

Workshop M***COMPLEX ISSUES IN
BUILDERS RISK CLAIMS*****Presented by****Douglas Patin
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Unlike liability insurance, builders risk forms and policy provisions vary widely. In addition, there is no uniform treatment by the courts of typical clauses. This session will discuss the more complex and difficult builders risk coverage issues, such as the application of policy exceptions to exclusions, causation proofs, concurrent causation clauses, sue and labor clauses, and interplay between covered builders risk claims and contract differing site conditions claims. Attendees will leave the session with a better overall understanding of builders risk coverages, the significance in variations in policy language, and how courts interpret various clauses in current use.



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Mr. Patin is presenting Workshop M, “Complex Issues in Builders Risk Claims,” on Wednesday. He leads Spriggs & Hollingsworth’s prominent construction practice and has an extensive nonconstruction government contracts practice. While Mr. Patin’s legal profession has involved traditional construction and government contract disputes, he has developed a specialized expertise in various aspects of construction law including builders risk and liability insurance disputes, bid protests, bond claims, jury trials, and complex litigation involving fiduciary duty claims.

Mr. Patin’s teaching and writing efforts keep him current on changing case law developments. He represents the owner of one of the largest construction projects in the United States (the Central Artery Tunnel in Boston), some of the largest general contractors and subcontractors in the country, and many smaller general contractors and subcontractors who have become devoted clients over several decades. He has several litigation achievements involving contractors issues to his credit.

Mr. Patin earned a bachelor of arts degree with highest honors from the University of Wisconsin—River Falls in 1976 and a juris doctor from George Washington University National Law Center in 1979.

Notes

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COMPLEX ISSUES IN BUILDERS RISK CLAIMS

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SPECIAL BUILDER'S RISK ISSUES

I. VARIATIONS IN BUILDER'S RISK FORMS

Builder's risk coverage may be provided in a wide variety of forms other than through a traditional "builder's risk" form. Builder's risk coverage may also be provided in an (1) installation floater policy; (2) commercial inland marine policy; (3) transportation policy; (4) an extension to standard fire insurance policy; and in (5) a manuscript policy. There are significant differences in the scope of coverage provided in the various policy forms available for purchase. Understanding the significance of language differences is critical in making informed decisions procuring builder's risk coverage. The predominant form of builder's risk coverage in the construction industry is "all risk" insurance.

II. BURDEN OF PROOF – "ALL RISK" INSURANCE

An "all risk" policy provides significant burden of proof advantages for an insured. Under a named peril policy the insured has the burden of proving that the loss is caused by one of the perils named in the policy, *i.e.*, fire, flood, etc. Under an "all risk" policy, however, the insured does not have to prove that the loss was caused by a particular risk or peril falling within an "all risk" policy's coverage, or the exact cause of the damage. See *Morrison Grain Co. v. Utica Mut. Ins. Co.*, 632 F.2d 424, 430 (5th Cir. 1980); *Harbour House Condominium Ass'n. v. Massachusetts Bay Ins. Co.*, 703 F. Supp. 1313 (N.D.Ill. 1988).

Most cases require the insured to prove that a loss or damage occurred, and that the loss was due to some fortuitous event or circumstance, with the burden then shifting to the insurer to show that the loss was excluded by language in the policy. See *Texas E. Transmission Corp. v. Marine Office-Appleton & Cox Corp.*, 579 F.2d 561 (10th Cir. 1978); *Redna Marine Corp. v. Poland*, 46 F.R.D. 81 (S.D.N.Y. 1969); *Glassner v. Detroit Fire & Marine Ins. Co.*, 127 N.W.2d 761 (Wis. 1964). It is the burden of the insurers to prove the applicability of any exclusion under the policy. See *Ferrara & DiMercurio v. St. Paul Mercury Insurance Company*, 169 F.3d 43 (1st Cir. 1999); *Farmers Bank & Trust Co. of Einchester v. Transamerica Ins. Co.*, 674 F.2d 548 (6th Cir. 1982) ("It is elementary in insurance law that a claimant under an insurance policy has the initial burden of proving that he comes within the terms of the policy..Conversely, the insurer carries the burden if it claims that one of the policy exclusions applies to the claimant and prevents recovery.").

One line of cases simply requires that the insured show loss or damage to the insured property, with the burden of proof shifting to the insurer to prove that the loss or damage arose from a cause that is excluded under the policy. See *Plaza Equities Corp. v. Aetna Cas. & Sur. Co.*, 372 F. Supp. 1325 (S.D.N.Y. 1974); *Walker v. Travelers Indem. Co.*, 289 So. 2d 864 (La. 1974); *Morrison Grain Co. v. Utica Mut. Ins. Co.*, 632 F.2d 424, 430 (5th Cir. 1980); *Dow Chem. Co. v. Royal Indem. Co.*, 635 F.2d 379 (5th Cir. 1981).

A. Fortuitous Event

There are important unwritten limitations in an "all risk" policy. As with all insurance, the loss or damage must not result from intentional misconduct, or fraud, and the risk insured must be lawful. See *Sun Ins. Office Ltd. v. Clay*, 133 So. 2d 735 (Fla. 1961); *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d 545 (N.C. 1973); *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 191 (D Conn. 1984). Most important is the rule that an "all risk" policy only covers fortuitous losses, unless expressly excluded under the policy.

The most commonly accepted definition of “fortuitous event” is that adopted in *Compagnie Des Bauxites De Guinee v. Insurance Co. of N. Am.*, 724 F.2d 369, 372 (3d Cir. 1983):

We hold that the district court did err because we believe that the definition of a fortuitous event that Pennsylvania would adopt is that found in the Restatement of Contracts:

A fortuitous event ... is an event which so far as the parties to the contract are aware, is dependent on chance. It may be beyond the power of any human being to bring the event to pass; it may be within the control of third persons; it may even be a past event, such as the loss of a vessel, provided that the fact is unknown to the parties.

Restatement of Contracts 291 comment a (1932) (emphasis added).

* * *

[T]he parties as well as the district court agree that “accident” is a synonym for “fortuitous event,” and the Restatement definition of a fortuitous event is consistent with Pennsylvania’s definition of an accident, which emphasizes its unplanned and unintentional nature. [Citations omitted.] Damage resulting from an unknown design defect is obviously unplanned and unintentional.

See also Fidelity & Guar. Ins. Underwriters, Inc. v. Allied Realty Co., 384 S.E.2d 613 (Va. 1989) (structural cracking was “fortuitous” even though insured’s experts would have designed building differently, since there was no certainty that the walls as designed would crack); *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 193 (D.C. Conn. 1984) (“A fortuitous event is one which occurs accidentally, as a layman, and not a technician or scientist would understand the term.”). In *Insurance Co. of N. Am. v. United States Gypsum Co.*, 678 F. Supp. 138 (W.D. Va. 1988), the court held that subsidence damage to a plant was fortuitous despite a long history of minor subsidences caused by mines in the general area, because the magnitude of the large subsidences in question was not expected. Given the definition of fortuity, issues of knowledge, accident, and unintentional conduct are fact issues for a jury.

The following events have been considered fortuitous causes of damage:

1. Painting and solvents applied to paneling and woodwork which would not take paint, which damaged the paneling and woodwork. *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d 545 (N.C. 1973).
2. Negligent backfilling damaged sewer pipe laid, and because they were improperly installed pipe collars leaked. *Associated Eng’rs, Inc. v. American Nat’l Fire Ins. Co.*, 175 F. Supp. 352 (S.D. Cal. 1959);
3. Negligent welding of the prefabrication welds in a truss system which contributed to the collapse of an underground testing facility. *General Am. Transp. Corp. v. Sun Insur. Office Ltd.*, 239 F. Supp. 844 (E.D. Penn. 1965), *aff’d*, 369 F.2d 906 (6th Cir. 1966).
4. Landslides resulting from the instability of the ground upon which residences were built. *Snapp v. State Farm Fire and Cas. Co.*, 24 Cal. Rptr. 44 (Cal. Dist Ct. App. 1962).

5. Heavy rain storms damaging subgrades in an area where seasonal rainfall is normal. *M.A. Mortenson Co. v. Indem. Co. of N. Am.*, 1999 U.S. Dist. LEXIS 22641 (D. Minn. 1999.).

An example of an event, which is not fortuitous and therefore not covered, is damage or loss resulting from ordinary wear and tear, or inevitable depreciation. See *British & Foreign Marine Ins. Co.*, *supra*. However, damage caused by excessive wear and tear is covered. See *Redna Marine Corp. v. Poland*, 46 F.R.D. 81 (S.D.N.Y. 1969). Other cases require that the loss or damage does not arise solely from an inherent quality or defect in the property. See, e.g., *Kraemer Bros., Inc. v. United States Fire Ins. Co.*, 278 N.W.2d 857 (Wis. 1979); *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d at 549.

Insurers often contend that the loss is inevitable and therefore not insurable. Although the damage caused by a specific event may be inevitable, if the event causing the damage itself was a risk that is insurable, this defense will be rejected. See *Miller Mutual Fire Insurance Co. v. Murrer*, 362 S.W.2d 868 (Tex. App. 1962) (where the court upheld the trial court's refusal to ask the jury whether the damage was inevitable); *Snapp v. State Farm Fire & Cas. Co.*, 24 Cal. Rptr. 44 (1962) ("After any movement of land has occurred it might be said to have been 'inevitable' with semantic correctness, but such 'inevitability' does not alter the fact that at the time the contract of insurance was entered into, the event was only a *contingency* or *risk* that might or might not occur within the term of the policy.").

This "inevitable" defense was specifically rejected when an underground test facility collapsed during construction. *General Am. Transp.*, *supra*. at 903. Where flooring in a house rotted because a shower stall was built without a shower pan, the court rejected the defense that the water damage loss was inevitable. The court held that the event was covered because the parties to the contract had no concept that any such event would occur when they entered into the contract of insurance. See *Employers Casualty Co. v. Holm*, 393 S.W.2d 363 (Tex. 1965); see also *Fidelity & Guar. Ins. Underwriters, Inc.*, *supra.*, (hindsight is inappropriate to determine fortuity; here no one knew at the time the policy was issued that the retaining wall would inevitably fail to support fill). In *Adams-Arapahoe School Dist. v. Continental Ins. Co.*, 891 F.2d 772, 775 (10th Cir. 1989), the court adopted a "clear trend of authority" that defective design and/or construction is an insurable risk even if it predates the policy.

B. Unwritten Extraneous Or External Cause Requirements

Some courts add an additional unwritten requirement for a loss to be covered by an "all risk" policy—i.e., it must result from at least one "extraneous" or "external" cause. See *Avis v. Hartford Fire Ins. Co.*, *supra.*; *Glassner v. Detroit Fire & Marine Ins. Co.*, 127 N.W.2d 761 (Wis. 1964); *Associated Eng'rs, Inc. v. American Nat'l Fire Ins. Co.*, 175 F. Supp. 352 (S.D. Cal. 1959); *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 191-93 (D. Conn. 1984) (extensive discussion and cases therein). Given the extended broad coverage of an "all-risk" policy, other courts have specifically rejected arguments that an extraneous cause requirement, or an inherent defect limitation should be imposed, absent specific written clauses specifying these limitations. See *Essex House v. St. Paul Fire & Marine Ins. Co.*, 404 F. Supp. 978, 988 (S.D. Ohio 1975). In *Morrison Grain Co. v. Utica Mut. Ins. Co.*, 632 F.2d 424 (5th Cir. 1980), the insurer argued that the insured had the burden to prove that the loss or damage was caused by an external cause. The court found that it would be inconsistent with the broad protective purposes of "all risks" insurance to impose on the insured the burden of proving the precise cause of the

loss or damage. The court refused to require the insured to demonstrate that the loss or damage was occasioned by an external cause.

Texas E. Transmission Corp. v. Marine Office—Appleton & Cox Corp., 579 F.2d 561 (10th Cir. 1978) involved the collapse of an underground storage cavern for liquified petroleum gas, where there were no eyewitnesses to the collapse. There was a conflict in the experts' opinions on the cause of the collapse. The insurer argued that the owner must lose because it failed to establish an "external" cause for the collapse. However, the court noted that with these facts it was difficult to see what risks the insurer was insuring against if the insurer's position was upheld. The court held that where past experience indicated that the particular design of the structure was satisfactory, and for reasons unknown the design did not work, a fortuitous event occurred. By proving feasibility study plans, and specifications, their submission to the insurer as a basis for the issuance of the policy, and their similarity to previously constructed caverns, which were satisfactorily completed, the owner met its burden of proof.

C. Written External Cause Limitations

Some policies contain a written limitation to insure against "all risks" of direct loss of or damage to the property "from an external cause." External cause has been explained in *Dubuque Fire & Marine Ins. Co. v. Caylor*, 249 F.2d 162 (10th Cir. 1957) as follows:

At the outset it is important to note the distinction between external "cause" and external "damage." External damage refers to the condition of a particular part of a thing, which has an inside and an outside, and, specifically, the outer or exterior part thereof. External cause, on the other hand, is concerned with the outward source of origin of an instigating agent. A cause which has an external source or origin is not rendered internal by the fact that its effect is internal, since it is the means and not the injury itself to which the phrase refers.

Id. at 164-65.

In *ABCD...Vision, Inc. v. Fireman's Fund Ins. Co.*, 734 P.2d 1376 (Or. Ct. App. 1987), the court also ruled that an external cause does not mean only a cause arising outside the physical boundaries of the insured property. It may include fortuitous events originating within the insured property. A broader reading of the term "external cause" appears in *Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040, 1042 (4th Cir. 1979):

The addition of the phrase 'external cause' to the 'all risks' clause constitutes no real limitation on the scope of the latter. If the loss did not result from inherent defect, ordinary wear and tear, or intentional misconduct, its cause was necessarily external.

Another case explained the "external cause" limitation as intending to exclude losses due to (1) the negligent acts of the owner or master, (2) normal wear and tear, and (3) internal decomposition or deterioration of the insured's property. *Contractors Realty v. Insurance Co. of N. Am.*, 469 F. Supp. 1287 (S.D.N.Y. 1979). This list was adopted in *N-Ren Corp. v. American Home Assurance Co.*, 619 F.2d 784 (8th Cir. 1980). Note, however, that the negligent acts clause in this list is contrary to the majority of the cases in the area. The majority of cases have held that negligence is one of the key risks intended to be covered by an "all risk" policy. See e.g., *City of Barre v. New Hampshire Ins. Co.*, 396 A.2d 121 (Vt. 1978); *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d 545 (N.C. 1973); *Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040 (4th Cir. 1979).

The following events were found to have resulted from external causes:

- Design errors, *N-Ren Corp. v. American Home Assurance Co., supra*. See also *Standard Structural Steel Co. v. Bethlehem Steel Corp., supra*. at 194.
- Negligent construction practices where wind blew down arches which were secured by defective and insufficient number of guy cables, *City of Barre v. New Hampshire Ins. Co.*, 396 A.2d 121 (Vt. 1978); *Standard Structural Steel Co., supra* at 194-95 (negligent failure to follow specifications and drawings).

A minority of courts find that defects in design and construction are inherent in property and do not qualify as external causes. See *Kraemer Bros., Inc. v. United States Fire Ins. Co.*, 278 N.W.2d 857 (Wis. 1979); *Aetna Casualty and Surety Company v. Yates*, 344 F.2d 939 (5th Cir. 1965). *Contra General Am. Transp. Corp. v. Sun Ins. Once Ltd.*, 239 F Supp. 844 (E.D. Tenn. 1965), *aff'd*, 369 F.2d 906 (6th Cir. 1966); *Essex House, supra.*; *N-Ren Corp., supra*.

III. WORKMANSHIP EXCLUSIONS

Policies include exclusions against loss from defective or faulty workmanship. A typical policy form provides:

[w]e will not pay for "loss" caused directly or indirectly by any of the following. But if "loss" by a covered cause of loss results, we will pay for the resulting "loss":

- a) Faulty, inadequate or defective

* * *

- 2) design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction.

A. Applicability to Subcontractors

One issue is whether the exclusion will apply to damage arising out of the insured's subcontractor's work. Workmanship exclusions have been applied to a contractor's subcontractors even if the subcontractor is not a name insured. *Kraemer Bros., supra*. In *Kraemer*, the insured brought a claim for damage caused by the collapse of a retaining wall that was erected by its subcontractor. The policy excluded perils from coverage that are caused by "faulty materials, improper workmanship or installation, errors in design or specifications." The court held that there was no "modifying or qualifying clause in [the exclusion] specifying the source of the faulty design, materials, or improper workmanship." Comparing the exclusion to other policy provisions that specifically limited their application to the insured, the court held that if the exclusion was intended only to apply to the insured, it should have expressly stated the limitation. Therefore, the court upheld the insurer's affirmative defense that the damage was excluded under the policy.

In *Kroll Constr Co. v. Great Am. Ins. Co.*, 594 F Supp. 304 (N.D. Ga. 1984), the policy excluded from coverage the cost of making good "any faulty or defective workmanship." The court held that pursuant to the all-encompassing language of the exclusion, faulty workmanship was not limited to only the insured's employees. The exclusion applied to the workmanship of the subcontractors and general contractor. The court held the "insurer has

no duty to include such specific language where it has included general language to the same effect.”

Where an exclusion for faulty workmanship stated that it applied to the insured’s property “when attributable to or performed by the insured [general contractor] or any person or persons in the employment or service of the insured,” this language did not apply to subcontractors, when the language of other exclusions in the policy applied “regardless of to whom attributable.” *Dow Chem. Co. v. Royal Indem. Co.*, 635 F.2d 379 (5th Cir. 1981).

B. Ambiguous Meaning

Courts have recognized the ambiguity in the term “faulty workmanship.” In *U.S. West, Inc. v. Aetna Casualty & Surety Company*, 117 F.3d 1415 (4th Cir. 1997) (unpublished opinion), the court defined the term “faulty workmanship” as “some form of avoidable dereliction” that can be “ascribed to the subcontractor’s doing of the work at issue.” The court concluded that the costs associated with replacing cracked and leaking battery jars as a result of the use of a lubricant causing stress corrosion was not a loss excluded from coverage based on the faulty workmanship exclusion. The court ruled that the exclusion’s applicability was dependent upon a finding that the subcontractor was at fault and the corrosive effect of the lubricant that caused the cracked battery jars was no fault of the subcontractor.

Other courts find the term “faulty workmanship” unambiguous. In *Trinity Indus., Inc. v. Insurance Co. of N. Am.*, 916 F.2d 267 (5th Cir. 1990), the insured brought a claim under its builder’s risk policy for misalignment of hull sections of a vessel, which caused a twist in the vessel. The court distinguished the faulty workmanship exclusion conclusion in *Dow Chemical* on the basis that faulty workmanship leading to an accident, i.e. collapse, is covered—but not the repair of defective workmanship alone where no accident occurs. The court stated that the words in the policy “should be given their plain meanings, and the court should not change the coverage of the policy under the guise of interpreting ambiguous language.” Relying on the Eleventh Circuit’s analysis in *Bender Shipbuilding & Repair Company v. Brasileiro*, 874 F.2d 1551 (11th Cir. 1989), which specifically addressed the Hull Risks and Collision Liability clauses, the court held the policy language was unambiguous. The court held that since the insured was seeking coverage for the design defect and not any damage caused by the design defect, its claim was not covered by the policy. The court stated that cases upholding coverage under a policy for defective workmanship have considered an “accident caused by defective workmanship, not with the cost of replacing or repairing defective workmanship.”

Another court found that a similar defective workmanship clause in an owner’s all risk policy was ambiguous. See *Allstate Ins. Co. v. Smith*, 929 F.2d 447 (9th Cir. 1991). In *Allstate*, the insured sought coverage for repair of his business property and lost earnings due to water damage caused by the contractor’s failure to cover the exposed roof. The faulty workmanship exclusion excluded “faulty, inadequate or defective: design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction.” The court held that a “flawed product” interpretation of the clause was reasonable, i.e., faulty workmanship clause refers to the flawed quality of a finished product and not to the faulty methods of construction. Therefore, the exclusion did not apply because the damage was not covered by a flawed product, but rather the contractor’s failure to protect the roof. Similarly, in *M.A. Mortenson Co. v. Indem. Ins. Co. of N. Am.*, 1999 U.S. Dist. LEXIS 22641 (D. Minn. 1999) the court found the term “faulty workmanship” to be ambiguous and interpreted it to only refer to a flawed product. The insured brought a claim for damage caused by severe rain and resulting flooding, which penetrated the protection devices

that the contractor had placed to protect the construction site. The insurer claimed that the contractor's damage was excluded by the faulty workmanship provision because the contractor "failed to comply with contract specifications requiring it to pave or hydroseed the subgrades prior to the beginning of the wet season." The court held that the faulty workmanship exclusion did not apply because the failure to complete the work "before the onset of the rainy season was a failure of process, not a flawed product."

C. Failure to Exercise Proper Judgment

The courts do not agree on what conduct constitutes defective workmanship. Some of the major cases interpreting defective material and workmanship exclusions have developed several rationales to avoid applying them. One leading case is *Equitable Fire & Marine Ins. Co. v. Allied Steel Coast Co.*, 421 F.2d 512 (10th Cir. 1970), which concerned whether there was an error in workmanship when the pipe fittings at a pier were replaced without first securing the pipe at another pier, thereby resulting in the collapse of a string of pipe into a river. The lower court found that as a matter of law "workmanship" as used in the exclusion did not include this type of misjudgment. The appellate court adopted the lower court's holding referring to an explanation for "workmanship" as "[a] defect in workmanship is a defect in the way some part of the machine is constructed" and "the execution or manner of making or doing something; craftsmanship; the quality imparted to a thing in the process of making; the character given to a work by the art or skill of the workman." Relying on the same dictionary definition of workmanship, the court in *Kroll Constr. Co. v. Great Am. Ins. Co.*, 594 F. Supp. 304 (N.D. Ga. 1984) expressly rejected the rationale of *Equitable Fire & Marine* that the failure of workmen to exercise proper judgment in executing their work does not constitute defective workmanship. In *Kroll*, the failure to waterproof the entire subsurface walls came within the defective workmanship exclusion.

D. Workmanship Versus Negligence

A faulty workmanship exclusion was held applicable in *United States Indus., Inc. v. Aetna Casualty & Sur Co.*, 690 F.2d 459 (5th Cir. 1982) where damage was caused by defects in a post-weld heat treatment operation to relieve stress in steel plates for a large steel tower. The contractor contended that the exclusion only applied to defects built into the structure and not work relating to procedures, which do not become a part of the completed product. The court accepted the insurer's argument that the stress-relieving operation was an integral part of the fabrication and construction so that the defective procedure was as much faulty workmanship as would have been defective welding of the tower itself. The court distinguished *Equitable Fire & Marine* and *City of Barre* on the grounds that in those cases, covered causes extraneous to construction contributed to the damage. In *United States Indus., Inc.*, however, the damages caused by the defective workmanship were excluded "whether due to negligence, inadvertence, misjudgment, or whatnot." *Id.* at 462.

Defective workmanship exclusions may be avoided by convincing the court that the damage was caused by negligence, not defective workmanship. For example, in *City of Barre v. New Hampshire Ins. Co.*, 396 A.2d 121 (Vt. 1978), arches collapsed because only two guy cables were used instead of the six called for by the erection plans (inadequate support), and because the guy cables used had only one-third of their original tensile strength. Following *Equitable Fire & Marine*, *supra*, the court found that the failure to use enough cable support was misjudgment and not faulty workmanship. See also *Texas E. Transmission Corp. v. Marine Office—Appleton & Cox Corp.*, 579 F.2d 561, 565 (10th Cir. 1978) (negligence of employees in constructing cavern that deviated from the dimensions of the columns and spacing in the plans is not an excluded peril); *C.H. Leavell & Co. v.*

Fireman's Fund Insurance Co., 372 F.2d 784 (9th Cir. 1967) (faulty workmanship exclusion was not applied because negligence of insured's employees in failing to follow the contractor's erection procedure and drawings in positioning the wind boom cable caused loss).

E. "Faulty" Language

Other policy exclusions may use the words "faulty" and "construction," which have caused courts to question whether these clauses exclude construction related negligence. One form states:

[w]e will not pay for "loss" caused directly or indirectly by any of the following...But if "loss" by a Covered Cause of Loss results, we will pay for the resulting "loss":

a) Faulty, inadequate or defective:

* * *

(2) workmanship, repair, construction, renovation, remodeling, grading, compaction.

In *Brodkin v. State Farm Fire & Casualty Co.*, 217 Cal.App.3d 210 (4th Dist. 1989), homeowners brought a claim for damage to the home's foundation caused by cow urine in the soil that was not removed by the contractor before constructing the home. The policy at issue excluded claims for any "defect, weakness, inadequacy, *fault* or unsoundness in ... planning, zoning, development surveying, siting ... design, specifications, workmanship, construction, grading, [or] compaction." The court held that if the damage was caused by negligent construction in failing to take any precautionary methods in removing the corrosives from the soil, the loss was barred from coverage under the policy.

IV. EARTH MOVEMENT EXCLUSIONS

A common exclusion in policies is for loss caused by "earth movement, including but not limited to earthquake, landslide, mudflow, earth sinking, earth rising or shifting." The purpose of such exclusions is to relieve the insurer from occasional major disasters which are almost impossible to predict and thus to insure against, e.g., earthquakes or floods which cause a major catastrophe and wreak damage to everyone in a large area rather than one individual policyholder. See *Wyatt v. Northwestern Mut. Ins. Co.*, 304 F. Supp. 781 (D. Minn. 1969). The Court in *Wyatt* explained that:

[t]his gives some force to the view that the various exclusions were not intended to cover the situation as here where 'earth movement' occurred under a single dwelling, allegedly due to human action of third persons in the immediate vicinity of the damage. It seems hard to contend that the insurance policy meant to exclude all earth movements, for it is difficult to distinguish between a situation where a piece of heavy equipment breaks loose and hits a house causing serious damage and a situation where equipment instead hits only an embankment next to a house but causes the earth to move and thereby damages the house. Certainly not all earth movements, or at least those where some human action causes such are included in the exclusion.

Similarly, in *Peters Township School District v. Hartford Accident and Indemnity Company*, 833 F.2d 32 (3rd Cir. 1987), the court concluded that the earth movement exclusion in the policy was "meant to deny coverage for spontaneous, natural, catastrophic earth movement, and not movements brought about by other causes." The earth movement exclusion did not apply to damage

caused by mine subsidence. See also *Barash v. Ins. Co. of North America*, 451 N.Y.S.2d 603 (N.Y. Sup.Ct. 1982)("[d]eterioration of the fill below one house is certainly not large-scale earth movement").

In *Winters v. Charter Oak Fire Insurance Company*, 4 F. Supp. 2d 1288 (D.N.M. 1998), an insured brought a claim after a water line broke which caused shifting of soil and resulting structural damage. The insurer contended that the damage was excluded under the "earth movement" exclusion specified in the policy because the structural damage occurred as a result of the soil movement. The court held that the damage was not excluded because earth movement covers only "naturally-occurring phenomena such as earthquake or landslide."

V. DESIGN EXCLUSIONS

A defective design exclusion applied when a decorative Egyptian phoenix fell through a plaza mall when modifications to the original plans did not provide sufficient structural support for the weight. See *Plaza Equities Corp. v. Aetna Casualty & Sur. Co.*, 372 F. Supp. 1325 (S.D.N.Y. 1974). In *Texas Eastern Transmission Corp. v. Marine Office—Appleton & Cox Corp.*, 579 F.2d 561 (10th Cir. 1978), a defective design exclusion was avoided by showing that past experience indicated that the particular design used would be satisfactory.

In *American Home Assurance Co. v. J.F. Shea Co.*, 445 F. Supp. 365 (D.D.C. 1978), the insurer argued that an owner's failure to anticipate a certain range of lateral pressures on a support of excavation system came within a defective design exclusion. However, the court in effect found that simply because a design does not work in a given circumstance, does not mean it is defective. The court found that the definition of "defective" suggests the involvement of negligence or other improper conduct. Where a loss results from a cause not within the insured's control, i.e., an outside force resulting from acts of nature (an imperceptible movement of earth along a slip-page plane), the defective design exclusion did not apply since this risk was one the "all risk" policy was intended to cover.

Similarly, in *Henning Nelson Construction Company v. Fireman's Fund American Life Insurance Company*, 303 N.W. 2d 645 (1986), the court found that although a poured concrete wall would have been stronger than a block wall to withstand earth movement, it was not a design defect that the wall was constructed out of blocks. Therefore, the loss was not excluded under the defective design exclusion excluding losses caused by "fault, defect, error or omission in design, plan or specifications."

VI. LATENT DEFECTS OR INHERENT VICE EXCLUSIONS

A. Latent Defect

Some "all risk" policies may exclude inherent vice or latent defects. The major cases have avoided the latent defect exclusion by characterizing the workmanship or improper construction practices causing the damage as negligence, and not some type of latent defect. These courts have followed the general rule that a latent defect is a defect that cannot be discovered by any known and customary test, or is a defect that could not have been discovered by a proper or reasonable inspection. See *General Am. Transp. Corp. v. Sun Ins. Office Ltd.*, 239 F Supp. 844 (E.D. Tenn. 1965), *aff'd*, 369 F.2d 906 (6th Cir. 1966) (improper welding not a latent defect because it was discoverable by radiography). The following events were not considered latent defects since they could have been discovered by ordinary or customary inspection or testing: (1) defective welding, *General Am.*, *supra*; (2) "shoddy" brick facing design and construction, *Essex House*, *supra*; and (3) excessive cable length installed in the spool of a crane drum resulting in the cable being caught in

the crane's gear and being severed, *Connie's Constr Co. v. Continental W. Ins. Co.*, 227 N.W.2d 204 (Iowa 1975). Similarly, where a design defect could have been discovered through the use of normal stress calculations there is no latent defect. See *Standard Structural Steel Co.*, *supra.* at 196, citing *Plaza Equities Corp. v. Aetna Casualty & Sur Co.*, 372 F Supp. 1325, 1331 (S.D.N.Y. 1974).

A latent defect exclusion will apply if the problems are not readily discoverable. See *Merz v. Allstate Ins. Co.*, 677 F. Supp. 388 (W.D. Pa. 1988) (wall, reinforcement, backfill, and absence of drain problems causing basement flooding were unknowable, concealed by the ground and thus were inherent defects). In *80 Broad St. v. United States Fire Ins. Co.*, 389 N.Y.S.2d 214 (N.Y. Sup. Ct. 1975), *aff'd* 390 N.Y.S.2d 768 (N.Y. App. Div. 1975), the court found that improper construction had been performed some thirty-nine years before the policy was issued, which led to the buckling of marble facing. Under those particular facts, an inherent or latent defect exclusion in the sublessee's policy was applicable. See also *Derenzo v. State Farm Mut. Ins. Co.*, 533 N.Y.S.2d 195 (N.Y. Sup. Ct. 1988) (construction defects, i.e. inadequate reinforcement, lack of expansion joints, non-uniform concrete thickness, and improperly prepared subgrade, were excluded latent defects causing differential settlement of footings and cracks in walls and floors).

Some all risk policies exclude a "latent defect," but the exclusion does not include the language "loss or damage caused by or resulting from." If such broad language appears in other exclusions, then the "latent defect" exclusion only applies to repairing the latent defect and not the damage resulting from the latent defect. See *Dickson v. United States Fidelity & Guar Co.*, 466 P.2d 515 (Wash. 1970).

B. Inherent Vice

In *American Home Assurance Co.*, *supra.*, preventative repair work to a transition cut in a support of excavation system was required because the design did not anticipate the movement of earth along a slippage plane. An "inherent vice" exclusion did not apply because the insured property did not contain "its own seeds of destruction," but rather was threatened by an outside natural force.

Negligence can also be used to avoid an "inherent vice" exclusion. For instance, where damage resulted from improper installation of pipe in trenches, and collars on pipes, the court ruled that the damage did not result from "inherent vice," but rather negligence. See *Associated Eng'rs, Inc. v. American Nat'l Fire Ins. Co.*, 175 F. Supp. 352 (S.D. Cal. 1959). An example of where an inherent vice exclusion did apply is *State Farm Fire & Casualty Co. v. Volding*, 426 S.W.2d 907 (Tex. 1968). In this case, rain water entered the pores of brick on a house and froze causing the brick to crack, collapse, and crumble. The loss resulted from an "inherent vice" because improper bricks were used, as they were unsuitable for outside use because of their porous condition. Inherent vice has also been defined as applying to losses from natural decay, ordinary wear and tear, and inevitable depreciation. See *Standard Structural Steel Co.*, *supra.* at 197.

VII. EXCEPTIONS WITHIN EXCLUSIONS

Most exclusions in “all risk” builder’s risk policies contain exceptions to the defective workmanship and design exclusions, as well as the latent defect or inherent vice exclusions. These exceptions may be grouped into the following categories.

A. Ensuing Loss or Damage Exceptions

In *Farmer’s Chem. Ass’n v. Maryland Casualty Co.*, 421 F.2d 319 (6th Cir. 1970), a policy excluded damage resulting from “error, omission or deficiency in design specifications, workmanship or materials unless fire or other accidents otherwise recoverable hereunder ensues and then only for such ensuing loss or damage.” The claim resulted when the transition pipe in a plant was improperly insulated during its installation. The pipe overheated, buckled and developed leaks. The exclusion was found to be ambiguous and the court accepted the owner’s argument that the faulty placement of insulation constituted the “error,” while the subsequent breaking of the pipe constituted the “other accident” which ensued as the result of the workmanship error.

In *Lake Charles Harbor & Terminal Dist. v. Imperial Casualty & Indem. Co.*, 670 F Supp. 189 (W.D. La. 1987), *aff’d* 857 F.2d 286 (5th Cir. 1988), the policy excluded “[m]echanical or machinery breakdown; unless an insured peril ensues, and then only for the actual loss or damage caused by such ensuing peril.” Characterizing this clause as “self-contradictory gibberish,” the appellate court affirmed a lower court holding finding coverage. The court held that the cable on a shiploader which broke because it had worn out, sending a shuttle crashing into the interior of the loader caused catastrophic damage and was an insured ensuing peril.

In *Blaine Construction Corp. v. Insurance Co. of North America*, 171 F.3d 343 (6th Cir. 1999), a contractor asserted a claim for the cost to remove and replace insulation damaged by water that had accumulated in the insulation blankets based on the subcontractor’s failure to install a vapor barrier. The policy excluded coverage for “loss or damage caused directly or indirectly by any Peril excluded. Such loss or damage is excluded whether contributed to, in whole or part, by any excluded Peril.” The excluded perils included “errors in design, errors in processing, faulty workmanship or faulty materials, unless loss or damage from an insured Peril ensues and then only for such ensuing loss.” The court considered whether the faulty workmanship exclusion, with the ensuing loss exception, unambiguously excluded coverage for the damage caused to the ceiling installation. The court held that the exclusion did not preclude coverage because rainwater was an insured peril.

In *N-Ren Corp., supra.*, a similar type of clause excluded loss or damage “caused by or resulting from... (c) errors in design... unless the collapse of the property or a part thereof ensues and then only for the ensuing loss.” The exception to the exclusion was held to apply when the refractory lining to a large processing unit in a fertilizer plant “collapsed” in two comparatively small areas, leading to a malfunction and subsequent damage in the unit.

B. “Cost of Making Good” Exclusions” With “Damages Resulting From” Exceptions

A common clause excludes the “cost of making good faulty workmanship, construction, or design; but this exclusion shall not apply to damage resulting from such faulty workmanship, construction or design.” In *Kroll Constr Co., supra*, the insured brought a claim for costs to replace or repair the landscaping, concrete work, irrigation system and electrical

system which were incurred following the correction of waterproofing work. The court held the costs did not fall within the narrow meaning of the phrase, "cost of making good any faulty or defective workmanship or materials," and thus, were recoverable. The Court explained that:

[t]he policy-exclusion language did not provide an exception for all losses or damages stemming from faulty workmanship, [citation omitted], nor did it except the cost of returning a project to its state at the time the defective workmanship was discovered; rather, it simply excepted the cost of making good faulty workmanship or materials, leaving covered the cost incurred after the faulty work was 'made good.'

Id. at 308.

The same exclusion arose in *Southern California Edison Co. v. Harbour Insurance Co.*, 148 Cal. Rptr. 106 (Cal. App. 1978). There the court found that the costs of mudjacking foundations to their prior elevation after settlement due to a faulty design were costs incurred in making a faulty design. But costs to repair damage to the superstructure caused by the settling foundations were covered.

In *National Fire Ins. Co. v. Valero Energy Corp.*, 777 S.W.2d 501 (Tex. Ct. App. 1989), a defective design resulted in corrosive damage to a transition piece passing flue gas to a citrate scrubber, and to panels ("demisters") within the scrubber designed to separate liquid from gas. The policy excluded the cost of making good a defective design but provided an exception for damages "arising as a consequence of" faulty design. The court analyzed the coverage issue as follows:

The loss in the present case can be characterized in either or both ways: the use of an inadequate transition piece and demisters required Valero to replace them in order to 'make good' the faulty design; however, as a consequence of the faulty design and the inadequacy of the components there was also physical damage to the transition piece and demisters which necessitated their replacement.

The court must adopt the construction of an exclusionary clause which favors the insured as long as that construction is not unreasonable. [citation omitted]. In the present case then, characterizing the loss sustained as a consequence of the faulty design brings it within the exception to the exclusion and thus within the coverage of the policy.

Id. at 506.

Whether the defect caused damage to another portion of the work may be determinative in the court's analysis. In *Laquila Construction, Inc. v. Travelers Indemnity Co. of Illinois*, 66 F. Supp. 2d 543 (S.D.N.Y. 1999), the policy excluded:

[c]ost of making good faulty or defective workmanship or material, but this exclusion shall not apply to physical damage resulting from such faulty or defective workmanship or material.

The court held that if it accepted Laquila's argument that because the concrete was "incorporated" into the building and the ensuing loss exception applied, it would "result in coverage for nearly every installation of cracked pipes, faulty electrical wiring, or a defective ventilation system – whether or not there was any actual ensuing loss or if such loss stemmed directly from a risk expressly and unquestionably excluded by the policy. Such

coverage would wrongfully insulate contractors from liability when their negligent or sloppy workmanship results in structural or other failings." The court noted, however, that had the concrete slab "collapsed and damaged machinery, plumbing and electrical fixtures, or even neighboring property, such losses – wholly separated from the defective materials – would qualify as non-excluded ensuing loss." See also *Allianz Insurance Co. v. Impero*, 654 F. Supp. 16 (E.D. Wash. 1986) (repair costs for defective concrete not covered by resulting loss exception).

In *Swire Pacific Holdings, Inc. v. Zurich Insurance Company*, 845 So. 2d 161 (Fla. 2003), design defects allegedly caused by a structural engineer's failure to comply with building codes resulting in \$4.5 million in costs to bring the building into compliance were not covered under the policy. The design defect exclusion provided that the policy excluded coverage for "loss or damage caused by fault, defect, error or omission in design, plan or specification, but this exclusion shall not apply to physical loss or damage resulting from such fault, defect, error or omission in design, plan or specification." The court found the design defect exclusion clause was unambiguous and that no ensuing loss resulted to invoke the exception to the exclusion. The court held that no distinct loss separate from the design defect had occurred. Therefore, the policy barred coverage for the costs incurred in bringing the building into compliance. The court stated the insurance policy does not "operate as a warranty for faulty workmanship and should not be transformed into a guarantee against design and construction defects."

The intent of such exclusions is to exclude paying for the cost of making good the defective material, workmanship, design or mechanical breakdown – but not to exclude coverage for resulting losses caused by such defects. If the excluded defect is discovered and repaired before a resulting loss occurs – no coverage will be afforded. If the defect is not discovered and repaired before a resulting loss occurs – there is coverage for the resulting loss. The extra premium paid for exclusions with such exceptions is well worth the money.

C. Peril Or Physical Damage Not Excluded Exceptions

Some all risk policies exclude specific causes for damage "unless such loss results from a peril not excluded in this policy." When a ruptured underground water main caused a subsidence, the loss was covered even though subsidence was excluded, because the subsidence resulted from a non-excluded cause, thus negating the subsidence exclusion. See *National Sur. Corp. v. Adrian Assocs. v.* 638 S.W.2d 138 (Tex. Ct. App. 1982), *aff'd per curiam*, 650 S.W.2d 67 (Tex. 1983). In *National Sur. Corp.*, the court's decision was based on the interpretation of two exclusions. These exclusions stated:

[i]n addition to the exclusions in the policy to which this endorsement is attached, this policy does not insure against:

* * *

(c)(3) Water below the surface of the ground, including that which exerts pressure on or flows, seeps or leaks through sidewalks, driveways, foundations, walls, basement or other floors, or through doors, windows or any other openings in such sidewalks, driveways, foundations, walls or floors; unless loss by fire or explosion ensues, and then only for such ensuing loss. This exclusion shall not apply to property in due course of transit or to loss arising from theft;

(d) Loss, damage or expense caused by or resulting from subsidence, settling, cracking, shrinkage, bulging or expansion of pavements, foundations, walls, sidewalks, driveways, patios, floors, roofs or ceilings unless such loss results from a

peril not excluded in this policy. If loss by a peril not excluded ensues, then this Company shall be liable only for such ensuing loss.

The court held that "water below the surface" did not include water from an artificial source and therefore, the exclusion did not apply.

Similarly, in *Adams-Arapahoe School Dist. v. Continental Ins. Co.*, 891 F.2d 772 (10th Cir. 1989) a corrosion exclusion did not apply because the defective design and/or construction was a covered risk causing corrosion. The policy's exclusion stated:

[b]y wear and tear, deterioration, *rust or corrosion*, mould, wet or dry rot; *inherent or latent defect*; ... *unless such loss results from a peril not excluded in this policy*. If loss by a peril not excluded in this policy ensues, then this Company shall be liable for only such ensuing loss.

The court held that the corrosion exclusion only applied to "naturally occurring corrosion." Therefore, the damage caused by the collapse of the roof due to corrosion was covered under the policy.

In *Alton Ochsner Medical Foundation v. Allendale Mutual Insurance Co.*, 219 F.3d 501 (5th Cir. 2000), the policy excluded "faulty workmanship, material, construction, or design from any cause, unless physical damage not excluded by this Policy results." The court held that impairment of structural integrity is not a distinct damage excepted from the exclusion. The court stated that the impairment of structural integrity does "not 'result' from cracking or faulty construction of the foundation; the cracked foundation *is* the impaired structural integrity... the minor damage to the foundation does not 'cause' the more severe impairment—the cracking *is* the impairment; they are synonymous."

In *Monteriore Medical Center v. American Protection Insurance Company*, 226 F. Supp. 2d 470 (S.D.N.Y. 2002), the claimed loss was the collapse of the portion of the building claimed to be defectively designed. The policy provision provided an exception to the faulty design exclusion for "ensuing loss from a peril not otherwise excluded by this policy." The court held that the exception to the ensuing loss provision applied only "to the extent that it could prove that collateral or subsequent damage occurred to other insured property as a result of the collapse." The court stated that an ensuing loss exception does "not cover loss caused by the excluded peril, but rather covers loss caused to other property wholly and separate from the defective property itself." Since no other portion of the building collapsed the ensuing loss exception was not applicable.

Another type of other peril caused exception is:

[w]e will not pay for loss or damage caused by or resulting from any of the following ... But if an excluded cause of loss that is listed [below] results in a Covered Cause of Loss, we will pay for the loss or damage caused by that Covered Cause of Loss.

....

c. Negligent Work

Faulty, inadequate or defective:

- 2) Design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction.

In *Weeks v. Co-Operative Insurance Companies*, 817 A.2d 292 (N.H. 2003), the court concluded that the above quoted covered cause of loss exception to the exclusion for faulty workmanship did not apply where a brick veneer wall that was built over an existing asphalt shingle wall was damaged when it separated from the shingle wall because of defective workmanship. There was no subsequent ensuing cause of loss separate and independent from the initially excluded cause of loss, *i.e.*, the brick veneer damage caused by faulty workmanship.

VIII. CAUSATION PROBLEMS

A loss often occurs through a combination of excluded and nonexcluded causes. There are two major different approaches in "all risk" cases. One line of cases simply holds that where a policy expressly insures against direct loss and damage by one element but excludes loss or damage caused by another element, the coverage extends to the loss even though the excluded element is a contributory cause. See *General Am. Transp. Corp. v. Sun Ins. Office Ltd.*, 239 F. Supp. 844 (E.D. Tenn. 1965) *aff'd* 369 F.2d 906 (6th Cir. 1966); *Essex House*, *supra*; *N-Ren Corp.*, *supra*. This rule is most favorable for policy holders because there is no explicit requirement that the covered risk or peril, such as negligence, must be the "efficient" or "primary" cause of the damage. These cases do not examine the causal relationships between the excluded or non-excluded causes of the loss. Nor do they analyze the issues in terms of "proximate" cause or "triggering" causes. Other courts have relied upon these cases to rule that as long as an excluded cause is not the *sole* cause for the damage, then the loss is covered. *Avis*, *supra*, at 550; *Kraemer Bros.*, *supra*, at 863-64.

Distinguishable from this line of cases is a line that has adopted an efficient proximate cause test, which states that:

[i]n determining whether a loss is within an exception in a policy, where there is a concurrence of different causes, the efficient cause—the one that sets others in motion—is the cause to which the loss is to be attributed, though the other causes may follow it, and operate more immediately in producing the disaster.

Sabella, *supra*. at 896-97 (resolving inconsistent state insurance code provisions); *Garvey*, *supra*. (citing *Sabella*); *Judah v. State Farm Fire & Casualty Co.*, 266 Cal. Rptr. 455 (Cal. Ct. App. 1990) (citing *Garvey* and the rejection of the concurrent proximate cause analysis in favor of the efficient proximate cause analysis); *McDonald v. State Farm Fire and Casualty Co.*, 119 Wash. 2d 724 (Wash. 1992). Similarly, a chain of causation leading to a covered loss may be covered by the ensuing loss exception to an exclusion.

The *Garvey* opinion reaffirmed *Sabella's* efficient proximate cause test and at the same time noted that coverage would not exist if the covered risk was a remote cause of the loss or if an excluded risk was the efficient, proximate cause, *i.e.*, predominant cause of the risk. *Garvey*, *supra*. In response to cases finding a loss covered even though an excluded peril contributed to the loss, insurers have redrafted exclusions to exclude any loss caused in part by an excluded peril regardless of the extent to which an "excluded peril" may contribute to the sequence of events causing the loss.

Some carriers have attempted to circumvent the effect of the efficient proximate cause role by drafting the following language:

We do not cover loss covered by any of the following excluded perils, whether occurring alone or in any sequence with a covered peril....

Despite this apparently clear attempt to exclude damage caused in part by an excluded peril, some courts have refused to allow this language to “circumvent” the efficient proximate cause rule. See *Safeco Ins. Co. v. Hirschmann*, 773 P.2d 413 (Wash. 1989), citing and following *Villela v. Public Employees Mut. Ins. Co.*, 725 P.2d 957 (Wash. 1986). These cases hold that the change in the contractual language does not affect the legal result of the efficient proximate cause rule. A rather forceful dissent in the *Safeco* case argues that the majority opinion invalidates unambiguous contractual policy language, depriving insurers the right to contract to exclude specific risks, without identifying how the contract language violates public policy. In both cases, the insurer argued that it had excluded coverage for loss resulting from a casual chain including any excluded peril “regardless how insignificant the contribution from the excluded peril may have been.” *Safeco, supra*, at 415. In *Safeco*, the destruction of a home was caused by rain and wind, covered perils, and the excluded peril of landslide was the final link in a chain. Thus, summary judgment in favor of the insured was incorrectly granted. *Id.* at 417.

However, other state courts have allowed insurance carriers to avoid application of the efficient proximate cause analysis through concurrent causation exclusions. See *Kane v. Royal Ins. Co. of Am.*, 768 P.2d 678, 685 n. 6 (Colo. 1989); *Village Inn Apartments v. State Farm Fire & Cas. Co.*, 790 P.2d 581 (Utah App. 1990). In one case, a federal court in Nevada, went so far as to hold that even if the efficient proximate cause test existed in Nevada, the insurer could “contract out” the doctrine upon finding that such provisions are not against public policy. *Schroeder v. State Farm & Cas. Co.*, 770 F. Supp. 558 (D. Nev. 1991).

In *Pioneer Chlor Alkali Company, Inc. v. National Union Fire Insurance Company of Pittsburgh Pennsylvania*, 863 F. Supp. 1226 (D. Nev. 1994), the policy provided that it did not insure against “loss, damage or expense caused by or resulting from” specific exclusions. The insurer argued that the parties had contracted out of the proximate cause analysis because the policy contained the language “resulting from.” The court held, however, that the language of the policy “indicates use of the efficient proximate cause doctrine rather than avoidance of the doctrine.” A loss “resulting from” means a “risk which is proximate as distinguished from remote.”

IX. SUE AND LABOR CLAUSES

Some policies include clauses that require the insured to mitigate the loss once the damage has occurred and the insurer will reimburse the insured for doing so. These clauses generally provide:

In case of actual or imminent loss or damage by a peril insured against, it shall, without prejudice to this insurance, be lawful and necessary for the Insured, their factors, servants or assigns to sue, labor and travel for, in, and about the defense, the safeguard, and for the recovery of the property or any part of the property insured hereunder...

GTE Corporation v. Allendale Mutual Insurance Company, 258 F. Supp. 2d 364 (D.N.J. 2003).

Reimbursement under the sue and labor clause is available if “the labor was to prevent a loss that the policy would have required.” *American Home Assur. Co. v. J.F. Shea Co., Inc.*, 445 F. Supp. 365 (D.C.D.C. 1978); see also *Reliance Ins. Co. v. The Yacht Escapade*, 280 F.2d 482 (5th Cir. 1960) (“the sue and labor ‘coverage’ is therefore tied irrevocably to the insured perils coverage.”).

In *Southern California Edison Co. v. Harbor Insurance Co.*, 83 Cal. App. 3d 747, 148 Cal. Rptr. 106 (Cal. Dist. Ct. App. 1978), the court rejected the insurers’ theory that the loss incurred in correcting foundation’s faulty design was reimbursable under sue and labor provision. The court held that a “although the duty of reimbursement is said to be separate and supplementary to the

basic insurance policy, a sue and labor clause does not extend or create coverage; the recovery under a sue and labor clause is tied irrevocably to the obligations undertaken by the insurer in the basic insurance policy." The correction of design defects was only to mitigate loss to the superstructure and not compensable under the policy. Therefore, the insured's "duty of reimbursement never matured."

In *Swire Pacific Holdings, Inc. v. Zurich Insurance Company*, 845 So. 2d 161 (Fla. 2003), the Supreme Court of Florida held that sue and labor clauses are only applicable if the costs are spent to prevent a covered loss. That ruling is consistent with the case law. However, the court went further and ruled that the clause did not apply to prevention efforts where no actual loss occurred. The court stated "[a]ny other conclusion would result in the sue and labor clause becoming the primary coverage provision of the contract without regard to the content of the contract or the coverage it was designed to provide." That rationale undermines the very purpose of a sue and labor clause. It makes no sense to require a party to stand by and watch damage start before one acts to prevent further damage. Compare *Blasser Bros., Inc. v. N. Pan-American Line*, 628 F.2d 376 (5th Cir. 1980); *Cont'l Food Prods., Inc. v. Ins. Co. of N. Am.*, 544 F.2d 834 (5th Cir. 1977); *Reliance Ins. Co. v. The Escapade*, 280 F.2d 482 (5th Cir. 1960) which rule that the purpose of the clause is to prevent a covered loss from occurring.

X. BUILDER'S RISK COVERAGE AND DIFFERING SITE CONDITIONS CLAIMS

The following is the standard federal construction contract differing site condition clause:

FAR 52.236-2 Differing Site Conditions provides:

- (a) The Contractor shall promptly, and before the conditions are disturbed, give a written notice to the Contracting Officer of (1) Subsurface or latent physical conditions at the site which differ materially from those indicated in this contract; or (2) Unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract.

Major support of excavation systems for open cut or tunnel excavation may be susceptible to damage caused by a differing site condition. Geotechnical forces are very difficult to predict in many kinds of underground construction. Unanticipated forces within the earth may cause the support of excavation to move and even collapse, causing significant damage to the support of excavation structure and ongoing work. The contractor may have a claim that the earth movement was caused by a differing site condition. Differing site conditions are by their nature "fortuitous," unanticipated events. The owner will typically defend such a claim since the costs of repair will then be paid by the owner. The owner and contractor may avoid a significant contract claim dispute over whether the damage was caused by a differing site condition if they agree to jointly pursue the claim as a builder's risk policy claim.

With a differing site condition claim, the contractor has the burden to prove a differing site condition. With an all risk builder's risk claim the contractor and/or owner only need to show fortuitous loss. The insurance carrier has the burden to prove that the defective design or workmanship exclusion applies. If the contractor points the design gun at the owner (which is not always needed since a differing site condition is not necessarily the result of a defective design), and/or the owner points the workmanship gun at the contractor in defense, they will be playing into typical workmanship and design exclusions in a builder's risk policy.

Thus, it may be in both the owner and contractor's interest to recover the damage caused by the differing site condition under the builder's risk policy.

All Risk Exclusion

- This policy does not insure against loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss...[¶] C. Loss caused by, resulting from, contributed to or aggravated by any of the following.

Howell v. State Farm Fire & Cas. Co., 267 Cal. Rptr. 708 (Cal. App. 1990)

All Risk Exclusion

- We do not insure under any coverage for loss (including collapse of an insured building or part of a building) which would not have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of: a) the cause of the excluded events; or b) other causes of the loss; or c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss:...

Howell v. State Farm Fire & Cas. Co., 267 Cal. Rptr. 708 (Cal. App. 1990)

Exceptions Within Design/ Workmanship Exclusions

- “Ensuing Loss or Damage” Exception

- **PERILS EXCLUDED:** This policy does not insure against loss or damage caused by or resulting from:

“...error, omission or deficiency in design specifications, workmanship or materials unless fire or other accidents otherwise recoverable hereunder ensues and then only for such **ensuing loss or damage.**”

Exceptions Within Design/ Workmanship Exclusions

- “Resulting From” Exceptions

- **PERILS EXCLUDED:** This policy does not insure against loss or damage caused by or resulting from:

“Cost of making good faulty workmanship, construction or design, but this exclusion shall not apply to damage **resulting from** such faulty workmanship, construction or design.”

Exceptions Within Design/ Workmanship Exclusions

- **“Resulting From” Exceptions**

- **PERILS EXCLUDED:** This policy does not insure against loss or damage caused by or resulting from:

“Loss or damage caused by fault, defect, error or omission in workmanship, design, plan or specification, but this exclusion shall not apply to physical loss or damage **resulting from** such fault, defect, error or omission in design, plan or specification.”

Exceptions Within Design/ Workmanship Exclusions

- **“Peril Not Excluded” Exception**

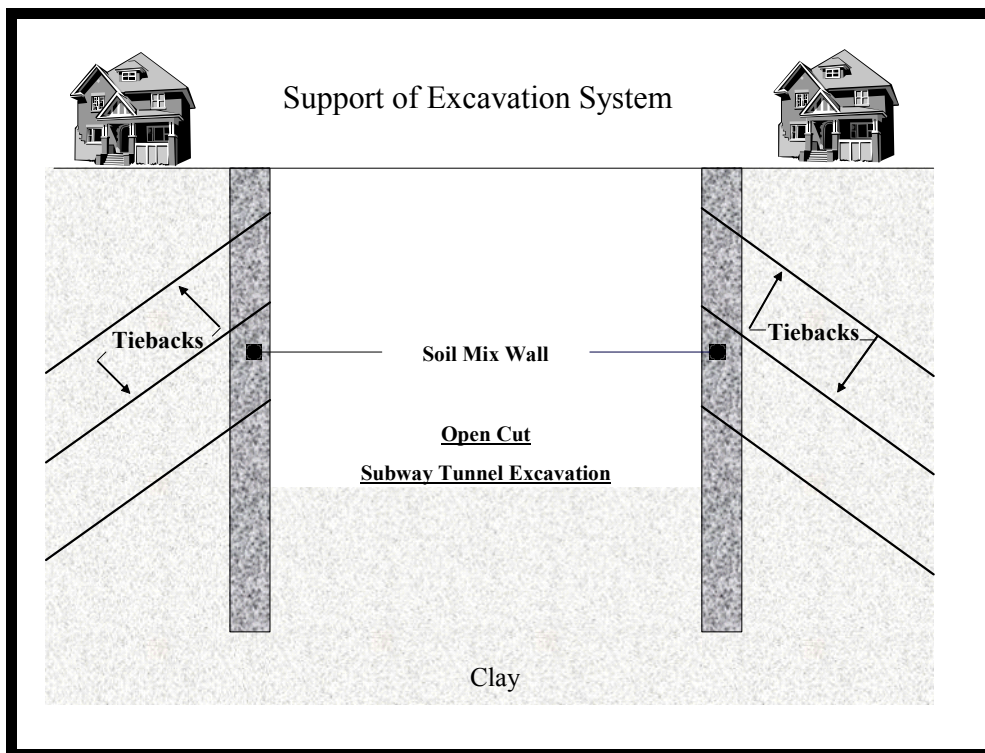
- **PERILS EXCLUDED:** This policy does not insure against loss or damage caused by or resulting from:

“Loss, damage or expense caused by or resulting from subsidence, settling, cracking, shrinkage, bulging or expansion of pavements, foundations, walls, sidewalks, driveways, patios, floors, roofs or ceilings unless such loss results from a peril not excluded in this policy. If loss by a **peril not excluded** ensues, then this Company shall be liable only for such ensuing loss.”

Exceptions Within Latent Defect or Inherent Vice Exclusions

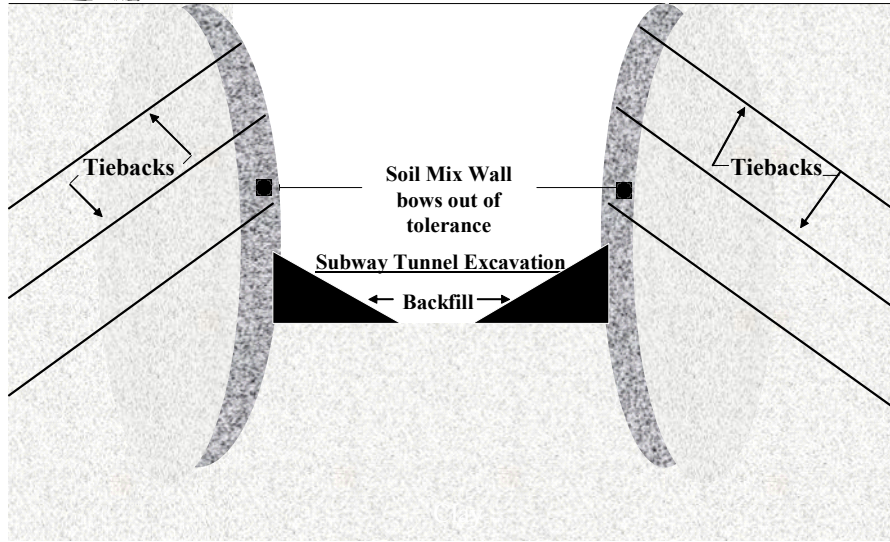
- Latent Defect/Inherent Vice Exclusion “Exception”
 - **PERILS EXCLUDED:** This policy does not insure against loss or damage caused by or resulting from:

“Moth, vermin, termites, or other insects, **inherent vice**, **latent defect**, wear, tear, gradual deterioration, contamination, rust, wet or dry rot, mold, dampness of atmosphere and extremes of temperatures, loss or damage by normal settling, shrinking or expansion of buildings or foundations, **unless direct physical loss or damage ensues** and then the policy will cover for such ensuing loss or damage only.”

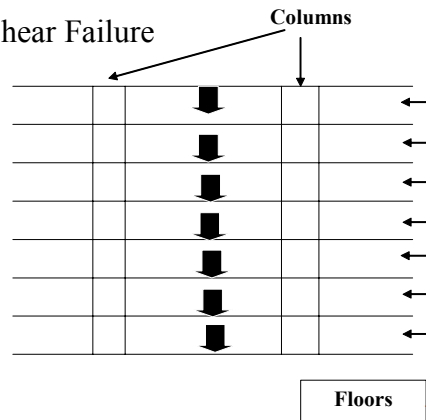
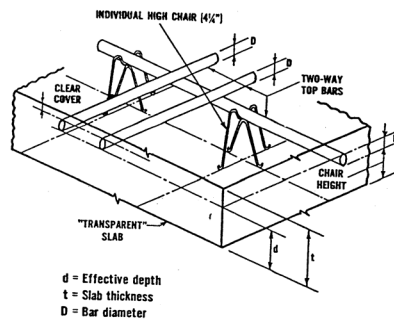




Support of Excavation System

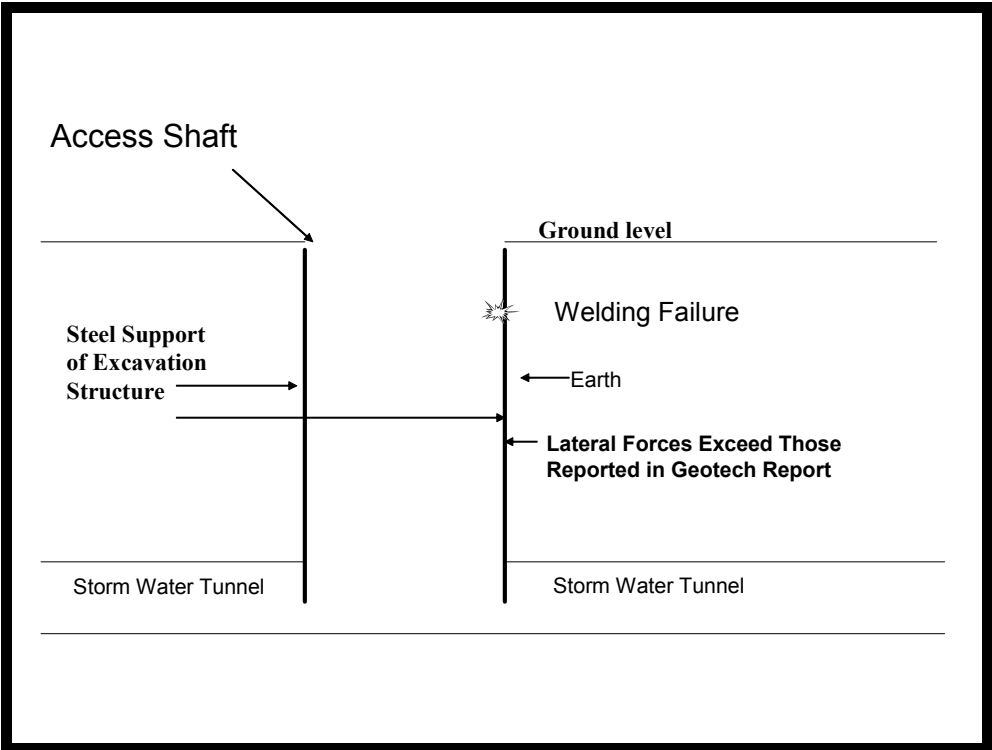
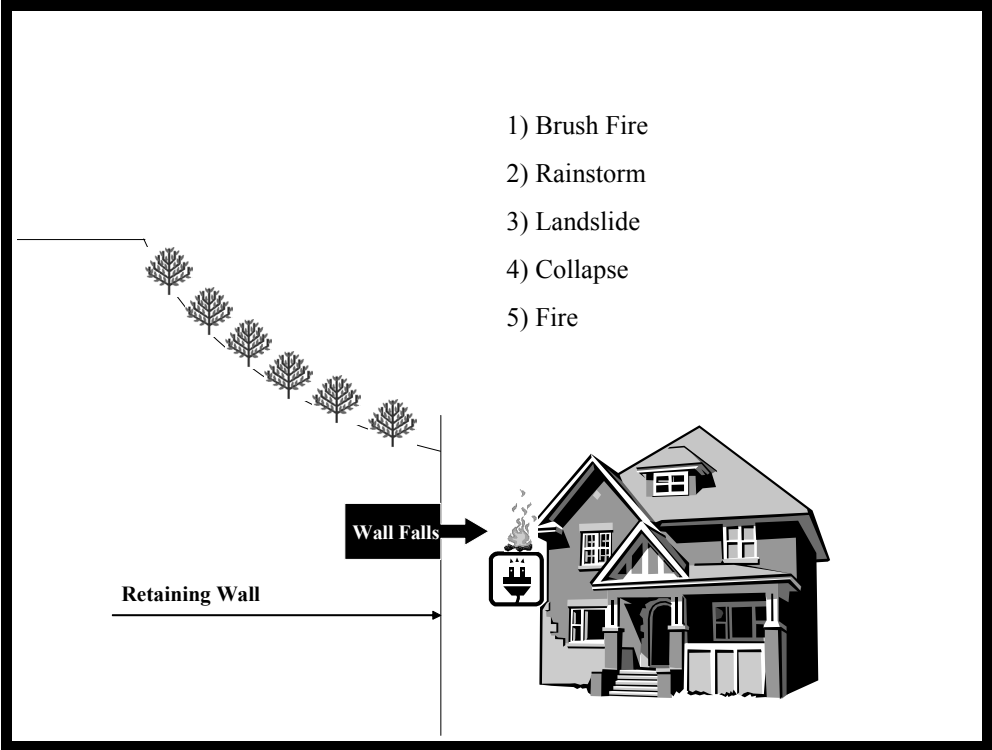


Punching Shear Failure



2 causes for collapse:

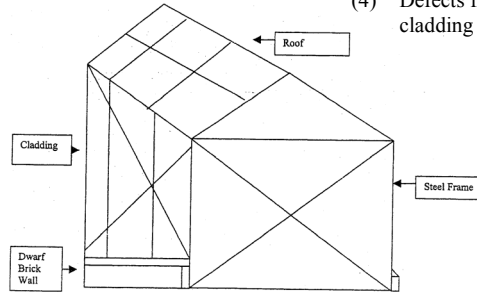
- 8" v. 10" Concrete
- Wrong size high chairs– 1 3/4 vs. 3/4 "cover"



Factual Scenarios:

Steel framed building,
roof completed, steel
frame completed,
cladding partially
completed.

- (1) Bolts used in construction of steel framework are defectively installed and the whole structure collapses, damaging everything.
- (2) Defect found in bolts and fixed without any damage
- (3) Defects found in bolts, and damage to steel frame repaired
- (4) Defects found in bolts, and damage to cladding and roof, repaired.



BUILDERS' RISK COVERAGE FORM

Various provisions in this Coverage Form restrict coverage. Read the entire Coverage Form carefully to determine rights, duties and what is and what is not covered. Throughout this Coverage Form, the words "you" and "your" refer to the Named Insured shown in the Declarations. The words "we", "us" and "our" refer to the Company providing this insurance. Other words and phrases that appear in quotation marks have special meaning. Refer to Section F — DEFINITIONS.

A. COVERAGE

We will pay for "loss" to Covered Property from any of the Covered Causes of Loss.

1. COVERED PROPERTY

Covered Property, as used in this Coverage Form, means:

- (a) structures or buildings described in the Builders' Risk Schedule of Coverages, while under construction, erection or fabrication. The terms structures and buildings include foundations, excavations, grading, filling, additions, attachments, permanent fixtures and materials and supplies which will become a permanent part of the structures or buildings;
- (b) scaffolding, construction forms and temporary structures provided the structures, buildings, scaffolding, construction forms and temporary structures are at the site of the construction location described in the Builders' Risk Schedule of Coverages;
- (c) the materials and supplies which will become a permanent part of structures or buildings when

A. COVERAGE

We will pay for "loss" to Covered Property from any of the Covered Causes of Loss.

- (d) land, including land on which the Covered Property is located;
- (e) machinery, tools and equipment which will not become a permanent part of structures or buildings described in the Builders' Risk Schedule of Coverages;
- (f) property while waterborne, except while in transit in the custody of a carrier for hire;
- (g) automobiles, motor trucks, tractors, motorcycles, trailers and similar conveyances licensed for highway use;
- (h) aircraft and watercraft;
- (i) accounts, bills, currency, deeds, evidence of debts and manuscripts;
- (j) contraband, or property in the course of illegal transportation or trade.

3. COVERED CAUSES OF LOSS

Covered Causes of Loss means risk of direct physical "loss" to Covered Property except those causes of "loss" shown in the Exclusions.

4. COVERAGE EXTENSIONS

- (a) Trees, Shrubs and Plants

3. COVERED CAUSES OF LOSS

Covered Causes of Loss means risk of direct physical "loss" to Covered Property except those causes of "loss" shown in the Exclusions.

BUILDERS' RISK COVERAGE FORM

2. We will not pay for "loss" caused directly or indirectly by any of the following. But if "loss" by a Covered Cause of Loss results, we will pay for the resulting "loss":

a) Faulty, inadequate or defective:

(1) planning, zoning, development, survey, siting;

(2) design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction;

(1) repairing the tearing down of any property, including the cost of removing its debris;

(2) We will not pay for "loss" caused directly or indirectly by any of the following. But if "loss" by a Covered Cause of Loss results, we will pay for the resulting "loss":

a) Faulty, inadequate or defective:

(1) planning, zoning, development, survey, siting;

(2) design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction;

(3) materials used in repair, construction, renovation or remodeling; or

(4) maintenance, of part or all of any property wherever located;

b) wear and tear, gradual deterioration, inherent vice, hidden or latent defect, mold, rot or any quality in property that causes it to damage or destroy itself, freezing or overheating, rust, corrosion or smog;

(3) depreciation, obsolescence or mechanical breakdowns, including rupture or bursting caused by overpressure force;

(4) settling, cracking, shrinking or expansion;

(5) insects, birds, vermin, rodents and other animals;

(6) artificially generated current creating a short circuit or other electrical disturbance;

3. We will not pay for "loss" caused directly or indirectly by any of the following:

(1) dishonest acts by you, anyone else with an interest in the property, your or their employees or authorized representatives or anyone employed with the property, whether or not acting alone or in collusion with other persons occurring during their employment with you. But this exclusion does not apply to a carrier for hire;

(2) rail, ship or shore to property in the open, which is not part of the permanent structure or building, except this exclusion does not apply to property in the custody of bond transportation carriers;

(3) water that leaks or flows from plumbing, heating, air conditioning, fire protective system or other equipment, caused by or resulting from freezing, unless:

(i) you do your best to maintain heat in the structure or building; or

(ii) you drain the equipment and shut off the water supply if the heat is not maintained;

(4) delay, loss of use or market or any other consequential "loss";

(5) unexplained disappearance except of property in the custody of a carrier for hire;

(6) theft;

(7) war;

(8) nuclear energy.

3. We will not pay for "loss" caused directly or indirectly by any of the following:

c) water that leaks or flows from plumbing, heating, air conditioning, fire protective system or other equipment, caused by or resulting from freezing, unless:

(1) you do your best to maintain heat in the structure or building; or

(2) you drain the equipment and shut off the water supply if the heat is not maintained;

BUILDERS' RISK COVERAGE FORM

Various provisions in this Coverage Form restrict coverage. Read the entire Coverage Form carefully to determine rights, duties and what is and what is not covered.

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Other words and phrases that appear in quotation marks have special meaning. Refer to Section F — DEFINITIONS.

A. COVERAGE

We will pay for "loss" to Covered Property from any of the Covered Causes of Loss.

1. COVERED PROPERTY

The most we will pay for "loss" under this Coverage Extension is \$1,000 but not more than \$250 for any one fire, theft or panic.

B. EXCLUSIONS

1. We will not pay for "loss" caused directly or indirectly by any of the following. Such "loss" is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the "loss":

a) **Earth Movement**

"Earth movement". But we will pay for direct physical "loss" caused by resulting fire if the fire would be a Covered Cause of Loss.

This exclusion does not apply to Covered Property in transit.

This exclusion will not apply when a Limit of Insurance is indicated for "earth movement" in the Builders' Risk Schedule of Coverages.

b) **Flood**

"Flood". But we will pay for direct physical "loss" caused by resulting fire, explosion or theft if these would be Covered Causes of Loss.

B. EXCLUSIONS

1. We will not pay for "loss" caused directly or indirectly by any of the following. Such "loss" is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the "loss":

a) **Earth Movement**

"Earth movement". But we will pay for direct physical "loss" caused by resulting fire if the fire would be a Covered Cause of Loss.

This exclusion does not apply to Covered Property in transit.

This exclusion will not apply when a Limit of Insurance is indicated for "earth movement" in the Builders' Risk Schedule of Coverages.

b) **Flood**

"Flood". But we will pay for direct physical "loss" caused by resulting fire, explosion or theft if these would be Covered Causes of Loss.

This exclusion does not apply to Covered Property in transit.

This exclusion shall not apply when a Limit of Insurance is indicated for "flood" in the Builders' Risk Schedule of Coverages.