General Liability Insurance and Construction Defects — What's Covered and What Isn't?

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Topics

- General Liability Coverage Issues
- Contractor’s Professional Liability
- Faulty Workmanship

General Liability Coverage Issues

Start with The Granting Clause

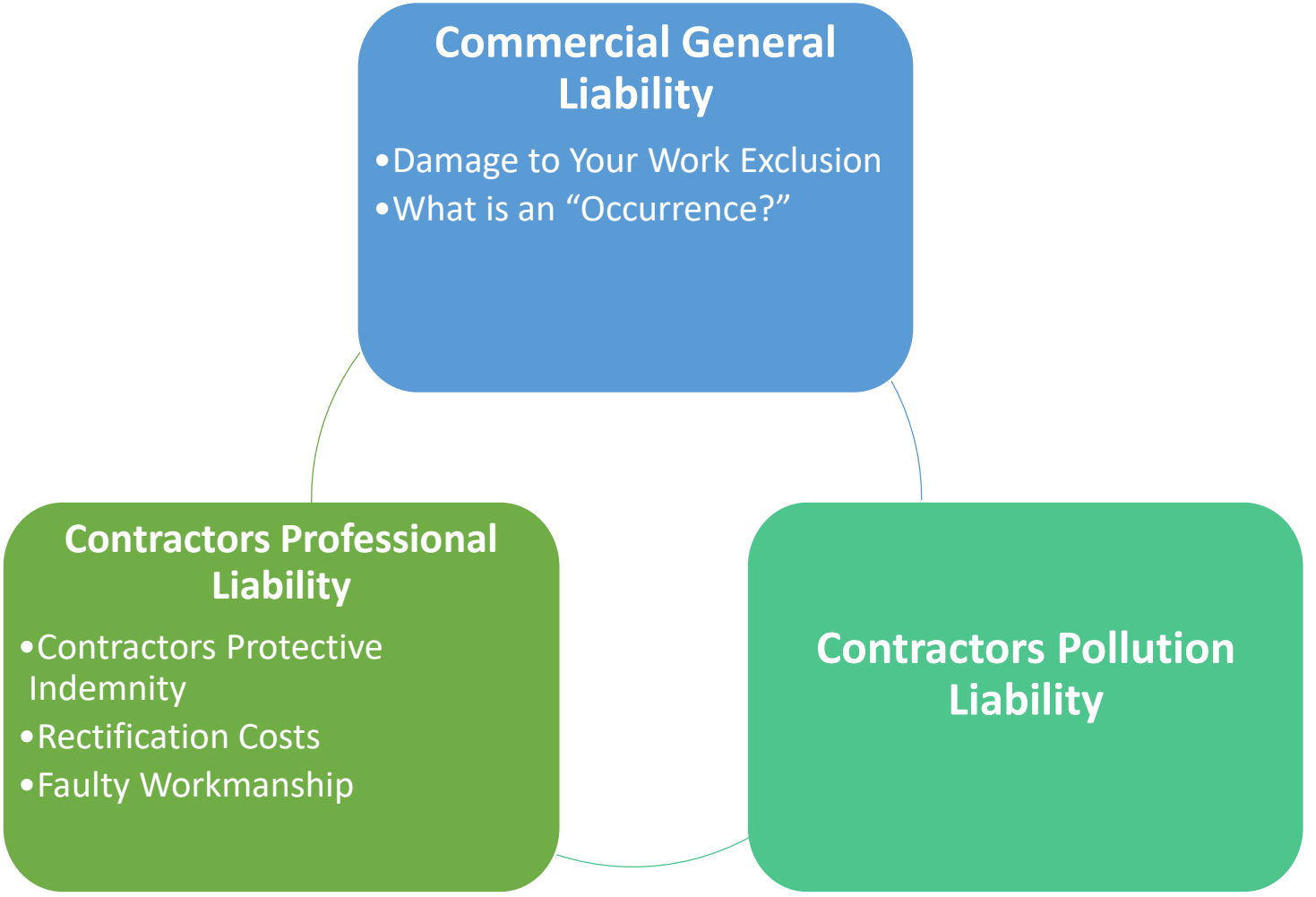
All three factors must be met:

- Physical damage
- Caused by an “Occurrence”
- Within the Policy Period

Then consider the exclusions

Then consider the exceptions to the exclusions

Construction Defect Insurance Coverage Topics



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Damage to “Your Work” Exclusion

The “damage to your work” exclusion is by far the most important in defining the scope of completed operations coverage, including damage arising out of construction defects.

This exclusion specifically states that it applies only to liability arising out of the “products-completed operations hazard,” which limits its application to completed work.

While a casual reading of this language may appear to render completed operations coverage virtually worthless, at least with respect to damage to the work itself, that is not accurate as significant completed operations coverage is retained in the exception to the exclusion.

I. Damage To Your Work

"Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard".

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

Damage to Your Work Exclusion

The definition of “your work” includes work performed by subcontractors; therefore, the first part of the exclusion reaches both self-performed and subcontracted work.

However, the subsequent sentence states that the exclusion does not apply if the damaged work or the work out of which the damage arises was performed by a subcontractor.

Coverage is thus preserved for damage *to* a subcontractors’ work and damage *caused by* a subcontractor’s work.

The only property damage to completed work that is not covered, therefore, is damage to the insured contractor’s own work that is the result of that work.

Examples

Exhibit 4.6 Damage to Completed Work	
Type of Loss	**Covered?**
Damage to the insured contractor's work that arises out of its own work	No
Damage to the insured contractor's work that arises out of the work of a subcontractor	Yes
Damage to a subcontractor's work that arises from that subcontractor's work	Yes
Damage to a subcontractor's work arising out of the insured contractor's work	Yes
Damage to a subcontractor's work arising out of another contractor's or subcontractor's work	Yes

Coverage Challenges

While the subcontractor exception provides a substantial grant of coverage for property damage caused by construction defects, the challenge remains of whether a construction defect qualifies as an “occurrence” as defined under a CGL policy.

Legal interpretations vary widely from state to state which will be discussed in detail.

Some carriers, especially in the Excess & Surplus Lines Markets, attach exclusions to their policies that take away the subcontractor exception to the Damage to Your Work exclusion (i.e. CG 22 94 - EXCLUSION – DAMAGE TO WORK PERFORMED BY SUBCONTRACTORS ON YOUR BEHALF).

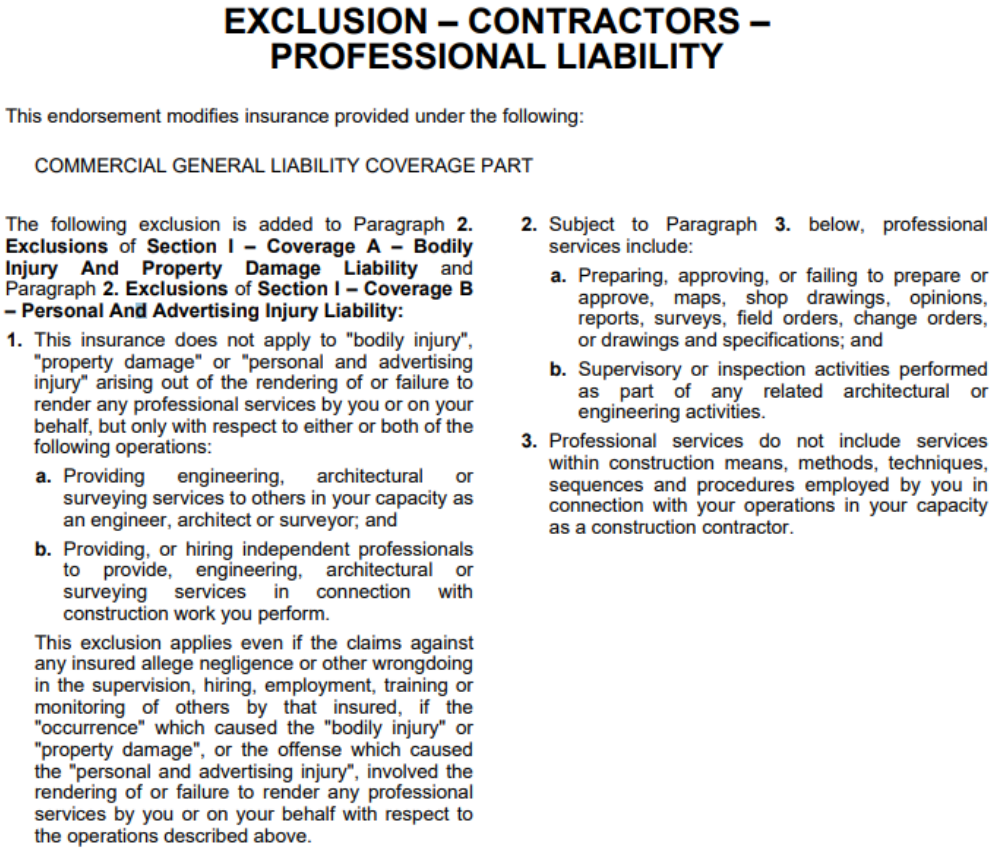
Damage caused by mold and fungi are excluded under most CGL policies. If mold coverage for damage to completed work is desired, Contractors Pollution Liability coverage can be used, but the exclusion for damage to your work must be reviewed closely (forms are not standaridized).

Contractor's Professional Liability

Contractors Professional Liability Coverage

While the need for professional liability coverage for contractors providing design-build services may be obvious, most CGL carriers attach broad professional liability exclusions that completely remove coverage for a variety of construction related professional services.

If a construction defect related claim is connected to professional services such as those outlined in this endorsement, it could likely be excluded by the CGL policy.



EXCLUSION – CONTRACTORS – PROFESSIONAL LIABILITY

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

The following exclusion is added to Paragraph **2. Exclusions** of **Section I – Coverage A – Bodily Injury And Property Damage Liability** and Paragraph **2. Exclusions** of **Section I – Coverage B – Personal And Advertising Injury Liability:**

1. This insurance does not apply to "bodily injury", "property damage" or "personal and advertising injury" arising out of the rendering of or failure to render any professional services by you or on your behalf, but only with respect to either or both of the following operations:
   - **a.** Providing engineering, architectural or surveying services to others in your capacity as an engineer, architect or surveyor; and
   - **b.** Providing, or hiring independent professionals to provide, engineering, architectural or surveying services in connection with construction work you perform.

   This exclusion applies even if the claims against any insured allege negligence or other wrongdoing in the supervision, hiring, employment, training or monitoring of others by that insured, if the "occurrence" which caused the "bodily injury" or "property damage", or the offense which caused the "personal and advertising injury", involved the rendering of or failure to render any professional services by you or on your behalf with respect to the operations described above.
2. Subject to Paragraph **3.** below, professional services include:
   - **a.** Preparing, approving, or failing to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders, or drawings and specifications; and
   - **b.** Supervisory or inspection activities performed as part of any related architectural or engineering activities.
3. Professional services do not include services within construction means, methods, techniques, sequences and procedures employed by you in connection with your operations in your capacity as a construction contractor.

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Contractors Professional Liability Coverage – Rectification Expense

Most modern contractors professional liability policies offer coverage for rectification expenses, which is generally defined as the reasonable and necessary costs and expenses you incur to rectify a design defect.

VERY IMPORTANT – for rectification costs to be covered the carrier must have provided prior consent.

Faulty Workmanship

Contractors Professional Liability Coverage – Contractors Protective Indemnity

Protective indemnity coverage is a first-party coverage that indemnifies the named insured contractor, excess of the design professional's professional liability insurance, for costs the named insured incurs, and is legally entitled to recover, as a result of negligent acts, errors, and omissions of design professionals with which the named insured contractor holds a contract.

Contractors Professional Liability Coverage – Faulty Workmanship Liability

Many Contractors Pollution & Professional Liability policies cover claims alleging faulty workmanship, but only to the extent resulting from 1) pollution events or 2) professional services.

An evolving product in the marketplace is Faulty Workmanship Liability coverage, which can be purchased as an endorsement to a combination Contractors Pollution/Contractors Professional Liability policy.

This provides faulty workmanship coverage for covered claims resulting from construction means and methods, not just pollution events or professional services.

Availability is not widespread but several carriers are offering coverage and the terms can be reasonable depending on claim history and firm profile.

I. The following is added to the end of Section I. Insuring agreements – What is covered:

Faulty workmanship liability	FW.	**We** will pay up to $2,000,000 for **faulty workmanship damages** and **claim expenses** in excess of the **retention** for covered **claims** against **you** alleging faulty or inadequate skill, quality, or craftsmanship in **your covered work**, or the use of defective materials or products in **your covered work**, on or after the **retroactive date**, provided the **claim** is first made against **you** during the **policy period** and is reported to **us** in accordance with Section V. Your obligations.

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What is an “Occurrence”?

M. Mooney Corp. v. U.S. Fidelity & Guar. Co., 136 N.H. 463 (1992)

The Supreme Court, Johnson, J., held that: (1) condominium association's claims for damages relating to 47 fireplaces closed by fire marshal after one unit was damaged by fire caused by defective fireplace were claims for "property damage" caused by "occurrence"; (2) policy's exclusion for claim arising when work or property is withdrawn from market because of defect was ambiguous and did not preclude insured contractor from recovering; and (3) exclusion for property damage to work performed by named insured arising out of such work did not apply.

High Country Associates v. New Hampshire Ins. Co., 139 N.H. 39 (1994)

The Supreme Court, Brock, C.J., held that underlying action alleging actual damage to structure of condominium units by continuing exposure to moisture from negligent construction resulted in occurrence covered under policy.

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

High Country Associates v. New Hampshire Ins. Co., 139 N.H. 39 (1994) *Cont'd…*

NHIC argues, however, that policies such as the one at issue are intended to cover accidents, not the "business risks" of poor workmanship. To effect that purpose, NHIC maintains that the policy's definition of "occurrence" should be limited by the interpretation of "accident" in the definition. NHIC contends that "accident," as used in the definition of "occurrence," means a sudden event that is identifiable in time and place. As urged by *44 NHIC, the definition of occurrence would read: "Occurrence" means a sudden event, identifiable in time and place, which was caused but not intended, by the insured, including continuous or repeated exposure to substantially the same general harmful conditions.

The plaintiffs assert that "accident" should be interpreted to mean circumstances that were unexpected or unintended from the standpoint of the insured, but not limited to a sudden, precipitous event. Their interpretation is both reasonable and consistent with our previous interpretations of "accident" in the context of liability insurance. See Fisher v. Fitchburg Mut. Ins. Co., 131 N.H. 769, 772–73, 560 A.2d 630, 632 (1989). "Occurrence" has a broader meaning than "accident" because "occurrence" includes "an injurious exposure to continuing conditions as well as a discrete event." Vermont Mut. Ins. Co. v. Malcolm, 128 N.H. 521, 523, 517 A.2d 800, 802 (1986). See generally The National Underwriter Company, The Fire Casualty & **478 Surety Bulletins, "Casualty & Surety," Occ–1 to –2 (January 1990).

Concord General Mut. Ins. Co. v. Green & Co. Bldg. and Development Corp. 160 N.H. 690 (2010)

Leaking carbon monoxide from faulty chimneys was not property damage caused by an "occurrence," and thus was not covered under policies.

Green's policy with Concord General and the Middlesex Mutual policy contain identical relevant language. Both policies provide coverage for "bodily injury" and "property damage" only if "[t]he 'bodily injury' or 'property damage' is caused by an 'occurrence' ...." The policies define "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." **28 Under both policies "property damage" means:

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

[10] [11] We have previously held that defective work, standing alone, does not constitute an occurrence. See Hull v. Berkshire Mut. Ins. Co., 121 N.H. 230, 231, 427 A.2d 523 (1981).

Russell v. NGM Insurance Company, 170 N.H. 424 (2017),

[W]e conclude that the homeowners' chain of reasoning—that hidden and unknown accumulated moisture was the causative agent of the damage, as opposed to the faulty workmanship; that hidden and unknown accumulated moisture is not specifically excluded from the policy; that coverage accordingly applies—essentially undoes the faulty workmanship exclusion. See id. at 576. We agree with the Sixth Circuit Court of Appeals that, when there is an exclusion for loss caused by faulty workmanship, "it should come as no surprise that the botched construction will permit ... water ... to enter the structure and inside of the building and eventually cause damage to both." Id. This is particularly so in the instant case when, according to the homeowners, the faulty workmanship consists of "ventilation and insulation construction defects."

Russell v. NGM Insurance Company, 170 N.H. 424 (2017), *Cont'd…*

[20] [21]"In other words, an ensuing loss provision excludes from coverage the normal results of defective construction, and applies only to distinct, separable, and ensuing losses." Taja Investments LLC, —— Fed.Appx. at ——, 2017 WL 4534788, at *2 (quotation omitted); see Friedberg v. Chubb & Son, Inc., 691 F.3d 948, 953 (8th Cir. 2012) (applying Minnesota law); see also Alton Ochsner Medical v. Allendale Mut. Ins. Co., 219 F.3d 501, 507 (5th Cir. 2000) (resulting loss clause generally applies only to damage that "result[s] fortuitously from events extraneous to the construction process" (quotation omitted) (applying Louisiana law)); In Re Chinese Manufactured Drywall Products Liab., 759 F.Supp.2d 822, 850 (E.D. La. 2010) (reasoning that ensuing loss clause does not apply to damages that are a direct and continuous result of workmanship defect (applying Louisiana law)). To be covered under an ensuing loss provision, "the damage that falls under the exclusion and the ensuing damage must be separable events in that the damage and the ensuing loss must be different in kind, not just degree."

Massachusetts Bay Insurance Co. V. Ferraiolo Construction Co., Inc. 584 A.2d 608 (1990)

The plaintiffs in the Coffey suit, which is still pending, allege that Ferraiolo operated its gravel pit in the town of Washington in such a fashion as to trespass upon their land. They seek damages both for common-law trespass and for violation of 14 M.R.S.A. § 7552 (injury to lands or property). Ferraiolo tendered the Coffey suit to the insurance company and requested it to defend. The insurance company declined to do so and filed this action seeking a declaratory judgment that it had no duty to defend the Coffey suit, nor to indemnify Ferraiolo for any liability incurred in the suit.

The policy covers "all sums which the insured shall become legally obligated to pay as damages because of ... property damage to which this policy applies, caused by an occurrence...." An "occurrence" is defined as "an accident ... which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured." The Superior Court held that the alleged trespass could not be an "occurrence.“

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Massachusetts Bay Insurance Co. V. Ferraiolo Construction Co., Inc. 584 A.2d 608 (1990)

The insurer's duty to defend the insured against third-party claims is determined by comparing the insurance policy against the complaint. If the complaint shows even a possibility that the events giving rise to it are within the policy coverage, the insurer must defend the suit. Any ambiguity must be resolved in favor of a duty to defend. See Union Mutual Fire Insurance Co. v. Inhabitants of Town of Topsham, 441 A.2d 1012, 1015 (Me.1982).

In general, occurrence of harm risks are those involving harm to others due to faulty work or products, while business risks are those involving business expenses incurred by the insured for repair or replacement of unsatisfactory work. See Peerless, 564 A.2d at 386 (quoting Baybutt, 455 A.2d at 923 (Wathen, J., dissenting)). In Peerless and Baybutt, the dispute focused on the interpretation of exclusion paragraphs (a), (n), and (o) of the standard policy, those being the exclusions for liability based on the contractor's warranty for its work. Peerless, 564 A.2d at 385. Overruling Baybutt, we held in Peerless that those exclusions do not contain an ambiguity giving rise to an insurer's duty to defend. Id. at 387.

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Massachusetts Bay Insurance Co. V. Ferraiolo Construction Co., Inc. 584 A.2d 608 (1990)

Unlike Peerless and Baybutt, where the contractor incurred expenses due to unsatisfactory work, this case does not involve a contractor's warranty liability. The distinction between occurrence of harm risks and business risks is not a broad philosophical distinction in construing liability insurance coverage; it relates to the meaning of certain standard business risk exclusions that are not at issue in this case. Because there is no issue in this case about the standard exclusion paragraphs for business risk, the court's reliance on Peerless was error. The Peerless test does not apply.[2] We therefore vacate the summary judgment.

The insurer was obligated to defend the suit.

General Casualty Company of Wisconsin v. Five Star Building Corporation, et al., 2013 U.S. Dist. LEXIS 134177 (D. Mass. September 19, 2013)

An HVAC contractor HVAC contractor made penetrations in an existing roof system to install supports for ductwork and other rooftop structures related to replacing the HVAC system, and put in temporary patches until subcontractors installed the supports and permanent patches. While this work was being performed, a severe rainstorm caused some temporary patches to fail. The rainwater intrusion caused extensive damage to the roofing insulation system and to the interior of the building.

HELD: Insurer was obligated to defend and indemnify for not only for the the resultant water damage to the building interior and contents, but all damage, including repair of the damaged roof insulation system.

The Court rejected the “Your Work” and Faulty Workmanship defenses, holding that the roof penetrations and patches were proven as performed improperly and were merely incidental to the main work of replacing the HVAC system.

Questions?

Thank you!