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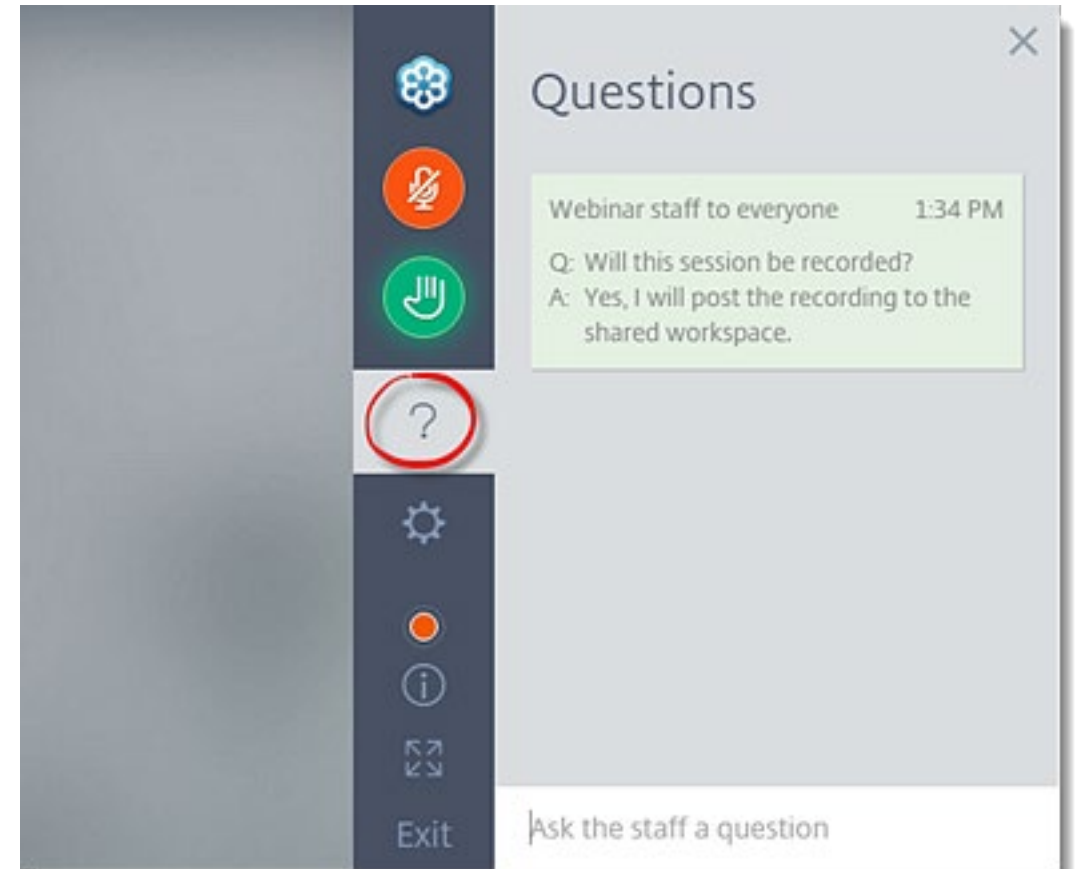


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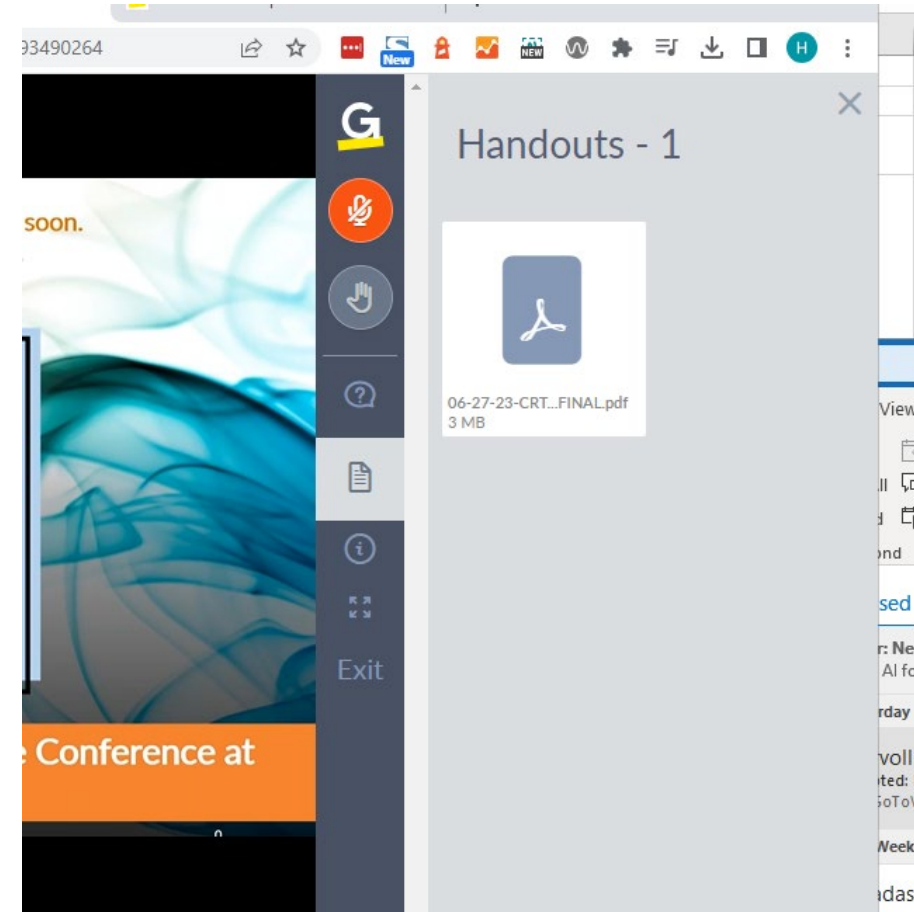
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# Your Webinar Presenter



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# Insuring Defective Construction Claims Over the Last 50 Years: The Song Remains the Same?

Presented By:  
**Patrick J. Wielinski**  
Cokinos | Young  
October 10, 2023

Alternative Title: Random  
Observations, Musings, and Rants  
Relating to Seemingly Intractable  
Construction Coverage Issues

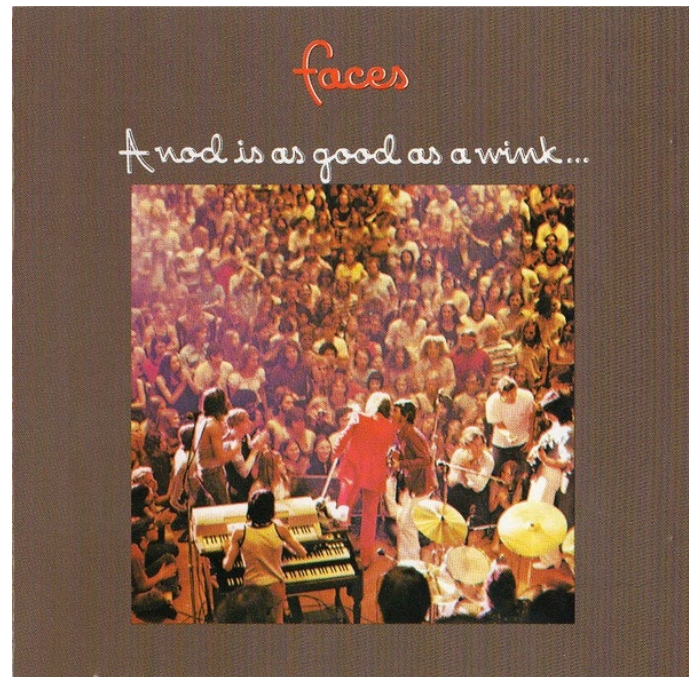
# The Song That Remains the Same . . .



The soundtrack for this presentation:

*“A Nod is as Good as a Wink . . . to a Blind Horse”*

- Rod Stewart and Faces album, circa 1971

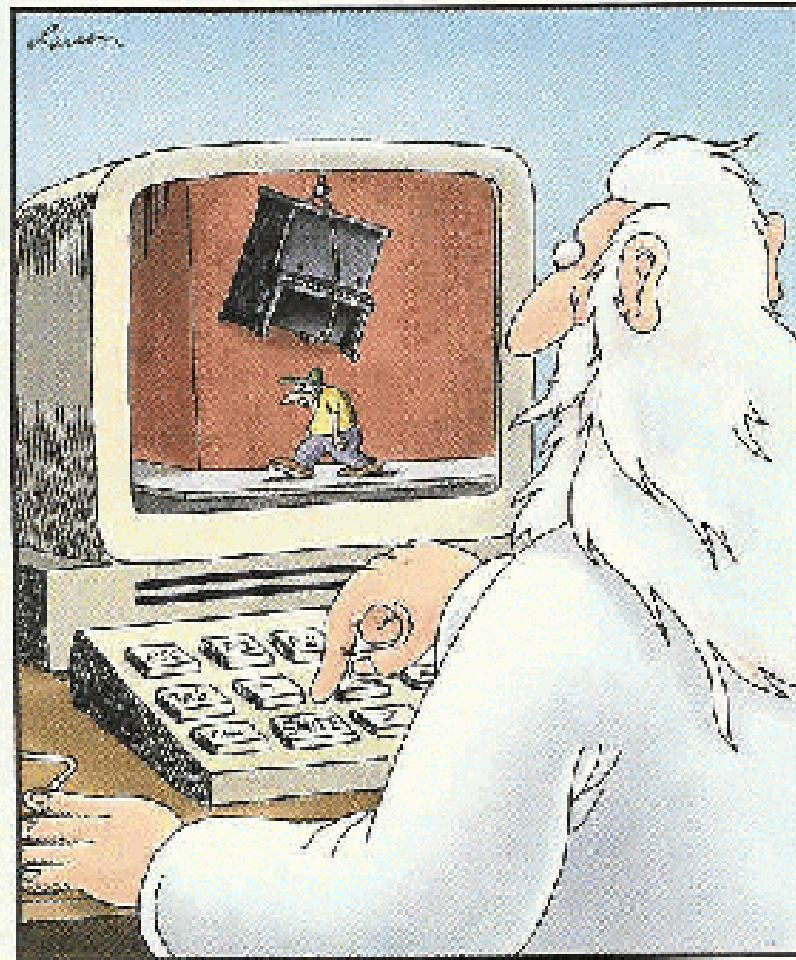


# Of Nods, Winks . . . and Blind Horses



- **The Nod** – the insurance industry’s drafting and revision of policy language as an accommodation to needs and risks of contractors
- **The Wink** – insurers’ interpretation and application of policy language to frequently deny claims in the face of that language
- **The Blind Horse** – courts (and sometimes uninformed insureds) accepting the winks

# All Things Insurance



God at His computer

The  
Far Side  
LAST IMPRESSIONS  
— 2002 —  
September

Yom Kippur

Monday 16

# NOD: 1966 Policy Revisions

# Nod: Clarification Between Products and Work



- 1966 revisions to the standard form CGL insurance policy created a dichotomy between products liability coverage for manufacturers and completed operations coverage for contractors and other providers of services.
- Modified the single policy Exclusion (h) in the prior 1955 policy forms with separate exclusions, including:
  - (l) damage to the insured's products; and
  - (m) damage to work performed by or on behalf of the insured.

# WINK: Expansion of Policy Exclusions

# Nod: Business Risk Theory



- Risks that management can and should control are reduced to manageable proportions and are not insured.
- Risks that management cannot effectively avoid because of the nature of the business may be insured.
- Risks often relate to the repair or replacement of faulty work or products.
- Normal, foreseeable, and expected incident of doing business.
- Should be reflected in the price of the product or service rather than the cost of insurance to be shared by others.
- Work and products claims collapsed into “work product.”

# Nod: Business Risk and the CGL Policy – The Reality



- Numerous parties on jobsite, complex relationships
- Risks cannot always be controlled
- Parties shifting as much risk as possible
- Recognizes fortuity in modern construction project; all variables cannot be controlled

# Wink: The Blind Horses Drink the Kool-Aid



- Defective work is an uninsurable business risk.
- The insured contractor is trying to obtain coverage for sloppy construction.
- The CGL policy is not intended to pay for “warranty work.”
- The CGL policy is not a “performance bond.”
- *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979).
- R. Henderson, “Insurance Protection for Products Liability and Completed Operations—What Every Lawyer Should Know,” 50 *Nebraska Law Review* 415, 441 (1971).

# NOD: 1969 Broad Form Property Damage Endorsement

# Major Wink: Expansion of Coverage



- Watershed revision
- Operations coverage: introduces *“that particular part”* limitation on the exclusion of property damage to property upon which operations are being performed or must be repaired or replaced because of the insured’s work upon it
- Deletes property damage to work performed *“or on behalf of”* the insured so that only damage to work performed *“by”* the insured itself, and not the work of subcontractors, is excluded
- Forerunner of the 1986 revisions

# Wink: What, Me Worry?



- Insurers continued to wink and apply *Weedo v. Stone-E-Brick* and the Henderson review article to completed subcontractor work.
  - The Blind Horse courts fail and refuse to recognize the importance of the addition of the BFPDE to a contractor's CGL policy, citing them nearly 200 times.
- *See, Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229 (Minn. 1986).
  - Completed operation claim for defective work by subcontractors to the insured general contractor.
  - "A slight difference in wording in the work performed exclusion in the BFPD endorsement does not affect this exclusion."

# NOD: 1986 Revisions Clarify and Circumscribe the Property Exclusions

# Nod: Operations Exclusion



- j.(5) *That particular part* of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the property damage arises out of those operations.
- Damage must occur to the *particular part* of property being worked on by the insured.
  - See, *Gore Design Completions, Ltd. v. Hartford Fire Ins. Co.*, 538 F.3d 365 (5th Cir. 2008).

# Nod: Incorrect Work Exclusion



j.(6) ***That particular part*** of any property that must be restored, repaired or replaced because ‘your work’ was incorrectly performed on it.

- Completed operations exception
- *See, Mid-Continent Cas. Co. v. JHP Dev., Inc., 557 F.3d 207 (5th Cir. 2009).*

# Nod: Your Work Exclusion Subcontractor Exception



- I. Property Damage to Your Work arising out of it or any part of it and included in the “**Products-Completed Operations Hazard.**”

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a **subcontractor**.

- *See, Lamar Homes v. Mid-Continent Casualty, 242 S.W.3d 1 (Tex. 2007); U.S. Fire Ins. v. J.U.S.B. Inc., 979 So.2d 871 (Fla. 2007).*
- *Contra: Ohio Northern University v. Charles Construction Services, Inc., 120 N.E.3d 762 (Ohio 2020).*

# Nod: Product Exclusion with Real Property Exception



## Exclusion:

- k. 'Property damage' arising out of 'your product' or any part of it.

## Definition:

- a. Any goods or products, **other than real property**, manufactured, sold, handled, distributed or disposed of by: (1) You . . .
- An attempt to separate exclusion of coverage for manufactured products from construction services.
- *See, Wanzek Constr., Inc. v. Employers Ins. of Wausau, 679 N.W.2d 322 (Minn. 2004).*

**THE DOUBLE WINK:** No  
Occurrence, No Property  
Damage = No Coverage

# Wink: Lack of Occurrence



- Allegations of breach of contract are not an “accident.”
- “Accident” as to occurrence means tort liability only.
- The economic loss rule eliminates negligence.
- Defective work in breach of contract is not unexpected and unintended.

# Wink: Lack of Property Damage



- Damage to the work itself involves no physical injury to tangible property.
  - Injury to the work itself is not property damage; it is an economic loss.
  - Injury to the work itself is an uninsurable business risk.

# Partial Nod: Property Damage Concepts



- The “physical damage” requirement distinguishes between **physical** injury to **tangible** property and a mere defect.
  - Installing defective windows
    - versus—
    - Water damage caused by defective installation of windows
  - *See, Auto-Owners Ins. Co. v. Pozzi Window Company, 984 So.2d 1241 (Fla. 2008).*
- Once property damage has been established, consequential economic losses are covered as damages **because of** property damage under the insuring agreement.
  - Includes lost profits or increased construction costs

## Nod: Applying the Property Damage Requirement



It is important to apply the definition as written without reading in hidden or imagined restrictions.

- There is no demarcation between the work and third-party property in terms of property damage.
- Whether a loss is excluded should not alter the “property damage” analysis.
- The economic loss rule is a *remedies* principle and should not alter the “property damage” analysis.
- Whether a claim sounds in tort, breach of contract, or breach of warranty should not alter the property damage analysis.
- The business risk rationale should not alter the analysis.

# Nod: Most Courts Reject the Lack of Occurrence Argument



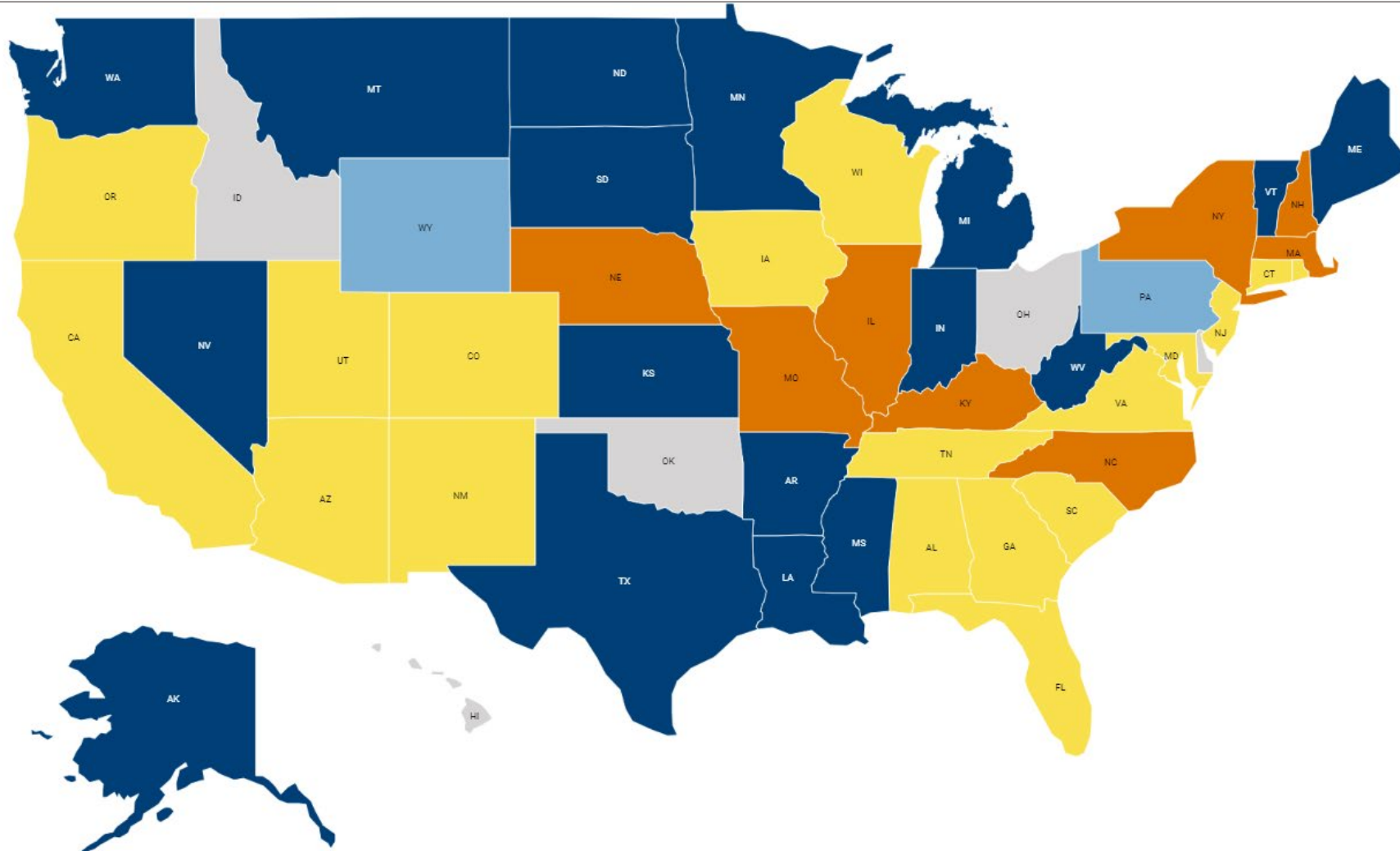
- *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. Sup. Ct 2004) – seminal case
- *Lamar Homes v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007) – truest to the intent of policy language
- *Cypress Point Condo. Ass'n, Inc. v. Adria Towers, LLC*, 143 A.3d 273 (N.J. 2016) – death knell to *Weedo*

# Blind Horses: They Live On



- *Kvaerner Metals Div. of Kvaerner U.S. Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. Sup. Ct. 2006)
- *Ohio Northern University v. Charles Construction Services, Inc.*, 120 N.E.3d 762 (Ohio 2020)

# Nods versus Winks: The Scorecard as of October 2023 (Give or Take)



# Nods versus Winks: Defective Work Itself



- Alaska, Arkansas, Indiana, Kansas, Louisiana, Maine, Michigan, Minnesota, Mississippi, Montana, Nevada, North Dakota, South Dakota, Texas, Vermont, Washington, and West Virginia

# Nods versus Winks: Resulting Damage to Other Work



- Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Iowa, Maryland, New Jersey, New Mexico, Oregon, Rhode Island, South Carolina, Tennessee, Utah, Virginia, and Wisconsin

# Nods versus Winks: Resulting Damage to Third-Party Property



- Illinois, Kentucky Massachusetts, Missouri, Nebraska, New Hampshire, New York, and North Carolina

# Nods versus Winks: Defective Work Never an Occurrence



- District of Columbia, Pennsylvania, and Wyoming

# Nods versus Winks: Law Is Undecided or Unclear



- Delaware, Hawaii, Idaho, Ohio, and Oklahoma

**WINK:** Contractual Liability  
Exclusion Applied to Breach of  
Contract Claims

# Wink: Contractual Liability Exclusion Applies to Breach of Contract



- *Olympic, Inc. v. Providence Washington Ins. Co.*, 648 P.2d 1008 (Alaska 1982) – seminal case holding that “assumption of liability” applied to obligations assumed under an indemnity or hold harmless agreement
- *Gilbert Tex. Const., L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010) - assumption of liability in a contract beyond the general law is excluded

# Half-Hearted Nod: Only Assumption of Liability Beyond Ordinary Law Excluded



- *Ewing Construction Co., Inc. v. Amerisure Ins. Co.*, 684 F.3d 512 (5th Cir. 2012), *opinion withdrawn*, 690 F.3d 628 (5th Cir. 2012), *questions certified*, *Ewing Constr. Co., Inc. v. Amerisure Ins. Co.*, 420 S.W.3d 30 (Tex. 2014), *questions answered* – implied warranty to perform work in a good and workmanlike manner is not a greater obligation than under general law
- *Crownover v. Mid-Continent Cas. Co.*, 757 F.3d 200 (5th Cir. Tex. 2014) - express warranty

# WINK: Breach of Contract Exclusions

# Wink: Breach of Contract Exclusions



- Response to the comments by courts to insurers to add specific exclusions to their policies if they intend to exclude coverage for defective work
  - *U.S. Fire Ins. v. J.S.U.B. Inc.*, 979 So.2d 871 (Fla. 2007)
- Most frequently used exclusion: CG 22 94
  - Eliminates the subcontractor exception to the Your Work Exclusion
- Sidebar: **Never** invite an insurance company to figure out how to exclude coverage

# Wink: Breach of Contract Exclusions



## Example Clause 1:

This insurance does not apply to “claims” for breach of contract, whether express or oral, nor “claims” for breach of an implied in law or implied in fact contract, whether “bodily injury,” “property damage,” or . . . an “occurrence” is alleged.

# Wink: Breach of Contract Exclusions



## Example Clause 2:

This insurance policy does not apply, nor do we have a duty to defend any claim or “suit” for “bodily injury,” “property damage,” or “personal and advertising injury” arising *directly or indirectly* out of the following:

- a. Breach of express or implied contract;
- b. Breach of express or implied warranty;
- c. Fraud or misrepresentation regarding the formation, terms or performance of a contract; or
- d. Libel, slander or defamation arising out of or within the contractual relationship.

# Wink: Breach of Contract Exclusionary Endorsements



- Intent is to exclude coverage for all claims that relate to breach of contract.
  - Extremely negative effect on the construction industry, especially construction defect claims.
  - Invariably allege contractual rather than tort causes of action due to the economic loss rule.
  - May be intended to exclude coverage for negligence claims arising out of breach of performance of the contract – as in the economic loss rule.
- Much broader than the exclusion of the subcontractor exception that only affects completed work.

# Wink: Breach of Contract Exclusionary Endorsements



- **Upheld:** *Mt. Hawley Ins. Co. v. Huser Construction Co., Inc.*, 797 Fed. Appx. 183 (5th Cir. 2020)
- **Upheld:** *HC Waterford Properties, LLC v. Mount Hawley Ins. Co.*, 2009 WL 2600431 (S.D. Fla. Aug. 21, 2009)
- **Struck down:** *Cincinnati Specialty Underwriters Ins. Co. v. KNS Group, LLC*, 561 F.Supp. 3d 1298 (S.D. Fla. 2021)

# Nod: Allocation Methods

# Nod: Pro Rata Allocation



- Majority method applied by the courts.
- Policy language obligates insurer to pay those damages that occurred during its policy period.
- Usually according to time on the risk where the total amount of damages is divided by the total number of years, or even months or days, on the risk.
- Seminal case: *Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980) – exposure to asbestos.
- Or based on policy limits, or a combination of policy limits and time on the risk.

# Nod: Horizontal Exhaustion



- Typically applied in jurisdictions that apply the pro rata allocation approach.
- Coverage available under all primary policies must be exhausted before any coverage in the excess layer is triggered.
- Generally, if the first layer of coverage is self-insured, the SIRs for all applicable policy periods must be exhausted before the next layer of coverage is required to respond.
- **Wink?:** Insured may be required to pay the full deductible/retention for each policy year.

# Wink for the Insured: All Sums Allocation



- Based upon the insuring agreement of the 1973 CGL policy form – the insurer will pay on behalf of the insured “all sums” that the insured is legally obligated to pay as damages.
  - Rationale is that the insurer is jointly and severally liable to the full limit of its policy .
  - *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981), cert. denied, 455 U.S. 1007, 102 S. Ct. 1644 (1982).
- Also referred to as the “joint and several” approach.
- 1986 – “all sums” was changed to “those sums,” but the same interpretation prevails.
- The insured is allowed to select the applicable policy period to satisfy the claim.
  - The selected insurer can then seek contribution or equitable subrogation from insurers providing coverage in other policy years.

# Wink for the Insured: Vertical Exhaustion



- Applies in tandem with the all sums allocation approach.
- The insured selects or “spikes” the most beneficial policy year that will provide coverage for the claim.
- Exhaustion proceeds up the single tower of coverage from the first layer through the excess layers until full indemnity or complete exhaustion of the policy limits occurs.
- In some states, the insured is limited to a single tower of coverage.
  - In others, the insured can select from other policy years upon the exhaustion of the coverage available in that policy year.

# Nod: Prior Knowledge Provision



- This insurance applies to bodily injury and property damage only if prior to the policy period, no insured knew that the “bodily injury” or “property damage” had occurred, in whole or in part.
- No subsequent policies are triggered or apply.

# Wink: Prior or Pre-Existing Injury Exclusions



- Excludes coverage if any ongoing property damage occurred before the policy period, *regardless* of knowledge of the insured.
- Example Clause 1:

This insurance applies to property damage only if the property damage was not caused by any construction defect or condition which resulted in bodily injury or property damage which first existed, prior to the effective date of this policy
- Example Clause 2:

This insurance does not apply to property damage which first occurred, or is alleged to have first occurred, in whole or in part, prior to the inception date of this policy or which is alleged to be in the process of occurring, in whole or in part, prior to the inception date of this policy, even if the occurrence continues, changes or resumes during the policy.

# Nod: Controlled Insurance Programs

# Nod: Selling Points of Controlled Insurance Programs



- Completed operations – tail is lengthened to period of repose.
- Internecine squabbling between insurers is eliminated.
- De-emphasis on additional insured and indemnity.
- Joint defense.
- Elimination of troublesome restrictive endorsements.

# Wink: Cross-Suits Exclusion



- This insurance does not apply:
  - To a claim or “suit” for damages initiated, alleged or caused to be brought about by any named insured covered by this policy against any other named insured covered by this policy.
- Often an exception for suits initiated by owner and general contractor.
- Subs are often left out and at the mercy of general contractor or owner.

# Wink: Builders Risk/Operations Exclusion



- Usually tucked away in the Wrap-Up Endorsement that includes modifications to the CGL form for purposes of the wrap program.
- Deletes Exclusions j(5), j(6), l, and n.
  - Extension of coverage? Not necessarily so.
- Replaces j(5) and j(6) with a much broader exclusion of operations coverage for property damage prior to substantial completion or inception of the completed operations tail.
- Theory: duplication of coverage with builders risk.
  - But CGL coverage is often broader than builders risk.

# Nod: Other Sources of Coverage for Construction Defect

# Nods and Winks: Other Coverages



- **Nod:** Builders risk – ensuing loss
- **Nod:** Professional Liability – design build
  - **Nod:** Contractors professional coverage
  - **Wink:** Rectification coverage
  - **Nod:** Protective Loss
- **Nod:** Subcontractor default

# Nods and Winks: Recap



- Any **Nod** to possibly expand or acknowledge coverage may still be followed by a **Wink** on the claims level.
- Don't be a **Blind Horse** and be caught unawares!!

# Questions



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