 621 S.E.2d at 36 (citing High Country Assocs. v. New Hampshire Ins. Co., 648 A.2d 474 (N.H. 1974)). In High Country, the court held that a CGL insurance policy, like the insurance policies involved in this case, covered property damage resulting from the policyholder's alleged negligent construction:

> The damages claimed are for the water-damaged walls, not the diminution in value or cost of repairing work of inferior quality. Therefore, the property damage described in the amended writ, caused by continuous exposure to moisture through leaky walls, is not simply a claim for the contractor's defective work. Instead, the plaintiff in the underlying suit alleged negligent construction that resulted in property damage, rather than merely negligent construction as in Hull and McAllister.[9] Our decisions in Hull and McAllister, therefore, do not control this case.

High Country, 648 A.2d at 477. Likewise, in this case the underlying plaintiffs seek redress for their water damaged homes, and not simply for the cost of the repairing the faulty subcontractor work that resulted in that water damage.

This crucial distinction was illustrated further in another case cited approvingly by the Supreme Court in Kvaerner. See Kvaerner, 589 Pa. at 335, 908 A.2d at 899 (citing Auto-Owners Insurance Co. v. Home Pride Companies, Inc., 684 N.W.2d 571 (Neb. 2004)). In Auto-Owners, the issue on appeal, as in this case, was whether "a standard commercial general liability

[9] Interestingly, the Kvaerner court relied on the decision by the New Hampshire Supreme Court in McAllister v. Peerless Ins. Co., 474 A.2d 1033 (N.H. 1984), the precise case that the New Hampshire Supreme Court distinguished in High Country.

('CGL') insurance policy covers an insured contractor for faulty workmanship of a subcontractor that it hired." Auto-Owners, 684 N.W.2d at 574. The Supreme Court of Nebraska properly distinguished between faulty workmanship "standing alone" and faulty workmanship that causes bodily injury or property damage to something other than the defective work:

> Important here, although faulty workmanship, *standing alone*, is not an occurrence under a CGL policy, an accident caused by faulty workmanship is a covered occurrence.
>
> * * *
>
> Stated otherwise, although a standard CGL policy does not provide coverage for faulty workmanship that damages only the resulting work product, if faulty workmanship causes bodily injury or property damage to something other than the insured's work product, an unintended and unexpected event has occurred, and coverage exists.

Auto-Owners, 684 N.W.2d at 577-78 (emphasis in original) (citations omitted).

The Auto-Owners court concluded that the underlying complaint alleged a covered "occurrence" where it was alleged that a contractor, through subcontractors, negligently installed shingles on a number of apartments which caused the shingles to fall off and, as a consequence of that faulty work, the roof structures and buildings experienced substantial damage.

> This latter allegation represents an unintended and unexpected consequence of the contractors' faulty workmanship and goes beyond damages to the contractors' own work product. Therefore, the amended petition properly alleged an occurrence within the meaning of the insurance policy.

Id. at 579.

Thus, contrary to the conclusion reached by the trial court, the Kvaerner Court did not hold that a claim for faulty workmanship can never give rise to a covered "occurrence." Rather, the Kvaerner Court held only that faulty work affecting the work product alone does not constitute a covered "occurrence." When, however, the faulty work results in bodily injury or damage to something other than the work product alone, there is a covered occurrence.

In this case, the faulty work by the subcontractors resulted in water infiltration and damage to property other than the work product of the subcontractors. Thus, in accordance with the true holding in Kvaerner, the trial court should have concluded that the underlying complaints did allege a covered "occurrence."

The trial court's reliance on Kvaerner is undermined further by the fact that the Kvaerner Court never addressed the operative insurance policy language at issue in this case, namely: (1) the "Products-completed operations hazard" and (2) the exceptions to the "business risk" exclusions. Indeed, the Kvaerner Court relied on a 1971 law review article that it described as "seminal." See Kvaerner, 589 Pa. at 335 n.10, 908 A.2d 899 n.10 (citing R. Henderson, Insurance Protection for Products Liability and Completed Operations; What Every Lawyer Should Know, 50 Neb. L. Rev. 415 (1971)). Thus, a principle authority upon which the Supreme Court rested its statement that, "the definition of 'accident' required to establish an 'occurrence' under the policies cannot be satisfied by claims based upon faulty workmanship," Kvaerner, 589 Pa. 335, 908 A.2d at 899, was written before the insurance industry refined its CGL policy to specifically insure contractors for property damage resulting from the faulty work of subcontractors, as embodied in the 1976 Broad Form Property Damage Endorsement and the 1986 CGL policy. See discussion supra at 19-22. Notwithstanding the holding in Kvaerner concerning the common meaning of the term "occurrence," the trial court erred when it followed Kvaerner blindly without consideration of the particular policy language at issue in this case and the overwhelming custom and usage evidence indicating that the insurance industry intended the CGL policies at issue to cover the underlying claims for faulty workmanship. See Sunbeam, 566 Pa. at 502-05, 781 A.2d at 1194-95 (lower courts erred when they relied on this Court's prior interpretation of policy language and failed to consider evidence of custom and usage).

For these additional reasons, the trial court misapplied the holding in Kvaerner and, accordingly, its summary judgment Orders should be reversed.

CONCLUSION

For all of the foregoing reasons, *amicus curiae* United Policyholders respectfully requests this Court to reverse the Orders of the trial court and enter summary judgment in favor of the Appellants.

Respectfully submitted,

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