CGL COVERAGE OF DEFECTIVE WORK

William H. Locke, Jr.,
Graves Dougherty Hearon & Moody
Austin, Texas

ACREL Fall Program
Washington, DC
October, 2009

USEFUL MATERIALS

Shapiro & Posner, It Was An Accident: Inadvertent Construction Defects Are An "Occurrence" Under Commercial General Liability Policies, in Vol. 10, No. 2, Coverage, at 3-8 (Winter 2000).

31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured.

58 A.L.R.3d 12 Construction and application of clause excluding from coverage of liability policy "completed operations hazards".

BRUNER AND O'CONNOR ON CONSTRUCTION LAW §§ 18 – 49 Commercial General Liability Insurance.

C.J.S. Insurance §430.

1 CONTRACTUAL RISK TRANSFER Strategies for Contract Indemnity and Insurance Provisions XVII. G. 1 *et seq*. Construction Contracts (International Risk Management Institute, Inc. 2009).

Dykes, Occurrences, Accidents, and Expectations: A Primer of These (and Some Other) Insurance-Law Concepts, UTAH L. REV. 831 (2003).

Franco, 30 TORT & INS. L.J. 785 Insurance Coverage for Faulty Workmanship Claims Under Commercial General Liability Policies (Spring, 1995).

Pryor, The Economic Loss Rule on Liability Insurance, 48 ARIZ. L. REV. 905 (2006).

Schneier, 30 CONSTRUCTION LITIGATION RPTR. 11 Under Texas Law, an Exclusion in a Contractor's Liability Policy, for Damage to that Part of the Property Upon Which the Contractor Was "Performing Operations," Does Not Apply to Water Damage During a Prolonged and Complete Suspension of the Work (April 2009).

2 STEMPEL ON INSURANCE CONTRACTS, § 14[13][D] at 14-224.8 and 14-224.9.

Windt, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS § 11.3 at 73-74 Existence of an "occurrence" (5th Ed.).

Turner, INSURANCE COVERAGE OF CONSTRUCTION DISPUTES Ch. 6 § 6.46; Ch. 29 Performing Operations Exclusion; Ch. 32 Faulty Workmanship/Incorrectly Performed Work Exclusion (2d Ed.).

The following articles by the author of this Article (Copy at GDHM Website (www.gdhm.com) at bio.): *Additional Insured Endorsements to Liability Policies: Typical Defects and Solutions* in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE DRAFTING COURSE (2008). *Annotated Risk Management Provisions: Indemnity and Insurance (Focus on TEXAS REAL*

ESTATE FORMS MANUAL Retail Lease), in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE DRAFTING COURSE (2007). *Allocating Extraordinary Risk in Leases: Indemnity/Insurance/Releases and Exculpations/Condemnation (Including a Review of the Risk Management Provisions of the TEXAS REAL ESTATE FORMS MANUAL Office Lease)*, in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE LAW COURSE (2006). *Fair Forms for Shifting Liability for Personal Injuries Between Landlords and Tenants and Owners and Contractors*, in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE DRAFTING COURSE (2004). *Risk Management for Landlords, Tenants and Contractors: Through Contractual Provisions for Indemnity, Additional Insureds, Waiver of Subrogation, Limitation, Exculpation and Release Vol. 1 "The Law" and Vol. 2 "The Forms"*, in TEXAS COLLEGE FOR JUDICIAL STUDIES (2003).

TABLE OF CONTENTS

CGL COVERAGE OF DEFECTIVE WORK

Bill Locke
Graves, Dougherty, Hearon & Moody, Austin, Texas
(October 2009)

I. INTRODUCTION

The most common means of insuring against property damage at a construction site is through "first party" coverage, *e.g.*, builder's risk insurance. Protection of owners, developers, contractors and subcontractors against third party claims (claims by parties other than the parties to the contract, for example, claims by injured employees of the contractor against the owner) is the subject of commercial general liability ("**CGL**") insurance policies. CGL insurance is thus commonly considered to be third party insurance. Contractors have sought to utilize CGL policies as first party insurance to cover property damage occurring at the construction site. Due to defective products and negligently performed work damage can occur to the contractor's work product and even beyond the work to the project.

This Article addresses the issue as to whether the standard CGL policy covers the risk of property damage as a result of an insured contractor's defective work occurring during construction or after operations have been completed. Liability insurers have sought to exclude from the coverage of CGL policies so-called "business risks", those risks thought generally to be under the control of the insured (contractor or subcontractor) and which are not regarded as fortuitous in nature. In crafting policy language (coverage and exclusions) insurers have struggled for decades to draft policy language that clearly and unambiguously covers "accidental" property damage but does not cover uninsurable business risks. The insurance industry has resisted insuring contractor's for property damage caused by "business risks" within the contractor's control.[1]

---

[1] Insurable Risks. One commentator has set out the following as the distinction between an "uninsurable business risk" and an "insurable risk":

> Risk may be grossly divided into two types: business risks and insurable risks. Business risks logically involve the success or failure of the particular business, based upon factors such as management's ability to gauge the market, product development/research, and logistics. In order to assure a profit and minimize losses, businesses employ experienced managers, accountants, and other skilled personnel. The risk of profit or loss is thus a distinguishable "business risk." Insurable risks do not hinge on management ability and success; rather, they turn on fortuitous losses. Insurable risks involve statistical loss probability. The application of a statistical abstract to certain factual parameters drives insurance underwriting. Insurable risks are thus fundamentally different from business risks. It follows that commercial general liability insurance policies cover only "insurable risks" and exclude business risks. Insurance coverage is bottomed on the concept of fortuity. Applying this rule in the construction context, truly accidental property damage generally is covered because such claims and risks fit within the statistical abstract. Conversely, faulty workmanship claims generally are not covered, except for their consequential damages, because they are not fortuitous. In short, contractors' "business risks" are not covered by insurance, but derivative damages are. The key issues are whether the contractor controlled the process leading to the damages and whether the damages were anticipated.

Franco, 30 TORT & INS. L.J. 785 Insurance Coverage for Faulty Workmanship Claims Under Commercial

This issue has been the subject of considerable litigation. Although the vast majority of cases involve interpretation of the same CGL policy language, there is a marked split of authority. As reviewed below, the recent focus has been on the "property damage" and "occurrence" requirements of the CGL policy, with some courts applying the legal theories of "business risk" and "economic loss" as a means to exclude coverage. In undertaking this approach, these courts have ignored interpreting the policy as a whole and have failed to consider the purpose and scope of the policy's construction-specific exclusions and the exceptions to these exclusions.

II. STANDARD CGL POLICY

The CGL policy published by the Insurance Services Office ("**ISO**") is considered to be the industry-standard policy.[2]

ISO CG 00 01 10 01[3]

SECTION I—COVERAGES

COVERAGE A. BODILY INJURY AND PROPERTY DAMAGE LIABILITY [4]

1. Insuring Agreement [5]

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies….

General Liability Policies (Spring, 1995).

[2] ISO. There are four nationwide insurance advisory organizations that develop standard insurance forms. ISO is the largest national insurance advisory organization. Its forms are considered to be the industry's standard. 1 CONTRACTUAL RISK TRANSFER Strategies for Contract Indemnity and Insurance Provisions (International Risk Management Institute, Inc. 2009).

[3] ISO Form Numbering System. ISO forms are identified by a designation composed of four elements. The current ISO CGL policy is designated as CG 00 01 10 01. The "CG" prefix identifies the form as part of the ISO commercial general liability form series, introduced originally in 1986. The first set of numbers identifies the "group" to which the form belongs. The second set of numbers identifies the form number for the form within the group. The final four numbers identify the form's revision date (October 2001).

[4] CGL Coverage Categories. The ISO CGL policy categorizes covered liabilities into three categories: Coverage A for "Bodily Injury" and "Property Damage"; Coverage B for "Personal Injury and Advertising Injury"; and Coverage C for "Medical Payments". Each of these terms is defined in the policy.

[5] Coverage A – The Insuring Clause. Simply put: "The insured needs to establish its liability arises out of an "occurrence" that resulted in either "bodily injury" or "property damage" and the injury must have occurred during the policy period. These are the requirements of the CGL policy's insuring clause. As a general rule, the insured bears the burden of satisfying the insuring clause requirements. By contrast, the insurer bears the burden of establishing that one or more exclusions limit or eliminate coverage." BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 11:26 Commercial General Liability (CGL) Coverage – What is "Occurrence"? – Florida, Texas, and Tennessee rule "faulty workmanship" an "occurrence".

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is caused by an "occurrence" …; (and)

(2) The "bodily injury" or "property damage" occurs during the policy period; ….

2. Exclusions

This insurance does not apply to: …

a. Expected or Intended Injury

"Bodily injury" or "property damage" expected or intended from the standpoint of the insured. ….

j. Damage to Property

"Property damage" to: …

(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; or

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

Paragraph **(6)** of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".
…

k. Damage to Your Product …

---

[6] "Physical" Injury to Tangible Property. The standard CGL policy was amended in 1973 to limit the scope of "property damage" coverage to "physical" injury. Like the 1966 amendment mentioned in the next footnote, this amendment was a further attempt to limit the scope of coverage to limit the occasions in which the measure of damages is for diminution in the value of the damaged property. Coverage is still available even after the 1973 amendment if there is a physical manifestation of the property damage even though the measure of damage invoked by the court is diminution in value. *See, e.g., W. E. O'Neil Construction Co. v. National Union & Fire Ins. Co. of Pittsburgh*, 721 F. Supp. 984 (N. D. Ill. 1989) where the court rejected the insurer's argument that the owner's claim was merely for economic loss and did not amount to a claim for "property damage". The court held that there a number of types of economic loss, including diminution in value and loss of use, which might be considered to be "property damage."

[7] "Property". The standard CGL policy was amended in 1966 to add a definition of "property damage" to the policy. This was in response to court cases construing "property damage" as including diminution in value damages.

l. Damage To Your Work

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

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.

SECTION IV—DEFINITIONS

13. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

16. "Products-completed operations hazard":

a. Includes all "bodily injury" and "property damage" occurring away from premises you own or rent and arising out of "your product" or "your work" except: …

(2) Work that has not yet been completed or abandoned. However, "your work" will be deemed completed at the earliest of the following times:

(a) When all of the work called for in your contract has been completed.
(b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.
(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise completed, will be treated as completed.

17. "Property damage" means:

a. Physical[6] injury to tangible[7] property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

22. "Your work":

a. Means:

(1) Work or operations performed by you or on your behalf; and

(2) Materials, parts or equipment furnished in connection with such work or operations.

b. Includes

(1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work," and

(2) The providing of or failure to provide warnings or instructions.

III. COMPETING VIEWS

A. The "Occurrence" Requirement

1. An "Accident"

The standard policy definition of an "occurrence" is set out in Paragraph 13. The policy defines occurrence as an "accident". However, the term "accident" is not defined and its definition is left to the courts. This circumstance has lead to a range of definitions and determinations of coverage.[8]

---

[8] Split of Authority – "No Occurrence"; "Occurrence". The following case summaries are quoted from footnotes in BRUNER AND O'CONNOR ON CONSTRUCTION LAW.

Decisions Finding Faulty Workmanship Not a Basis for an "Occurrence":

Ark. *Nabohlz Const., Corp. St. Paul Fire and Marine Ins. Co.,* 354 F.Supp.2d 917 (E. D. Ark. 2005) – Suit to recover cost to repair faulty roof did not allege an "occurrence".

Illinois. *Viking Const. Management, Inc. v. Liberty Mut. Ins. Co.*, 358 Ill. App. 3d 34, 294, Ill. Dec. 478, 831 N.E.2d 1 (1st Dist. 2005) - wall collapse caused by defective construction not covered as complaint did not allege property damage caused by an occurrence; collapse of wall under natural and ordinary circumstances did not constitute "occurrence" within the meaning of CGL policy.

Indiana. *Amerisure, Inc. v. Wurster Const. Co., Inc.*, 181 N.E.2d 998 (Ind. Ct. App. 2004), decision clarified on reh'g, 822 N.E.2d 1115 (Ind. Ct. App. 2005) - defective exterior insulation finish system was not an "occurrence".

Ill. *Stoneridge Development Co., Inc. v. Essex Ins. Co.,* 888 N.E.2d 633 (Ill. 2d Dist), app. denied 897 N.E.2d 264 (Ill. 2008) - cracks that developed in home "were not an unforeseen occurrence that would qualify as an 'accident' because they were the natural and ordinary consequences of defective workmanship"; *Cincinnati Ins. Co. v. Tayor-Morely, Inc.* 556 F. Supp.2d 908 (S.D. Ill. 2008) - developer's allegedly faulty construction of homes did not constitute an "accident" or "occurrence".

Md. *OneBeacon Ins. v. Metro Ready-Mix, Inc.*, 427 F. Supp. 2d 574 (D. Md. 2006) - concrete manufacturer's provision of defective grout that was insufficient to support pile caps did not involve an accident within the policy definition of "occurrence".

Mo. *Hartford Ins. Co. of the Midwest v. Wyllie*, 396 F. Supp. 2d 1033 (E. D. Mo. 2005) - suit against seller of condominium alleging intentional misrepresentation for failing to disclose problems and defects with roof and heating systems did not allege an "occurrence"; *Charles Hampton's A-1 Signs, Inc. v. American States Ins. Co.*, 225 S.W.3d 482 (Tenn. Ct. App. 2006 app. denied 2007) – applying Missouri law; *J. E. Jones Const.*

Co. v. Chubb & Sons, Inc. 486 F.3d 337 (8th Cir. 2007) – applying Missouri law; *St. Paul Fire and Marine Ins. Co. v. Building Const. Enterprises, Inc.*, 484 F. Supp.2d (W.D. Mo. 2007).

ND. *Century Sur. Co. v. Demolition & Dev., Ltd*, 2006 WL 163174 (N. D. Ill. 2006) - misidentifying building for demolition was not an "occurrence".

Oh. *Westfield Cos. v. Gibbs*, 2005 WL 1940305 (Oh. Ct. App. – 11th Dist. 2005) – property owner's action against contractor alleging fraud and trespass did not satisfy occurrence element; and later case at 2006 WL 120041 – damages resulting from contractor's delay was not an "accident" and therefore did not arise for an "occurrence".

Or. *Oak Crest Const. Co. v. Austin Mutual Ins. Co.*, 998 P.2d 1254 (Or. 2006).

Pa. *Millers Capital Ins. Co. v. Gambone Bros. Development Co., Inc.* 941 A.2d 706 (Pa. 2007), app. denied. 963 A.2d 471 (Pa. 2008) - defective drywall resulting in delamination, pealing and disfigurement, which compromised structural integrity, was not caused by an accident and, thus, the policy provided no coverage as there was no "occurrence" ; *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 589 Pa. 317, 908 A.2d 888 (Pa. 2006) - failure to construct coke oven battery properly such that oven walls spalled, rod housings bowed, and ovens cracked paver bricks was not an accident and, therefore, was not an "occurrence".

S.C. *L-J, Inc. v. Bituminous Fire and Marine Ins. Co.*, 366 S.C. 117, 621 S.E.2d 33 (S. C. 2005) – poor workmanship resulting in roads that deteriorated much more quickly than normal did not amount to an "occurrence".

Wash. *Mid-Continent Cas. Co. v. Williamsburg Condominium Ass'n*, 2006 WL 2927664 (W. D. Wash. 2006) - property damage to condominiums caused by builder's breach of contract and/or breach of warranty could not be regarded as an "occurrence".

W. Va. *Webster County Solid Waste Authority v. Brackenrich & Associates, Inc.* 217 W.Va. 304, 617 S.E.2d 851 (W. Va. 2005) - defective workmanship by engineering firm hired to design and supervise the construction of upgrades to a county land fill was not an "occurrence".

Decisions Finding Faulty Work a Basis for an "Occurrence":

Ariz. *Lennar Corp. v. Auto-Owners Ins. Co.*, 151 P.3d 538 (Ariz. Ct. App. Div. 1 2007).

Ark. *U.S. Fidelity & Guar. Co. v. Continental Cas. Co.*, 120 S.W.3d 556 (Ark. 2003) - "First, we must consider whether there was an occurrence. Appellants argue that the 'occurrence' that gave rise to the property damage was Ray's defective workmanship on the Wal-Mart projects. The policy defines an 'occurrence' as 'an accident.' We have defined an 'accident' as 'an event that takes place without one's foresight or expectation—an event that proceeds from an unknown cause, or is an unusual effect of a known cause, and therefore not expected.' Because the policy has defined 'occurrence,' and because we have defined 'accident,' we conclude that the remaining fact question which must be resolved in this case before coverage can be determined is whether Ray's workmanship on the Wal-Mart projects constituted an 'accident.'" The court noted that there is a split of authority on whether defective workmanship is an accident and therefore an "occurrence" under a general liability policy.

Cal. *McGranahan v. insurance Corp. of NY*, 544 F. Supp.2d 1052 (E.D. Call 2008) - "occurrence" alleged where complaint was neutral regarding whether insured intended to install moldy drywall, as it only asserted it installed moldy drywall.

Colo. *Hoang v. Monterra Homes (Powederhorn) LLC,*, 129 P.3d 1028 (Colo. Ct. App. 2005), as modified on denial of reh'g and cert. granted - claim that homebuilder was negligent in constructing homes on unsuitable site containing expansive soils alleged an "occurrence".

Fla. *U. S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007). See discussion in this Article.

Ga. *SawHorse, Inc. v. Southern Guar. Ins. Co. of Georgia*, 269 Ga. App. 493, 604 S.E.2d 541 (Ga. 2004) - "Southern Guaranty has cited no Georgia authority supporting its apparent claim that faulty workmanship cannot constitute an 'occurrence' under a general commercial liability policy. And this claim runs counter to case law finding that policies with similar 'occurrence' language provide coverage for 'the risk that. . . defective or faulty workmanship will cause injury to people or damage to other property.' Furthermore, Southern Guaranty has pointed to no evidence that SawHorse intended for the faulty workmanship to occur. Under these circumstances, Southern Guaranty is not entitled to summary judgment based on the 'occurrence' language in the policy."

Ind. *Indiana Ins. Co. v. Alloyd Insulation Co.*, 2002 WL 1770491 (Ohio Ct. App. 2d Dist. Montgomery County 2002) - corrosion and consequential property damage from faulty roof due to defective workmanship constituted an "accident" and thus an "occurrence".

Kan. *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 33 Kan. App.2d 504, 104 P.3d 997 (Kan. 2005) - damage that occurs over time as a result of defective materials or workmanship in the construction of a home and leads to structural damage is an "occurrence"; 281 Kan. 844, 137 P.3d 486 (Kan. 2006) - homeowners' claim for property damage from window leaks against general contractor constituted an "occurrence" as there is nothing in the basic coverage language of the CGL policy to support any definitive tort/contract line of demarcation for purposes of determining coverage.

Ky. *Bituminous Cas. Corp. v. Kenway Contracting, Inc.*, 240 S.W.3d 633 (Ky. 2007) - intentional act of contractor's employee in demolishing part of home, allegedly because contractor had not communicated to employee that the project was limited to demolishing the home's carport, constituted an “accident” and therefore was an “occurrence,” within the meaning of CGL policy.

La. *Broadmoor Anderson v. National Union Fire Ins. Co. of Louisiana*, 912 So.2d 400 (La. Ct. App.2d Cir. 2005) - defective ceramic tile and stone work resulting in water infiltration constituted an "occurrence"; *North American Treatment Systems, Inc. v. Scottsdale Ins. Co.*, 943 So.2d 429 (La. Ct. App. [1st Cir.] 2006), writ denied, 2007 WL 781850 and 2007 WL 781854 - claims of negligent work resulting in a collapse at a wastewater treatment plant clearly claimed damages by reason of an "occurrence".

Minn. *O'Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99 (Minn. Ct. App. 1996) abrogated on other grounds by *Gordon v. Microsoft Corp.*, 645 N.W.2d 393 (Minn. 2002).

Mo. *Columbia Mut. Ins. Co. v. Epstein*, 239 S.W.3d 667 (Mo. Ct. App. E.D. 2007) - defect in concrete purchased for house foundation was "accident" and, thus, "occurrence"; *American States Ins. Co. v. Herman C. Kempker Const. Co., Inc.*, 71 S.W.3d 232 (Mo. Ct. App. W.D. 2002) - developer's claim that insured contractor negligently misrepresented construction of street in development potentially was an "occurrence" and therefore, insurer had a duty to defend.

Oh. *Dublin Bldg. Sys. v. Selective Ins. Co. of South Carolina*, 874 N.E.2d 788 (Ohio Ct. App. 10th Dist. Franklin County 2007) - property damage, including mold contamination, caused by exterior stucco subcontractor, who failed to properly seal office building's exterior walls, constituted an insurable “occurrence”; *Erie Ins. Exchange v. Colony Dev. Corp.* 736 N.E.2d 941 (Ohio Ct. App. 10th Dist. Franklin County 2006); *Victoria's Secret Stores, Inc. v. Epstein Contracting, Inc.*, 2002 WL 723215 (Ohio Ct. App. 10th Dist. Franklin County 2002) - collapse of store's ceiling was an "accident" and, therefore, an "occurrence" within the meaning of contractor's CGL policy, but express contractual liability exclusion applied to shield insurers from liability.

Pa. *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 2003 Pa Super 149, 825 A.2d 641, 654 (Pa. 2003) - "In the instant case, the damage at issue is not the absence of the grout or the size of the grout spaces but the deformation and deflection of the brick work, tie rods and roof of the battery which occurred after the battery was placed in use. Whether that damage was caused in whole or in part by the torrential rains of October 31st and November 1st, or by some other event during the heatup of the battery, we

are not hesitant to conclude that the physical damage to the battery constituted an occurrence for which the policies provide coverage *UNLESS* otherwise precluded by one of the exclusions set forth in the policy."

N.D. *ACUITY v. Burd & Smith Const., Inc.*, 721 N.W.2d 33, 39-40 (N.D. 2006) - "We agree with the rationale of those courts holding that faulty workmanship causing damage to property other than the work product is an accidental occurrence for purposes of the CGL policy. . . . Here, the Kailliers allege damage to the interior of the apartment building. We conclude that claim is the type of risk covered by a CGL policy and constitutes an 'occurrence' under ACUITY's policy."

Neb. *Auto-Owners Ins. Co. v. Home Pride Companies, Inc.*, 268 Neb. 528, 684 N.W.2d 571, 577-78 (Neb. 2004) - "Although it is clear that faulty workmanship, standing alone, is not covered under a standard CGL policy, it is important to realize that there are two different justifications for this rule. On the one hand, the rule has been justified on public policy grounds, primarily on the long-founded notion that the cost to repair and replace the damages caused by faulty workmanship is a business risk not covered under a CGL policy. Today, the business risk rule is part of standard CGL policies in the form of "your work" exceptions to coverage. Therefore, the business risk rule does not serve as an initial bar to coverage, but, rather, as a potential exclusion, via the "your work" exclusions, if an initial grant of coverage is founded. . . . Important here, although faulty workmanship, standing alone is not an occurrence under a CGL policy, an accident caused by faulty workmanship is a covered occurrence. . . . In the instant case, [insureds' subcontractors] negligently installed shingles on a number of apartments, which caused the shingles to fall off. Additionally, the amended petition alleged that as a consequence of the faulty work, the roof structures and buildings have experienced substantial damage. This latter allegation represents an unintended and unexpected consequence of the contractors' faulty workmanship and goes beyond damages to the contractors' own work product. Therefore, the amended petition properly alleged an occurrence within the meaning of the insurance policy."

S.C. *Auto Owners Ins. Co., Inc. v. Newman*, 2008 WL 648546 (S.C. 2008) - water intrusion and resulting damage was an "occurrence" covered under the policy; *L-J, Inc. v. Bituminous Fire and Marine Ins. Co.* 350 S.C. 549, 567 S.E.2d 489 (S. C. Ct. App. 2002) - deterioration and failure of roads from repeated water runoff was an "accident" and, therefore, an "occurrence" and subcontractor exception to policy's business risk exclusion restored coverage otherwise excluded under the policy.

S.D. *Corner Const. Co. v. U. S. Fidelity and Guar. Co.*, 2002 S.D. 5, 638 N.W.2d 887 (S.D. 2002) - failure to fill voids between studs with insulation and to securely attach the vapor barrier was an "accident" resulting in property damage.

Tenn. *Travelers Indem. Co. of America v. Moore & Associates, Inc.*, 216 S.W.3d 302, 308-09 (Tenn. 2007) – see discussion in this Article; and *State Farm Fire and Cas. Co. v. McGowan*, 421 F.3d 433, 2005 FED App. 0374P (6th Cir. 2005) - holding that an insured's negligence was an "occurrence" under an insurance policy because it was unintended and unforeseen.

Tex. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007), answer to certified question conformed to, 501 F.3d 435 (5th Cir. 2007) – see discussion in this Article; and *CU Lloyd's of Texas v. Main Street Homes, Inc.*, 79 S.W.3d 687 (Tex. App.—Austin 2002) - homeowners' allegations that general contractor built homes after learning that foundation designs were inadequate for soil conditions and failed to disclose that knowledge to purchasers stated an "accident" and thus an "occurrence". *King v. Dallas Fire Ins. Co.* 45 Tex. Sup. Ct. J. 715, 2002 WL 1118438 (Tex. 2002), op. withdrawn and superseded on reh'g on other grounds, 85 S.W.3d 185 (Tex. 2002) - liability insurer owed duty to defend employer accused of negligently hiring and supervising employee accused of battery, because the employer's negligent hiring constituted an "occurrence"; *Lennar Corp. v. Great American Ins. Co.*, 2005 WL 1324833 (Tex. App.—Hou. [14th Dist.] 2005) - suit to recover costs paid to repair water damage and replace defective exterior insulation and finish systems on hundreds of homes built in the Houston area in the late 1990s alleged an "occurrence", and 200 S.W.3d 651 (Tex. App. Hou. [14th Dist.] 2006, writ granted) - homebuilder's negligent construction of homes using defective exterior insulation and finish system constituted an "occurrence" within scope of CGL and commercial umbrella liability policies; *Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 2009 WL 189886 (5th Cir. [Tex.] 2009) - faulty workmanship allegations against contractor in the construction of five condominiums that

2. Three Views of an "Accident"

The following are three views adopted by courts as to determining whether faulty workmanship constitutes an "accident" and thus an "occurrence".

a. First View: Intent Irrelevant; Faulty Workmanship *Per Se* Not an "Occurrence"

Some courts find that faulty workmanship *per se* can not trigger a covered "occurrence."[9] Some

---

resulted in water leakage was an occurrence; *Pine Oak Builders, Inc. v. Great American Lloyds Ins. Co.*, 2006 WL 1892669 (Tex. App.—Hou. [14th Dist.] 2006) - property damage caused by defective construction may constitute an "occurrence" if it is inadvertent and results in damage to the insured's own work, the result of which is unintended and unexpected, *rev'd on other grounds Pine Oak Builders' Inc. v. Great American Lloyds Ins. Co*., 279 S.W.3d 650 (Tex. 2009) – see discussion in this Article.

Utah. *Great American Ins. Co. v. Woodside Homes Corp.*, 448 F. Supp.2d 1275 (D. Utah 2006) - subcontractor's faulty work causing cracks in building foundation, basement floor, and driveway involved an occurrence such that breach of warranty claim and breach of contract claim were potentially covered.

Wash. *Mid-Continent Cas. Co. v. Titan Const. Corp.* 281 Fed. Appx. 766 (9th Cir. 2008) - negligent construction of condominium that resulted in breach of contract and breach of warranty claims constituted "occurrence" under CGL policy.

Wisc. *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65, 76 (Wis. 2004) - "American Family argues that because Pleasant's claim is for breach of contract/breach of warranty it cannot be an "occurrence," because the CGL is not intended to cover contract claims arising out of the insured's defective work or product, but this is by operation of the CGL's business risk exclusions, not because a loss actionable only in contract can never be the result of an "occurrence" within the meaning of the CGL's initial grant of coverage. This distinction is sometimes overlooked and has resulted in some regrettably overbroad generalizations about CGL policies in our case law."; *1325 North Van Buren, LLC v. T-3 Group, Ltd.*, 284 Wis.2d 387, 2005 WI. App. 121, 701 N.W.2d 13 (Ct. App. 2005), review granted 2005 WI. 150, 286 Wis.2d 97, 705 N.W.2d 659 (Wis. 2005) - CM-at-risk failures that result in property damage and delays were an occurrence; *Glendenning's Limestone & Ready-Mix Co., Inc. v. Reimer*, 721 N.W.2d 704 (Wis. Ct. App. 2006) - concluding, after a detailed discussion, that "occurrence" is not equivalent to faulty workmanship, but rather faulty workmanship may result in an "occurrence" and, in this case, where pleading alleges that the rubber mats that subcontractor improperly installed were damaged by a scraper that cleans manure from them is a claim for property damage caused by an occurrence in that the damage was not intended or anticipated and that it was also not intended or anticipated that using the scraper to clean the manure off the mats would damage the mats; *Stuart v. Weisflog's Showroom Gallery, Inc.*, 722 N.W.2d 766 (Wis. Ct. App. 2006, review granted), 727 N.W.2d 34 (Wis. 2006) - insured's misrepresentations that it was a licensed architect and familiar with building code requirements qualified as "occurrences" per its insurance policy because intent to deceive is not a necessary element of homeowners' cause of action.

[9] Faulty Workmanship Not Grounds for an "Occurrence". *DCB Const. Co., Inc. v. Travelers Indem. Co. of Illinois*, 225 F.Supp.2d 1230 (D. Colo. 2002) - no accident where contractor had to tear down walls and rebuild them because they did not meet specifications for sound transmission; *Monticello Ins. Co. v. Wil—Freds Const., Inc.* 661 N.E.2d 451 (Ill. 2d Dist. 1996); *State Farm Fire and Cas. Co. v. Tillerson*, 334 Ill. App.3d 404, 777 N.E.2d 986 (Ill. 5th Dist. 2002) - construction defects not an "occurrence" as they were ordinary consequence of contractor's improper work; *Hawkeye-Security Ins. Co. v. Vector Const. Co.*, 460 N.W.2d 329 (1990); *ACS Const. Co., Inc. of Mississippi v. CGU*, 332 F.3d 885, 889 (5th Cir. [Miss.] 2003) - "The faulty workmanship of the waterproofing membrane resulting in the leaks does not constitute an 'occurrence' under the policy."; *Cincinnati Ins. Co. v. Venetian Terrazzo, Inc.*, 198 F. Supp.2d 1074 (E.D. Mo. 2001) - alleged negligence in pouring concrete subfloor did not constitute an accident or an "occurrence" and therefore insurer had no duty to defend; *L-J, Inc. v. Bituminous Fire and Marine Ins. Co.*, 2004 WL 1775571 (S.C. 2004) - premature

courts ground their decision of no occurrence on the rationale that CGL insurance is not intended to protect an insured from having to repair or replace improperly performed work.[10] These courts hold that such losses are an "expectation" loss, and to hold otherwise would be to encourage poor workmanship. These courts do not base their opinion on the terms of the policy but on "public policy". Some courts falling into this line of reasoning compare use of CGL policies for this purpose as an attempt to substitute a CGL policy for a performance bond.[11] These courts overlook the fact that property damage may be covered by both a CGL policy and a performance bond, but for different purposes.

b. Second View: Coverage Depends on Actor's Intent

The majority of courts focus on the intent of the actor.[12] However, since most action involves a

---

deterioration of roads as a result of faulty workmanship was not caused by an "occurrence"; *ProDent, Inc. v. Zurich U.S.*, 33 Fed. Appx. 32 (3rd Cir. 2002) - negligence in installing copper pipes instead of PVC called for by drawings was not an "occurrence" within meaning of policy.

[10] Rationale that Faulty Workmanship is a "Business Risk" Not Covered by CGL Policy. For example, this rationale is set out in Henderson, Insurance Protection for Products Liability & Completed Operations—What Every Lawyer Should Know, 50 NEB. L. REV. 415, 441 (1971) where the commentator states that CGL coverage is "for tort liability for physical damage to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained." *See* the following Minnesota court decisions following this "tort vs. contract" rationale in interpreting the Broad Form Property Damage Endorsement to the pre-1986 CGL policy form: *Bor-Son Building Corp. v. Employers Commercial Union Ins. Co. of America*, 323 N.W.2d 58 (Minn. 1982) and *Knutson Construction Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229 (Minn. 1986). Henderson's article is addressing the coverage language of even the earlier pre-1966 version. Unfortunately, some court decisions have cited this article and the "tort vs. contract" rationale as the coverage test in construing post-1986 policies without recognizing the changes reflected in the 1986 revision. *See, e.g., Data Specialties, Inc. v. Transcontinental Ins. Co.*, 125 F.3d 909 (5th Cir. 1997) – court found no coverage as insured's obligation to repair arose out of a contract obligation, not a tort; *Silk v. Flat Top Const., Inc.*, 453 S.E.2d 356 (Va. 1994) – construction manager's liability for failing to properly supervise and inspect work resulting in cost overruns is a result of breach of contract not tort.

[11] The Illogical Performance Bond Comparison. *Essex Ins. Co. v. Holder*, 261 S.W.3d 456 (Ark. 2007) - faulty workmanship is not an accident; instead it is a foreseeable occurrence and performance bonds exist in the market place to insure the contractor against claims for the cost of repair or replacement of faulty work; *Oak Crest Const. Co. v. Austin Mut. Ins. Co.*, 137 Or. App. 475, 905 P.2d 848 (Or. 1995) aff'd 329 Or. 620, 998 P.2d 1254 (Or. 2000); *U. S. Fidelity & Guar. Corp. v. Advance Roofing & Supply Co., Inc.*, 163 Ariz. 476, 788 P.2d 1227 (Ariz. Ct. App. Div. 1 1989) – no coverage existed for contractor that installed negligent roofs as poor workmanship did not amount to an occurrence and to hold otherwise would be tantamount to converting the CGL policy into a performance bond. However, although there is an overlap in coverage between performance bonds and CGL insurance, neither is a substitute for the other. A performance bond does not extend to cover "bodily injury" like a CGL policy; and a performance bond covers many other risks than failure of the contractor or, if given by subcontractors, the subcontractors' breaches of contract, except to the extent of a CGL's coverage of a subcontractor's damage to the work or the project.

[12] An Intent-Based Definition of "Occurrence" – the Majority Rule. *Sheets v. Brethren Mut. Ins. Co.*, 342 Md. 634, 679 A.2d 540, 58 A.L.R.5th 883 (1996) – court states that Maryland follows the majority position that whether a loss arises from an accident is to be determined from the standpoint of the insured's subjective intent. The court in *Indiana Ins. Co. v. Hydra Corp.*, 245 Ill. App.3d, 185 Ill. Dec. 775, 615 N.E.2d 70, 73 (2d Dist. 1993) defined an "occurrence" with a focus on whether the damages were intended or expected by the insured. The court defined "occurrence" as "an unforeseen occurrence, usually of an untoward or disastrous character or an undesigned, sudden or unexpected event of an inflictive or unfortunate character." *Voorhees v. Preferred*

degree of intent, focus on an actor's intent to act runs the risk of holding that an "accident" could not occur as the actor intended his action, even though he did not intend to cause the damage that resulted. Even when the focus is on the consequence of an insured's act, as opposed to the act itself, there is a wide divergence in court decisions as to whether a covered loss has occurred.

The concept of excluding from coverage expected or intended damages is specifically addressed in the standard policy at Paragraph 2a Exclusion – Expected or Intended Injury. Paragraph 2a is the result of ISO's modifying the standard policy form in 1986 to remove the following language from the definition of an "occurrence":

> which results in 'bodily injury' or 'property damage' neither expected nor intended from the standpoint of the insured.

and by creating a new exclusion from coverage for "expected or intended injuries", set out in the standard policy above at Paragraph 2a.

The Tennessee Supreme Court noted the following seven approaches that courts have taken to determine whether the injury or damage incurred is excluded from coverage as an expected or intended injury.[13]

> (1) One approach has been to decide whether there was an intent to do "some" harm, which disregards the question of whether the insured wanted to cause the particular harm that resulted. … (2) A second approach has been to focus on whether the insured intended to commit the act and also intended to commit some type of harm. … [S]ome jurisdictions have indicated that the insured's intent in this regard may be actual or inferred from the nature of the act and the accompanying reasonable foreseeability of harm. … (3) A third approach is to hold that an exclusionary provision … applies where an intentional act by an insured person results in injuries or damages that are a natural and probable result of the act. … (4) A fourth method has been to construe the policy language so that there can be no recovery if the ultimate result is substantially certain to be a consequence of the insured's actions. … (5) A fifth view has been to hold that the insured must have intended that the act cause the type of injury that actually occurred and, in addition, intended to harm the person who actually sustained the injury. … (6) A sixth method of analysis has become known as the "damn fool"

Mut. Ins. Co., 128 N.J. 165, 607 A.2d 1255, 1263, 8 A.L.R. 5th 937 (1992); *Economy Lumber Co. v. Insurance Co. of North America*, 157 Cal. App. 3d 641, 204 Cal. Rptr. 135 (1st Dist. 1984) - damage caused by the application of defective siding was an occurrence; however, if more siding applied after knowing of the damage it caused, then damage is not unforeseeable and no "occurrence". *Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720 (5th Cir. 1999) - suit which included allegations that insured excavation subcontractor negligently damaged work of paving subcontractor through use of substandard fill asserted "accident" within definition ascribed to that term by Texas Supreme Court and thus "occurrence" within meaning of commercial general liability policy.

[13] Seven Approaches in Determining if Damages are Covered as Expected or Unforeseeable Damages. *Tennessee Farmers Mut. Ins. Co. v. Evans*, 814 S.W.2d 49, 54-55 (Tenn. 1991).

> doctrine, which simply means that coverage is not provided for acts which are simply too ill-conceived to warrant allowing the insured to transfer the risk of such conduct to an insurer. … (7) A seventh view, a combination of some of those mentioned previously, is that the insured must have intended the act and also to have caused some kind of injury in order for the intentional injury exclusion to apply, but once it is found that harm was intended, it is immaterial that the actual harm caused is of a different character or magnitude from that intended by the insured. (*Approach numbering and underlining added by author*.)

Illustrative of these approaches are the following seven approaches:

(1) The "Specific Intent Rule" - No Coverage if There is an Intent to Do Some Harm

The approach results in a broad reading of the exclusion and thus results in very limited coverage for the insured. This approach is followed by very few courts.[14]

(2) No Coverage if Act Is Intentional and There is an Expectation of Resulting Damage

Some courts have employed an "expectation" of injury standard, and in so doing have imported a "foreseeability" test.[15] Other courts have recognized the fallacy of this as the test.[16]

---

[14] 1st Approach to Interpreting Exclusion 2a for Expected or Intended Injuries. Keeton, INSURANCE LAW 520 (1988). *See discussion at* 31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured § 5(a) Construction of "intended" – View that insured must have intended act and to cause some kind of bodily injury or property damage – generally (1984).

[15] 2nd Approach to Interpreting Exclusion 2a for Expected or Intended Injuries – the View that Coverage (Finding an "Accident") Depends on Whether the Loss is an Unexpected or Unforeseeable Consequence of Insured's Actions. *Calvert Ins. Co. v. Western Ins. Co.*, 874 F.2d 396, 399 (7th Cir. 1989) - "Injury is 'expected' where the damages are not accomplished by design or plan, *i.e.*, not 'intended,' but are 'of such a nature that they should have been *reasonably anticipated* (expected) by the insured.'" (emphasis in original). *Taylor-Moreley-Simmon, Inc. v. Michigan Mut. Ins. Co.*, 645 F. Supp. 596, 599-600 (E. D. Mo. 1986), judgm't aff'd, 822 F.2d 1093 (8th Cir. 1987) - "[A]n accident includes that which happens by chance or fortuitously, without intention or design, and which is unexpected, unusual, and unforeseen… . The alleged breaches of warranty raised in the [plaintiff's] petition do not remove the conduct at issue here from the "accident" category for purposes of this lawsuit." *Smith v. Hughes Aircraft Co. Corp.* 783 F.Supp. 1222, 1235-37 (D. Ariz. 1991), aff'd in relevant part, rev'd in part and remanded, 22 F.3d 1432 (9th Cir. 1993) - "Because the insured's intent is measured subjectively, it follows that the insured's expectations should be measured similarly.") *Queen City Farms, Inc. v. Central Nat. Ins. Co. of Omaha*, 126 Wash. 2d 50, 882 P.2d 703 (Wash. 1994), as amended (1994) and as clarified on denial of reconsideration (Wash. 1995) - subjective standard applied in determining whether personal injury or property damage arising from contamination of groundwater resulting from leak of toxic materials from waste pit was "occurrence," covered by liability policies, which defined occurrence as accident or happening or event or continuous or repeated exposure to conditions which unexpectedly and unintentionally resulted in personal injury or property damage. Keeton, INSURANCE LAW 520 (1988). *See discussion at* 31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured § 5(a) Construction of "intended" – View that insured must have intended act and to cause some kind of bodily injury or property damage – generally (1984).

[16] Rejection of Foreseeability as the Test. *Armstrong World Industries, Inc. v. Aetna Cas. & Surety Co.*, 45 Cal. App. 4th 1, 52 Cal. Rptr.2d 690 (1st Dist. 1996):

(3) The "Natural and Probable Consequences" Test

Other courts have stated the standard as whether the damages are a result of the natural and ordinary consequence of the insured's action and thus not covered.[17] The Fifth Circuit in *Federated Mut. Ins. Co. v. Grapevine Excavation*, 197 F.3d 720 (5th Cir. 1999) addressed the Texas law approach of distinguishing between excluded intentional conduct and covered voluntary conduct as follows:

> We perceive a clearly reconcilable dichotomy, not a tension, resulting from the distinction between the *Maupin*[18] and *Orkin*[19] line of cases; in the former, the damage-causing acts of the tortfeasor are either actually or legally deemed to be intentionally harmful; in the latter, the acts that are performed intentionally are

---

> In our view, imposing a "should have known" standard on insureds would defeat the essential purpose of insurance agreements. What is expected or intended is different from that which was reasonably foreseeable or what should have been known. An insurance policy exclusion from manufacturing activities which carry a risk of causing environmental harm, although not known or intended to cause harm in the insureds business conduct, would create an exclusion swallowing the entire purpose of the insurance protection for unintended consequences. Insurance is purchased and premiums are paid to indemnify the insured for damages caused by accidents, that is, for conduct not meant to cause harm but which goes awry. The insured may be negligent indeed in failing to take precautions or to foresee the possibility of harm, yet insurance coverage protects the insured from his own lack of due care. If coverage is lost for damage which a prudent person should have foreseen, there would be no point to purchasing a policy of liability insurance.

[17] 3rd Approach to Interpreting Exclusion 2a for Expected or Intended Injuries – the Minority View - the Natural and Ordinary Consequence of Action is Not Covered. *See discussion at* 31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured § 5(d) Construction of "intended" – View that classic tort doctrine of looking to natural and probable consequences of insured's act determines intent – generally (1984). *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633 (Tex. 1973) – court found that an "occurrence" did not exist as the damage was a natural result of voluntary and intentional acts by the insured, even if the insured was unaware or did not intend the resulting damages. The court found that the insured, a contractor, acted intentionally when it removed soil from the property pursuant to a contract with a tenant. *Armstrong v. Security Ins. Group*, 292 Ala. 27, 288 So.2d 134 (Ala. 1973); *Casualty Reciprocal Exchange v. Thomas*, 647 P.2d 1361 (Kan. 1982); *Northwestern Nat. Casualty Co. v. Phalen*, 597 P.2d 720 (Mont. 1979); *Vittum v. New Hampshire Ins. Co.*, 369 A.2d 184 (N.H. 1977). *See discussion at* 31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured § 5(d) Construction of "intended" – View that classic tort doctrine of looking to natural and probable consequences of insured's act determines intent – generally (1984).

This approach has been criticized by commentators. See Holmes, APPLEMAN ON INSURANCE, 2d, § 116.4 at 148 (1996) - "[Minority rule that the natural and ordinary consequences of a negligent act do not constitute an accident] is, of course, nonsense."); and § 117.3 at 247 "This judicial holding seriously restricts or limits the liability insurer's liability so as to render the liability policy valueless or even meaningless."; and § 117.3 at 259 "[T]hese opinions. . . essentially annul a large amount of liability coverage."

[18] *Maupin*. *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633 (Tex. 1973).

[19] *Orkin*. *Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396 (Tex. 1967). The court in *Orkin* determined that an accident occurred and the insured was covered for property damage resulting from its negligent application of pesticide. The court stated that "accident" included "negligent acts of the insured causing damage which is undersigned and unexpected." *Id.* at 400.

> not intended to cause harm but do so as the result of negligent performance of those acts. In the instant case, both types of tortious acts frequently occur in the performance of a contract; the difference lies in the way that the obligor performs. An obligor who intends his performance to result in damage—or, one who commits an act that is legally deemed to constitute an intentional tort—is a *Maupin* tortfeasor. On the other hand, an obligor that intends his performance to be correct, but who negligently falls short of the appropriate standard and causes unintentional damage, is an *Orkin* tortfeasor. Had the only allegations against GEI [the insured] accused it of knowingly and willfully choosing and using the substandard material that damaged the paving, and doing so to cut corners or gain unearned profit, GEI would be a *Maupin* tortfeasor. As [the contractor's] allegations against GEI include negligence, however, GEI is an *Orkin* tortfeasor.

In *Grapevine Excavation* the insured contractor subcontracted to provide excavation, backfill and compaction for a retailer's parking lot. Due to the contractor's use of fill materials that failed to meet the retailer's compaction specifications, its subcontractor's paving failed and the contractor cured the construction defect by overlaying another coat of blacktop. The court found that the damages suffered by the contractor were the result of a covered accident.

(4) No Coverage if Ultimate Result is a Substantially Certain Consequence of the Act[20]

Courts adopting this view employ a more objective test as to intent.[21]

(5) No Coverage if Insured Intended Act that Caused Type of Injury that Actually Occurred and Intended to Injure Person that Was Actually Injured.[22]

Few courts have adopted this stringent test as the sole basis of finding an exclusion from coverage.

(6) The "Damn Fool" Doctrine

This approach is to exclude coverage for damage caused by actions too ill-conceived to permit coverage. Discussing this doctrine, Professor Keeton states:

---

[20] 4th Approach to Interpreting Exclusion 2a for Expected or Intended Injuries: No Coverage if Ultimate Result is a Substantially Certain Consequence of the Act. Keeton, INSURANCE LAW 523 (1988).

[21] 4th Approach – an Objective Test. *City of Carter Lake v. Aetna Cas. & Sur. Co.*, 604 F.2d 1052 (8th Cir. 1979) – court held no coverage for damage to a property's owner's basement due to the insured's operations where the court determined the insured "knew or should have known after the first instance of flooding that further flooding was 'substantially probable."

[22] 5th Approach to Interpreting Exclusion 2a for Expected or Intended Injuries: No Coverage if Insured Intended Act that Caused Type of Injury that Actually Occurred and Intended to Injure Person that Was Actually Injured. Keeton, INSURANCE LAW 521 (1988). *See discussion at* 31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured § 5(f) Construction of "intended" – View that insured must have had specific intent to cause type of injuries suffered (1984).

> All of these situations involve 'calculated' decisions by insureds. There are many instances in which an insured's course of conduct was intentional, but the consequences which resulted, though highly expectable, were clearly not intended or desired by the insured. When one attempts to predict whether a court will negate the insuror's decision to reject coverage under a liability insurance policy in such cases, an analytical approach that is worth considering is whether the insured's actions fall into the category of incredibly foolish conduct.[23]

However, in some jurisdictions coverage is found even though the insured's conduct was reckless.[24]

(7) No Coverage if Insured Intended Some Harm, Even if the Damage is Not the Harm Intended

In this approach the insured must have intended the act and also to have caused some kind of injury in order for the intentional injury exclusion to apply, but once it is found that harm was intended, it is immaterial that the actual harm caused is of a different character or magnitude from that intended by the insured.[25]

c. Third View: "Occurrence" is Too Ambiguous

Some courts have held that the term "occurrence" is ambiguous and does not provide a basis for limitation on coverage.[26]

3. <u>Texas, Florida and Tennessee – the "2007 Cases": the Rejection of Negligence, Foreseeability of Damage and Natural and Probable Consequence as Exclusions in Determining an "Occurrence"</u>

---

[23] <u>No Coverage for "Damn Fool" Conduct</u>. Keeton, INSURANCE LAW 539-541 (1988).

[24] <u>Coverage for Reckless Action</u>. *Koch Engineering Co., Inc. v. Gibraltar Casualty Co., Inc.*, 78 F.3d 1291 (8th Cir. 1996) – insured defectively designed and provided equipment to plant resulting in $7,000,000 in damages for breach of warranty. The court stated "regardless of the reckless character of behavior, the insurer must show that Koch (the insured) intended the results of its actions. *Id.* at 1294. There was no evidence that Koch actually intended that the equipment would perform in a defective manner.

[25] <u>7th Approach: Coverage Denied If Intentional Act Has Resulted in Intentional Injury</u>. *Lockhart v. Allstate Ins. Co.*, 579 P.2d 1120 (Az. 1978); *Butler v. Behaeghe*, 548 P.2d 934 (Colo. 1976); *Hartford Fire Ins. Co. v. Spreen*, 343 So.2d 649 (Fla. App. 1977); *Colonial Penn Ins. Co. v. Hart*, 291 S.E.2d 410 (Ga. 1982); *Aetna Cas. & Sur. Co. v. Freyer*, 411 N.E.2d 1157 (Ill. 1980); *Hanover Ins. Co. v. Newcomer*, 585 S.W.2d 285 (Mo. App. 1979); *Oakes v. State Farm Fire & Cas. Co.*, 137 N.J. Super. 365, 349 A.2d 102 (N.J. 1975).

[26] <u>"Occurrence", an Ambiguous Term</u>. *Western World v. Paradise Pools & Spas, Inc.*, 633 So.2d 790 (La. Ct. App. 5th Cir. 1994) – defective construction resulting in cracks in a swimming pool constituted an "occurrence" as the term "occurrence" is ambiguous. *See discussion at* 31 A.L.R.4th 957 Construction and application of provision of liability insurance policy expressly excluding injuries intended or expected by insured § 3(a) Ambiguity of exclusion clause – View that clause is inherently ambiguous (1984).

In its 2007 decision the Texas Supreme Court in *Lamar Homes, Inc. v. Mid-Continent Cas. Co.* held that an insured builder's faulty workmanship in building a house foundation met the "occurrence" requirement of its CGL policy. The court analyzed the issue as follows:[27]

> We begin with the question whether defective construction or faulty workmanship that damages only the work of the insured is an "occurrence." As previously mentioned, "occurrence" is defined, in part, as an accident, but accident is not otherwise defined in the policy. Terms that are not defined in a policy are given their generally accepted or commonly understood meaning.
>
> The insurance carrier submits that the damages alleged here for repairs to the home are direct economic damages flowing from Lamar's contractual undertaking and are conclusively presumed to have been foreseen by Lamar. [The homeowners alleged that Lamar was negligent in designing and constructing their home's foundation and that, as a result, the home's sheetrock and stone veneer cracked.] Thus, the carrier concludes that faulty workmanship is not an accident because injury to the general contractor's work is the expected and foreseeable consequence. … [Texas law], however, did not adopt foreseeability as the boundary between accidental and intentional conduct. Insurance is typically priced and purchased on the basis of foreseeable risks, and reading [Texas law] as the carrier urges would undermine the basis for most insurance coverage. Moreover, the carrier's argument includes a false assumption—that the failure to perform under a contract is always intentional (or stated differently "that an accident can never exist apart from a tort claim"). …
>
> An accident is generally understood to be a fortuitous, unexpected, and unintended event. … [A] claim does not involve an accident or occurrence when either direct allegations purport that the insured intended the injury (which is presumed in cases of intentional tort) or circumstances confirm that the resulting damage was the natural and expected result of the insured's actions, that is, was highly probable whether the insured was negligent or not. Applying our prior decisions, the Fifth Circuit has concluded that the terms "accident" and "occurrence" include damage that is the "unexpected, unforeseen or undesigned happening or consequence" of an insured's negligent behavior, including "claims for damage caused by an insured's defective performance or faulty workmanship." The federal district court here [question certified by the Fifth Circuit under appeal from the federal district court that ruled against the insured] distinguishes [prior Fifth Circuit case law finding poor workmanship meets the occurrence element] by drawing the distinction between faulty workmanship that damages the insured's work or product and faulty workmanship that damages a third party's property. … The CGL policy, however, does not define an "occurrence" in terms of the ownership or character of the property damaged by the act or event. Rather, the policy asks whether the injury was intended or fortuitous, that is, whether the

[27] Texas. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007), answer to certified question conformed to, 501 F.3d 435 (5th Cir. 2007).

> injury was an accident. … We … see no basis in the definition of "occurrence" for the district court's distinction.
>
> The determination of whether an insured's faulty workmanship was intended or accidental is dependent on the facts and circumstances of the particular case. For purposes of the duty to defend, those facts and circumstances must generally be gleaned from the plaintiffs' complaint. Here, the complaint alleges an "occurrence" because it asserts that Lamar's defective construction was a product of its negligence. No one alleges that Lamar intended or expected its work or its subcontractors' work to damage the DiMares' home. (citations omitted.)"

Subsequently, the Florida Supreme Court similarly held that a contractor's faulty workmanship (poor soil selection and improper soil compaction and testing causing damage to foundations, drywall, and interior portions of homes) was an "occurrence" under a post-1986 CGL policy. The court stated:[28]

> U.S. Fire … argues that a subcontractor's faulty workmanship that damages the contractor's own work can never be an "accident" because it results in reasonably foreseeable damages. We expressly rejected the use of the concept of "natural and probable consequences" or "foreseeability" in insurance contract interpretation in [case law]. … Further, we fail to see how defective work that results in a claim against the contractor because of injury to a third party or damage to a third party's property is "unforeseeable," while the same defective work that results in a claim against the contractor because of damage to the completed project is "foreseeable." This distinction would make the definition of "occurrence" dependent on which property was damaged. For example, applying U.S. Fire's interpretation in this case would make the subcontractor's improper soil compaction and testing an "occurrence" when it damages the homeowners' personal property, such as the wallpaper, but not an "occurrence" when it damages the homeowners' foundations and drywall.

The Tennessee Supreme Court addressed this issue in a case where the insured hired a subcontractor to install windows in a Houston hotel. The windows leaked and caused damage to the interior walls and mold resulted. The owner filed an arbitration claim with the contractor. The insured's carrier filed a declaratory judgment action in Tennessee seeking to avoid defense and coverage. The Tennessee Supreme Court followed the Texas and Florida courts' lead and stated:[29]

> Travelers argues that the water penetration was foreseeable to Moore because water penetration is a natural consequence of improperly installed windows. We are unpersuaded that the foreseeability of damages should be determined under an

---

[28] Florida. *U. S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007).

[29] Tennessee. *Travelers Indem. Co. of America v. Moore & Associates, Inc.*, 216 S.W.3d 302, 308-09 (Tenn. 2007).

assumption that the windows would be installed improperly. If foreseeability is determined from the negligent completion of the project, then the negligent acts of the insured will almost never be "accidents" because, by definition, negligence requires that damages be foreseeable. Holding that a negligent act does not constitute an "accident" is inconsistent with our previous holding that an "accident" may include the negligent acts of the insured. Other courts have observed that construing "accident" in a manner that does not cover the insured's negligence would render a CGL almost meaningless. We decline to adopt a construction of "accident" which would so drastically limit the coverage under a CGL.

Therefore, the determination of whether an "accident" has occurred under the terms of a CGL requires us to determine whether damages would have been foreseeable if the insured had completed the work properly. An example is instructive. Travelers concedes that if a contractor improperly installs a shingle that later falls and hits a passerby, this event is unforeseeable and is an "occurrence" or "accident." However, Travelers simultaneously insists that if a contractor improperly installs windows that leak and cause flood damage to the hotel, this event is foreseeable because it is a natural consequence of improperly installed windows. We are unpersuaded by this distinction. A shingle falling and injuring a person is a natural consequence of an improperly installed shingle just as water damage is a natural consequence of an improperly installed window. If we assume that either the shingle or the window installation will be completed negligently, it is foreseeable that damages will result. If, however, we assume that the installation of both the shingle and the window will be completed properly, then neither the falling shingle nor the water penetration is foreseeable and both events are "accidents." Assuming that the windows would be installed properly, Moore could not have foreseen the water penetration. Because we conclude the water penetration was an event that was unforeseeable to Moore, the alleged water penetration is both an "accident" and an "occurrence" for which there is coverage under the "insuring agreement."

4. Triggers

A question arises as to the timing of the "occurrence" and which policy affords coverage. There are four theories of "occurrence" triggers: (1) exposure – a policy is triggered upon the first exposure to the injury-causing event; (2) manifestation – a policy is triggered upon the first manifestation of injury; (3) injury-in-fact – a policy is triggered when the first injury takes place; and (4) continuous – all policies between the date of first exposure and the date of manifestation are triggered.[30]

[30] "Occurrence" Triggers.

(1) Injury-in-Fact: *Transcon. Ins. Co. v. W.G. Samuels Co.*, 370 F.3d 755 (8th Cir.); *Mut. Fire, Marine & Inland Ins. Co. v. Safeco Ins. Co.* 473 So.2d 1012 (Ala. 1985); *Hoang v. Assurance Co. of Am.*, 149 P.3d 798 (Colo. 2007); *Sentinel Ins. Co. v. First Ins. Co. of Haw.*, 875 P.2d 894 (1994); *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 481 (2001); *Gelman Scis., Inc. v. Fid. & Cas. Co. of N.Y.*, 572 N.W.2d 617 (1998) *reh'g granted on other grounds*, 576 N.W.2d 168 (1998), *overruled on other grounds by Wilkie v. Auto-Owners ins.*

The Texas Supreme Court addressed this question in *Don's Building Supply, Inc. v. OneBeacon Insurance Co.*, 267 S.W.3d 20 (Tex. 2008). In response to certified questions raised by the Fifth Circuit, 496 F.3d 361, the supreme court responded as follows adopting the "injury-in-fact" trigger in Texas:

> The Fifth Circuit asks generally when property damage "occurs" under Texas law for purposes of an occurrence-based commercial general liability insurance policy, a question this Court has never answered. More specifically, is an insurer's duty to defend triggered where damage is alleged to have occurred during the policy period but was inherently undiscoverable until after the policy expired? As to this policy, which focuses on when damage comes to pass, not when damage comes to light, we answer "yes"-the insurer's duty is triggered under Texas law; the key date is when injury happens, not when someone happens upon it.[31]

In *Don's Building Supply* the insurer sought a declaration that it had no duty to defend or indemnify its insured, Don's Building Supply (DBS), in 22 lawsuits that various homeowners filed against DBS and other defendants. Previously homeowners had filed suits against DBS asserting claims arising from water intrusion into the wall cavities of their homes due to an allegedly defective synthetic siding system know as Exterior Insulation and Finish Systems ("EIFS"). The EIFS was distributed and sold by DBS and designed, manufactured, and marketed by the other defendants. The defects are latent, being not readily apparent to one examining the exterior of the EIFS surface. DBS requested a defense from OneBeacon under three occurrence-based CGL policies issued to DBS by Potomac Insurance Company of Illinois and assigned by Potomac to OneBeacon. The central question before the federal district court was whether the property damage described in the suit is alleged to have occurred within the respective policy

---

Co., 664 N.W.2d 776 (2003); *N. States Power Co. v. Fid. & Cas. Co. of N.Y.*, 523 N.W.2d 657 (Minn. 1994); *Energy North Natural Gas*, 848 Ala.2d at 719-23; *Kief Farmers Coop. Elevator Co. v. Farmland Mut. Ins. Co.*, 534 N.W.2d 28 (N.D. 1995); *St. Paul Fire & Marine Ins. Co. v. McCormick & Baxter Creosoting Co.*, 923 P.2d 1200 (1996); *Joe Harden Builders, Inc. v. Aetna Cas. & Sur. Co.*, 486 S.E.2d 89 (1997); *Transcon Ins. Co. v. Wash. Pub. Utils. Dists.' Util. Sys.*, 760 P.2d 337 (1988).

(2) Manifestation: *Textron, Inc. v. Aetna Cas. & Sur. Co.*, 723 A.2d 1138 (R.I. 1999); *Eagle-Picher Indus. Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 121 (1st Cir. 1982)

(3) Exposure: *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc,.,* 633 F.2d 1212 (6th Cir. 1980).

(4) Continuous: *Montrose Chem. Corp. of Cal. v. Admiral Ins. Co.*, 913 P.2d 878, 880, 904 (1995) distinguishing *Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230 (1990).

[31] Texas: "Injury-in-Fact" Trigger as to an "Occurrence". *Don's Building Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008). The court specifically abrogated the holdings in the following cases: *Summit Custom Homes, Inc. v. Great Am. Lloyds Ins. Co.*, 202 S.W.3d 823 (Tex. App.—Dallas 2006, pet. filed); *State Farm Fire & Cas. Co. v. Rodriguez*, 88 S.W.3d 313 (Tex. App.—San Antonio 2002, pet. denied); *Closner v. State Farm Lloyds*, 64 S.W.3d 51 (Tex. App.—San Antonio 2001, no pet.); *State Farm Mut. Auto. Ins. Co. v. Kelly*, 945 S.W.2d 905 (Tex. App.—Austin 1997, writ denied); *Cullen/Frost Bank of Dallas, N.A. v. Commonwealth Lloyd's Ins. Co.*, 852 S.W.2d 252 (Tex. App.—Dallas 193), *writ denied*, 889 S.W.2d 266 (Tex. 1994)(per curiam); and *Dorchester Dev. Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380 (Tex. App.—Dallas 1987, no writ).

periods such that OneBeacon's duty to defend DBS was triggered. Based on the Texas Supreme Court's response, the Fifth Circuit issued its *per curiam* opinion finding that[32]

> So in this case, property damage occurred when a home that is the subject of an underlying lawsuit suffered wood rot or other physical damage. The date that the physical damage is or could have been discovered is irrelevant under the policy…. Under the actual-injury rule applicable to this policy, a plaintiff's claim against DBS that any amount of physical injury to tangible property occurred during the policy period and was caused by DBS's allegedly defective product triggers OneBeacon's duty to defend. The duty is not diminished because the property damage was undiscoverable, or not readily apparent or "manifest," until after the policy period ended.

Another recent Fifth Circuit case, *Wilshire Insurance Co. v. RJT Construction, LLC*[33] illustrates how the injury in fact may occur many years after the defective work was performed. In finding that the CGL insurance issuer had a duty to defend a foundation repair contractor, the court noted

> Wilshire urges that the homeowner's complaint in this case makes no allegations that property damage occurred during the policy period. We disagree. The complaint alleges that "cracks in the walls and ceilings" were "suddenly appearing" in late 2005. The cracks themselves are physical damage allegedly caused by the faulty foundation. This is not a case where latent internal rot long lies undiscovered before external signs war of the festering damage. The cracks are not merely a warning of prior undiscovered damage; they are the damage itself. It is of no moment that the faulty foundation work occurred in 1999, [citation omitted] or that the damage was discovered in 2005; it matters only that damage was alleged to have occurred in 2005.[34]

5. Resulting "Bodily Injury" vs. "Property Damage"

Generally, courts have been more likely to find that an injury which has resulted from faulty workmanship is an "occurrence" (*i.e.*, "accidental") if the injury is a "bodily injury" as opposed to "property damage". Also, an "occurrence" is more likely to be found if the injury is damage to property other than the insured's work.

---

[32] 5th Circuit Application of Texas Injury-in-Fact Rule. *OneBeacon Ins. Co. v. Don's Building Supply, Inc.*, F.3d (5th Cir. 2009 *per curiam*).

[33] A Covered Injury-in-Fact May "Occur" Years After the Defective Work. *Wilshire Insurance Co. v. RJT Construction* 2009 WL 2605436 (5th Cir. [Tex.] August 26, 2009). Wilshire insured RJT under two consecutive CGL policies running from June 2004 through June 2006. In 1999, RJT repaired the foundation of Ashbaugh's home after the home was damaged by an accidental discharge of plumbing water. In 2007 Ashbaugh sued RJT for negligently performing the foundation repair. Ashbaughs alleged that late in 2005 cracks in the walls and ceilings suddenly appeared in his home, damage which he attributed to the foundation being out of level.

[34] Covered Damage to Portion of Home other Than Foundation. *See* citation to this case and related discussion below of the inapplicability of Exclusion l, the "Your Work" Exclusion aka the "Completed Operations Work" Exclusion.

B. The "Property Damage" Requirement

A typical insurer argument is that an insured's "economic losses" are not covered by a CGL policy. The "economic loss" doctrine is a court-made doctrine employed in bodily injury cases to eliminate liability if the sole loss is "economic" as opposed to "bodily" injury. However, this doctrine has been employed by insurers in attempts to avoid coverage of "property damage" claims arising out of faulty construction. The court in *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65, 75-78 (Wis. 2004) addressed this argument as follows:

> The economic loss doctrine may indeed preclude tort recovery here (the underlying claim is in arbitration and not before us); regardless, everyone agrees that the loss remains actionable in contract, pursuant to specific warranties in the construction agreement between Pleasant and Renschler. To the extent that American Family is arguing categorically that a loss giving rise to a breach of contract or warranty claim can *never* constitute "property damage" within the meaning of the CGL's coverage grant, we disagree. "The language of the CGL policy and the purpose of the CGL insuring agreement will provide coverage for claims sounding in part in breach-of-contract/breach-of-warranty under some circumstances." This is such a circumstance. Pleasant's claim against Renschler for the damage to the 94DC [warehouse] is a claim for "property damage" within the meaning of the CGL's coverage grant. . . . [T]here is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL's initial grant of coverage. "Occurrence" is not defined by reference to the legal category of the claim. The term "tort" does not appear in the CGL policy. . . .
>
> If, as American Family contends, losses actionable in contract are never CGL "occurrences" for purposes of the initial coverage grant, then the business risk exclusions are entirely unnecessary. The business risk exclusions eliminate coverage for liability for property damage to the insured's own work or product—liability that is typically actionable between the parties pursuant to the terms of their contract, not in tort. If the insuring agreement never confers coverage for this type of liability as an original definitional matter, then there is no need to specifically exclude it. Why would the insurance industry exclude damage to the insured's own work or product if the damage could never be considered to have arisen from a covered "occurrence" in the first place? (cited authorities omitted.)

A recent federal court addressing Texas law rejected the insurer's argument that the insured's loss was purely an economic loss stating:[35]

> Plaintiff Admiral next argues that the Underlying Defendants' actions that resulted

[35] Texas – Coverage for More than Purely Economic Losses. *Admiral Ins. Co. v. Little Big Inch Pipeline Co., Inc.*, 523 F. Supp.2d 524, 538 (W.D. Tex. 2007).

> in a 'diminution in value' are not covered under the policy because Texas law does not recognize economic damages as 'property damage.' Defendants Texas Gas and LBI argue, however, that plaintiff erroneously understood the underlying Plaintiffs' claims to be seeking 'purely economic damages' while ignoring that the 'diminution in value' claim is directly tied to and arises from the physically-injured tangible property…. The Underlying Petition alleges that LBI dug up gas lines, concrete driveways, concrete slabs and foundations on the Property. LBI also left a considerable amount of debris behind. The underlying Plaintiffs claim these actions resulted in 'damages to its property' as well as 'damages to its Project' to build new homes on the Property. Moreover, the underlying Plaintiffs claim Texas Gas and LBI's actions caused Plaintiffs to incur substantial expense to restore the property to its initial state, caused the value of the Plaintiffs' Property to decrease and caused a diminution in value of the remainder of the property.
>
> The Court holds that the underlying Plaintiffs have sufficiently pleaded 'property damage' with regards to the destruction of concrete driveways, concrete slabs and foundations on the property. Moreover, left-over debris on surrounding land also represents 'property damage' pursuant to the Policy.

Another typical insurer argument, and a position adopted by many courts, is that CGL insurance does not cover an insured's repair and replacement costs arising out of its defective workmanship.[36] But in many cases the defective work must be repaired and replaced and is a covered loss where it is necessary to replace the defective product in order to correct the resulting damage to the property.[37]

---

[36] Repair and Replacement Costs Not Covered as Part of Property Damages. *Fireman's Fund Ins. Co. v. Amstek Metal, LLC*, 2008 WL 4066096 (N.D. Ill. 2008); *Amerisure, Inc. v. Wurster Const. Co., Inc.* 818 N.E.2d 998 (Ind. Ct. App. 2004,) decision clarified on reh'g on other grounds, 822 N.E.2d 1115 (Ind. Ct. App. 2005); *U.S. Fire Ins. Co. v. J.S.U.B., Inc.* 979 So.2d 871 (Fla. 2007).

[37] Repair and Replacement in Connection with Remediation of Other Resultant Property Damage. *Mutual of Enumclaw Ins. Co. v. T & G Const., Inc.*, 984 P.3d 376 (Wash. 2008) – property damage included the cost of replacement of improperly installed siding which permitted water damage. In so holding the court analyzed "property damage" and covered loss as follows:

> The insurance policy at issue covered property damage, not breach of contract damages. MOE [insurer] argues that much of the damage award is based upon a breach of contract. The trial court rejected this argument at summary judgment, finding as a matter of law that the damages were property damages. MOE concedes that some interior walls were damaged by water intrusion. However, MOE argues that the siding was largely undamaged. It reasons that the cost of removing and reinstalling the siding is not property damage. But "property damage" like "comprehensive general liability coverage" is a term of art and does not necessarily mean tangible damage to tangible property. It can include consequential damages, such as those alleged here. MOE focuses on the siding and argues that it was not damaged property under the insurance contract so it should not have to pay to have it remediated. But the subsurface and interior walls were not installed by T&G [insured] and damage to these areas was property damage covered by the policy. Removing and repairing the siding is simply part of the cost of repairing the damage to the interior walls and was properly treated as property damage by the trial court.

Some courts have sought to draw a distinction between covered property damage and uninsured property damage arising out of faulty workmanship based on whether the damage is to the insured's own work product or to work other than the insured's work.[38] However, the fact that the property damage is confined to the work itself does not address the volitional nature of the defective work. The fallacy of this distinction is noted by Bruner & O'Connor:[39]

> What is unstated in this analysis and what is really operating to drive the court to a finding of no coverage is the belief that where damage is limited to the project itself there is no coverage. … [T]here is, however, no rigid deductive or causal tie between non-accidental conduct and injury to one's own work. Negligence is not so neatly bound. Insureds performing construction work are no different than others engaged in commerce, who make mistakes, act without thinking or otherwise screw-up and as a result have to make things right. The fact that their mistakes are confined to their own work says nothing about the volitional nature of their behavior. True, most contractors understand that if they improperly perform their work, they are likely to be responsible for repairing their mistakes. There is nothing revelatory here. . . this is an uninteresting consequence of most contractual undertakings. The situation is no different than if one mistakenly operates a crane causing damage to the owner's property. In this case, one's contractual responsibility is to repair the damage. Few, if any, contractors would view these situations as different in kind. In both cases they must repair the damage. Nor do these two situations automatically admit of a distinction from a volitional or accidental perspective. A contractor can just as "accidentally" perform defective work as it can improperly operate a crane. Courts that deny coverage for failure to meet the "occurrence" requirement simply because the injury is limited to the insured's work are making coverage determinations based on policy considerations rather than adhering to principles of contract interpretation.

---

[38] "Property Damage" to Other than the Insured's Work.

No "Occurrence": In *DeWitt Const., Inc. v. Charter Oak Fire Ins. Co.*, 307 F.3d 1127 (9th Cir. 2002) the court found that although an "occurrence" had occurred, the damage was the faulty work itself and this did not constitute "property damage". The contractor had to replace over 300 concrete foundation pilings it had poured, but which did not set properly. Damage to the land by "impaling it with unremoveable piles" did not constitute property damage.

No "Property Damage": In *Travelers Indem. Co. v. Miller Bldg. Corp*., 221 Fed. Appx. 265, 269 (4th Cir. [N.C.] 2007) the court found no property damage stating

> The policy limited payment to those sums that the insured becomes legally obligated to pay as damages because of … "property damage," so long as the "property damage" is caused by an "occurrence." We concluded in our prior opinion that, to the extent that [owner] is seeking to recover from Miller the cost of correcting Miller's faulty workmanship, the claims do not fall within the scope of the policy issued by Travelers, because faulty workmanship does not constitute "property damage.

[39] Confining Coverage to "Property Damage" Other than to the Work Itself. BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 11:26 Commercial General Liability (CGL) Coverage – What is "Occurrence"? – Some basic misunderstandings about the relationship between poor workmanship and an "occurrence".

Also, "physical injury" to "tangible property" can occur due to a contractor's use of the wrong product.[40] One accepted limitation on coverage is for construction defects that are purely of an aesthetic nature causing loss in value; these are considered an "economic loss" not covered by a CGL policy.[41]

C. The "Business Risk" Exclusions

There would be no purpose for the policy coverage exclusions if coverage for damages resulting from faulty workmanship is *per se* not covered. As noted in Bruner & O'Connor[42]:

> If a purely objective standard along foreseeability lines is used to define the parameters of "occurrence" and if the concept of "foreseeability" is broadly interpreted to cover nearly all repair or restoration activities resulting from defective workmanship, one has to wonder just why the numerous "business risks" exclusions were incorporated into the standard policy and what possibly could the meaning be of the "subcontractor exception" to the completed operations exclusion. See Turner, INSURANCE COVERAGE OF CONSTRUCTION DISPUTES, 2d, § 6:46 (citing Shapiro & Posner, It Was An Accident: Inadvertent Construction Defects Are An "Occurrence" Under Commercial General Liability Policies, in Vol. 10, No. 2, Coverage, at 3-8 (Winter 2000) ("The business risk exclusions. . . clearly contemplate that some construction defects are covered and some are not. This distinction being drawn in the policy exclusions becomes completely pointless if all construction defects are categorically precluded from coverage by the "occurrence" requirement before analysis of the exclusions is ever reached.").

---

[40] Use of Wrong Product Causing Physical Injury. The court in *Swank Enter., Inc. v. All-Purpose Servs., Ltd.*, 154 P.3d 52 (Mont. 2007) found that the application of improper paint caused a "physical injury" to the property and thus was a covered loss. The court held:

> Here, the application of improper paint during the 1997 policy period caused “physical injury” because it physically and materially altered the treatment center's tanks and pipes, resulting in a detriment to the City of Libby. The detriment in fact was that the pipes and tanks had to be stripped and repainted. However, even if the City of Libby had taken no action (that is, even if the treatment plant had not been shut down and repainted), the City still would have been damaged because the paint would not have sufficiently protected the pipes and tanks. Additionally, the fact that the discovery or diagnosis of the problem did not occur until after the 1997 policy period is of no consequence. A “physical injury” can occur “even though the injury is not ‘diagnosable,’ ‘compensable,’ or manifest during the policy period as long as it can be determined, even retroactively, that some injury did occur during the policy period.

[41] Aesthetic Defects. *Down Under Masonry, Inc. v. Peerless Ins. Co.*, 950 A.2d 1213 (Vt. 2008) – court held builder's CGL policy did not cover builder's liability to homeowner for builder's installation of shingles of inferior quality (Grade B) and of different color (white instead of red) than specified since the shingles were not defective.

[42] The Exclusions. BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 11:26 Commercial General Liability (CGL) Coverage – What is "Occurrence"? – Intention and Expectation (West 2002 as supplemented).

1. Exclusion j(5) — the "Ongoing Operations" Exclusion aka the "Property Being Worked On" Exclusion

This insurance does not apply to: …

j. Damage to Property

"Property damage" to: …

(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; or (*emphasis added*.)

A number of terms used in this exclusion are not defined in the standard policy. For example, "that particular part" and "are performing operations."

a. "That particular part"[43]

That the phrase "that particular part" is intended to limit the breadth of the exclusion from coverage is illustrated by the following analysis by the Missouri Supreme Court in *Columbia Mut. Ins. Co. v. Schauf,* 967 S.W.2d 74, 80 (Mo. 1998) when it was called on to decide whether this exclusion resulted in excluding coverage for all fire loss damages to a house or merely to the portion of the work from which the fire originated:

> Houses and buildings can be divided into so many parts that attempting to determine which part or parts are the subject of the insured's operations can produce several reasonable conclusions. For example, the "particular part of the real property on which [the insured] is performing operations" could mean, as Columbia Mutual contends, "the entire area of the real property that Schauf is scheduled to work." Under this interpretation, any damage the insured causes to property in the area which he was contracted to work would be excluded from coverage.

---

[43] Exclusions j(5) and j(6) – "That Particular Part". See Turner, INSURANCE COVERAGE OF CONSTRUCTION DISPUTES (2d ed.) § 31:5.

The use of the word "particular" suggests that the exclusion should only apply to the smallest unit of division available to the work in question. This coverage approach is often called the "component parts" approach. Even in cases where work is being performed on a large, undivided and undifferentiated piece of property, such as bare land, the "particular part" language seems too limiting to allow the entire property to fall within the exclusion. More appropriately, only the immediate area of the work where the property damage arises should fall within the exclusion. Certainly, the entire building or piece of real property being worked on cannot be the "particular part." Thus, damages for the diminution in value of the entire building or property have been held to be unaffected by exclusions containing the "particular part" limitation.

> Another possible definition of the instant exclusion is that the "particular part of real property on which [the insured] is performing operations" is only the part of the property that is the subject of the insured's work at the time of the damage. Under this interpretation, only the damage the insured causes to the particular part of the property that is actually the object of the insured's work where the damage occurs is excluded from coverage; any other damage would not be subject to the exclusion….
>
> In accordance with the relevant maxims of construction and the language and purpose of the instant exclusion, this Court upholds that the instant exclusion denies coverage for property damage to the particular part of real property that is the subject of the insured's work at the time of the damage, if the damage arises out of those operations.
>
> Applying the holding to the facts of this case compels the conclusion that the exclusion applies to any damage to the kitchen cabinets. When the damage in this case occurred, Schauf was cleaning from his spray equipment the lacquer he had applied to the kitchen cabinets. Because cleaning the lacquer was the last step in the job of lacquering the kitchen cabinets, the kitchen cabinets were the particular part of the real property that was the subject of Schauf's operations at the time of the damage. Consequently, the damage to the kitchen cabinets is excluded from coverage.

This exclusion has been narrowly interpreted to except from the exclusion damage to property of third parties unrelated to the job site.[44]

b. "Are Performing Operations"

A second limitation on Exclusion j(5) is for damage to "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." This language is interpreted to exclude damages involving "works in progress", in other words it does not apply to

---

[44] Exclusion j(5). The court in *Thommes v. Milwaukee Mut. Ins. Co.*, 622 N.W.2d 155 (Minn. Ct. App. 2001) held that damage caused by a contractor in cutting down a neighbor's trees was not excluded by this exclusion. The court stated

> Significantly, under the business risk doctrine, harm to the property of a third party caused by the insured's defective work is *not* excluded from coverage… . The policy exclusions here, 2j(5) and 2j(6), may be read as the embodiment of the business risk doctrine principles. Other jurisdictions have squarely and sensibly characterized 2j(5) and 2j(6) as business risk exclusions. We conclude that 2j(5) and 2j(6) exclusions are business risk exclusions designed to exclude coverage for faulty workmanship that is within the insured's control… . By applying the business risk doctrine in this case, damage to third-party property caused by appellant's work is not excluded from coverage. The parties do not dispute that, in the course of clearing the HHA property, appellant's employees accidentally damaged third-party property by clearing trees located on property owned by a third party. Accordingly, we conclude that exclusions 2j(5) and 2j(6) do not operate to deny appellant coverage.

"completed operations." The "arises out of operations" has caused confusion for some courts in interpreting the scope of the exclusion. However, the vast majority of courts have concluded that this exclusion is limited to barring coverage for property damage occurring during on going operations.[45]

The lack of definition of these terms and their inherent ambiguity has lead to interesting cases. The Supreme Court of Kentucky in *Bituminous Cas. Corp. v. Kenway Contracting, Inc.*, 240 S.W.3d 633 (Ky. 2007), as modified on denial of reh'g (2008) was called on to address whether the demolition of a homeowner's home in error was excluded from coverage under the contractor's CGL policy as property damage occurring while the contractor was "performing operations." A miscommunication occurred between the insured's heavy equipment operator and the job site superintendent. The equipment operator was only to have removed the garage. The insurer argued that exclusion j(5) applied as the insured was performing operations on the residence when the residence was destroyed in error. The court rejected the insurer's argument and noted:

> [W]e note that the phrase "that particular part of real property" and the term "operations" are not defined in the CGL policy. The Allens [insured] suggest that from their perspective, operations should be limited to the carport. BCC [insurer] argues operations should be determined from the perspective of McComas [equipment operator], and real property should extend to any real property upon which operations are occurring. Given that the policy contains terms that are not defined, and given that each party has suggested a reasonable interpretation in light of the plain meaning of the words used, we conclude the policy is ambiguous. In keeping with the principle that "[a]n ambiguous policy is to be construed against the drafter, and so as to effectuate the policy indemnity[,]" we conclude exclusion 2j(5) does not operate to preclude coverage.

Another interesting case is *Mid-Continent Casualty Co. v. JHP Development, Inc.*, 2009 WL 189886 (5th Cir. [Tex.] 2009). The developer hired an insured contractor to build a multi-unit business condominium in Austin, Texas. The interior was left in and marketed in shell condition, subject to buyers finishing out the shell space after closing or on a seller turnkey basis once a buyer determined the level of desired finish out. Exterior work and internal partitioning walls were completed in the Spring of 2001. The interior of the units still required painting, flooring, plumbing and electrical fixtures, and activation of the HVAC system. Due to the insured contractor's failure to properly seal the exterior of the building, rain penetrated into the

---

[45] Exclusion j(5) for "Property Damage" Occurring During "On Going Operations". *American States Ins. Co. v. Powers*, 262 F. Supp.2d 1245, 1250-51 (D. Kan. 2003):

> The vast majority of commentators that have addressed exclusion j(5) have recognized that the exclusion in intended to "bar coverage for the work being done by a contractor when claims arise at the time the work is being performed." … The uncontroverted facts demonstrate that Mr. Powers' work was not "in progress" at the time the Stouts' claim arose. Rather, Mr. Powers last day on the job was May 30, 2000 and, more than one year later, the Stouts filed a claim asserting that the building, as constructed by Mr. Powers, did not meet current building codes for structural design and safety; was not constructed according to agreed specifications; and was not constructed in a workmanlike manner. Thus, because the damage did not occur while Mr. Powers was working on the project, exclusion j(5) has no application here.

building's interior beginning in the fall of 2001. The contractor refused to correct the construction defect and the developer hired a replacement contractor to repair and complete the condominiums. The developer incurred $438,000 of expense with the replacement contractor to investigate, demolish, repair and replace non-defective interior finishes and wiring that were damaged by the water intrusion. The water intrusion occurred during the period between the completion of the shell and the later time that a buyer was to be identified. The contractor had left the job site and work was thus "suspended" during this prolonged marketing period. The developer sued the insured contractor, and the insured contractor tendered its defense to its insurer, Mid-Continent Casualty Company. Mid-Continent refused to provide a defense. The owner obtained a default judgment against the insured in excess of $1,500,000. The federal court case is the ensuing declaratory judgment action filed in the federal courts by Mid-Continent. With regard to exclusion j(5), both the insured and the insurer agreed that "are performing operations" means that this exclusion only applies to property damage that occurs during the performance of construction operations by the insured. The developer argued that the contractor was not performing operations because work had been suspended pending sale of the condominiums. The insurer countered that the work was not yet complete. The court sided with the owner finding that

> This was not merely a brief, temporary halt, such as that which might occur at the conclusion of each workday or during several days of inclement weather, but rather a total cessation of active construction work for the foreseeable future. Although (the contractor) intended to eventually complete construction work once the units were sold, an actor is not actively performing a task simply because he has not yet completed it but plans to do so at some point in the future.

The court also found that exclusion j(6) (discussed below) did not apply. The court found that the exclusion excluded damages to "that particular part" of the contractor's work damaged by faulty workmanship. The court stated the issue as whether exclusion j(6) "bars recovery for damage to any part of a property worked on by a contractor that is caused by the contractor's defective work, including damage to parts of the property that were the subject of only non-defective work, or whether the exclusion only applies to property damage to parts of the property that were themselves the subject of the defective work." The contractor's defective work was done to the exterior of the building. The interiors were not defectively constructed. The court noted:

> [T]he "particular part" referred to is the part of the property that (1) must be restored, repaired or replaced (2) because the insured's work was incorrectly performed on it. The second requirement makes clear that the "particular part" of the property must have been the subject of incorrectly performed work. The narrowing "that particular part" language is used to distinguish the damaged property that was itself the subject of the defective work from other damaged property that was either the subject of nondefective work by the insured or that was not worked on by the insured at all.

A United States District Court in Louisiana found in *Grand Acadian, Inc. v. Flour Corp.* that, although a contractor's work was not complete, exclusions j(5) and (6) did not apply since the

owner had "abandoned" the project and had directed the contractor to stop work.[46] The court recognized that coverage extended to Flour as an additional insured on the policy of its subcontractor which had performed the defective work.

2. Exclusion j(6) — the "Faulty Workmanship" Exclusion

This insurance does not apply to: …

j. Damage to Property

"Property damage" to: …

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

Paragraph **(6)** of this exclusion does not apply to "property damage" included in the *"products-completed operations hazard"*.

a. "Products-Completed Operations Hazard"

The stated exception to this exclusion is for "property damage" included in the "products-completed operations". Thus, if the claim arises from defective work that is discovered after the contractor has completed its work, exclusion j(6) does not apply. The purpose of exclusion j(6) is to exclude coverage for the costs to repair or replace particular work discovered while the insured is still performing its work.[47]

---

[46] Operation are Not Ongoing Once Owner Abandons Project. *Grand Acadian, Inc. v. Flour Corp.*, 2009 WL 994990 (W.D. La.). The court held that the work was not complete, but the PCOH was triggered because the project was "abandoned" by the owner. *See also Gottsegen v. Hart Prop. Mgmt., Inc.*, 820 So.2d 1138, 1141-42 (La. App. 5 Cir. 2002). In *Gottsegen* the court found that work on a pitched roof was "abandoned" when the contractors ceased working after the Parish halted the job because the proper permits were not obtained. Interpreting a PCOH clause the court concluded that because the work was abandoned and the damage occurred after the job was halted, the damage was covered under the PCOH.

[47] Exclusion j(6) for "Property Damage" to Your Work Except if Occurs After Completion of Operations. *American States Ins. Co. v. Powers*, 262 F. Supp.2d 1245, 1251-52 (D. Kan. 2003):

> Thus, when exclusion j(6) is read together with the "product-completed operations hazard" provision, the result is that exclusion j(6) does not apply to claims arising from 'defective work that is discovered after the contractor has completed its work.' The application of exclusion j(6), then, turns on whether Mr. Powers' work on the building was incomplete (in which case the exclusion would apply) or complete (in which case the exclusion would not apply). There is no evidence before the court suggesting that Mr. Powers' work on the building was incomplete at the time the Stouts discovered the allegedly defective work. Rather, the uncontroverted facts demonstrate that Mr. Powers completed the building on May 30, 2000 and that sometime thereafter the Stouts realized that the building allegedly did not meet the contract specifications, did not meet various building codes pertaining to structural design, and was not constructed in a workmanlike manner. While the work performed by Mr. Powers may have needed significant correction, repair or replacement, such work is nonetheless treated as "complete" for purposes of the policy. Thus, because Mr. Powers' work was complete at the time of the damage, the property damage falls within the 'property-completed operations hazard' exception to

b. "That Particular Part"

Note that exclusion j(6) also employs the "that particular part" limitation to the exclusion.[48]

3. Exclusion l — the "Your Work" Exclusion aka the "Completed Operations Work" Exclusion

> This insurance does not apply to: …
>
> **l. Damage To Your Work**
>
> "Property damage" to *"your work"* arising out of it or any part of it and included in the *"products-completed operations hazard"*.
>
> 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*. (emphasis added.)

a. Damage to "Your Work"

The exclusion is limited to damages to "your work". Damage to other property (*i.e.*, others' non-defective work or personal property) is not encompassed by this exclusion.[49]

---

exclusion j(6) and, accordingly, exclusion j(6) does not apply here.

[48] Exclusion j(6) – "That Particular Part". *E & R Rubalcava Const., Inc. v. Burlington Ins. Co.*, 147 F. Supp.2d 523 (N. D. Tex. 2000):

> [T]he *business risk* exclusion [j(6)] … only applies to the cost of repair of the foundation work itself, not to the cost of repair of any other damage to the homes in issue.

and *Dorchester Development Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380 (Tex. App.—Dallas 1987).

However, some courts have interpreted the exclusion to apply to the whole project. *See, e.g., E. H. Spencer & Company, LLC v. Essex Insurance Co.*, 2009 WL 2231222 (Mass. Super.) following rationale in *Jet Line Servs., Inc. v. American Employers Ins. Co.*, 494 Mass 706 (Mass. 1989) where court stated "[w]here the insured was retained to perform work on an entire unit of property, and not just a portion of it, the applicability of the exclusion to damage of the entire unit is more apparent than in cases in which the insured was retained to work on only a part of the unit."

[49] Covered Damages. The Fifth Circuit in *Wilshire Insurance Co. v. RJT Construction Co.*, 2009 WL 2605436 (5th Cir. [Tex.]) found that Exclusion l precluded coverage only for the cost of repairing its insured's own work, the defective foundation, but did not exclude coverage of the damages caused to the balance of the home. The court noted that in *Travelers Insurance Co. v. Volentine*, 578 S.W.2d 501, 503 (Tex. Civ. App.—Texarkana 1979 no writ) the insured, an automobile mechanic, performed faulty work on an engine's valves which resulted in the destruction of the entire engine, and that the Texas court found that the Exclusion l precluded only the cost of replacing the valves themselves, but 't]o the extent those other parts [of the engine] were damaged or destroyed and Volentine is liable therefor, the policy affords coverage. *Travelers* at 504.

b. Damage to "Your Work" Included in the "Products-Completed Operations Hazard"

This exclusion is the "heart" of the "business risk" doctrine. It is most often asserted by insurers in claims against contractors for latent defective work. It is oft said that "CGL insurance does not insure against faulty workmanship." The policy arguments supporting this exclusion are the concerns that substituting CGL insurance for the contractor's workmanship obligation is tantamount to providing a performance bond; expanding CGL insurance to cover performance promises will encourage poor workmanship; shifting the economic loss to the insurer for the contractor's faulty performance affords little incentive for the insured to exercise the necessary care and workmanship to operate in a sound business manner; and to do otherwise would encourage the contractor to underestimate the cost of performing the job, and thus shift the cost of doing business from the insured to the insurer.[50]

The function of the "products-completed operations hazard" ("**PCOH**") exception has been defined as follows:[51]

> Before proceeding to our analysis of whether there was coverage, we think it would be helpful to explain how the PCOH provision fits into a CGL policy. A CGL policy, like every other insurance policy, has an insuring clause under which the insurer agrees to pay sums that the insured becomes legally obligated to pay because of property damages caused by an occurrence. The CGL policy also has exclusions that take away some of this coverage. The PCOH provision is an exception to these exclusions. Or, stated another way, the PCOH provision is simply a category of losses that are covered even though these losses might otherwise be excluded. Viewed in this light, the PCOH provision does not create a separate category of coverage. Rather, any loss falling within the PCOH provision must still meet all the requirements of the policy, like any other loss, except the exclusion from which the losses are excepted.

c. Exclusion Does Not Apply If the Damaged Work Is Performed by a Subcontractor

But note that that Exclusion l does not apply if the "damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor."

This exclusion and this exception were introduced into the standard policy and have remained unchanged since their introduction in the 1986 revision to the standard CGL policy. The 1986 exclusion/exception to exclusion replaced the 1973 "exclusion o" aka the "Work Performed"

---

[50] Rationale for the "Business Risk" Exclusions. Hendrick and Weizel, The New Commercial General Liability Forms—An Introduction and Critique, 36 F.I.C.C., 319, 322 (Summer 1986). "Business Risks" are "[those risks] which are the normal, frequent, or predictable consequences of doing business, and which business management can or should control and manage. CGL insurance is not meant to be a safety net for every business error or omission."

[51] PCOH. *Pursell Const., Inc. v. Hawkeye-Security Ins. Co.*, 596 N.W.2d 67, 69 (Iowa 1999).

exclusion which read:

> This insurance does not apply … to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof or out of the materials, parts or equipment furnished in connection therewith.

Note that the 1973 Work Performed exclusion applied to both property damage occurring during the course of construction and to completed operations. Also, the 1973 exclusion does not contain the "subcontractor exception". The 1986 exclusion is substantially narrower than the 1973 exclusion. Thus whether this exclusion permits broader coverage depends on the extent to which the contractor has performed its services through subcontractors.[52] As the Texas Supreme Court explained in the 2007 *Lamar Homes* case:[53]

> Lamar submits that this exclusion would have eliminated coverage here but for the subcontractor exception. According to Lamar, this exception was added to protect the insured from the consequences of a subcontractor's faulty workmanship causing "property damage." Thus, when a general contractor becomes liable for damage to work performed by a subcontractor—or for damage to the general contractor's own work arising out of a subcontractor's work—the subcontractor exception preserves coverage that the "your-work" exclusion would otherwise negate. Lamar's understanding of the subcontractor exception is consistent with other authorities who have commented on its effect.[54]

The following are discussions of the "subcontractor exception" from a few of the cases that have applied this exception:

> We cannot conclude that the exception to exclusion (l) has no meaning or effect. The CGL policy already covers damage to the property of others. The exception to the exclusion, which addresses "property damage" to "your work" must therefore apply to damages to the insured's own work that arise out of the work of a subcontractor. Thus, we conclude that the exception at issue was intended to narrow the business risk doctrine… . Under our holding in the current language of the policy, the business risk doctrine would still apply to work performed by the general contractor and to other deficiencies in a subcontractor's work that do not constitute "property damage." Absent policy language to the contrary, the business risk doctrine would also preclude a subcontractor from making a claim against its own insurer to recover the cost of the repair or replacement of its own

---

[52] The "Subcontractor Exception". *See e.g., O'Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99 (Minn. Ct. App. 1996); *Kalchthaler v. Keller Const. Co.*, 591 N.W.2d 169 (Wis. Ct. App. 1999); *Mid-Continent Cas. Co. v. Titan Const., Corp.*, 281 Fed. Appx. 766 (9th Cir. 2008) and the 2007 Cases discussed herein.

[53] Texas – its 2007 Case. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007), answer to certified question conformed to, 501 F.3d 435 (5th Cir. 2007).

[54] Minnesota – the Subcontractor Exception. *O'Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99 (Minn. Ct. App. 1996).

> defective work. The insurance industry is, of course, free to alter this result in future cases by seeking to change the language of its policies.
>
> For whatever reason, the industry chose to add the new exception [subcontractor exception] to the business risk exclusion in 1986. We may not ignore that language when interpreting case law decided before and after the addition. To do so would render the new language superfluous. We realize that under our holding a general contractor who contracts out all the work to subcontractors, remaining on the job in a merely supervisory capacity, can ensure complete coverage for faulty workmanship. However, it is not our holding that creates this result; it is the addition of the new language to the policy. We have not made the policy closer to a performance bond for general contractors, the insurance industry has.[55]

And:

> Absent any allegation that the substandard construction in this case resulted from an intentional breach of contract by Titan, we conclude that the negligent construction of the Williamsburg project that resulted in breach of contract and breach of warranty claims constituted an "occurrence." … Exclusion 2(*l*), which excludes damage to "your work" also does not apply. The exclusion specifically excepts work performed on Titan's behalf by a subcontractor. The parties do not contest that all work was performed by Titan's subcontractors.[56]

As is illustrated in *Pine Oak Builders' Inc. v. Great American Lloyds Insurance Company*, 279 S.W.3d 650 (Tex. 2009), even if the work was done by the insured's subcontractor, the insurer's duty to defend and indemnify is not triggered unless the plaintiff's petition alleges that the work was or may have been performed by the insured's subcontractors. The supreme court stated the following as to the application of the "eight corner rule" and the failure of the pleadings to trigger coverage:[57]

> The final issue is whether evidence extrinsic to the eight corners of the policy and the underlying lawsuit may be used to establish the insurer's duty to defend. Exclusion "*l* " of the CGL policy removes coverage for property damage to the insured's completed work. This exclusion contains an exception "if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." As *Lamar Homes* explained, coverage therefore depends in part on whether the alleged defective work was performed by Pine Oak or a subcontractor. In four of the underlying suits against Pine Oak, the petitions expressly alleged defective work by one or more subcontractors. In the Glass

---

[55] Wisconsin – the Subcontractor Exception. *Kalchthaler v. Keller Const. Co.*, 591 N.W.2d 169 (Wis. Ct. App. 1999).

[56] Washington – the Subcontractor Exception. *Mid-Continent Casualty Co. v. Titan Construction Corp.*, 2008 WL 2340493 (C.A. 9 (Wash)).

[57] Texas – "Eight Corner Rule". *Pine Oak Builders' Inc. v. Great American Lloyds Insurance Company*, 279 S.W.3d 650, 653-54 (Tex. 2009).

case, the petition contains no allegations of defective work by a subcontractor….

The extrinsic fact Pine Oak seeks to introduce in this coverage action contradicts the facts alleged in the Glass suit. The petition in the Glass suit alleges that Pine Oak agreed to construct the plaintiffs' house, that Pine Oak alone "constructed columns that provided inadequate support," "failed to properly seal seams," "negligently attempted to correct" a problem with the balcony, failed "to perform the work in a good and workmanlike manner," and failed "to make the repairs described above." These claims of faulty workmanship by Pine Oak are excluded from coverage under the "your work" exclusion. Faulty workmanship by a subcontractor that might fall under the subcontractor exception to the "your work" exclusion is not mentioned in the petition. "If the petition only alleges facts excluded by the policy, the insurer is not required to defend.