

Dichotomizing CGL Coverage for Construction Defects

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Topics for Today

- Learning to:
 - Recognize basic frameworks of CGL risks, i.e., dichotomies
 - By recognizing those dichotomies, an insured may be better able to analyze a claim and pursue it from a stronger position
 - Recognize false or mistaken dichotomies that are often relied upon to reduce or deny coverage

Ultimate Dichotomy: Covered versus Uncovered Claims

- Very seldom black and white as to construction defects
 - Legal obligation
 - Property damage
 - Occurrence
 - Business risk exclusions
 - Your work
 - Your product
 - Impaired property
- Considerable room to maneuver (create your own dichotomies)

False Dichotomy: Breach of Contract versus Tort

- The familiar (but former) argument as to occurrence
- Intentional breach of contract versus negligent performance
- Not supported by policy language
- No distinction between property damage resulting from breach of contract versus tort
 - Property damage can be accidental even if it arises out of intentional conduct

False Dichotomy: Third Party Property versus Insured's Work

- “Physical injury to tangible property”
- No distinction between property damage to third party property and work performed by or on behalf of the insured contractor in the definition
- Limiting coverage to third party property eliminates coverage for many, if not most, construction defects
- The true dichotomies are to be determined in the exclusions

Mistaken Dichotomy: Property Damage versus the Economic Loss Rule

- “Physical injury to tangible property”
- Precludes recovery in tort for economic losses resulting from the failure of a party to perform under a contract
- Construction defects are often mistaken for “economic loss”
- A remedies doctrine, not a coverage rule of interpretation
- Ignores the exception to the economic loss rule: *Property damage*
 - Often covered under the CGL policy

Major Dichotomy: Operations versus Completed Operations Claims

- Provides the road map for classification of property damage claims
- Governs which set of exclusions apply
- Ongoing operations: Primarily Exclusions j(5) and j(6)
- Completed operations: Primarily Exclusions l and m
- Many claims are not black and white and coverage depends on the parties' ability to characterize them either way

Major Dichotomy: Operations versus Completed Ops Claims – Products-Completed Operations Hazard Definition

- The fork in the road. Work is completed at the earliest of:
 - When all of the work called for in your contract has been completed
 - When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site
 - When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project

Major Dichotomy: Operations Exclusion j(5)

- The insurance does not apply to:
 - That particular part of real property on which you [the named insured] or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the “property damage” arises out of those operations
- Present tense = ongoing operations
- “Particular part” – traditional limitation

Major Dichotomy: Operations Exclusion j(6)

- The insurance does not apply to:
 - That particular part of any property that must be restored, repaired, or replaced because “your work” was incorrectly performed on it.
 - Exception: does not apply to property damage included in the products-completed operations hazard
 - Ongoing operations
- “Particular part” – Damage to non-defective work is covered

Major Dichotomy: Your Work Exclusion I

- The insurance does not apply to:
 - “Property Damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard.”
 - This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.
- Classic exclusion known for creating the “subcontractor exception”

Major Dichotomy: Your Work Exclusion I

- Scope of coverage:
 - Property damage to work performed by the named insured when the damage results from the work of the insured's subcontractor
 - Property damage to work performed by the named insured's subcontractor when the damage results from that subcontractor's work
 - Property damage to work performed by the named insured's subcontractor when the damage results from work performed by the named insured
 - Property damage to work performed by the named insured's subcontractor when the damage results from the work of another contractor or subcontractor

Major Dichotomy: Your Work Exclusion I

- Major inroad to the “Business Risk Doctrine”
- Key to completed operations coverage
- Source of classic judicial statements of coverage for defective work
- “Subcontractor” is broadly construed to include many types of entities
 - Malleable concept – suppliers as subs
- Completion includes abandonment
- Long tail claims may involve both operations and completed operations components
 - Allocation issues

Major Dichotomy: “Your Work” versus “Your Product”

- Separate exclusions
- “Your Work”:
 - “Property Damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard.” This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.
- “Your Product”:
 - “Property damage” to “your product” arising out of it or any part of it.

Major Dichotomy: “Your Work” versus “Your Product”

- Separate definitions
- “Your Work”:
 - Work or operations performed by you or on your behalf and materials, parts or equipment furnished in connection with such work or operations, including warranties
- “Your Product”:
 - Any goods or products, *other than real property*, manufactured, sold, handled, distributed or disposed of by you or others trading under your name

Major Dichotomy: “Your Work” versus “Your Product”

- A bit of history:
 - 1966 - A dichotomy was drafted into the CGL form between products as to manufacturers and work as to contractors
 - 1973 - An insured’s work was often melded into “work product” and sometimes resulted in an end run around the coverage provided for damage arising out of a subcontractor’s work under the Broad Form Property Damage Endorsement
 - Continues to arise under the current CGL form – return of the Green Bay Sweep

Major Dichotomy: “Your Work” versus “Your Product”

- Installation of systems or equipment often blurs the distinction between the contractor’s “work” and “product”
- Example: installation of plastic piping by plumbing contractor
- If the piping is the plumbing contractor’s “product,” there may be no coverage for damage to the piping or the building itself, even though performed by a subcontractor and occurring within the products-completed operations hazard
- Is the piping a “discrete component”?
 - If so, are all damages, including property damage to a home when removing the PEX piping, excluded damages as the cost of the repair of the insured’s product?

Major Dichotomy: “Your Work” versus “Your Product”

- Definition of “Your Product”:
 - Applies to “any goods or products, *other than real property*, manufactured, sold, handled, distributed or disposed of by” the named insured
 - Intended to support the dichotomy, but mixed results
- Law of Fixtures
 - Personal property is so affixed to the real property that it cannot be removed without substantial damage

Semantic Dichotomy: Contractual Liability versus Breach of Contract

- Exclusion b:
 - Applies to bodily injury or property damage for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement
 - Exception for “insured contract” – indemnity clause contained in most construction contracts in which the insured indemnitor assumes the tort liability of another party to pay for bodily injury or property damage to a third person

Semantic Dichotomy: Contractual Liability versus Breach of Contract

- Exclusion b:
 - “Assumption of liability” is not a simple breach of the contract
 - Must assume liability greater than under general law
 - As opposed to a true breach of contract exclusion

Property Damage Dichotomy: Physical Injury versus Loss of Use

- Two types of loss of use under definition of property damage:
 - Physical injury to tangible property, including all resulting loss of use of that property
 - Loss of use of tangible property that is not physically injured

Property Damage Dichotomy: Physical Injury versus Loss of Use

- Property damage in the form of loss of use of tangible property that is not physically injured:
 - Subject to Exclusion m, The Property Not Injured/Impaired Property Exclusion
 - Applies to property that has not been physically injured because of the insured's defective work or product or the insured's breach of contract

Property Damage Dichotomy: Physical Injury versus Loss of Use

- Loss of use of property due to physical injury to tangible property may be “impaired property,” defined for purposes of Exclusion m as:
 - Tangible property, other than the insured’s work, that cannot be used or is less useful because it incorporates the insured’s work that is defective, or in breach of the insured’s contract if such property can be restored to use by the repair, replacement, adjustment or removal of the insured’s work or its fulfilling its contract
- May not apply to property destroyed in the repair process that cannot be restored to use

Types of Coverage Dichotomy: Builders Risk versus CGL Coverage

- Faulty workmanship and design exclusions
- Subject to exception for covered losses that “ensue” from the faulty workmanship or design
- Similar to resulting damage in CGL context
- Exclusions re-introduce notions of fault
 - Subrogation unless waived against the damage-causing party
 - Or if the damage-causing party is insured under the policy
 - Invokes the damage-causing party’s CGL policy to defend the third party claim

Thank You!

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