

# CONSTRUCTION DEFECT CLAIMS COVERAGE & INSURER OBLIGATIONS

**Pete Fowler**

President, Pete Fowler  
Construction Services, Inc.

**David Heemann**

Claims Risk Manager,  
Mutual of Enumclaw

**John Mumford**

Director, Hancock Daniel

1

# INSTRUCTOR

---

## Pete Fowler

- President and Senior Consultant,  
*Pete Fowler Construction Services, Inc.*
- [pf@petefowler.com](mailto:pf@petefowler.com)



Image Source: PFCS

# INSTRUCTOR

---

## David Heemann

- Claims Risk Manager,  
*Mutual of Enumclaw*
- [dheemann@mutualofenumclaw.com](mailto:dheemann@mutualofenumclaw.com)



Image Source: David Heemann

# INSTRUCTOR

---

## John Mumford

- Director, *Hancock Daniel*
- [jmumford@hancockdaniel.com](mailto:jmumford@hancockdaniel.com)



Image Source: Hancock Daniel



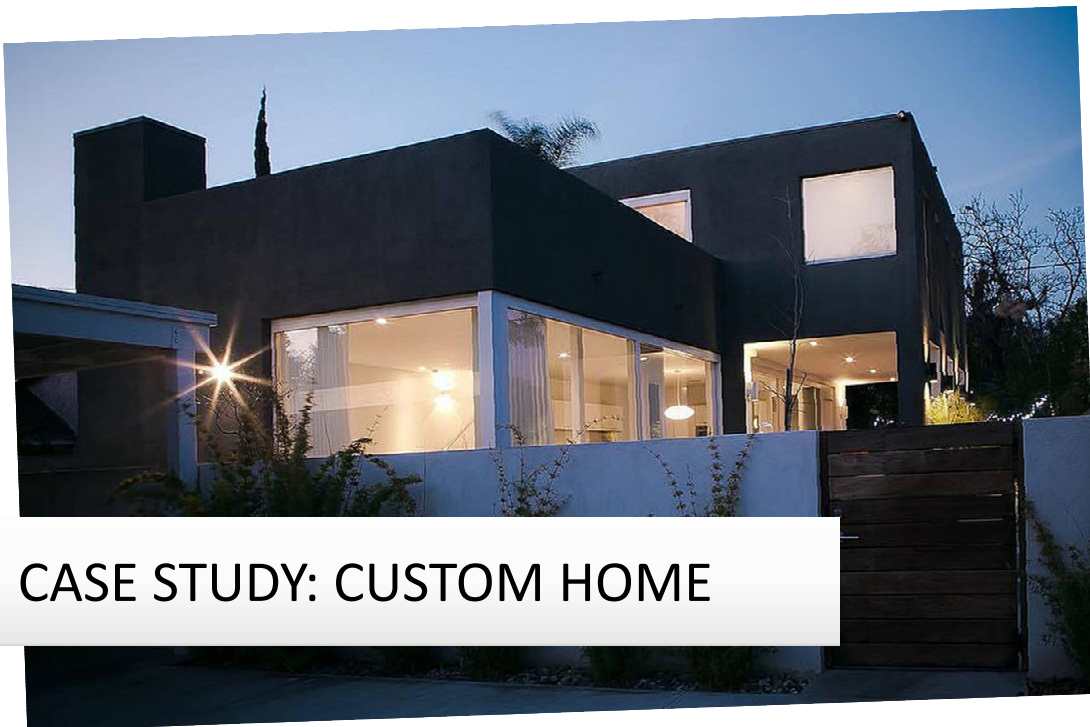
# OBJECTIVES

---

- Survey trends in construction defect claims against builders and subcontractors
- Describe differences in coverage issues and insurer obligations relating to contractors, subcontractors, additional insureds, and indemnitees
- Analyze key policy provisions, including what constitutes an “occurrence,” “damage to property,” “your work,” and more
- Evaluate how tenders of defense and indemnity should be made under both policy and trade agreements



Image Source: Unsplash/Henry Co



## CASE STUDY: CUSTOM HOME

Image Source: PFCS





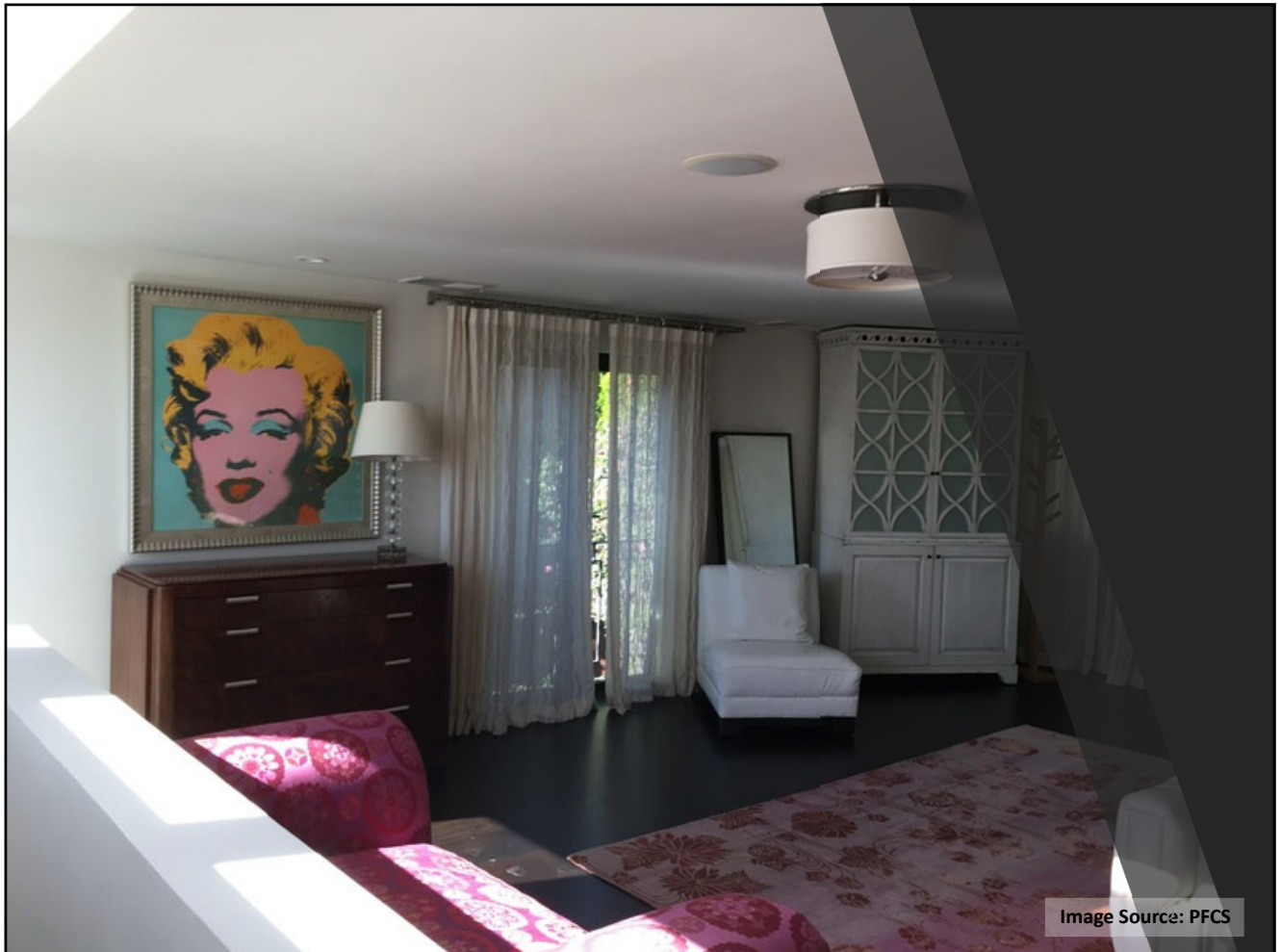


Image Source: PFCS

























**Pete Fowler CONSTRUCTION Services, Inc.** Job Name BLUE JAY WAY Job # 18-115  
Date 1/22/2017 By PK Page 1/2

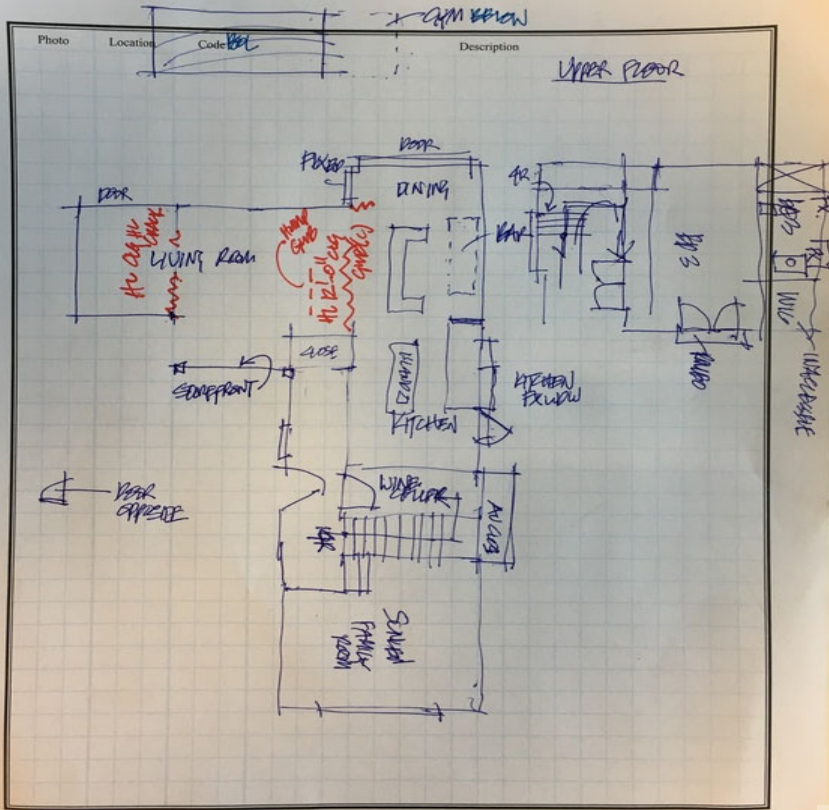
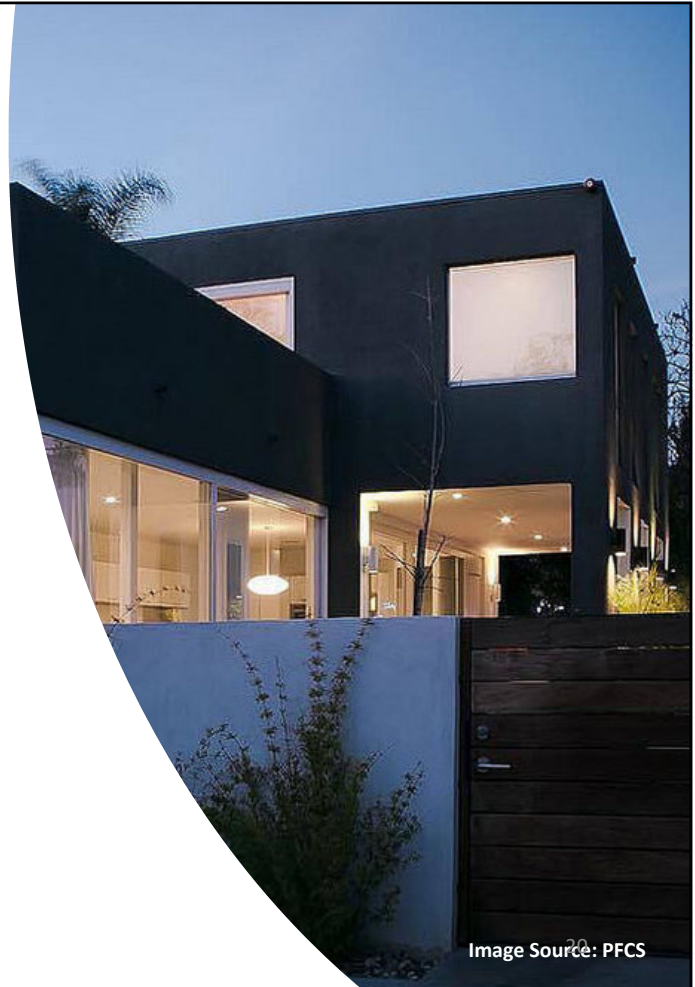


Image Source: PFCS

# DISCUSSION

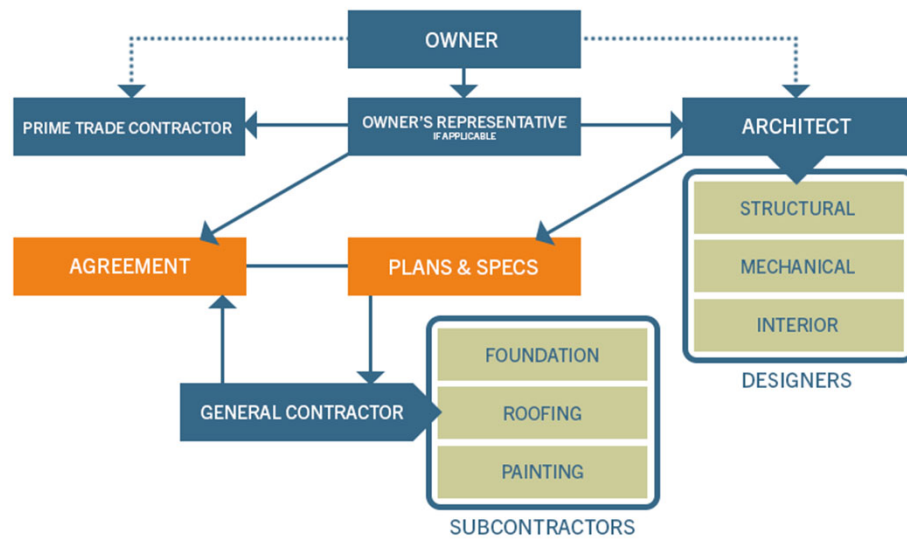
---

- Defending Claims
- Investigating Claims
- Claims Handling
- Coverage





# CONTRACTING 101 FRAMEWORK



## CGL COVERAGE ISSUES

---

### **The Insuring Agreement**

- Pays sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which insurance applies;
- Insurance applies to “bodily injury” and property damage” only if:
  - Injury/damage is caused by an occurrence that takes place in the “coverage territory”
  - Injury/damage occurs during the policy period

22

## CGL COVERAGE ISSUES

---

### **Is faulty work an “occurrence?”**

- Occurrence is defined in the policy as:
  - “an accident including continuous or repeated exposure to substantially the same general harmful conditions”
- Viewpoints
  - Where property damage is confined to the work of an insured contractor, it is not caused by an “occurrence”
    - Group Builders, Inc., v. Admiral Ins. Co., 123 Haw.142,231 P.3d 67 (Ct. App. 2010)
  - Faulty workmanship that causes damage to property, other than defective workmanship itself, is covered
    - Nat’l Sur. Corp. v. Westlake Invs., LLC, 2015 Iowa App. Lexis 982) (Ct. App. Oct. 28, 2015);
    - Pulte Homes of New Mexico v. Lumbermens Ins., 2015 WL 9263675 (N.M. Ct. App. Dec. 17, 2015)

23

# CGL COVERAGE ISSUES

---

## Legislative Intervention

- Some state legislatures have passed legislation mandating that construction defects be included in definition of "occurrence."
  - *See Ark. Code Ann. § 23-79-155 (Arkansas); Colo. Rev. Stat. § 13-20-808 (Colorado); Haw. Rev. Stat. § 431:1 (Hawaii); S.C. Code Ann. § 38-61-70 (South Carolina).*
- AR Code § 23-79-155 (2012)
  - (a) A commercial general liability insurance policy offered for sale in this state shall contain a definition of "occurrence" that includes:
    - (1) Accidents, including continuous or repeated exposure to substantially the same general harmful conditions; and
    - (2) Property damage or bodily injury resulting from faulty workmanship.
  - (b) This section is not intended to restrict or limit the nature or types of exclusions from coverage that an insurer may include in a commercial general liability insurance policy.

## CGL COVERAGE ISSUES

---

### **What is potentially covered? What is not covered?**

- Rip & Tear Costs (Investigation and Access Costs):
  - *Lennar Corp v. Markel American Insurance Co.*, 413 S.W.3d 750 (Tex. 2013) – CGL insuring agreement extension of coverage to pay “damages because of property damage” required insurer to pay “rip and tear” costs builder-insured incurred in ripping all of the EIFS off of the homes to access wood rot due to water infiltration

25

## CGL COVERAGE ISSUES

---

**When a stucco subcontractor utilizes improper installation methods resulting in progressive wood rot from multiple years of water intrusion, when did the property damage occur?**

- Answer will depend on the trigger of coverage theory utilized by Court.

# CGL COVERAGE ISSUES

---

## Triggers

- Courts nationally have applied different “triggers” to determine when “property damage” occurs for purposes of CGL coverage.
  - Exposure
  - Injury-in-fact
  - Manifestation
  - Continuous
  - and some variations on these

27

## CGL COVERAGE ISSUES

---

### **Allocation**

- For Exposure, Injury-In-Fact (and continuing during progressive damage), and Continuous triggers, multiple policies issued to Perfect Exteriors (by different insurers) could be triggered in this claim
- Each of these policies only cover “‘property damage’ that occurs during the policy period”
- Where claimant house sustained water intrusion and progressive wood rot from 9/1/2011 through present, how are the related damages allocated among the various policies?

28



# CGL COVERAGE ISSUES

---

## **Allocation: All Sums**

- The all sums method of allocation (also referred to as “joint and several liability”) permits the insured to recover its total liability under any policy in effect when the damage occurred, thereby allowing the insured to choose the policy year (or years) providing optimal coverage, subject to applicable limits
  - *Viking Pump Inc. v. TIG Insurance Co.*, N.Y.3d (N.Y. May 3, 2016)
- More prevalent in bodily injury exposure cases than property damage

29

## CGL COVERAGE ISSUES

---

### **Allocation: Time on Risk (Pro Rata)**

- Formulated method used to divide total loss in a manner that reasonably approximates the loss attributable to each policy period
  - *Crossman Cmty. of N.C. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40 (2011)
- In this way, each trigger which the insurer is responsible for a share of the total loss that is proportionate to its time on the risk.
- The portion of the loss that exceeds the policy limit would either fall back onto the policyholder or be covered by an excess insurance policy. (Some other courts disagree with this approach)

30

## CGL COVERAGE ISSUES

---

### Could this exclusion apply?

- This insurance does not apply to . . . “property damage” to: (5) [t]hat 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.
- Paragraph **(6)** of this exclusion does not apply to “property damage” included in the “products-completed operations hazard”

31

# CGL COVERAGE ISSUES

---

## Could this exclusion apply?

- "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:
    - (1) Products that are still in your physical possession; or
    - (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 complete, will be treated as completed.

32

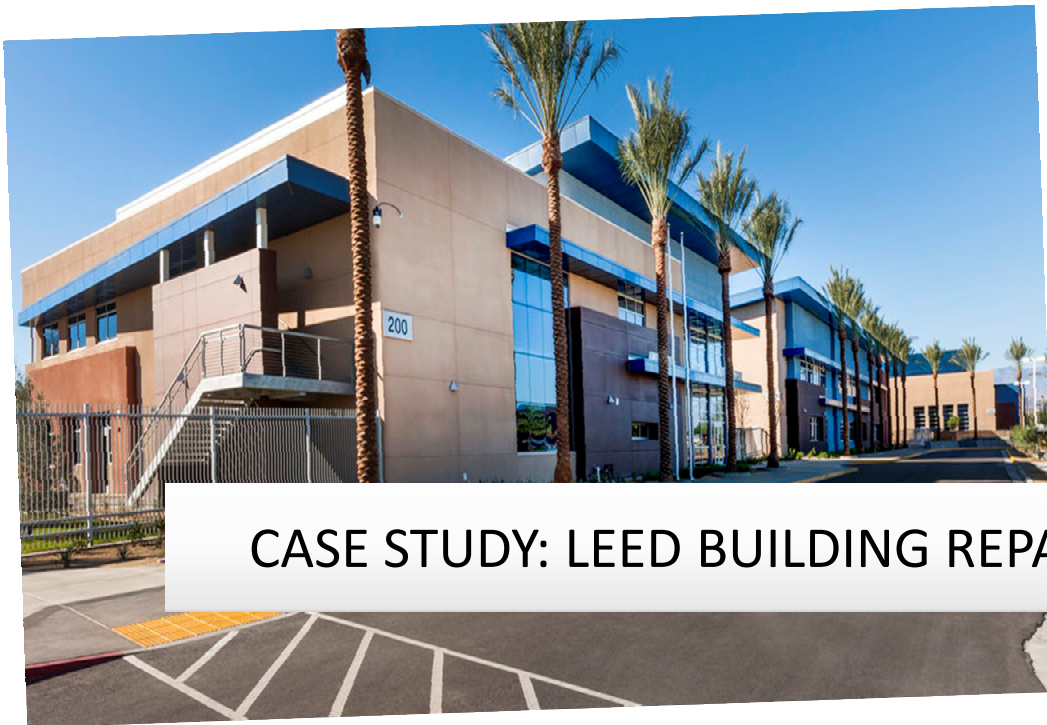
## CGL COVERAGE ISSUES

---

### **Could this exclusion apply?**

- “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

33



## CASE STUDY: LEED BUILDING REPAIR

Image Source: PFCS

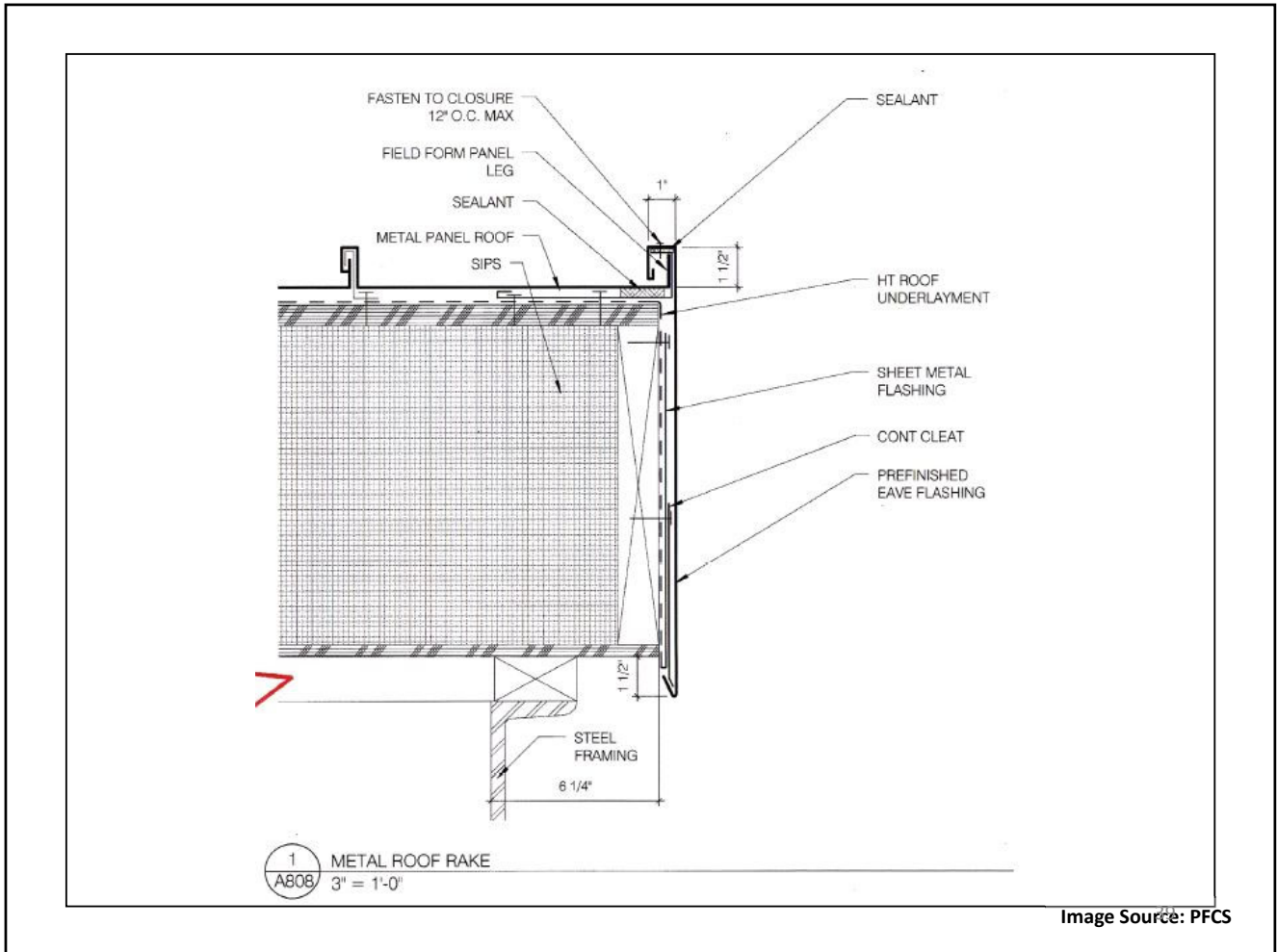


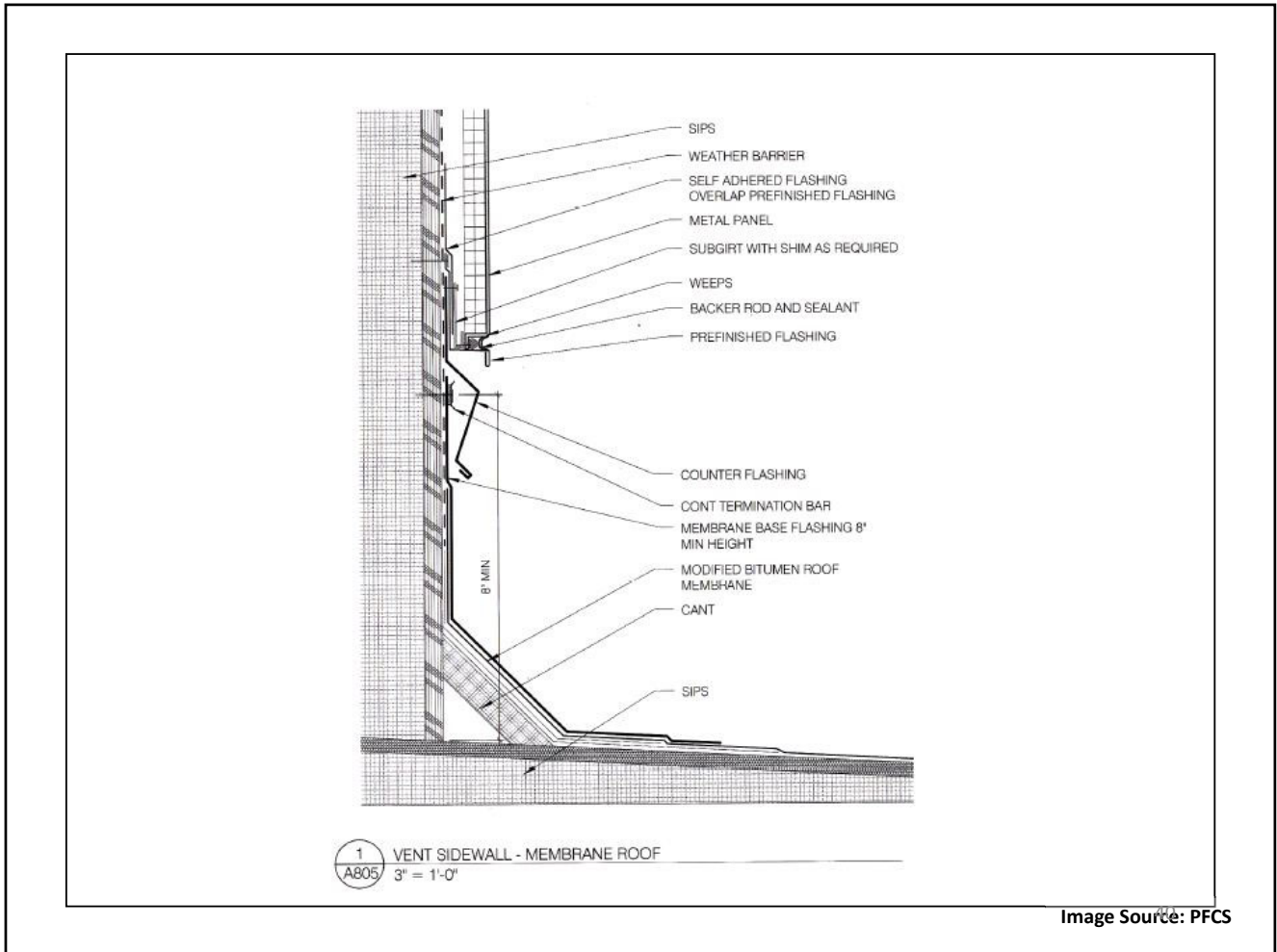












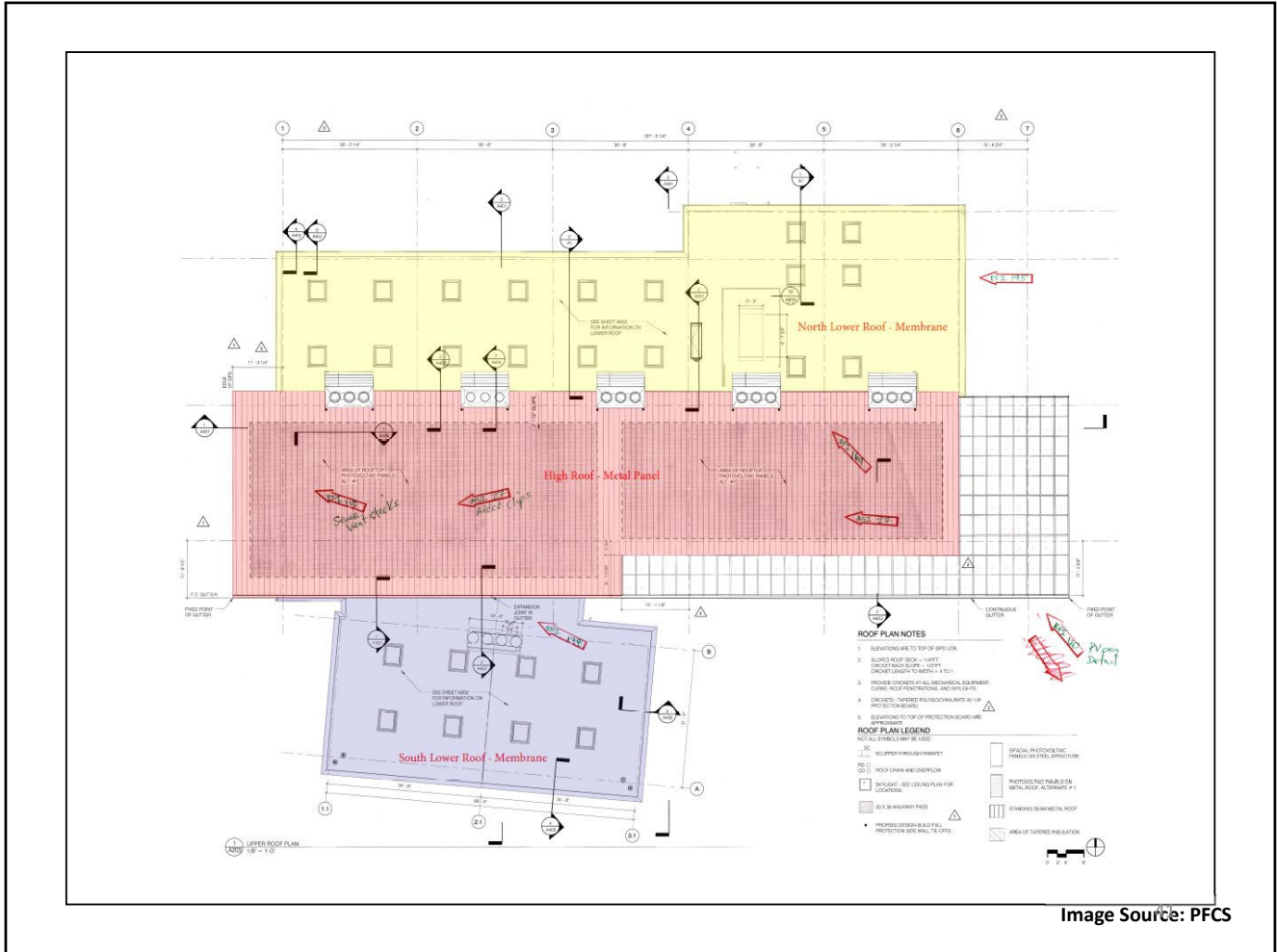


Image Source: PFCS



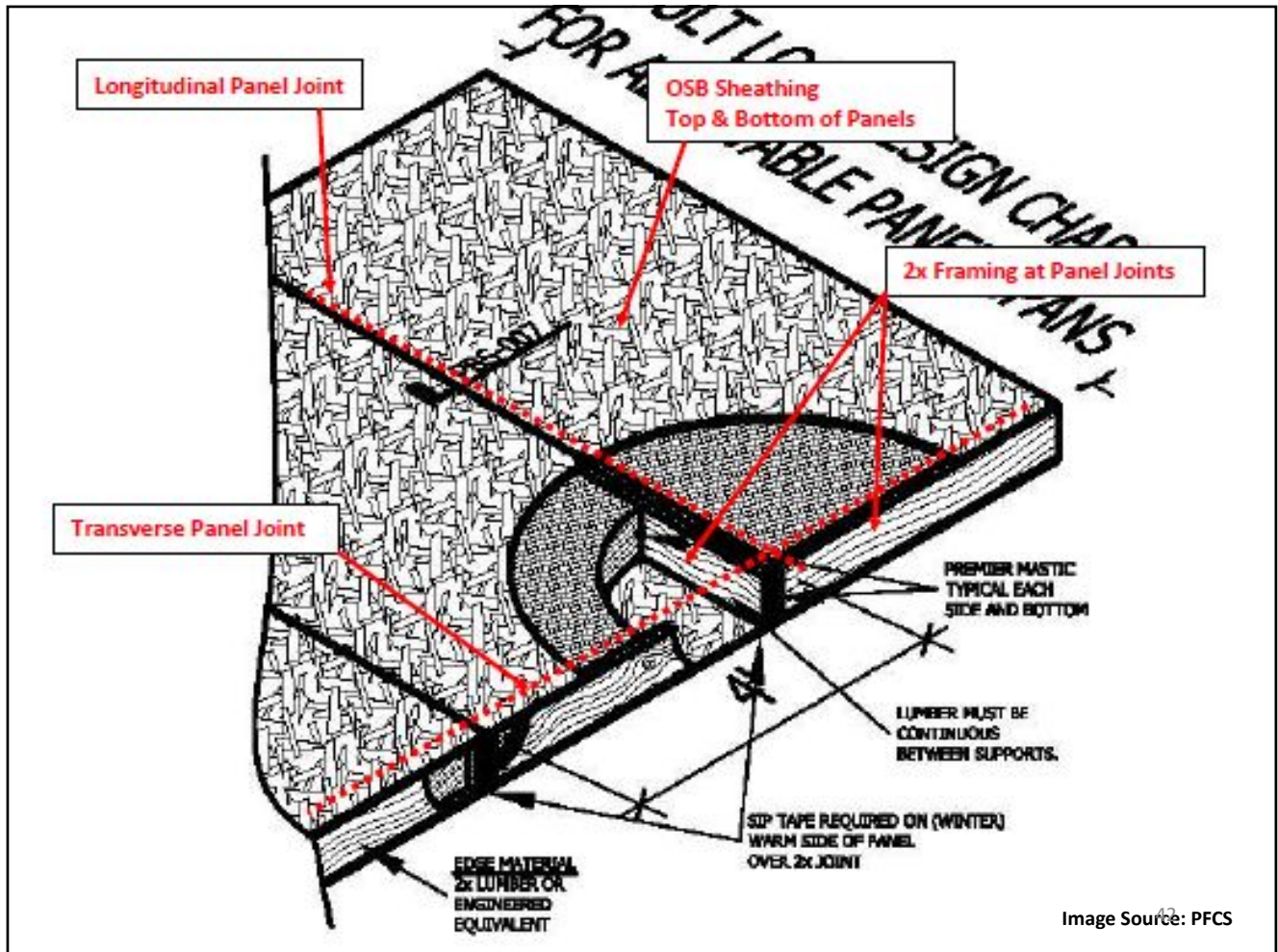
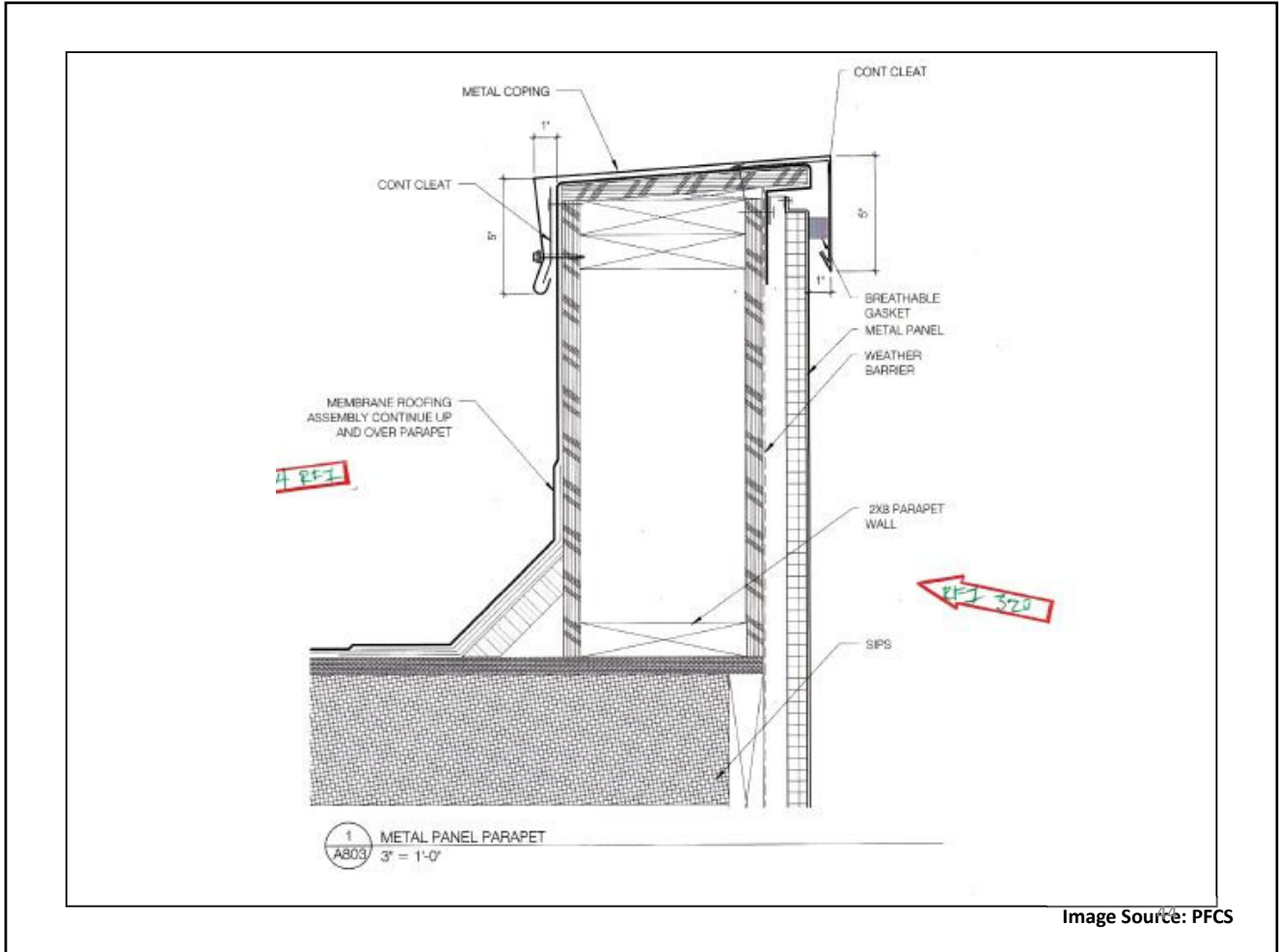




Image Source: PFCS





# DISCUSSION

---

- Defending Claims
- Investigating Claims
- Claims Handling
- Coverage



# PLAN vs. PERFORMANCE

---

SCOPE	BUDGET	ACTUAL	SCHEDULE				
Item 1	\$ XXX	\$ XXX	Plan	Actual			
Item 2	\$ XXX	\$ XXX		Plan	Actual		
Item 3	\$ XXX	\$ XXX			Plan	Actual	
Item 4	\$ XXX	\$ XXX			Plan	Actual	
Item 5	\$ XXX	\$ XXX				Plan	Actual
<b>Total</b>	<b>\$ X,XXX</b>	<b>\$ X,XXX</b>					

## CGL COVERAGE ISSUES

---

### **How can Contractor fall “under the tent” of Subcontractor’s CGL coverage?**

- Additional Insured Endorsements
  - Sub names Contractor as an Additional Insured on Sub’s CGL policy (and that such coverage be primary and noncontributory)
- Indemnity/Insured Contract
  - Contract between Contractor and Sub contains indemnity provision

47

## CGL COVERAGE ISSUES

---

### **What happens if Subcontractor fails to get contracted coverage from insurer? Does this change insurers' obligation?**

- In many cases, insurance requirements in the contract between Contractor and Sub are not carried into the actual CGL policy issued to Sub (not much industry diligence on this issue by contractors)
- Typically, not insurer's problem.

48

## CGL COVERAGE ISSUES

---

There are a variety of different Additional Insureds endorsements in use in construction context:

- Does entity qualify as an additional insured by specifically being named (easier) or belonging to a category?
- What is the injury or damage that is the basis of the claim – did it arise from ongoing operations or completed operations or both?
- What are the allegations against the entity requesting additional insured coverage – sole vicarious liability based on named insureds acts, sole negligent actor, or something in between?
- The specific language of the additional insured endorsement controls?
- Typically will not extend AI coverage to Contractor for its sole negligence

49

# CGL COVERAGE ISSUES

---

## **Indemnity/Insured Contract**

- Contract between Contractor and Sub contains indemnity provision (AIA):
  - INDEMNIFICATION: The Subcontractor shall indemnify and hold the Contractor, Owner, Architect, their agents, consultants and employees harmless from and against all claims, losses, costs and damages, including but not limited to attorney's fees, pertaining to the performance of the Subcontract and involving personal injury, sickness, disease, death or property damages ... but only to the extent caused in whole or in part by the negligent acts or omissions of the Subcontractor.
  - If owner wins suit against Contractor and Contractor wins suit against Sub based on this indemnity – damages awarded to Contractor against Sub may be covered (on behalf of Sub) under Insuring Agreement extension of coverage to damages the Sub “becomes legally obligated to pay because of property damage” (i.e., this indemnity award was an amount that Sub became legally obligated to pay to Contractor because of property damage)

# CGL COVERAGE ISSUES

---

## **Contractual Liability Exclusion**

- This exclusion does not apply to liability for damages:
  - (2) Assumed in a contract or agreement that is an “insured contract”, provided the “bodily injury” or “property damage” occurs subsequent to the execution of the contract or agreement.
- Insured contract is defined in part as “[t]hat part of any other contract or agreement pertaining to your business under which you assume the tort liability of another party to pay for “bodily injury” or “property damage” to a third person or organization.
- Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

51

## CGL COVERAGE ISSUES

---

**What are some important things to review/know in order to assess an insured contract (assumption of tort liability of another) claim:**

- The contract's indemnification provision – is it triggered in these circumstances? (e.g., claim of vicarious versus active negligence)
- Does state law limit or prohibit indemnity claimed? (e.g., anti-indemnification statute in construction context)
- Is tort liability assumed otherwise covered? (i.e., comes within insuring agreement and no exclusions apply)



## CGL COVERAGE ISSUES

---

### **What is consequence of a qualifying “insured contract?”**

- Someone insured never knew may effectively have coverage under the policy (including defense)
- How are defense costs handled? (Supplementary Payments Provision)



## CASE STUDY: BUILDER'S RIGHT TO REPAIR

Image Source: PFCS











Image Source: PFCS





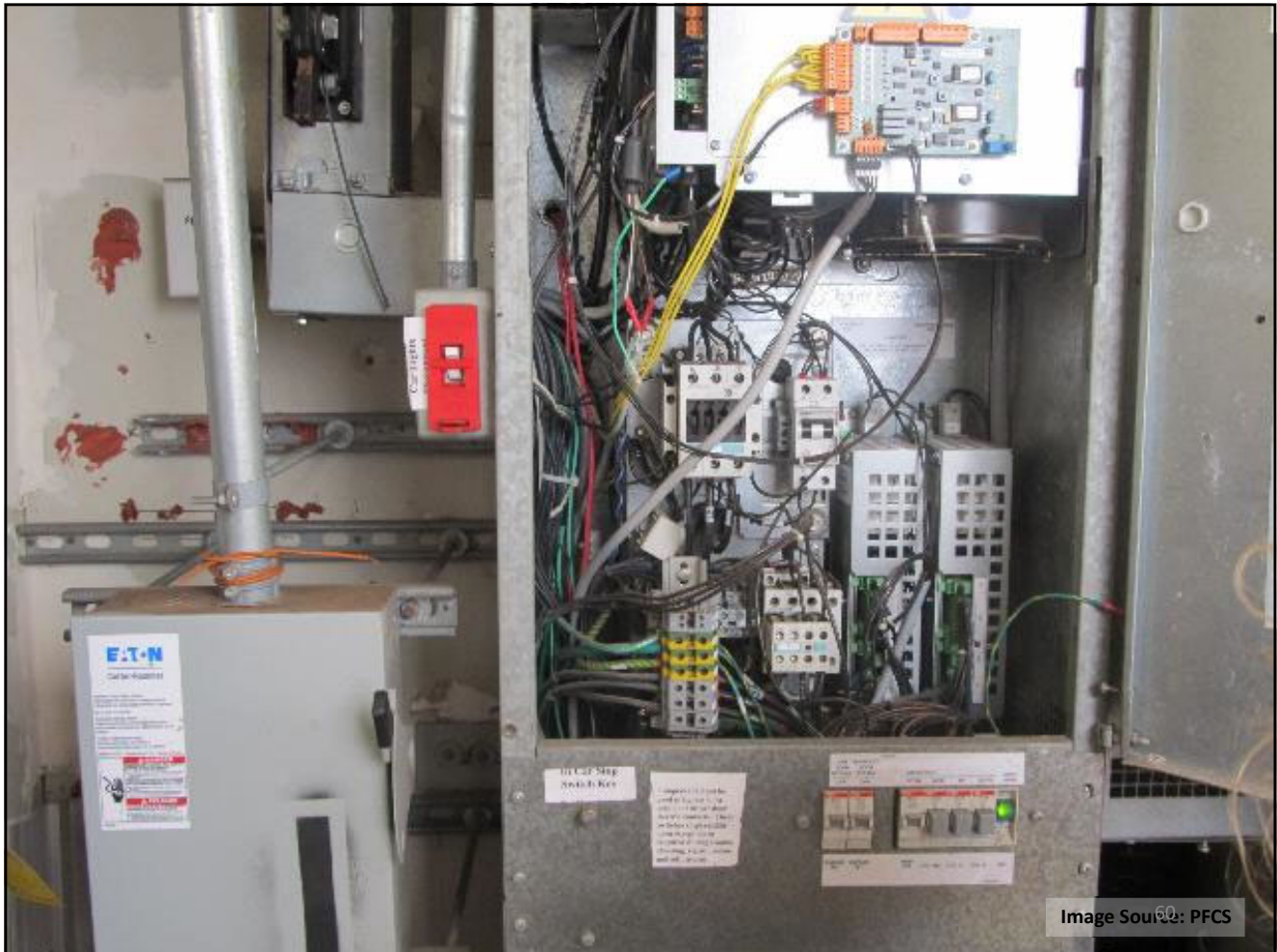
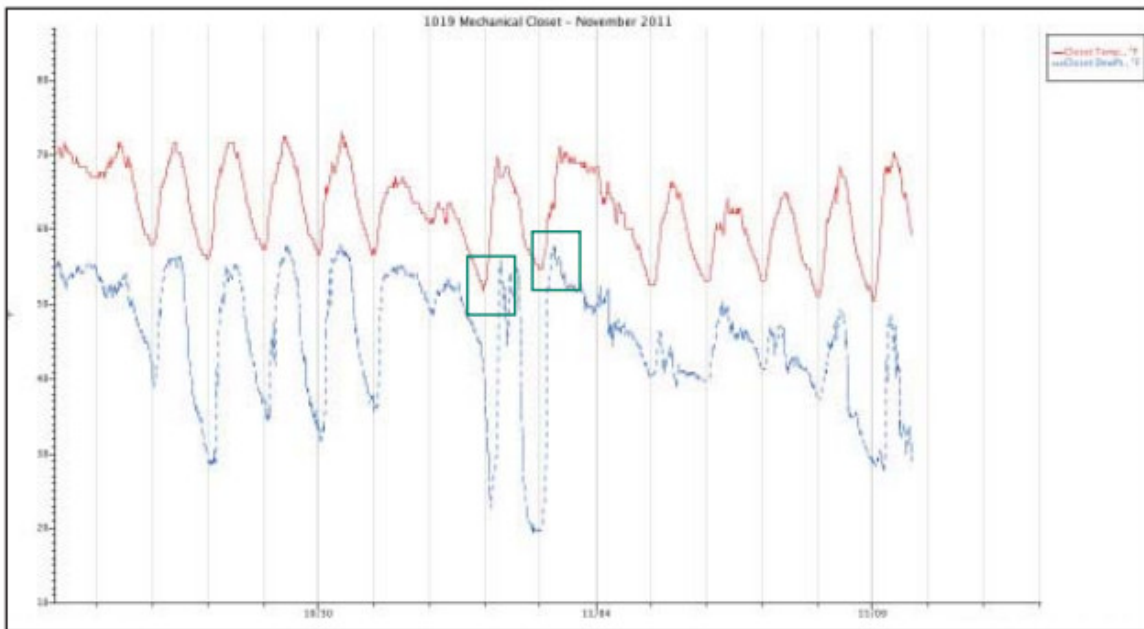


Image Source: PFCS





Image Source: PFCS



**Fig. 16 November 2011 - Condensation is possible... Dew point rises quickly in the morning, while surfaces may still be cool**  
*In late October and November, the temperature and dew point still rise and fall together. But note how they are much closer. If the dew point rises quickly, surfaces inside the closet may have remained cool enough to condense moisture, as could have been the case during the highlighted periods.*

Image Source: PFC3



# DISCUSSION

---

- Defending Claims
- Investigating Claims
- Claims Handling
- Coverage



Image Source: PFCS

## PFCS BUILDING PERFORMANCE ANALYSIS (BPA) PROCESS

---

1. Document & Information Management
2. Meetings/Interviews with Key People
3. Building Information Management
4. Inspection
5. Analysis
6. Testing (Only as Necessary)
7. Estimate
8. Report/Property Condition Report (PCR)

# OBJECTIVES

---

- Survey trends in construction defect claims against builders and subcontractors
- Describe differences in coverage issues and insurer obligations relating to contractors, subcontractors, additional insureds, and indemnitees
- Analyze key policy provisions, including what constitutes an “occurrence,” “damage to property,” “your work,” and more
- Evaluate how tenders of defense and indemnity should be made under both policy and trade agreements



Image Source: Unsplash/Henry Co



