CAPSTONE BUILDING CORPORATION *v.* AMERICAN MOTORISTS INSURANCE COMPANY

CAPSTONE DEVELOPMENT CORPORATION *v.* AMERICAN MOTORISTS INSURANCE COMPANY
(SC 18886)

Rogers, C. J., and Norcott, Palmer, Zarella, Eveleigh, Harper and Vertefeuille, Js.*

Argued November 27, 2012—officially released June 11, 2013

Jeffrey J. Vita and *David G. Jordan*, for the appellants (plaintiff in each case).

Tom E. Ellis, with whom were *Susan Evans Jones* and, on the brief, *Deborah Etlinger*, for the appellee (defendant in both cases).

Michael J. Donnelly and *Patrick J. Wielinski*, pro hac vice, filed a brief for the American Subcontractors Association as amicus curiae.

Wystan M. Ackerman filed a brief for the Property Casualty Insurers Association of America as amicus curiae.

Joseph K. Scully filed a brief for the American Insur-

ance Association as amicus curiae.

Opinion

ROGERS, C. J. This case, on certification from the United States District Court for the Northern District of Alabama, Southern Division (District Court), pursuant to General Statutes § 51-199b,[1] presents questions regarding the interpretation of commercial general liability insurance policies under Connecticut law. The plaintiffs, Capstone Building Corporation (Capstone Building) and Capstone Development Corporation (Capstone Development),[2] served, respectively, as the general contractor and the project developer for construction of the Hilltop student housing complex (Hilltop) at the University of Connecticut (UConn). UConn procured a commercial general liability policy for the Hilltop project, which insured the plaintiffs and their work. The defendant, American Motorists Insurance Company (AMICO), is the issuing insurer's successor in interest.[3] The District Court determined that the resolution of the parties' claims depended on propositions of law for which there was no controlling precedent in this court's decisions.

We accepted the following three questions for our consideration, and answer them accordingly: "1. Whether damage to a project contracted to be built, which was caused by defective construction or faulty workmanship associated with the construction project, may constitute 'property damage' resulting from an 'occurrence,' triggering coverage under a commercial general liability insurance policy?"

We conclude that allegations of unintended defective construction work by a subcontractor that damages nondefective property may constitute an "occurrence" resulting in "property damage" under certain circumstances. We also hold, however, that defective work standing alone or repairs to that defective work do not constitute property damage and, therefore, are not covered under the particular insurance policy in the present case. Finally, we hold that work by a contractor, as opposed to a subcontractor, is excluded from coverage under the terms of the policy.

"2. Can an insurer's bad faith conduct in investigating an insurance claim provide a basis for a cause of action for bad faith under Connecticut law?"

We conclude that under the plain language of the insurance policy in the present case, we do not recognize a cause of action based on the insurer's failure to conduct a discretionary investigation of claims for coverage.

"3. Does *Alderman* v. *Hanover Ins. Group*, 169 Conn. 603 [363 A.2d 1102] (1975), apply to pre-suit settlement cases wherein the insurer, under a commercial general liability insurance policy, wrongfully denies coverage, but where only some of the underlying claims should have been covered under the policy?"

We conclude that, in global settlements encompassing multiple claims, the insured has the burden of proving that the settlement is reasonable in proportion to claims that, considered independently, the insurer had a duty to defend.

I

The District Court has provided us with the following facts relevant to resolving these questions.[4] *Capstone Building Corp.* v. *American Motorists Ins. Co.*, United States District Court, Docket No. 2:08-CV-00513-RDP (N.D. Ala. September 22, 2011). On June 2, 2000, Capstone Development entered into an agreement with UConn to coordinate and supervise construction at Hilltop. Pursuant to the agreement, Capstone Building would serve as the general contractor for the project. The cost of the project was not to exceed $39,325,000. The contract between the plaintiffs and UConn contained provisions governing, inter alia, insurance and the resolution of disputes arising out of the project. The contract required UConn to procure "[l]iability insurance providing coverage not less than a [c]ommercial [g]eneral [l]iability insurance policy and insuring [itself], the [s]tate of Connecticut, the Design/Builder, Subcontractors of all tiers and such other persons or interest as [UConn] may designate in connection with the performance of the work . . . such that the total available limits to all insureds combined will not be less than $2,000,000 per occurrence and $5,000,000 aggregate . . . ."

Accordingly, UConn procured an owner controlled insurance program commercial general liability policy (policy) from AMICO's predecessor in interest.[5] The commercial general liability policy is the standardized form used in the construction business, and tracks the language of the 1986 revisions by the Insurance Services Office, Inc.[6] The policy provides that "[a]ny entity you [i.e., the Named Insured] are required in a written contract . . . to name as an insured (the 'Additional Insured') is an Insured but only with respect to liability arising out of 'your work' for the Additional Insured, or acts or omissions of the Additional Insured in connection with the general supervision of 'your work.' " The policy's definition of " '[y]our work' " includes "[w]ork or operations performed by you or on your behalf . . . ."[7] The policy's general insuring provision covers damages resulting from "bodily injury" or "property damage" if the bodily injury or property damage is caused by an "occurrence" that takes place in the "coverage territory" and occurs during the "coverage period."[8] We discuss these terms as they relate to the certified question in more detail later in this opinion.

The project was completed in August, 2001, and the project's architect certified that it complied with the state building and fire safety codes. More than three

years later, on September 29, 2004, UConn sent a letter to the plaintiffs regarding alleged defects in the project. See footnote 20 of this opinion. The letter was triggered by the discovery of elevated levels of carbon monoxide in several areas of Hilltop. According to UConn's investigation, the source of the leak "was the individual hot water heaters serving the residential units and the insufficient draft of the exhaust from the heater through the venting system." In the course of the investigation, UConn identified a number of other "defects and deficiencies" allegedly attributable to the plaintiffs' work. Consequently, UConn prepared to take remediation efforts, including "the installation of direct and separate flues from all third floor hot water heaters, the provision for consistent sizes of piping, the installation of spill switches, the installation of hard-wired carbon monoxide detectors directed to [UConn's] [d]epartment of [p]ublic [s]afety, the replacement or modification of the fan coil units in the two-bedroom residential units, and other potential actions."

In response, Capstone Building forwarded UConn's letter to AMICO, and demanded that AMICO defend against UConn's claims. AMICO acknowledged receipt of the letter on December 6, 2004, recognizing that UConn had made a claim against Capstone Building for elevated levels of carbon monoxide. Apart from the carbon monoxide issue, however, AMICO's response did not detail UConn's other allegations, except to note "[a]dditional defects and deficiencies in the performance [by Capstone Building], its engineers and contractors . . . ." AMICO concluded that UConn's claims were not covered under the policy: "As the liability at issue arises out of [Capstone Building's] own work, including its role as general contractor and heating and plumbing installation, there can be no coverage for this matter for Capstone [Building] under the policy."[9]

Subsequently, on April 4, 2005, Capstone Building filed an action against AMICO's predecessor in interest in the Circuit Court of Jefferson County, Alabama, seeking, inter alia, a declaratory judgment that "the subject insurance policy obligates [AMICO] to provide coverage to [Capstone Building] for [UConn's] claims and contentions against [it]." AMICO removed the case to the District Court on March 31, 2006. *Capstone Building Corp.* v. *Kemper Ins. Co.*, United States District Court, Docket No. 2:06-CV-639-JHH (N.D. Ala. 2006). The District Court dismissed the declaratory judgment claim for failure to join UConn, a necessary party, and dismissed the breach of contract and bad faith claims on ripeness grounds, noting that there was no "suit" under the meaning of the policy when the action was filed.[10] In addition, on May 31, 2006, in response to Capstone Building's requests that AMICO review UConn's claims, AMICO sought a declaratory judgment against Capstone Development, denying any responsibility for the claims, which the District Court dismissed for failure to join

UConn as a necessary party. *American Motorist Ins. Co.* v. *Capstone Development Corp., Inc.*, United States District Court, Docket No. 2:06-CV-1031-WMA (N.D. Ala. 2006).

Meanwhile, on May 16, 2006, UConn sent the plaintiffs a letter formally requesting their participation in mediation pursuant to the construction contract.[11] Upon receipt of the mediation request, Capstone Building again contacted AMICO, demanding its defense at the mediation. AMICO responded on May 31, 2006, asserting, in addition to generic defenses, the pending declaratory judgment action in the District Court and denying any contract with Capstone Building or a breach of that contract. Consequently, the plaintiffs and UConn proceeded to mediation without AMICO. At the mediation, UConn alleged that the plaintiffs had breached its agreement by failing to properly implement construction plans and had been negligent and deficient in the construction process. UConn claimed damages in excess of $25,000,000 which included "necessary corrective work, the need for peer reviews . . . to review and design proposed changes and revisions, loss of use of the premises resulting in rebates of rent to students for the periods of evacuation of the housing units or for periods when [systems] such as . . . air conditioning . . . [were] not operational, and [an extensive list of] damages associated with [the plaintiffs'] failure to perform [their] work in compliance with the [c]ontract, codes, [s]tate laws, and regulations." (Internal quotation marks omitted.)

On December 26, 2007, the parties reached a settlement agreement in which the plaintiffs each agreed to pay UConn $1 million. In addition, the plaintiffs incurred substantial attorney's fees.

Upon resolution of the settlement, the plaintiffs filed separate actions against AMICO in the Circuit Court of Jefferson County, Alabama, for breach of contract and bad faith. AMICO removed the actions to the District Court, which consolidated the actions and certified the aforementioned questions for our consideration. Additional facts will be set forth in the opinion as necessary.

"The scope of our review in a case involving a certified question from a federal court is ordinarily limited to the issue raised by that question." *Gerrity* v. *R.J. Reynolds Tobacco Co.*, 263 Conn. 120, 131, 818 A.2d 769 (2003). "[T]he purpose of the certification process is to answer the question of law submitted pursuant to the certification, not to resolve factual disputes between the parties." 32A Am. Jur. 2d 540, Federal Courts § 1136 (2007). The specific facts of a case, as found in the District Court's memorandum, provide the necessary context for our legal analysis. *Arrowood Indemnity Co.* v. *King*, 304 Conn. 179, 186, 39 A.3d 712 (2012).

II

We begin with the first certified question: "Whether damage to a project contracted to be built, which was caused by defective construction or faulty workmanship associated with the construction project, may constitute 'property damage' resulting from an 'occurrence,' triggering coverage under a commercial general liability insurance policy?" We conclude that defective construction or faulty workmanship that causes damage to nondefective property may constitute property damage resulting from an occurrence, thus triggering coverage under the commercial general liability policy. We also conclude, however, that if the property damage is the result of an insured's defective work, it is excluded from coverage by such a policy. Finally, property damage caused by a subcontractor's defective work may be covered under the exception to the "your work" exclusion.

The policy's insuring agreement provides in relevant part: "We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies. We will have the right and duty to defend the insured against any 'suit' seeking those damages. However, we will have no duty to defend the insured against any 'suit' seeking damages for 'bodily injury' or 'property damage' to which this insurance does not apply. We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result. . . ." The insuring agreement also specifies: "This insurance applies to 'bodily injury' and 'property damage' only if . . . [t]he 'bodily injury' or 'property damage' is caused by an 'occurrence' . . . ." Because the insuring agreement covers only those occurrences that cause property damage or bodily injury, the interpretation of these terms is closely interrelated.

We begin by noting that the first certified question is an issue of first impression in Connecticut, and that the decisions of our sister jurisdictions reveal a split of opinion. Among courts denying coverage for claims arising from defective work, some focus on policy grounds, holding that the cost to repair damages caused by faulty workmanship is a business risk not covered under a commercial general liability policy.[12] Others hold that defective work lacks the element of fortuity necessary to qualify as an "accident" or "occurrence" under such a policy.[13] A significant number of decisions, however, support the opposite conclusion, and find coverage for damage to other, nondefective, property caused by defective work.[14] We are convinced that the latter line of decisions is more persuasively reasoned with respect to the commercial general liability policy in the present case. Accordingly, we conclude that the policy at issue covers damage to nondefective property caused by a subcontractor's defective work.

Our analysis is guided by our usual procedures for

interpreting insurance policies. "[C]onstruction of a contract of insurance presents a question of law . . . . The [i]nterpretation of an insurance policy . . . involves a determination of the intent of the parties as expressed by the language of the policy . . . [including] what coverage the . . . [insured] expected to receive and what the [insurer] was to provide, as disclosed by the provisions of the policy. . . . [A] contract of insurance must be viewed in its entirety, and the intent of the parties for entering it derived from the four corners of the policy . . . [giving the] words . . . [of the policy] their natural and ordinary meaning . . . [and construing] any ambiguity in the terms . . . in favor of the insured . . . ." (Citations omitted; internal quotation marks omitted.) *Hartford Casualty Ins. Co.* v. *Litchfield Mutual Fire Ins. Co.*, 274 Conn. 457, 462–63, 876 A.2d 1139 (2005).

The commercial general liability policy is a standard form developed by the Insurance Services Office, Inc., and has been used throughout the United States since 1940. *American Family Mutual Ins. Co.* v. *American Girl, Inc.*, 268 Wis. 2d 16, 33, 673 N.W.2d 65 (2004).[15] It begins with a broad grant of coverage in the "insuring agreement," followed by a series of "exclusions" (and exceptions to the exclusions) that define the contours of coverage. Accordingly, we begin our analysis with the initial grant of coverage in the "insuring agreement" and then consider the effect of the exceptions and exclusions to the policy's coverage.

A

The contract defines "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The term "accident," however, is not defined in the contract. Whether faulty workmanship can be the basis for a claim under a commercial general liability policy is an issue of first impression for this court.

The terms of an insurance policy are given their "natural and ordinary meaning . . . ." (Internal quotation marks omitted.) *Hartford Casualty Ins. Co.* v. *Litchfield Mutual Fire Ins. Co.*, supra, 274 Conn. 462. We have held that "the term 'accident' is to be construed in its ordinary meaning of an 'unexpected happening' "; *Commerical Contractors Corp.* v. *American Ins. Co.*, 152 Conn. 31, 42, 202 A.2d 498 (1964); and means "unexpected or unintended." (Internal quotation marks omitted.) *Buell Industries, Inc.* v. *Greater New York Mutual Ins. Co.*, 259 Conn. 527, 541, 791 A.2d 489 (2002). This construction is consistent with the dictionary definition of accident. See Black's Law Dictionary (9th Ed. 2009) ("[t]he word accident in accident policies means an event which takes place without one's foresight or expectation"), quoting 1 A. Appleman & J. Appleman, Insurance Law and Practice (1981) § 360; Webster's Third International Dictionary of the English Language

(2002) ("an event or condition occurring by chance or arising from unknown or remote causes"). We also have held that the definition of occurrence is unambiguous and refers to "something that happens unexpectedly without design." (Internal quotation marks omitted.) *Metropolitan Life Ins. Co.* v. *Aetna Casualty & Surety Co.*, 255 Conn. 295, 307, 765 A.2d 891 (2001).

The defendant argues that defective construction lacks the element of "fortuity" necessary for an accident. This suggests that a foreseeable event can never be an accident under the terms of the commercial general liability policy. Insurance policies, however, are designed to cover foreseeable risk, including negligent acts. For the same reason, the mere fact that defective work is in some sense volitional does not preclude it from coverage under the terms of the policy.[16] "[A] deliberate act, performed negligently, is an accident if the effect is not the intended or expected result; that is, the result would have been different had the deliberate act been performed correctly." *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, 242 S.W.3d 1, 8 (Tex. 2007). We have held that "[a]n accident is an event that is unintended from the perspective of the insured." (Internal quotation marks omitted.) *Vermont Mutual Ins. Co.* v. *Walukiewicz*, 290 Conn. 582, 594, 966 A.2d 672 (2009). In the context of a homeowner's insurance policy, the motive of the acting party is determinative of whether an act was intentional or accidental. *Allstate Ins. Co.* v. *Barron*, 269 Conn. 394, 408 n.10, 848 A.2d 1165 (2004) ("to the extent that [the insured] engaged in conduct for which she could not be held responsible because her mental incapacity negated her intent, the consequences of her conduct were accidental and, therefore, an 'occurrence' within the meaning of the policy"). Accordingly, because negligent work is unintentional from the point of view of the insured, we find that it may constitute the basis for an "accident" or "occurrence" under the plain terms of the commercial general liability policy.[17]

On the basis of the foregoing analysis, we conclude that defective workmanship can give rise to an "occurrence" under the insuring agreement. This is, however, only the first step in determining whether the damage at issue in the present case is covered under the policy. The terms of the insuring agreement require both an "occurrence" and "property damage" for coverage. We therefore turn to consider the "property damage" requirement of the insuring agreement.

B

The policy defines " '[p]roperty damage' " as "[p]hysical injury to tangible property, including all resulting loss of use of that property" and "[l]oss of use of tangible property that is not physically injured."[18] Much like the meaning of "occurrence" discussed previously herein, there is no consensus on the meaning of the term prop-

erty damage in the context of claims for defective work under commercial general liability policies.[19]

The parties agree that the commercial general liability policy covers physical injury to third parties' property. They disagree, however, about the application of the term property damage when invoked to cover damages to the work of the insured contractor or subcontractor. As a threshold matter, we see no basis in the language of the policy for limiting coverage to liability for harm to third parties. "[J]ust like the definition of the term 'occurrence,' the definition of 'property damage' in the [commercial general liability policy] does not differentiate between damage to the contractor's work and damage to other property." *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, 979 So. 2d 871, 889 (Fla. 2007). Although a contractor's work will often be excluded from coverage pursuant to contractual exclusions in a commercial general liability policy, this distinction is not found in the plain language of the insuring agreement's initial grant of coverage. Accordingly, we conclude that physical injury to or loss of use of the insured's property is within the initial grant of coverage as described in the policy's insuring agreement.

Although we reject AMICO's argument that the insuring agreement never covers damage to the insured's project, whether an insured party makes a viable claim for property damage is a highly fact-dependent determination in each case. The allegations detailed in the District Court's memorandum of law may be divided into four categories: (1) damage to nondefective property stemming from defective construction; (2) carbon monoxide; (3) defective work, standing alone, including building and fire safety code violations; and (4) repairs to damaged work.[20]

1

Although the majority of the allegedly defective work involved defective construction, poor quality, or building code violations, without more, the plaintiffs argue that "assertions made by [UConn] that the [p]roject suffered water damage, mold damage, elevated carbon monoxide exposure, cracked piping, and structural problems . . . clearly involve 'property damage' as defined within the [owner controlled program commercial general liability policy]."

The policy defines " '[p]roperty damage' " as "[p]hysical injury to tangible property, including all resulting loss of use of that property." Hilltop and its component parts are clearly "tangible property." Thus, under the plain language of the commercial general liability policy, water and mold damage to portions of the insured's project, beyond the defective work itself, would qualify as "physical injury to tangible property." *Auto Owners Ins. Co.* v. *Newman*, 385 S.C. 187, 194, 684 S.E.2d 541 (2009) (moisture intrusion to sheathing and building

frame due to defective stucco was "property damage" under commercial general liability policy); *Travelers Indemnity Co. of America* v. *Moore & Associates, Inc.*, 216 S.W.3d 302, 310 (Tenn. 2007) (water and mold damage to walls from defective window installation was "property damage" under commercial general liability policy). To the extent that the plaintiffs' claims are based on physical injury to or loss of use of nondefective property, we hold that they are within the insuring agreement's coverage.

2

Whether the escape of carbon monoxide is "[p]hysical injury to tangible property, including all resulting loss of use of that property," is a question of first impression for this court. We hold that under the plain language of the commercial general liability policy, the escape of carbon monoxide, without more, is not property damage. The New Hampshire Supreme Court recently held that the seepage of odorless carbon monoxide from defectively installed chimneys was not "property damage," reasoning that the gas "caused no physical, tangible alteration to any property" or any physical injury to the homeowners. *Concord General Mutual Ins. Co.* v. *Green & Co. Building & Development Corp.*, 160 N.H. 690, 694, 8 A.3d 24 (2010). Thus, the loss of use of the defective chimneys, standing alone, did not constitute property damage under either of the policy's definitions. Id.[21] We find the New Hampshire court's reasoning persuasive and hold that the escape of carbon monoxide alone does not qualify as property damage.

3

The alleged defects and deficiencies also include building code violations, defective construction and poor quality control. For the reasons discussed in the following paragraphs, we conclude that these alleged defects do not constitute "[p]hysical injury to tangible property, including all resulting loss of use of that property" unless they result in damage to other, nondefective property.

A plain reading of the policy suggests that project components defective prior to delivery, or those defectively installed, did not suffer physical injury within the meaning of the policy's terms. *Crossmann Communities of North Carolina, Inc.* v. *Harleysville Mutual Ins. Co.*, 395 S.C. 40, 48–49, 717 S.E.2d 589 (2011) ("the critical phrase . . . 'physical injury' . . . suggests the property was not defective at the outset, but rather was initially proper and injured thereafter"); *Travelers Ins. Co.* v. *Eljer Mfg., Inc.*, 197 Ill. 2d 278, 312, 757 N.E.2d 481 (2001) (stating that under its plain meaning, "physical injury" in commercial general liability policy unambiguously "connotes . . . an alteration in appearance, shape, color or in other material dimension"). This is

true even if the defective work diminishes the building's value, since "faulty workmanship that merely diminishes the value of the home without causing physical injury or loss of use does not involve 'property damage.' " *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, supra 242 S.W.3d 10.[22]

This principle is illustrated by the Tennessee Supreme Court in *Travelers Indemnity Co. of America* v. *Moore & Associates, Inc.*, supra, 216 S.W.3d 302, in which the court had to decide whether damage caused by a subcontractor's faulty window installation was covered by the contractor's commercial general liability policy, which was in all pertinent respects identical to the policy in this case. The court held that a claim "in which the sole damages are for replacement of a defective component or correction of a faulty installation" was not within the policy's definition of property damage. Id., 310. "Without more, this alleged defect is the equivalent of the 'mere inclusion of a defective component' . . . and no 'property damage' has occurred." Id. However, "[b]ecause the alleged defective installation resulted in water penetration causing further damage, [the insured] has alleged 'property damage.' " Id.

We find this analysis persuasive. On the basis of the language of the policy, "physical injury to tangible property" would not include construction deficiencies unless they damage other, nondefective property. In *American Family Mutual Ins. Co.* v. *American Girl, Inc.*, supra, 268 Wis. 2d 35–36, the Wisconsin Supreme Court held that "sinking, buckling, and cracking of [a warehouse] as a result of soil settlement qualifies as 'physical injury to tangible property.' " Similarly, the Texas Supreme Court held that "allegations of cracking sheetrock and stone veneer [as a result of a defective foundation] are allegations of 'physical injury' to 'tangible property.' " *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, supra, 242 S.W.3d 10. In those cases, however, the "physical injury to tangible property" was not the structural defect itself, but the damage the defect caused to other, nondefective property. Thus, allegations of construction defects, without more, do not state a claim for "injury to tangible property" under the plain meaning of the terms of the insuring agreement.[23] We agree with the Florida Supreme Court that "faulty workmanship or defective work that has damaged the otherwise nondefective completed project has caused 'physical injury to tangible property' within the plain meaning of the definition of the policy. If there is no damage beyond the faulty workmanship or defective work, then there may be no resulting 'property damage.' " *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, supra, 979 So. 2d 889.

We next turn to consider to what extent repair work

is covered under the policy. The insuring agreement provides that "[w]e will pay those sums that the insured becomes legally obligated to pay as damages because of . . . 'property damage' . . . ." We have already held that defective work, without more, is not "property damage" within the meaning of the policy. Extending coverage to the repair of the defective work itself would render the policy's requirement for "[p]hysical injury to tangible property" meaningless, since it would allow the insured to recover the costs to repair work that, although defective, did not meet the definition of property damage. We are not aware of any cases that have extended coverage in commercial general liability policies this far.

Other courts have recognized the "difference between a claim for the costs of repairing or removing defective work, which is not a claim for 'property damage,' and a claim for the costs of repairing damage caused by the defective work, which is a claim for 'property damage.' " *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, supra, 979 So. 2d 889; see also *Travelers Indemnity Co. of America* v. *Moore & Associates, Inc.*, supra, 216 S.W.3d 310 ("claim limited to faulty workmanship or materials is one in which the sole damages are for replacement of a defective component or correction of faulty installation" [internal quotation marks omitted]). Because " 'physical injury' unambiguously connotes damage to tangible property causing an alteration in appearance, shape, color or in other material dimension"; *Travelers Ins. Co.* v. *Eljer Mfg. Inc.*, supra, 197 Ill. 2d 312; repair of defective work itself is not a liability "because of . . . 'property damage' " under the plain meaning of policy's terms. It follows that repairs to the defective work itself are not covered in the insuring agreement. Cf. *Times Fiber Communications, Inc.* v. *Travelers Indemnity Co.*, Superior Court, judicial district of Stamford-Norwalk, Docket No. X05-CV-03-0196619S (February 2, 2005) (38 Conn. L. Rptr. 642) (replacing defective work not "occurrence" under commercial general liability policy).

We emphasize, however, that the insuring agreement clearly does contemplate coverage for repairs to nondefective property stemming from "[p]hysical injury to tangible property" or "loss of use" caused by defective work stemming from an occurrence, including consequential costs for the necessary repairs and remediation. See *Federated Mutual Ins. Co.* v. *Concrete Units, Inc.*, 363 N.W.2d 751, 757 (Minn. 1985) (phrase "damages because of . . . 'property damage' requires the insurer to pay all damages which are causally related to an item of 'property damage' which satisfies either of the policy's definitions"). Accordingly, we conclude that the commercial general liability policy covers claims for property damage caused by defective work, but not claims for repair of the defective work itself. *Travelers Indemnity Co. of America* v. *Moore & Associ-*

ates, Inc., supra, 216 S.W.3d 310.

C

We now turn to consider the exclusionary clauses in the policy, as well as their exceptions. The various exclusions and exceptions constitute the bulk of the policy's language and are often determinative of coverage for any particular claim.[24] As the Wisconsin Supreme Court observed, "[commercial general liability] policies generally do not cover contract claims arising out of the insured's defective work or product, but this is by operation of the [policy's] business risk exclusions . . . ." *American Family Mutual Ins. Co.* v. *American Girl, Inc.*, supra, 268 Wis. 2d 39.[25] Of course, an exclusion can only affect a claim covered in the insuring agreement, and an exception can only reinstate coverage in the initial grant.[26]

The commercial general liability insurance policy in the present case contains fifteen lettered exclusions limiting the scope of coverage in the insuring agreement.[27] The parties primarily focus on exclusion (*l*), the "your work" exclusion, and the accompanying "subcontractor exception" in the coverage form of the policy. Exclusion (*l*) provides:

"*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."[28]

When read together, the "your work" exclusion and the "subcontractor exception" eliminate coverage for property damage caused by an insured contractor's work, but restore coverage for property damage caused by a subcontractor's work. The exclusion and exception are triggered, however, only when there is an initial grant of coverage in the insuring agreement.[29]

Applying the exclusion's language to the facts of this case, the entire Hilltop project meets the definition of "your work" because it was completed by the plaintiffs or their subcontractors. All "property damage" arising out of an "occurrence" is therefore initially excluded by the "your work" exclusion. The "subcontractor exception," however, restores coverage for subcontractors' work which caused damage under the insuring agreement of the policy. Whether the "work out of which the damage arises" was performed by a subcontractor is a matter of fact, to be determined in each case. Here, insofar as the plaintiffs' claims meet the definition of "occurrences" causing "property damage," the plaintiffs allege that they arose from faulty heating, venting, and mechanical work performed by their subcontractors. We hold that the "subcontractor excep-

tion" to the "your work" exclusion would reinstate coverage if the plaintiffs ultimately prove that property damage was caused by its subcontractors' defective work. Property damage resulting from the plaintiffs' own faulty work, however, is precluded from coverage by the "your work" exclusion.[30]

D

AMICO also argues that covering damages to the insured's property resulting from defective workmanship inappropriately turns the commercial general liability policy into a performance bond. As an initial matter, overlapping coverage does not negate a commercial general liability policy's express terms. "The . . . policy covers what it covers. No rule of construction operates to eliminate coverage simply because similar protection may be available through another insurance product." *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, supra, 242 S.W.3d 10. Although the historical trend demonstrates that commercial general liability coverage has expanded from tort liability to third parties to today's much broader coverage, our analysis is guided by the plain language of the current policy's provisions.[31]

Moreover, there are important differences between performance bonds and commercial general liability contracts. "[T]he obligation of a surety is an additional assurance to the one entitled to the performance of an act that the act will be performed." (Internal quotation marks omitted.) *Southington* v. *Commercial Union Ins. Co.*, 254 Conn. 348, 358, 757 A.2d 549 (2000). "The purpose of a performance bond is to guarantee the completion of the contract upon default by the contractor." (Internal quotation marks omitted.) *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, supra, 979 So. 2d 887. Accordingly, suretyship is properly viewed as "a form of credit enhancement" in which "[p]remiums . . . are charged in consideration of the fundamental underwriting assumption that the surety will be protected against loss by the principal." 4A P. Bruner & P. O'Connor, Construction Law (2009) c. 12, § 12:9, pp. 50–51; see, e.g., *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, supra, 888 (performance bonds are "based on what amounts to a credit evaluation of the particular contractor and its capabilities to perform its contracts" [internal quotation marks omitted]). Importantly, the surety, unlike the insurer, may seek indemnification from the contractor, as principal, when the bond is invoked to benefit the owner-obligee. *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, supra, 242 S.W.3d 10 n.7. While a performance bond may, in the appropriate case, cover the costs to remedy property damage under a commercial general liability contract, its main purpose is to benefit the owner upon the default by a general contractor.[32]

In light of the differences in coverage and risk allocation between commercial general liability insurance

policies and performance bonds, any similarities between these policies do not preclude our conclusion that the commercial general liability policy in the present case covers property damage caused by unintentional faulty workmanship.

In summary, we conclude that unintended construction defects may form the basis of an "occurrence" or "accident" under commercial general liability policies. Furthermore, damage to an insured's nondefective work is "property damage" within the commercial general liability policy's initial grant of coverage. Claims limited to damages for the replacement of defective components or poor workmanship, however, without more, do not constitute "property damage" under the policy. Finally, the policy excludes damage caused by the plaintffs' work, but does not exclude damage caused by a subcontractor's defective work.

III

We now turn to discuss the second question certified by the District Court: "Can an insurer's bad faith conduct in investigating an insurance claim provide a basis for a cause of action for bad faith under Connecticut law?" We understand the certified question to refer solely to a cause of action for bad faith in investigating the claim, as opposed to the breach of AMICO's duties to defend and to indemnify under the policy.[33] Under our precedent, a bad faith action must allege denial of the receipt of an express benefit under the policy.[34] *Renaissance Management Co.* v. *Connecticut Housing Finance Authority*, 281 Conn. 227, 240, 915 A.2d 290 (2007). Accordingly, under the facts of the present case, we do not recognize a cause of action based solely on the insurer's failure to investigate because the insurance policy at issue provides that the decision of whether and how to investigate lies exclusively with the insurer.

We begin by setting forth the required elements for bad faith claims. "[I]t is axiomatic that the . . . duty of good faith and fair dealing is a covenant implied into a contract or a contractual relationship. . . . In other words, every contract carries an implied duty requiring that neither party do anything that will injure the right of the other to receive the benefits of the agreement. . . . The covenant of good faith and fair dealing presupposes that the terms and purpose of the contract are agreed upon by the parties and that what is in dispute is a party's discretionary application or interpretation of a contract term. . . .

"To constitute a breach of [the implied covenant of good faith and fair dealing], the acts by which a defendant allegedly impedes the plaintiff's right to receive benefits that he or she reasonably expected to receive under the contract must have been taken in bad faith. . . . Bad faith in general implies both actual or constructive fraud, or a design to mislead or deceive

another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive. . . . Bad faith means more than mere negligence; it involves a dishonest purpose." (Citations omitted; internal quotation marks omitted.) *De La Concha of Hartford, Inc.* v. *Aetna Life Ins. Co.*, 269 Conn. 424, 432–33, 849 A.2d 382 (2004).

Accordingly, because the covenant of good faith and fair dealing only "requir[es] that neither party [to a contract] do anything that will injure the right of the other to receive the benefits of the agreement," it is not implicated by conduct that does not impair contractual rights. (Internal quotation marks omitted.) *Home Ins. Co.* v. *Aetna Life & Casualty Co.*, 235 Conn. 185, 200, 663 A.2d 1001 (1995), quoting *Habetz* v. *Condon*, 224 Conn. 231, 238, 618 A.2d 501 (1992). In *Renaissance Management Co.* v. *Connecticut Housing Finance Authority*, supra, 281 Conn. 240, for example, we held that the defendant housing authority's refusal to accept mortgage prepayments, in order to facilitate new loans for owners of low income housing, did not violate the covenant of good faith and fair dealing when the agency was not contractually obligated to accept prepayments. In so holding, we reasoned that "[t]he covenant of good faith and fair dealing presupposes the *terms and purpose of the contract* are agreed upon by the parties and that what is in dispute is a party's *discretionary application or interpretation of a contract term*." (Emphasis added; internal quotation marks omitted.) Id.

Because bad faith actions require the denial of benefits under the policy, we must analyze the plaintiffs' proposed cause of action based on the actual terms of the insuring agreement. Unless the alleged failure to investigate led to the denial of a contractually mandated benefit in this case, the plaintiffs have not raised a viable bad faith claim. See, e.g., *Home Ins. Co.* v. *Aetna Life & Casualty Co.*, supra, 235 Conn. 200. The insuring agreement at issue provides: "We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies. We will have the right and duty to defend the insured against any 'suit' seeking those damages. However, we will have no duty to defend the insured against any 'suit' seeking damages for 'bodily injury' or 'property damage' to which this insurance does not apply. *We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result.*" (Emphasis added.) These terms (1) specifically disclaim any duty to investigate claims not qualifying as occurrences, and (2) commit the decision to investigate to AMICO's discretion. Because the express terms of the commercial general liability policy in this case gave AMICO the sole discretion to decide whether to investigate, the plaintiffs cannot argue that

they reasonably expected an investigation for every claim submitted.[35] *Heyse* v. *Case*, 114 Conn. App. 640, 652, 971 A.2d 699 (no bad faith liability when defendant did not "[impair the plaintiff's] right to enforce any benefits to which she was entitled under [the] policy") cert. denied, 293 Conn. 905, 976 A.2d 705 (2009).

The implied duty of good faith and fair dealing is "a purely instrumental duty intended to protect insureds' rights to receive their policy benefits." D. Richmond, "Bad Insurance Bad Faith Law," 39 Tort Trial & Ins. Prac. L.J. 1, 18 (2003), citing *Love* v. *Fire Ins. Exchange*, 221 Cal. App. 3d 1136, 271 Cal. Rptr. 246 (1990). Although we recognize that a discretionary investigation is often necessary to assess the duty to defend or indemnify under the policy, a bad faith action is properly addressed to the insurer's conduct depriving the insured of these contractual benefits, rather than the precedent, investigatory step.[36] See, e.g., *Renaissance Management Co.* v. *Connecticut Housing Finance Authority*, supra, 281 Conn. 240. A bad faith cause of action not tied to duties under the insurance policy must therefore fail as a matter of law.

A review of our cases involving the duty of good faith and fair dealing reveals that violations of express duties are necessary to maintain a bad faith cause of action. In *PSE Consulting, Inc.* v. *Frank Mercede & Sons, Inc.*, 267 Conn. 279, 306, 838 A.2d 135 (2004), the performance bond contained mandatory terms obligating the surety to "send an answer to [the principal] within forty-five days after receiving formal notice of the [principal's] claim against the bond," and to "identify what part of the claim it had determined to be undisputed, as well as to provide the basis for challenging any disputed amounts." Unlike the inadequate discretionary investigation alleged by the plaintiffs in the present case, the bad faith action in *PSE Consulting, Inc.*, was based on a breach of the surety's express duties under the contract. Moreover, in considering the principal's bad faith, we concluded that "[the failure] to investigate [the principal's] claim properly is not, *by itself*, sufficient evidence of bad faith." (Emphasis in original.) Id., 309. Accordingly, in the absence of an underlying breach of a contractual duty, *PSE Consulting, Inc.*, does not support a bad faith cause of action based solely on an allegedly inadequate discretionary investigation.

Our discussion in *Buckman* v. *People Express, Inc.*, 205 Conn. 166, 169–72, 530 A.2d 596 (1987), also supports this conclusion. In that case, we held that a self-insured employer who violated his statutory duty to provide a terminated employee with notice of his right to continue health benefits was liable under a cause of action for bad faith.[37] Although the employer-insurer's failure to give notice did not conclusively deny coverage to the plaintiff, the cause of action arose from the breach of the employer's independent, statutory duty. Id., 171.

Unlike the bad faith claim in *Buckman*, the plaintiffs' proposed cause of action would rest solely on the alleged nonperformance of an expressly discretionary procedure.

Our conclusion that bad faith is not actionable apart from a wrongful denial of a benefit under the policy finds support in both authoritative treatises and cases from other jurisdictions. For example, one treatise on insurance references the "duty of investigation" while clarifying that "[i]f a claim is beyond the scope of coverage, however, the duty to investigate is not separately actionable, as that would be outside the entire contractual basis for both the duty to investigate, and the duty of good faith and fair dealing." 14 L. Russ & T. Segalla, Couch on Insurance (3d Ed. 2007) § 198:28; see also id., § 204:20 ("if there is no potential for coverage and hence no duty to defend under [the] terms of [the] insurance policy, there can be no action for breach of implied covenant of good faith and fair dealing, since the covenant is based on the contractual relationship between insured and insurer"); 46A C.J.S. 160, Insurance § 1873 (2007) ("an insurer's negligent or subpar investigation or evaluation of a claim is relevant in [a] bad-faith action to the fact finder's determination of whether the insurer should have known its denial lacked a reasonable basis").[38]

Likewise, the majority of jurisdictions to consider the matter would also disallow independent actions for bad faith investigation. As the California Supreme Court explained, "if there is . . . no duty to defend under the terms of the policy, there can be no action for breach of the implied covenant of good faith and fair dealing because the covenant is based on the contractual relationship between the insured and the insurer. . . . In sum, the covenant is implied as a supplement to the express contractual covenants, to prevent a contracting party from engaging in conduct that frustrates the other party's rights to the benefits of the agreement . . . . Absent that contractual right, however, the implied covenant has nothing upon which to act as a supplement, and should not be endowed with an existence independent of its contractual underpinnings." (Citations omitted; internal quotation marks omitted.) *Waller* v. *Truck Ins. Exchange, Inc.*, 11 Cal. 4th 1, 36, 900 P.2d 619, 44 Cal. Rptr. 2d 370 (1995); see also *Federated Mutual Ins. Co.* v. *Vaughn*, 961 So. 2d 816, 820 (Ala. 2007) ("[t]o recover for bad-faith failure to investigate an insurance claim, the insured must show that the insurer breached the insurance contract when it refused to pay the insured's claim"); *Board of Directors of Assn. of Apartment Owners of the Discovery Bay Condominium* v. *United Pacific Ins. Co.*, 77 Haw. 358, 361, 884 P.2d 1134 (1994) (no bad faith action for failure to investigate when insured did not prevail on claim that insurer was liable under policy); *Bellville* v. *Farm Bureau Mutual Ins. Co.*, 702 N.W.2d 468, 474 (Iowa 2005) ("[a]n insur-

er's negligent or sub-par investigation or evaluation of a claim is relevant to the fact finder's determination of whether the insurer should have known its denial lacked a reasonable basis"); *Brethorst* v. *Allstate Property & Casualty Ins. Co.*, 334 Wis. 2d 23, 48, 798 N.W.2d 467 (2011) (no claim for bad faith duty to investigate can exist unless there was "a wrongful denial of some contracted-for benefit").[39] We find these cases persuasive and conclude that, in the absence of a breach of an express duty under the insurance policy, there is no independent cause of action for deficiencies in the insurer's investigation.

It is important to note, however, that an insurer's "failure to conduct an adequate investigation of a claim . . . when accompanied by other evidence, reflecting an improper motive, properly *may* be considered as evidence of . . . bad faith." (Emphasis in original.) *PSE Consulting, Inc.* v. *Frank Mercede & Sons, Inc.*, supra, 267 Conn. 310. "As a technical matter, failure to investigate a claim is not a cause of action in itself. Rather, it is evidence of bad faith, which may entitle an insured to additional damages, beyond the recovery of the benefits due under the insurance policy, if the insurer denies the claim. That is, failure to investigate is evidence of an unreasonable denial of a claim." 46 Am. Jur. 3d 297, Proof of Facts § 2 (1998). Consequently, although not actionable separate from the bad faith denial of a substantive benefit, an insurer's investigation will often be key evidence in a bad faith cause of action.

Although we decline to extend bad faith actions to allegations based solely on a failure to investigate where the investigation is not mandated under the policy, our holding today should not create an incentive for insurers to fail to investigate claims. Insurers disclaiming their duty to defend or indemnify under the policy, subsequent to a failure to investigate, risk extracontractual liability for consequential economic and noneconomic losses.[40] In addition, the Connecticut Unfair Insurance Policies Act (CUIPA), General Statutes § 38a-815 et seq., and the Connecticut Unfair Trade Practices Act (CUTPA), General Statutes § 42-110a et seq., provide a statutory remedy against insurers with a "general business practice" of inadequate investigations.[41]

In contrast, allowing independent bad faith actions based on a failure to investigate could spawn a number of undesirable consequences. By way of example, imposing liability for bad faith investigation, even in the absence of any duty to defend or indemnify, would open a new avenue for the litigation of claims that, by definition, are outside of the policy's coverage, and burden our courts with litigation on peripheral issues.[42] Conversely, to the extent that the rule would incentivize insurers to investigate meritless claims, these costs would be passed on to all consumers of commercial general liability policies.[43] Lastly, it would be difficult to

calculate damages where the insured was, by definition, not deprived of any benefit under the policy.[44]

IV

We next turn to the third certified question posed by the District Court: "Does *Alderman* v. *Hanover Ins. Group*, [supra, 169 Conn. 603], apply to pre-suit settlement cases wherein the insurer, under a commercial general liability insurance policy, wrongfully denies coverage, but where only some of the underlying claims should have been covered under the policy?" This is another question of first impression for this court.[45] At the outset, we note that answering this certified question requires the assumption that at least some of the allegations would have formed the basis of claims for which AMICO had a duty to defend under the policy.[46] We conclude that, although an insurer breaching its duty to defend is generally liable for the amount of the settlement and costs, the insured has the burden of proving that the settlement is reasonable in proportion to the insurer's liability under its duty to defend.

A brief summary of the duty to defend, as established in our cases, is relevant to the resolution of this legal question. We have consistently held that the duty to defend is broader than the duty to indemnify. *Schilberg Integrated Metals Corp.* v. *Continental Casualty Co.*, 263 Conn. 245, 256, 819 A.2d 773 (2003). An insurer's duty to defend is triggered if at least one allegation of the complaint "falls even *possibly* within the coverage." (Emphasis in original; internal quotation marks omitted.) *Hartford Casualty Ins. Co.* v. *Litchfield Mutual Fire Ins. Co.*, supra, 274 Conn. 463.[47] Indeed, "[i]t is well established . . . that a liability insurer has a duty to defend its insured in a pending lawsuit if the pleadings allege a covered occurrence, even though facts outside the four corners of those pleadings indicate that the claim may be meritless or not covered." (Internal quotation marks omitted.) Id., 464. "The obligation of the insurer to defend does not depend on whether the injured party will successfully maintain a cause of action against the insured but on whether he has, in his complaint, stated facts which bring the injury within the coverage. If the latter situation prevails, the policy requires the insurer to defend, irrespective of the insured's ultimate liability. . . . In contrast to the duty to defend, the duty to indemnify is narrower: while the duty to defend depends only on the allegations made against the insured, the duty to indemnify depends upon the facts established at trial and the theory under which judgment is actually entered in the case." (Citations omitted; internal quotation marks omitted.) *DaCruz* v. *State Farm Fire & Casualty Co.*, 268 Conn. 675, 687–88, 846 A.2d 849 (2004). "Thus, the duty to defend is triggered whenever a complaint alleges facts that *potentially* could fall within the scope of coverage . . . ." (Emphasis in original.) Id., 688.

An insurer asserting that a claim is not covered under its policy can "either refuse to defend or it [can] defend under a reservation of its right to contest coverage under the various avenues which would subsequently be open to it for that purpose." *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, 155 Conn. 104, 113, 230 A.2d 21 (1967) (*Missionaries*). If the insurer declines to provide its insured with a defense and is subsequently found to have breached its duty to do so, it bears the consequences of its decision, including the payment of any reasonable settlement agreed to by the plaintiff and the insured, and the costs incurred effectuating the settlement up to the limits of the policy. *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 611–12; *Schurgast* v. *Schumann*, 156 Conn. 471, 491, 242 A.2d 695 (1968); *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 114. Moreover, an insurer, "after breaking the contract by its unqualified refusal to defend, should not thereafter be permitted to seek the protection of that contract in avoidance of its indemnity provisions. Nor should [the insurer] be permitted, by its breach of the contract, to cast upon the [insured] the difficult burden of proving a causal relation between the [insurer's] breach of the duty to defend and the results which are claimed to have flowed from it." *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 114.

In *Alderman*, this court extended the rule enunciated in *Missionaries* to situations in which the insured settled claims before the claimant had filed an action. *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 610–12. The court reasoned that requiring the insured to remain passive subsequent to a clear denial of coverage "could serve no useful purpose: it would have been a gesture of futility, and would have fostered unnecessary litigation, with attendant delays and additional expenses." (Internal quotation marks omitted.) Id., 611. Accordingly, the court in *Alderman* recognized that the duty to defend may arise before an action is initiated by the claimant. "Where an insurer refuses to acknowledge any duty or obligation arising under the contract of insurance, the insured is in much the same position whether or not suit has actually been filed." Id., 612. In the context of presuit demands by an insured, the insurer's duty is triggered when the demand is "sufficiently detailed for the defendant to discern whether the allegations . . . [are] within the scope of the plaintiff's insurance coverage." *R.T. Vanderbilt Co., Inc.* v. *Continental Casualty Co.*, 273 Conn. 448, 471, 870 A.2d 1048 (2005).[48]

Thus, under *Alderman* and *Missionaries*, the insured need not prove, and the insurer is estopped from contesting, actual liability for settled claims for which the insurer wrongly denied defense. "[T]he insured need not establish actual liability to the party with whom it

settled so long as . . . a potential liability on the facts known to the [insured is] shown to exist . . . ." (Internal quotations mark omitted.) *Black* v. *Goodwin*, *Loomis & Britton, Inc.*, 239 Conn. 144, 160, 681 A.2d 293 (1996). Accordingly, "[w]here . . . an insured alleges that an insurer improperly has failed to defend and provide coverage for underlying claims that the insured has settled the insured has the burden of proving that the claims were within the policy's coverage [for defense] *and* that the settlements were reasonable." (Emphasis in original.) *Metropolitan Life Ins. Co.* v. *Aetna Casualty & Surety Co.*, 249 Conn. 36, 55, 730 A.2d 51 (1999), citing *Black* v. *Goodwin*, *Loomis & Britton, Inc.*, supra, 160.[49]

In the present case, Capstone Building received a denial of coverage letter from AMICO on December 6, 2004.[50] Although AMICO never expressly denied Capstone Development's separate coverage request, AMICO initially declined to provide any coverage position, and subsequently filed a declaratory judgment action against Capstone Development in the Alabama federal District Court on May 31, 2006, denying any responsibility for the claims.[51] Subsequently, after UConn formally requested that the plaintiffs participate in mediation as provided in the building contract, the plaintiffs again demanded AMICO's defense in conjunction with the mediation, and was again rebuffed.[52] Consequently, the mediation proceeded without AMICO's participation. As a part of the mediation, UConn submitted an extensive list of deficiencies, for which it claimed damages in excess of $25 million.[53] In the final agreement, however, Capstone Building and Capstone Development each agreed to pay UConn $1 million to settle all claims. In addition, the plaintiffs incurred substantial attorney's fees.

Under these facts, it is apparent that AMICO "refuse[d] to acknowledge any duty or obligation arising under the contract of insurance"; *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 612; with respect to both plaintiffs. Even if we were to assume, for the purposes of deciding this certified question, that AMICO wrongfully denied the requested defense, the plaintiffs argue that AMICO is liable for the reasonable amount and costs of the settlement up to the limit of the policy under *Missionaries* and *Alderman*.[54]

A closer inspection of those cases, however, reveals that they are distinguishable from the facts of the present case. In each of those cases, the action to recover settlement costs from the insurer was based on a single claim for which the insurer was found to have wrongfully denied a defense. In *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 155 Conn. 110, for example, the insurer invoked a policy exclusion to refuse to defend a suit against the insured. In holding that the complaint's allegations stated facts

that triggered the insurer's duty to defend, we necessarily concluded that the insurer had breached its duty with regard to the single claim at issue.[55] Similarly, *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 607–12, involved an insurer's invocation of policy exclusions to disclaim its duty to defend against a manufacturer whose facilities were damaged by the insured contractor. Our conclusion therein that the policy exclusions did not apply necessarily meant that the insurer had breached its duty to defend as to the single claim.[56] Thus, in both *Missionaries* and *Alderman*, the insurer's duty to defend applied to the claims in toto. Additionally, in neither case was there any allegation that the settlement was unreasonable, in bad faith, or fraudulent. *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 114 (insurer made no claim "that the amount of the settlement, the expenses incurred by the plaintiff or its attorney's fees were unreasonable"); *Alderman* v. *Hanover Ins. Group*, supra, 609 (insurer conceded that "in the event coverage is found, the amounts paid in settlement" were proper).

In contrast, the certified question in this case assumes that the plaintiffs' demand for defense contained allegations that would have obligated AMICO to defend against at least one, but not all, of UConn's claims. Consequently, we must decide whether *Missionaries* and *Alderman* are applicable to settlements in which some of the claims would not independently trigger the insurer's duty to defend.

While not dispositive of the certified question in the present case, this court's reasoning in *Alderman* and *Missionaries* does provide some guidance. Significantly, as we noted previously, although an insurer who improperly fails to defend an insured is liable for the value and costs of the settlement, the insured "is required to prove that the settlement . . . was reasonable." *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160, citing *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 611.

In *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160–61, this court addressed the tension between the rule in *Missionaries*, which estops an insurer in breach of its duty to defend from contesting liability for a settlement, and the requirement of reasonableness.[57] "It is well settled that when an insurer improperly fails to defend an insured who subsequently settles the case with the injured party, the insurer is estopped from raising the issue of the insured's liability as a defense to an action arising from the insurer's failure to defend. . . . Nevertheless, the [insured] is required to prove that the settlement—whether it be by stipulated judgment or otherwise—was reasonable. . . . In order to recover the amount of the settlement from the insurer, the insured need not establish actual liability to the party with whom it has settled so long

as . . . a potential liability on the facts known to [the insured] is shown to exist, culminating in a settlement in an *amount reasonable in view of the size of possible recovery and degree of probability of* [*a*] *claimant's success against the* [*insured*]." (Citations omitted; emphasis in original; internal quotation marks omitted.) Id., 160.

We see two options, consistent with *Alderman*, for determining whether a settlement reached subsequent to an insured's unheeded demand for defense is reasonable.[58] First, we could hold the breaching insurer liable for the entire settlement amount, without regard to the portion of the settlement attributable to allegations that could form the basis of claims for which the insurer had an independent duty to defend. This procedure would provide a powerful incentive for insurance companies to defend under a reservation of rights or seek a declaratory judgment, when the allegations in the demand for defense contain a potentially covered claim under the policy. *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 155 Conn. 113. On the other hand, this approach would constrain the reasonableness inquiry to the amount of the settlement, without regard for other reasonableness factors. *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160–61.[59] Moreover, because it would create coverage, via estoppel, even for allegations for which the insurer did not have an independent obligation to defend, much less indemnify, this approach would constitute a significant extension of the rule enunciated in *Missionaries*.

The second option would tie the insurer's liability, subsequent to a wrongful refusal to defend an insured under a reservation or seek a declaratory judgment, solely to allegations which, considered independently, trigger the insurer's broad duty to defend under the policy. This approach avoids creating liability, via estoppel, for claims for which even the insurer's broad duty to defend does not attach. *DaCruz* v. *State Farm Fire & Casualty Co.*, supra, 268 Conn. 688. Moreover, by holding the insurer liable for the portion of a pretrial settlement that may be reasonably allocated to allegations that form the basis of claims for which the insurer had an independent duty to defend, this approach preserves the penalties enunciated in *Alderman* for abandoning the insured before an action has been filed. *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 155 Conn. 110 ("[t]he duty to defend has a broader aspect than the duty to indemnify and does not depend on whether the injured party will prevail against the insured"). We believe that the second approach is more appropriate in global settlements with multiple claims.

We acknowledge that the insurer's duty to defend against all claims when even one claim falls " 'even *possibly*' " within the policy's coverage; (emphasis in

original) *Hartford Casualty Ins. Co.* v. *Litchfield Mutual Fire Ins. Co.*, supra, 274 Conn. 463; suggests that an insurer who declines to either defend under a reservation or seek a declaratory judgment is technically in breach of his duty to defend against all claims in a global settlement. For the purposes of determining the reasonableness of settlements under the equitable estoppel rule of *Missionaries* and *Alderman*, however, we believe that the proper inquiry is whether the insurer would have had the duty to defend against each claim, contained in the complaint or fairly discernible from the demand for defense, when considered independently. To hold otherwise would be to expand coverage by estoppel to claims for which the insurer owes no duties under the policy. Because the duty to defend is broader than the duty to indemnify; *DaCruz* v. *State Farm Fire & Casualty Co.*, supra, 268 Conn. 688; holding a breaching insurer liable for settlement amounts attributable to claims for which there was no duty to defend is unreasonable.

Accordingly, the breaching insurer's liability for reasonable costs should be limited to the portion of the settlement corresponding to claims for which the insurer had a duty to defend, when considered independently. The insured seeking compensation for the settlement, however, bears the burden of proving reasonableness. *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160. "In short, an insurer cannot avoid paying for a settlement on the ground that the insured was not liable. What it can do is argue that, in light of the insured's defenses to liability, the amount of the settlement was unreasonably high." 2 A. Windt, Insurance Claims and Disputes: Representation of Insurance Companies and Insureds (5th Ed. 2007) § 6:29, available at https://a.next.westlaw.com/Document/I26b7971814d011daa1fd912bf881a0c3.[60]

We see no reason why the reasonableness standard should not apply to the allocation of settlement costs between claims. See, e.g., *Connecticut Indemnity Co.* v. *Perrotti*, 390 F. Sup. 2d 158, 170–71 (D. Conn. 2005) (applying *Black* to hold that insurer's liability in global settlement, subsequent to breach of duty to defend, is limited to "an amount that is reasonable considering [the insured's] potential liability in the underlying case"). Because we find that holding an insurer liable for the settlement of claims which it had no duty to defend is per se unreasonable, we hold today that an insurer may challenge the reasonableness of global settlements on the basis of the allocation of damages.

We acknowledge that this procedure erodes some of the advantages of the rule in *Missionaries* for the insured in settlements with multiple claims. Although the insurer is estopped from contesting liability subsequent to a wrongful denial of a request for defense, the insured bears the burden of proving the reasonable

allocation of the settlement in relation to the claims for which, when considered independently, the insurer had a duty to defend.[61] In the context of global settlements for more than one claim, this procedure may require a trial to determine the reasonable allocation of the settlement. *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 155 ("we are satisfied that the right of the insurer to challenge the settlement entered into by its insured on grounds of . . . unreasonableness provides it with ample opportunity to contest the propriety of such a settlement").[62]

We stress, however, that the insured is not required to prove actual liability, only "potential liability on the facts known to the [insured]"; (internal quotation marks omitted) id., 160; in light of the terms of the insurance policy.[63] We believe that this approach balances the legitimate interests of both parties, without undermining the central holding of our cases, which estop an insurer in breach of its duty to defend from "seek[ing] the protection of [the] contract in avoidance of its indemnity provisions." *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 155 Conn. 114. Accordingly, in a hearing contesting the reasonableness of a global settlement disposing of multiple claims, the issue to be decided will be the reasonable allocation of the settlement amount and associated costs in proportion to the claims for which the insurer had an independent duty to defend.[64]

The certified questions are answered as follows: (1) allegations of unintended defective construction work by a subcontractor that damages nondefective property may constitute an "occurrence" resulting in "property damage" under certain circumstances, however, defective work standing alone or repairs to that defective work do not constitute property damage and, therefore, are not covered under the particular insurance policy in the present case, and work by a contractor, as opposed to a subcontractor, is excluded from coverage under the terms of the policy; (2) under the plain language of the insurance policy in the present case, we do not recognize a cause of action based on the insurer's failure to conduct a discretionary investigation of claims for coverage; and (3) in global settlements encompassing multiple claims, the insured has the burden of proving that the settlement is reasonable in proportion to claims that, considered independently, the insurer had a duty to defend.

No costs shall be taxed in this court to either party.

In this opinion the other justices concurred.

* The listing of justices reflects their seniority status on this court as of the date of oral argument.

[1] General Statutes § 51-199b (d) provides in relevant part: "The Supreme Court may answer a question of law certified to it by a court of the United States . . . if the answer may be determinative of an issue in pending litigation in the certifying court and if there is no controlling appellate decision, constitutional provision or statute of this state."

[2] For clarity and convenience, we refer to Capstone Building and Capstone Development, collectively, as the plaintiffs and, where appropriate, individually by name.

[3] AMICO is a successor in interest to Kemper Insurance Company, which made the coverage determinations in this case. For convenience, we refer to the defendant as AMICO throughout this opinion.

[4] The District Court's "Memorandum Opinion Regarding Certified Questions" describes its recitation as "summary judgment facts" based on that court's analysis pursuant to rule 56 of the Federal Rules of Civil Procedure. As the District Court notes, "[t]hey may not be the actual facts or even the facts presented at trial." In the context of our review of a certified question, the facts meet the requirement of "showing fully the nature of the controversy out of which the question arose . . . ." General Statutes § 51-199b (f) (2).

[5] An owner controlled insurance program is a class of "[w]rap-up" insurance that provides coverage for many construction project participants under one program. 4 P. Bruner & P. O'Connor, Construction Law (2010) c.11, § 11:310, p. 882. The owner controlled insurance program policy in the present case listed "UCONN 2000 PHASE II [owner controlled insurance program]" as the insured. The contract between UConn and the plaintiffs provides that the "Named Insured on the [owner controlled insurance program] policies shall include the Owner, the State of Connecticut, their officers, agents and employees, Design/Builders and Subcontractors of any tier for whom the Owner has agreed to furnish [insurance program] coverage." AMICO, however, initially denied coverage for the plaintiffs' claims because it claimed that the plaintiffs were not insured parties under the policy. According to the District Court's memorandum, "AMICO has never reconsidered its position on the 'named insured' issue . . . ." Nevertheless, for the purposes of this certified question, we assume that the plaintiffs are insured parties.

[6] See *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764, 772, 113 S. Ct. 2891, 125 L. Ed. 2d 612 (1993) ("Insurance Services Office, Inc., an association of approximately 1400 domestic property and casualty insurers . . . is the almost exclusive source of support services in this country for [commercial general liability] insurance. [Insurance Services Office, Inc.] develops standard policy forms and files or lodges them with each [s]tate's insurance regulators; most [commercial general liability] insurance written in the United States is written on these forms." [Citation omitted.]).

[7] The commercial general liability policy defines " '[y]our work' " as:

"a. Work or operations performed by you or on your behalf; and

"b. Materials, parts or equipment furnished in connection with such work or operations.

" 'Your work' includes:

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

"b. The providing of or failure to provide warnings or instructions."

[8] The policy's general insuring provision provides in relevant part: "We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies. We will have the right and duty to defend the insured against any 'suit' seeking those damages. However, we will have no duty to defend the insured against any 'suit' seeking damages for 'bodily injury' or 'property damage' to which this insurance does not apply. We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result."

The following definitions, which we discuss subsequently in more detail, are relevant to the insuring agreement.

"13. 'Occurrence' means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. . . .

"17. 'Property damage' means:

"a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

"b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it."

[9] Similarly, on May, 9, 2005, Capstone Development also sent AMICO a letter requesting a review of UConn's claims. AMICO responded by noting that the matter did not "[appear] . . . [to] potentially implicate" the policy, and declined to "provide a coverage position at [that] time."

[10] The policy's definition of suit provides: " 'Suit' means a civil proceeding

in which damages because of 'bodily injury', 'property damage' or 'personal and advertising injury' to which this insurance applies are alleged. 'Suit' includes:

"a. An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent; or

"b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent."

[11] The construction contract between the plaintiffs and UConn provided, inter alia, that "[i]f a controversy or claim arises between the parties arising out of, or relating to this [c]ontract or the breach thereof, the parties agree to use the following procedure prior to and as a precondition to either party pursuing any other available remedies, including arbitration or litigation:

"(1) A meeting shall be held promptly between the parties . . . to attempt in good faith to negotiate a resolution of the dispute.

"(2) If, within 30 days after such meeting, the parties have not succeeded in negotiating a resolution of the dispute, they agree to submit the dispute to a non-binding mediation in accordance with the Construction Industry Mediation Rules of the American Arbitration Association."

[12] See, e.g., *Weedo* v. *Stone-E-Brick, Inc.*, 81 N.J. 233, 239, 405 A.2d 788 (1979).

[13] See, e.g., Cincinnati Ins. Co. v. Motorists Mutual Ins. Co., 306 S.W.3d 69, 73–76 (Ky. 2010); Westfield Ins. Co. v. Custom Agri Systems, Inc., 133 Ohio St. 3d 476, 484, 979 N.E.2d 269 (2012); Kvaerner Metals v. Commercial Union Ins. Co., 589 Pa. 317, 335–36, 908 A.2d 888 (2006); Auto Owners Ins. Co. v. Newman, 385 S.C. 187, 194, 684 S.E.2d 541 (2009); Webster County Solid Waste Authority v. Brakenrich & Associates, Inc., 217 W. Va. 304, 310, 617 S.E.2d 851 (2005).

[14] See, e.g., *Fejes* v. *Alaska Ins. Co.*, 984 P.2d 519, 524–26 (Alaska 1999); *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, 979 So. 2d 871, 891 (Fla. 2007); *Sheehan Construction Co.* v. *Continental Casualty Co.*, 935 N.E.2d 160, 169–71 (Ind. 2010); *Lee Builders, Inc.* v. *Farm Bureau Mutual Ins. Co.*, 281 Kan. 844, 859, 137 P.3d 486 (2006); *Wanzek Construction, Inc.* v. *Employers Ins. of Wausau*, 679 N.W.2d 322, 324–27 (Minn. 2004); *Corner Construction Co.* v. *United States Fidelity & Guaranty Co.*, 638 N.W.2d 887, 894–95 (S.D. 2002); *Travelers Indemnity Co. of America* v. *Moore & Associates, Inc.*, 216 S.W.3d 302, 308–309 (Tenn. 2007); *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, 242 S.W.3d 1, 20 (Tex. 2007); *American Family Mutual Ins. Co.* v. *American Girl, Inc.*, 268 Wis. 2d 16, 38–44, 673 N.W. 2d 65 (2004).

[15] See footnote 6 of this opinion.

[16] "To restrict insurance to cases where liability is incurred without fault of the insured would reduce indemnity to a shadow." *Messersmith* v. *American Fidelity Co.*, 232 N.Y. 161, 163, 133 N.E. 432 (1921).

[17] Indeed, because there is no question that property damage or physical injury *to third parties*, stemming from defective work, are covered occurrences under the commercial general liability policy's general insuring agreement, AMICO's arguments concerning fortuity and foreseeability provide no principled basis for distinguishing these occurrences from those that damage the contractor's own work. The commercial general liability policy does not define occurrence by reference to the ownership of damaged property. *United States Fire Ins. Co.* v. *J.S.U.B., Inc.*, 979 So. 2d 871, 883 (Fla. 2007) ("[t]his distinction would make the definition of 'occurrence' dependent on which property was damaged").

Likewise, there is no basis in the policy for denying coverage based on a distinction between tort and contract principles. While damage from an occurrence to a third party is characterized as a tort, and defective workmanship by a contractor or subcontractor will usually implicate a breach of contractual terms, "there is nothing in the basic coverage language of the current [commercial general liability] policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the [commercial general liability policy's] initial grant of coverage. 'Occurrence' is not defined by the legal category of the claim. The term 'tort' does not appear in the [commercial general liability] policy." *American Family Mutual Ins. Co.* v. *American Girl, Inc.*, supra, 268 Wis. 2d 40. Nevertheless, claims stemming from defective work that also constitute a breach of contract or warranty on the part of the insured will often be excluded pursuant to the policy's exclusions. See part II C of this opinion. For analytical clarity, and because the exclusions apply differently to contractors and subcontractors, it is important to keep this analysis separate.

[18] Because the parties have not briefed the issue of whether defective work can constitute "[l]oss of use of tangible property that is not physically

injured," our analysis tracks the parties' briefs, which exclusively discuss the policy's first definition of "property damage" as "[p]hysical injury to tangible property, including all resulting loss of use of that property."

[19] See footnotes 13 and 14 of this opinion and accompanying text.

[20] In September, 2004, UConn identified elevated levels of carbon monoxide through routine maintenance, and subsequently identified a number of building code violations, instances of nonconforming construction, and allegedly defective workmanship. In addition to elevated levels of carbon monoxide, UConn identified the following alleged deficiencies, as noted in the District Court's memorandum:

"(a) The venting system is inadequate as designed and/or constructed incorrectly to properly vent the water heater exhaust from individual apartment units,

"(b) The size of flues are questionable and vary in diameter,

"(c) The size and capacity of the air handling equipment including condensers for the two-bedroom unit are too large,

"(d) There is insufficient rise in the vent connectors,

"(e) The hot water heaters on each of the floors of the buildings are vented through common flues, without separate venting for individual water heaters,

"(f) Improper proximity of hot water heaters to air handling units and 'B' vents to combustible construction,

"(g) Violation of numerous code requirements [throughout] the complex,

"(h) Insufficient protection against emission of hot water system exhaust into individual living units,

"(i) Poor workmanship and quality control, as evidenced by cutting and crimping the pipe material and construction and other debris found in the pipes, thus obstructing and preventing the flow of exhaust from pipes,

"(j) Poor workmanship and quality control, as evidenced by pieces of the venting system not properly put together or sealed . . . ."

In December 2006, during mediation with the plaintiffs, UConn detailed its two phase remediation work to cure the alleged defects. In phase one, completed in 2004 and 2005, UConn listed the following updates, as noted in the District Court's memorandum:

"(1) The installation of heating units and flue vents in mechanical closets 'violated the State Building Code in that flue vents were not installed in shaft enclosures through fire-resistant floor assemblies and the flue vents from multiple stories were stacked into a common flue vent.' . . . [UConn] estimated the cost of remediation at $10,849,492. . . .

"(2) The vent for the washing and drying machines exceeded the code specifications by nineteen inches. . . . [UConn] estimated the cost of remediation at $636,206. . . .

"(3) 'The State Building Code requires that 4 [percent] of the student apartments be handicapped accessible. During the design phase, [Capstone Development] failed to properly plan for the proper number of apartments. To comply with the State Building Code additional apartments had to undergo significant modifications to allow accessibility.' . . . [UConn] estimated the cost of remediation at $595,835.

"(4) 'At various locations in the installation liquid tight flexible non-metallic conduit was employed. In many instances, an inadequate number of supports were installed, especially adjacent to the exterior condenser units.' . . . [UConn] estimated the cost of remediation at $35,264.

"(5) 'The design documents called for metal drain pans to be located under air handling units to comply with the State Building Code and to protect the adjacent area surrounding the mechanical equipment in the event the primary drain is blocked. The auxiliary pans were not installed.' . . . [UConn] estimated the cost of remediation at $409,063. . . .

"(6) 'The electrical design called for recessed light fixtures in the ceilings of many of the units. The units specified were replaced with a substitution by the electrical contractor and approved by [Capstone Development's] electrical engineer. The substituted units, however, did not allow contact with insulation, as was required for that application.' . . . [UConn] estimated the cost of remediation at $25,545. . . .

"(7) 'The plans for the units included many exit doors that led only a short distance from the apartment buildings. The State Building Code requires that the exit discharge must lead from the exit doors to a public way. Further, it was revealed that there were missing handrails, improper slopes and inaccessible egress.' . . . [UConn] estimated remediation at $86,094. . . .

"(8) '[T]he stair rails did not extend at least [twelve inches] beyond the top riser and the depth of one tread beyond the bottom riser. The rails had

to be extended to meet the code. Also . . . there were not barriers underneath the stairs to protect people from colliding with the bottom of the stairs.' . . . [UConn] estimated remediation at $122,323. . . .

"(9) Cabinets containing fire extinguishers 'protrude[d] more than [four inches] into egress paths, resulting in a code violation.' . . . [UConn] estimated remediation at $139,758. . . .

"(10) 'The design of the structures designated the buildings as Type 5A wood framed structures with sprinkler protection. Based on that designation, the drawings further provided fire-rating requirements for floor and roof assemblies. Notwithstanding those designations, the actual installation compromised the fire-rating because of numerous heater flues, light fixtures and ductwork penetrations into those fire-rated assemblies.' . . . [UConn] estimated the cost of remediation at $2,363,085. . . .

"(11) At odds with the State Building Code, 'gypsum wallboard was installed adjacent to Fire Sprinkler devices and valves in stair shafts.' . . . [UConn] estimated the cost of remediation at $9,011. . . .

"(12) '[E]lectrical panels in buildings 19 and 20 had been designed and installed in clothes closets which is a violation of the State Building Code.' . . . [UConn] estimated the cost of remediation at $36,696." (Citations omitted.)

UConn lists the following repairs during phase two of the remediation project, completed during 2006, as noted in the District Court's memorandum:

"(1) '[T]he lack of continuity of the stair shaft wall was a violation of code.' . . . '[A]n additional code deficiency of the penetration of the shaft wall assemblies by floor trusses also existed.' . . . While [UConn] began repairing these issues with the stair shafts, 'water damage was discovered in the stair shaft wall of building 19. Upon further investigation, it was discovered that the water damage originated from a leak in a water pipe due to its penetration by a screw during the original construction. The water leak led to the discovery of plumbing systems penetrating the shaft wall which was also a code violation.' . . . 'During this process [of addressing the aforementioned problems], condensate piping and refrigerant piping was found penetrating the fire separation assembly. In some buildings, this work required the existing kitchen fixtures and cabinetry to be removed, utilities to be removed and relocated and the original kitchen fixtures and cabinetry reinstalled.' . . . [UConn] estimated the cost of remediation at $5,900,000 and the lost revenue associated with the evacuation of students at $1,160,000. . . .

"(2) 'The design and installation of the Hilltop . . . fire protection system result[ed] in several code deficiencies.' . . . [UConn] estimated the cost of remediation at $1,800,000. . . .

"(3) '[T]he design and construction of firewalls and attic spaces' resulted in 'several code deficiencies.' . . . [UConn] estimated the cost of remediation at $82,462. . . .

"(4) Electrical installations violated the State Building Code. . . . For example, 'electrical panels [were] installed in fire rated walls along with duplex receptacles that were loose, device face plates . . . were improperly installed, and outlet and switch device boxes . . . were recessed more than 1/4 [inch] from the finished surface.' . . . Additionally, 'no warning ribbon was installed over some of the secondary direct burial cables and the warning ribbon that was in place was installed improperly, less than 12 [inches] above the service lateral. . . . [I]nadequate grounding was provided at each main panel board.' . . . Finally, 'outlets for the kitchen range . . . had connectors left unattached to the device boxes and exposed copper conductors in the wall cavity . . . time delay relay devices for the bathroom exhaust fans [were improperly installed, and] fire alarm audible sound in individual apartments [was] set to the wrong tone.' . . . [UConn] estimated the cost of remediation at $784,995. . . .

"(5) Regarding interior egress, the following State Building Code violations were discovered: '(1) handrails that were located less than 34 [inches] from the nose of the tread in the exit stair enclosures; (2) exit stair enclosures that did not contain tactile signage; (3) a lobby entrance/exit in building 22 that was not constructed as shown on the drawings [which] result[ed] in non-compliant doors; and (4) there was only one exit for lower level units in buildings 19 and 20, where the code required two exits.' . . . [UConn] estimated the cost of remediation at $487,701. . . .

"(6) Exterior code violations were also discovered. . . . In particular, '[t]read and riser dimensions on exterior egress stairs were found to exceed the required dimensional uniformity. Several rear [exits] discharged onto

the lawn without clear paths to travel to public way and erosion was observed on temporary gravel walkways.' . . . Because [UConn], at the time of the Revised Demand, was investigat[ing] possible solutions, the cost was not yet determined. . . .

"(7) [UConn] discovered that 'the rigid metal conduits used to sleeve the direct burial cables into the transformer pads . . . were not properly bonded resulting in a code deficient installation. . . . [I]mproper backfill material was used around the direct burial of secondary cables.' . . . At the time of the Revised Demand, [UConn] was exploring possible remediation approaches, and consequently, the cost was not yet determined. . . .

"(8) '[A] sample of magnetic door hold-open devices . . . appeared to be operating at higher than normal temperatures [which] result[ed] in . . . code discrepancies.' . . . At the time of the Revised Demand, the cost was not yet determined. . . .

"(9) Finally, [UConn] 'identified various code issues that [were] considered maintenance issues . . . (1) roof trusses that had been cut in the mechanical room of apartment buildings; (2) incandescent light fixtures that were improperly installed in closets; (3) temporary lighting cords and applicant cords that were found to be improperly installed in various locations; (4) missing escutcheon plates, electrical box covers and light fixture covers, along with broken light fixtures and sprinkler heads; (5) water flow devices mounted too close to the ceiling and an improperly mounted smoke detector; and (6) . . . [Carbon monoxide] detector cables in mechanical closets . . . were not supported or properly protected.' . . . Similarly, 'two aluminum conductors rated at 500 amps were improperly connected to a 600 amp breaker and inadequate ground rod protection was used at each main panel board in the original construction . . . .' " (Citations omitted.)

[21] We emphasize that the parties in the present case did not brief the issue of whether the presence of carbon monoxide would meet the policy's second definition of property damage, "loss of use of tangible property that is not physically injured." While we take no position on this matter, we note that in *Concord General Mutual Ins. Co.* v. *Green & Co. Building & Development Corp.*, supra, 160 N.H. 694, the New Hampshire Supreme Court held that because "the homeowners were not required to vacate their homes while the chimneys were being repaired" there was no loss of use of other, nondefective property under the policy's terms.

[22] Likewise, such claims do not, by themselves, meet the definition of property damage as "[l]oss of use of tangible property that is not physically injured" because there is no loss in the use of property that was already defective when incorporated into the project. *Travelers Indemnity Co. of America* v. *Moore & Associates, Inc.*, supra, 216 S.W.3d 310 ("mere inclusion of a defective component" is not property damage [internal quotation marks omitted]); *Travelers Ins. Co.* v. *Eljer Mfg., Inc.*, supra, 197 Ill. 2d 312 (rejecting incorporation theory); see *Esicorp, Inc.* v. *Liberty Mutual Ins. Co.*, 266 F.3d 859, 862 (8th Cir. 2001) (generally, courts addressing term "property damage" in standard commercial general liability policy hold that mere incorporation of defective component is not "property damage").

[23] Likewise, repairs to structural deficiencies, made for the purpose of preventing "[p]hysical injury to tangible property, including all resulting loss of use of that property," before the alleged deficiency has caused "property damage" are not within the insuring agreement's definition of property damage. *Concord General Mutual Ins. Co.* v. *Green & Co. Building & Development Corp.*, supra, 160 N.H. 694 (damages include only those costs which are remedial, not preventative). *Fidelity & Deposit Co. of Maryland* v. *Hartford Casualty & Ins. Co.*, 215 F. Sup. 2d 1171, 1183–84 (D. Kan. 2002), provides a good example of this principle. The contractor's defective construction caused cracked walls, joints and floor slabs, which were unquestionably "property damage" under the commercial general liability policy. Other defective work, however, such as discontinuous reinforcement bars in laid concrete, had not yet caused physical injury to other property, although it would likely have damaged property in the future. The court stated that the insured's decision to demolish and rebuild the project may have been a good business decision, but it was not necessary to repair the property that was physically injured at the time of the action. Because the proper measure of damages was the cost to repair the physically injured property, the court apportioned damages between costs to repair physically injured property and the costs to prevent future damages.

[24] The burden of proving that an exclusion applies is on the insurer, but the insured has the burden of proving that an exception to an exclusion reinstates coverage. *Buell Industries, Inc.* v. *Greater New York Mutual Ins.*

Co., supra, 259 Conn. 551.

[25] We note, however, that the increasing use of subcontractors will tend to expand coverage for defective work or faulty workmanship in policies containing the subcontractor exception, which is discussed herein. To the extent that this development reflects the intent of the parties as reflected in the four corners of the policy, we are unwilling to limit the scope of commercial general liability coverage to their original bounds. The parties may expand or contract coverage by modifying the terms of the policy. See *Lamar Homes*, *Inc.* v. *Mid-Continent Casualty Co.*, supra, 242 S.W.3d 12 ("[m]ore recently, the Insurance Services Office [Inc.] has issued an endorsement that may be included in the [commercial general liability] to eliminate the subcontractor exception to the 'your work' exclusion").

[26] The leading case cited for the proposition that "[t]he [commercial general liability] coverage is for tort liability for physical damages to others and 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"; *Weedo* v. *Stone-E-Brick*, *Inc.*, 81 N.J. 233, 240, 405 A.2d 788 (1979); conceded that "but for the exclusions in the policy, coverage would obtain." Id., 237 n.2. The discussion in *Weedo* of the pre-1986 commercial general liability policy, containing different, and broader "business risk" exclusions than those in the present commercial general liability policy, is not persuasive authority for denying coverage here. See, e.g., *Travelers Indemnity Co. of America* v. *Moore & Associates*, *Inc.*, supra, 216 S.W.3d 306–307 (distinguishing *Weedo* and cases interpreting pre-1986 policy forms); *American Family Mutual Ins. Co.* v. *American Girl*, *Inc.*, supra, 268 Wis. 2d 41 (same).

[27] Exclusions (j) through (n), which generally preclude coverage for damage to the work of the insured, are sometimes referred to as "business risk exclusions." See, e.g., *American Family Mutual Ins. Co.* v. *American Girl*, *Inc.*, supra, 268 Wis. 2d 50.

[28] Section V (21) of the policy defines " 'Your work' " as follows:

"a. Work or operations performed by you or on your behalf; and

"b. Materials, parts or equipment furnished in connection with such work or operations."

Section V (16) of the policy defines " '[p]roducts-completed operations hazard' " in relevant part as:

"a. Includes all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work' except:

"(1) Products that are still in your physical possession; or

"(2) Work that has not yet been completed or abandoned. However, 'your work' will be deemed complete at the earliest of the following times:

"(a) When all of the work called for in your contract has been completed. . . .

"(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

"Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed. . . ."

[29] Contrary to AMICO's assertion, this analysis does not find coverage based on an exclusion. Nevertheless, because "[a] contract of insurance must be viewed in its entirety"; (internal quotation marks omitted) *Hartford Casualty Ins. Co.* v. *Litchfield Mutual Fire Ins. Co.*, supra, 274 Conn. 463; the subcontractor exception to the "your work" exclusion does provide further support for our holding that the policy covers property damage caused by defective workmanship that results in damage to nondefective property. See, e.g., *Sheehan Construction Co.* v. *Continental Casualty Ins. Co.*, 935 N.E.2d 160, 171 (Ind. 2010) ("[i]f the insuring provisions do not confer an initial grant of coverage, then there would be no reason for the 'your work' exclusion").

[30] This holding is consistent with the history of commercial general liability policies promulgated by the insurance industry. The Wisconsin Supreme Court described the origins of the subcontractor exception: "Prior to 1986 the [commercial general liability] business risk exclusions operated collectively to preclude coverage for damage to construction projects caused by subcontractors. Many contractors were unhappy with this state of affairs, since more and more projects were being completed with the help of subcontractors. In response to this changing reality, insurers began to offer coverage for damage caused by subcontractors through an endorsement to the [commercial general liability] . . . . Among other changes, the [endorsement]

extended coverage to property damage caused by the work of subcontractors. In 1986 the insurance industry incorporated this aspect of the [endorsement] directly into the [commercial general liability] itself by inserting the subcontractor exception to the 'your work' exclusion." *American Family Mutual Ins. Co.* v. *American Girl, Inc.*, supra, 268 Wis. 2d 52–53.

[31] We acknowledge that other courts have taken a contrary position. See, e.g., *Kvaerner Metals* v. *Commercial Union Ins. Co.*, 589 Pa. 317, 335–36, 908 A.2d 888 (2006) ("We hold that the definition of 'accident' required to establish an 'occurrence' under the policies cannot be satisfied by claims based upon faulty workmanship . . . . To hold otherwise would be to convert a policy for insurance into a performance bond."); see also *Town & Country Property, LLC* v. *Amerisure Ins. Co.*, So. 3d , 2011 WL 5009777, *6 (Ala. October 21, 2011) (citing *Kvaerner Metals* and concluding similarly that "faulty workmanship" itself was not occurrence and thus insurer was not required to indemnify insured). These decisions, however, do not focus their analysis on the terms of the commercial general liability contract. As we have explained previously, we find this reasoning unpersuasive.

[32] "[A]n insurance policy spreads the contractor's risk while a bond guarantees its performance. An insurance policy is issued based on an evaluation of risks and losses that is actuarially linked to premiums; that is, losses are expected. In contrast, a surety bond is underwritten based on what amounts to a credit evaluation of the particular contractor and its capabilities to perform its contracts, with the expectation that no losses will occur. Unlike insurance, the performance bond offers no indemnity for the contractor; it only protects the owner." *Lamar Homes, Inc.* v. *Mid-Continent Casualty Co.*, supra, 242 S.W.3d 10 n.7. In the present case, Capstone Building was the principal to a $35.5 million bond with Travelers Casualty and Surety Company of America, entered into on July 28, 2000. On September 29, 2004, UConn gave notice and asserted its claims against Travelers Casualty and Surety Company of America, as surety on the performance bond, "for reimbursement and indemnification for any and all costs, expenses and damages incurred or suffered, or to be incurred or suffered . . . in connection with the discovery, investigation, engineering and remediation undertaken in connection with the condition described in the enclosed . . . letter, and the failure of performance of Capstone Building . . . ." Given the differences between a commercial general liability policy and a performance bond, we need not decide the scope of the coverage of the surety bond in this case.

[33] An independent cause of action for a bad faith denial of policy benefits is well established. *Buckman* v. *People Express, Inc.*, 205 Conn. 166, 170, 530 A.2d 596 (1987). In light of the facts of the present case, and the issues raised in the briefs, we focus our analysis on whether a cause of action for bad faith investigation exists in the absence of any breach of express duties under the policy. "[I]t is the practice of this court to analyze [certified] questions with respect to the specific contract at issue, where such analysis can yield an appropriate answer." *Arrowood Indemnity Co.* v. *King*, supra, 304 Conn. 186.

[34] "This court has tended to use the terms 'bad faith,' 'lack of good faith' and 'breach of the covenant of good faith and fair dealing' interchangeably"; *PSE Consulting, Inc.* v. *Frank Mercede & Sons, Inc.*, 267 Conn. 279, 296 n.7, 838 A.2d 135 (2004); and applies the same analysis to claims brought under each of these terms. See *Buckman* v. *People Express, Inc.*, 205 Conn. 166, 170, 530 A.2d 596 (1987) (referring to allegations of breach of good faith and fair dealing as "claim of bad faith").

[35] In contrast to AMICO's discretion to investigate, the policy affirmatively commits AMICO to "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" and to "defend the insured against any 'suit' seeking those damages."

[36] Because the duty to defend is broader than the duty to indemnify and arises when a complaint "falls even possibly within the coverage"; *Schilberg Integrated Metals Corp.* v. *Continental Casualty Co.*, 263 Conn. 245, 256–57, 819 A.2d 773 (2003); an insurer may breach the duty to defend even if the claim is ultimately found to be uncovered. Accordingly, in bad faith cases where the insured is alleged to have violated a substantive provision of the insurance contract, the court must consider the distinct standards triggering the duties to defend and to indemnify.

[37] The self-insured employer in *Buckman* violated General Statutes § 38-262d. As we explained in *Buckman* v. *People Express, Inc.*, supra, 205 Conn.

169–70, the statute "provides that whenever an employee who is a member of a group hospital or medical insurance plan becomes ineligible for continued participation in such plan for any reason, the medical benefits under such plan shall be made available by the employer to the employee for an extension period of thirty-nine weeks or until the discontinued employee becomes eligible for benefits under another group medical insurance plan. The statute further provides that the employer must inform the employee in writing of his right to continue his medical insurance coverage within ten days after the employee becomes ineligible to participate in the group plan."

[38] A closer review of the authorities purporting to establish a bad faith cause of action resting solely on a failure to investigate reveals that many actually involve the denial of substantive benefit under the policy. For example, one treatise provides: "The standard [Insurance Services Office, Inc.] commercial general liability coverage form makes the insurer's investigation discretionary. Notwithstanding this policy language, most states have developed laws that place a duty to investigate a claim on an insurer before making a coverage determination." 4 P. Bruner & P. O'Connor, supra, c. 11, § 11:58, pp. 171–72. The case cited in support of this proposition, however, only states that evidence that the insurer "did not make a good-faith effort to objectively investigate the [insured's] claim" by conducting an investigation designed to support the insured's arson theory was evidence from which a jury could logically infer that "[the insurer] denied the claim in bad faith." *State Farm & Fire Casualty Co.* v. *Simmons*, 963 S.W.2d 42, 45–46 (Tex. 1998). This reasoning is consistent with our holding that bad faith actions must be tethered to allegations of denial of benefits under the policy.

[39] Other jurisdictions, however, would permit bad faith claims even in the absence of a breach of an underlying policy term. See *Lloyd* v. *State Farm Mutual Automobile Ins. Co.*, 189 Ariz. 369, 377, 943 P.2d 729 (1996) ("[t]he covenant of good faith and fair dealing can be breached even if the policy does not provide coverage"); *St. Paul Fire & Marine Ins. Co.* v. *Onvia, Inc.*, 165 Wn. 2d 122, 132, 196 P.3d 664 (2008) ("third-party insured has a cause of action for bad faith claims handling that is not dependent on the duty to indemnify, settle, or defend"); *Coventry Associates* v. *American States Ins. Co.*, 136 Wn. 2d 269, 279, 961 P.2d 933 (1998) (action for bad faith investigation permissible "regardless of whether the insurer was ultimately correct in determining coverage did not exist"*)*. The reasoning of these cases, however, is based on finding a cognizable "security" and "peace of mind" interest for the insured in the insurer's handling of claims, apart from the receipt of the policy's benefits. See, e.g., *Coventry Associates* v. *American States Ins. Co.*, supra, 283 ("[T]he insurance contract brings the insured a certain peace of mind that the insurer will deal with it fairly and justly when a claim is made. Conduct by the insurer which erodes the security purchased by the insured breaches the insurer's duty to act in good faith."). For the reasons discussed in this part of the opinion, we decline to adopt this theory of bad faith.

[40] Insurers who fail to defend or to indemnify in bad faith may face liability in addition to the policy's benefits, including damages for financial loss and mental and emotional distress. *Buckman* v. *People Express, Inc.*, supra, 205 Conn. 173. In the appropriate case, punitive damages for attorney's fees may be awarded. *L. F. Pace & Sons, Inc.* v. *Travelers Indemnity Co.*, 9 Conn. App. 30, 48, 514 A.2d 766 (1986) ("[e]lements of tort such as wanton or malicious injury or reckless indifference to the interests of others giving a tortious overtone to a breach of contract action justify an award of punitive or exemplary damages . . . [of] an amount which will serve to compensate the plaintiff to the extent of his expenses of litigation less taxable costs"), cert. denied, 201 Conn. 811, 516 A.2d 886 (1986).

[41] General Statutes § 38a-816 (6) provides in relevant part: "Unfair claim settlement practices. Committing or performing with such frequency as to indicate a general business practice any of the following . . . (C) failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies; (D) refusing to pay claims without conducting a reasonable investigation based upon all available information; (E) failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed; (F) not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear . . . (N) failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement . . . ."

We note that § 38a-816 (6) requires that a plaintiff allege and prove that

the relevant conduct was a part of a general business practice. *Lees* v. *Middlesex Ins. Co.*, 229 Conn. 842, 849, 643 A.2d 1282 (1994).

[42] *Brethorst* v. *Allstate Property & Casualty Ins. Co.*, supra, 334 Wis. 2d 53 ("permitting a party to succeed on a first-party bad faith claim completely uncoupled from a prerequisite breach of contract would invite the filing of unmeritorious claims, focused on the insurer's alleged misconduct").

[43] "An insurer's duty of good faith does not require it to squander its resources or those of its other policyholders in obviously futile exercises." D. Richmond, supra, 39 Tort Trial & Ins. Prac. L.J. 20.

[44] An inadequate investigation causes no compensable damage to the insured when no benefits are due under the policy. "An insured's investigation expenses cannot amount to harm caused by an insurer's bad faith unless the insured's investigation reveals that the subject claim or loss is covered. In that situation, of course, the issue is not bad faith in the absence of coverage, but the insurer's wrongful denial of coverage." D. Richmond, supra, 39 Tort Trial & Ins. Prac. L.J. 19–20; see also S. Ashley, Bad Faith Actions: Liability and Damages (1997) § 5A:02, commentary, p. 5A-10 ("[i]f the insured bases his bad faith claim on the insurer's unreasonable withholding of benefits due under the policy, it follows that a finding of no coverage necessarily implies no bad faith"); but see *Coventry Associates* v. *American States Ins. Co.*, 136 Wn. 2d 269, 285, 961 P.2d 933 (1998) (insured may recover expenses incurred to conduct own investigation in bad faith tort action based on inadequate investigation by insurer, despite fact that coverage was eventually shown to be excluded). Because we reject a separate "security interest" in the investigation, apart from the benefits of the policy itself; see footnote 39 of this opinion; the insured may not recover damages based on this class of harm.

[45] The court in *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 611, held that "an insurer who denies liability under a policy is liable for the amount of a settlement made by the insured before suit is brought . . . ." We note that the rule in *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, 155 Conn. 104, 112, 230 A.2d 21 (1967), from which *Alderman* derives, is not universally accepted. See, e.g., *A.B.C. Builders, Inc.* v. *American Mutual Ins. Co.*, 139 N.H. 745, 751, 661 A.2d 1187 (1995) (breach of duty to defend "should not be used as a method of obtaining coverage for the insured that the insured did not purchase"); *Servidone Construction Corp.* v. *Security Ins. Co.*, 64 N.Y.2d 419, 423, 477 N.E.2d 441, 488 N.Y.S.2d 139 (1985) (holding that in New York "an insurer's breach of duty to defend does not create coverage and . . . even in cases of negotiated settlements, there can be no duty to indemnify unless there is first a covered loss"). Other states, however, follow some version of a rule estopping insurers from denying liability after an unjustified refusal to defend. *Gray* v. *Zurich Ins. Co.*, 65 Cal. 2d 263, 279, 419 P.2d 168, 54 Cal. Rptr. 104 (1966) ("an insurer that wrongfully refuses to defend is liable on the judgment against the insured"); *State Farm Fire & Casualty Co.* v. *Martin*, 186 Ill. 2d 367, 371, 710 N.E.2d 1228 (1999) (insurer breaching duty to defend is estopped from raising policy defenses to coverage).

[46] Because "[t]he purpose of the certification process is to answer the question of law submitted pursuant to the certification, not to resolve factual disputes between the parties"; 32A Am. Jur. 2d, supra, § 1136, p. 540; we assume, only for the purposes of part IV of this opinion, that AMICO had a duty to defend at least one of the claims under the policy. This somewhat unusual posture is necessary to guide the District Court's disposition of the case, which requires an application of the legal principles in this decision to the facts of the case. See, e.g., 69 A.L.R.6th 444, § 12 (2011) ("a court answering questions certified under the Uniform Certification of Questions of Law Act is not sitting as an appellate court but rather simply answers the questions of law presented"). Because we hold that, in appropriate circumstances, property damage caused by defective workmanship may be covered under the commercial general liability policy; see part II of this opinion; the answer to the third certified question "may be determinative of an issue in pending litigation in the certifying court . . . ." General Statutes § 51-199b (d).

[47] See *Imperial Casualty & Indemnity Co.* v. *State*, 246 Conn. 313, 332, 714 A.2d 1230 (1998) ("[t]he fact that the complaint alleges a claim that is excluded by the policy does not excuse [the] insurer from defending [the] insured where other counts of the claim fall within the provisions of the policy" [internal quotation marks omitted]).

[48] In *R.T. Vanderbilt Co.* v. *Continental Casualty Co.*, supra, 273 Conn. 471, we held that "a [potentially responsible party] letter issued by the

Environmental Protection Agency will *always* constitute a suit within the meaning of standard comprehensive general liability insurance policy language." (Emphasis in original.) As additional support for this conclusion, however, we also noted that "the [potentially responsible party] letters in the present matter were sufficiently detailed for the defendant to discern whether the allegations contained within the letters fell within the scope of the plaintiff's insurance coverage." Id. Although our decision in *Alderman* did not specifically address the content of the insured's presuit demand for coverage, under the facts of that case, it was apparent that the insured "continued to demand payment from the [insurer]" for ten months, during which time the insurer continuously denied coverage under the policy. *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 605. Under these facts, we held that "the insurer [had] wrongfully denied coverage," despite the absence of an action at the time of settlement. Id., 610. Moreover, we have also held that courts "should not employ a wooden application of the four corners of the complaint rule . . . [because] [a]fter all, the duty to defend derives from the insurer's contract with the insured, not from the complaint." (Citations omitted; internal quotation marks omitted.) *Hartford Casualty Ins. Co.* v. *Litchfield Mutual Fire Ins. Co.*, supra, 274 Conn. 467. Accordingly, when an insurer denies coverage altogether in response to a demand for defense that sufficiently alerts the insurer to the possibility of coverage under the policy, the insurer is not required to sit idle, and may settle with the claimant. *Alderman* v. *Hanover Ins. Group*, supra, 611.

[49] An insurer can also avoid liability for settlements tainted by fraud or collusion. *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 154. These factors are beyond the scope of this certified question.

[50] AMICO's response stated, "[a]s the liability at issue arises out of [Capstone Building's] own work, including its role as general contractor and heating and plumbing installation, there can be no coverage for this matter for Capstone [Building] under the policy." AMICO reached this conclusion by characterizing the "named insured" on the policy as "UCONN 2000 Phase II [owner controlled insurance program]" and Capstone Building as "additional insured." Pursuant to this definition, AMICO relied on a policy endorsement concerning coverage to an "additional insured" to assert that only damages arising from the work of "UCONN 2000 Phase II [owner controlled insurance program]" were covered under the policy. AMICO declined to reconsider this determination in response to Capstone Building's requests.

[51] AMICO's complaint in the declaratory judgment action asserted: "[AMICO] is not responsible under the [insurance policy] to provide to [Capstone Development] the protection from [UConn] claimed by [Capstone Development]; that the claims presented by [UConn] are not claims or losses for which there is coverage under the [insurance policy]; [and] that [AMICO] has no obligation to participate in any mediation urged by [Capstone Development] . . . ." *American Motorist Ins. Co.* v. *Capstone Development Corp., Inc.*, supra, United States District Court, Docket No. 2:06-CV-1031-WMA. The declaratory judgment action was subsequently dismissed for failure to join UConn as a necessary party.

[52] As noted in the District Court's memorandum, the building contract included "Supplementary Conditions," which provided in relevant part: " 'Mediation of Claims'

"If a controversy or claim arises between the parties arising out of, or relating to this Contract or breach thereof, the parties agree to use the following procedure prior to and as a precondition to either party pursuing any other available remedies, including arbitration or litigation:

"1. A meeting shall be held promptly between the parties, attended by individuals with decision-making authority regarding the dispute, to attempt in good faith to negotiate a resolution of the dispute."

[53] For a list of damages and remediation submitted by UConn as a part of the mediation, see footnote 20 of this opinion.

[54] For the purposes of deciding this third certified question, we assume that at least some of the claims were covered under AMICO's broad duty to defend. See footnote 46 of this opinion. We note that, in light of the extensive list in UConn's complaint, it appears that AMICO had a duty to defend only a small portion of UConn's claims.

[55] The action in *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 155 Conn. 108, stemmed from a claim by a deliveryman injured by falling into a ditch that had been dug for a construction project on the insured property. The defendant insurer maintained that the ditch was a "hazard arising from the construction of the new addition and consequently the injury was excluded from the policy coverage, and that exclusion

relieved the [insurer] of any obligation to defend the action." Id., 109–10. The insured thereafter undertook defense of the injured party's claim. A verdict was rendered against the insured, which the trial court set aside, and the parties settled the case. Id., 106. The insured then brought an action against the insurer to recover the value of the settlement and costs. The trial court concluded that the insurer had breached its duty to defend, under the policy, and the insurer's breach made it liable for the value and costs of the settlement. On appeal, this court agreed that the insurer had breached its duty to defend the action. Although we noted that the trial court had held the policy's exclusions were not applicable to the claims of injury, we found it unnecessary to reach the issue of whether the insured had also breached its duty to indemnify. Id., 112–13.

[56] In *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 605, an insured contractor had damaged a manufacturer's facility in the course of removing a coal conveyer tower. In response to repeated requests for defense by the insurer, the insurer maintained that the damage was not covered because of exclusions in the policy. Consequently, the insured settled the claim with the manufacturer, and thereafter brought an action against the insurer to recover the amount of the settlement and associated costs. Id.

[57] As relevant to this question, the court in *Black* addressed an insurer's challenge to a stipulated judgment, on the basis that the settlement amount was excessive in light of the damages alleged in the insured's claim and probable liability had the claim gone to trial. The reasoning is equally applicable, however, to cases in which the insurer, subsequent to breaching its duty to defend, seeks to contest the reasonableness of a settlement alleged to include both covered and uncovered claims. *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160 (reasonableness determination applicable to stipulated judgments and other insurance settlements).

[58] We acknowledge, of course, that abandoning the estoppel rule in *Missionaries* would open the door to other approaches. For example, the insurer breaching its duty to defend could be liable only for those claims for which it is ultimately found to have a duty to indemnify. See, e.g., *Polaroid Corp.* v. *Travelers Indemnity Co.*, 414 Mass. 747, 762–63, 610 N.E.2d 912 (1993) ("[i]f an underlying claim . . . is not within the coverage of an insurance policy, an insurer's improper failure to defend that claim would not ordinarily be a cause of any payment that the insured made in settlement of that claim"); *Servidone Construction Corp.* v. *Security Ins. Co.*, 64 N.Y.2d 419, 424, 477 N.E.2d 441, 488 N.Y.S.2d 139 (1985) ("[t]he duty to defend is measured against the allegations of pleadings but the duty to pay is determined by the actual basis for the insured's liability to a third person"). This approach, however, is contrary to *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 155 Conn. 113 (holding it "unnecessary to reach [the] issue" of duty to indemnify once insured was found to be in breach of its duty to defend), and *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 612 ("plaintiff's 'present rights against defendant are based upon defendant's breach of the insurance contract and not upon provisions of such contract requiring defendant to pay any amounts for which plaintiff [had] become legally obligated' "). Moreover, this approach provides little incentive for the insurer to honor its duty to defend, since it could await the insured's settlement and then litigate the ultimate issue of indemnification. *Missionaries of the Co. of Mary, Inc.* v. *Aetna Casualty & Surety Co.*, supra, 114.

[59] In *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160, this court held that "[i]n determining whether a settlement is reasonable, the jury is entitled to consider not only the damage sustained by the injured party, but also the likelihood that the injured party would have succeeded in establishing the insured's liability." This flexible reasonableness determination is consistent with allocating settlement costs in proportion to those claims for which an insurer breached its duty to defend.

[60] The reasonableness determination may rely on a variety of factors, including, but not limited to "whether there is a significant prospect of an adverse judgment, whether settlement is generally advisable, [whether] the action is taken in good faith, and [whether it is] not excessive in amount . . . ." (Internal quotation marks omitted.) *Metropolitan Life Ins. Co.* v. *Aetna Casualty & Surety Co.*, supra, 249 Conn. 56. "In order to recover the amount of the settlement from the insurer, the insured need not establish actual liability to the party with whom it has settled so long as . . . a potential liability on the facts known to the [insured is] shown to exist, culminating in a settlement in an amount reasonable in view of the size of possible recovery and degree of probability of [a] claimant's success against

the [insured]. . . . Accordingly, the strength of the [insured's] case is a factor . . . in deciding whether the settlement [was] reasonable." (Citation omitted; internal quotation marks omitted.) *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160–61.

[61] As the party with knowledge of the circumstances and facts surrounding the settlement, the insured properly should bear the burden of justifying the settlement's reasonableness on the insured. Other courts follow a burden shifting approach under which "[t]he initial burden of going forward with proofs of [reasonableness] rests upon the insured and the ultimate burden of persuasion as to these elements is the responsibility of the insurer." *Griggs* v. *Bertram*, 88 N.J. 347, 368, 443 A.2d 163 (1982). In these jurisdictions, however, the breaching insurer is liable for the settlement only to the extent it is for claims "later found to be covered under the policy . . . ." Id., 364. In contrast, under the rule in *Missionaries*, an insurer is liable for the reasonable settlement of claims for which it breached its duty to defend regardless of whether they would ultimately have been covered under the policy's indemnification provisions.

[62] See, e.g., *American Motorists Ins. Co.* v. *Trane Co.*, 544 F. Sup. 669, 689–91 (W.D. Wis. 1982) (insurer breaching its duty to defend against one of four claims liable for settlement costs up to $50,000 policy limit when this amount was "presumably a relatively small proportion of the total settlement").

[63] We note that, "[n]either the insurer nor the insured should be allowed to try the plaintiff's claim in the coverage suit. The insurer should not, however, be bound by how the settlement is allocated by the insured/claimant or by what the agreement states is the reason the settlement money was paid." 2 A. Windt, supra, § 6:31. We believe this procedure balances the public policy in favor of settlement; *Allstate Ins. Co.* v. *Mottolese*, 261 Conn. 521, 531, 803 A.2d 311 (2002); against the equitable requirement for reasonable settlements.

[64] The reasonableness standard applies to both the amount of the presuit settlement and the expenses incurred in reaching the settlement subsequent to the insurer's breach of its duty to defend. In *Alderman* v. *Hanover Ins. Group*, supra, 169 Conn. 611, this court noted that the "right of the insured to recover the amount of a reasonable, presuit settlement is severely limited if there is not a corresponding right to recover costs incurred in effecting that settlement." Accordingly, the court held that "where the insurer wrongfully refuses to defend a suit, the insurer is obligated to pay to the insured all the expenses that the insured incurs in defending the suit, including costs of investigation and legal fees." Id., 612. The insured bears the burden of showing that attorney's fees were reasonable with respect to the claims for which the insured breached its duty to defend. *Black* v. *Goodwin, Loomis & Britton, Inc.*, supra, 239 Conn. 160. Where "an apportionment is impracticable because the claims arise from a common factual nucleus and are intertwined," however, the court may order the full recovery or reasonable attorney's fees and settlement costs. *Total Recycling Services of Connecticut, Inc.* v. *Connecticut Oil Recycling Services, LLC*, 308 Conn. 312, 333, A.3d (2013).