

SPECIAL BUILDER'S RISK ISSUES

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Douglas L. Patin

It would be folly to undertake [a construction] contract without insurance against any fortuitous loss that might occur by reason of the elements, the negligence of employees . . . 'or from any other cause whatsoever.'

C.H. Leavell & Co. v. Fireman's Fund Ins. Co., 372 F.2d 784, 789 (9th Cir. 1967).

I. NOTICE CLAUSES

Insurance policies generally contain provisions requiring the insured to provide the insurer timely notification of a loss or claim. Courts recognize the utility of these notice provisions and enforce them on the grounds that they permit the insurer to investigate the loss, make a timely assessment of its rights and liabilities, and prevent fraud. *Lee v. Prudential Ins. Co.*, 812 F.2d 1344 (11th Cir. 1987); *Phico Ins. Co. v. Providers Ins. Co.*, 888 F.2d 663 (10th Cir. 1989); *Thomas v. Transamerica Occidental Life Ins. Co.*, 761 F. Supp. 709 (D. Or. 1991); *Allstate Ins. Co. v. Fitzgerald*, 743 F. Supp. 539 (W.D. Tenn. 1990); *State Farm Mut. Auto. Ins. Co. v. Hollingsworth*, 668 F. Supp. 1476 (D. Wyo. 1987); *Hamm v. Ledesma*, 361 S.E.2d 205 (1987).

A. Types of Notice Provisions

(1) Notice of Loss, Claim, Occurrence Requirements

Standard notice provisions require that the insured provide the insurer with notice either "immediately," "promptly," or "as soon as possible." Courts have different requirements for determining whether notice was timely.

Under the traditional view, still followed by a minority of jurisdictions, the insured is required to strictly adhere to a policy's notice requirements, and recovery only will be allowed if the insured provides "reasonable notice" or notice "within a reasonable time." *See, e.g., Lemuel v. Admiral Ins. Co.*, 414 F. Supp. 2d 1037, 1050 (M.D. Ala. 2006) ("Pursuant to Alabama law, when a primary liability insurance policy requires notice 'as soon as practicable' or 'immediately,' the insured is required to give notice 'within a reasonable time' in view of all the facts and circumstances of the case, and the insured's failure to do so releases the insurer from providing coverage"); *Myers v. Cigna Property and Cas. Ins. Co.*, 953 F. Supp. 551, 556 (S.D. N.Y. 1997) (holding that two-month delay between insured's discovery of damage to his yacht and notification to insurer was unreasonable delay under notice of loss provision in property damage provision of marine insurance policy: "New York courts have adhered strictly to prompt notification provisions, even for losses 'which appear insubstantial or which in the insured's estimation may not ultimately ripen into a claim'"); *Bolivar County Bd. Of Supervisors v. Forum Ins. Co.*, 779 F.2d 1081, 1085-86 (5th Cir. 1986) (applying Mississippi law and determining that insured's five month delay in giving notice was inexcusable and that insured could not recover because liability insurance "policy here clearly and expressly provided that the giving of notice 'as soon as practicable' was a condition precedent to

recovery”); *Atlanta Int’l Props., Inc. v. Georgia Underwriting Ass’n*, 256 S.E.2d 472 (Ga. 1979) (stating, in the context of interpreting property damage insurance policy: “It is not contested that failure to comply with notice of loss provisions will . . . be a bar to an action on the policy where such provision is made a condition precedent by the terms of the contract”). These courts characterize notification requirements as contractual requirements which the insured bears the burden of demonstrating. See *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 227 (Colo. 2001) (rejecting this view but recognizing it to be the “traditional approach . . . grounded upon a strict contractual interpretation of insurance policies under which delayed notice was viewed as constituting a breach of contract”). The need for such strict adherence to these requirements is further justified on the basis that prompt notice assists the investigation by the insurer and may prevent fraud or mitigate further loss. *Id.*

The modern view recognizes that the “[i]f the insured violates the notice provision without harming the interests of the insurer – *i.e.* without prejudice – then there is no reason to deny coverage.” *Prince George’s County v. Local Gov’t Ins. Trust*, 879 A.2d 81, 94 n. 9 (Md. 2005) (collecting cases and recognizing that thirty-eight states and two territories require a showing of prejudice to the insurer, while six states and the District of Columbia do not require it); see also, *e.g.*, *Billings Mut. Ins. Co. v. Cameron Mut. Ins. Co.*, 229 S.W.3d 138 (Mo. App. 2007) (“[i]n Missouri, the purpose of notice provisions in insurance policies is to prevent prejudice to the insurer, not to ‘provide a technical escape hatch by which to deny coverage in the absence of prejudice’”); *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 227 (Colo. 2001) (noting that “[f]ew courts today strictly adhere to the traditional approach which allowed for no consideration of insurer prejudice in determining whether benefits should be denied due to noncompliance with an insurance policy’s notice requirements”); *FDIC v. Oldenburg*, 34 F.3d 1529, 1546 (10th Cir. 1994) (“The modern trend is to require insurers to show prejudice in order to avoid policy coverage for noncompliance with certain notice provisions.”); *First Nat’l Bank v. Lustig*, 961 F.2d 1162, 1168 (5th Cir. 1992) (insurer must show that “probable prejudice” to it was caused by the policyholder’s delay); *Winthrop & Weinstine v. Travelers Cas. & Sur. Co.*, 993 F. Supp. 1248, 1256 (D. Minn. 1998) (holding that an insurance company must show it was prejudiced by the policyholder’s delay in giving notice); *Northwood Nursing & Convalescent Home, Inc. v. Continental Ins. Co.*, 902 F. Supp. 79, 84 (E.D. Pa. 1995) (stating that an insurance company must prove that notice was untimely and that it was prejudiced); *Resolution Trust Corp. v. Moskowitz*, 868 F. Supp. 634, 641 (D.N.J. 1994) (requiring an insurance company to prove “appreciable prejudice” before denying a claim based on late notice); *Shields v. National Union Fire Ins. Co. (In re Lloyd Sec., Inc.)*, 153 B.R. 677, 683 (Bankr. E.D. Pa. 1993) (requiring the insurance company to prove that “actual prejudice” took place); *Oritani Sav. & Loan Ass’n v. Fidelity & Deposit Co.*, 744 F. Supp. 1311, 1317 (D.N.J. 1990) (requiring the insurance company to prove that it suffered prejudice due to untimeliness and ruling against an insurance company that did not present evidence of prejudice), *rev’d on other grounds*, 989 F.2d 635 (3d Cir. 1993); *Security Nat’l Bank v. Continental Ins. Co.*, 586 F. Supp. 139, 150 (D. Kan. 1982) (requiring showing of prejudice); *National Union Fire Ins. Co. v. FDIC*, 957 P.2d 357, 359 (Kan. 1998) (requiring an insurance company to prove that late submission of notice caused it “substantial prejudice”); *Downey Sav. & Loan Ass’n v. Ohio Cas. Ins. Co.*, 234 Cal. Rptr. 835, 843 (Cal. Ct. App. 1987) (requiring the insurance company to prove that it was “substantially prejudiced” by the delay).

In some states, the standard is determined by statute. The Maryland insurance code, for example, requires “actual prejudice” established by a preponderance of evidence. *See St. Paul Fire & Marine Ins., Co. v. House*, 533 A.2d 301, 302 (Md. App. 1987) (citing MD ANN. Code art. 48A § 482) (now MD Code, Insurance § 19-110).

(a) Notice-Prejudice Rule

The requirement that an insurer be able to demonstrate prejudice attributable to the insured’s late notice in order to avoid its potential defense and indemnity obligations is known as the “notice-prejudice rule.” In *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 198 (Pa. 1977), the court identified two rationales for application of the notice-prejudice rule: (i) protection of the consumer from contracts of adhesion; and (ii) avoidance of a forfeiture of coverage absent prejudice.

The notice-prejudice rule applies to an “occurrence” policy and not a “claims made” policy. Builder’s risk insurance policies almost always are “occurrence” policies. An “occurrence” policy provides coverage if the event insured against (“physical loss or damage” in a builder’s risk policy) takes place within the policy period, regardless of the date of discovery, or when the injured or damaged party sues the insured. *See Titan Indem. Co. v. Williams*, 743 So. 2d 1020, 1024 (Miss. Ct. App. 1999); *Employers Reinsurance Corp. v. Landmark*, 547 N.W.2d 527, 531 (N.D. 1996). A “claims made” policy provides coverage only if the third-party’s claim against the insured is made during the policy period. *See Lexington Ins. Co. v. St. Louis Univ.*, 88 F.3d 632, 633-34 (8th Cir. 1996); *Landmark*, 547 N.W.2d at 531. Though both types of policies include notice requirements, with a claims made policy the notice requirement “defines the limit of the insurer’s obligation.” *Lexington*, 88 F.3d at 634. Because the notice requirement defines the “scope of coverage under a claims made policy, to excuse a delay in notice beyond the policy period would alter a basic term of the insurance contract.” *Ins. Placements, Inc. v. Utica Mut. Ins. Co.*, 917 S.W.2d 592, 597 (Mo. Ct. App. 1996). Accordingly, an insurer that issues a claims made policy does not have to prove prejudice attributable to the insured’s failure to give notice during the policy period in order to deny coverage. *See id.*

The burden of demonstrating prejudice has frequently been placed upon the insurer. Four rationales have been given for this: (1) it is more equitable for the insurer to bear the burden because it is the insurer who seeks to disclaim coverage; (2) it is more difficult for the insured to prove a negative, that there was not prejudice, than for the insurer to prove a positive, that there was prejudice; (3) the insurer is in a better position to produce evidence that it suffered prejudice; and (4) shifting the burden to the insurer encourages the insurer to undertake a timely investigation. *Prince George’s County v. Local Gov’t Ins. Trust*, 879 A.2d 81, 97 (Md. 2005); *see also, e.g., Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 230 (Colo. 2001) (noting that a majority of courts place the burden of proof on the insurer to prove prejudice).

In a few jurisdictions, the burden of showing prejudice is placed on the insured on the grounds that it is the insured “who is seeking to be excused from the consequences of a contract provision with which he has concededly failed to comply.” *Aetna Cas. and Sur. Co. v. Murphy*, 538 A.2d 219, 224 (Conn. 1988) (collecting cases); *see also, e.g., Atlantic Mut. Ins. Companies v. Lotz*, 384 F. Supp. 2d 1292, 1298 (E.D. Wis. 2005) (considering burden under all-risk policy

and stating that “[u]nder Wisconsin law, once insured’s lack of timely notice of claim has been demonstrated, insured must produce sufficient evidence to satisfy fact finder by preponderance of evidence that no prejudice has been suffered by the insurer as a result of insured’s failure”). Additionally, the ability of the insured to invoke the notice-prejudice rule may be dependent upon the insured demonstrating good faith in efforts to notify the insurer of a loss or claim. *South Carolina Ins. Co. v. Hallmark Enters.*, 364 S.E.2d 678 (N.C. 1988).

(2) Proof of Loss Requirements

Typically, the insured is required to provide the insurance company with a proof of loss statement detailing the nature and extent of the insured’s loss. The proof of loss statement has a similar purpose to that of notice (i.e., enabling the insurer to protect its interests). Many policies require that a proof of loss be filed within a certain number of days (e.g., 60 days) after the loss. However, like notice, even if a policyholder fails to timely submit a proof of loss, the majority of jurisdictions will allow the policyholder to recover as long as the insurer was not prejudiced by the delay. This is because the two types of provisions have the same purpose; i.e. “to allow the insurer to form an intelligent estimate of its rights and liabilities, to afford it an opportunity for investigation, and to prevent fraud and imposition upon it reason that the requirement of prejudice notice and loss provisions have the same purpose.” *Perry v. Middle Atlantic Lumbermens Ass’n*, 542 A.2d 81 (Pa. 1988). Accordingly, courts in these jurisdictions reason that “[s]ince the purpose of the proof of loss provision, like the notice provision, is to enable the insurance company to investigate and pay the claim without prejudice, it only makes sense to require the insurance company to prove prejudice before denying coverage based on the late filing of a proof of loss.” *Resolution Trust Corp. v. Moskowitz*, 868 F. Supp. 634, 638-40 (D. N.J. 1994); *see also, e.g., Nathe Bros, Inc. v. American Nat. Fire Ins. Co.*, 615 N.W.2d 341, 348-89 (Minn. 2000) (“the failure to submit a sworn proof of loss in a timely manner will not necessarily bar recovery on a policy, absent specific policy language stating that failure to timely submit a sworn proof of loss will be fatal to the rights of the insured or that the submission of a sworn proof of loss is a condition precedent to the liability of the insurer”); *Smith v. North Carolina Farm Bureau Mut. Ins. Co.*, 361 S.E.2d 571, 575 (N.C. 1987) (requiring prejudice “because these statutory policy provisions are designed to allow the insurance company to investigate the nature and cause of the loss so as to protect its interests”) *Federal Deposit Ins. Corp. v. Aetna Cas. And Sur. Co.*, 744 F. Supp. 729, 734 (E.D. La. 1990) (“time limits on notice or proof of loss provisions are generally valid. . . [but] a default of any notice provision in an insurance contract can void coverage only if the insurer proves that it was actually prejudiced by the lapse”).

In some jurisdictions, an insured’s non-compliance with the condition that the insured file a proof of loss may preclude recovery regardless of whether the insured submitted timely notice and regardless of whether the non-compliance was prejudicial to the insurer. Courts in these jurisdictions reason that notice and proof of loss requirements are separate and distinct obligations, each of which an insured must comply with before being allowed to recover. *See, e.g., Hunter v. Fireman’s Fund Ins. Co.*, 448 F.2d 805 (10th Cir. 1971) (“though notice of claim and proof of loss have similarities, the two are distinct and the fact that notice may have been given does not dispense with the requirement of furnishing formal proof of loss”); *Himelfarb v. Hartford Fire Ins. Co.*, 718 A.2d 693, 697 (Md. App. 1998), *aff’d* 736 A.2d 295 (1999) (in Maryland, prejudice need not be shown to deny coverage based on the failure to timely provide

a proof of loss, even though actual prejudice must be shown before an insurer can properly deny coverage based on untimely notice: “The requirements of notice and proof of loss contained in insurance policies are two different things”).

Courts are split as to whether a fraudulent proof of loss claim prevents the insured from recovery or only prevents the insured from recovering insurance with regard to the fraudulent claim. *Johnson v. South State Ins. Co.*, 341 S.E.2d 793, 794-95 (S.C. 1986) (precluding recovery only as to subject of fraudulent submission and noting that the “overwhelming majority of jurisdictions hold that any fraud or misrepresentation as to any portion of property under an insurance policy voids the entire policy”). *Contra, e.g., Webb v. American Family Mut. Ins. Co.*, 493 N.W.2d 808, 811-12 (Iowa 1992) (insured would lose all coverage if guilty of fraudulently stating the amount of its loss, even though the fraudulent portion of the claim was in excess of the policy limit); *Patterson v. State Auto. Mut. Ins. Co.*, 105 F.3d 1251, 1253 (8th Cir. 1997) (Missouri law) (misrepresentation as to one of several types of coverage provided by policy allowed insurer totally to deny coverage).

II. STATUTES OF LIMITATIONS

A. Enforceability of Shorter Statute of Limitations Provisions in Policies

Insurance policies include limitations provisions setting forth what an insured needs to do if coverage is denied and the insured believes the denial to be improper. These limitations provisions typically provide that for an insured to bring an action or proceeding against the insurer to recover for damage, the insured must do so within a set period of time (*e.g.*, one year), unless a longer period of time is provided by state statute. Insureds have argued that such limitations periods are not applicable because insurance policies are contracts of insurance, and state statutes of limitations governing contract actions provide for longer periods of time than the typical one year limitations period.

For example, in *Wabash Power Equipment Co. v. International Insurance Co.*, 540 N.E.2d 960 (Ill. App. 1989), the limitations provision required an insured to file suit within one year, ““unless a longer period [was] provided by applicable statute’.” In rejecting the contention that this language referred to the statute of limitations on contract actions in general, the court reasoned that if it adopted that interpretation the one-year limitations provision would be meaningless. The court declined to construe the policy in such a matter and held that the insured’s failure to bring suit within one year of the date of the theft of the insured’s equipment acted to bar recovery under the policy. Similarly, in *Bargaintown, D.C., Inc. v. Bellefonte Insurance Co.*, 426 N.E.2d 469, 470 (N.Y. 1981), the Court of Appeals of New York refused to read the phrase ““unless a longer period of time is provided by applicable statute”” as referring to that state’s statute of limitations on contract actions in general, which was six years. Like the *Wabash* court, the *Bargaintown* court reasoned that to do so would render meaningless a one-year limitation contained in the parties’ all-risk insurance policy. And, like the *Wabash* court, the *Bargaintown* court refused to read the policy in such a way because “to do so would necessarily be to ascribe to the parties an intention to include a wholly meaningless reference to a one-year period of limitation.” *Id.* at 470.

Similarly, in *Graingrowers Warehouse Co. v. Central National Insurance Co. of*

Omaha, Nebraska, 711 F. Supp. 1040, 1045 (E.D. Wash. 1989), the court rejected the argument that the phrase ““unless a longer period of time is provided by applicable statute”” referred to the general contract statute of limitations. The court reasoned that no reasonable consumer could interpret that phrase as referencing the general statute; instead, “upon reading the insurance contract[] as a whole, an average person purchasing insurance would conclude that the one-year limitation provisions in the policies control unless a particular [state] statute invalidated such a provision and required a longer limitations period.” *Graingrowers Warehouse*, 711 F. Supp. at 1045; *see also Atwood v. St. Paul Fire and Marine Ins. Co.*, 845 N.E.2d 68 (Ill. App. Ct. 2006) (“state law” as used in policy limitations period requiring insurer to conform to state law if it provided more than one year to bring suit did not refer to statute of limitations applicable to contract actions in general); *United Technologies Automotive Systems, Inc. v. Affiliated FM Insurance Co.*, 725 N.E.2d 871, 874 n. 5 (Ind. App. 2000) (provision in insurance policy providing one year to file suit unless state law provided more time did not refer to statute of limitations on contract actions in general); *Salcedo v. John Hancock Mutual Life Insurance Co.*, 38 F. Supp. 2d 37, 41-42 (D. Mass. 1998) (provision in insurance policy providing that suits must be commenced within three years unless state law required more time did not refer to statute of limitations on contract actions in general); *Villa Clement, Inc. v. National Union Fire Insurance Co. of Pittsburgh*, 353 N.W.2d 369, 370 (Wis. Ct. App. 1984) (provision in insurance policy providing one year to file suit unless state law provided more time did not refer to statute of limitations on contract actions in general); *Green v. John Hancock Mutual Life Insurance Co.*, 601 S.W.2d 612, 613-14 (Ky. Ct. App. 1980) (provision in insurance policy providing that actions must be commenced within three years unless state law required more time did not refer to statute of limitations on contract actions in general).

But some jurisdictions hold otherwise. In *Queen Tufting Co. v. Fireman's Fund Insurance Co.*, 239 S.E.2d 27, 28 (Ga. 1977), the court, without explanation, determined that the phrase “unless a longer period of time is provided by applicable statute” referred to the statute of limitations on contract actions in general. The court, therefore, allowed the insured to recover for loss of yarn due to theft because the claim was brought within the longer statutory period. *Id.*; *see also General Instrument Corp. v. American Home Assurance Co.*, 397 F. Supp. 1074 (E.D. Pa. 1975) (finding that provision establishing a twelve-month limitations period “unless a longer period of time is provided by applicable statute” was ambiguous and holding that, on the construction most favorable to the insured, Pennsylvania’s six-year statute of limitations for contract actions took precedence over the contractual limitation).

B. Waiver Issues

An insured can attempt to avoid having a lawsuit against the insurer barred by a contractual limitations period by demonstrating that the insurer waived the limitations provision, or should be otherwise estopped from relying on it. Although the doctrines of waiver and estoppel are distinct, both doctrines frequently are based upon the same or similar statements or conduct.

A waiver will be present if the insurance company's conduct showed an intentional relinquishment of its right to assert the limitations period. *See, e.g., Hounshell v. American States Ins. Co.*, 424 N.E.2d 311 (Ohio 1981) (finding waiver because “by making these settlement offers, [insurer] waived its right to assert the one-year limitation of action defense

contained in the policy of insurance”); *Insurance Co. of North America v. Board of Ed. of Independent School Dist. No. 12, Texas County, Okl.*, 196 F.2d 901 (10th Cir. 1952) (by continuing to negotiate with insured for settlement of claim, insurer waived right to argue that insured’s claim was untimely because not brought within one year period stipulated in policy); *O’Brien v. Country Mut. Ins. Co.*, 245 N.E.2d 30 (Ill. App. Ct. 1969) (“When an insurance company, by holding out reasonable hope of adjustment, deters an insured from bringing suit within the time limits of the policy, such limitation is thereby waived. . . . Once the insurer waives the policy limitation provision, the limitation cannot be revived and the case will be barred only by the regular statutory limitation”).

An estoppel will be present if the insured can prove (a) having been in some manner misled by the acts or statements of the company or its agents, (b) reliance on that conduct in failing timely to file suit, and (c) that such reliance was reasonable. *See, e.g., North American Foreign Trading Corp., v. Mitsui Sumitomo Ins. USA, Inc.*, 477 F. Supp. 2d 576, 586 (S.D. N.Y. 2006) (insurer “lulled” insured into delaying filing of its suit and thus was estopped from asserting limitations defense where, in response to inquiry regarding status of its claim, insurer’s claims manager stated that he was awaiting investigator’s report and would update it soon, even though manager had already received draft report, forwarded it to counsel for coverage opinion, and requested authority to deny claim); *Northern Petrochemical Co. v. U.S. Fire Ins. Co.*, 277 N.W.2d 408 (Minn. 1979) (finding that general contractor’s assurance to owner that claim for water damage need not be processed until initial litigation determined cause of damage, was “a sufficient representation, based on the words and the conduct of defendant, for estoppel” to be imputed to the contractor’s insurer); *Asher v. Reliance Ins. Co.*, 308 F. Supp. 847, 849, 853 (N.D. Cal. 1970) (Alaska law) (because of their repeated promises to pay the insured, the insurer could not avail himself of the defense of a policy time limitation on suit); *Lee v. Safeco Ins. Co.*, 241 S.E.2d 627, 629 (Ga. 1978) (insurer company could not assert limitations defense as to portion of a claim that it promised to pay: “the insurance company promised to pay certain amounts to the insured and insofar as these amounts constitute any part of the amount sought by the plaintiff they would not be barred by the one-year statute of limitation”); *Shea North, Inc. v. Ohio Cas. Ins. Co.*, 564 P.2d 1263, 1265 (Az. Ct. App. 1977) (denying insurer’s motion for summary judgment on limitations defense because there was an issue of fact as to whether insured believed, based on insurer’s promise of payment and failure to deny liability until after limitation period, that its insurance claims would be adjusted without the necessity of resorting to the courts).

With respect to whether settlement negotiations are sufficient to justify waiver or estoppel, courts have held that it is not necessary to show that the insurer intended to mislead the insured about the possibility of settlement; rather, the insured’s belief that the claim would be settled must be reasonable. *See, e.g., Dickman v. Prudential Prop. & Cas. Ins. Co.*, 623 N.E.2d 240, 241 (Ohio App. 1993) (“mere negotiation or discussion concerning liability of an insurance company under the policy would not be sufficient action to constitute waiver”); *Broadview Sav. & Loan Co. v. Buckeye Union Ins. Co.*, 434 N.E.2d 1092, 1095 (1982) (“where . . . adjuster was attempting to gather information for consideration of the claim, and where no settlement offers were made or any assurances made with respect to the likelihood of future settlement offers, there is no basis for an estoppel of the insurance company’s right to enforce the suit limitation provision”). Additionally, the fact that settlement negotiations are ongoing

between the insurer and the insured typically will be a sufficient basis for invoking waiver or estoppel if the insurer allows the negotiations to continue past or very close to the expiration of the limitations period. *See, e.g., Forrester v. Aetna Cas. and Sur. Co.*, 478 F. Supp. 42, 44 (N.D. Ga. 1979) (jury may find an implied waiver whenever there are settlement discussions and the insurer does not unconditionally deny coverage prior to expiration of the limitations period); *Shea North, Inc. v. Ohio Cas. Ins. Co.*, 564 P.2d 1263, 1265 (Ariz. Ct. App. 1977) (“Negotiation alone is insufficient to support a finding of waiver or estoppel if it is terminated within adequate time for the insured to institute action on the policy”); *Scheetz v. IMT Ins. Co.*, 324 N.W.2d 302, 304 (Iowa 1982) (“It is clear to us as a matter of law . . . than when IMT carried the negotiations through the end of the twelve-month period it could have had no other intent than to relinquish its contractual right to limit suits to that period”). *But see Gilbert Frank Corp. v. Federal Ins. Co.*, 520 N.E.2d 512, 514 (N.Y. 1988) (“communications or settlement negotiations between an insured and its insurer either before or after expiration of a limitations period contained in a policy is not, without more, sufficient to prove waiver or estoppel”).

III. STANDARD STATUTORY FIRE PROVISIONS CONFLICTING WITH BUILDER’S RISK POLICY PROVISIONS

Fire damage is one of the two earliest risks for which insurance was offered. The other risk was loss of cargo at sea. Out of marine insurance evolved “inland marine insurance” and, ultimately, builder’s risk insurance. Out of fire insurance evolved “all risks” property coverage and statutory fire policy provisions. *See Hunt Const. Group, Inc. v. Allianz Global Risks U.S. Ins. Co.*, ___ F.3d ___, 2007 WL 2822385 (7th Cir. Oct. 1, 2007). Statutory fire policy provisions have been adopted in many states. Such provisions typically carry limitations periods that are shorter than those usually applicable to contract actions for which no other limitations period governs. The language contained in these statutory provisions typically includes words to the effect that:

“An action must be commenced within 1 year after the loss or within the time period specified in the policy, whichever is longer.”

M.C.L.A. § 500.2833 (1)(q). Courts have had difficulty reconciling these statutory provisions with builder’s risk policies.

Some courts maintain that statutory fire policy provisions only apply to fire losses, and not non-fire losses. Recently, the Seventh Circuit held that a builder’s risk policy does not constitute “fire insurance” under Michigan law and, therefore, the state’s statutory fire provision and limitations period did not apply to a construction company’s attempt to recover under a builder’s risk policy for liquidated damages it had to pay the owner as a result of delay caused by excessive rain. *Hunt Const. Group, Inc. v. Allianz Global Risks U.S. Ins. Co.*, *supra*. Hunt contracted to build a major terminal facility at the Detroit airport. Heavy rainfall delayed construction, which forced Hunt to pay penalties and incur other losses on the project. The company asked its builder’s risk carrier, Allianz, to pay for the damages, but Allianz refused. Hunt sued, and Allianz prevailed in the district court by arguing that because the policy included coverage for losses from fire, the one-year limitations period applied to Hunt’s claim for construction delays. The Seventh Circuit, per Judge Posner, reversed and held that Hunt’s

claim was not an action governed by the statutory fire insurance provisions, even though the policy covered fire damage. In reaching this decision, the Court of Appeals traced the origins of builder's risk insurance to coverage for cargo losses at sea. The Court explained that coverage for cargo losses at sea evolved into "inland marine" insurance, at first for cargo traveling over land, and then into protection against losses to building projects, and finally to construction sites which constitute a "terminus for cargo" consisting of bricks, mortar, and other construction materials. While builder's risk insurance evolved from the need to insure against the loss of cargo at sea, fire damage originally was a separate risk for which insurance was offered. Out of fire insurance evolved "all risks" property coverage, such as homeowner policies. Given the evolution of these two lines of insurance, the Court concluded that Michigan did not intend the shorter limitations period for "fire insurance" to apply to insurance policies that grew out of the "coverage for sea cargo" line of insurance. The Court reversed the decision of the district court and remanded the case for further proceedings consistent with its opinion.

In *Henning Nelson Const. Co. v. Fireman's Fund American Life Ins. Co.*, 383 N.W.2d 645 (Minn. 1986), the Supreme Court of Minnesota held that the provisions of Minnesota's Standard Fire Insurance Policy applied only to fire losses, and not nonfire losses, under an all risk insurance policy. The statute at issue in *Henning* provided, in part:

Any policy or contract otherwise subject to the provisions of this subdivision * * * which includes * * * coverage against the peril of fire and coverage against other perils may be issued without incorporating the exact language of the Minnesota Standard Fire Insurance Policy, provided: Such policy or contract shall, *with respect to the peril of fire*, afford the insured all the rights and benefits of the [Standard Policy] * * *.

Id. at 651 n. 8 The court reasoned that this language demonstrated that the statutory policy provisions were meant to apply only to fire losses, even though the policy in question may cover other risks. *Id.*

Other courts have held that statutory fire policy limitations provisions do apply to risks, other than fire, contained in all risk policies. In *Hitt Contracting, Inc. v. Industrial Risk Insurers*, 516 S.E.2d 216 (Va. 1999), the court held that a two-year limitations period required by statute under Virginia law in a standard fire insurance policy applied to a suit to recover the replacement cost of a non-fire loss under an all risk policy which covered additional perils and provided for liability on a basis other than actual cash value. The policy in *Hitt* included an endorsement for replacement cost allowing for recovery of expenses incurred up to two years after the loss. The insureds argued that the two-year limitations period required by statute did not apply to their claims under the endorsement because the endorsement constituted additional coverage separate and broader than the standard fire insurance policy. Instead, argued the insureds, the five-year limitations period specified by Virginia statute for breach of contract actions governed. The court rejected the insureds' argument reasoning that there was nothing about the all risk policy's coverage that removed it from the mandatory statutory limitations period.

Also, in *Villa Clement, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 353 N.W.2d

369 (Wis. Ct. App. 1984), the court held that the all risk policy, which insured against “all risks of direct physical loss of or damage to the property insured from any external cause, subject to the exclusions, limitations, terms and conditions of this policy” and expressly included fire as peril insured against, was governed by the one-year limitations period set forth in the Wisconsin statute for actions on policies of fire insurance. In reaching its decision, the court reasoned that the Wisconsin state legislature was aware, when it enacted the statute, that “‘fire insurance’ had been treated in prior statutes and case law as a generic term for property indemnity insurance covering a broad spectrum of perils.”

IV. WAIVER OF SUBROGATION RIGHTS

Many construction contracts contain a waiver of subrogation clause with respect to property damages covered by the project’s property insurance. The purpose of a waiver of subrogation clause in construction contracts is to avoid disruptions and disputes among the parties working on a project. *Commercial Union Ins. v. Bituminous Casualty Corp.* 851 F.2d 98, 101 (3d Cir. 1988). The clause is also meant to require a party to the contract to provide property insurance for all the parties. *Industrial Risk v. Garlock Equip.*, 576 So.2d 652, 656 (Ala. 1991). One example of a waiver of subrogation clause is the AIA Document A201 General Conditions, Paragraph 11.4.7, which states:

The Owner and Contractor waive all rights against (1) each other and their subcontractors, sub-subcontractors, agents and employees, each of the other . . . for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Paragraph 11.4 or other property insurance applicable to the Work

1997 Edition (the 2007 edition of AIA Document A201 is scheduled to be released November 5, 2007; it is not expected that the language of this provision will be substantively different from the 1997 edition). Various versions of this provision have been relied upon to deny builder’s risk carriers’ subrogation claims against negligent contractors or subcontractors. *See, e.g., Richmond Steel, Inc. v. Legal & Gen. Assur. Soc’y, Ltd.*, 821 F. Supp. 793, 798 (D.P.R. 1993) (where general contractor waived, in provision of construction contract, its rights against subcontractor to extent that general contractor’s losses were covered by insurance, insurer of general contractor could not bring subrogation claim against subcontractor); *Tokio Marine & Fire Ins. Co. v. Employers Ins.*, 786 F.2d 101 (2d Cir. 1986) (liability for water damage to Florida construction project was covered by property policy purchased by general contractor containing “waiver of subrogation provision”, rather than by liability policy purchased by subcontractor, regarding injuries to third parties arising from construction project); *E.C. Long, Inc. v. Brennan’s of Atlanta, Inc.*, 252 S.E.2d 642 (Ga. App. 1979) (“an insurer may not insure an insured against a peril for a premium, and when the loss occurs pay the insured, take subrogation, and then sue the insured on the basis that his negligence caused the damage. . . . In the same manner where there are two co-insureds, and the insurer pays one insured the amount claimed as damages, ‘(n)o right of subrogation arises against a person who holds the status of an additional insured . . .’).

In *Intergovernmental Risk Mgt. v. O’Donnell, Wicklund, Pigozzi & Peterson Architects*,

Inc., 692 N.E.2d 739 (Ill. App. Ct. 1998), the court addressed a situation where a fire destroyed a portion of the project that had been completed. The contracts between the owner and the architects and between the owner and the contractor contained waiver of subrogation clauses. The contract also required the owner to purchase insurance to cover the project until “final payment” which was to be made after completion and certification by the architect. During construction, a completed portion of the project was destroyed by fire. The owner’s insurers paid for the damages and then sued the architect and other contractors for negligence. The appellate court affirmed the trial court’s determination that the subrogation claim was barred by the waivers in the contracts. The court rejected the insurers’ argument that because that portion of the project had been completed at the time of the loss, the waiver did not apply. 692 N.E.2d at 744.

In another case, *Travelers Indem. Co. of Conn. V. Losco Group, Inc.*, 136 F. Supp. 2d 253 (S.D.N.Y. 2001), an owner had hired an architect to construct a school gymnasium. During construction, part of the roof collapsed. The contract between the owner and the architect contained a provision that waived subrogation rights as they related to the property insurance. The owner brought a suit against the architect, claiming gross negligence and breach of contract. The court held that owner could not pursue the breach of contract claim because it was related to the property insurance, and thus encompassed in the waiver of subrogation clause. However, the owner could pursue the gross negligence claim against the architect, because that claim fell outside of the scope of property insurance and the waiver of subrogation clause.

The opposite result was reached in *Behr v. Hook*, 787 A.2d 499 (Vt. 2001), where the court ruled that a waiver of subrogation clause did not violate public policy when applied to claims for gross negligence. In addition, the waiver applied even if the general contractor failed to obtain a written waiver from the negligent subcontractors causing the damage. No such condition precedent existed in the standard AIA waiver of subrogation clause.

Additionally, if a builder’s risk policy covers two or more parties against property damage (i.e., co-insureds) and one of the co-insureds causes damage to another co-insured’s property, the insurer may not subrogate to the rights of the damaged co-insured and sue the co-insured who caused the damage. An insurer may not sue its own insured. *Richmond Steel, Inc. v. Legal & Gen. Assur. Soc’y, Ltd.*, 821 F. Supp. 793, 798 (D.P.R. 1993) (“[a]n insurer has no right of subrogation against an insured, even if the insured’s protection is indirect”). Thus, a contractor’s insurer may not subrogate to the contractor’s rights and sue a subcontractor for damage caused by the subcontractor where the subcontractor is a co-insured under the builder’s risk policy. *Frank Briscoe Co. v. Georgia Sprinkler Co.*, 713 F.2d 1500 (11th Cir. 1983) (“[s]ubrogation does not arise, however, in favor of the insurer against its insured since by definition subrogation arises only with respect to the rights of the insured against third persons to whom the insurer owes no duty”). The same principle applies to an owner’s insurer suing a co-insured contractor, *Glen Falls Ins. Co v. Globe Indem. Co.*, 38 So. 2d 139 (La. 1948)) or an owner suing a co-insured subcontractor, *1700 Lincoln Ltd. v. Denver Marble & Tile Co.*, 741 P.2d 1270 (Colo. App. 1987). This rule applies whether the insurer sues the co-insured directly, or where the insurer issues a loan receipt. *E.C. Long, Inc. v. Brennan’s of Atlanta, Inc.*, 252 S.E.2d 642 (Ga. App. 1979) (insurers could not be permitted to sue contractor indirectly by

issuing drafts and requiring owner to sign “loan receipt” directing it to sue contractor and remit the funds to the insurers).

In *Loverde v. Building Management, Inc.*, 2006 WL 1994576 (Va. Cir. Ct. June 27, 2006), plaintiff Loverde contracted with a contractor, Chamberlain Construction Corporation, to build an addition to a school. The conditions of the contract required Loverde to purchase and maintain builder’s risk insurance, with the explicit purpose of protecting the “interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Work.” The contractor entered into a subcontract with Building Management, Inc., and subsequently Building Management, Inc. subcontracted with an engineering firm. A portion of the roof on the addition collapsed and Loverde brought a breach of contract claim against Building Management. Cross-claims and counterclaims were filed by the parties, including a counterclaim that Loverde filed against Chamberlain which included a breach of contract claim. The court held that the breach of contract claim was barred by the contractual provision that required Loverde to purchase and maintain builder’s risk insurance. In reaching this conclusion, the court relied on a previous decision of the Virginia Supreme Court which held that where “a plaintiff has contracted to protect the defendant from a loss by procuring insurance, the plaintiff (or his subrogee) may not recover for that loss from the defendant even if the loss is caused by the defendant’s negligence”. *Id.* at *2 (quoting *Walker v. Vanderpool*, 302 S.E.2d 669, 672 (Va. 1983)). One argument posed by Loverde in support of its breach of contract claim was that the parties struck the waiver of subrogation provision in the contract, thereby giving Loverde the right to recover from Chamberlain. According to the court this made no difference: “Plaintiff contracted to protect the Owner, Contractor, Subcontractors and Sub-subcontractors by procuring insurance; therefore, it is the Court’s belief that the deletion of the waiver of subrogation provision has no effect on the issue of insurance and the Plaintiff may not recover for losses that would be covered by that insurance as to the work which is the subject of the Contract.” *Id.*

Similarly, in *Indiana Insurance Co. v. Carnegie Construction, Inc.*, 661 N.E.2d 776 (Ohio 1995) the contract between the owner and general contractor required the owner to procure builder’s risk insurance for the owner and contractor. This agreement shifted the risk of loss from the contractor to the insurer. While there was no explicit waiver of subrogation, the waiver was implicit in the prime contract. Since the owner contractually waived its right to sue the contractor for the loss, the insurer, as a subrogee, cannot succeed to rights greater than the owner.

A federal district court held that a builder’s risk insurer is prohibited from bringing a subrogation claim against an additional insured party, when the additional insured allegedly caused a fire which damaged the insured property. *General Elec. Co. v. Zurich-American Ins. Co.*, 952 F. Supp. 18 (D. Me. 1996). Alternative Energy, Inc. (AEI) obtained builder’s risk insurance from Zurich-American Insurance Co. for several wood-fired electric generating plants that it was having built. General Electric (GE) contracted to sell and install steam turbines at each plant. GE’s alleged negligent installation of the steam turbines caused a fire at one of the plants. Under the builder’s risk insurance agreement, GE was listed as an additional insured party which gave it an insurable interest in the property. The court found it significant that the policy did not exclude damages caused by negligence or defective workmanship. It followed

the definition of insurable interest under the Maine statute: “any actual, lawful, and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction, or pecuniary damage or impairment. Me. Rev. Stat. Ann. Tit. 24-A, § 2406(2). The court stated that it “is satisfied that an insured’s interest in being held free from any liability arising out of its involvement in a construction project is indeed a substantial economic interest of the kind referred to in the statute.” *General Elec. Co.*, 952 F. Supp. at 21.

In *Best Friends Pet Care, Inc. v. Design Leaned, Inc.*, 823 A.2d 329 (Conn. 2003), a property owner brought a subrogation action for the benefit of its insurer against a subcontractor on a construction project, alleging negligence relating to a fire which resulted in property damage. The court considered the effect of a state statute on the waiver of subrogation provision in a standard AIA contract. The statute banned the use of any indemnification provisions in construction contracts which hold harmless the promisee against liability from bodily injury or property damage. The court found that the waiver of subrogation provision in the AIA contract merely allocated the risks among various parties and still covered injury suffered by a third party. Accordingly, the court held that the waiver of subrogation provision did not violate the state statute and that it precluded the owner from maintaining a cause of action against the subcontractor.

In *Trinity Universal Insurance Co. v. Bill Cox Construction Co.*, 75 S.W.3d 6 (Tex. Ct. App. 2001), the Court of Appeals of Texas held that the waiver of subrogation rights contained in the contract between Bill Cox Construction Co (BCCI) and Dog Team (owner) barred Trinity’s suit. BCCI, the general contractor, employed De Leon on a renovation project for the owner. Trinity issued an all-risk builder’s policy to the owner. De Leon’s welding caused a fire that damaged the property. Trinity paid the policy limits, \$300,000 and informed the owner and BCCI that it intended to assert its subrogation rights against BCCI. The owner filed a bad faith claim against Trinity. An arbitrator determined that BCCI and De Leon were negligent and awarded the owner \$656,000, but held that under the AIA contract the owner had waived its rights against BCCI to the extent covered by Trinity, and credited BCCI \$300,000. Trinity did not participate in the arbitration and the trial court affirmed the arbitration award. Trinity filed a third-party claim against BCCI and De Leon. The court granted BCCI’s motion for summary judgment, holding that the contract between BCCI and the owner waived Trinity’s rights under Article 17.6

Trinity appealed, and the appeals court affirmed. Trinity argued that because Article 17.6 of the AIA contract waived Trinity’s subrogation rights to the extent of the policy payments, and because Trinity was not notified of this waiver, the clause was unenforceable. The appeals court rejected this argument. The court first that held Trinity’s right to subrogation was limited to the owner’s rights and was drawn from the contract between Trinity and the owner. The contract between Trinity and the owner stated, “Transfer of Rights of Recovery Against Other to Us . . . If any person or organization to or for whom we make payment under this insurance has rights to recover damages from another, those rights are transferred to us to the extent of our payment. That person or organization must do everything necessary to secure our rights and must do nothing after ‘loss’ to impair them.” The Court concluded that because the contract, and therefore Article 17.6, was entered into before the fire, the contractual waiver was valid.

A. Determining Who Is a Co-Insured

One line of cases holds that an ambiguity will be construed against the insurer in determining whether a third party is a co-insured. *Greenbriar Shopping Center, Inc. v. Lorne Co.*, 310 F. Supp. 303 (N.D. Ga. 1969) (subcontractor was “named insured” under builder's risk policy which provided, in typewriting, that “insureds” included all “subcontractors as their interests may appear”, although printed portion of policy provided that subcontractor could become insured only at option of named insureds and option was not exercised), *aff'd*, 424 F.2d 544 (5th Cir. 1970); *Factory Ins. Ass'n v. Donco Corp.*, 496 S.W.2d 331 (Mo. App. 1973); *Transamerica Ins. Co. v. Gage Plumbing & Heating Co.*, 433 F.2d 1051 (10th Cir. 1970) (unnamed contractor was co-insured under policy which contained an “also covers” provision that included similar property of others).

Another line of cases states that the ambiguity rule operates only after the court has determined who are the insured parties. This line reasons that the ambiguity rules of construction do not apply in deciding whether a certain party belongs to the insured class described in the policy. A third person who is not a party to the policy is not entitled to a strict construction in its favor in determining whether the contract was made for his benefit. *Tri-State Ins. Co. of Minnesota v. Commercial Group West, LLC*, 698 N.W.2d 483 (N.D. 2005) (subcontractor for construction of motel from modules was not an implied co-insured under builder's risk policy issued to property owner and, therefore, was not protected by the anti-subrogation rule from liability to insurer, even if the policy covered some property such as scaffolding and construction forms belonging to subcontractor; subcontractor did not share any officers, shareholders, or employees with owner or general contractor, and the policy did not expressly cover property of others); *Travelers Indemnity Co. of Conn. V. the Losco Group, Inc.*, 150 F. Supp. 2d 556 (S.D.N.Y. 2001) (unnamed contractor is not co-insured, because there was nothing in the language of the policy to show an intention to benefit the contractor); *Richmond Steel Inc. v. Legal and Gen. Assurance Society, Ltd.*, 821 F. Supp. 793 (D. P.R. 1993) (unnamed subcontractor is not co-insured, because policy language is not sufficiently expansive to cover subcontractor absent a “property of others” clause); *Willis Realty Assoc's v. Cimino Const. Co.*, 623 A.2d 1287 (Me. 1993) (contractor was not implied co-insured under policy, because policy coverage does not extend to personal property of others within the control of the named insured); *McBroome-Bennett Plumbing, Inc., v. Villa France, Inc.* 515 S.W.2d 32 (Tex. Civ. App. 1974) (unnamed subcontractor that did not pay for insurance premiums and only had interest in certain tools on property was not co-insured under builder's risk policy).

In *Atlas Assurance Co. v. General Builder's Inc.*, 600 P.2d 850, 853 (N.M. App. 1979), the court ruled that an ambiguity existed in the meaning of the intended “insured.” The court relied upon extrinsic evidence to show that the general contractor was an intended additional insured, such as evidence that the general contractor and owner intended to insure the project together, and if not for this agreement, the general contractor would have bought additional insurance.

In another case, a subcontractor went bankrupt and its surety hired a substitute subcontractor to complete the work. The substitute subcontractor was not considered a “subcontractor” under the builder’s risk policy since there was no contract between it and the

general contractor. *Dondlinger & Sons' Constr. Co. v. Emcco, Inc.*, 606 P.2d 1026 (Kan. 1980). Several courts have found that materialmen are covered "subcontractors" under a policy's waiver of subrogation clause. These courts have rejected a technical distinction drawn in some lien and bond cases between subcontractors and materialmen. *Crow-Williams v. Federal Pac. Elec. Co.*, 683 S.W.2d 523 (Tex. App. 1984) (inclusion of the word "sub-subcontractor" in waiver clause of builder's risk policy indicated that a considerable depth of parties was contemplated and that waiver was not meant to extend to only those who contracted directly with the prime contractor); *South Tippecanoe Sch. Bldg. Corp. v. Shambaugh & Son*, 395 N.E. 2d 320 (Ind. App. 1979) (under builder's risk insurance, various defendants, including subcontractor, contractor, architect, and a defendant who may have described himself as a materialman were "insureds" under policy); *Contra Aetna Cas. & Sur. Co. v. Canam Steel Corp.*, 794 P.2d 1077 (Colo. App. 1990) (supplier of joists not a subcontractor).

In *State Regents of N.M. v. Siplast*, 877 P.2d 38 (N.M. 1994), a supplier of roofing material made twelve site visits where it conducted inspections and provided instructions to the general contractor's employees installing the materials. The prime contract defined "subcontractor" as "a person or entity who has a direct contract with the contractor to perform any of the Work at the site." The court concluded that the roofing supplier easily fell into that definition. 877 P.2d at 40. The contract also included a waiver of subrogation clause, which waived "all rights against each other by the owner, contractor, subcontractors, and sub-subcontractors 'for damages caused by fire . . . to the extent covered by Insurance obtained.'" The builder's risk policy provided coverage for "contractor's, subcontractors, and sub-contractors' interests." 877 P.2d at 41. Consequently, the claim against the roofing supplier, for damages caused by a fire while re-roofing the building, was barred.

In another case, an insurer sued a subcontractor for subrogation for damages resulting from a fire caused by the plumbing subcontractor. *Lumbermen's Underwriting Alliance v. RCR Plumbing, Inc.*, 969 P.2d 301 (Nev. 1998). Pursuant to the terms of the construction contract, the plumbing subcontractor agreed to hold harmless and to indemnify the general contractor for any losses resulting from its performance and to obtain liability insurance, which included the general contractor as an additional insured. The general contractor was also covered under a Lumbermen's builder's risk policy obtained by the holding company which owned the project; the holding company was the only insured named in the policy. This policy covered the project during construction "together with all building materials and supplies at the construction site . . . owned by the insured or for which the insured is legally liable." 969 P.2d at 302. After a fire damaged the project, Lumbermen's paid out over 1 million dollars to the owner pursuant this policy. Lumbermen's then sued the subcontractor for subrogation, claiming the fire was a result of its negligence. The trial court dismissed Lumbermen's claim based on its finding that the subcontractor was a co-insured under the policy. This ruling followed precedent in which a subcontractor was found to be a co-insured under a policy covering the general contractor because the policy provided coverage for property "for which the insured is liable." 969 P.2d at 304. There, the court held "that the term 'liable' was not to be construed as being restricted to the legal liability of the developer, but extended coverage to the owner of any property for which the developer was generally responsible." *Id.* Here, the Nevada Supreme Court "conclude[d] that the distinction between legal liability and general responsibility should be abandoned." *Id.* This eliminated any inference that the subcontractor was an insured under the

Lumbermen's policy. Consequently, Lumbermen's was permitted to pursue its subrogation claim against the subcontractor.

B. Unnamed Co-Insureds

Even if a subcontractor is not listed by name or generically (e.g., "subcontractors") in a builder's risk policy, it may still be treated as a co-insured immune from the subrogation claims of the contractor's or owner's insurer. For example, in one case where the policy did not specifically name the subcontractor but did cover "subcontractors generally," the subcontractor was still ruled to be a co-insured, immune from a suit by the contractor's insurer. *Louisiana Fire Ins. Co. v. Royal Indem. Co.*, 38 So. 2d 807 (La. App. 1949). The court reasoned that the clause, "materials, equipment and supplies and temporary structures of all kinds incidental to the construction of buildings and structures, and similar properties belonging to others for which the insured is liable," applied to a subcontractor and made it a co-insured. In another case, the insurer argued that it changed its policy language to avoid the result of the latter case. The court still held that where a policy only named the general contractor and owner, a subcontractor was still a co-insured and could not be sued by the insurer. The court reasoned that the language "owned by the Insured or similar property of others for which the Insured is legally liable," did not clearly exclude subcontractors. *Transamerica Ins. Co. v. Gage Plumbing & Heating Co.*, 433 F.2d 1051 (10th Cir. 1970). Other courts have relied on policy language covering all property regardless of ownership. As a result, sub-subcontractors were covered even though the policy explicitly named only the general contractor and its subcontractors. *St. Paul Fire & Marine Ins. Co. v. Murray Plumbing & Heating Co.*, 135 Cal. Rptr. 120 (Cal. App. 1976) (under builder's risk insurance policy which described "property covered" as being any and all materials, machinery, equipment and supplies of any nature whatsoever, whether "the property of the assured or the property of others in the custody or control of the assured," intent of policy was to cover all property, regardless of ownership, which was being used in construction of building, whether such property was owned by a subcontractor or a subcontractor of a subcontractor).

When the policy does not list subcontractors as insureds or cover the "property of others," a subcontractor will not be considered an insured under the policy. *Tri-State Ins. Co. of Minnesota v. Commercial Group West, LLC*, 698 N.W.2d 483, 491 (N.D. 2005) ("a party who is not expressly named as a co-insured under the policy is protected from subrogation only to the extent that the insurance policy expressly covers the party's property"); *Richmond Steel, Inc. v. Legal & Gen. Assur. Soc'y, Ltd.*, 821 F. Supp. 793, 798 (D.P.R. 1993) (subcontractor was not an "insured" under builder's risk policy issued to general contractor, where construction contract did not require that general contractor obtain insurance on project; policy named only general contractor and the Puerto Rico Aqueduct and Sewer Authority (PRASA), and it nowhere mentioned subcontractor or subcontractors in general; moreover, it did not refer to "property of others," a clause that would indicate subcontractors were also insureds under the policy).

The cases are split on the extent of a co-insured subcontractor's immunity from suit by a co-insured. One line of cases holds that where a subcontractor is not specifically named in the policy, but "subcontractors" are, the subcontractor can be sued on a subrogation claim by the insurer for the damage it causes to other parties' work or property. The subcontractor is only immune for damage caused to its work or property. These cases reason that a builder's risk

policy should not operate as a liability policy for damage that the subcontractor causes to other parties' work and equipment. *See, e.g., Turner Constr. Co. v. John B. Kelly Co.*, 442 F. Supp. 551 (E.D. Pa. 1976) (purpose of provision of general contractor's fire insurance policy insuring subcontractors as additional assureds "as their interests may appear" was to give subcontractor an interest in building according to amount of subcontractor's work and material already utilized; it was not inserted to make subcontractor a coinsured for all purposes).

In *St. Paul Fire & Marine Ins. Co. v. L.E.S. Subsurface Plumbing Co.*, 266 A.D.2d 139 (N.Y. 1999), a builder's risk insurer sued a plumbing contractor for subrogation for damages resulting from a burst water pipe. The policy did not name the subcontractor as an insured. However, the policy included an "Additional Property Extension Endorsement" which "cover[ed] the loss of 'all materials, supplies, equipment and machinery intended for use in and to become a permanent part of construction work.'" 266 A.2d at 139. The appellate court permitted the subrogation action, ruling that "the anti-subrogation bar operates only to the extent of [the subcontractor's] insurable interest, which is limited in this instance to the repairs made by defendant [subcontractor] . . . necessitated by the burst pipe." *Id.* (citations omitted).

However, another line of cases has rejected the result and rationale of these cases. Courts in these cases reason that when a subcontractor is a co-insured, whether or not "subcontractors" are named in the policy, it is immune from subrogation claims for damage to work and property of other parties. *See, e.g., Frank Briscoe Co. v. Georgia Sprinkler Co.*, 713 F.2d 1500 (11th Cir. 1983) (subcontractor was a coinsured, against whom no subrogation right could arise, notwithstanding indemnity agreement between general and subcontractor); *E.C. Long, Inc. v. Brennan's of Atlanta, Inc.*, 252 S.E.2d 642 (Ga. App. 1979) (insurers could not indirectly sue the general contractor, who was a coinsured with an insurable interest, by issuing drafts and then requiring owner to sign "loan receipt" directing it to sue contractor and remit the funds to the insurers); *Harvey's Wagon Wheel, Inc. v. MacSween*, 606 P.2d 1095 (Nev. 1980) (under fire policy, phrase "as their interests may appear" as applied to contractors, who were added as insureds during course of construction, could reasonably be read to limit recovery of the added insureds in case of loss, but for subrogation purposes did not shift risk of loss from insurer to added insureds). Many of these decisions involve the following public policy concerns: (1) the severe conflict of interest if an insurer was permitted to recover from a co-insured; (2) reduction of litigation; and (3) the resulting "tremendous burden" placed on subcontractors' insurance costs which would result in the public suffering from increased costs of construction. *Baugh-Belarde Constr. Co. v. College Utilities Corp.*, 561 P.2d 1211 (Ala. 1977).

V. BURDEN OF PROOF ISSUES

A. Burden of Proof Differences Between "All Risk" and "Named Peril" Policies

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. *Morrison Grain Co. v. Utica Mut. Ins. Co.*, 632 F.2d 424, 430 (5th Cir. 1980) ("It would seem to 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”); *Harbour House Condominium Ass’n. v. Massachusetts Bay Ins. Co.*, 703 F. Supp. 1313, 1317 (N.D.Ill. 1988) (“Unlike a plaintiff who asserts a loss under a “specific risk” policy, a plaintiff claiming damage under an ‘all risk’ policy need not prove the exact cause of his damage”); *Frank Coluccio Const. Co., Inc. v. King County*, 150 P.3d 1147, 1155 (Wash. App. 2007) (“purpose of [all risk insurance] is to shift the risk of loss away from the contractor and the owner and to place it upon an insurer”).

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. *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. *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. *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).

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. *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Stroh Cos.*, 265 F.3d 97, 106 (2d Cir. 2001) (“the fortuity doctrine holds that the insurance is not available for losses that the policyholder knows of, planned, intended, or is aware are substantially certain to occur”); *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. *British & Foreign Marine Ins. Co.*, *supra*. However, damage caused by excessive wear and tear is covered. *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 906. Also, 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. *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 the “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. *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. *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 risk” 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 was 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. *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*.

VI. DIFFERENT EXCEPTIONS TO DEFECTIVE DESIGN AND WORKMANSHIP 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” Exception

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.*, 594 F. Supp. 304 (N.D. Ga. 1984), 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. *National Sur. Corp. v. Adrian Assocs.*, 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. 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.

Therefore, the damage caused by the collapse of the roof due to corrosion, if fortuitous, 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 *Montefiore 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.

D. 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).

VII. WORKMANSHIP AND DESIGN EXCLUSION DEFINITION ISSUES

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. Defining Workmanship

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 defective workmanship and not any damage caused by the defective workmanship, 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.” See also *L.F. Driscoll Co. v. Am. Protection Ins. Co.*, 930 F. Supp. 184, 187 (E.D. Pa. 1996) (“This Court finds the phrase ‘faulty workmanship’ to be unambiguous and will rely on its plain, ordinary meaning rather than straining to justify a liberal interpretation of the phrase.”); *Kroll Constr. Co. v. Great Amer. Ins. Co.*, 594 F. Supp. 304, 307 (N.D. Ga. 1984) (“The term ‘workmanship’ is not ambiguous; it simply means ‘the execution or manner of making or doing something.’”); *Brodkin v. State Farm Fire & Cas. Co.*, 217 Cal. App. 3d (1989) (“Again, the exclusion is clear and unambiguous and expressly covers the damage claimed here.”); *McDonald v. State Farm Fire & Cas. Co.*, 837 P.2d 1000, 1005 (Wash. 1992) (“[I]t is difficult to reasonably

interpret the policy exclusion for faulty construction and defective materials ... as ambiguous.”).

Another court found that a similar defective workmanship clause in an owner’s all risk policy was ambiguous. *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 caused 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.”

1. 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 court held that while the cost of replacing the defective waterproofing on a building was subject to the defective workmanship exclusion, other significant damages were insured by the exception. The *Kroll* court stated: “The policy-exclusion language did not provide an exception for all losses or damages *stemming* from faulty workmanship, 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.” *Id.* at 308.

B. 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; *see also City of Burlington v. Hartford Steam Boiler Inspection and Ins. Co.*, 190 F. Supp. 2d 663, 672 (D. Vt. 2002) (holding that “faulty workmanship” cannot be read to encompass “accidental damage to the product caused by the builder’s negligence during construction”).

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).

C. “Faulty” Policy 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.

VIII. CONCURRENT CAUSATION ISSUES

A. Tests for Combination of Excluded and Nonexcluded Causes

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. *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. The relevant policy provisions at issue in *Essex House* were:

Subject to the provisions herein and of this Policy, such insurance as is afforded under coverage C of Section II is extended to insure against all risks of direct physical loss or damage, except as excluded or limited herein.

EXCLUSIONS AND LIMITATIONS

1. This Company shall not be liable, under this rider, for loss caused by a peril which is otherwise insured against under Section II of this policy.

2. The 'EXCLUSIONS' of Section II are applicable to this rider.

3. The following additional exclusions and limitations apply:

A. This rider does not insure against loss caused by :

(1) Wear and tear, deterioration, rust or corrosion, mould, wet or dry rot; inherent or latent defect; smog, smoke, vapor or gas from agricultural or industrial operations; mechanical breakdown, including rupture or bursting caused by centrifugal force; settling, cracking, shrinkage, bulging or expansion of pavements, foundations, walls, floors, roofs or ceilings, animals, birds, vermin, termites or insects; unless loss by a peril not excluded ensues and then this company shall be liable for only such ensuing loss."

The *Essex* court held that the policy exclusion for loss caused by inherent or latent defects did not apply to bar recovery by insureds for apartment building brick failure which

resulted from temperature differentials coupled with negligence in design and construction of building. 404 F. Supp. at 993.

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.

B. Efficient Proximate Cause Test

Distinguishable from the line of cases that do not examine causal relationship between the excluded or non-excluded causes of the loss, 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 v. Wisler, 377 P.2d 889, 896-97 (Cal. 1963) (resolving inconsistent state insurance code provisions); *Garvey v. State Farm Fire & Cas. Co.*, 770 P.2d 704 (Cal. 1989) (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.

If the causes of loss are both excluded under the policy, coverage obviously will be denied. See *Sapiro v. Encompass Ins.*, 2004 WL 2496090 (N.D. Cal. Nov. 2, 2004) (rejecting as “tortured” the implication in plaintiffs' argument that “a property loss caused by a combination of two excluded perils falls outside of both exclusions”).

C. Policy Language Overriding Efficient Proximate Cause Test

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. *Safeco Ins. Co. v. Hirshmann*, 773 P.2d 413 (Wash. 1989), citing and following *Vilella 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. *Schraeder 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.” *See also T.H.E. Ins. Co. v. Charles Boyer Children’s Trust*, 455 F. Supp. 2d 284 (M.D. Pa. 2006) (under Pennsylvania law, language of lead-in clause stating that any loss caused directly or indirectly by enumerated exclusion was excluded “regardless of any other cause or event that contributes concurrently or in any sequence to the loss,” negated application of efficient proximate cause doctrine in assessing whether claim fell within enumerated exclusion).

IX. SUE AND LABOR CAUSES

A. Duty to Prevent Imminent Loss or Damage

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 Hone Assur. Co. v. J.F. Shea Co., Inc.*, 445 F. Supp. 365 (D. 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.”).

B. Clause Does Not Extend Coverage

In *Southern California Edison Co. v. Harbor Insurance Co.*, 148 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 a 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. Recovery Of Overhead And Profit As Part of Repair Costs

The question arises as to whether the insured can recover overhead and profit as actual cash value if the insured, himself, undertakes to repair the damage or loss. Some policies address this issue as follows.

At the time of loss, the basis of adjustment of a claim, unless otherwise endorsed herein, shall be as follows:

- A. Property Under Construction – Cost to repair or replace the property lost or damaged at the time and place of loss with material of like kind and quality, less any betterment, including contractor's profit and overhead in the same proportion as that of the original contract bid documents, but in no event to exceed the Limit of Liability. If not so replaced then the loss shall be settled on the basis of the actual purchased cost of the lost or damaged property.
- B. Property Of Others (Including Items Supplied By The Owner) – At owner's cost or other actual cash value, whichever is greater, including the contractor's charges.
- C. Property In Transit – The invoiced cost of the materials or supplies plus shipping costs incurred to the date of loss less any liability assumed by any contract or common carrier.
- D. Other Property – As allowed for in the Extensions of Coverage stated elsewhere in the policy.

Taken From a Zurich American Insurance Company Completed Value Builders Risk Policy Declarations, Valuation Provision, *circa* 2000.

Other policies fail to address the issue, e.g.:

Replacement Cost Basis

Lost or damaged contract works will be valued at the full cost to repair or replace it at the time of loss or damage . . . But not more than you actually spend to repair or replace the contract works There is no deduction for physical deterioration, depreciation, obsolescence or depreciation.

Taken from a Chubb Project Builders Risk Policy, circa 2002.

Courts considering this issue in other contexts have allowed insureds to recover overhead and profit. *See, e.g., Tritschler v. Allstate Ins. Co.*, 144 P.3d 519 (Ariz. App. Div. 2006) (finding that insured homeowner who completes repairs can recover contractor's overhead and profit as part of actual cash value: "regardless of whether an insured hires a general contractor or completes his or her own repairs, the insured would still be entitled to what was contracted for in the insurance policy: the actual cash value of the loss, which may include a contractor's overhead and profit when a contractor would reasonably be used to make repairs"); *Mazzocki v. State Farm Fire & Casualty Corp.*, 1 A.D.3d 9 (N.Y. 2003) (addressing a replacement cost policy, and holding that the insurer was "obligated to include profit and overhead in ... actual cash value, whenever a general contractor would likely be needed").