



# INSURANCE COVERAGE FOR CONSTRUCTION RISKS

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# OVERVIEW OF PRESENTATION

- Basic Forms of Insurance Coverage for Construction Risks
- Wrap-Up Programs (OCIP and CCIP)
- Common Issues with Commercial General Liability Policies
  - “Property damage”
  - “Occurrence”
  - Exclusions
- Practical Considerations for the Coverage Construction Lawyer

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# BASIC FORMS OF INSURANCE COVERAGE FOR CONSTRUCTION RISKS

# BASIC FORMS OF COVERAGE

- Third-Party Liability Coverage
  - Commercial General Liability (CGL) Coverage
  - Professional Liability Coverage
- First Party Coverage
  - Builders Risk
  - Contractor's Protective Coverage

# COMMERCIAL GENERAL LIABILITY (CGL) INSURANCE

- Third-party liability coverage – defense and indemnification.
- Provides coverage for (a) bodily injury or property damage liability, and (b) personal and advertising injury liability.
- Occurrence or claims made.

# PROFESSIONAL (ERRORS & OMISSIONS) INSURANCE

- Third-party liability insurance which provides coverage for claims alleging an error or omission in the performance of professional duties – such as negligent design work on a project.
- Commercial General Liability (CGL) policies often contain a professional services exclusion (usually added by endorsement), necessitating the need for a professional liability policy.
  - See, e.g., ISO Endorsements:
    - CG 22 43 – Broad Professional Liability Exclusion Endorsement
    - CG 22 79 – Construction Means and Methods Endorsement
    - CG 22 80 – Design Build Endorsement
- Contractor's Protective Professional Indemnity and Liability Policy (CPPI Coverage).

# BUILDERS RISK INSURANCE

- Property insurance policy which indemnifies against damage to buildings, machinery, equipment, or other property while under construction.
- Normally purchased by either property owner or general contractor on an “all risk” basis.
- No single standard builders risk form.
  - ISO CP 00 20 06 95
- Estimated completed value of the project normally used as the limit of insurance.
- Who bears the risk of uninsured losses?

# SUBGUARD (DEFAULT) INSURANCE

- Offers an alternative to performance/payment bonds.
- Targeted towards private (rather than public) projects.
- Policy specifies that insurer will compensate the insured contractor for losses resulting from a subcontractor's default.
- Policy covers all subcontractors on a given project or on an annualized basis for multiple projects.
- Generally covers both first and second tier subcontractors.
- Coverage for indirect losses due to subcontractor default (e.g. liquidated damages).
- Creates exposure for bad faith liability.



# MARINE DELAY IN START-UP (DSU) INSURANCE

- Coverage for financial losses (e.g. loss of gross profit) caused by damaged or lost machinery or equipment that are critical components for project.
- Policy often triggered by: (1) loss due to material damage; (2) occurrence of a fortuitous event to the conveyance; and/or (3) loss due to uncontrollable maritime events.
- Can also be included in Builders Risk Coverage.

## EFFICACY INSURANCE

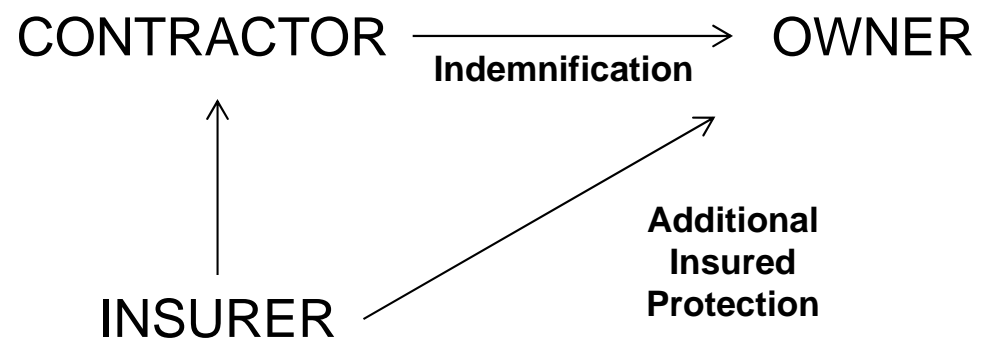
- Provides coverage for the failure of an item to meet the technical level of performance required by the contract.
- May reimburse a policyholder for bringing the product back to its expected level of performance.
- Often purchased as an extension to other policies.
- Most often obtained for high-tech projects.

## OTHERS

- Business Automobile Liability
- Workers' Compensation and Employers' Liability
- Commercial General Liability (CGL) Policies
- Umbrella Policies
- Additional Insured Endorsements

## ADDITIONAL INSURED ENDORSEMENTS

- Adds an additional party as an insured under someone else's policy.
- Accomplished via an endorsement to the policy.
- May extend to additional insured's negligence.
- Compare to Indemnity Agreements:



## ADDITIONAL INSURED CONTRACT PROVISIONS

- Require Additional Insured Coverage with specific endorsement.
- Specify criteria for insurer, limits, policy form, or required coverage.
- Require copy of endorsement and obtain before contractor commences work.
- Additional Insured coverage to be primary to other coverage maintained by additional insured.
- Address coverage for self-insured layers.

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# WRAP-UP PROGRAMS

## TYPES OF WRAP-UP PROGRAMS

- Owner Controlled Insurance Program (OCIP)
- Contractor Controlled Insurance Program (CCIP)

# OWNER CONTROLLED INSURANCE PROGRAM (OCIP)

- What it is:
  - A coordinated insurance program, purchased by the project owner, which provides general liability, business automobile, workers' compensation, and/or professional liability (errors and omissions) insurance for all participants on a construction project.
- Who it covers:
  - Participants generally include all contractors, subcontractors, architects, and/or engineers on the project.
  - Typically does not cover vendors, suppliers, or material dealers.



# OWNER CONTROLLED INSURANCE PROGRAM (OCIP)

- Practical Implications:
  - Owners maintain control of the insurance program for the entire construction project or series of projects.
  - Contractors are not required to provide their own insurance which theoretically reduces insurance cost to the owner.
  - May be implemented for a single, high dollar project or a series of construction projects.
  - Can be used on public and private projects.
  - No standard wrap-up policy.

# OWNER CONTROLLED INSURANCE PROGRAM (OCIP)

- Advantages:
  - Simplicity
    - Uniform coverage and limits of liability
    - Coordinated claims and loss control
  - Cost savings (e.g. reduction in premiums)
  - May be able to obtain coverages and limits otherwise unavailable to contractors
- Disadvantages:
  - Higher up-front premiums
  - Greater administrative costs
  - (To contractors): Owner controls the insurance program

# MAIN ISSUES FOR CONTRACTORS SUBJECT TO OCIP PROGRAM

- Need to assure that there are no holes in OCIP.
- Can be difficult to get detailed information at inception of the project.
- Does the consolidated counsel idea work if there are uncovered claims?

# CONTRACTOR CONTROLLED INSURANCE PROGRAM (CCIP)

- A coordinated insurance program, purchased by the construction manager at risk or general/prime contractor, which provides general liability, business automobile, workers' compensation, and/or professional liability (errors and omissions) insurance for its company and participating subcontractors on a construction project.
- Can be implemented for a single project or a number of projects enrolled in the program.
- Duration may extend through completion of the project or until the end of the applicable statute of repose.

# CONTRACTOR CONTROLLED INSURANCE PROGRAM (CCIP)

- Advantages:
  - Cost savings to contractors and subcontractors.
  - (To owner): Completed-operations exposure falls on contractor.
- Disadvantages:
  - Many CCIP programs include high deductibles per claim (e.g. \$250,000 or \$500,000), depending on the jurisdiction.
  - Owners with well-established OCIP programs may view CCIP programs negatively.
  - Subcontractors may already have an insurance program in place.

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COMMERCIAL GENERAL LIABILITY  
(CGL) POLICIES – COMMON  
ROADBLOCKS TO COVERAGE

# COMMERCIAL GENERAL LIABILITY (CGL) POLICIES

- Provides defense and indemnification for third-party (a) bodily injury and property damage claims, and (b) personal and advertising injury claims.
- Duty to defend vs. duty to indemnify.
- Duty to defend is broader than the duty to indemnify.

# COMMERCIAL GENERAL LIABILITY (CGL) POLICIES

- Basic Insuring Agreement:
  - The insurance company agrees to pay “those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’” that is caused by an “occurrence” during the policy period.
- Recurring roadblocks for contractors seeking coverage under a CGL policy.
  - Focus: third-party claims against contractors for “property damage.”



# “PROPERTY DAMAGE” CLAIMS AGAINST A CONTRACTOR - HYPOTHETICAL

- Owner: Michael Scott
- Contractor: Dwight K. Schrute
- Subcontractor: Toby Flenderson
  
- In preparation for a dinner party featuring his new \$200 plasma TV and his live-in girlfriend Jan Levinson’s (formerly Jan Levinson-Gould) new candle line (Serenity by Jan), Owner hires Contractor to perform certain renovations on his newly purchased townhouse, including moving certain walls and installing new windows.
- Contractor hires Subcontractor, Owner’s arch nemesis, to install the new windows.
- After Contractor and Subcontractor complete their work, Owner discovers that the walls failed to meet construction specifications and that the windows installed by Subcontractor are leaking. Owner sues Contractor.

# “PROPERTY DAMAGE” CLAIMS AGAINST A CONTRACTOR

- Three questions to analyze:
  - (1) is there “property damage”
  - (2) was the “property damage” caused by an “occurrence”
  - (3) is there a policy exclusion which bars coverage

# “PROPERTY DAMAGE”

- (1) is there “property damage”?
  - (a) Physical injury to tangible property, including all resulting loss of use of that property;
    - A “physical injury” is any physical change or alteration of property.

## CASE EXAMPLES

- See, e.g., Tweet/Garot-August Winter, LLC v. Liberty Mut. Fire Ins. Co., 06-C-800, 2007 WL 445988, at \*5 (E.D. Wis. Feb. 7, 2007) (“tangible property suffers a ‘physical’ injury when the property is altered in appearance, shape, color or other material dimension”).
- Essex Ins. Co. v. BloomSouth Flooring Corp., 562 F.3d 399, 406 (1st Cir. 2009) (odor can constitute physical injury to property).
- But see Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 67 A.3d 961, 980 (Conn. 2013) (escape of carbon monoxide from defective chimneys, resulting in loss of use of the chimneys, did not qualify as property damage).

## “PROPERTY DAMAGE”

- Use of the wrong product may constitute “physical injury” to “tangible property”.
  - See, e.g., Swank Enter., Inc. v. All-Purpose Servs., Ltd., 154 P.3d 52 (Mont. 2007) (application of improper paint caused a “physical injury” to the property and was a covered loss).

## “PROPERTY DAMAGE”

- Incorporation theory – harmful presence of work, product, or other material that must be removed should be sufficient to constitute physical injury to the property on which it is found.
  - Not widely accepted today.
  - But see Hauenstein v. Saint Paul-Mercury Indem. Co., 65 N.W.2d 122 (Minn. 1954) (application of defective plaster to a building, which needed to be removed and replaced, constituted “property damage” to the building); Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co., 45 Cal. App. 4th 1 (1996) (asbestos materials were physically incorporated into the building and therefore physically affected tangible property).

# “PROPERTY DAMAGE”

- Diminution in value:
  - Can constitute “property damage”. Aetna Cas. & Sur. Co. v. PPG Indus., Inc., 554 F. Supp. 290, 293 (D. Ariz. 1983) (“Diminution in value of property caused by installation of a defective product sufficiently alleges property damage to give rise to a duty to defend.”).
  - As measure of damages, not the “injury”. Hartford Acc. & Indem. Co. v. Pac. Mut. Life Ins. Co., 861 F.2d 250 (10th Cir. 1988).

## “PROPERTY DAMAGE”

- (b) Loss of use of tangible property that is not physically injured.
  - Loss of use covered even where unaccompanied by physical injury to tangible property.
    - Commercial Union Ins. Co. v. R.H. Barto Co., 440 So. 2d 383 (Fla. Dist. Ct. App. 4<sup>th</sup> Dist. 1983) (building’s uninhabitable and unrentable nature, which was caused by malfunctioning air conditioning equipment, constituted loss of use of tangible property and qualified as “property damage”).
  - Impaired access to real property, caused by the insured’s construction work, should qualify as “loss of use”.
    - Gibson & Assocs., Inc. v. Home Ins. Co., 966 F. Supp. 468 (N.D. Tex. 1997) (impaired access to shop owners’ stores constituted “property damage”).



## ... CAUSED BY AN “OCCURRENCE”

- (2) was the “property damage” caused by an “occurrence”?
  - “Occurrence” is generally defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” ISO CG 00011207.
  - Some policies define “accident” and others do not.
  - Consequences resulting from the act causing injury or damage must not be “expected or intended” to be an accident.
  - Does defective construction or faulty workmanship constitute an “occurrence”? Split in authority.

## ... CAUSED BY AN “OCCURRENCE”

- (1) Did the faulty workmanship damage only the insured’s completed work or product?
- (2) Did the insured’s faulty workmanship cause damage to property other than the insured’s work?

# (1) DAMAGE SOLELY TO THE INSURED'S WORK OR PRODUCT

- Courts have held that faulty workmanship, which results in damage solely to the insured's work or product, does not constitute an "occurrence."
  - See, e.g., Essex Ins. Co. v. Holder, 261 S.W.3d 456, 459-60 (Ark. 2007) ("Faulty workmanship is not an accident; instead it is a foreseeable occurrence, and performance bonds exist in the marketplace to insure the contractor against claims for the cost of repair or replacement of faulty work.").
  - Rationale: Not an "accident" and lacks the requisite degree of "fortuity" to trigger coverage. Damages as foreseeable consequences of intentional acts.

# (1) DAMAGE SOLELY TO THE INSURED'S WORK OR PRODUCT

- Other courts have held that faulty workmanship can constitute an “occurrence” even where it results in damage to the insured’s work or product alone.
  - See, e.g., Ameron Int’l Corp. v. Am. Home Assur. Co., No. CV-11-1601, 2011 WL 2261195 (C.D. Cal. June 6, 2011) (the unintentional supplying of defective products may constitute an “occurrence”); Sheehan Constr. Co. v. Cont’l Cas. Co., 935 N.E.2d 160, 169 (Ind. 2010) (“[I]mproper or faulty workmanship does constitute an accident so long as the resulting damage is an event that occurs without expectation or foresight.”); Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007) (there was no logical basis for distinguishing between damage to the insured’s work and damage to a third party’s property).

## (2) FAULTY WORKMANSHIP WHICH CAUSES DAMAGE TO OTHER PROPERTY IS AN “OCCURRENCE”

- Majority of courts have held that if faulty workmanship causes property damage to something other than the insured’s work, the faulty workmanship may constitute an “occurrence.”
  - Examples: AL, AK, AZ, AR (statutory), CO (statutory), FL, GA, HI (statutory), IL, KS, MD, MO, NE, NV, NH, NY, NC, ND, OH, SC (statutory), TN

## CASE EXAMPLES

- See, e.g., Auto-Owners Ins. Co. of Home Pride Cos., 684 N.W.2d 571, 577-78 (Neb. 2004) (“[A]lthough faulty workmanship, *standing alone*, is not an occurrence under a CGL policy, an accident caused by faulty workmanship is a covered occurrence.”); Acuity v. Burd & Smith Constr., Inc., 721 N.W.2d 33, 39 (N.D. 2006) (“[P]roperty damage caused by faulty workmanship is a covered occurrence to the extent the faulty workmanship causes bodily injury or property damage to property other than the insured’s work.”).
- Recent pro-policyholder decision in Pennsylvania. Indalex Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, No. 612 WDA 2012 (Pa. Super. Ct. Dec. 3, 2013) (in products liability arena, physical damage to home caused by defective product constituted an “occurrence”).

## (2) FAULTY WORKMANSHIP WHICH CAUSES DAMAGE TO OTHER PROPERTY IS NOT AN “OCCURRENCE”

- A minority of courts have held that faulty workmanship, even where it causes other property damage, does not constitute an “occurrence.”
  - HI (case law), WY
  - See, e.g., Grp. Builders, Inc. v. Admiral Ins. Co., 231 P.3d 67 (Haw. Ct. App. 2010) (precluding coverage for the defects in the contractor’s own work and also any consequential damages caused by the contractor’s faulty workmanship); Great Divide Ins. Co. v. Bitterroot Timberframes of Wyoming, LLC, No. 06-CV-020, 2006 WL 3933078, at \*8 (D. Wyo. Oct. 20, 2006) (“Defendant could foresee the natural consequences of any negligence or poor workmanship . . . [A]ny resulting damage is not considered an ‘accident’ triggering an ‘occurrence’ under the Policy.”).

# STATE LEGISLATIVE EFFORTS TO ADDRESS THE “OCCURRENCE” ISSUE

- **Colorado (C.R.S.A. § 13-20-808)** (“In interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured.”).
- **Hawaii (Haw. Rev. Stat. § 431:1(a))** (only policies issued after May 19, 2010 will be subject to the Hawaii appellate court’s holding that faulty workmanship claims do not constitute an occurrence).
- **Arkansas (Ark. Code § 23-79-155(a)(2))** (CGL policies’ “occurrence” definition must include “property damage or bodily injury resulting from faulty workmanship”).
- **South Carolina (S.C. Code §38-61-70)** (CGL policies’ “occurrence” definition must include “property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself”).



## TRIGGER OF COVERAGE

- Water damage cases raise trigger of coverage issues similar to environmental coverage cases.
  - Continuous trigger
  - Manifestation theory
  - Exposure theory
  - Injury-in-fact theory
- “Montrose” endorsements seek to limit coverage under multiple policies.

# EXCLUSIONS

- Despite the existence of an “occurrence”, CGL policies often contain exclusions which insurers contend exclude coverage for faulty workmanship claims.
  - “damage to property” exclusion
  - “your work” exclusion
  - “your product” exclusion
- Other common exclusions:
  - “owned property” exclusion
  - “impaired property” exclusion

# “DAMAGE TO PROPERTY” EXCLUSION

- Exclusion j(5): “This insurance does not apply to: . . . ‘property damage’ to . . . that particular part of real property on which you or any contractors or subcontractors . . . are performing operations, if the ‘property damage’ arises out of those operations.”
  - Limited to barring coverage for property damage occurring during ongoing operations. See, e.g., Advantage Homebuilding, LLC v. Maryland Cas. Co., 470 F.3d 1003, 1010 (10th Cir. 2006) (exclusion j(5) focuses on when the “property damage” at issue occurs, not when the legal claim accrues).
  - “[T]hat particular part” operates to exclude damage to the specific area on which the insured was performing operations, but not to other areas which are damaged as a result. See, e.g., Scottsdale Ins. Co. v. Knox Park Constr., Inc., No. 301CV1852K, 2003 WL 22519536, at \*2 (N.D. Tex. 2003).
- Coverage for damage to a construction project during operations obtained through a separate builder’s risk policy.

# “DAMAGE TO PROPERTY” EXCLUSION

- Exclusion j(6) : “This 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.”
  - “[D]oes not apply to ‘property damage’ included in the ‘products-completed operations hazard.’”
  - “Products-completed operations hazard” (appears in “Definitions” section of CGL policy):
    - If property damage resulting from the contractor’s faulty workmanship occurs away from the premises the contractor owns or rents; or
    - if the claim arises from defective work that is discovered after the contractor has completed its work.

## “YOUR WORK” EXCLUSION

- Exclusion (l): “This 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.’”
  - Exclusion is limited to damages to “your work” – damage to other property (i.e. other non-defective work or personal property) is not encompassed within the exclusion.
    - See, e.g., Wilshire Ins. Co. v. RJT Constr. Co., No. 08-50925, 2009 WL 2605436 (5th Cir. Aug. 26, 2009) (exclusion (l) precluded coverage only for cost of repairing the foundation, but did not exclude coverage for damage to other parts of the house resulting from the faulty foundation).
  - Exclusion applies to work falling inside the “products-completed operations hazard” (i.e. after the work is completed).
    - *Compare to* “damage to property” exclusion (j(5) and j(6)), which applies to property damage occurring during operations.

# “YOUR WORK” EXCLUSION

- Subcontractor exception: “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.”
  - Compare Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007) (enforcing the exception) to ACS Constr. Co., Inc. of Mississippi v. CGU, 332 F.3d 885 (5th Cir. 2003) (exception “cannot be used to create coverage where none exists”).
- “Business risk” doctrine:
  - Purpose is to place the risk of defective workmanship on the insured.
  - CGL policy as performance bond.
  - Providing CGL coverage would encourage poor workmanship.
  - Shifts costs of doing business from the policyholder to the insurer.

# KEY QUESTIONS

- (1) did the damage occur:
  - (a) during operations; or
    - Exclusion (j) potentially applicable.
  - (b) after the project is complete.
    - Exclusion (l) potentially applicable.
- (2) are the damages:
  - (a) only for the cost to repair the insured's defective work; or
    - Exclusion (l) potentially applicable.
  - (b) for damage to other property.
    - Exclusion (l) should not apply to those damages.
- (3) Was the work performed by a subcontractor?
  - If yes:
    - Exclusion (l) should not apply if subcontractor exception is contained in the policy.

## “YOUR PRODUCT” EXCLUSION

- Exclusion (k): excludes coverage for “property damage” to “your product” arising out of it or any part of it.
- Does not contain a subcontractor exception, or distinguish between ongoing and completed projects.
- Definition of “your product” is important.
  - In CGL policies that do not define “your product” (or the “insured’s product”), the exclusion may be held to apply to finished structures. See, e.g., Zanco, Inc. v. Michigan Mut. Ins. Co., 464 N.E.2d 513 (Ohio 1984).
  - Most policies exclude “real property” from the definition of “your product”, which has been interpreted to include structures that are affixed to the land. See, e.g., Essex Ins. Co. v. BloomSouth Flooring Corp., 562 F.3d 399 (1st Cir. 2009) (concrete floor).
    - This interpretation makes the “your product” exclusion inapplicable in the construction defect context.



## “OWNED PROPERTY” EXCLUSION

- Excludes coverage for damage to property that the insured owns or that is in the “care, custody or control” of the insured.

## “IMPAIRED PROPERTY” EXCLUSION

- Exclusion (m): excludes coverage for “property damage” to “impaired property”, which is often defined as “tangible property other than ‘your product’ or ‘your work’ that cannot be used or is less useful . . . if such property can be restored to use by . . . repair, replacement, adjustment or removal of ‘your product’ or ‘your work.’” Mut. Of Enumclaw Ins. Co. v. T & G Constr., Inc., 199 P.3d 376, 384 (Wash. 2008).
- Exception for loss of use of property “arising out of sudden and accident physical injury to ‘your product’ or ‘your work.’”

# NUMBER OF OCCURRENCES

- Single vs. Multiple Occurrences
  - Effects Test: each resulting injury or instance of damage constitutes a separate occurrence.
  - Cause Test (majority of jurisdictions): the court looks to the cause of an injury or damage, rather than the number of injuries it caused.
  - Impact on Limits & Deductibles:
    - Limits: multiple occurrences can multiply the amount of coverage available.
    - Deductibles: multiple occurrences can multiply the number of deductibles the insured must satisfy.



PRACTICAL CONSIDERATIONS FOR THE  
COVERAGES CONSTRUCTION LAWYER



# GETTING AND KEEPING INSURANCE POLICIES IN PLAY

- (1) Always ask whether insurance was purchased for the project.
- (2) Review the terms of any policy(ies). Request a copy of the policy if the insured does not have one.
- (3) The position(s) the insured takes in a complaint or other legal demand letter may affect its insurance coverage, or whether the defendant or adverse party will have insurance coverage.
- (4) Cooperate with insurers, but be cognizant of insurers defending under a reservation of rights.

# QUESTIONS?