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A Single Construction Defect Lawsuit as Multiple Occurrences: Five Reasons It Just Doesn't Add Up

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For several decades insurers and insureds alike agreed that a construction defect case involved only a single occurrence. Relatively recently, however, some insurers have reversed course and began to argue that each such case involves several occurrences. What precipitated this radical shift in approach? Did insurers alter the fundamental terms of standard general liability policies?

The change in approach can likely be traced to the proliferation of high self-insured retentions ("SIR") in modern general liability policies. Under these policies, an insured must pay a substantial SIR for each occurrence before the insurer provides any coverage.[1] The number of SIRs involved in a given case is therefore inversely correlated to the amount of coverage the carrier must ultimately provide. The more occurrences (and corresponding SIRs) at issue, the less the insurer will pay. So, the per-occurrence SIR creates a perverse incentive for insurers to argue that each case involves multiple occurrences.

For insurers looking to minimize coverage, construction defect cases offer fertile ground and seemingly unbounded opportunity to dissect a single lawsuit into numerous occurrences. Some insurers might argue that each type of alleged defect constitutes a separate occurrence. Others might argue that each *structure* constitutes an additional layer of occurrences and multiply the number of homes by the type of defects alleged in the lawsuit.

Fortunately for policyholders, under California law and the terms of general liability policies, a construction defect case involves just one occurrence.

1. The Number of Occurrences Is Determined by Cause, Not Effect.

To determine the number of occurrences involved in any particular case, California courts use the "cause test," which focuses on the root cause giving rise to a loss. Our courts have correctly concluded that when several homeowners sue a homebuilder for defects, there is one, and only one, cause: alleged faulty construction.

Conversely, insurers arguing multiple occurrences typically cite to the results of the alleged faulty construction, often focusing on the intermediate effect (different types of defects) or the various end results (different types of damage). In any event, the multiple-occurrence argument fails because it seeks to isolate and tally each *effect*

1 The same general multiple occurrence issue applies to policies that use deductibles. However, given the predominance of SIRs in general liability policies, this article focuses on SIRs throughout.

while ignoring the common causality leading to such result.

The basic premise underlying the multiple occurrence argument is fundamentally flawed and antithetical to the law of states, like California, which apply the cause test.

2. Standardized General Liability Terms Aggregate the Effects of Defective Construction Into a Single Occurrence.

General liability policies are "occurrence based" such that coverage is predicated upon an occurrence during the policy period. The term "occurrence" is therefore foundational to all coverage under the policy. The insurance industry has carefully developed a standardized definition of the term "occurrence" to provide the framework upon which coverage turns. The standardized definition, used in nearly all general liability policies, provides that the term "occurrence" means "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

A critical feature of the standard definition in this context is the "funneling effect" for exposure to substantially the same general harmful conditions. The definition aggregates all such exposure into a single accident, and thus a single "occurrence." Thus, by definition, several homes that are damaged by negligent construction performed by several different subcontractors (i.e., the same general harmful conditions) have all been affected by a single occurrence.

Insurers advancing the multiple occurrence argument ignore the collective and plural descriptors that form part of this fundamental definition.

3. Decades of Industry Practice Establish that a Construction Defect Lawsuit Involves a Single Occurrence.

For several decades, insurers have treated each construction defect case as a single occurrence, even though the lawsuits involved property damage from a litany of defects to numerous structures arising from the work of the developer and multiple subtrades. Courts will consider this long history as powerful evidence that both insurers and insureds intended that each construction defect case would be treated as a single occurrence. Waiver and estoppel may well prevent many insurers from raising the argument in the first instance.

Moreover, reversing decades of conduct could have severe unintended consequences that insurers may not have fully considered. If a single construction defect case were suddenly deemed to involve multiple occurrences, insurers will likely face claims from policyholders and coinsurers alike. For example, consider a general liability policy with $2,000,000 each occurrence and $4,000,000 aggregate limits. If a construction defect case resulted in a $3,000,000 judgment, the insurer would have paid its $2,000,000 each occurrence limit and left the remainder for the insured or its excess insurer. If that same construction defect case involved multiple occurrences, the insurer should have paid the entire judgment. Such a dramatic shift would cause exhaustive litigation that would dwarf any perceived benefit from jettisoning the approach agreed to by carriers and their insureds.

4. The Multiple Occurrence Argument Renders Coverage Illusory.

A major conceptual problem with the multiple-occurrence argument is that it lacks any logical end point or boundary. In many cases, insurers initially raise the specter of multiple occurrences without advising the insured exactly how many SIRs they will seek. Insureds are often left to guess the insurer's position, until the parties attempt to discuss settlement, which may be years later. In each case, insureds face the distinct possibility that the insurer will argue that a case involves multiple occurrences, which require the insured pay multiple SIRs which equal or exceed the amount of damages claimed in the case.

The incongruity of this result has not escaped the attention of the courts. As one court noted, "[s]uch an interpretation would produce an absurd, unacceptable result that would render [insurance] meaningless . . . ." (*Stonewall Ins. Co. v. E.I. DuPont de Nemours & Co.* (Del. 2010) 996 A.2d 1254 1258.)

5. SIR Provisions Constitute Limitations on Coverage Which Are Strictly Construed.

SIR provisions operate as a limitation on coverage. Under California law, such limitations are strictly construed against the insurer and liberally in favor of the insured. Furthermore, our courts require that any provision that limits coverage be set forth in a manner that is conspicuous, plain and clear. Such limitations must be stated in precise and understandable words that are part of the working vocabulary of the average lay person.

California courts are unlikely to find that standard general liability terms adequately advise builders that they would be subject to an incalculable number of SIRs in every single construction defect case. Our courts are likely to continue to reject any interpretation that suggests any reasonable insured would willingly agree to pay substantial premiums in return for little to no coverage.

Conclusion

Builders pay significant premiums for insurance and reasonably expect coverage in the event they are sued for construction defects. As the saying goes "forewarned is forearmed." To prevent disputes over the number of occurrences, builders should carefully review their policies and retentions at the onset of a case and be prepared to refute any argument not supported by the policy or the law.

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