

“YOUR WORK”

EXCLUSIONS IN CGL POLICIES

Presented by
Wayman, Irvin & McAuley, LLC
www.waymanlaw.com
(412) 566-2970

Dale K. Forsythe, Esq.
Scott W. Stephan, Esq.



September 7, 2010

For
Hartford Insurance

2

Background of Commercial General Liability Policies and Business Risk Exclusions

Evolution of Commercial General Liability Policies

3

- The first standard form comprehensive general liability insurance policy (CGL) was drafted by the insurance industry in 1940. The standard policy was the result of a voluntary effort in the insurance industry to address the misunderstanding, coverage disputes, and litigation that resulted from the unique language used by each liability insurer. *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007)
- The standard CGL policy and its exclusions have been revised several times since 1940. *Id.*

What does a CGL Policy Cover?

4

- CGL policies are designed to protect an insured against certain losses arising out of business operations. A CGL policy covers the liability exposures of a business that are not specifically excluded under that policy. The range of coverage encompasses product liability, completed operations, premises and operations, and independent contractors. *Id.*
- Generally, CGL insurance includes coverage for “damage caused by a contractors faulty work,” not for the expense for repair or replacement of the actual faulty work. To be considered “property damage,” the property must have been undamaged previously.

What is the Purpose of a CGL?

5

- The purpose of a CGL policy is to safeguard the insured from liability for personal injury or property damage to a third party that could be caused by the insured's products or services. The purpose is NOT to provide for the repair or replacement of the insured's poorly constructed product, or to perform the service correctly. 11 Suffolk J. Trial & App. Adv. 119
- Liability coverage is not a replacement for a warranty or a guaranty of the performance to be given to the insured's customer. *Id.*

Determining Whether the Claim is Valid

6

- The Insurer must ask the following questions to determine whether the claim is valid:
 - Is there coverage?
 - Was there an occurrence?
 - Is coverage excluded under the “your work” exclusions?
 - Is the exclusion negated under the subcontractor or completed operations hazard exception?

What are the Insurer's Duties Under a CGL Policy?

7

- The CGL insurer has two major duties to the insured:
 - The duty to indemnify for settlements and judgments within the coverage granted, and
 - The duty to provide defense for the policyholder

- CGL policies traditionally are “occurrence” based, unlike other liability policies, which are “claims-made.” Through the “occurrence” based CGL policy, the insurer is obligated to pay or defend claims, whenever they are made, resulting from an incident that occurred during the policy period.

- Insurers have a duty to provide defense if the complaint against the insured suggests facts which could potentially bring the claim within the policy's coverage grant.

- It is the nature of the allegations, not the details surrounding the injuries suffered, that is the basis upon which the insurer's duty to defend the insured arises.

What is the Extent of Coverage under a CGL Policy?

8

- Disagreement exists regarding the extent of insurance coverage available to contractors under a CGL policy.
- A central question in disagreements regarding coverage is whether a construction defect is considered “property damage” and an “occurrence,” as defined in a CGL policy. The CGL policy defines “occurrence,” a condition precedent of policy coverage, as “an accident.” The definition of “occurrence” also includes “property damage” which is not expected or intended by the insured.

The 1986 Revisions

- When the CGL policy was revised in 1986, it contained new provisions and exclusions, including the “products-completed operation hazard” and “your work” exclusions.
- These exclusions are part of the “business risk” exclusions.

Policy Behind the Business Risk Exclusion

10

- Insurers should not be held liable for risks within the direct control of the insured
- Created to prevent CGL coverage for third party claims of injury suffered from the policyholder's inadequate performance of its contractual obligations to the third party.

“Your Work” Exclusion

11

- The 1986 policy added new exclusion (I), the “your work exclusion,” with an express exception for subcontractor work as follows:
 - 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.”
 - 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.

Reasoning Behind Subcontractor Exception

12

- The reason for this 1986 revision that added the subcontractor exception has been explained as follows:
- The insurance and policyholder communities agreed that the CGL policy should provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor rather than the policyholder itself. This resulted because of the demands of the policyholder community and the viewpoint of insurers that the CGL could be better sold if it contained this coverage. *U.S. Fire Ins.*, 979 So. 2d 871 (Fla. 2007)

What Does “Your Work” Mean?

13

- Work or operations performed by you or on your behalf and
- Materials, parts or equipment furnished in connection with such work or operations

What Does “Your Work” Include?

14

- Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your work” and
- The providing of or failure to provide warnings or instructions
- Not designed to protect contractors from the cost of replacing inferior or defective work

15

Common Issues Arising Regarding Coverage Under CGL Policies

What Constitutes Property Damage under the Standard CGL Policy?

16

- Property damage is generally defined as “physical injury to tangible property or loss of use of tangible property that is not physically injured.”
- To the average, ordinary person, tangible property suffers a physical injury when the property is altered in appearance, shape, color or in another material dimension. 44 Tort Trial & Ins. Prac. L.J. 996
- The North Carolina courts have consistently held that “property damage” in the context of commercial general liability policies means “damage to property that was previously undamaged” and does not include “the expense of repairing property or completing a project that was not done correctly or according to contract in the first instance” by the insured.
- The rationale underlying this view is that “the quality of the insured’s work is a ‘business risk’ which is solely within his own control,” and that “liability insurance generally does not provide coverage for claims arising out of the failure of the insured’s product or work to meet the quality or specifications for which the insured may be liable as a matter of contract.”

Property Damage Can Be Caused By Unlikely Sources

17

- The courts in Michigan held that contaminated wood chips used to construct a playground could cause property damage.
- In *Newby Int'l v. Nautilus Ins. Co.*, 112 Fed. Appx. 397 (6th Cir. Mich. 2004) Newby, the insured, supplied wood chips containing metal debris for the construction of school playgrounds. PMI, additional insured, supplied other flooring materials. The insureds sought indemnification for the cost of removing the defective wood chips and repairing the playgrounds. The district court concluded that there was no “property damage” and no “occurrence” under the policy. On appeal, the court found that the district court improperly resolved a factual dispute in favor of the insurer when it concluded that the wood chips did not cause any damage to the property of another.

continued...

Property Damage Can Be Caused By Unlikely Sources

18

□ *Newby continued...*

The evidence showed that the wood chips might have caused physical injury to another supplier's wood chips, to the flooring materials, and to a construction company's materials. The court thus found a genuine issue of material fact as to whether and when the wood chips caused physical injury and whether they caused the school district to suffer a loss of use of their playgrounds. The court also found a genuine issue as to whether the named insured could have reasonably foreseen that its wood chips would injure the property of another and thus whether the property damage was caused by an "accident."

Before There Can be Coverage There Must Be An Occurrence

19

- Coverage under a CGL policy is only provided for “bodily injury” or “property damage” caused by an “occurrence” that takes place in the coverage territory.
- “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.” *Architex Ass’n v. Scottsdale Ins. Co.*, 27 So. 3d 1148 (Miss. 2010) (citing Dekker, et al., *The Expansion of Insurance Coverage for Defective Construction*, 28 *Construction Lawyer* at 20). In the absence of an “occurrence,” there is no coverage.
- An occurrence is generally defined as an “accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.”

Common Issues Involving “Occurrences”

20

- Breach of Contract
 - There is a split among the jurisdictions as to whether a breach of contract or warranty alone qualifies as an occurrence.

- Faulty Workmanship
 - Although most courts agree that faulty workmanship is not an occurrence, many have held that there is an occurrence if the faulty workmanship causes damage that is unexpected or unintended.

- Whether coverage was triggered during the relevant time period.

Breach of Contract as an Occurrence

21

- The Wisconsin courts held that breach of contract qualifies as an occurrence and coverage for contractual liability is not precluded by the standard CGL policy.
- In *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 2004 WI 2 (Wis. 2004) the court expressly recognized that inadvertent faulty workmanship as an accidental occurrence potentially covered under a CGL policy. The general contractor, potentially liable to the corporation under certain contractual warranties, notified its insurer of the loss. The circuit court, on summary judgment, found coverage under some, but not all of the policies. The appellate court reversed, concluding that the “contractual liability” exclusion in each of the policies excluded coverage because the contractor’s liability to the corporation derived entirely from its obligations under the construction contract.
continued...

Breach of Contract as an Occurrence

22

□ *Am. Family continued...*

The court disagreed and reversed, stating that there was “property damage” caused by an “occurrence” within the meaning of the commercial general liability policies. The court rejected the argument that there could be no occurrence because the claim was based on breach of contract or breach of warranty. The insurance company further argued that the CGL policy is intended only to provide coverage for tort liability for physical damages to others and not contractual liability of the insured for economic loss because the completed work is not that which was bargained for.

The court held that while the terms generally apply as argued by the insurance company, it is not true that the CGL policy never applies to provide coverage for claims that arise out of breach of contract or that the term occurrence is limited to tort claims.

Breach of Contract Not An Occurrence

23

- Contrary to other jurisdictions, the Pennsylvania courts have held that breach of contract is not an occurrence and therefore does not trigger coverage under standard CGL policies.
- In *Snyder Heating Co. v. Pennsylvania Mfrs.' Ass'n Ins. Co.*, 715 A.2d 483 (Pa. Super. Ct. 1998), Snyder initiated a declaratory judgment action against Pennsylvania Mfrs.' after Pennsylvania Mfrs.' disavowed coverage under a commercial general liability insurance policy for claims asserted against Snyder by a third party alleging that the third party suffered property damage as a result of Snyder's breach of contracts to provide maintenance. The trial court held that Pennsylvania Mfrs.' had the duty to defend Snyder and that Pennsylvania Mfrs.' was obligated to pay the third party's damage. The trial court denied Pennsylvania Mfrs.'s motion for post-trial relief.

continued...

Breach of Contract Not An Occurrence

24

□ *Snyder continued...*

On appeal, the court held that Snyder policy excluded coverage for breach of contract allegations. The court held that the general liability insurance policy was intended to provide coverage where Snyder's product or work caused personal or property damage and that such policy was limited in nature. The court held that Snyder's policy clearly excluded coverage from Snyder's failure to perform a contract. The court vacated and remanded the judgment of the trial court to enter judgment in favor of Pennsylvania Mfrs.'

Faulty Workmanship

25

- Insurance coverage for construction defects or faulty workmanship under a CGL policy has long been a contentious issue between insurers and policyholders. In recent years, the high courts of Texas, Florida, Tennessee, Kansas, Wisconsin, North Dakota, Nebraska, and Minnesota have held that CGL policies can provide coverage for defect claims or faulty workmanship.

Damages Arising From Faulty Workmanship are Nonaccidental

26

- In Pennsylvania, the Supreme Court held that damages arising from faulty workmanship do not constitute an accident or occurrence.
- In *Kvaerner Metals Div. of Kvaerner United States, Inc. v. Commercial Union Ins. Co.*, 589 Pa. 317 (Pa. 2006), the coverage dispute involved whether Commercial Union was obligated to defend or indemnify Kvaerner in a breach of contract case brought against Kvaerner in reference to a product it supplied. The breach suit alleged that the product did not meet the contract specifications and warranties. In a declaratory judgment action filed by the Commercial Union, the trial court granted summary judgment in favor of Commercial Union because it found that Commercial Union was only required to provide coverage for accidental damages and damages resulting from a party's breach of contract could never be classified as accidental.
- That decision was reversed and remanded by the Superior Court, which looked beyond the allegations raised in the breach complaint and examined expert reports to determine that Commercial Union had a duty to defend because the damages might have been the result of an occurrence.

Continued...

Damages Arising From Faulty Workmanship are Nonaccidental

27

□ *Kvaerner continued...*

On review, the court held that the Superior Court erred by looking to information not contained in the underlying complaint. Because the underlying suit alleged only property damage from faulty workmanship, such event did not constitute an accident or occurrence under the policies.

The court stated, a commercial general liability (CGL) policy might provide coverage where faulty workmanship caused bodily injury or damage to another property, but not in cases where faulty workmanship damages the work product alone. To permit coverage in such instances would convert CGL policies into performance bonds, which guarantee the work, rather than like an insurance policy, which is intended to insure against accidents.

Faulty Workmanship Not An Occurrence

28

- Under North Carolina law, not only is the cost of repair or replacement of faulty workmanship not property damage, but neither is damage to an insured's own work that is caused by such faulty workmanship.
- In *Breezewood of Wilmington Condos. Homeowners' Ass'n v. Amerisure Mut. Ins. Co.*, 335 Fed. Appx. 268 (4th Cir. N.C. 2009), Breezewood, a homeowners' association, sought a declaratory judgment that Homeowners breached its duty to defend its insured, Quality Built, with respect to state court claims arising out of the construction of a condominium development. Quality Built was the general contractor for a condominium development. In the underlying action, Breezewood alleged that defects in the construction and design of the condominium development buildings required extraordinary repairs and reconstruction of common elements. Breezewood settled its claims with Quality Built and accepted an assignment of Quality Built's rights against Homeowners. Homeowners sought a declaratory judgment that it had no duty to defend the Quality Built. The district court granted summary judgment to Homeowners. Breezewood appealed.

Continued...

Faulty Workmanship Not An Occurrence

29

- *Breezewood continued...*

The court held that Homeowners had no duty to defend Quality Built because Breezewood's allegations in the underlying action did not allege property damage within the meaning of the Quality Built's commercial general liability insurance policy. Breezewood's allegations of faulty workmanship by Quality Built and damages associated with repairing deficient construction did not allege property damage under North Carolina law.

The underlying complaint alleged that Quality Built did not construct the condominium development according to contract, but costs associated with bringing the project into compliance with contractual expectations did not constitute property damage. Additionally, water damage to the condominium development did not constitute property damage because the water damage was caused by the insured's faulty workmanship.

Faulty Workmanship As An Occurrence

30

- Texas courts held that faulty workmanship qualifies as an occurrence, even if the faulty workmanship only damaged the work of the insured
- In *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007), the home buyers purchased a new home from Lamar. The buyers later encountered problems attributed to defects in their foundation. They brought a construction defect suit against the Lamar who forwarded the lawsuit to Mid-Continent. Mid-Continent refused to defend, prompting Lamar to seek a declaration of its rights under the CGL policy.
- The court concluded that allegations of unintended construction defects or faulty workmanship that damaged only the work of the insured could constitute an “accident” or “occurrence” under a CGL policy and that allegations of damage to the home itself could constitute “property damage” sufficient to trigger the insurer’s duty to defend under a CGL policy.

Faulty Workmanship Damaging Subcontractor Work

31

- Applying Pennsylvania law, the court of appeals for the Fourth Circuit held that the “your work” exclusion only excludes coverage for damage to an insured’s work that arises out of the insured’s faulty workmanship. It does not exclude coverage for damage to a third party’s work.
- In *Limbach Co. LLC v. Zurich American Ins. Co.*, 396 F.3d 358 (4th Cir. 2005), Limbach sued Zurich, claiming that a commercial liability policy provided coverage for property damages caused by Limbach’s faulty workmanship. Zurich argued that the damaged work was excluded from coverage under the policy’s “your work” exclusion. The district court ruled that the property damage was excluded from coverage by the policy and awarded the insurer summary judgment. The insured appealed. The district court erred in finding that the damaged backfill placed around the stream line fell under the exclusion as the exclusion contained an exception for work performed by a subcontractor and the backfill work was performed by a subcontractor on the insured’s behalf.

Continued...

Faulty Workmanship Damaging Subcontractor Work

32

□ *Limbach continued...*

As a result, the “your work” exclusion did not preclude coverage for the cost of repairing the damaged backfill. The cost of replacing a damaged steam pipe was not excluded from coverage by the “your work” exclusion as the pipe’s manufacturer was a subcontractor, not a materialman. Specifically, the manufacturer custom manufactured the steam pipe in accordance with shop drawings and project specifications and provided on-site installation instructions. Finally, the costs of replacing concrete and repairing damaged landscaping were not excluded from coverage as that work was performed by third parties, not the insured. Thus, the “your work” exclusion did not apply.

The court noted that “[g]eneral liability insurance policies are intended to provide coverage where the insured’s product or work causes personal injury or damage to the person or property of another.” The court observed that the “your work” exclusion does not exclude all property damage arising from an insured’s work but “[b]y its plain language . . . only excludes coverage for damage to an insured’s work that arises out of the insured’s faulty workmanship.” The court concluded that the commercial general liability policy covered damage to a third party’s work that resulted from the general contractor’s effort to repair his faulty workmanship.

Occurrences Must Arise During the Relevant Policy Period

33

- Coverage is generally not triggered unless the property damage occurs during the “policy period.”
- In resolving when property damage occurs for purposes of triggering coverage, courts throughout the country have not been consistent. However, the approaches they have taken may be categorized into four general “trigger” theories:
 - The “Exposure” Theory holds that property damage occurs upon exposure and therefore triggers the policy in effect upon exposure to the damaging condition.
 - The “Damage-in-Fact” Theory triggers the policy when the injury or damage, in fact, occurs. This is also referred to as the “actual” injury or damage theory.
 - Under the “Manifestation” Theory, the only policy that must respond is the one in effect when the damage is discovered or manifests.
 - Under the “Continuous” Trigger Theory, all policies on the risk from “exposure” through “manifestation” are triggered.

Relevant Period Under the Policy – Exposure Theory

34

- In *Boardman Petroleum v. Federated Mut. Ins.*, 926 F. Supp. 1566 (S.D. Ga. 1995), Boardman had a general liability policy for both gas stations with one insurer and then with the other. After the policies had been cancelled, Boardman learned that underground storage tanks had leaked during the period of coverage and sought a defense and coverage. The court found that the “exposure” trigger of coverage applied because the insurers were liable for property damage caused by an occurrence, and where the leak began during the policy, it occurred during the policy.

Negligent Actions Intentionally Caused by the Insured are Not Occurrences

35

- Another issue arising in various jurisdictions is whether the negligence acts intentionally caused by the insured qualify as occurrences under the standard CGL policy.
- An injury is accidental if from the viewpoint of the insured, it is not the natural and probable consequence of the action or occurrence that produced the injury. In other words, the injury could not reasonably be anticipated by insured, or would not ordinarily follow from the action or occurrence which caused the injury.
- An accident is generally understood to be a fortuitous, unexpected, and unintended event. It occurs not as the result of natural routine, but as the culmination of forces working without design, coordination, or plan. An intentional tort is not an accident and thus not an occurrence regardless of whether the effect was unintended or unexpected.

Negligent Actions Intentionally Caused by the Insured are Not Occurrences

36

- The Mississippi courts held that an insurer's duty to defend under a general commercial liability policy does not extend to negligent actions that are intentionally caused by the insured.
- In *United States Fid. & Guar. Co. v. OmniBank*, 812 So. 2d 196 (Miss. 2002), an individual financed her car purchase through OmniBank, but failed to obtain car insurance, as required by OmniBank. Subsequently, OmniBank "allegedly 'force-placed' insurance coverage on the car and charged and added to the amount of loan the premiums and interest. After the individual filed suit in federal court against OmniBank for "wrongfully force-placing collateral protection insurance," OmniBank filed a third-party complaint against its insurer, United States Fidelity & Guaranty Company ("USF&G"), for breaching its duty to defend and bad faith. Subsequently, the district court granted USF&G's motion for summary judgment as to the bad-faith claim, but denied the motion regarding the duty-to-defend claim. The issue on appeal was "whether ... an insurer's duty to defend under a general commercial liability policy for injuries caused by accidents extends to injuries unintended by the insured but which resulted from intentional actions of the insured if those actions were negligent but not intentionally tortious."

Continued...

Negligent Actions Intentionally Caused by the Insured are Not Occurrences

37

□ *OmniBank continued...*

The court determined that the chain of events was set in motion and followed a course consciously devised and controlled by OmniBank, without the unexpected intervention of any third person or extrinsic force; therefore, USF&G was under no duty to defend. “Even if an insured acts in a negligent manner, that action must still be accidental and unintended in order to implicate policy coverage.” This Court added that “a claim resulting from intentional conduct which causes foreseeable harm is not covered, even where the actual injury or damages are greater than expected or intended.”

Relevant Period Under the Policy – Damage in Fact

38

- The courts in Texas follow the damage in fact theory, holding that coverage is triggered when damage occurs, not when it is discovered.
- In *Wilshire Ins. Co. v. RJT Constr., LLC*, 581 F.3d 222 (5th Cir. Tex. 2009), Wilshire covered RJT under two consecutive CGL policies running from June 2004 through June 2006. RJT repaired the foundation of a home after it was damaged by an accidental discharge of water. The homeowner later found cracks in the walls and ceilings, damage which he attributed to the foundation being unlevel, and he sued RJT. The district court granted summary judgment to Wilshire in its action seeking a declaratory judgment that it had no duty to defend RJT in the underlying faulty construction suit. The appellate court disagreed, holding that the homeowner's allegation that the cracks began appearing in 2005 brought the claims within the policies, which covered damage that occurred between June 2004 and June 2006; stating that "occurred" means when damage occurred, not when discovery occurred.

Continued...

Relevant Period Under the Policy – Damage in Fact

39

□ *Wilshire continued...*

Additionally, the court held the “your work” exclusion in the policies did not preclude coverage except as to claims by the homeowner for repair of the foundation, and did not exclude coverage for damage to other property resulting from the defective work. The exclusion only precluded coverage for liability for repairing or replacing the insured’s own defective work; it does not exclude coverage for damage to other property resulting from the defective work.

Relevant Period Under the Policy – Manifestation Theory

40

- In *Mraz v. Canadian Universal Ins. Co.*, 804 F.2d 1325 (4th Cir. Md. 1986), the government brought suit under the CERCLA against Mraz for the costs of removing hazardous wastes that Mraz had buried years before. Mraz then brought an action seeking a declaratory judgment that Canadian had a duty to defend and indemnify them in that suit. The district court found for Mraz, and Canadian appealed. The court reversed the judgment. The court held that the timing of the damage in hazardous waste burial cases was the time at which the leakage and damage were first discovered.
- The court stated, the time of the occurrence of an accident within the meaning of an indemnity policy is not the time the wrongful act was committed but the time when the complaining party was actually damaged. Determining exactly when damage begins can be difficult, if not impossible. In such cases the better rule is that the occurrence is deemed to take place when the injuries first manifest themselves.

Relevant Period Under the Policy – Continuous Trigger Theory

41

- In *Gottlieb v. Newark Ins. Co.*, 238 N.J. Super. 531 (App.Div. 1990) Gottlieb applied toxic chemicals to parts of plaintiff homeowners' home. Decontamination was needed when the chemicals migrated into untreated rooms. Newark insured Gottlieb under successively increased policies. Plaintiffs received an offer to settle for the amount of the first policy but brought suit for a determination of coverage under the later larger policies. The trial judge granted summary judgment for plaintiffs. The court granted leave to appeal and ordered a limited remand.
- The trial judge vacated the original order and held that the policy definition of occurrence included all damages that commenced during the first policy, irrespective of subsequent dates of injury. Plaintiffs appealed judgment for Newark. The court held that summary judgment was improper, reversed, and remanded. The parties were not precluded from resorting to the policies in effect during the several periods of injury that occurred. It was relevant when all of the damage from migrating pesticide could have been known or predicted and whether early notification and correction would have prevented subsequent chemical migration or other damages. The court stated, where an injury process is not a definite, discrete event, the date of the occurrence should be the continuous period from exposure to manifestation of damage. The continuous trigger theory and other theories respecting occurrence typically arise out of efforts to maximize insurance coverage by use of the ambiguity approach.

42

The Subcontractor Exception

“Your Work” – The Subcontractor Exception

43

- Generally the subcontractor exception to the “your work” exclusion provides coverage for property damage to the insured’s completed work if a subcontractor performed the work.
- If the damage first occurs after the insured contractor completes its work, there are two possible scenarios for coverage:
 - If the contractor performed the damaged work, there is no coverage under the “your work” exclusion
 - If the subcontractor performed the work, or the damage was caused by the subcontractor’s work, the subcontractor exception to the “your work” exclusion applies and the damage is covered if all other requirements are met.

Faulty Subcontractor Work

44

- There is a clear jurisdictional split regarding whether defective subcontractor construction constitutes an “occurrence” under a CGL policy.
- One line of cases has held that faulty or improper construction does not constitute an accident; rather, the damage is the natural and ordinary consequence of the insured’s act.
- The other line of cases has held that improper or faulty construction does constitute an accident as long as the resulting damage is an event that occurs without the insured’s expectation or foresight. *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 281 Kan. 844 (2006).

Coverage for Faulty Subcontractor Work

45

- The Florida courts are among those who hold that faulty subcontractor work is not intended or anticipated and therefore qualifies as an occurrence under the standard CGL policy.
- In *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007), after the completion of several homes that J.S.U.B built, damage to the foundations, drywall, and other interior portions of the homes appeared. The damage was caused by subcontractors using poor soil, and improper soil compaction and testing. The homeowners demanded that J.S.U.B repair the damages. J.S.U.B made the necessary repairs and filed a declaratory judgment action regarding commercial general liability (CGL) policies U.S. Fire had issued to J.S.U.B to determine whether coverage existed for the cost of damage repair.
- The trial court ruled for U.S. Fire. The appellate court reversed, finding that the policies contained “broad policy language” that provided coverage to J.S.U.B and that none of the exclusions in the policies applied. The court found that faulty workmanship of a subcontractor that was neither intended nor expected from the contractor’s standpoint could constitute an “accident” and, thus, an “occurrence” under a post-1986 standard form CGL policy.

Coverage for Damage Caused by Subcontractor

46

- The Nebraska courts held that although faulty workmanship of a subcontractor alone did not qualify as an occurrence, damages resulting from the faulty workmanship did.
- In *Auto-Owners Ins. Co. v. Home Pride Cos.*, 268 Neb. 528 (Neb. 2004) Auto-Owners instituted a declaratory judgment action to determine its obligations to Home Pride, its insured, under a suit brought by the owner of an apartment building for work done by a subcontractor. The district court for held that the insurance policy issued to Home Pride did not cover Home Pride's claim and granted summary judgment to the Auto-Owners. Home Pride appealed. The main issue was whether a standard commercial general liability (CGL) insurance policy covered an insured contractor for the faulty workmanship of its subcontractor. Auto-Owners argued that faulty workmanship did not constitute an "occurrence" under the policy.

Continued...

Coverage for Damage Caused by Subcontractor

47

□ *Auto-Owners continued...*

Although faulty workmanship, standing alone, was not an occurrence under a CGL policy, an accident caused by faulty workmanship was a covered occurrence. The owner alleged that the contractors negligently installed shingles on the apartments, which caused the shingles to fall off and that, as a consequence of the faulty work, the roof structures and buildings had experienced substantial damage. That was an unintended and unexpected consequence of the faulty workmanship and was an occurrence within the meaning of the insurance policy.

The court held that the claimed damages fell outside of the contract's exclusion and Auto-Owners had a duty to defend and, to the extent that the contractor was found liable for the resulting damage, Auto-Owners was obligated to provide coverage. The judgment of the trial court was reversed, and the case was remanded to the district court to enter judgment in favor of the contractor.

Defective Performance by Subcontractor Not An Occurrence

48

- The Virginia courts, stating that damages resulting from a subcontractor's work are not unforeseeable, held that faulty subcontractor work is not an occurrence.
- In *Travelers Indem. Co. of Am. v. Miller Bldg. Corp.*, 142 Fed. Appx. 147 (4th Cir. Va. 2005) Miller obtained commercial general liability insurance policies from Travelers. Those policies provided coverage for property damage caused by an "occurrence." They also contained various exclusions, including a "your work" exclusion, which did not apply if the damaged work or the work out of which the damage arose was performed on the insured's behalf by a subcontractor. The subcontractor allegedly made errors when performing a contract with Miller. The customer sued the Miller for damages that arose from the subcontractor's error. Traveler's then filed an action seeking a declaratory judgment that Traveler's was not obligated to indemnify Miller for the customer's claim.

Continued...

Defective Performance by Subcontractor Not An Occurrence

49

□ *Travelers continued...*

The district court erred by holding for the insured. Under Virginia law, damages resulting from a subcontractor's defective performance of a contract and limited to the insured's work or product is not unforeseeable and therefore was not an "occurrence" that triggered coverage under Miller's policies. The court stated the subcontractor exception to the "your work" exclusion simply limited the exclusion, it did not provide coverage under the policy.

Subcontractor Faulty Workmanship

50

- The Virginia courts distinguished their holding in *Travelers* (above) in *French v. Assurance Co. of Am.*, 448 F.3d 693 (4th Cir. Va. 2006), holding that the standard comprehensive general liability policy does not provide coverage to a general contractor to correct defective workmanship of a subcontractor but does provide coverage to the general contractor for the damages caused by the subcontractor's defective workmanship.
- In *French* the court examined in depth the "your work" exclusion and its interplay with the exception for damages caused by the faulty work of a subcontractor. The Frenchs sued their contractor when their house was damaged by defective stucco exterior installed by a subcontractor. The parties settled. Thereafter, the Frenchs (as assignees to the contractor's rights) sued Assurance. The district court granted Assurance's motion for summary judgment. On appeal, the court held that the defective application of the stucco exterior to appellants' home by a subcontractor did not constitute an "accident," and therefore, was not an "occurrence."

Continued...

Subcontractor Faulty Workmanship

51

□ *French continued...*

The obligation to repair the defect was not unexpected or unforeseen under the terms of the sales contract. Therefore, the repair or replacement damages represented economic loss and consequently did not trigger a duty to indemnify under the policies at issue. However, there was no evidence that the contractor subjectively expected or intended that the non-defective structure and walls of appellants' home would suffer damage from moisture intrusion. Accordingly, the moisture intrusion into the nondefective structure and walls of appellants' home was an accident, and therefore, an "occurrence" under the initial grant of coverage of the policies, which coverage was not defeated by the express exclusion for coverage of damage which was expected or intended from the standpoint of the insured.

The Court noted that the subcontractor exception restored coverage limited by the "your work" exclusion. The Court also observed that a plain reading, along with a thorough examination of the history of the "your work" provision, compelled the following conclusion: the standard comprehensive general liability policy does not provide coverage to a general contractor to correct defective workmanship of a subcontractor but does provide coverage to the general contractor for the damages caused by the subcontractor's defective workmanship. Thus, the damage to the general contractor's work was covered only because it fell within the subcontractor exception to the "your work" exclusion.

Negligent Work of Intentionally Hired Subcontractors

52

- The Mississippi courts have held that the faulty work of a subcontractor constitutes an occurrence for purposes of triggering coverage under the standard CGL policy, regardless of the fact that the contractor intentionally hired the subcontractor.
- In *Architex Ass'n v. Scottsdale Ins. Co.*, 27 So. 3d 1148 (Miss. 2010), Architex sought coverage from Scottsdale after Architex was sued due to a foundation that was negligently installed by subcontractors on a project. Architex had a standard CGL policy that included the “Your Work” exclusion and subcontractor exception. Scottsdale refused to provide coverage, arguing that negligent work done by a subcontractor did not constitute an occurrence. Architex claimed the property damage resulted from acts which were not intended by them, therefore the damage constituted an occurrence. Scottsdale argued that the intentional hiring of the subcontractors was not an “accident” as defined under the policy, but a conscious decision that led to the injuries complained of, and therefore there was no occurrence to trigger coverage. The circuit court granted summary judgment in favor of the Scottsdale, holding that no coverage existed.

Continued...

Negligent Work of Intentionally Hired Subcontractors

53

□ *Architek continued...*

The issue on appeal was whether Architek's intentional hiring of subcontractors negated coverage included in the CGL policy issued by Scottsdale to Architek.

The supreme court reversed and remanded, stating that the term "occurrence" could not have been construed to preclude coverage for unexpected or unintended property damage resulting from negligent acts or conduct of a subcontractor, unless otherwise excluded or the insured breached its duties after loss. By failing to consider the policy as a whole, the circuit court erred in its "occurrence" analysis.

Material Supplier as Subcontractor

54

- Courts in both Minnesota and Montana have held that material suppliers qualify as subcontractors for purposes of granting the insured coverage under the subcontractor exception to the standard “your work” exclusion.
- In *Wanzek Constr., Inc. v. Empls. Ins.*, 679 N.W.2d 322 (Minn. 2004), Wanzek, a general contractor for the construction of a swimming pool, sought to recover the costs associated with replacing faulty stones obtained from a supplier under its CGL policy. After the claim was denied, Wanzek filed an indemnity action against Employers. The district court granted Employer’s motion for summary judgment, but the decision was reversed by the appellate court. On review, the court determined that the extent to which the CGL policy covered the business risk of Wanzek was determined by the specific terms of the insurance contract.

Continued...

Material Supplier as Subcontractor

55

□ *Wanzek continued...*

The failure of the stones constituted an “occurrence” resulting in “property damage.” The term “subcontractor” in the “your work” exclusion was ambiguous.

The court held that where a supplier custom fabricates the materials to the owner’s specifications and provides on-site services in connection with the installation, the supplier meets the definition of subcontractor under the exception to the “your works” exclusion. The supplier had met the definition of “subcontractor,” as it fabricated materials to an owner’s specifications and provided on-site installation services.

Material Supplier as Subcontractor

56

- In *Revelation Indus. v. St. Paul Fire & Marine Ins. Co.*, 2009 MT 123 (Mont. 2009), Revelation agreed to develop a disposable sanitary bag for a client's portable environmental toilets and subsequently contracted with a subcontractor to produce the bags according to the client's specifications. The bags shipped to the client did not contain cornstarch. The client sued for damages as a result of the Revelation's failure to provide a conforming product. Revelation forwarded the complaint to its general liability insurer. The St. Paul reviewed the complaint and declined coverage, concluding that the damages were not the result of an "event" and that several policy exclusions applied. Revelation sued St. Paul for refusing to defend and indemnify Revelation in a lawsuit brought by the Revelation's client.
- The district court ruled that St. Paul had no duty to defend Revelation. Revelation appealed. The appellate court held that St. Paul was not allowed to ignore knowledge of facts outside the complaint that could give rise to coverage. In this case, the subcontractor exception to the policy exclusion obligated St. Paul to defend Revelation. The policy requirement of an "event" did not preclude coverage.

57

The Products-Operations Completed Hazards Exception

“Your Work” Exclusion

58

- Another possible exclusion in a construction defect case is policy exclusion j(6), which is a standard exclusion in most CGL policies.
- The j(6) exclusion precludes coverage of: “property damage” to that particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.
- However, the products-completed operations hazard exception often restores coverage taken precluded under this exclusion. The products-completed operations hazard exception states that exclusion j(6) will not apply to property damage that occurs after the completion of the contractor’s work.

Completed Operations

59

- When property damage occurs after the completion of the contractor's work, whether the CGL policy covers claims falling under the completed operations hazard is an important issue in determining coverage.
- The completed operations hazard generally includes property damage that occurs away from the premises owned by the named insured after the insured's work has been completed.
- If the CGL policy includes coverage for completed operations hazard claims, coverage is generally provided subject to the additional terms of the policy.
- If the CGL policy does not include coverage for such claims, the insurer has a valid defense to many construction defect coverage claims. Generally, there is no coverage for property damage that occurs away from the insured, contractor's premises after the contractor's work is completed.

Products Completed Operations Hazard Exception

60

- For the “products completed operations hazard” portion of the “your work” exception to apply three elements must be met:
 - The injury or damage must arise out of the insured’s product or completed operations
 - The injury or damage must occur after the insured has relinquished control of the product or completed its operations
 - The injury or damage must occur away from the insured’s premises

Faulty Work is Not Complete

61

- In *Upright Material Handling v. Ohio Casualty Group*, 2005 Pa. Dist. & Cnty. LEXIS 131 (Commw. Ct. 2005) the insured purchased an insurance policy which included products-completed hazard coverage. The contract defined products-completed operations hazard in part as bodily injury arising out of your work, except work that has not yet been completed or abandoned. Work was 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 jobsite 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 jobsite has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.
- The court held that the installation of a backup alarm on the forklift which caused the underlying plaintiff's injury was a service, but was not completed at the time of the accident because the installation was both faulty and negligent, and therefore the insurer carried the duty to defend until it met its burden of proving the applicability of its exclusion.

Damage Caused by Abandoned Materials

62

- In *Tonicstar Ltd. v. Lovegreen Turbine Servs.*, 2006 U.S. Dist. LEXIS 60750 (D. Minn. Aug. 25, 2006) Tonicstar, a subscribing insurance syndicate, filed a declaratory judgment action that it had no duty to defend nor indemnify Lovegreen regarding its alleged failure to perform repairs in a workmanlike manner by leaving a cloth rag inside the compressor and claims by Lovegreen refining company for its business interruption losses incurred when the compressor was shutdown to remove the rag. Based on the allegations in the refining company's underlying complaint against the repair company, the court concluded that the policy term "Your Work" referred to the overhaul, which included a duty to inspect and remove foreign matter.

Continued...

Damage Caused by Abandoned Materials

63

□ *Tonicstar continued...*

The policy term “Property Damage” included both the damage to the compressor itself, as well as the damage from the loss of use of the compressor. Applying the allegations in the complaint to the terms, the court found that the Property Damage to Your Work exclusion applied. However, there was an exception to the exclusion under the Products-Completed Operations Hazard. Property damage caused by the existence of “abandoned or unused materials” was not included in the exception. The cloth rag qualified as “abandoned or unused materials,” and therefore, the property damage alleged was not included as a Products-Completed Operations Hazard, and the exclusion applied. Tonicstar had no duty to defend and no duty to indemnify.

Completed Operations Exclusion does Not Exclude Negligence Claims

64

- In *Devich v. Commercial Union Insurance Company*, 867 F. Supp. 1230 (W.D. Pa. 1994) the central issue was whether a negligence claim of failure to warn fell outside the coverage of a general liability insurance policy issued by insurer to insured, where the terms of the policy included a products-completed operations hazard exclusion. The court held that the products-completed operations hazard exclusion did not exclude plaintiff's negligence claims from coverage.
- Pursuant to an agreement with the Navy, insured was required to purchase a general liability insurance policy, which it purchased from insurer. After the Navy cancelled the contract with insured, the insured defaulted on its financial obligations to its financier. Thus, the financier seized the insured's products and while the insurance policy was still in effect, an employee of the financier was injured while using the product. After tendering a letter of defense, insurer's only stated reason for denial of coverage was the products-completed operations hazard exclusion.

Continued...

Completed Operations Exclusion does Not Exclude Negligence Claims

65

□ *Devich continued...*

Insurer argued that pursuant to the exclusion, insured's claims were excluded because: the product was no longer in insured's possession; insured had completed or abandoned work on the product by the time the employee was injured; and the injuries were caused by a defect. Plaintiff argued that the exclusion was inapplicable to insured's negligence claims. Consequently, the court held that plaintiff's claim of negligent failure to warn does not fit within any of the express exclusions and therefore was covered by the policy.

Products Still In Insured's Possession

66

- The South Carolina courts analyzed the products completed operations hazard exception in *Century Indemnity Co. v. Golden Hills Builders, Inc.*, 348 S.C. 559 S.E.2d 355 (2002).
- In *Century*, the homeowners alleged that the builder applied the synthetic stucco system to the home in a negligent manner. The Supreme Court found that Century's CGL policy was in place at the time of the injury-in-fact; therefore, the policy covered property damage that occurred "during the policy period and for any continuing damage." The Court found that the damages to the substrate of the home that were caused by the subcontractor's faulty stucco application were an occurrence, but the damages were excluded by the general contractor's CGL policy under the faulty workmanship exclusion. The Court made it clear that such damage came under the "business risk doctrine" and that CGL policies are not intended to provide coverage for faulty work but for tort liability for physical injury or damage to the property of others.
- *Continued...*

Products Still In Insured's Possession

67

- *Century continued...*

Having determined that coverage was excluded due to the business risk exclusion, the Court then examined whether coverage was restored under the products-completed operations coverage exception. The Court found that the completed operations exception did not restore coverage because the completed operations exception does not apply to products still in the builder's possession and the injury-in-fact occurred while the builder still possessed the home.

No Coverage For Completed Operations

68

- In *State Farm Fire & Casualty Co. v. Avant*, 404 So. 2d 1311 (La.App. 2 Cir. 1981), Avant contracted with the homeowner to build a fireplace in a new home. As a result of a defective design and construction, a fire occurred resulting in property damage. The homeowner and Avant filed an action to recover property damages sustained from the State Farm. Thereafter, State Farm filed a motion for summary judgment contending that Avant's liability policy excluded from coverage completed operations and products hazards. The trial court granted the motion for summary judgment and Avant appealed. The court upheld the trial court's judgment. The court held that summary judgment was properly granted in State Farm's favor. The court reasoned that the policy excluded coverage of Avant from completed operations or products hazards. Additionally, the court reasoned that the policy did not cover damage allegedly caused by the insured's faulty design and workmanship or failure to warn, after the work was completed.
- The court stated, "The coverages provided by Avant's policy were designed to cover Avant's liability for losses which occur during the actual period of construction. Where completed operations and products hazards are excluded from coverage as they were in Avant's policy, losses which occur subsequent to completion of the construction are not covered."

Risk Transfer

Methods of Risk Transfer

70

- Contractual Indemnification and Defense
- Contract to Procure Insurance
- Additional Insured Clauses

“Express and Unequivocal”

71

- The language in an indemnification clause must be express and unequivocal.
 - Assuming liability for “any and all injuries and claims” is not adequately specific
 - The clause must include language assuming negligence of the indemnitee
- If the claimant is injured employee of the indemnitor the language in the indemnification clause must waive immunity under the Workers Compensation Act or expressly reference claims by injured workers to be valid.

Example of a Valid Indemnification Clause

72

- Subcontractor agrees to indemnify, save and hold harmless contractor, its subsidiaries, affiliates, their directors, officers, agents, workmen, servants or employees, against any and all claim or claims brought by the agents, workmen, servants or employees of subcontractor for any alleged negligence or condition, caused or created, [in] whole or in part, by contractor. *Hackman v. Moyer Packing*, 423 Pa. Super. 378 (Pa. Super. Ct. 1993)

General Contractor's Claims Under Subcontractor's Policy

73

- When evaluating a claim from a general contractor under an insured subcontractor's CGL policy there are three things you must analyze to determine whether there is an obligation to defend or indemnify:
 - Any contractual agreement to obtain insurance coverage
 - The wording of the defense and indemnity provision of the contract between the contractor and subcontractor
- The wording of any additional insured endorsement

Indemnity Provisions in Pennsylvania

74

- Under Pennsylvania law, provisions to indemnify for another party's negligence are to be narrowly construed, requiring a clear and unequivocal agreement before a party may transfer its liability to another party.
- Indemnification provisions are given effect only when clearly and explicitly stated in the contract between two parties.

“To The Extent Caused” - Inadequate

75

- In *Greer v. City of Philadelphia*, 568 Pa. 244 (Pa. 2002), the supreme court found that the language of the indemnity provision, stating that the subcontractor will indemnify “*to the extent caused or alleged to be caused,*” did not demonstrate an unambiguous intention to provide indemnification for subcontractor’s negligence. The parties communicated their intent to limit any indemnification to that portion of damages attributed to the negligence of the contractor and those under its supervision. The contract simply did not put it beyond doubt by express stipulation that the contractor intended to indemnify subcontractor for contractor’s own negligence. The provision only required the subcontractor to provide indemnity from liability for damages that resulted from the subcontractor’s negligence.

“Performance of the Work” - Inadequate

76

- In *Hershey Foods Corp. v. General Elec. Serv. Co.*, 422 Pa. Super. 143 (Pa. Super. Ct. 1992) General Electric provided services to appellant food company. Hershey and General Electric had a contract for the services that provided that General Electric would have been liable for Hershey’s negligence in all claims resulting from the “performance of the work.” General Electric’s employee was killed when he sat on an elevator while eating. Hershey did not inform the employee that the elevator was automatic. After employee’s estate recovered against Hershey for negligence, Hershey brought an action against General Electric seeking indemnification based on the contract between the parties.
- *Continued...*

“Performance of the Work” - Inadequate

77

□ *Hershey continued...*

The lower court granted General Electric’s motion for summary judgment and denied Hershey’s cross-motion. On appeal, the court affirmed and found that a contract for indemnity could have indemnified the negligence of Hershey, if the contract had been in unequivocal terms. The court found that the language in the contract did not clearly define “performance of the work.” The court found that the employee’s conduct was not clearly within “performance of the work,” and because the language of the contract was ambiguous, the contract must be strictly construed against the drafter, Hershey.

Multiple Indemnification Clauses

78

- When multiple indemnification clauses were in effect, the Pennsylvania courts have held the clause that is more restrictive towards the drafter applies.
- In *Chester Upland Sch. Dist. v. Edward J. Meloney, Inc.*, 2006 PA Super 141 (Pa. Super. Ct. 2006), the court stated that when there are conflicting indemnification clauses, the more restrictive clause applies. Chester brought an action against the architect and the contractor, alleging breach of a construction contract and negligence after a chiller installed at the school failed to function. The court held that indemnity agreements were to be narrowly interpreted in light of the parties' intentions as evidenced by the entire contract. The contract in question contained three different indemnification clauses.

Continued...

Multiple Indemnification Clauses

79

□ *Chester continued...*

The appellate court held that a reasonable interpretation of one indemnification agreement was that the contractor had an obligation to indemnify the architect, but that this obligation was limited by specific provisions within the paragraph. Another indemnification agreement contained absolutely no limitations on the contractor's obligation to indemnify.

Thus, the appellate court held that the agreements were ambiguous. The architect drafted the portion of the contract that contained the indemnification provisions. Construing these documents against the architect as the drafter, the appellate court concluded that the more restrictive indemnification provision applied, and that the architect was not entitled to indemnification under that provision.

Waiver of the Worker's Compensation Act

80

- The law requires that in order for an employer to be held liable in indemnification for injuries to its own employees caused by the negligence of the indemnitee there must be an express provision for this contingency in the indemnification clause.
- The absence of a provision in a hold-harmless clause that lessee would indemnify lessor against the negligence of lessor in a claim by lessee's employee requires the conclusion that the clause does not meet the requirements of the Workmen's Compensation Act concerning express waiver.

Absence of An Express Waiver Negates Coverage

81

- In *Bester v. Essex Crane Rental Corp.*, 422 Pa. Super. 178 (Pa. Super. Ct. 1993) Bester's employee filed suit for personal injuries against Essex alleging that Essex was negligent in supplying an unfit and careless mechanic, whose actions caused injury to the employee. Essex sought to obtain joinder of Bester as an additional defendant under a clause on a lease relating to indemnification. The court affirmed the trial court's grant of preliminary objections for Bester and affirmed the dismissal from the action for indemnity liability for the damages arising from the employee's claim.
- *Continued...*

Absence of An Express Waiver Negates Coverage

82

□ *Bester continued...*

The court held that the hold harmless clause was insufficient to establish a duty to indemnify because it did not unequivocally state that Bester would indemnify Essex for its own negligent acts.

The court concluded that an indemnification clause had to contain language which would avoid the employer's protection from double responsibility which was afforded by the Workers' Compensation Act. Absent such provision, the conclusion was that the clause did not meet the requirements of the compensation act regarding express waiver under 7 Pa. Cons. Stat. § 481(b).

Defense Provisions in Pennsylvania

83

- Agreements to defend are construed less strictly than indemnification agreements. Even if the indemnification clause is inadequate to shift the risk from the general contractor to the subcontractor, the language might be adequate to require the subcontractor to defend the contractor as long as the injury arose at least partially from the subcontractor's work.

Insured's Negligence does Not Preclude Defense

84

- In *Mace v. Atl. Ref. & Mktg. Corp.*, 567 Pa. 71 (Pa. 2001) Mace operated a convenience store and gas station pursuant to a franchise agreement and real estate lease with the Atlantic. Mace's employee worked as a stock clerk at the store. While working, the employee got into an altercation with the injured party and severely beat the injured party with an aluminum bat in the store's parking lot. Atlantic argued that the superior court erred in holding that Mace had no obligation to defend it when the injured party sued it for injuries caused by Mace's employee on the store's premises.

Continued...

Insured's Negligence does Not Preclude Defense

85

□ *Mace continued...*

Upon review, the supreme court held that the superior court erred when it construed the indemnity provisions in the agreement and lease. Atlantic was not seeking indemnification for its own negligence, but was only seeking reimbursement for Mace's failure to defend it as required. Mace failed to perform his obligations under the agreement and lease and was therefore responsible for reimbursing Atlantic for the counsel fees that it was forced to expend in defending itself from the lawsuit initiated by the injured party.

Contractual Agreement to Procure Insurance

86

- Often contracts require the subcontractor to purchase certain types of insurance. Failure to do so may result in a breach of contract claim.
- Claims for breach of contract for failure to obtain insurance are generally not “occurrences” under CGL policies, and therefore are not covered by the subcontractor’s policy.

Insured Contract

87

- A party's contract with another party to name the additional party as an insured under its policy, does not make the additional party an additional insured under the policy, but creates an insured contract.
- An insured contract can be defined in part as a contract under which the first party assumes the tort liability of the second party. In order for liability to attach, the language must be unequivocal. If the language is inadequate to require indemnification, the contract will not qualify as an insured contract under the policy.
- Under an insured contract the insurer provides the first party with coverage for its obligation to defend and indemnify the second party.
- Although the insurer is not required to defend the additional party directly, the insurer may choose to do so rather than provide the first party with coverage for the defense, in order to control the defense and the cost of the defense.

Insured Contract Insufficient to Provide Coverage

88

- In *Tremco, Inc. v. Mfrs. Ass'n Ins. Co.*, 2003 PA Super 343 (Pa. Super. Ct. 2003) Tremco sued Manufacturers, for its defense costs and counsel fees in an underlying personal injury action, and for punitive damages for Manufacturer's alleged bad faith breach of contract in refusing to defend and indemnify Tremco. The trial court granted Manufacturer's summary judgment motion, and Tremco appealed. Tremco's contract with a contractor required the contractor to name Tremco as an insured in its general liability policy, but the contractor did not do so, and the contractor and Tremco were sued for personal injuries arising from a project. The appellate court held that Tremco could not sue Manufacturers, the contractor's insurer.

Continued...

Insured Contract Insufficient to Provide Coverage

89

□ *Tremco continued...*

While the contract between Tremco and the contractor bound the contractor to assume liability for tort claims against Tremco arising out of the contractor's negligence, and was thus an "insured contract" under the contractor's insurance contract, Tremco could not enforce the policy in a direct action against the insurer as it was not listed as an additional insured. Though the contractor's insurance policy envisioned an "insured contract" such as the one between the supplier and the contractor, the supplier did not show the contractor and the insurer explicitly indicated an intent to benefit the supplier in particular in that policy, so the supplier did not show it was an intended third party beneficiary of the policy that could sue the insurer directly for coverage.

Additional Insureds

- The term additional insured refers to a party that has been added to another party's insurance policy. The additional insured then has the benefits and direct rights on the insurance policy and enjoys the same coverage as the purchaser.
- The endorsements to policies that add entities as additional insureds typically attempt to limit the carrier's exposure by relying on language stating that the person is covered "only with respect to liability arising out of 'your work' for the additional insureds."
- Additional insured clauses range from broad, where coverage is provided to the additional insureds to the same extent as the named insured, to narrow, where coverage is only provided for certain situations.

Coverage as an Additional Insured

91

- Generally, general contractors are not entitled to any rights under a subcontractor's general liability policy where coverage is provided under the exception to the contractual liability exclusion.
- Where the general contractor is named as an additional insured, however, the general contractor is directly covered under the policy. The terms of the additional insured clause determine the nature and extent of the coverage.

Vicarious Liability

- Additional insured clauses provided narrow coverage only on a vicarious liability theory, will not cover a party's independent acts of negligence.
- Language stating “liability caused in whole or in part by your acts or omissions” has been construed in various jurisdictions as limiting the scope of coverage to providing indemnity only where the additional insured is vicariously liable.

“Arising out of” Not Strictly Construed

- *In BBL-McCarthy, LLC v. Baldwin Paving Co.*, 285 Ga. App. 494 (Ga. Ct. App. 2007), BBL was hired to construct a highway and subcontracted with Baldwin to build a deceleration lane. After an automobile accident, personal injury suits were brought in which the plaintiffs alleged that the deceleration lane had been negligently constructed. BBL and its insurer filed an indemnity and insurance coverage action against Baldwin and their insurers. The trial court granted summary judgment in favor of the Baldwin and their insurers, which BBL appealed.
- On appeal, the court held that the trial court erred in finding that the subcontractors’ insurers had no duty to defend the general contractor and the owners as additional insureds. Given the allegations of negligent supervision and construction and the “arising out of” language in the subcontractors’ policies, the general contractor and the owners were additional insureds and Baldwin’s insurers had a duty to defend BBL.
- *Continued...*

“Arising out of” Not Strictly Construed

- *BBL continued...*

The court stated that the “term ‘arising out of’ does not mean proximate cause in the strict legal sense, nor require a finding that the injury was directly and proximately caused by the insured’s actions,” but that, “[a]lmost any causal connection or relationship will do.” Additionally, the court stated that where the insurer grants coverage for liability “arising out of” the named insured’s work, the additional insured is covered without regard to whether the injury was attributable to the named insured or the additional insured.

The trial court also erred in finding that the subcontractors did not have a duty to indemnify the general contractor and the owners. The indemnification clause in the subcontracts stated that the subcontractors were to indemnify the general contractor and the owners against all claims arising out of the performance of the subcontractors’ work, and the claims here arose out of such work.

Additional Insureds Must be Indicated in the Insurance Policy

95

- In *Clarendon Am. Ins. Co. v. Aargus Sec. Sys.*, 374 Ill. App. 3d 591 (Ill. App. Ct. 1st Dist. 2007), Clarendon filed a declaratory judgment action seeking a determination that it owed no duty to defend or indemnify Aargus in several underlying lawsuits arising out of a fire. Clarendon issued a commercial general liability policy to BGK, a security company, from which Aargus sought coverage as an additional insured. The circuit court granted Clarendon's summary judgment motion, and Aargus appealed. On appeal, Aargus argued that the trial court erred in holding that the insurance contract and certificates of insurance were insufficient to demonstrate a potential insured coverage for the corporation.
- *Continued...*

Additional Insureds Must be Indicated in the Insurance Policy

96

□ *Clarendon continued...*

Under the additional insured endorsement in the policy in question, an insured was amended to include those that the named insured was obligated by valid written contract to provide such coverage. The appellate court held that the language of the agreement between Aargus and BGK did not discuss any obligation undertaken by BGK or Aargus to provide insurance. Based on this language, the appellate court held that Aargus was not an additional insured under the policy in question. The appellate court further held that the existence of certificates of insurance did not change the fact that agreement did not discuss insurance requirements. The appellate court would not look to documents outside of the insurance contract to create an obligation.

Sole Negligence of Additional Insured Insufficient to Trigger Coverage

97

- In *Nat'l Fire Ins. of Hartford v. Walsh Constr. Co.*, 392 Ill. App. 3d 312 (Ill. App. Ct. 1st Dist. 2009), Walsh, a general contractor and The Chicago Historical Society, property owners, sought indemnification from National Fire, under a policy naming Walsh as an additional insured. The trial court granted summary judgment in favor of National Fire declaring that National Fire had no duty to defend Walsh in an underlying construction negligence suit filed by a subcontractor's employee. The appellate court held that the underlying suit did not accuse the subcontractor of any negligence. The negligent act alleged in the construction negligence suit concerned only an act by a Walsh employee.
- *Continued...*

Sole Negligence of Additional Insured Insufficient to Trigger Coverage

98

□ *Nat'l continued...*

The mere fact that the employee of the subcontractor, which was the primary insured, was injured on the jobsite did not give rise to an inference of the subcontractor's negligence so as to trigger National Fire's duty to defend Walsh as additional insureds. More than some unspecified breach of the subcontractor's duty to provide a safe work place was required to support a claim that the negligence complaint implicated negligence by the subcontractor. The sole negligence of Walsh as an additional insured did not give rise to a duty to defend.

Certificates of Insurance

- At times the general contractor requires the subcontractor to produce a Certificate of Insurance naming the general contractor as an additional insured.
- It is unsettled whether the Certificate of Insurance provides coverage to the certificate holder when the certificate holder is not named as an additional insured under an additional insured endorsement.
- The Certificate generally contains language of disclaimer, stating that it confers no rights upon the holder and does not amend coverage under the policy.
- Parties seeking coverage may argue, however, that it does in fact confer coverage where the agent who provided the certificate has the right to contract for the insurer.

Certificate of Insurance Inadequate to Modify Policy

100

- In *Schafer v. Paragano Custom Building, Inc.*, 2010 WL 624108 (NJ App. Div. 2010) the court held that a certificate of insurance could not modify the original policy it referred to. In *Schafer*, Schafer fell to his death due in part to Paragano's negligent construction of a scaffold. Paragano sought indemnification from the third party defendant insurance company which the trial court granted. The appellate court overruled the trial court, stating that although the certificate did name Paragano as an additional insured, the certificate could not override the language of the policy, which denied coverage for Paragano's own negligence.

Other Insurance Clauses

- “Other insurance” clauses are relied on by carriers to coordinate coverage when two policies apply to the same loss. A variety of “other insurance” clauses are designed to rank the carriers in order of priority once a loss occurs. In the context of an “additional insured” endorsement, the additional insured generally will have two policies of insurance: one available as the result of the “additional insured” endorsement, and one purchased by the insured to cover its own general liability. When the time comes to submit a claim, the additional insured usually will involve the carrier to which it is not paying a premium rather than its own carrier.

Other Insurance Clauses

102

- It is not always clear whether the policy conferring additional insured coverage is primary or excess.
- Often the additional insured clauses have “other insurance” provisions.
- If there is more than one policy with an other insurance clause:
 - If the clauses are not conflicting, the policy provisions will be applied. In the case that both insurers have the same “other insurance” language, the policy granting additional insured coverage is the primary policy.
 - If the clauses are conflicting, both “other insurance” clauses are struck and each policy is deemed primary.

Additional Issues To Consider

Choice of Law

104

- Always consider what state's law will be applied
- State law varies greatly on different issues.
- The court interpreting the policy may apply the law of a different state

Reservation of Rights

105

- When any of the aforementioned issues arises, the insurer should provide the parties involved with a reservation of rights, informing them of the insurer's position and clearly outlining the extent of coverage provided. The reservation of rights should detail what claims may or may not be covered and should advise the parties involved that they have the right to retain their own counsel, at their expense, to protect them with regard to any uncovered claims.

- The insurer should:
 - Reserve the right to file a declaratory judgment action
 - Reserve the right to intervene in the underlying litigation in order to receive an allocation of damages to determine which may or may not be covered under the policy

Deny at Your Own Risk

106

- An insurer who disclaims its duty to defend based on a policy exclusion bears the burden of proving the applicability of the exclusion. Therefore, insurers should exercise caution in denying defense as they bear the burden of proving that an exclusion precludes coverage.
- An insurer who is not certain that an exclusion is unambiguous risks having it construed in favor of the insured. It is well established that where a policy provision is ambiguous it is construed in favor of the insured and against the insurer, the drafter of the contract.
- A declaratory judgment action, though not required, may resolve the question of an insurer's duty to defend and therefore protect an insurer.



107

Wayman, Irvin & McAuley, LLC

Founded in 1965, Wayman, Irvin & McAuley, LLC, has earned its reputation for zealous representation of clients in a diverse range of legal matters.

Concentrating in the area of insurance defense for over 40 years, the firm has represented insurance carriers and their insureds in all state and federal courts in Pennsylvania, Ohio and West Virginia. We understand the insurance business and the unique needs of the carrier, the broker and the risk manager. Please visit our Web site, www.waymanlaw.com, for a more detailed look at the firm's capabilities and staff as well as a wealth of resource materials.



108

Wayman, Irvin & McAuley, LLC

401 Liberty Avenue, Suite 1700
Three Gateway Center
Pittsburgh, PA 15222

(412) 566-2970

Fax: (412) 391-1464

www.waymanlaw.com

dforsythe@waymanlaw.com

sstephan@waymanlaw.com