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Kate Enos Frownfelter

Insurance 101: What Every Construction Lawyer Needs to Know about Insurance

By Kate Enos Frownfelter and Tim Clancy

Tim Clancy

Construction lawyers representing owners, constructors, and design professionals need to understand the various insurance policies that may provide coverage to their clients in the event of a construction loss. In many cases, an insured's solvency may depend on the scope of coverage under its own policies, the policies of other companies involved in the project, and the manner in which the parties allocated risk of loss in the construction contracts. This article covers some basic concepts that every construction lawyer needs to know about insurance.

The Property/Casualty Programs and Construction

The ISO Commercial General Liability Insurance Policy

The standard insurance industry forms for the core commercial property and casualty lines of coverage are the forms drafted by the Insurance Services Office (ISO). The ISO commercial general liability (CGL) policy form covers bodily injury and property damage liability exposures that are related to normal business

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Ronald W. Messerly

A Crane Collapses: Am I Liable and, More Important, Am I Covered?

By Ronald W. Messerly and David T. Dekker

David T. Dekker

Your client calls: A tower crane has just collapsed at the high-rise condominium project the company is working on. You start hearing terms like "luffing jib," "horizontal jib," "hammerhead," "flat top," "boom," and "headache ball." If you think these terms refer to hair cuts, your client is about to take one. Cranes are complex machines, sometimes uniquely manufactured, with many component parts requiring careful engineering. Errors can and do happen. When a crane collapses, one or more of these errors will be to blame, but discovering which one at the bottom of a hundred tons of twisted steel is not easy.

Unwinding and interpreting the insurance maze that usually applies to projects on which large cranes are used will likely prove almost as difficult. The damages flowing from a large crane collapse will inevitably include property damage, often will include personal injury, and not infrequently include death. Beyond this, there are damages flowing from delays in the project, including costs

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Message from the Cochairs

Patrick J. Greene

Charlotte Wiessner

We want to thank David Kurtz and Ed Salanga, and of course our contributors, for another great issue of *Construct!* This issue focuses on the dynamic topic of insurance in construction. Under the direction of our former committee cochair, Jim Landgraf, the committee, along with the ABA Forum on the Construction Industry, hosted a two-day program, entitled "Critical Insurance and Litigation Insight: Coverages, Disputes and Tactics for Survival," which offered a series of plenary and workshop sessions focusing on the role of insurance in construction disputes. The program, which was held in January in Bonita Springs, Florida, was very well received. The articles in this issue follow up on that program and range from a basic insurance overview to current hot topics.

Continuing its efforts to work with the forum, the committee also sponsored a plenary program at the forum's annual meeting in New Orleans in April entitled "When 'Green' Turns to 'Red' and LEEDs to a Summons and Complaint: Potential Liability on Green Projects." We were also very pleased to have a breakfast slot at the forum meeting where Joe Kovars spoke on "When the Surety Does Not Stand in the Shoes of the Principal."

We continue to be active and out front within the section. At the Section of Litigation Annual Conference, which took place from April 29 to May 1, 2009 in Atlanta, Georgia, we sponsored two programs: one on workplace safety and the other on immigration. We also participated in a networking lunch that focused on the worldwide financial crisis and its impact not only on the financial, credit, securities, and real estate markets, but also on the construction industry.

The committee continues to get great marks on its website, and we want to thank Tina Paries and Ray Garcia for their efforts in keeping the website vibrant and current. If you would like your web-based articles or news pieces linked to the committee's website, please submit the link to Tina at tparies@BTlaw.com or Ray at r_garcia@garciamilas.com.

We appreciate the efforts of our membership, and especially our subcommittee chairs. We have a great track record of providing meaningful programs and articles not only to our membership but also to the entire section. Without our subcommittee chairs' tireless efforts, that would not be possible. Because of our success, we invite those interested in serving on the Program and Publications subcommittees to volunteer their services. Just let us know what you would like to do, and we will put you to work. As always, we are also looking for articles from our young lawyers—for either *Construct!* or the website.

The ABA Annual Meeting will be held this year at the Hyatt Regency in Chicago, July 30–August 4. We hope to see you there.

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Paul A. Sandars III

Insurance for Construction Defects: "Property Damage" or "Occurrence"?

By Paul A. Sandars III

Construction defect coverage litigation is rampant and on the rise, and it affects all parties involved in the construction process. Potential parties to such litigation include builders, contractors, subcontractors, and project owners. Construction defect coverage litigation is a broad topic that encompasses such areas as defective design and defective materials. This article addresses coverage of "defective work."

Just as construction defect coverage litigation has evolved over time, so too has the language of standard commercial general liability (CGL) policies. Most insurance policies draw from and use language promulgated by the Insurance Services Office (ISO), an insurance industry trade association in Jersey City, New Jersey. Irrespective of whether the language established by the ISO is used by a particular underwriter, it is, at the very least, generally incorporated into such policies. As a result, the language of a standard CGL policy, whether or not it is the actual language of the policy at issue in a particular case, is often the source of much contention and at the center of a coverage dispute. It therefore becomes easy to understand why it has been necessary for both construction defect coverage litigation as a whole and the language of a standard CGL policy to evolve over time. As evolution presupposes some form of growth and change, it is inevitable that new light will eventually be shed on this evolving area of construction insurance law.

The Current Status of Defective Work as "Property Damage"

One of the most significant issues among a number of coverage issues related to construction defect claims under a CGL policy is whether a particular claim constitutes an "occurrence." Once that is determined, the next critical issue is whether there is "property damage."

Under most standard CGL policies, coverage is granted only where there is "property damage" caused by an "occurrence" during the policy period. Both terms are defined by the standard CGL Coverage Form, in particular, ISO Form CG 00 01 10 01.

"Occurrence" is defined as:

a. An accident, including continuous or repeated exposure to substantially the same general harmful conditions.

"Property damage" is defined as:

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.

In construction defect coverage cases, the primary issue is not whether there has been an actual occurrence; rather, the main issue is whether property damage has occurred during the policy period and, if so, whether an exclusion applies that would circumscribe coverage in that particular instance. Under the "your work" exclusion, when property damage arises out of the insured's defective workmanship, there may be no occurrence and thus no coverage.[1] On the other hand, when the damage was neither expected nor intended, there will likely be an "occurrence" under the policy due to the unpredictable circumstances giving rise to the alleged damage.[2] The determination of whether there is an occurrence under the policy, therefore, will depend upon the actual components of the construction defect claim and the type of property damage alleged.

Under the subcontractor exception to the "your work" exclusion, the exclusion is inapplicable to work performed by a subcontractor on behalf of a general contractor. Therefore, coverage extends to instances where claims are filed against a general contractor because of damage caused by a subcontractor.[3] In situations where the subcontractor was subject to the control of the insured, courts have determined the exclusion to be inapplicable, primarily for agency related reasons.[4] In 2008, the South Carolina Supreme Court, in *Auto Owners Insurance Co., Inc. v. Newman*, noted the following with regard to the subcontractor exception to the "your work" exclusion:

> The presence of the subcontractor exception to the "your work" exclusion also establishes the scope of "work product" for purposes of determining whether a CGL policy covers a homeowner's negligent construction claim in cases arising out of a subcontractor's faulty workmanship. In cases of subcontractor negligence, consideration of whether a homeowner's complaint alleges property damage to other property or property damage to the work product alone *must be limited to the subcontractor's own work product, and not extended to the contractor's entire project*. To hold otherwise would obviate the purpose of the subcontractor exception to the "your work" exclusion in post-1986 CGL policies.[5]

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In *Auto Owners*, a homeowner filed a claim against a general contractor, alleging defective construction. Specifically, the claim related to the installation of stucco siding by a subcontractor that allegedly resulted in water infiltration into the home's framing and sheathing. Following a thorough analysis of the facts of this case, the court held as follows:

> [T]he continuous water intrusion into the home resulting from the subcontractor's negligence qualifies as an "accident" involving "continuous or repeated exposure to substantially the same harmful conditions." Accordingly, we hold that the subcontractor's negligence led to an "occurrence" invoking coverage under the CGL policy for the resulting "property damage" to other property not the work product.[6]

In determining whether coverage applies in a particular case, analysis must be conducted as to whether the defect claim seeks "property damage" as it is defined by the standard CGL policy. As noted above, CGL policies generally define property damage as "physical injury to tangible property." The definition of "property damage" under the standard CGL policy distinguishes between actual injury to tangible property and intangible loss, such as economic loss. The general view held by courts is that construction defect claims based on defective or faulty workmanship do not constitute property damage insofar as property damage implies injury to tangible property. However, where faulty workmanship is alleged to have caused damage to other parts of a project, courts may consider the resulting damage to be property damage that is covered under the policy. In such cases, while the resulting injury to tangible property is covered, economic loss remains uncovered under most, if not all, policies.

Economic Loss v. Property Damage

Damage to intangible property is often considered economic loss and is therefore not covered under a standard CGL policy. In other words, the contention is often made that the cost of repairing or replacing defective work is merely an economic loss rather than "actual injury to tangible property," and for that reason such costs are not covered. The Texas Supreme Court, in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, explained why the economic loss rule is not useful in determining coverage. Specifically, the court noted, "[The economic loss doctrine] is a liability defense or remedies doctrine, not a test for insurance coverage."[7] Rather, the court held that "allegations of unintended construction defects may constitute an 'accident' or 'occurrence' under a CGL policy and that allegations of damage to, or loss of use of, the home itself may constitute 'property damage' sufficient to trigger the duty to defend under a CGL policy."[8]

The economic loss doctrine is not a test for insurance coverage.

As discussed earlier, in litigating a construction defect claim, a central inquiry is whether there has been "property damage" during the requisite policy period. This issue must be fully explored before any discussion is had regarding the existence or nonexistence of economic loss. It then follows that the existence of economic loss in a particular case depends upon an initial assessment of whether there is in fact "property damage," or actual injury to tangible property. Only after making such a determination is it then appropriate to discuss the potential existence of injury to intangibles, which includes economic loss.

Construction Defects as Occurrences of Property Damage

In certain jurisdictions, construction defects can constitute "occurrences" of "property damage." Such cases reemphasize the importance of various exclusions, including the business risk exclusion, discussed in further detail below. In *Rando v. Top Notch Properties, L.L.C.*, the court address this issue as follows:

> With construction defects, the real issue usually is not whether there has been an "occurrence," but whether there has been property damage during the policy period, and, if so, whether the work exclusion is applicable. If the roof leaks or the wall collapses, the resulting property damage triggers coverage under an "occurrence" basis policy, even if the sole cause is improper construction and the only damage is to the work performed by the contractor. Whether coverage for such an "occurrence" is excluded by the work, product or other exclusion is a separate, very important inquiry . . . On the other hand, the mere existence of a construction defect does not trigger coverage under an "occurrence" basis policy; coverage is triggered *only* if the defect causes property damage during the policy term.[9]

For years, many courts maintained the position that there is never insurance coverage in cases involving claims against contractors for "defective work." This position was maintained by many, despite the fact that for more than 30 years, broad form property damage (BFPD) coverage has been marketed by insurance companies. The persistent argument raised in such cases was that there had been no "occurrence" and thus no coverage. The problem stemming from this position was the fact that contractors were being exposed to limitless claims involving faulty workmanship. This was very problematic because oftentimes the faulty work was actually performed by

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subcontractors, and contractors were thus unjustly stripped of coverage when in fact coverage should have applied in such cases.

As noted above, many courts have held that coverage is inapplicable in cases involving defective work because the resulting damage is not accidental and, therefore, there has been no "occurrence." Policyholders have responded to such arguments, noting that they are contrary to the intent of BFPD coverage.

The Evolution of Coverage

Prior to 1973, general contractors were subject to limitless claims for faulty work due to the existence of an exclusion that barred coverage in cases where there has been "property damage to work performed by or *on behalf of* the named insured arising out of the work of any portion thereof."[10] Because of this "on behalf of" language, general contractors were being held liable for faulty work performed by subcontractors, the argument being that subcontractors perform work on behalf of general contractors, even though the general contractor may maintain only minimal control over a subcontractor's work product.

In 1973, BFPD coverage was introduced. Dekker, Green, and Palley summarize the manner in which such coverage was introduced to the construction industry and the effect it had on all involved:

> In response to industry concern, insurance companies began offering coverage for the risk of damage to otherwise nondefective work resulting from defective subcontractor performance. This coverage became known as BFPD coverage. Materials circulated by the insurance industry emphasized that the BFPD endorsement provided coverage to general contractors for losses arising out of subcontractor work. For example, a circular prepared by the ISO explained that "[the insured] would have coverage for damage to his own work arising out of a subcontractor's work [and] [t]he insured would have coverage for damage to a subcontractor's work arising out of the subcontractor's work."[11]

In 1986, the ISO incorporated BFPD coverage into its standard CGL policy. The form incorporating this coverage is known as the CG 00 01 policy form.[12]

Dekker, Green, and Palley also discuss at length the nature and content of post-1986 policies and the implications such policies have had on the area of construction coverage defect litigation.

> Post-1986 ISO CGL policies provide coverage in pertinent part for "those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. The legal obligation to pay, however, must arise from an "occurrence," which is defined as an "accident, including continuous or repeated exposure to substantially the same general harmful condition." Coverage for "damages because of 'property damage'" to the insured's own work is typically limited to exclusion l in the standard policy form . . .[13]

It is important to recognize the significant impact policy language plays in these cases. Dekker, Green, and Palley hone in on this point:

> [C]onstruction defect coverage litigation often boils down to a dispute first over the meaning of the word "accident" within the definition of "occurrence" and then the scope and application of the "your work" exclusion.[14]

In 2007, the Florida Supreme Court, in *United States Fire Insurance Co. v. J.S.U.B., Inc.*, confirmed that the faulty work of a subcontractor can constitute an "occurrence" under a post-1986 standard CGL policy. This case involved an insured general contractor's claim against a subcontractor for use of poor soil and improper soil compaction and testing that resulted in damage to homes constructed by the contractor. In determining whether the faulty workmanship of the subcontractor can constitute an "occurrence," the court noted as follows:

> The question of whether faulty workmanship can constitute an "occurrence" is a matter governed by the actual terms of the policy and Florida law interpreting insurance contracts. The policy and renewal policy in this case define an "occurrence" as an "accident" but leave "accident" undefined. Thus, under our decision in *CTC Development*, these policies provide coverage not only for "accidental events, *but also injuries or damage neither expected nor intended from the standpoint of the insured*."[15]

The court also determined that the subcontractor's improper soil preparation caused "property damage" in that the claim did not seek costs for repairing the subcontractor's defective work; rather, it sought the cost of repairing the structural damage to the homes caused by the subcontractor's defective work.

Business Risk Exclusion

According to the court in *Firemen's Insurance Co. of Newark v. National Union Fire Insurance Co.*, insured contractors are exposed to two potential risks, only one of which is covered by the standard CGL policy.[16] The risk that *is* covered by the standard CGL policy is what the New Jersey Supreme Court in *Firemen's* and *Weedo* referred to as "risk of injury to people and damage to property caused by faulty workmanship."[17] The second risk, which is the non-covered risk, is often referred to as the "business risk exclusion."

Whereas according to the business risk exclusion, policies exclude coverage for defective work, accidental injury to property caused by such defective work is in fact covered. The coverage is granted in this instance because the consequences of being deemed liable for damage to one's

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property are potentially limitless, while the consequences of being deemed liable under the competing theory are more predictable and contained.

In *Knutson Construction Company v. St. Paul Fire and Marine Insurance Co.*, the Minnesota Supreme Court also examined the business risk exclusion. This case involved a suit by a general contractor against its carrier, whereby the contractor, Knutson, was seeking declaratory judgment as to whether the carrier was required to defend and indemnify Knutson pending a lawsuit by the owner of an apartment building against Knutson alleging extensive damage to the project apartment building primarily due to breach of contract and negligence.[18] The court, in referring to covered and uncovered risks in the context of construction defect coverage litigation, noted that the contractual business risk that the contractor may become liable to the owner for failing to perform the work properly "is one the general contractor effectively controls and one which the insurer does not assume because it has no effective control over those risks and cannot establish predictable and affordable insurance rates." [19]

Thus, it is clear from the case law that a coverage determination also boils down to the predictability of the risk and the insurer's control over that risk.

Conclusion

As the law on this topic evolves, so too does the policy language that drives the entire process. Policyholder response to the policy language of a given time, whether positive or negative, prompts discussion about potential problem areas surrounding such language and, if necessary, modifications to a standard CGL policy.

It appears that the trend will continue toward increased protection of contractors from claims by third parties alleging defective work. This will serve to carry out the primary purpose of BFPD coverage, which is to afford contractors greater protection from such claims.

As the past few years indicate, however, construction defect coverage litigation often boils down to a dispute over policy language, and when that happens, there is room for interpretation and, therefore, room for additional change to the policy language and the law itself. The challenge for litigators in this area is to use the "wiggle room" to their clients' advantage—coverage for contractor clients and exclusions for insurer clients.

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Endnotes

1. *See* Solcar Equip. Leasing v. Pa. Mfrs.' Ass'n Ins. Co., 606 A.2d 522 (Pa. Sup. Ct. 1992); Monticello Ins. Co v. Wil-Freds Co., 277 Ill. App. 3d 697 (1996).
2. *E.g.*, High Country Assocs. v. N.H. Ins. Corp., 648 A.2d 474 (N.H. 1994).
3. Nat'l Union Fire Ins. Co. v. Structural Sys. Technology, Inc., 964 F.2d 759 (8th Cir. 1992); *See also* Prudential-LMI Commercial Ins. Co. v. Reliance Ins. Co., 27 Cal. Rptr. 2d 841 (Ct. App. 1994).
4. *E.g.*, Bor-Son Bldg. Corp. v. Employers Commercial Ins. Co., 323 N.W.2d 58 (Minn. 1982).
5. Auto Owners Ins. Co., Inc. v. Newman, 2008 WL 648546 (S.C. 2008) (emphasis added).
6. *Id.* at *3.
7. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007).
8. *Id.* at 18.
9. Rando v. Top Notch Props., L.L.C., 879 So. 2d 821, 830 (La. App. 2004) (citations omitted).
10. David Dekker, Douglas Green, & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, Construction Law. 20 (Fall 2008).
11. *Id.*
12. *Id.*
13. *Id.* Exclusion l of the standard CGL form excludes "property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."
14. *Id.*
15. U.S. Fire Ins. Co. v. J.S.U.B. Inc., 979 So. 2d 871, 883 (Fla. 2007) (emphasis added).
16. Firemen's Ins. Co. of Newark v. National Union Fire Ins. Co., 387 N.J. Super. 434 (App. Div. 2006).
17. *Id.* (citing Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 237 (1979)).
18. Knutson Constr. Co. v. St. Paul Fire and Marine Ins. Co., 396 N.W.2d 229 (Minn. Sup. Ct. 1986).
19. *Id.* at 234.

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Patrick J. Wielinski

Litigating the Defect or Litigating to Coverage

By Patrick J. Wielinski

In the past few years, a number of significant court opinions have addressed the issue of whether damage attributable to defective construction is covered under a commercial general liability (CGL) insurance policy. Those opinions centered on whether damage to a construction project meets the definitions of "occurrence" and "property damage" in the policy. Those courts also had to address the effect of the policy exclusions in ultimately determining coverage.[1] This article reassesses the viability of the property damage exclusions (sometimes referred to as the "business risk" exclusions) in light of the recent trend toward upholding the existence of "occurrence" and "property damage" in the context of construction defect claims.

Exclusion L — The "Your Work" Exclusion

The CGL policy form was revised in 1986 by the Insurance Services Office. The centerpiece of the revisions (at least as to construction risks) was the express insertion of the subcontractor exception into exclusion l, the "your work" exclusion, in the standard coverage of the policy. Exclusion l states that the insurance does not apply to:

> "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.

The term "your work" includes work performed by or on behalf of the named insured. Moreover, it applies only to property damage that occurs in the "products-completed operations hazard," defined in the policy as follows:

> "Products-completed operations hazard":
>
> 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 completed at the earliest of the following times:
>
> (a) When all of the work called for in your contract has been completed.
>
> (b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.
>
> (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.

In the completed operations context, the 1986 work performed exclusion would preclude coverage for property damage arising out of work performed by or on behalf of the named insured if the exception to the exclusion was not applicable. By virtue of the plain language of the subcontractor exception, insurers specifically agreed to provide insured contractors with considerable coverage for property damage arising out of the defective work of subcontractors.

The notion that a CGL policy should not cover a contractor's business risk of defective workmanship has a proper but, nevertheless, somewhat limited place in the analysis of insurance coverage for defective construction work under a CGL policy. It sets the outer limit, but any coverage analysis must begin and end at the same point: the plain language of the policy. That recognition is in full accord with the intent of the drafters of the CGL policy. In a landmark commentary, published shortly after the 1973 revisions to the CGL policy were promulgated, George H. Tinker, Associate General Counsel of Kemper Insurance Company, described the role of the business risk doctrine in analyzing coverage under a CGL policy as follows:

> The foregoing is designed to be a descriptive, not a definitive, treatment of an important underwriting concept [the business risk doctrine]. It is recognized that regardless of what concepts underwriters may employ and regardless of what their intent may be, the scope of coverage is found in the four corners of the contract. Nonetheless, an awareness of the business risk concept helps to give dimension and understanding to some of the key provisions of the policy.[2]

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Thus, even the drafters of the 1973 revisions of the CGL policy recognized that the policy language itself can modify underwriting concepts, such as the business risk doctrine. That is exactly what the subcontractor exception in the 1986 form accomplishes. The subcontractor exception circumscribes and limits the business risk concept as to insurance coverage for certain types of defective work.

"Pre-Broad Form" Cases Do Not Apply

Insurers often rely upon inapplicable and easily distinguishable case law to support their plea to courts to abandon the terms of their policy in favor of vague notions that defective workmanship can never amount to an "occurrence" or "property damage" under a CGL policy. Many of those authorities address coverage under policy forms that were not modified to limit the business risk concept.

For example, one such authority that is still frequently cited by insurers for the business risk proposition is an early New Jersey case, *Weedo v. Stone-E-Brick, Inc.*,[3] in which claim was made against the insured contractor for faulty masonry work on a home. The insured had also performed defective roofing and gutter work on another home for which another claim was made against him. In the course of ultimately denying coverage based on the damage to products and the work performed exclusions, the court engaged in an extended analysis of insurable versus uninsurable risks. However, that analysis applied to the limited coverage under the 1966 CGL policy form before the court.

In support of its denial of coverage, the *Weedo* court relied on a law review article by Professor Roger Henderson published in 1971.[4] This article, for better or for worse, is another of the most frequently cited authorities in support of the denial of coverage for defective workmanship to an insured contractor. The article contains no analysis of the effect of the addition of the exception for a subcontractor's work through the broad form property damage endorsement in 1973 or the addition of the subcontractor exception to the 1986 forms.

Despite the fact that hundreds of cases have cited them, much of the analysis of *Weedo* and the Henderson law review article has been rendered obsolete as to the newer policy forms that expand coverage for insured contractors.[5] Not surprisingly, most of the courts that have considered the scope of coverage available under the 1986 CGL form have looked to the property damage exclusions, particularly the subcontractor exception to exclusion l, as indicating the intent to provide at least a modicum of coverage for property damage arising out of defective construction.

Even the drafters recognized that the policy language itself can modify underwriting concepts.

Case Law Upholds Coverage

The Wisconsin Supreme Court's opinion in *American Family Mutual Insurance Co. v. American Girl, Inc.*, remains one of the leading cases as to the broadening effect of the subcontractor exception to the "your work" exclusion.[6] There, a subcontractor gave the insured general contractor faulty site preparation advice, resulting in excessive settlement and eventual demolition of a warehouse. The court upheld coverage for the property damage attributable to the actions of the subcontractor, relying extensively on the drafting history of the CGL policy and stating as follows:

> This subcontractor exception dates to the 1986 revision of the standard CGL policy form. Prior to 1986 the CGL 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 CGL known as the Broad Form Property Damage Endorsement (BFPDE). Introduced in 1976, the BFPDE deleted several portions from the business risk exclusions and replaced them with more specific exclusions that effectively broadened coverage. Among other changes, the BFPDE extended coverage to property damage caused by the work of subcontractors. In 1986 the insurance industry incorporated this aspect of the BFPDE directly into the CGL itself by inserting the subcontractor exception to the "your work" exclusion.

A more recent opinion is from the Texas Supreme Court in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, a case involving CGL coverage for the insured home builder for property damage caused to a home by the defective workmanship of a foundation subcontractor.[7] In *Lamar Homes*, the court traced the expanded coverage provided under the CGL policy for certain business risks, recognizing the effect of the broad form property damage endorsement, which culminated in the insertion of the subcontractor exception into exclusion l, the "your work" exclusion, in 1986. By incorporating the subcontractor exception into the "your work" exclusion, the Texas Supreme Court found that the insurance industry specifically contemplated coverage for property damage caused by a subcontractor's defective performance. In construing

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the subcontractor exception to the "your work" exclusion, the court rejected the notion that the subcontractor exception creates coverage, finding rather that it reinstates coverage that would otherwise be excluded under that exclusion.

Of course, application of the property damage exclusions does not always result in a finding of coverage under the facts of a particular claim. For example, in *Calcasieu Parish School Board v. Lewing Construction Co., Inc.*, on remand, the court found that despite its previous finding of coverage, various exclusions, including exclusion l, the "your work" exclusion, applied to bar coverage for property damage to a floor installed in a school by the insured flooring subcontractor.[8] The court did not differentiate between whether the insured's installation of the flooring was considered "your work" or "your product," as defined under the policy; instead, it simply held that either the "your work" exclusion or the your product exclusion would apply to deny coverage.

The "No Coverage Through an Exception to Exclusion" Argument

Insurers sometimes argue that applying the explicit terms of the subcontractor provision amounts to an impermissible creation of coverage by an exclusion. This line of argument is based on the questionable assumption that defective workmanship can never give rise to an "occurrence" of property damage and thus can never be within the initial coverage grant of the CGL policy. However, the most recent cases on this issue reject this line of argument. For example, in *Lamar Homes v. Mid-Continent Casualty*, the Texas Supreme Court stated: "[W]e have not said that the subcontractor exception creates coverage; rather, it reinstates coverage that would otherwise be excluded under the your-work exclusion."[9]

Exclusion J(5)—The Ongoing Operations Exclusion

Exclusion j(5), the ongoing operations exclusion, states that the insurance does not apply to property damage to:

> That particular part of real property on which you [the named insured] or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations.

This exclusion does not apply to property damage within the product-completed operations hazard, but only to property damage that occurs while operations are in progress. Perhaps the most significant limitation on the scope of exclusion j(5) is that it applies only to property damage to the "particular part" of the property upon which the insured or its subcontractors are performing operations. In other words, only the portion of the work on which operations are actually being performed and is damaged is excluded. In the classic example provided by the ISO, the policy drafting organization, a steel erector is erecting steel beams furnished by the general contractor. Having erected four of the beams, the subcontractor is in the process of erecting a fifth steel beam when this beam falls, resulting in damage to all five beams. Only the damage to the fifth beam is excluded.[10]

Although insurers often argue that the "particular part" of the real property that is subject to exclusion is the entire project, many courts give meaning to the "particular part" formulation. For example, in *Fejes v. Alaska Insurance Co., Inc.*,[11] the insured general contractor sought coverage under its CGL policy endorsed with a broad form property damage endorsement for damage arising out of the defective installation of a curtain drain by a subcontractor. The defective drain caused the entire septic system in the home to fail. In response, the carrier raised, among other policy defenses, exclusion (2)(d)(ii) of the broad form property damage endorsement to deny coverage. That exclusion, although contained in the 1973 policy form before the court, contains the identical "that particular part" formulation as exclusion j(5). Specifically, the carrier contended that the exclusion eliminated coverage for the particular part of any property out of which the property damage arose, that is, the entire septic system.

Exclusion J(6)—The Faulty Work Exclusion

A companion exclusion to exclusion j(5) is exclusion j(6), the faulty work exclusion, which states that the insurance does not apply to property damage to:

> That particular part of any property that must be restored, repaired, or replaced because "your work" was incorrectly performed on it.

Exclusion j(6) is subject to the same "particular part" limitation as exclusion j(5). In *Mid-Continent Casualty Co. v. JHP Development, Inc.*,[12] the owner of a condominium complex obtained a default judgment against the insured contractor in an amount in excess of $1.5 million, and despite the fact that virtually all work performed on the project was defective, the owner segregated $438,000 of non-defective work that was required to be repaired due to the defective work of the insured contractor. That work did not constitute "that particular part," the repair or replacement of which was made necessary by the defective work of JHP, and was outside the exclusion. On the other hand, the insurer argued that all property damage was excluded under the faulty workmanship exclusion. The court rejected the insurer's position, stating that if defective work is performed by or on behalf of the insured contractor, and such defective work causes damage to other work of the insured that was not defective, then there would be coverage for the repair, replacement, or restoration of the work that was not defective.

Insurers routinely argue that the "that particular part" limitation applies, contending that coverage for all of the insured's work is excluded under the faulty workmanship exclusion. Thus, the insured must be able to segregate the defective from the

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non-defective portions of the work in determining "that particular part" to limit the scope of the exclusion.

Exclusion M—The Impaired Property Exclusion

Exclusion m, the impaired property exclusion, states that the insurance does not apply to:

> "Property damage" to "impaired property" or property that has not been physically injured, arising out of:
>
> (1) a defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or
>
> (2) a delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

The term "impaired property" is defined as follows:

> "Impaired property" means tangible property, other than "your product" or "your work," that cannot be used or is less useful because:
>
> a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or
>
> b. You have failed to fulfill the terms of a contract or agreement;
>
> If such property can be restored to use by:
>
> a. The repair, replacement, adjustment or removal of "your product" or "your work;" or
>
> b. Your fulfilling the terms of the contract or agreement.

Although usually referred to as the "impaired property exclusion," exclusion m actually applies to two different types of property damage: impaired property and property that has not been physically injured. The new term "impaired property" appears to be primarily directed at exclusion of loss of use damages in that it means tangible property other than the insured's product or work that cannot be used or is less useful. In addition to excluding coverage for property damage to "impaired property," the exclusion also denies coverage for property that has not been physically injured, so that the exclusion appears to include diminution in value claims where there has been no loss of use of property and where property has neither been physically injured nor destroyed.

If the insured's product or work causes physical injury to tangible property, it would not qualify as "impaired property" under the definition. This is because where the product or work causes physical injury to property, it is most likely not possible to restore that property to use by merely repairing or replacing the insured's product or work (due to the fact that the other property must also be repaired or replaced). Thus, the exclusion may not apply to such property because it is not impaired and because the property has been physically injured. For example, in *Federated Mutual Insurance Co. v. Grapevine Excavation, Inc.*, the sub-base installed by an insured excavation subcontractor on a parking lot caused the asphalt overlay to crack.[13] The parking lot could not be repaired by removal of the sub-base; rather, it was repaired by adding another overlay of asphalt. Therefore, even though the defective work of the subcontractor rendered the parking lot less useful, it was not "impaired" within the terms of the definition, and the insured subcontractor was entitled to coverage.

In *Standard Fire Insurance Co. v. Chester-O'Donley & Associates, Inc.*, the insured mechanical subcontractor sought coverage under its CGL policy for claims by the architect, general contractor, and performance bond surety arising out of the need to replace the subcontractor's duct work.[14] The carrier raised the impaired property exclusion in response to a portion of the claim for the cost to repair water damage to walls, ceilings, and other parts of the building caused by the faulty duct work. The court determined that the impaired property exclusion did not apply under the circumstances of the case, that is, where the claim involved actual physical damage to portions of the building not within the scope of the insured's work and that damage resulted from the repair or replacement of the insured's defective duct work.

When the insured is the general contractor, no portion of the project constitutes "impaired property." Property is, by definition, "impaired" only if it is property *other than* the named insured's work. Moreover, as discussed above, it must be emphasized that property can be "impaired" only if it can be restored to use by the repair, replacement, adjustment, or removal of the insured's product or work. Often, such repair, replacement, adjustment, or removal is not possible in the context of defective workmanship.

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Endnotes

1. *See* Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007); U.S. Fire Ins. Co. v. J.S.U.B. Inc., 979 So. 2d 871 (Fla. 2007); Auto Owners Ins. Co., Inc. v. Newman, 2008 WL 648546 (S.C. Mar. 10, 2008); Travelers Indem. Co. of Am. v. Moore & Assocs., Inc., 216 S.W.3d 302 (Tenn. 2007).
2. G.H. Tinker, *Comprehensive General Liability Insurance—Perspective and Overview*, 25 Fed'n Ins. Couns. Q. 217, 226 (1975).
3. Weedo v. Stone-E-Brick, Inc., 405 A.2d 788 (N.J. 1979).
4. Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know*, 50 Neb. L. Rev. 415, 441 (1971).
5. This obsolescence was recently recognized by the Florida Supreme Court in *U.S. Fire Insurance Co. v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007).
6. Am. Family Mut. Ins. Co. v. Am. Girl, Inc., 673 N.W.2d 65 (Wis. 2004).
7. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007).

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Continued from page 1

operations arising from the insured's negligence. The policy covers the named insured (often the company) as well as its officers, directors, employees, and other "additional insureds," with respect to their liability in that capacity. Because of its breadth, in the event of a claim for bodily injury or for a construction defect, the search for coverage normally begins with the CGL policy.

Although CGL forms written on an "occurrence" or "claims made" basis are both available, the occurrence form is the most widely used. The occurrence-based form provides protection for covered losses where the actual injury itself occurred during the policy period, regardless of when notification of the loss or claim happened.

The CGL's insuring agreement is the starting point to determine whether coverage exists for a claim. Under the insuring agreement, the insurer agrees to pay (a) those sums that the insured becomes obligated to pay as damages, (b) because of bodily injury or property damage to which the insurance applies, (c) caused by an occurrence during the coverage period. If these conditions are met and none of the policy exclusions apply, the insurer must respond to the claim.

When the insurer responds to the claim, it will pay on behalf of the insured the third-party liability damages incurred by the insured (up to the policy limits), and in addition to that, it will pay:

- defense and investigation costs; and
- certain specified supplementary payments (e.g., expenses incurred by the insured in assisting the company in the investigation of suits, costs taxed against the insured in a suit, and pre- and post-judgment interest).

There has been a great deal of litigation concerning the extent of coverage available under the CGL for construction defect claims. Many of the cases concern one or more of the following common coverage issues:

(1) Whether the defective work constitutes an "occurrence" causing "property damage";
(2) When the "property damage" occurred; and
(3) Whether any of the exclusions apply.

Whether there is an "occurrence" causing "property damage." The CGL policy defines an "occurrence" as "an accident, including continuous and repeated exposure to the same generally harmful conditions." The term "accident," however, is not defined in the policy. Although judicial interpretation of the term varies by jurisdiction, generally there is an "occurrence" if the substandard work was performed by the insured's subcontractor, or the damage extends to property other than the faulty work.

Assuming there has been an "occurrence," the next question is whether there has been property damage. The CGL defines "property damage" to include both physical injury to tangible property as well as the loss of use of tangible property that is not physically injured. Often at issue is whether the mere incorporation of defective work in a building constitutes "property damage." A plain reading of the definition would suggest that a claim for damage caused by defective work would constitute "property damage," which appears to be the trend.

When the property damage occurred. Coverage under CGL occurrence-based forms remains in effect indefinitely with respect to injury or damage that occurred during the policy period. But determining the time at which bodily injury or property damage occurs can be factually difficult, especially because defective work may be undetected until the work actually fails.

Different jurisdictions have provided different approaches to fixing the time of the "occurrence." Courts have variously held that the property becomes damaged the moment the defective work is installed, when the property first suffers damage, when the defective work first becomes discoverable, or even over the course of several years (the "continuous trigger"). It is thus advisable to provide notice of a claim to any of the carriers that might conceivably provide coverage.

Exclusions. The 2007 version of the ISO CGL policy contains 17 exclusions. In addition, most insurance carriers add additional exclusions in endorsements to the CGL policy. The most significant exclusions within the CGL policy relating to construction defect claims are known as the "business risk" exclusions. These exclusions are denominated as damage to property (exclusion j), damage to your work (exclusion l), and damage to impaired property or property not physically injured (exclusion m).

The Builder's Risk Policy

The first-party insurance covering the building under construction as well as on-site materials to be incorporated into the building may be the most important insurance policy for both the contractors and the owner. A comprehensive builder's risk policy provides immediate (first-party) funding to keep the project on schedule and, together with properly crafted waivers of subrogation in the contract documents, may also reduce litigation among the parties.

Builder's risk policies are specialized policies designed to cover the property loss exposures associated with construction projects. The broadest builder's risk forms are generally written on an "all risks" or "open perils" basis, in which all losses are covered unless specifically excluded. A builder's risk program may also cover materials in transit, materials stored off-site, and special construction perils, such as collapse resulting from construction defect. Builder's risk policies may also insure indirect losses. These losses include those

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related to losses of earnings (revenues or rents) due to delayed completion, as well as additional interest expense, additional real estate taxes, and, sometimes, additional advertising and promotional expense.

Larger general contractors and subcontractors with numerous work sites may also obtain a difference in condition policy (DIC) to supplement the builder's risk coverage. A DIC provides additional limits of coverage for certain property perils, fills in coverage for perils that are excluded in standard property policies, and may provide funding for a large deductible in a particular builder's risk policy.

Subcontractors often purchase an "installation floater" that applies to several projects. An installation floater is essentially a builder's risk policy purchased by a subcontractor to cover specialized equipment that the subcontractor might install on different jobs. The installation floater covers only the subcontractor's materials.

Indemnification and Insurance

Construction contracts contain two important methods of transferring risk from a higher tier contractor/owner to lower tier contractors: indemnification clauses and additional insured requirements.

Indemnification clauses. A project owner generally requires the general contractor to indemnify and hold it harmless against third-party claims arising out of the contractor's operations on the project. The general contractor in turn requires the same from its subcontractors. Coverage for these agreements to indemnify is found within the CGL policy and is known as "contractual liability coverage."

Contractual liability coverage is actually found within exclusion b to the standard CGL policy form, which is directed to liabilities assumed by contract. Exclusion b first excludes coverage for bodily injury or property damage liability arising out of an assumption of liability in a contract, but then it excepts from the scope of the exclusion certain "insured contracts," thus retaining coverage for those "insured contracts."[1] An indemnification agreement is one such "insured contract," although there is no coverage unless the indemnification agreement itself was executed *before* the occurrence of the injury.

Additional insured requirements. An additional insured is a party who is covered on another party's insurance policy. Normally, an upstream party such as a general contractor will require all downstream parties, such as subcontractors, to name it as an additional insured on the subcontractors' general liability, auto, and umbrella policies. This additional insured coverage provides the upstream parties with significant rights.

The first-party coverage for the building as well as for on-site materials may be the most important policy for both the contractors and the owner.

For example, an additional insured has the right to file a claim directly against the named insured's policy, receive a defense, and keep much or all of the loss off its own loss history. The additional insured's coverage also operates independently of the indemnity clause, which is important if the indemnity clause is for some reason unenforceable.

Additional insured coverage is obtained through an endorsement to the named insured's CGL policy, and the scope of the additional insured's coverage is determined with reference to that endorsement. Most such endorsements provide the additional insured with coverage for its own liability for "bodily injury" or "property damage" arising out of the named insured contractor's work performed on the additional insured's behalf.

When evaluating additional insured coverage, it is important to recognize that the CGL policy provides two different coverages with separate limits, both of which are relevant to the construction project: premises/operations coverage and products/completed operations coverage. The premises/operations coverage covers the liability arising out of the day-to-day operations at the named insured's premises and the job site. The products/completed operations coverage applies to liability after the job has been completed, and this is most often where coverage for construction defects is found.

ISO has drafted different additional insured endorsements to add parties as additional insureds for both the premises/operations and products/completed operations coverage. The most commonly issued for premises/operations is CG 20 10, and the most common for products/completed operations is CG 20 37.

Because of the cost of construction defect claims, many carriers have reduced or eliminated coverage for products/completed operations, sometimes with respect to an additional insured coverage only and sometimes with respect to both the named insured and the additional insured. Therefore, despite the existence of these standard additional insured endorsements, many carriers have manuscripted their own to place additional restrictions on the additional insured's coverage and to state expressly that coverage is limited to damages attributable to the work of the named insured.

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The Professional Liability Policy

Design and construction is a very complex process with numerous entities participating during the life cycle of the project. After the owner, design professionals are generally the most active participants during a project and have at least one of the following roles and responsibilities:

(1) Providing consulting services (client could be the owner or contractor)
(2) Administering the construction contract (acting as an agent to the owner)
(3) Serving as an initial dispute neutral (assuming a quasi-judicial capacity)

The professional liability policy (often referred to as "E&O insurance") is designed to transfer the risk of liability the design professional (or other project participant providing "professional services") may have to others when providing professional services. The transferred risks are ultimately shared across a pool of similarly situated design professionals, and it is this sharing of risks that allows the design professional to reduce the risk of liability. The risks that are transferred are limited by deductible obligations and policy claim limits; the design professional always retains some risk of liability that could be incurred by his or her professional services.

Coverage of Professional Services

The scope of coverage of the professional liability policy has not been standardized by an organization similar to the ISO. The actual services that are covered by a particular policy may be defined somewhat differently from the general scope of coverage of most professional liability policies discussed in this article. Some policies, for example, do not include ancillary services (such as construction management) to be within the scope of coverage of the insuring agreement. Other policies are written broadly to provide coverage for the services that a design professional offers to a client in the practice of his or her profession.

The architects and engineers professional liability policy is designed to cover an insured's liability caused by the negligent performance of professional services by the insured design professionals. The law requires that design professionals practice with the standard of care expected of design professionals. The standard of care is defined as that level of skill and competence ordinarily and contemporaneously demonstrated by professionals of the same discipline, practicing in the same locale, and faced with the same or similar facts and circumstances. From a professional liability underwriting perspective, using the negligence standard of tort law to define the risks being transferred by the insurance policy allows the insurance company to take on the total (or aggregate) of all losses and distribute it across a pool of design professionals that are each transferring their individual risk. Regardless of the myriad roles and responsibilities that design professionals take on in their practice, they are always legally held to the standard of care, and to the extent that design professionals have liability for not meeting the standard of care, the professional liability policy will provide coverage.

Although delegation of duties to an independent consultant is common, responsibility for negligence remains with the prime design professional.

The risks that are transferred by the professional liability policy are those that are defined by the negligence standard. Liabilities that arise from contractual obligations that alter or elevate the standard of care are typically considered to be outside the scope of coverage. This is often evidenced by contractual obligations that require the design professional to exceed the standard of care. Words such as "best efforts," "most capable," and "the highest standards" can create an inference of elevating the standard of care, and liability caused by a failure to meet this elevated standard exceeds the scope of coverage of the professional liability policy. Design professionals often have to engage subconsultants for portions of the services they are obligated to perform. Although delegation of duties to an independent consultant is common, ultimate responsibility for negligence remains with the prime design professional, and the professional liability policy provides coverage for the vicarious liability the *prime* design professional has for the subconsultant's negligence in the performance of professional services.

During times of rapid change in the industry, determining the applicable standard of care can be difficult. The emergence of a new technology such as Building Information Modeling may quickly change the applicable standard of care, leaving design professionals who are still designing with traditional methods open to the claim that they are not meeting the applicable standard of care.

Contractual Liability Coverage

The professional liability policy provides coverage for a limited contractual liability; it is limited to the extent that there is contractual liability based on the design professional's

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negligence in the performance of professional services. In other words, there is coverage for any liability the design professional may have in the absence of a contract. The professional liability policy provides coverage for services that do not meet the standard of care when providing professional services. The policy is not designed to stand behind all contractual obligations whose breach may cause the design professional to incur liability. Generally, a design professional's agreement by contract to accept liability for more than negligence in the performance of professional services is a business risk that is not covered by the professional liability policy.

Claims Made Versus Occurrence

Professional liability policies are written on a "claims made" basis, rather than an "occurrence" basis. Under a claims-made policy, the availability of coverage is determined by the date that a claim, as defined by the policy, is first made. The trigger for coverage under a claims-made policy begins with the question whether there is a policy in effect at the time a claim is made.

Prior Acts Coverage

Although a claims-made form effectively limits the insurer's exposure to future losses, it can provide unlimited retroactive coverage unless it is modified. Professional liability policies are modified by using a "retroactive" or "knowledge" date limiting coverage to claims that result from negligence after the specified date.

Terminating Coverage

The claims-made form provides no prospective coverage beyond the policy year. Therefore, the design professional who wants to stop practicing but have coverage for any negligence he or she may have during the last few years of practice will require "tail" coverage. Tail coverage, such as an extended reporting period, allows the reporting of a claim that arose out of professional services rendered prior to expiration of the policy. Tail coverage can typically be purchased for one, three, or five years, depending on the firm's loss experience and other underwriting considerations unless statutorily mandated otherwise by states.

Additional Insured Status

Although owners typically request it of design professionals, additional insured status is not an available option on the professional liability policy, unlike on the CGL policy form. Neither the client nor the contractor typically provide "professional services" and, therefore, do not have the risks that the policy is designed to cover.

Key Exclusions in the Professional Liability Policy

The typical professional liability policy has several key exclusions. There is no coverage for contractual liquidated damage provisions that are in excess of liability imposed by the negligence standard. The professional liability policy also excludes coverage for any construction activities that the design professional performs. Risks from construction activities can be covered by other types of insurance policies. As noted earlier, whether or not construction management services are within the scope of coverage depends on how a particular policy defines the professional services that are covered by the professional liability policy.

Express warranties and guarantees made by the design professional are also excluded from coverage in professional liability policies. An express warranty is a representation upon which a party can rely that a fact is as stated or promised; it is a guarantee that something will be done exactly as promised. Because express warranties and guarantees are separate contractual obligations negotiated with the client or provided to a third party, it is, from the insurer's view, impossible to calculate the professional liability premium that includes coverage for the transfer of this risk. From the insurer's perspective, an express warranty effectively raises the standard of care to an unreasonable and unachievable status, making it uninsurable.

Project Policies

Project insurance policies typically provide broad professional liability coverage to a group of design professionals arising from a specific project. Typically, coverage under a project policy is in force for the construction period and several years after completion of the project. This coverage offers the owner of the project assurances that a predetermined dedicated insurance limit is going to be maintained on the project and typically that no underlying limits erosion will take place as a result of a member of the design team's exposure on other project claims.[2]

Project policies can be beneficial to small design firms that can participate on projects when their own practice policy limits would have been insufficient to meet the owner's need for higher policy limits. The purchase of larger limits can be better managed on the project policy, and because the costs of the policy are typically paid for by the owner of the project, the design professional's costs for such coverage can be mitigated.

Project policies are typically primary to a firm's underlying layer of professional liability coverage; however, underwriting parameters vary between insurance companies, and some are making this coverage excess to the practice policy. This means that the underlying practice policy limits would have to be exhausted before the project-specific policy provides coverage. In recent years, it has become increasingly difficult to find project insurance in the marketplace as it has become cost prohibitive to secure it or it is not available for all project types. For example, it can be exceedingly difficult to find project policies for condominium and other residential projects because these types of projects have a high loss ratio.

There are other types of insurance coverages that may be obtained to help manage these project risks in addition to or in lieu of a project policy. An owner who wants higher dedicated project insurance limits may purchase an Owner Controlled Insurance Program (OCIP). The owner who purchases an OCIP is

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purchasing insurance for the contractor and subcontractors for a particular project. The OCIP may also include the design professional's liability exposure. The owner will most likely expect a deduction in the fees charged to reflect the cost savings that the OCIP participants have in their practice policies. Because particular project risks may not be covered by the OCIP policy, close scrutiny of the OCIP is required to make sure that the policy coverage terms are equivalent to that of the underlying practice policy. For example, an OCIP may not provide coverage for claims made by the owner against the design professional.

An owner may require a design firm to carry higher practice policy limits to participate in a particular project. For the design firm that is not able or willing to increase its practice policy limits, the purchase of a Specific Additional Limit Endorsement (SALE) may be an option. Purchasing a SALE allows the design firm to have higher practice policy limits for that specific project only. A SALE covers only the design firm insured on the practice policy, and it is important to realize that the underlying practice policy limits are not specifically dedicated to the project listed on the SALE. Therefore, in the event of a claim on a project for which a SALE has been purchased that exhausts the available policy limits, it is only the SALE portion of the total policy limit that is specifically dedicated to the project. If the underlying practice policy limits have been eroded by claims from other projects, then the available policy limits will be eroded by the same amount. Another important consideration is the term of a SALE: Underwriting guidelines set by the insurer may limit the SALE endorsement to a predetermined number of years, which may be less than the applicable statute of repose.

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Endnotes

1. The exclusion states that it "does not apply to liability for damages . . . [a]ssumed in a contract or agreement that is an 'insured contract', provided the 'bodily injury' or 'property damage' occurs subsequent to the execution of the contract or agreement. . . ."

2. Although the owner of a project is assured that the underlying limits of the design professional are available, some policies will deplete the design professional's limits on the underlying practice policy when a project policy responds to a claim.

Litigating the Defect or Litigating to Coverage

Continued from page 10

8. Calcasieu Parish Sch. Bd. v. Lewing Constr. Co., Inc., 2007 WL 4322161 (La. Ct. App. Dec. 12, 2007).

9. *Lamar Homes*, 242 S.W.3d at 14.

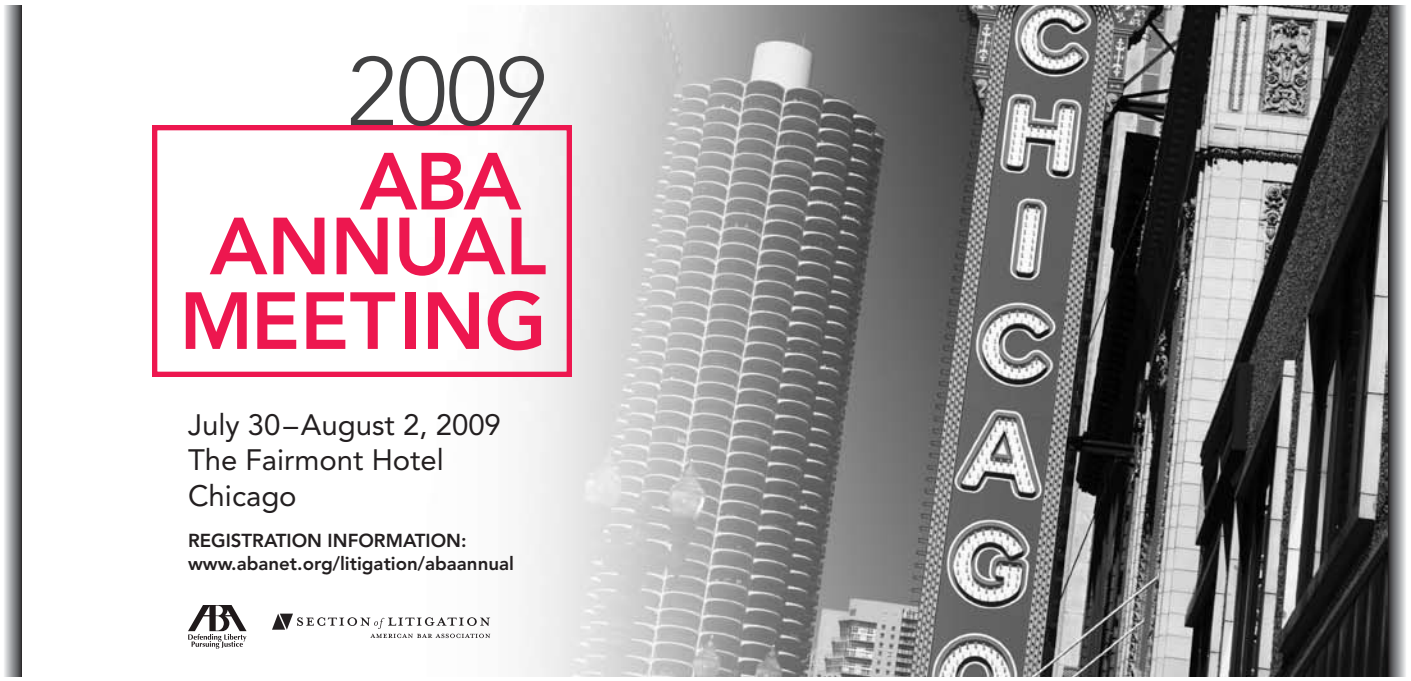
10. Insurance Services Office, Inc., ISO Circular General Liability GL 79-12 (Jan. 29, 1979).

11. Fejes v. Alaska Ins. Co., 984 P.2d 519 (Alaska 1990).

12. Mid-Continent Cas. Co. v. JHP Dev., Inc., ___F.3d___, 2009 WL 189886 (5th Cir. Jan. 28, 2009), *petition for reh'g pending* (applying Texas law).

13. Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.,197 F.3d 720 (5th Cir. 1999).

14. Standard Fire Ins. Co. v. Chester-O'Donley & Assocs., Inc., 972 S.W.2d 1 (Tenn. Ct. App. 1998).



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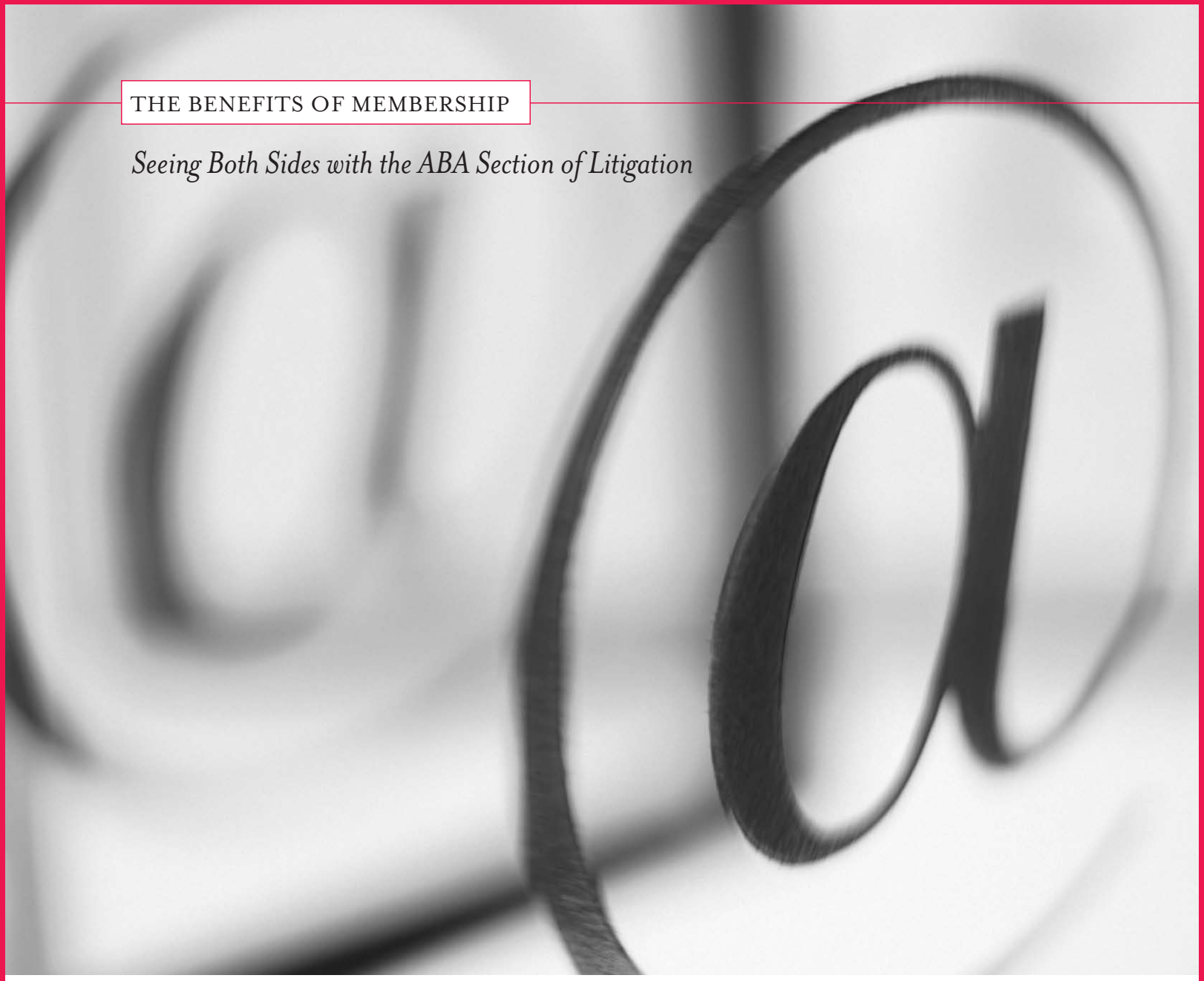

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A Crane Collapses: Am I Liable and, More Important, Am I Covered?

Continued from page 1

to accelerate, liquidated damages for late performance, and other loss of use damages.

To cover such losses, the parties suffering a loss will look to nearly all persons connected with the equipment failure, whether or not insured. If your client is on the receiving end of such a claim, the first questions you are likely to get are, Am I liable and, more importantly, am I covered? Although both questions will turn primarily on the facts of the particular case, the potential sources of coverage can be identified at the outset and should be explored promptly, and tender of defense and indemnity to all potential carriers should be made early and often. The potential sources of insurance include policies for builder's risk, commercial general liability, riggers liability (including potential endorsements to cover liquidated damages, costs of acceleration to ensure completion dates, or both), contractor's equipment coverage, worker's compensation and employer's liability, and professional liability. This article explores these issues.

Analysis

General Discussion

Crane accidents and other job site injuries can create multiple liability and damages issues. Liability issues arise because there are numerous parties involved in any given construction project, any combination of which could be responsible for an injury. Likewise, crane collapses and construction accidents give rise to difficult damages assessments because there are numerous claims available as a result of a job site accident. The following example illustrates the complex nature of determining liability and damages for a single construction event.

Land Owner owned a parcel of land in a large city surrounded by several residential apartment buildings and various commercial businesses. Land Owner entered into a contract with General Contractor to construct a building with residential and commercial space on the vacant land. General Contractor then hired Subcontractor, who specializes in crane operations, to help move equipment and materials throughout the job site. Subcontractor did not own its own cranes; rather, it leased the cranes from Crane Rentals, a local supplier. Crane Rentals purchased the cranes it leased to customers from Manufacturer. Subcontractor also hired Maintainer to provide periodic maintenance for the crane to ensure that the crane continued to operate in a safe and satisfactory manner.

Once the crane was erected at the job site, Subcontractor and General Contractor notified the city's Construction Safety Board for approval of the crane prior to its use. The board sent an official to inspect the crane and approve the crane for use at the job site. After receiving approval, Subcontractor then hired Crane Operator, Crane Assistant, and Crane Helper, who all worked together to operate the crane. Crane Operator managed the crane's controls, while Assistant and Helper signaled Operator to assist in the proper movement of the crane.

Eight months into constructing the building, disaster struck. The crane, while carrying a payload that slightly exceeded maximum weight, collapsed and destroyed the partially constructed building and severely damaged an adjacent property. In addition, the collapse killed two workers at the job site and two pedestrians on an adjacent road. The first pedestrian was killed instantly by metal falling from the crane. The second pedestrian was killed after being struck by debris falling from the adjacent property, which broke off after being struck by the collapsed crane. The crane's collapse delayed the completion of the building by one year, damaged the adjacent property, and rendered unusable a store at the bottom of the adjacent property. Moreover, the scattered debris that fell into the surrounding street closed a nearby restaurant for over a week as customers were unable to enter the building, but the restaurant itself suffered no physical damages.

Numerous causes of action and insurance coverage questions arise in this scenario. Any party involved in the construction of the building or supply of the crane could be liable for violating their respective job responsibilities or duties. Likewise, such exposure could also give rise to vicarious liability. Similarly, any of the parties could be liable for breach of contract for failing to comply with their contractual duties. The fact that many causes of action are possible does not lessen the difficulty of determining who ultimately is responsible for the collapse. The multiple parties involved in providing or using the crane could share some form of liability.

Damages Potentially Available

Given the wide spectrum of harm that may result from crane collapses and job site injuries, there are several damages claims available to an injured party. Compensatory damages for death or personal injury are available to any victim arising out of the tortious conduct of a defendant. Property damages are also available for damage to a construction project together with its loss of use, as well as for damage to other property not related to the job site, such as an adjacent home or building. The aggrieved party may also be entitled to damages relating to the economic loss caused by the job site accident. Breach of contract damages may be available in the form of general damages and special damages.

Difficulties in Identifying Causes and Responsible Parties

Beyond the sheer complexity of the accident itself and attempting to determine what the cause or causes of a crane collapse were, determining ultimate legal and financial responsibility for the tragedy is truly a tangled web because of the number of people associated with the manufacturing, maintenance, erection, inspection, and operation of a crane.

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Legal concepts of contributory negligence and joint and several liability may come into play in the states where those doctrines still exist. Contributory negligence is conduct by the injured party that "falls below the standard to which he should conform for his own protection, and which is a legally contributing cause co-operating with the negligence of the defendant in bringing about the [injured party's] harm."[1] Joint liability, or "contributing tortfeasors," is the notion that "two or more persons whose tortious conduct is a legal cause of a single and indivisible harm to the injured party" are each liable "to the injured party for the entire harm."[2] However, if this harm is divisible, each party is subject to liability only for the portion of the total harm that the person, individually, caused.

Possibly Liable Parties—Generally

Machine operator and the machine operator's employer. Liability based on negligence is often imposed on the operator of a crane or similar construction machine.[3] The employer of a crane or construction machine operator has also been held liable for negligence resulting in a construction accident. The employer can be liable through the concept of respondeat superior and through his or her own negligence. For example, in *Elliot Crane Service, Inc. v. H.G. Hill Stores*, Inc., the court held that the owner of a crane who employed the crane's operator at the job site could be liable under the doctrine of respondeat superior.[4]

The lessee of a crane also has been found liable to a lessor of the crane for damage to the crane caused by the negligence of the lessee in constructing a building. In *Awalt v. Mercer, Fraser Co.*, the court determined that negligent construction of a building by the builder caused its collapse and subsequent damage to a leased crane. The court imposed liability on the builder for his negligence.[5]

Crane or machine owner. The owner of a crane or construction machine can be responsible for the collapse of a crane at a job site through vicarious liability involving improper use by the owner's employee, as shown above, or by providing a defective crane or construction machine to the job site.

Construction premises owner. Generally, courts refuse to impose liability on owners of the construction premises when a crane collapse or job site accident results in harm to an employee of the construction site because the owner of the premises has no legal duty. More specifically, courts have held that the owner of the premises does not possess a duty of safety at the work site because the owner does not exercise control over the site.[6] However, the owner may still be liable if the owner was responsible for the operation of the crane or had sufficient "control" of the work site.[7]

Discovering the error that caused a crane collapse, at the bottom of a hundred tons of twisted steel, is not easy.

General contractor. Determining a general contractor's liability for a crane collapse caused by his or her subcontractor is similar to the inquiry conducted in regards to the owner or possessor of the construction premises. "[A] general contractor remains liable for the torts of an independent contractor, even if he is not liable as a master, if the owner or general contractor has retained the general control and supervision of the work and has failed to exercise reasonable care in doing so."[8] Conversely, courts such hold that a general contractor, as possessor of the land, is not liable for a job site accident when the general contractor does not possess the necessary element of control, as in *United States Fidelity & Guaranty Co. v. James F. O'Neil Co., Inc.*[9]

Crane or machine manufacturers, designers, and sellers. Generally, crane or construction machine manufacturers, designers, and sellers can be liable in connection with a crane collapse or other job site accident. Liability usually arises from a defect in the crane or device. For example, the court in *American Pecco Corp. v. Eastern Foundation Co.* held that the seller of a defective crane that collapsed was liable even though the general contractor negligently installed the crane at the job site.[10] Manufacturers, designers, and sellers of cranes can also be liable based on failure to warn,[11] breach of warranty,[12] and lack of view provided to the operator of a crane.[13]

Subcontractor. The subcontractor whose scope of work encompasses the use of the crane will likely incur liability in the event of a significant accident. This may include tort liability to third parties, under principles like those applicable to general contractors. Liability to the general contractor is also likely to exist under indemnity provisions of the subcontract.

Possible Claims and Causes of Action

Many causes of action may arise from a crane collapse or other job site accident. Most of these claims arise in tort, although a small percentage are breach of contract/breach of warranty claims.

Negligence and wrongful death. The overwhelming majority of claims resulting from crane collapses or other job site accidents are negligence claims. In general, to claim negligence successfully, one must establish the existence of a duty to a party, a breach of that duty, an injury to the party, and that the breach of the duty was the

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proximate cause of the injury.[14] Courts have determined liability for various types of negligence claims, such as failure to look out and failure to operate the machinery properly.

Negligence claims have also relied on the doctrine of res ipsa loquitor, but only with mixed success. In *Walt v. Mercer, Fraser Co.*, the court allowed a claim of negligence based on the doctrine of res ipsa loquitor to succeed because it appeared that the source of the accident was under the management and control of the defendant and the defendant did not provide any alternative explanation for its cause.[15] However, *Camillo v. Geer*[16] is one case in which a court disallowed the doctrine of res ipsa loquitor.

Liability has also existed for claims of negligence per se, such as in *Chancler v. American Hardware Mutual Insurance Co.*[17] To prevail in a negligence per se action, a plaintiff:

> must show that the statute or regulation clearly defines the required standard of conduct, the statute or regulation was intended to prevent the type of harm the defendant's act or omission caused, the plaintiff was a member of the class of persons intended to be protected by the statute or regulation and the violation was the proximate cause of the injury.[18]

Such claims likely are common given the multitude of state and federal law provisions regulating the use and manufacture of cranes, construction equipment, and building codes. However, because these codes are "typically enacted to protect the public," it may be difficult to impose liability by relying on negligence per se if the victim is a general contractor, subcontractor, or their employees.[19]

With any negligence claim, attorneys must be aware of the doctrines of contributory or comparative negligence and last clear chance. Contributory or comparative negligence may reduce or completely preclude a finding of liability against a defendant for a crane or construction accident. A jury's finding of contributory negligence bars the imposition of any liability on a defendant.[20] However, most jurisdictions now recognize the doctrine of "comparative negligence" as opposed to contributory negligence.[21] Depending on the jurisdiction, under comparative negligence, certain thresholds of negligence by the plaintiff are allowed before a plaintiff's negligence claim is extinguished.[22]

The doctrine of last clear chance can impose liability even if a plaintiff is contributorily negligent. The theory behind the doctrine is that "if the defendant has the last clear opportunity to avoid the harm, the plaintiff's negligence is not a 'proximate cause' of the result."[23] In an action for negligence for a job site accident, the doctrine of last clear chance therefore may allow the award of damages despite the plaintiff's contributory negligence.

Strict liability. A strict liability claim may also be successful in connection with a crane collapse or job site accident. The majority of strict liability cases apply to product liability. However, non–product liability cases can be brought based on common law or statutory notions of strict liability. Strict liability occurs when a party carries on an "abnormally dangerous activity" that harms a person, land, or chattel, even if that party has exercised the utmost care to prevent such harm.[24]

Product liability. The various types of product liability claims constitute a large potion of litigation involving a manufacturer of a crane or other construction device that collapses or fails. Within the realm of product liability, courts primarily have recognized three claims: negligence,[25] strict liability,[26] and breach of warranty.[27] The common link between these three claims is that there must be proof of a defect.[28]

Consumer fraud. At least one case exists indicating that a claim of consumer fraud can be successful in connection with a crane collapse or job site accident. In *Naporano Iron & Metal Co. v. American Crane Corp.*, the court held that a consumer fraud claim under New Jersey law was proper on the merits against the manufacturer of a collapsed crane, although the claim was dismissed on procedural grounds.[29] In *Naporano*, the plaintiffs alleged that the defendant manufacturer "misrepresented and issued false promises concerning the safety, quality, and capability of [its] products," which the court held was sufficiently aggravating to come within the scope of New Jersey's Consumer Fraud Act.

Breach of Contract. Several breach of contract actions are potentially available if a crane collapse or construction accident occurs. An accident caused by a general contractor or subcontractor could result in an action for breach if it violates the specific provisions of the contract and results in damages to a contracting party. Lessors of cranes or construction equipment also may have valid breach of contract claims if the equipment is destroyed by a lessee.[30]

Indemnity. In the early investigation of any claim, all contracts at all tiers should be examined for express indemnity clauses. For example, a project owner may have neglected to obtain an express indemnity from its general contractor, but the general contractor may have required the subcontractor to provide an express indemnity running in favor of the owner, making the owner a third-party beneficiary of that clause. Where no express indemnity clause is found, the law of implied or common law indemnity in the applicable jurisdiction should be examined for possible avenues of recovery.

Insurance Coverages Implicated

A crane collapse or job site injury can implicate many types of insurance coverages and create a multitude of issues regarding who is insured and to what extent there is coverage. There are several types of insurance that a job site accident severally implicates: builder's risk, contractor's equipment coverage, riggers liability, commercial general liability (CGL), worker's compensation/employer's

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liability, and professional liability.

1 First-Party Policies

Builder's risk insurance. Builder's risk is insurance that "ordinarily indemnifies a builder or contractor against the loss of, or damage to, a building he or she is in the process of constructing."[31] This insurance, however, usually does not cover damages resulting from faulty or defective workmanship by the insured standing alone (but loss resulting from defective work typically should be).[32] A builder's risk policy will be implicated if a construction accident, such as a crane collapse, destroys some portion of the property being constructed. Without such insurance, the contractor would typically have to rebuild the property at his or her own expense. Builder's risk insures the contractor for this risk and provides compensation if such an event occurs.[33]

The basic coverage provided is for cost of repair, typically in the amount of the value of the completed work. Limits should replenish after each accident. There is often coverage of actions taken to mitigate loss (e.g., shoring, temporary weather protection, outside experts), although not strictly "cost of repair." Some policies cover mitigation directly, within limits. Another place to look: "Sue and Labor" clause. These clauses sometimes provide coverage on top of limits.

Many policies cover losses in addition to the cost of repairing physical damage, including one or more of the following: soft costs, extra expense, expediting expense, debris removal, demolition and increased cost of construction, time element coverages, and overhead and profit. Generally, builder's risk is primary to CGL coverage for accidents during construction, but CGL policies can sometimes fill gaps in builder's risk coverage.

Contractors' equipment insurance. Contractors' equipment insurance, as its name implies, exists to provide protection to the contractors' tools and equipment, including the crane itself. Similar protections can be obtained through boom coverage, upset coverage, or both. Boom coverage is a physical damage coverage for the boom of a crane, generally added as an endorsement to the equipment floater. The floater normally contains an exclusion for booms over a specified length while in operation unless the damage is caused by a named peril. The policy may be amended to provide coverage for the boom while not operational, thereby enlarging the scope of coverage. Upset coverage provides coverage for damage to a crane caused by its upset and is also usually provided under an endorsement to an equipment floater. The endorsement usually specifies that if the weight carried by the crane at the time of upset exceeded the maximum rated load for the equipment, coverage will not apply. This exclusion, generally referred to as the "boom overload" exclusion, can usually be "bought back" by paying additional premium to eliminate the endorsement.

The doctrine of last clear chance therefore may allow the award of damages despite the plaintiff's contributory negligence.

2 Third-Party Policies

Commercial general liability insurance. CGL insurance is designed to protect against liabilities that may arise during or following completion of the work by reason of an accident. For example, CGL insurance is implicated if a general contractor uses a crane that later collapses and destroys an adjacent building and injures a pedestrian. For damages caused by this collapse to the general contractor's own work, one should look to builder's risk in the first instance, but CGL coverage may be implicated.

A related issue regarding CGL insurance is in connection with additional insureds. In a typical contract between a subcontractor and general contractor, the contract will require the subcontractor "to add [the general contractor] as an additional insured to the subcontractors' [CGL] policy and provide [the general contractor] with a certificate of insurance indicating the limits of that insurance."[34] Ideally, the general contractor would require the subcontractor to "obtain additional insured coverage for as many years as the general contractor may have exposure to construction defect claims respecting that project" and obtain additional insured coverage for completed operations.[35] Realistically, however, subcontractors rarely maintain coverage for general contractors for a substantial period of time beyond project completion.

Riggers liability insurance. Riggers liability insurance provides coverage for a contractor's liability arising out of the moving of property and equipment belonging to others, such as with a crane. This coverage can be affected by attaching a riggers liability endorsement to the CGL policy that modifies or deletes the exclusion for damage to property in the insured's "care, custody or control," or by attaching a floater to the contractor's inland marine policy that adds coverage for damage to property of others while in the contractor's care, custody, or control. If placed on the project, it provides coverages to avoid gaps in coverage that might otherwise lead to costly coverage disputes.

Professional liability insurance. An engineer, architect, or other construction professional will typically have professional liability insurance

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that protects against acts, errors or omissions, or negligent acts, errors, or omissions arising out of his or her project-related performance.[36] For example, this insurance may be implicated when an engineer's negligent design contributes to a collapse. Construction managers sometimes purchase professional liability coverage for claims and losses subject to professional liability exclusions of CGL polices, and other exposures.

3 Worker's Compensation Insurance and Employer's Liability

Insurance coverage for required worker's compensation payments will likely be implicated when an employee of a general contractor or subcontractor suffers an injury on the job site. The law of every state requires "that an employer purchase worker's compensation insurance coverage."[37] In addition to worker's compensation coverage, a contractor should also have an employer's liability insurance policy covering any further liability of the employer that may arise in common law or statute in connection with an employee's injury.[38]

Conclusion

Crane collapses are a particularly difficult species of construction accident cases because the havoc wreaked by such a calamity can serve to obfuscate the causes of the accident and, consequently, the identity of the party that should bear the financial responsibility for the loss. When a collapse occurs, control of the site and early investigation can be the keys to sorting out the liabilities in the most responsible and equitable manner, placing the liability where it belongs, on the party or parties who were in the best position to avoid the factor that caused the harm.

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Endnotes

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3. J.H. Cooper, Annotation, *Liability for Injury or Damage Caused by Negligent Operation of Crane, Derrick, or the Like*, 81 A.L.R.2d 473 § 2 (2007).
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6. Jordan v. NUCOR Corp., 295 F.3d 828, 835–36 (8th Cir. 2002).
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10. Am. Pecco Corp. v. E. Found. Co., 264 A.2d 491, 493 (D.C. 1970).
11. *See generally* Bohnert Equip. Co., Inc. v. Cleveland Crane & Eng'g Co., 569 S.W.2d 161 (Ky. 1978); *but see* Daniels v. Bucyrus-Erie Corp., 516 S.E.2d 848, 849–50 (Ga. Ct. App. 1999) (no duty to warn when danger was generally known).
12. *See, e.g.*, Quigley v. Spano Crane Sales & Serv., Inc., 422 P.2d 512, 513, 515 (Wash. 1967).
13. *See, e.g.*, Zahora v. Harnischfeger Corp., 404 F.2d 172, 175–78 (7th Cir. 1968).
14. Jackson v. Murphy Farm and Ranch, Inc., 982 So. 2d 1000, 1002 (Miss. Ct. App. 2008).
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17. Chancler v. Am. Hardware Mut. Ins. Co., 712 P.2d 542, 549 (Idaho 1986).
18. Construction and Design Law § 36.1a.6 (Michie Co. 1991).
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20. *See id.* § 36.2a.5c.
21. *Id.*
22. *See id.*
23. Carter v. Senate Masonry, Inc. 846 A.2d 50, 54 (Md. Ct. Spec. App. 2004).
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28. Larry D. Scheafer, Annotation, *Products Liability: Cranes and Other Lifting Apparatuses*, 13 A.L.R.4th 476 § 2 (2008).
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35. *Id.* at 10.
36. Cameron, *supra* note 30, § 2.04(d)(2).
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38. *Id.* § 2.04(c).

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