

New Challenges to Insurance Coverage for Defective Construction[†]

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I. INTRODUCTION

As any general contractor, subcontractor, and particularly any residential contractor will tell you, insurance coverage for defective construction has been constricting steadily over the past several years. Two sources of constriction of coverage are the subject of this article. The first limitation is the result of efforts by the insurance industry to amend the policy to eliminate or limit coverage for risks that are perceived to be difficult or impossible to underwrite. The second type of limitation is imposed through interpretation of the policy language by the courts.

Recent years have seen new and largely unforeseen developments in liabilities being faced by the construction industry. These liabilities are particularly centered in the residential construction sector, including subdivision-wide construction defect lawsuits in single-family units and condominium construction defect suits filed by homeowners associations in the commercial residential context. In addition, mold and Exterior Insulation and Finish Systems (“EIFS”) claims increased, and terrorism emerged as a legitimate underwriting concern. This took place during the hard market portion of the normal insurance cycle, when prices are higher and coverage more difficult to obtain. Unfortunately, all of these factors have affected the availability of coverage under commercial general liability (“CGL”) insurance policies for many other construction contractors, even those not typically involved in residential construction, much the same as the residential mold scare resulted in absolute exclusions being attached to commercial contractors’ policies.

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The result of the convergence of these factors is a reduction in the coverage available for construction exposures, a reduction that is accomplished through the amendment of the language of standard policies, usually through the attachments of endorsements to the policy. The last few years have seen the issuance of numerous such endorsements. Those that will be discussed in this article include elimination of the “subcontractor” exception as to coverage for defective work under the CGL policy; habitational exclusions for residential exposures; restrictive additional insured endorsements; silica exclusions; broad wrap up endorsements, as well as mold and Exterior Insulation and Finish Systems (“EIFS”) endorsements.

Policy amendments to limit coverage are not the only issue facing the construction industry, particularly as to coverage for defective construction. That is the subject of a continuous effort by the insurance industry to limit coverage through insurance coverage litigation. As detailed below, the uninsured “business risks” for contractors under their CGL policies are carefully circumscribed under the policy—particularly in the property damage exclusions—which, when read and applied together with the insuring agreement and the definitions, often provide coverage for portions of this exposure. Unfortunately, certain insurers have experienced some success in diverting courts’ attention from the entire policy and limiting the focus to artificial distinctions based upon breach of contract versus negligence and economic loss versus property damage, artificial distinctions without basis in the policy language or the better-reasoned case law.

As a result, courts continue to grapple with the issue of whether defective construction by an insured contractor constitutes an “occurrence” of “property damage” as defined in the CGL policy. Despite standardized policy language, courts around the United States have, at best, produced a confusing and mixed bag of results in applying those terms to defective construction. While mixed bags often defy categorization, a general trend is



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discernable in this case law. The courts that forsake the language of the policy for an amalgam of “breach of contract-economic loss” analysis tend to find no occurrence or property damage, and in turn, no coverage for the insured contractor. Those courts never reach the exclusion provisions of the policy that often extend coverage. In contrast, the courts that employ a more traditional analysis, that is, whether the physical injury to tangible property caused by the defect was either expected or intended from the standpoint of the insured, tend to find a covered occurrence. Part and parcel of this analysis is a determination of whether the claim involves damage to property other than the insured’s own work.

These limitations only exacerbate one of the major problems facing the construction industry today, that is the disconnect between the tiers on a construction project as to the fair and practical allocation of risk. This disconnect is particularly apparent in the onerous and impossible insurance requirements imposed by many owners upon general contractors, or the even more onerous and impossible requirements imposed by a lender. Of course, general contractors are quick to rely on the “flow down,” the argument that they are only passing on to their subcontractors the requirements they have assumed from the owner. Of course, this approach ignores the fact that insurers are usually more likely to provide broader coverage to larger general contractors than smaller risks such as specialty subcontractors. Thus, the risk is not effectively transferred when all is said and done.

The limitations on coverage under standard CGL and related policies make it extremely difficult for the construction industry to meet its most significant risk management challenge, to match available and affordable insurance coverage with contractual requirements—both insurance specifications and other contractual risk transfer provisions, such as broad indemnity. One of the questions that needs to be answered is whether contract requirements drive the availability of insurance, or whether availability of insurance should drive the contract provisions. The answer is undoubtedly somewhere in between,

although the limits being placed on an insured contractor's coverage would seem to indicate that neither may be the case, as the gulf between contract specifications and available coverage continues to widen.

II. NEW POLICY LIMITATIONS

One of the risk exposures that have increased dramatically over the last few years is construction defect litigation, spearheaded by the residential sector. This increase has, in turn, spearheaded an effort by insurers to limit their exposure to lawsuits that are filed years after completion of the project, condominium, single family home or commercial building, and usually only slightly in advance of the running of the statute of repose. This is what insurers refer to as the "products-completed operations hazard," and that hazard commences upon completion and occupation of the work. The usual completed operations claim is filed an average of six and one half years after completion, so the underwriting difficulties are readily apparent. Thus, it is little wonder that completed operations losses involving defective construction have been the greatest area of concern for the insurance industry, particularly in terms of the cost of defense of massive subdivision-wide and homeowners association condominium claims.

The following are some of the limitations that are being drafted into the CGL policies to limit construction exposures.

A. *Elimination of the Subcontractor Exception by Endorsement*

There has always been an uneasy compromise in the insurance industry between providing coverage for what is often viewed as the uninsurable business risk of the insured's own defective work and the occurrence of defective work performed by the named insured's subcontractors. The compromise recognized that general contractors hire subcontractors to perform items of the work that specialized tradesmen are better suited to perform more efficiently and cost-effectively. The result of this recognition was the creation of an exception to the general exclusion for the insured's own defective work under a CGL policy. Under the exception, the named insured is provided coverage for property damage arising out of the defective work of its subcontractors. This exception (the "subcontractor exception") has been accomplished in a number of ways since it was first introduced in 1969, first as part of various Broad Form Property Damage ("BFPD") endorsements, and later by incorporation into Exclusion (I) as part of the 1986 revisions of the CGL forms.¹

In terms of mechanics, the subcontractor exception is found in Exclusion (I), the "Your Work Exclusion." That exclusion states that the insurance does not apply to:

¹ See Section IV of this article for an additional discussion of this development in connection with the recent case law applying the subcontractor exception.

“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 damage to work or the work out of which the damage arises was performed on your behalf by a subcontractor.*²

The italicized language sets out the straightforward exception that is relied upon throughout the construction industry to provide completed operations coverage for property damage arising out of the defective work of subcontractors.

As of December 1, 2001, the Insurance Services Office (“ISO”) came full circle back to pre-1970’s policies by offering two new endorsements for attachment to an insured contractor’s CGL policy. Endorsement CG 22 94 eliminates the subcontractor exception to Exclusion (I). Another endorsement, CG 22 95, applies on a per project basis. By issuing the endorsement ISO has, in effect, stamped its imprimatur on a significant reduction in coverage for many construction insureds. At the same time, this new endorsement is sure to alter the way in which construction-related “business risks” have been previously addressed by the courts. The endorsement is elegantly, if not innocuously, simple, stating as follows:

**EXCLUSION B DAMAGE TO WORK PERFORMED BY
SUBCONTRACTORS ON YOUR BEHALF**

Exclusion 1. of Section 1 B Coverage A B Bodily Injury and Property Damage Liability is replaced by the following.

2. Exclusions

This insurance does not apply to:

1. Damage To Your Work

“Property damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard.”³

Thus, the working of the endorsement is straightforward in that it simply replaces the standard “Your Work Exclusion” containing the customary exception for subcontractor work with an exclusion that is identically worded, but which does not contain the exception. The obvious problem is that what appears to be a minor change in wording can result in major changes in coverage.

² ISO form CG 00 01 11 85.

³ ISO form CG 22 94.

Endorsement CG 22 94 was approved in most states upon promulgation in December 2001. Obviously, insurers, particularly surplus lines insurers, have previously been able to eliminate the subcontractor exception in individual policies via the use of manuscript endorsements. Now, however, the availability of a standard form ISO endorsement will undoubtedly make it simpler to accomplish the elimination of that coverage. Coupled with the hardened insurance market and the tightening of coverage for other related risks such as residential, an increasing number of construction insureds may be forced to accept this reduction in coverage upon renewal, or, at least, to pay an increased premium to retain coverage for subcontractors' defective work.

Admittedly, the extra coverage to an insured general contractor provided through the subcontractor exception should be worth a higher premium, which construction insureds are already paying. Moreover, from a purely legal standpoint, the danger in eliminating the subcontractor exception amounts to a significant expansion of the "business risk" rationale in that it also eliminates the concession from the insurance industry that a general contractor may not have the ability to control all risks associated with a subcontractor's work. Nevertheless, the perceived need by the insurance industry to attach an endorsement to the standard CGL policy certainly indicates that this coverage has been provided under the standard forms. This is contrary to the arguments made by some insurers in coverage litigation that defective work is not an occurrence or does not give rise to property damage as defined in the policy.

B. Habitational Exclusionary Endorsements

The massive lawsuits over defects in "residential" construction have attracted not only the attention of the construction industry, plaintiffs' lawyers, and homeowners associations, but also the insurance industry. Huge lawsuits involving entire subdivisions of single family homes or dozens, even hundreds, of units in large condominium projects, have sparked concern among insurers for many reasons, including:

- Defense costs that make up well over half of every dollar spent on residential construction defect litigation.
- A sea of multiple defendant subcontractors, brought in with little or no regard for actual liability.
- A sea of codefendant parties, with codefendant subcontractors owing additional insured and indemnity obligations to the general, resulting in the necessity of providing separate counsel to defend multiple insureds.
- Impossibility of underwriting and pricing completed operations losses that are not reported until years after completion, resulting in lawsuits filed near the expiration of the statute of repose.
- Satellite insurance coverage litigation among multiple parties and their insurers.

On a much smaller scale, there are parallels between the effect of the unforeseen exposure of asbestos on products liability coverage of manufacturers and the effect of construction defect on completed operations coverage for contractors. Like asbestos, the insurance industry is now reacting in the same manner, by excluding the risk. The result is the attachment of endorsements to CGL policies issued to construction insureds that seek to exclude “residential” risks. The term residential is used loosely, since most of these endorsements go well beyond what is traditionally thought of as residential construction. While no standard endorsement has been promulgated, a couple of representative endorsements are attached as Appendices A and B to this article.

As stated, the use of the term “residential” to describe these exclusionary endorsements is something of a misnomer. Rather, the term “habitational” is more descriptive. In cocktail conversation, underwriters may admit that the scope of the exclusion includes every structure where a bed is used. Thus, the exclusion goes well beyond traditional single family homes or multifamily condominium developments. It includes apartments, assisted living, nursing homes, co-ops, condominiums, single family, hotels, military housing, dormitories, tract housing, and townhouses.

Obviously, the attachment of a habitational endorsement to a residential contractor’s CGL policy is potentially devastating, not only in terms of creating a gap in coverage as wide as the scope of the contractor’s operations, but also in terms of breach of his contractual obligation to provide insurance for his operations. Equally serious is the potentially devastating effect of the attachment of such an endorsement to the CGL policy of a contractor with only incidental residential exposure, such as a commercial contractor constructing medical or hotel facilities. The exposure exists as to contractors that may have engaged in such construction in the past, since it is the current CGL that is triggered by a completed operations loss that occurs during that policy period. The contractor may be without coverage for past residential exposures under that scenario.

A contractor must be sure to understand the import of the attachment of such an endorsement upon the insurability of its operations. Only then can the contractor undertake informed consideration of alternative means, if any, to deal with that exposure.

C. Restrictive Additional Insured Endorsements

Construction contracts usually include a requirement that the contractor name the owner as an “additional insured” on the contractor’s CGL policy as well as on the contractor’s auto and umbrella policies. Likewise, subcontracts require that the subcontractor name the general contractor as an additional insured on the sub’s policies. This requirement is imposed as a device in addition to indemnity in order to transfer risks associated with the construction of the project from the owner to the contractor, and from the contractor down to the subcontractor.

In essence, the upper tier becomes an “insured” on the lower tier’s liability policy, enjoying the same rights as any other insured under the policy. Nevertheless, in determining whether there is coverage for defective work, the insuring agreement, definitions, and exclusions all apply in the same manner as to the named insured. For example, under the

“Your Work” exclusion, there is no coverage for a contractor, even as an additional insured, for property damage to the subcontractor’s work and arising out of it. Additional insured status is conferred upon another party by the insertion of an endorsement to the contractor’s policy. The endorsement can either be written specifically for that additional insured, or on a blanket basis, adding as an additional insured all parties that the contractor is obligated under contract to name as additional insureds on its policy.

Due to the customary uncertainty surrounding the enforceability of indemnity clauses under the laws of many states, additional insured status was usually the preferred contractual risk transfer device over indemnity clauses. This was particularly true during the softer insurance market of the late 1980’s and early 1990’s when insurance coverage was more readily available. During that time, extremely broad additional insured endorsements were promulgated by ISO and became the additional insured endorsements of choice in the construction industry. The following is a brief description of the evolution of those broad endorsements to the more limited endorsements that are available in today’s market.

1. 1985 CG 20 10

Most additional insured endorsements found on contractor’s policies are permutations of the standard ISO endorsement, CG 20 10. The 1985 edition of that endorsement, CG 20 10 11 85, provided as follows:

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of ‘your work’ for that insured by or for you.⁴

The term “you” refers to the named insured, that is, the contractor or subcontractor providing the additional insured status to an upper tier. Moreover, the term “your work,” as used in CG 20 10, is defined within the policy as follows:

‘Your Work’ means:

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

⁴ ISO form CG 20 20 11 85.

'Your Work' includes:

- a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of 'your work'; and
- b. The providing of or failure to provide warnings or instructions.⁵

Thus, the coverage available to an additional insured under the 1985 edition of CG 20 10 was extremely broad, with the only qualification being that the liability must arise out of the named insured's work for the additional insured. The majority of courts have expansively interpreted the scope of coverage afforded to an additional insured under such an endorsement. As long as there is a nexus between the loss and the work or operations of the insured, most courts uphold coverage, particularly when the employee of a lower tier is injured at a job site. Under those circumstances, courts have routinely held that "but for" the fact that the employee was on the job site, the employee would not have been injured; therefore, the injury arose out of the employer's operations, thus upholding additional insured coverage for the additional insured.

2. 1993 Edition of CG 20 10

Because of the breadth of the 1985 edition of CG 20 10, a more restrictive endorsement was rolled out by ISO in 1993, CG 20 10 10 93. That endorsement states as follows:

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown on the Schedule, but only with respect to liability arising out of your *ongoing operations performed for that insured*.⁶

The emphasized language was apparently intended by the insurance industry to restrict the scope of additional insured coverage to liabilities arising only while the named insured's work was in progress. In other words, there would be no coverage for the named insured for bodily injury or property damage that occurred after completion. The endorsement was an attempt to limit liability for completed operations or loss claims that arose years after completion of a project, including the residential claims that were beginning to surface, particularly on the West Coast.

⁵ ISO form CG 20 10.

⁶ ISO form CG 20 10 10 93 (emphasis added).

3. 2001 Edition of CG 20 10

The additional insured endorsement was again modified in 2001, with more provisions added to solidify the intent that coverage does not apply to bodily injury and property damage occurring within the completed operations hazard. A copy of Endorsement CG 20 10 01 is attached as Appendix C. Another endorsement, CG 20 37, was promulgated for use in tandem with CG 20 10. The purpose of the CG 20 37 endorsement was to restore completed operations coverage. A copy of that endorsement is attached as Appendix D. Note that *both* endorsements, CG 20 10 *and* CG 20 37, must be used in order to insure that both ongoing operations and completed operations coverage is provided.

4. 2004 Edition of CG 20 10

The ongoing constriction of coverage under the standard form additional insured endorsement reached its pinnacle in 2004 with the promulgation of CG 20 10 07 04, a copy of which is attached as Appendix E. That endorsement provides, in relevant part, as follows:

SECTION II WHO IS AN INSURED is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury,” “property damage” or “personal and advertising injury” *caused, in whole or in part, by:*

1. Your acts or omissions; or
2. The acts or omissions of those acting on your behalf; *in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.*⁷

The emphasized language constitutes a significant departure from prior additional insured endorsement forms, with the primary goal of restricting coverage to only those liabilities caused by the fault of the named insured. Gone is the broad “arising out of” language. That language that had previously been interpreted by courts to include coverage for the additional insured for its own fault, as long as it was tangentially related to the work of the named insured contractor or subcontractor. Now, a causal nexus is required, and coverage is specifically restricted to bodily injury or property damage caused “in whole or in part” by the named insureds’ acts or omissions.

The “whole or in part” language is particularly troublesome, since it calls into question the utility of additional insured coverage for “third party over actions” that are allowed under the laws of many states. Third party over actions do not involve coverage for defec-

⁷ ISO form LCG 20 10 07 04 (emphasis added).

tive construction. Rather, they involve situations in which the injured employee of a subcontractor (or contractor) sues the upper tier contractor (or owner), alleging that their negligence contributed to the injury. These types of claims were customarily tendered by the upper tier, as additional insured, back to the employer based upon the additional insured coverage provided by the employer. Because of the workers compensation exclusive remedy, the injured employee alleges only the sole negligence of the third party in the lawsuit. Arguably, that sole negligence is outside the coverage of CG 20 01 07 04, since there is no allegation that the injury was caused “in whole or in part” by the employer, the named insured.

In light of the broad scope of coverage, additional insured status has been a major mechanism to transfer the risk of defective workmanship performed by subcontractors down to their insurers. It plays a major role in large construction defect claims, and this tightening of coverage, as illustrated by the revision of the standard forms, will naturally cause additional problems for lower tiers asked to provide broader coverage than is available to the general contractor or owner. Subcontractors are particularly squeezed, with contractors passing down insurance specifications that are virtually impossible to meet in today’s market. Many insurance specifications still require that the contractor or subcontractor name the owner or contractor as an additional insured, using CG 20 10 11 85, or equivalent. If that coverage is not available, a breach of the contractual requirement has occurred. In the event of a claim that would have been covered but for the failure to satisfy the additional insured specification, the subcontractor’s own assets are at risk. Note that a CGL policy does not cover liability for breach of contract for failure to provide insurance.

Often, the endorsement on the named insured’s policy is more limited than the additional insured coverage specified, but that limitation is not reflected in the certificate of insurance, which only states that the party is named as an additional insured, without further qualification. Since the certificate of insurance does not modify the policy, the requested broad coverage is not provided and again, the named insured is faced with a breach of contract situation or its agent may face an errors and omissions exposure.

In short, nowhere is the disconnect between stringent contract requirements and the realities of the current insurance marketplace more apparent than in the struggle to comply with additional insured requirements that no longer match the market, at least for the majority of players. It appears that only larger contractors and subcontractors with significant premium are able to obtain this coverage.

D. Other Restrictive Endorsements

Separate and apart from hardening and softening of insurance cycles, as unforeseen indemnity risks arise, insurers frequently respond with corresponding exclusions to their policies. Such is the case with Exterior Insulation and Finish Systems (“EIFS”), mold, and now silica. They join such substances as asbestos and lead as routinely excluded exposures.

Mold, in and of itself, is not a new phenomenon, and has traditionally been regarded by the construction industry, and insurers for that matter, as a variety of water damage. Nevertheless, due to the bodily injury concerns raised in personal injury suits, mold exclusions

appeared and have already been the topic of much commentary, and little else need be said. To the extent a contractor can limit the property damage to traditional water infiltration damages, as opposed to mold, the scope of the exclusion may be limited. As a final note, coverage may be available from some carriers under their pollution legal liability policies. That coverage, however, will be on a claims made basis and will likely be subject to lower sublimits than the overall coverage.

EIFS exclusionary endorsements are also a fact of life, and there tends to be a great variation in them. Again, the insured's effort should be both to obtain an endorsement that restricts the exclusion to the direct EIFS damages, rather than other water damage to the construction. A couple of representative EIFS exclusionary endorsements are attached as Appendices F and G.

The wave of silicosis lawsuits, riding the coattails of asbestosis litigation, has spawned endorsements that exclude coverage for silica-related injury. A copy of such an endorsement that is coupled with an exclusion for asbestos and other toxic substances is attached as Appendix H.

E. Design-Build Liabilities

As the preferred project delivery system continues to move toward design-build, professional liability or design-related liability endorsements are becoming the rule, rather than the exception, for contractors. These endorsements often exclude coverage for design-related liabilities. Such an endorsement can be devastating for a contractor that has undertaken design-build projects.

Architectural or engineering services give rise to professional liability exposure, and insurers seek to avoid the inadvertent insuring of pure design exposures. As a response, many design-build contractors subcontract the design to the professionals that maintain professional liability insurance for pure design exposures. Alternatively, many contractors maintain contractors' professional liability policies to cover incidental design exposures.

Design-build has been the subject of considerable attention of both CGL and professional liability insurers, and new products are being developed. For example, as to large projects, an owners protective professional insurance policy ("OPPI") may be available. This policy provides first party coverage in excess of the designer's primary professional liability policy. Once the underlying professional liability policy is exhausted, the OPPI covers damage due to design errors or negligence. The policy can also be written to include the contractor's exposure ("CPPI"). It may be written on a project specific, or a blanket basis, for owners that construct numerous projects.

III.

PROSPECTS AND ALTERNATIVES?

There are alternatives to the traditional approach of insuring certain construction defects through CGL policies. Unfortunately, many of them, so far, appear available only to larger players in the industry. Nevertheless, there may be room for some optimism.

A. *Market Cycle*

Although not strictly an “alternative approach,” the customary insurance cycle may bring relief as to many of these issues. The recent “hard” market, in which premiums increase and coverages decrease, appears to be at, or near, its end. Apparently, the cost of certain lines is already going down, while the cost for construction-related liability insurance is at least at a plateau, and has ceased rising. Therefore, there is optimism that softening of the market will occur, and with that softening, a willingness to write more difficult coverages, including construction defect.

B. *Alternative Approaches and Products*

Subject to the proviso set out above, the following is a thumbnail sketch of the ways that owners, contractors, and subcontractors are dealing with the construction and traditional coverage.

1. Rip and Tear, Construction Defect and GAP Insurance Policies

A limited number of insurers still offer rip and tear, construction defect, and GAP policies. These products, either as stand alone policies, or as endorsements to an existing CGL policy, close the gap in the standard CGL coverage relating to property damage for construction defects. The hard market cycle correspondingly restricted the availability of these coverages, but they may become more available in the future.

Another suggested alternative is to reduce the huge costs associated with multi-party construction defect claims is the issuance of indemnity only liability policies. These policies would not provide a defense, but would simply indemnify for the loss. The feasibility of such an alternative is somewhat questionable in light of the fact that over half of the dollars spent in construction defect litigation pays defense costs. On the other hand, that funding of the defense by the insured itself could possibly foster earlier settlement.

2. Wrap Up Policy Programs

The inability of many subcontractors to obtain construction defect coverage has caused owners and contractors to consider wrap up policies on many projects. Alternatively, this coverage may be provided on a “rolling” basis, that is, in the form of a blanket policy that covers a number of projects. While the driving factor behind the development of wrap ups was the desire to achieve economies of scale and cost savings, the ability to provide theoretically better coverages has increased the impetus for many owners and general contractors to consider this option.

Owner controlled insurance programs (“OCIPs”) on public projects are subject to statutory regulation, setting a floor on the size of projects for which they are allowed. Practically, the same is true with all wrap up problems, OCIPs, and contractor controlled insurance programs (“CCIPs”), in which economies of scale dictate the feasibility of the use of such a program on a given project. Moreover, these programs usually “wrap” general CGL and workers compensation coverages, which often raise issues as to the negative effect on the workers compensation modifier of participating contractors.

One of the major issues with regard to a wrap up policy is the availability of completed operations coverage. Often, that coverage will extend no longer than three to five years under the wrap up policy, leaving an uninsured “tail” until the expiration of the applicable statutes of repose and limitations. In that instance, participating contractors must be careful that their own policies will provide insurance for that “tail,” or in excess of the limits of the wrap policy. The standard wrap up endorsement, CG 21 54, provides that it does not apply to property damage arising out of any project subject to a wrap, thus excluding completed operations and excess coverage. A copy of that endorsement is attached as Appendix I. That endorsement could be devastating, and contractors should attempt to obtain an endorsement stating that the policy will provide excess or a difference in conditions coverage with regard to wrap up projects.

3. Subguard Programs

Subguard is an insurance/financing alternative to traditional performance bonding of subcontractors. Currently, it is written by only one insurance company and recently, that company has offered a new product to allow participating contractors to provide liability insurance for construction defects for their subcontractors. This program, like Subguard, is based on the general contractor’s ability to select and underwrite its subs. As everyone in the construction industry is aware, Subguard is a subject of much controversy, particularly among sureties.

4. Risk Retention Groups

Some contractors with closely aligned interests form risk retention groups and self-insure a portion of their risk, usually in offshore companies. Often, fronting policies are used to provide certificates to satisfy insurance requirements.

5. Warranty Funds

A warranty fund is one established by contributions from the owner/developer and contractor to cover warranty repairs on a given project. The theory is that over the period of the warranty, the fund can provide a source of funding for repairs and perhaps prevent warranty claims from becoming liability claims.

6. QA/QC

Another means of reducing the reliance on insurance as a means to pay for construction defect is to emphasize quality assurance/quality control at the front end in order to reduce claims. This is an ongoing effort on the part of the construction industry.

IV. COURT IMPOSED LIMITATIONS

Particularly since 1986, when the standard CGL insurance policy form was revised into arguably a more “plain language” format, courts have generally upheld the intent to provide coverage to an insured contractor for property damage arising out of the work of subcontractors. This coverage extended to defective work of those subcontractors. The coverage available for property damage attributable to subcontractor work has assumed increasing importance due to the escalation of construction defect litigation, particularly residential subdivision and condominium lawsuits. Completed operations coverage for subcontractor defects has taken center stage to provide coverage for settlements in these cases. While not of the same magnitude as asbestos or mold, this exposure is proving to be much greater than underwritten, and like asbestos, can trigger coverage under policies that were issued years ago.

Because many of these policies have been issued years ago, other arguments have been raised to support the denial of coverage for defective work claims. These arguments have evolved into an attempt to eliminate coverage without the necessity of applying the exclusions in the policy. In fact, many of them represent a studied attempt to ignore the language of the policy itself, language that had been previously recognized as providing coverage. These attempts involve reliance on the definition of occurrence, to argue that property damage caused by defective work in breach of contract is natural and probable and not an occurrence. Another argument is based upon the definition of property damage, applying the economic loss rule to conclude that property damage from construction defects constitutes economic loss that is not covered under the CGL definition. The occurrence and economic loss arguments have been the subject of considerable recent litigation and are the focus of this article. Other related arguments are based upon the “legally obligated” requirement in the insuring agreement⁸ and non-policy based “defenses” such as the “conver-

⁸ This argument is most often made against the backdrop of the language in the CGL insuring agreement to the effect that the insurer shall pay all sums that the insured becomes “legally obligated” to pay. Some insurers argue that this language limits coverage to only tort-based damages and not damages for breach of contract. Of course, this argument is frequently encountered in the defective construction context due to the fact that most construction work is performed pursuant to contract, of which defective construction work may be a breach. This argument met with some initial success, but was later rejected by the California Supreme Court in *Vandenberg v. Superior Court*, 982 P.2d 229 (Cal. 1999). More recently, other courts have held that damages incurred to repair a defective product pursuant to a contractual requirement constitute damages that the insured is “legally obligated” to pay under a liability policy. *Venture Encoding Serv., Inc. v. Atlantic Mut. Ins. Co.*, 107 S.W.3d 729 (Tex. App. 2003), *pet. denied*; *see also*, *Wanzek Constr., Inc. v. Employers Ins. of Wausau*, 667 N.W.2d 473 (Minn. Ct. App. 2003), *aff’d on other grounds*, 679 N.W.2d 322 (Minn. 2004) (costs of repairing pool due to defective coping stone provided by insured’s subcontractor involved property damage and a contractual obligation to repair, thus constituting a covered legal obligation of the insured).

sion of the CGL policy into a performance bond.”⁹

The primary target of these attacks on coverage is the exception to Exclusion (l), the “Your Work Exclusion,” often referred to as the “subcontractor exception.” That exclusion denies coverage for property damage to the named insured’s work arising out of it and included in the products-completed operations hazard. However, the exclusion specifically states that, “[t]his exclusion does not apply if the damage to work or the work out of which the damage arises was performed on your behalf by a subcontractor.”¹⁰ The construction industry, the insurance industry, and the courts have regarded the subcontractor exception as an enhancement to the CGL coverage provided to a general contractor or any other entity that uses subcontractors in its operations. As a result, general contractors have been able to tap a considerable amount of completed operations coverage under appropriate circumstances in reliance on that exception.¹¹

While this article focuses on the effect of these arguments on Exclusion (l), the “Your Work Exclusion,” the analysis applies with equal force to the other property exclusions, also referred to as the “business risk” exclusions, all of which, as explained below, circumscribe and limit the doctrine that defective work is an uninsurable business risk that the insured contractor should be able to control in its everyday operations. These exclusions are Exclusion (j.5), ongoing operations; (j.6), faulty workmanship; (k), your product; (m), impaired property; and (n), products recall.

⁹ This argument, though easier to state than to justify, ignores the fact that a performance bond is a financial guarantee posted by the contractor in favor of the owner that the project will be constructed as set out in the contract documents. It also ignores the fact that the surety has a right of contractual indemnity against the contractor for any amounts paid out pursuant to the bond. Some claims, particularly claims that involve defective workmanship that cause damage to the project, can trigger both the CGL policy and the performance bond. In that instance, the CGL policy should respond first, particularly in light of the contractor’s indemnity obligations to the surety. Because of the contractor’s indemnity obligation, upon payment of a performance bond claim involving defective workmanship, the insured contractor’s rights under its CGL policy are frequently assigned to the surety for pursuit of subrogation. For cases involving subrogation by performance bond sureties against CGL insurers, see, *Auto Owners Ins. Co. v. Travelers Cas. & Surety Co.*, 227 F. Supp. 2d 1248 (N.D. Fla. 2002); *Western World Ins. Co., Inc. v. Travelers Indem. Co.*, 358 So.2d 602 (Fla. Dist. Ct. App. 1978); *Gulf Ins. Co. v. TIG Ins. Co.*, 103 Cal. Rptr.2d 305 (Ct. App. 2001); *Fidelity & Deposit Co. v. Hartford Cas. Ins. Co.*, 189 F. Supp. 2d 1212 (D. Kan. 2002) (surety as assignee of both bond principal and obligee).

¹⁰ ISO form CG 00 01 11 85.

¹¹ ISO promulgated a standard endorsement in December 2001, intended to eliminate the subcontractor exception from the policies to which it was attached. That endorsement is Endorsement No. CG 22 94. Nevertheless, the endorsement, for obvious reasons, is not used throughout the industry on a blanket basis. Moreover, most defective construction insurance litigation involves past policies not so endorsed.

A. *Traditional Coverage Approach: Circumscribing “Business Risk”*

A review of the importance of the “Business Risk Doctrine” and its relationship to the property damage exclusions in the CGL policy is useful to understanding the seriousness of the issues facing insured contractors. Historically, there has always been a tension between CGL coverage for defective construction work and what insurers have traditionally referred to as an uninsured “business risk.” This tension gained momentum with the 1973 revisions to the ISO CGL form, when the exclusion for property damage arising out of work performed by the named insured was split from the exclusion for property damage arising out of the named insured’s product. At the same time, ISO promulgated the Broad Form Property Damage Endorsement (“BFPDE”) to the standard policy form. That endorsement expanded the coverage under the 1973 form by modifying the “work performed” exclusion so as to provide an insured coverage for property damage arising out of the defective work of its subcontractors. It also narrowed the exclusion, in the operations context, to property damage to “that particular part” of the work upon which operations are being performed, out of which the property damage arises or that must be repaired or replaced because the insured’s workmanship was faulty.

Nevertheless, the argument persisted that, despite the attachment of a BFPDE to an insured contractor’s CGL policy, all property damage arising from defective workmanship, including property damage arising from a subcontractor’s defective work, constituted an uninsurable business risk. This argument was supported by frequent reference to an early case, *Weedo v. Stone-E-Brick, Inc.*,¹² that employed an analysis based upon CGL coverage unmodified, *i.e.*, unexpanded, by the BFPDE. Therefore, these seminal authorities and the numerous cases that followed them reached the erroneous conclusion that defective workmanship is a business risk that is uninsurable *per se*, even though those cases involved policies that were modified by the BFPDE to provide expanded coverage and to limit the business risk concept, particularly as to subcontractor work.

Through the 1986 revisions to the CGL form, ISO sought to clarify the limitations on the business risk concept by the revised exclusions of the BFPDE as applied to CGL coverage for defective work. Major clarifications such as the “subcontractor exception” (Exclusion l) and the “particular part” limitation on the operations in progress and the faulty workmanship exclusions (Exclusions j(5) and (6)) were incorporated into the standard forms. Most courts, with some exceptions, such as Florida, upheld the circumscription and limitation of the business risk doctrine by the 1986 revisions to the CGL policy form.

¹² 405 A.2d 788 (N.J. 1979).

B. “New Approach” Occurrence Cases

Despite the standardized language of the CGL policy, including the subcontractor exception, some courts have exhibited a tendency not to apply it. Recent cases sidestep the coverage preserved through the subcontractor exception by applying the definition of occurrence to deny coverage for claims involving the defective work of subcontractors. These “new” approach cases call into question the need to include provisions in a policy excluding coverage for defective work and to include a subcontractor exception as a means to preserve the coverage available for defective workmanship. For if property damage arising out of defective work cannot constitute an occurrence, *by definition*, there is no need to reach and apply the exclusions in the policy. Of course, the fact that ISO saw a need for the promulgation of an endorsement to eliminate the subcontractor exception may indicate that the insurance industry does not truly believe that defective workmanship cannot *per se* satisfy the definition of occurrence so that the policy exclusions can be ignored.

One case to take this approach is *Hartrick v. Great American Lloyds Insurance Co.*¹³ There, the insured homebuilder was out of business, so the insurer controlled the defense of the underlying lawsuit, including the submission of the case to the jury. The jury specifically found that neither the builder nor its subcontractors were negligent, but that the builder had breached its implied warranties of good and workmanlike construction and habitability. The *Hartrick* court concluded that lack of compliance with an implied warranty is not accidental, but results from not doing what one must do. By not doing what it had to do, the builder could reasonably anticipate harm to the homeowner. Of course, because of this peculiar procedural twist alone, the *Hartrick* case is distinguishable from most construction claims. The *Hartrick* court ignored the fact that a cause of action for breach of an implied warranty involves strict liability.¹⁴ There is no foreseeability requirement necessary to establish strict liability. Obviously, under traditional notions of occurrence, a homebuilder can find itself in breach of an implied warranty without having expected or intended the property damage arising from that breach. Moreover, a homebuilder can find itself in breach of warranty without ever having committed an intentional act. The property damage arising out of an unintended breach is an “occurrence.”

The *Hartrick* court reached its conclusion despite the fact that a subcontractor performed the defective site work that caused the damage to the home. The court never explicitly ruled on the subcontractor exception, embarking only upon a truncated analysis of coverage under the policy that did not necessarily track prior case law on construction-related occurrences.

¹³ 62 S.W.3d 270 (Tex. App. 2001).

¹⁴ *Centex Homes v. Buecher*, 95 S.W.3d 266 (Tex. 2002).

Another such case is *Jim Johnson Homes, Inc. v. Mid-Continent Casualty Co.*¹⁵ Although the court ultimately held that there was no occurrence, one should note the unique facts before the court. That case did not involve a completed operations claim, *i.e.* property damage that was discovered subsequent to completion; accordingly, the subcontractor exception was not in play. Rather, the home was never completed because the insured contractor walked off the job based upon a payment dispute with the homeowners. Moreover, during construction, problems as to defective work were actually brought to the insured's attention by the homeowner. They were led to believe that the problems had been corrected, only later to discover that they were not properly corrected. There were also allegations in the arbitration that representations made by the insured builder that the piers and foundation of the home would be designed and inspected by a registered engineer were false and that no such inspection occurred. The causes of action alleged included breach of contract, violation of the DTPA, fraud based on false representation regarding the design and construction of the home, and negligence.

Since the insured contractor walked off the job and failed and refused to correct defective work brought to its attention, the court's scepticism as to the negligence claim asserted against the builder was warranted. Moreover, the court's characterization of the issue as more akin to a performance bond than a CGL policy is also somewhat understandable because facts before him involved a default and termination of the contractor, a classic scenario that may invoke the obligations of a surety under a performance bond. Due to the disparity in the facts, the analogy to a performance bond in *Jim Johnson* should not carry over to most defective construction claims.

Courts of other states have wrestled with similar issues. One such recent cases is *L-J, Inc. v. Bituminous Fire & Marine Insurance Co.*¹⁶ In that case, L-J, the insured site development contractor, faced claims against it arising out of an inadequately compacted road base, which resulted in the deterioration of pavement in a subdivision several years after completion. Subcontractors performed all of the defective site compaction work. As a result, the developers sued L-J for breach of contract, breach of warranty, and negligence. Several companies insured L-J for the period of 1989 through 1996. Three of them contributed to a \$750,000 settlement. Bituminous refused to participate in the settlement and the other three insurers and L-J filed a declaratory judgment action seeking contribution from Bituminous for the settlement amount, coupled with indemnification for all defense costs. The trial court upheld coverage and was affirmed by the South Carolina Court of Appeals.¹⁷

¹⁵ 244 F. Supp. 2d 706 (N.D. Tex. 2003).

¹⁶ No. 25854, 2004 WL 1775571 (S.C. Sept. 26, 2005), *op. on rehearing*.

¹⁷ *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 567 S.E.2d 489 (S.C. App. 2002).

Before the Court of Appeals, Bituminous argued that faulty workmanship can never constitute an occurrence under a CGL policy. The court rejected this argument, and in a footnote, acknowledged the proposition that an automatic denial of coverage, on the basis that defective work cannot be an occurrence, constitutes a “rehash” of the business risk doctrine and depends entirely on the court ignoring the terms of the CGL policy.¹⁸ Rather, the Court of Appeals held that while faulty workmanship, standing alone, may not constitute an accident, when the damage due to the faulty site compaction extended beyond the cost of repairing the compaction, there was an accident that was neither expected nor intended from the standpoint of the insured. There was damage beyond the faulty site compaction because the failure to properly compact the roadbed led to the failure of the road surfaces. All of this work was part of the insured’s work under its contract. Finally, the Court of Appeals went on to uphold coverage and to apply the “subcontractor exception” to the Your Work Exclusion. Therefore, even though the entire road construction project fell within the definition of “your [L-J’s] work” within the Your Work Exclusion, the subcontractor exception preserved coverage where the damage to L-J’s work arose out of the work of a subcontractor. In other words, the Court of Appeals applied the plain and unambiguous language of the policy in its 2002 opinion.

Bituminous appealed that result to the South Carolina Supreme Court, and more than three years later, that court did a rapid about-face, reversing the Court of Appeals and, in the process, forsaking the policy language and intent. Inexplicably, the Supreme Court held that even though there were numerous acts of negligence on the part of L-J, no occurrence had taken place. The court stated as follows:

Although the alligator cracking may have constituted property damage, we find that an “occurrence,” as defined under the CGL policy did not take place. According to the deposition testimony outlined above, the only “occurrences” were various negligent acts by Contractor during road design, preparation, and construction, which led to the premature deterioration of the roads. Those negligent acts included: (1) failure to prepare the subgrade by deciding not to remove the tree stumps and by failing to remove or compact the wet clay in the subgrade; (2) improperly designed drainage system; (3) ill-prepared, thin road course that could not handle heavy wheel- loads; and (4) improperly designed curve edge detail.

We find that these negligent acts constitute faulty workmanship, which damaged the roadway system only. And because faulty workmanship is not something that is typically caused by an accident or by exposure to the same general harmful conditions, we hold that the damage in this case did not constitute an occurrence.¹⁹

¹⁸ *Id.* at 493 n.8.

¹⁹ 621 S.E.2d 33, 36 (S.C. 2005).

The Bituminous policy contained the standard definition of occurrence, meaning “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”²⁰ Thus, while the court recognized the negligent conduct of L-J, in a footnote, it stated that a CGL policy may “provide coverage in cases where faulty workmanship causes a third party bodily injury or damage to other property, *not in cases where faulty workmanship damages the work product alone.*”²¹ The court’s holding is not supported by the language of the definition itself, which contains no requirement of third party property damage to constitute an occurrence. The court seems to confuse the actions of the insured contractor, the faulty workmanship giving rise to the damage, with the property damage resulting from it. If that property damage is unexpected and unintended, it is an accident under the traditional formulations of occurrence described below. These formulations are truer to the policy language and intent.

Moreover, the court’s holding fails to take into account the fact that it is the property damage exclusions, including the Your Work Exclusion, that differentiate between covered and non-covered property damage once there has been an occurrence. Because of its reliance on the definition of occurrence, the South Carolina Supreme Court declined to address whether the damage fell within the subcontractor exception to the Your Work Exclusion.

Since the Court of Appeals’ opinion in *L-J* was issued in April of 2002, and the Supreme Court opinion was not handed down until well over three years later in September of 2005, in the interim, other courts have relied upon the analysis of the court of appeals. One of the most recent of those cases is *Auto-Owners Insurance Co. v. Home Pride Cos., Inc.*²² The opinion was issued by the Nebraska Supreme Court on August 6, 2004, only three days before the lower court opinion in *L-J* was reversed by the South Carolina Supreme Court. In upholding coverage for an insured roofer for property damage to roof structures in a building damaged by its faulty installation of shingles, the Nebraska Supreme Court relied upon the lower *L-J* opinion for the proposition that while faulty workmanship, standing alone, does not constitute an accident and cannot therefore be an occurrence, faulty workmanship that causes an accident is covered under a standard CGL policy.

*Groves v. Doe*²³ is another recent case relying upon the occurrence requirement to bypass coverage for a general contractor for property damage arising out of defective work of subcontractors. There, Bland, the insured homebuilder, sued Groves, the party with whom Bland had contracted to construct a home, seeking recovery of the balance owed on the contract. Groves counterclaimed, seeking to recover damages for the costs of completion and the cost to repair construction defects in the home. Groves subsequently filed suit as judgment creditor against Erie, Bland’s CGL insurer, to recover the repair costs.

²⁰ *Id.*

²¹ *Id.* n.4 (emphasis added).

²² 684 N.W.2d 571 (Neb. 2004).

²³ 333 F. Supp. 2d 568 (N.D. W. Va. 2004).

Faced with the coverage dispute, the court framed the issue as “whether the Policy covers property damage arising out of negligent workmanship by Bland or his subcontractors.”²⁴ In resolving the dispute, the court addressed the issue of whether faulty workmanship constitutes an occurrence. Initially, it felt compelled to determine whether negligence can be an “occurrence” under the standard definition in the CGL policy, *i.e.*, “an accident, including continuous or repeated exposure to substantially the same general, harmful conditions.”²⁵ The court noted that although an occurrence can include a continuous or repeated exposure to the same general harmful conditions, it must nevertheless be an accident, going on to apply the following reasoning:

[A]n “accident” generally means an unusual, unexpected and unforeseen event. . . . An accident is never present when a deliberate act is performed unless some additional unexpected, independent and unforeseen happening occurs which produces the damage. . . . To be an accident, both the means and the result must be unforeseen, involuntary, unexpected, and unusual.²⁶

It then concluded that in order to support a cause of action on behalf of the plaintiff, negligence must be reasonably expected to produce an injury. In contrast, the cause and result of an accident are unforeseen, involuntary, unexpected, or unusual. Therefore, the court reached the somewhat novel conclusion that “the unambiguous definition of ‘accident’ does not encompass negligent acts. Accordingly, the negligent workmanship by Bland or his subcontractors is not an ‘occurrence’ and receives no coverage under the Policy.”²⁷ Of course, in reaching this conclusion, the court appears to have ignored the traditional formulation of occurrence, that is, an accident resulting in property damage that is neither expected nor intended from the standpoint of the insured. Moreover, its formulation of “occurrence” runs counter to the notion that one of the basic purposes of the CGL policy is to provide coverage for the negligence of the insured. Only where the property damage is expected or intended should the definition of occurrence not be satisfied.

In addition, the *Groves* case contains a truncated treatment of the subcontractor exception, addressing it in a single sentence, “the parties argue that whether a certain exclusion in the Policy that is inapplicable to subcontractors consequently creates coverage for subcontractors for their negligent work.”²⁸ However, the court never addressed that issue, even though the opinion appears to make a point of describing the property damage as having

²⁴ *Id.* at 571.

²⁵ *Id.* at 570-71.

²⁶ *Id.* at 571-72.

²⁷ *Id.* at 572.

²⁸ *Id.* at 571.

been caused by subcontractors. The failure to address the subcontractor exception is not particularly astounding in light of the court's occurrence analysis and result. In fact, it is a characteristic of many of the "defective work as no occurrence" cases that the court stops short of considering the effect of the subcontractor exception.

B. *The Traditional "Occurrence" Approach*

At the same time, other courts continue to uphold coverage for these types of claims. One of these cases is *American Family Mutual Insurance Co. v. American Girl, Inc.*²⁹ There, the insured general contractor, Renschler, contracted with Pleasant (now known as American Girl) to design and construct a distribution warehouse. The soils engineering subcontractor, Lawson, gave Renschler faulty site preparation advice. As a result, there was excessive settlement of the soil under the building, causing it to sink by as much as eight inches on one end. The structure buckled and cracked. Ultimately, the warehouse was found unsafe due to structural steel over-stress and had to be torn down. American Family, the CGL insurer of Renschler, denied the claim, but the Wisconsin Supreme Court upheld coverage for Renschler for the property damage attributable to the actions of Lawson, its subcontractor. The court noted that the Your Work Exclusion would operate to exclude coverage under the circumstances of the case before it, but for the subcontractor exception that specifically restored coverage for the property damage that arose out of the work performed by the subcontractor. In that connection, the court set out the history of the exception as follows:

This subcontractor exception dates to the 1986 revision of the standard CGL policy form. Prior to 1986 the CGL business risk exclusions operated collectively to preclude coverage for damage to construction projects caused by subcontractors. Many contractors were unhappy with this state of affairs, since more and more projects were being completed with the help of subcontractors. In response to this changing reality, insurers began to offer coverage for damage caused by subcontractors through an endorsement to the CGL known as the Broad Form Property Damage Endorsement, or BFPD. Introduced in 1976, the BFPD deleted several portions from the business risk exclusions and replaced them with more specific exclusions that effectively broadened coverage. Among other changes, the BFPD extended coverage to property damage caused by the work of subcontractors. In 1986 the insurance industry incorporated this aspect of the BFPD directly into the CGL itself by inserting the subcontractor exception to the "your work" exclusion.³⁰

²⁹ 673 N.W.2d 65 (Wis. 2004).

³⁰ *Id.* at 82-83.

The Wisconsin Supreme Court also relied upon the subcontractor exception in rejecting American Family's argument that the installation of defective work by Renschler did not constitute an occurrence under the CGL policy. The court stated:

If, as American Family contends, losses actionable in contract are never CGL "occurrences" for purposes of the initial coverage grant, then the business risk exclusions are entirely unnecessary. The business risk exclusions eliminate coverage for liability for property damage to the insured's own work or product—liability that is typically actionable between the parties pursuant to the terms of their contract, not in tort. If the insuring agreement never confers coverage for this type of liability as an original definitional matter, then there is no need to specifically exclude it. Why would the insurance industry exclude damage to the insured's own work or product if the damage could never be considered to have arisen from a covered "occurrence" in the first place?³¹

Thus, the coverage provided by virtue of the subcontractor exception to the Your Work Exclusion preserves coverage not only for a subcontractor's defective work, but also serves as the cornerstone for the argument that in light of the presence of such restrictions on the property damage exclusions in the CGL policy, the policy does in fact extend coverage to certain elements of an insured's defective work.

In *Kvaerner Metals v. Commercial Union Insurance Co.*,³² Kvaerner, the insured contractor, sought coverage from its CGL insurer after the coke battery it constructed was damaged in heavy rains. As a result, the owner made a claim against Kvaerner for those damages. Premature grouting of the battery during construction resulted in a lack of expansion space during heat up, which, in combination with the heavy rains, caused deformation of the joints in the roof. The court held that there was no requirement in the policy that a civil complaint be filed against Kvaerner in order to trigger coverage, that the battery deformities were caused by an occurrence, and that they resulted in property damage. The court then considered the effect of the property damage exclusions, primarily the subcontractor exception, and remanded the case to the trial court to determine what part of the work on the battery, if any, was performed by subcontractors.

The insurer petitioned for appeal to the Pennsylvania Supreme Court, and the issue to be addressed is the "appropriate test or inquiry in ascertaining whether an underlying claim sounds in contract or tort for purposes of insurance coverage."³³ The appeal of *Kvaerner* should be interesting based upon the fact that the lower court placed primarily reliance on

³¹ *Id.* at 78.

³² 825 A.2d 641 (Pa. Super. 2003), *appeal pending*, 848 A.2d 925 (Pa. 2004).

³³ 848 A.2d. at 925.

the court of appeals opinion in *L-J, Inc. v. Bituminous Fire & Marine*,³⁴ a case that has, in the interim, been reversed by the South Carolina Supreme Court as discussed above.

On January 24, 2005, the Fourth Circuit Court of Appeals, applying Pennsylvania law, followed *Kvaerner in Limbach Co., L.L.C. v. Zurich American Insurance Co.*,³⁵ holding that costs of replacement of a leaky steam pipe fell within the subcontractor exception. The court also held that the supplier of the leaky steam pipe was a subcontractor, relying on several cases, including *Wanzek Construction, Inc. v. Employers Insurance of Wausau*,³⁶ immediately below.

Despite the contrary Texas precedent represented by *Hartrick*, the case of *Gehan Homes v. Employers Mutual Casualty Co.*³⁷ should be explored. There, the court held that a complaint against the insured homebuilder for negligent construction of a defective foundation that resulted in unexpected and unforeseen property damage to a home alleged an “occurrence” under a standard CGL policy. Reversing the lower court’s grant of summary judgment in favor of the insurer, the *Gehan* court began its analysis with the policy language that defined the term “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions,” a definition identical to the one before this court.³⁸ The policies left the term “accident” undefined, so the court reviewed Texas Supreme Court precedent stating that an injury is accidental if the injury is not the natural and probable consequence of the action that caused the occurrence.³⁹ Nevertheless, the *Gehan* court acknowledged the proper inquiry as to the existence of an “occurrence” under a CGL policy is whether the injury was expected or intended from the standpoint of the insured. Under *King*, the Court of Appeals noted that limiting the definition of “occurrence” to only unintentional acts renders the policy exclusion for intended injury surplusage. The *Gehan* court further explained that there is an accident when the action is intentionally taken but is performed negligently and the effect is not what would have been intended or expected had the deliberate action been performed non-negligently. Accordingly, although the claim involved damage to the house, which was the subject matter of the contract, there was still an occurrence, and, therefore, a covered claim. Another Texas Court of Appeals reached a similar result in the context of coverage for water damage caused by EIFS.⁴⁰

³⁴ 567 S.E.2d 489 (S.C. Ct. App. 2002).

³⁵ No. 04-1261, 2005 WL 127335 (4th Cir. Jan. 24, 2005).

³⁶ 679 N.W.2d 322 (Minn. 2004).

³⁷ 146 S.W.3d 833 (Tex. App. 2004).

³⁸ *Id.* at 839.

³⁹ *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002).

⁴⁰ *Lennar Corp. v. Great Am. Ins. Co.*, No. 14-02-00860-CV, 2005 WL 1324833 (Tex. App. June 2, 2005).

The subcontractor exception has also received broad treatment as to the type of entity that constitutes a “subcontractor” for purposes of application of the exception. One of the very recent cases to engage in such an interpretation is *Wanzek Construction, Inc.*⁴¹ Although the opinion does not directly address the “occurrence” issue, it nevertheless is useful to illustrate the breadth of coverage available to general contractors by virtue of the subcontractor exception. In that case, Wanzek, the general contractor, entered into a contract to construct a city aquatic center, including a pool. The contract called for Wanzek to install custom fabricated coping stone at the perimeter of the pool. That coping stone was provided by Aquatic. As part of its obligation to supply the coping stone, Aquatic also provided training to Wanzek personnel as to installation of the stone. After completion, occupancy, and use of the pool, the stones failed. Wanzek replaced the stones pursuant to its obligations under the contract, seeking coverage for the cost of repair from Wausau, its CGL insurer.

Wausau raised several defenses to the claim, first arguing that the coping stone constituted Wanzek’s product, so that the “your product” exclusion applied, in that the entire construction project constitutes a general contractor’s project. The court rejected this argument based upon the definition of “your product” contained in the standard CGL policy form that contains an exception for “real property.”

Wausau’s main argument was that the subcontractor exception to the Your Work Exclusion did not apply to the supplier of materials so that the exclusion denied coverage for property damage arising out of Wanzek’s work. In support of that argument, Wausau relied upon state sales tax cases, while on the other hand, Wanzek relied upon payment bond cases for its position that a supplier should be treated the same as a subcontractor. The court found neither of these lines of cases controlling because that precedent did not deal with the language of the “Your Work Exclusion” in Wausau’s policy. The court stated as follows:

The policy language governs. If the policy language is ambiguous, it must be interpreted in favor of finding coverage. Because there is no statutory or regulatory definition of subcontractor that is incorporated into the “your work” exclusion, and the policy does not define the term, we hold that the term “subcontractor” in the exception to the “your work” exclusion of the CGL insurance policy is ambiguous and we will construe it liberally in favor of coverage.⁴²

Wausau also argued that even if the supplier met the definition of a subcontractor, the Your Work Exclusion nevertheless applied because the supplier did not perform its work on behalf of Wanzek, but had supplied materials manufactured to the specification of the

⁴¹ 679 N.W.2d 322 (Minn. 2004).

⁴² *Id.* at 329.

owner. The court was not persuaded by this argument, observing that Aquatic had no agreement with the city for providing the coping stone. Instead, it contracted directly with Wanzek and that contract obligated Aquatic to furnish and pay for supervision, labor, materials, tools, equipment, services, and all other items necessary to design and fabricate the stones. The court held that since Aquatic's performance of its obligations to Wanzek contributed to the performance by Wanzek of its obligation to the city to furnish and install the coping stones, Aquatic had performed its work as a subcontractor on behalf of Wanzek.⁴³

These "traditional" cases apply the intent behind the subcontractor exception to uphold coverage for insured general contractors for property damage arising out of the defective work of their subcontractors. In the process, the courts gave effect to all provisions in the entire policy, harmonizing them to determine the policy intent. In other words, they did not stop short at the definition of occurrence and ignored the property damage exclusions, particularly the subcontractor exception.

E. *Economic Loss Versus "Property Damage"*

Another argument that is frequently heard is that defective construction gives rise to mere economic loss and does not constitute "property damage" as defined in the CGL policy. This position is frequently framed in terms of economic loss. In other words, the contention is often made that the cost of repairing or replacing defective work is an economic loss that is not covered under the policy. Under many circumstances, such costs may not be in fact covered. Take, for example, the costs of repairing or replacing work that is known to be defective, but that has not yet failed, discussed later in this article.⁴⁴

A problem is created, however, when an economic loss argument is used to divert attention away from the exclusions in the policy, or even away from the definition of "property damage" in connection with reviewing coverage for defective work claims under a CGL policy. In other words, initially approaching coverage for defective work claims from

⁴³ Perhaps one of the most fascinating aspects of the *Wanzek* case was not yet briefed and argued before the Minnesota Supreme Court. However, it was discussed by the lower Court of Appeals in its opinion, *Wanzek Constr., Inc. v. Employers Ins. of Wausau*, 667 N.W.2d 473 (Minn. Ct. App. 2003). There, the court addressed Wausau's argument that since Wanzek had repaired the defective work per the requirements of its contract so that no lawsuit had been filed against Wanzek, it could not be "legally obligated" to pay damages within the meaning of the insuring agreement of the standard CGL policy. The court rejected that argument stating that the insuring agreement was broad and general enough to pertain to Wanzek's claim which involved property damage and an apparent contractual obligation on Wanzek's part to repair or pay for the property damage. Nothing in the provision suggested a lawsuit was necessary to trigger coverage. Finally, the court concluded that to construe the language of the provision to require a lawsuit to trigger coverage would not serve the public policy goal of encouraging the resolution of disputes without litigation.

⁴⁴ *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E. 2d 481 (Ill. 2001).

the perspective that economic loss is *per se* not covered is, in reality, backward. Somehow, the existence of “property damage” is avoided if it is called something else: “economic loss.” Rather, the inquiry should focus on whether the claim involves “property damage,” as defined in the policy, *i.e.*, physical injury to tangible property or loss of use of tangible property. If the definition of property damage is not satisfied, then the claim may in fact involve mere economic loss, but not because economic loss is not covered, but rather, because there is no “property damage.” If in fact there is “property damage,” then the exclusions must be applied before a definitive coverage determination can be made.

Recently, the assertion that defective work claims involve mere economic losses has often been combined with a companion assertion that this result is in accord with the “Economic Loss Rule.” Of course, references to neither “economic loss” nor the “economic loss rule” can be found within the CGL policy itself. Thus, this analysis is another effort to misdirect the attention of the insured and the courts away from the policy itself toward vague and largely irrelevant concepts.

1. Economic Loss and Defective Work Claims

As previously stated, in order to be covered under the policy, a claim, including a defective work claim, must meet the definition of “property damage.” That is, it must involve “physical injury to tangible property, including all resulting loss of use of that property,” or “loss of use of tangible property that is not physically injured.”⁴⁵ Then the claim is evaluated in light of the property damage exclusions, an exercise that will eventually confirm or eliminate coverage. Nevertheless, the steppingstone to the exclusions is the definition of property damage.

One of the most recent cases to engage in an in-depth analysis of property damage versus economic loss in the context of CGL coverage for defective work is *Travelers Insurance Co. v. Eljer Manufacturing, Inc.*⁴⁶ In that case, the insured manufacturer of the Qest polybutylene plumbing system sought coverage for the costs of replacing leaky plumbing systems, including plumbing systems installed in homes where the systems were replaced prior to the development of an actual leak. The damages sought against the insured manufacturer were the costs of replacing the system and diminution in value of the homes.

The court determined that tangible property suffers a “physical injury” when the property is altered “in appearance, shape, color or in other material dimension,”⁴⁷ and went on to state as follows:

⁴⁵ ISO form CG 00 01 11 85.

⁴⁶ 757 N.E. 2d 481 (Ill. 2001).

⁴⁷ *Id.* at 502.

Conversely, to the average mind, tangible property does not experience “physical injury” if that property suffers intangible damage, such as diminution in value as a result from the failure of a component, such as the Qest System, to function as promised.⁴⁸

Based upon the standard CGL definition of “physical injury,” the Illinois Supreme Court concluded that the mere installation of the Qest plumbing system, without some physical injury to the home itself, did not constitute an “alteration in appearance, shape, color or other material dimension” and, thus, did not constitute property damage.

The *Eljer* court also concluded that economic losses do not involve property damage, holding that coverage is not triggered by purely economic losses. Absent physical injury to tangible property, economic losses such as damages for inadequate value, costs of repair or replacement, and diminution in value that result from a product’s inferior quality or its failure to perform for the general purposes for which it was manufactured and sold are not covered.

2. The Economic Loss Rule

Obviously, cases that address mere economic loss are of limited utility as applied to claims involving occurrences of physical injury to tangible property, as is the case with many defective work claims. As a result, an argument has emerged that seeks to meld concepts from economic loss cases with an additional argument in order to deny coverage for claims involving physical injury to tangible property without the necessity of resorting to the policy exclusions and in the process find coverage. This argument borrows from an unlikely source—the Economic Loss Rule.

The economic loss rule provides that a cause of action for negligence is not available when the only loss or damage is to the subject matter of the contract. In that case, the plaintiff’s action is ordinarily limited to one in contract. In other words, in determining whether to apply the rule, the court determines whether the cause of action is in contract or tort, and when the loss is only to the subject matter of the contract itself, the action stands in contract alone. However, an exception to the economic loss rule exists where the conduct of the wrongdoer causes damage to property other than the subject matter of the work itself.

While the economic loss rule developed as an offshoot of products liability law, its utility in the construction context is obvious. Construction work is performed pursuant to contracts, and construction claims involving construction failures, including defective workmanship, are prosecuted under various theories, including breach of contract, breach of warranty, and negligence. Again, when the defective construction involves the work contracted for under the construction contract, the possibility of an economic loss defense exists, particularly when no damage in third party property has occurred. In construction

⁴⁸ *Id.* at 496.

litigation, motions for summary judgment based upon the economic loss rule are commonplace, and are sometimes granted, thus eliminating the negligence cause of action, a tort cause of action perhaps giving rise to more remote damages that are not recoverable under a breach of contract theory.

3. The Economic Loss Rule and Insurance Coverage

It must be kept in mind that the economic loss rule is a *liability* defense; it is not necessarily dispositive of insurance coverage. Nevertheless, insurers will frequently state the position that once the economic loss rule has eliminated the negligence cause of action, they no longer owe a duty to defend and indemnify an insured contractor as to the remaining breach of contract cause of action.⁴⁹ Moreover, of late, the economic loss rule has been offered up in support of the argument that damage to a project arising out of the insured contractor's defective work is an economic loss due to the applicability of the economic loss rule.

Particularly, in the case of a general contractor or homebuilder, the entire project or home may constitute the "subject matter" of the contract with the owner. Taken to its illogical extreme, application of the economic loss rule dictates that since damage to the subject matter of the contract is economic loss, *ergo*, it cannot be property damage covered under the CGL policy. Once again, this argument ignores the remainder of the policy, including the property damage exclusions that carve out coverage for elements of the work that is the subject matter of the contract, particularly after the application of Exclusions (j) and (l). Of course, it goes without saying that the CGL policy makes no reference to the economic loss rule and that the applicability of that rule to insurance coverage ignores the definition of property damage, *i.e.* physical injury to tangible property, or loss of use of tangible property that has not been physically injured.

Obviously, "physical injury to tangible property" can occur to a construction project—the subject matter of the contract between the insured contractor and the owner. For example, consider a project that is subject to water infiltration due to defective installation of the windows and exterior cladding. Water infiltrates the building and causes damage to interior finishes, rotting of the wooden structural members, and causes mold. Obviously, there has been "physical injury to tangible property," the building, but at the same time, that building is the subject matter of the contract between the contractor and the owner. At that point, there has clearly been an "occurrence" of "property damage" as those terms are

⁴⁹ This position is sometimes based upon the questionable notion that a CGL policy provides coverage only for tort damages, and not for breach of contract. Coverage does not necessarily depend upon the assertion of a cause of action for negligence versus breach of contract, but rather, whether the claim involves an occurrence of property damage, as those terms are defined in the policy.

defined in the policy, and resort must be had to the property damage exclusions to determine the scope of coverage. If the contractor constructed the project using subcontractors, there is likely a considerable amount of insurance coverage available.

The economic loss rule analysis has been steadily creeping into coverage litigation over defective construction. For example, in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*,⁵⁰ the insurer relied upon an economic loss rule analysis to support its contention that its policy did not provide coverage to a homebuilder. The allegations were of defective construction of a home resulting in foundation failure and associated damages to the structure and finishes. The court stated that though the acts of a party may breach duties simultaneously in tort and contract, the nature of the injury determines which duty is breached. When the injury is only the economic loss to the subject of the contract itself, the action sounds in contract alone. Economic loss encompasses damage based on the “loss of bargain,” the difference between the value of what is received and its value as represented. Direct economic loss may also be measured by costs of replacement and repair.

As to insurance coverage for that economic loss, the court went on to hold that something other than pure economic damage must be sought by the underlying claimant in order to trigger obligations under a commercial general liability insurance policy. The court reached this conclusion with no consideration whatsoever of the exclusions in the policy, including the Your Work Exclusion or the Impaired Property Exclusion—the exclusions that are necessary to determine whether particular property damage is covered. In *Lamar Homes*, the contractor neither expected nor intended that its subcontractors would cause the defects in the foundation, and those defects caused physical injury to tangible property, *i.e.* the home. The true coverage issue was the applicability of the subcontractor exception. The exception should have been applied to preserve coverage. *Lamar Homes* is currently on appeal to the Fifth Circuit and has generated several *amicus curiae* briefs by construction and insurance industry groups. The Fifth Circuit has certified the questions of defective construction as an occurrence and property damage to the Texas Supreme Court, with similar *amicus curiae* participation before it.

As expected, other courts that have carefully considered this issue have rejected the notion that a liability defense such as the economic loss rule can control insurance coverage in the absence of express policy language to that effect. A similar argument was made in *American Family Mutual Insurance Co. v. American Girl*,⁵¹ and the Wisconsin Supreme Court resoundingly rejected it. In the process, the court called into question whether the

⁵⁰ 335 F. Supp. 2d 754 (W.D. Tex. 2004), *appeal pending*.

⁵¹ 673 N.W.2d 65 (Wis. 2004).

sinking, buckling, and cracking of a foundation as the result of soil settlement was subject to the economic loss rule, and was not “physical injury to tangible property.” It stated that even though the economic loss doctrine restricted the owner’s recovery to specific warranties in the construction contract, there was no basis for the insurer’s argument that a loss giving rise to a breach of contract or warranty claim could never categorically constitute “property damage” within the meaning of the CGL policy’s coverage grant. The court determined that, under the circumstances of an occurrence of physical injury to tangible property, the CGL insuring agreement provided coverage for the claim, a claim for “property damage” within the meaning of the policy. The court stated:

The economic loss doctrine operates to restrict contracting parties to contract rather than tort remedies for recovery of economic losses associated with the contract relationship. The economic loss doctrine is a remedies principle. It determines how a loss can be recovered—in tort or in contract/warranty law. It does not determine whether an insurance policy covers a claim, which depends instead upon the policy language.

The economic loss doctrine may indeed preclude tort recovery here (the underlying claim is in arbitration and not before us); regardless, everyone agrees that the loss remains actionable in contract, pursuant to specific warranties in the construction agreement between Pleasant [the owner] and Renschler [the insured contractor]. To the extent that American Family [the insurer] is arguing categorically that a loss giving rise to a breach of contract or warranty claim can *never* constitute “property damage” within the meaning of the CGL’s coverage grant, we disagree.⁵²

Thus, the theory of recovery against the insured is not dispositive of whether there has been an “occurrence” of “property damage” as defined in the policy.

Another example is *Commercial Union Insurance Co. v. Roxborough Village Joint Venture*,⁵³ in which the court also rejected the economic loss analysis. In that case, Pulte, the homebuilder, sued Roxborough, the developer, due to its negligent installation and maintenance of utilities and misrepresentation and concealment of conditions making the land unsuitable for construction. Roxborough raised the economic loss rule as a defense to Pulte’s claim. In refusing to apply the economic loss rule, the court held that while the rule prevents recovery in tort where the duty breached is a contractual duty and the harm incurred is the failure of the purpose of the contract, the rule is not absolute, and its application is limited to cases involving economic loss only. As to the allegations of Pulte against Roxborough, the court held that the claims involved allegations of intentional misconduct on the part of Roxborough and breaches of duties of care independent of contractual obligations. Therefore, the economic loss rule did not apply.

⁵² *Id.* at 75.

⁵³ 944 F. Supp. 827 (D. Colo. 1996).

As far as the reliance by Commercial Union, the insurer, upon the economic loss rule, the court stated as follows:

I find the use of the rule in the insurance context troublesome generally and specifically question its applicability in this case. As an initial matter, Commercial Union's argument that it owed Roxborough no indemnification duty under the Policies because *Pulte's* claims Roxborough settled sounded in contract, rather than tort, is a novel one. Commercial Union cites no case in which an insurer invoked the rule in this manner and I find no reasoned basis for doing so.⁵⁴

The court added the following:

In essence, Commercial Union argues application of the economic loss rule to "protect" the contractual relationship between Pulte and Roxborough. Citing *Adventura*, Commercial Union argues that a characterization of Pulte's claims in the Underlying case as sounding in tort will "undermine" the Pulte-Roxborough relationship and "frustrate" the ability of commercial entities like them to allocate the risk of pecuniary loss. Commercial Union's use of the economic loss rule in this manner is strained and self-serving.⁵⁵

As the *Roxborough* court observed, the applicability of an economic loss rule analysis to coverage under a CGL policy for defective work impermissibly mixes liability and coverage concepts. Quite predictably, this "strained and self-serving analysis" invites the parties, and the courts, to ignore the remainder of the policy, that is, the property damage exclusions, where the complete coverage analysis is intended to be played out. That analysis may result in coverage for property damage to and arising out of defective work.

V. CONCLUSION

At first blush, the disparate results between cases such as *Gehan Homes*, *American Girl*, and *Wanzek*, as opposed to *Jim Johnson*, *Lamar Homes*, *L-J*, and *Groves*, is surprising, possibly disturbing. After all, these courts are all considering and applying CGL policies on standard forms promulgated by ISO. Such cases span the full gamut of construction defect claims, from single family homes to subdivision-wide residential to large scale commercial office, retail, and industrial to road construction projects. Despite similar fact pat-

⁵⁴ *Id.* at 832.

⁵⁵ *Id.* at 832 n.5 (citation omitted).

terns, results are so divergent that they are impossible to reconcile, and even an explanation is difficult to achieve. However, the single thread that winds throughout many of them is the diversion of the court's attention from the policy as a whole, overemphasizing the definition of occurrence and economic loss over the property damage exclusions that serve to limit the business risk doctrine. That failure to consider the entire policy cannot be squared with either the intent of the drafters or the rules of insurance policy interpretation applied by the courts. As such, this truncated analysis is misguided.

If this occurrence and economic loss analysis is followed, truncating the coverage and cutting the policy off at the knees, there is no need for the restrictive endorsements recently promulgated by ISO to eliminate the coverage preserved by the subcontractor exception. No defective work will constitute an occurrence or property damage and the insuring agreement of the CGL policy will not be satisfied, eliminating the need to consider the property damage exclusions and their limitations on the business risk doctrine.

APPENDIX B

THIS ENDORSEMENT CHANGES THE POLICY - PLEASE READ IT CAREFULLY

CONDOMINIUM, TOWNHOUSE, MULTI-FAMILY DWELLING PROJECTS EXCLUSION

This Endorsement shall not serve to increase our limits of insurance, as described in SECTION III - LIMITS OF INSURANCE.

The following exclusion shall be added to SECTION I, COVERAGE A - and COVERAGE B., Par. 2. of the policy.

This insurance does not apply to and the Company shall have no obligation to provide indemnity or defense against any "occurrence", "bodily injury",

"property damage"; "personal and advertising injury", incident or "suits" "arising from" any work or operations performed by you or any contractors or subcontractors working directly or indirectly on your behalf in connection with any condominium, townhouse or multifamily dwelling project.

All other terms, conditions and exclusions under the policy are applicable to this Endorsement and remain unchanged.

APPENDIX C

POLICY NUMBER:

COMMERCIAL GENERAL LIABILITY
CG 20 10 10 01

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

**ADDITIONAL INSURED – OWNERS, LESSEES OR
CONTRACTORS – SCHEDULED PERSON OR
ORGANIZATION**

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name of Person or Organization:

(If no entry appears above, information required to complete this endorsement will be shown in the Declarations as applicable to this endorsement.)

A. Section II – Who Is An Insured is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.

B. With respect to the insurance afforded to these additional insureds, the following exclusion is added:

2. Exclusions

This insurance does not apply to "bodily injury" or "property damage" occurring after:

(1) All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed; or

(2) That portion of "your work" out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.

APPENDIX D

POLICY NUMBER:

COMMERCIAL GENERAL LIABILITY
CG 20 37 07 04

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

ADDITIONAL INSURED – OWNERS, LESSEES OR CONTRACTORS – COMPLETED OPERATIONS

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name Of Additional Insured Person(s) Or Organization(s):	Location And Description Of Completed Operations
<p>EXAMPLE</p>	
<p>Information required to complete this Schedule, not shown above, will be shown in the Declarations.</p>	

Section II – Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury" or "property damage" caused, in whole or in part, by "your work" at the location designated and described in the schedule of this endorsement performed for that additional insured and included in the "products-completed operations hazard".

APPENDIX E

POLICY NUMBER:

COMMERCIAL GENERAL LIABILITY
CG 20 10 07 04

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

**ADDITIONAL INSURED – OWNERS, LESSEES OR
CONTRACTORS – SCHEDULED PERSON OR
ORGANIZATION**

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name Of Additional Insured Person(s) Or Organization(s):	Location(s) Of Covered Operations
<p style="font-size: 48px; opacity: 0.5; transform: rotate(-45deg);">SAMPLE</p>	
<p>Information required to complete this Schedule, if not shown above, will be shown in the Declarations.</p>	

A. Section II – Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury," "property damage" or "personal and advertising injury" caused, in whole or in part, by:

1. Your acts or omissions; or
2. The acts or omissions of those acting on your behalf;

in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

B. With respect to the insurance afforded to these additional insureds, the following additional exclusions apply:

This insurance does not apply to "bodily injury" or "property damage" occurring after:

1. All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the location of the covered operations has been completed; or
2. That portion of "your work" out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.

APPENDIX F

THIS ENDORSEMENT CHANGES THE POLICY - PLEASE READ IT CAREFULLY

**EXCLUSION – PRODUCTS-COMPLETED OPERATIONS
EXTERIOR INSULATION AND FINISH SYSTEMS (EIFS)**

This endorsement modifies such insurance provided under the following:

COMMERCIAL GENERAL LIABILITY PART

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

This insurance does not apply to "bodily injury", "property damage", or "personal and advertising injury" within the "products-completed operations hazard" arising out of building construction, maintenance or repairs using products, techniques or operations commonly known as "Exterior Insulation and Finish Systems" (EIFS).

Additional Definition:

"Exterior Insulation and Finish Systems (EIFS) are non-load bearing exterior wall systems with four primary components. In order of appearance, the four primary EIFS components from the substrate to the outside of the building are:

- a. panels of expanded polystyrene foam insulation adhesively or mechanically fastened to the substrate;
- b. a base coat that is troweled over the foam insulation panels;
- c. a glass fiber reinforcing mesh that is laid over the polystyrene insulation panels and fully embedded in the base coat; and
- d. a finish coat that is troweled over the base coat and the reinforcing mesh.

EIFS is not stucco. Stucco is a plaster made of Portland cement and other materials, usually troweled into a masonry surface or metal lath. Most EIFS finish coats contain no cement at all and there is usually no lath or masonry wall.

APPENDIX G

THIS ENDORSEMENT CHANGES THE POLICY - PLEASE READ IT CAREFULLY

EXCLUSION – EXTERIOR INSULATION AND FINISH SYSTEMS

This endorsement modifies Insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

This insurance does not apply to "bodily injury", "property damage" or "personal and advertising injury" arising out of the following, whether performed by you or by any person who is alleged to be your agent, employee or indemnitee or sub-contractor:

1. The design, manufacture, construction, fabrication, preparation, installation, application, maintenance, use, sale, service, or repair, including remodeling, correction, replacement or service, of any exterior insulation and finish system (commonly referred to as synthetic stucco or EIFS) or any direct-applied exterior finish system (commonly referred to as DEFS) or any part or portion thereof, or any substantially similar system or any part or portion thereof, including the application or use of conditioners, primers, accessories, flashings, coating, caulking, or sealants in connection with such a system; or
2. Any design, manufacture, construction, fabrication, preparation, installation, application, maintenance, use, sale, service, or repair, including remodeling, correction, replacement or service, of any exterior component, fixture or feature on any structure if any exterior insulation and finish system, direct-applied exterior finish system or substantially similar system is used on any part of that structure.

All other terms, conditions and agreement remain unchanged.

Company Name	Policy Number
	Endorsement Effective
Name Insured	Countersigned at by

(Authorized Representative)

(The Attaching Clause need be completed only when this endorsement is issued subsequent to preparation of the policy.)

APPENDIX H

THIS ENDORSEMENT CHANGES THE POLICY - PLEASE READ IT CAREFULLY

EXCLUSIONS ASBESTOS, SILICA DUST, TOXIC SUBSTANCE

This insurance does not apply to "bodily injury" or "personal and advertising injury" caused by asbestosis, silicosis, mesothelioma, emphysema, pneumoconiosis, pulmonary fibrosis, pleuritis, endothelioma or any lung disease or any ailment caused by, or aggravated by exposure, inhalation, consumption or absorption of asbestos fibers or dust or silica dust.

This insurance does not apply to any "property damage" due to or arising out of the actual or alleged presence of asbestos or silica dust in any form, including the costs of remedial investigations or feasibility studies, or to the costs of testing, monitoring, cleaning or removal of any property or substance.

APPENDIX I

POLICY NUMBER:

COMMERCIAL GENERAL LIABILITY
CG 21 54 01 96

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

**EXCLUSION – DESIGNATED OPERATIONS COVERED BY
A CONSOLIDATED (WRAP-UP) INSURANCE PROGRAM**

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Description and Location of Operation(s):

(If no entry appears above, information required to complete this endorsement will be shown in the Declarations as applicable to this endorsement.)

The following exclusion is added to paragraph 2, Exclusions of COVERAGE A – BODILY INJURY AND PROPERTY DAMAGE LIABILITY (Section 1 – Coverages):

This insurance does not apply to "bodily injury" or "property damage" arising out of either your ongoing operations or operations included within the "products-completed operations hazard" at the location described in the Schedule of this endorsement, as a consolidated (wrap-up) insurance program has been provided by the prime contractor/project manager or owner of the construction project in which you are involved.

This exclusion applies whether or not the consolidated (wrap-up) insurance program:

- (1) Provides coverage identical to that provided by this Coverage Part;
- (2) Has limits adequate to cover all claims; or
- (3) Remains in effect.

FUTURE MEETINGS

2006

ANNUAL 2006

Sunday, July 23 – Sunday, July 30

Fairmont Southampton

Southampton, Bermuda

WINTER 2007

Sunday, February 25 – Sunday, March 4

Fairmont Scottsdale Princess

Scottsdale, Arizona

ANNUAL 2007

Sunday, July 22 – Sunday, July 29

Sun Valley Resort

Sun Valley, Idaho

2007