

**FIFTEENTH ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS
CONFERENCE**

**St. Pete Beach, Florida
APRIL 15th-16th, 2004**

**PAY ME NOW OR PAY ME LATER!
RECOVERY OF PERFORMANCE BOND PAYMENTS MADE BY
THE SURETY FROM THE PRINCIPAL'S CGL CARRIER**

PRESENTED BY:

**STEVEN G. SCHEMBER, ESQ.
ERNEST J. MARQUART, ESQ.
SHUMAKER LOOP & KENDRICK, LLP**

Bank of America Plaza
101 East Kennedy Boulevard
Tampa, Florida 33602

(813) 229-7600

(813) 229-1660

PAY ME NOW OR PAY ME LATER!

**Recovery of Performance Bond Payments Made By The Surety From the Principal's
CGL Carrier**

**I. COVERAGE UNDER CGL POLICY FOR DAMAGES CAUSED BY CONTRACTOR
DURING PERFORMANCE OF WORK**

A. Factual Scenario

_____The Association ("Association") of a thirty-year-old condominium project located in Longboat Key, Florida, enters into a construction contract ("the Contract") with a local contractor ("Contractor") to perform general rehabilitation and "fix up" work at the condominium.

The two principal scopes of work under the Contract are:

1. Removal of old separated decayed stucco from the wall of the condominium replacing the old stucco with new stucco and repainting the wall to match up with the existing walls of the project.
2. Cleaning and painting of sliding glass doors and door frames at the project.

All of the work is to be performed by the Contractor. There are no subcontractors on the job. The Contract between the Association and Contractor provides that Contractor is to provide a Performance Bond guaranteeing performance of the work of Contractor under the Contract. The Contract also provides that Contractor obtain comprehensive general liability ("CGL") insurance covering Contractor during his performance of the work and thereafter on the Contract.

While performing the stucco repair portion of the project, Contractor uses air blasting, water jet blasting and sand blasting to remove the old stucco and prepare the wall surface for applying of new stucco and repainting. While performing the blasting operations, Contractor allows chunks of stucco, grit, stucco dust, sand from sand blasting and other foreign matter to become generally airborne at the project. In particular, the stucco dust and debris gets imbedded in the hurricane shutters for the units at the condominium project and also gets imbedded in the electric motors which power the hurricane shutters.

_____During the painting operations described above, there is paint overspray generally throughout the project. Paint gets spilled on the paver bricked driveway of the project, screen doors which are removed in order to allow painting of the sliding glass doors are damaged during removal, paint gets oversprayed on the screen portion of the screen doors, and paint gets into the plastic gaskets in the screen door jams such that when the screen doors are replaced into the doorways, they become stuck and will not open.

_____ In addition to the above, the Contractor's scaffolding, which it uses for both its stucco and painting operations described above, is improperly utilized causing damage to the roof of the condominium as well as to the parapet walls of the condominium.

B. The Performance Bond and the Construction Project

_____ The Performance Bond is a standard AIA311 Bond which incorporates the terms and provisions of the construction contract by reference. The construction contract contains a clause making the Contractor responsible for protecting all of the condominium project from damage while the Contractor is performing its operations and making the Contractor liable for repair or replacement of any damages caused by the Contractor during construction.

_____ The Contractor and its individual owner principals have executed a standard, general indemnity agreement ("GIA") in favor of the Surety which includes an assignment to Surety by the indemnitors of any and all rights under any policies of insurance insuring the principal and indemnitors.

C. Legal Proceedings between Association and Surety

_____ The Association follows the various steps for declaring default and terminating Contractor for nonperformance under the Contract. Contractor goes out of business, one of the principal indemnitors commits suicide, and the other principal indemnitor disappears. The Association sues Surety claiming that Surety is liable as follows:

1. For repair and replacement of improperly installed stucco, and improperly applied painting on the project.
2. For repair and correction of the hurricane shutters, screen doors, roof, and concrete pavers damaged by Contractor during the construction.
3. For several unpaid payment bond claims to material suppliers of Contractor.

_____ The Association also makes a claim against the CGL carrier for the damages caused by the Contractor during construction as outlined above. The CGL carrier denies coverage. The Association decides to proceed with its claims under the Performance Bond and does not pursue a claim against the CGL carrier.

_____ The Surety satisfies the payment bond claims against its payment bond. The Surety further establishes that Contractor's actual performance of the stucco and painting work was in accordance with the Contract specifications and has been accepted by the project engineer. The case proceeds to mediation as to the damage claims described above. As expected, at the mediation, the Association presents a "Rolls Royce" cost of repair and replacement of the damage items while Surety presents a "Honda" cost of such repair and replacement. The case is settled at mediation for a number in between the numbers as submitted by Association and Surety, but in actuality closer to the Surety's numbers than the Association's.

D. Surety's Claim against CGL Carrier

_____ After settling the claim by the Association at mediation as described above, the Surety then files a declaratory judgment action against the CGL carrier seeking a determination that the damages paid by the Surety at mediation, including costs and attorneys fees, are damages which were covered under the CGL policy and which should have been paid by the CGL carrier. After some discovery on both sides, both the Surety and the CGL carrier file cross-motions for summary judgment as to the coverage issues presented.

E. Surety's Coverage Claims in Summary Judgment Motion Against CGL Carrier

The CGL policy is a standard Insurance Services Office ("ISO") Form postdating the 1986 revisions to the form. The specific CGL policy covering the Contractor in this case was issued in 1996 and names the Association as a named insured in addition to naming the Contractor as a named insured.

1. "Property Damage" Coverage Provisions Under CGL Policy

_____ The standard ISO Form used by most CGL carriers employs language "to cover a broad risk at the beginning of the policy but then to shift certain risks back to the insurance buyer by means of exclusions stated later in the policy." *Maryland Casualty Co. v. Reeder*, 270 Cal.Rptr. 719, 722 (Cal. App. 4th Dist. 1990).

When arguing coverage issues under a CGL policy, it is critical to point out to the Court that the broad scope of coverage granted at the outset of the policy is to be liberally construed in favor of coverage to the insured while the exclusions stated later in the policy are to be strictly construed against the CGL carrier.

The broad grant of coverage under the policy is contained in Insuring Agreement 1. which provides as follows:

- "a. We will pay those sums that the insured becomes legally obligated to pay as damages because of. . . 'property damage' to which this insurance applies. . .
- b. This insurance applies to. . . 'property damage' only if:
 - (1) The. . . 'property damage' is caused by an 'occurrence'. . . and
 - (2) The. . . 'property damage' occurs during the policy period."

The term "property damage" is defined in the policy as:

- "a. Physical injury to tangible property, including all resulting loss of use of that property. . .
- b. Loss of use of tangible property that is not physically injured. . ."

As can be seen, the grant of coverage under the standard ISO Form CGL policy is extremely broad. The CGL policy covers not only “property damage” as defined in the policy but also “those sums that the insured becomes legally obligated to pay as damages because of “property damage”. (emphasis added) If the policy ended at this point, all physical injury to tangible property plus all damages because of such physical injury to tangible property of any sort whatever would be covered under the CGL policy.

2. Defective Construction is an “Occurrence”

In order to be covered under the CGL policy, the property damage must be caused by an “occurrence”. The term “occurrence” is defined in the policy as:

“. . .an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”

The “occurrence” in the scenario set forth above was the defective work by the Contractor which resulted in physical damage to other portions of the property other than that on which the Contractor’s work was being performed. Courts construing the term “occurrence”, and its defining word “accident”, have found these terms to be ambiguous.

The Florida Supreme Court recently dealt with the meaning of the term “occurrence” in an insurance policy issued by State Farm Fire and Casualty Company (“State Farm”), which defined “occurrence” as an “accident” exactly as does the CGL Policy in the fact scenario above. *State Farm Fire and Casualty Co. v. CTC Development Corp.*, 720 So. 2d 1072 (Fla. 1998). In *State Farm*, an architect and his construction company were hired to build a house. After construction, they were sued by neighboring property owners because they had built the house beyond a 15 foot setback requirement. Before construction commenced, the architect thought he had obtained a variance from the homeowners’ association president to build beyond the setback line. The architect called upon his CGL insurer, State Farm, to defend the suit and State Farm refused. The lawsuit filed by the homeowners was settled for \$22,500, and the architect incurred \$29,400 in attorney’s fees and costs defending the suit.

_____The architect and his construction company then sued State Farm under the CGL policy to be reimbursed for these damages. State Farm argued that the construction of the home beyond the setback did not constitute an “occurrence.” The Supreme Court of Florida interpreted the meaning of “occurrence” broadly to include “damages or injuries that are neither expected nor intended from the viewpoint of the insured.” *State Farm*, 720 So. 2d at 1076. The Court held that even though the architect had knowingly built the house beyond the setback line, his claim was covered because the damages incurred were “neither expected nor intended.”

Redmer v. Auto Owners Ins., 2000 Mich.App. 1960 (Mich.Ct.App. 2000) involved remarkably similar claims to those in *State Farm*. In *Redmer*, Auto Owners was sued for damages arising from the construction of a dwelling which encroached a setback line. The *Redmer* Court held:

...although plaintiff intended to construct the [owners’] home, because he did not do so with the intention of interfering with the [neighbors’] use of their property or causing drainage and runoff problems, any property damage was the result of an

accident and therefore was an 'occurrence' under plaintiff's insurance policy.

Redmer, 2000 Mich.App. at 1967 (*emphasis added*).

In *High Country Assocs. v. New Hampshire Ins. Co.*, 648 A.2d 474 (N.H. 1994), the Supreme Court of New Hampshire found that because the faulty workmanship in that case resulted in damage that was unexpected and unintended from the standpoint of the insured, it satisfied the definition of "occurrence." See *High Country Assocs.*, 648 A.2d. at 478; see also *Fejes v. Alaska Ins. Co., Inc.*, 984 P.2d 519, 523 (Alaska 1999); *Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720, 723-26 (5th Cir. 1999); *Hamilton Die Cast, Inc. v. USF&G Co.*, 508 F.2d 417, 420 (7th Cir. 1975); *Bundy Tubing Co. v. Royal Indem. Co.*, 298 F.2d 151, 153 (6th Cir. 1962); *Young Women's Christian Assoc. of the Nat'l Capital Area, Inc. v. Allstate Ins. Co. of Canada*, 275 F.3d 1145, 1147 (D.C. Dist. 2002); *Corner Construction Company v. USF&G Co.*, 638 N.W. 2d 887, 894-95 (S.D. 2002).

In the factual scenario above, the Contractor performed work which it believed was in conformance with its contract with the Association but which was later determined to be defective. Under the authorities cited above, such defective construction by the Contractor is an "occurrence" under the CGL policy.

3. Standing of Surety To Bring Action

CGL carriers will often argue that the Surety has no standing to bring an action against the CGL policy because the Surety is not a named insured under the policy. The CGL carriers will also cite anti-assignment clauses contained in their policies as precluding the Surety's being able to bring an action under the policy. Finally, CGL carriers will also raise defenses under the terms of the policy that the carrier would have against its insured, most often a claimed failure of the insured to cooperate in the defense or a claimed failure by the insured to give proper notice of this claim to the insurer.

There are several ways the Surety can get around these legal obstacles imposed by the CGL carriers. The first and most obvious way is to point out that the Surety, as a matter of law by virtue of its equitable subrogation rights, "stands in the shoes" of its principal, the named insured under the CGL policy. While the writers have been unable to find any authority for this proposition, an argument has nevertheless been persuasively made before several courts that an anti-assignment clause contained in an insurance policy cannot "trump" or otherwise abrogate the historical long-standing equitable subrogation rights of a Surety. Of course, if the CGL policy does not contain an anti-assignment clause, then the Surety also can argue that it "stands in the shoes" of its insured by virtue of the assignment in the GIA of all rights of the insured under the policy to the Surety.

In some instances, the owner of the project is also a named insured under the CGL policy covering the general contractor. In such instances, the Surety can argue that it "stands in the shoes" of the owner and also is, therefore, entitled to make a claim under the policy.

Sometimes more troublesome is the fact that the CGL insurer may have defenses against the named insureds under the policy for failure to give proper notice or to cooperate in the defense of the case. In such instances, it behooves the Surety to claim that it not only “stands in the shoes” of its insured principal as a named insured under the policy, but also is a third-party claimant under the terms of the policy and thus not subject to any defenses of the insurer against the named insured. The basis for claiming status as a third-party claimant against the policy is the Surety’s GIA with its principal, who is also a named insured under the policy. As a third-party claimant, the Surety is bringing an action against its principal to enforce the principal’s indemnity obligations under the GIA. The principal’s indemnity obligations under the GIA are covered by the CGL policy issued by the insurer.

Of course, the obligations of the principal to the Surety pursuant to the GIA are contractual in nature. Nearly all CGL policies contain a standard “contracted liability” exclusion which provides:

_____“This insurance does not apply to: . . .

‘property damage’ for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.”

This exclusion would appear on its face to bar coverage for a third-party claim by the Surety based upon the obligations of the principal to the Surety under the GIA. However, the so-called “contracted liability” exclusion goes on to say:

“This exclusion does not apply to liability for damages: . . .

(2) That the insured would have in the absence of the contract or agreement.”

Thus, if the principal/insured would be liable to the Surety in the absence of the GIA, then the mere fact that there is also liability under the GIA would not preclude coverage.

Of course it is hornbook law that a principal owes its Surety a duty of indemnity at common law separate and apart from whether or not there is also a written GIA providing the same indemnity. Under common law principles of indemnity and suretyship, the Contractor in the scenario above would have been liable to the Surety in the absence of the Indemnity Agreement. A surety’s common law right to indemnity from its principal is well established. In *Doster v. Continental Casualty Co.*, 105 So. 2d 83 (Ala. 1958), the Alabama supreme court, in discussing a surety’s right to exoneration, stated:

No principle of equity is more familiar, or more firmly established, than that a surety, after the debt for which he is liable has become due, without paying, or being called upon to pay it, may file a bill in equity to compel the principal debtor to exonerate him from liability by its payment, provided no rights of the creditor are prejudiced thereby.

Doster, 105 So. 2d at 85-86, quoting *Searcy v. Shows*, 85 So. 444, 445 (Ala. 1920). These common law principles are available to the Surety even if there were no Indemnity Agreement. See *Transamerica Premium Ins. Co. v. Cavalry Constr., Inc.*, 552 So. 2d 225, 226 (Fla. 5th DCA 1989); *Scott v. National City Bank of Tampa*, 139 So. 367, 370 (Fla. 1931) (“The law implies a promise on the part of the principal to indemnify his surety.”); *Borey v. National Union Fire Ins. Co. of Pittsburgh*, 934 F.2d 30, 32-33 (2d. Cir. 1991); *Milwaukie Constr. Co. v. Glens Falls Ins. Co.*, 367 F.2d 964, 966 (9th Cir. 1966); *Northwestern Nat’l Ins. Co. of Milwaukee v. Barney*, 1988 WL 215411, *4-*5 (N.D. Ohio 1988); 28 Fla. Jur., *Guaranty & Suretyship* §§ 80, 82; RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §18, cmt. A, §21 (1996).

At least one court in an analogous situation has held that the so-called “contracted liability” exclusion did not preclude coverage under a CGL policy for a claim arising out of an indemnity agreement. In *Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720 (5th Cir. 1999), the insured was a subcontractor defending a suit brought against it by the general contractor for damages arising out of substandard fill material provided by the subcontractor. The subcontract between the general contractor and subcontractor contained a clause which imposed a duty upon the subcontractor to indemnify the general contractor for property damages arising out of the subcontractor’s performance of the contract. The subcontractor tendered defense of the claim to its CGL carrier. The CGL carrier refused to defend asserting that the claims against the subcontractor were excluded by the “contracted liability” exclusion in its CGL policy, which was identical to the exclusion cited above. The Fifth Circuit Court of Appeal found that the subcontractor would have been liable to the general contractor under a negligence theory or other common law duty even if there had been no indemnity clause in the contract. In finding coverage under the CGL policy for the general contractor’s claim against the subcontractor, the Court ruled:

“When, as here, liability could be imposed pursuant to either a contractual indemnity provision or a generally applicable legal principle, the contractual liability exclusion will not bar coverage.” *Id* at 726.

The legal principles set forth in *Federated* are clearly applicable to the Surety’s claim against the CGL carrier under the above factual scenario. Accordingly, a Surety has standing to bring a claim against a CGL policy insuring its principal both as a first-party claimant “standing in the shoes” of its principal and as a third-party claimant based upon the principal’s obligations to the Surety under the terms of the GIA.

4. Coverage Under CGL Policy for Damage Caused By Contractor During Construction

Having established under the scenario above that there is “property damage” as defined in the CGL policy; that there has been a “an occurrence” as defined in the CGL policy; and that the Surety has standing to bring both first-party and third-party claims under the CGL policy, the next question is whether the “property damages” caused by the Contractor during the course of construction are excluded under the terms of the CGL policy. The answer to this particular question will turn upon the particular facts of each case.

As pointed out above, the term “property damage” is broadly defined in the CGL policy. However, exclusions to j(5) and to j(6) of the policy contain arguably applicable exclusions. These exclusions provide as follows:

“This insurance does not apply to: . . .

j. ‘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.”

(emphasis added) Accordingly, there is no coverage during the performance of the work by the Contractor for damage to “that particular part” of the project upon which the Contractor is actually performing operations. However, if there is “property damage” to property other than “that particular part” of the property being worked upon, then there is coverage.

Several cases have discussed the meaning of “that particular part” as contained in exclusion j(5) and j(6) quoted above. In *Frankel v. J. Watson Co., Inc.*, 484 N.E. 2d. 104 (1985), the insured contractor was hired to move a farmhouse to an alternative site, to construct a roadway to the new site, to install underground utilities and a new septic system, and to pour and construct a new complete foundation. The insured contractor performed all the work itself. The owner made a claim against the insured contractor for damage to the farmhouse resulting from the contractor’s negligent construction of the foundation. The insured contractor tendered the defense to its CGL carrier which denied coverage under an exclusion essentially identical to exclusion j.5 and j.6 quoted above.

The Court in *Frankel* concluded that the exclusion applied only to the foundation upon which the insured contractor had performed defective work and not for damages to the remainder of the property.

In *Blackfield v. Underwriters at Lloyd’s, London*, 245 Cal. App. 2d 271; 53 Cal. Rptr. 838 (1996), the homeowners sued the builder/developer of a subdivision claiming that the builder/developer had defectively constructed the foundation of their home and compacted the fill on which the home was placed such that the foundation had settled, the house slanted, the stucco portion of the house cracked, and the windows and sliding doors did not open or close properly. The builder/developer tendered the defense to its CGL carrier, Lloyds, which denied coverage based upon an exclusion nearly identical to those in j.5 and j.6 quoted above. The Court ruled 245 Cal.App.2d at 276:

“Appellants (Lloyds) attempt to extend Exclusion 3 n1 to damage to the whole house, including the nondefective parts thereof, on the theory that it is property upon which the respondents had worked. This is an unreasonable interpretation of the provision. It

only excludes damage to ‘that particular part’ or parts upon which the Assured has performed faulty work.

---Footnotes---

n1 For convenience we repeat this exclusion: ‘3. For damage to that particular part of any property upon which the Assured is or has been working caused by the faulty manner in which the work has been performed.’

The Court ordered Lloyds to defend the action brought against the builder/developer.

Yet another case, *Baugh Construction Co. v. Mission Insurance Company*, 836 F.2d 1164 (9th Cir. 1988) involved construction of an eleven-story office building. A dispute arose between *Baugh* and the owner over *Baugh*’s performance of the contract. *Baugh* commenced a lien foreclosure action and the owner counterclaimed alleging defective construction by *Baugh*. In particular, the owner alleged that *Baugh* had laid floor slabs that lacked adequate reinforcing steel in the building and that the seismic resistance system (the building was located in an earthquake prone area on the West Coast) was defective.

Baugh tendered the defense of the action to its CGL carrier. A declaratory judgment was entered by the district court against the CGL carrier, Lloyds, finding there was coverage for the damages claimed by the owner. On appeal, Lloyds, citing an identical exclusion to that contained in paragraphs j.5 and j.6 quoted above, argued that the trial court had erred by interpreting the faulty work exclusion as applying only to claims for repair or replacement of defective parts of the project but not to claims for damages to non-defective parts of the project. Citing *Blackfield*, the Ninth Circuit Court of Appeals rejected Lloyds’ claims and held, 836 F.2d at 1172:

“The (*Blackfield*) court interpreted the identical exclusions claimed by Lloyd’s here and held that the policy did not exclude liability for damages unrelated to the actual cost of repairing or replacing the defective part of the product. (citation omitted) We agree, and find that the exclusion for damage to *Baugh*’s work does not exclude the claim for damage to tenant improvements.”

W.E. O’Neil Const. v. National Union Fire Ins. Co., 721 F.Supp. 984 (N.D. Ill. 1989), which is discussed more extensively in Part II of this paper, is one of the leading cases describing what constitutes “that particular part” of property as that term is used in the exclusion set forth above.

The general contractor, *O’Neil*, entered into a contract with the owner to build a project consisting of two apartment towers, various townhomes and a four-level concrete parking garage. Both during construction and after completion, cracks began to appear in the concrete floors and walls of the parking garage. These cracks worsened over time. Experts concluded that the primary cause of the cracking was improper placement of the steel mesh embedded in the concrete walls.

The owner of the project sued *O’Neil* for repair of the garage. *O’Neil* tendered defense of the owner’s action to its CGL carrier, National Union, which denied coverage

under its CGL policy for numerous reasons. One of the reasons advanced by National Union was that because *O'Neil* was the general contractor, the entire project, including the garage, constituted "that particular part" of the property on which *O'Neil* was performing work and, accordingly, there was no coverage under the National Union policy for any of the damaged garage.

The District Court in *O'Neil* rejected National Union's argument holding at 995:

"However, where the insured is responsible for assembling many components of a large structure, such as a building, courts have interpreted exclusion. . . (similar to j.5 and j.6 quoted above). . . so as to exclude coverage only for damage to the defective component itself, and not to damage to the remainder of the structure."

Citing *Blackfield*, *Baugh*, and *Frankel* discussed above, the Court held:

"This Court finds these authorities persuasive and holds that the literal language of the exclusion limits the exclusion to the cost of repairing or replacing the defective component itself, and not to damages to the remainder of the structure. Even if the exclusion were ambiguous, however, the Court would follow the principle that exclusions are to be interpreted narrowly against the insurer, and reach the same result."

Id. at 996.

A recent Florida case, *American Equity Ins.Co. v. Van Ginhoven*, 788 So.2d 388 (Fla.App. 5th Dist. 2001) involved a swimming pool contractor who was performing repairs to a residential pool. While draining the pool in order to allow it to effect the repairs, the pool popped out of the ground resulting in damage to the pool, pump, heating system, deck, screen enclosure and the surrounding landscaping and sprinkler system. *Van Ginhoven* submitted the damage claims to his insurance carrier. The CGL policy issued by the carrier contained identical exclusions to paragraphs j.5 and j.6 quoted above. The Court found, at 391:

"At trial, *Van Ginhoven* admitted that when the pool popped, he was draining the pool, and thus working on, or performing operations on the pool. Therefore, this exclusion bars coverage for property damage to 'that particular part of real property on which [*Van Ginhoven*]. . . was performing operations.' . . The exclusion applies to all property on which work was incorrectly performed. . . Accordingly, the term 'all property' clearly refers to the pool because *Van Ginhoven* incorrectly performed work on it."

Having found that there was no coverage for actual damage to the pool itself, the Court went on to hold, however:

"Conversely, damage to any property that *Van Ginhoven* was not performing operations on, or incorrectly performing work on, is not excluded. Because *Van*

Ginhoven was not working on the plumbing, electrical, deck work, patio, screen enclosure or the residence, any damage to those items is covered.” *Id.* at 391.

The above cases make clear that the term “that particular part” of any property upon which the Contractor is performing work is limited to the “property on which work was incorrectly performed.” The term “that particular part” does not apply to other portions of the property on which no work was incorrectly performed even if those other portions of the property were within the scope of work of the construction contract.

Under the factual scenario above, the Contractor was performing stucco repair and replacement work to the walls of the condominium project. The Contractor was also applying paint to the sliding glass doors on the project. As a consequence, the Contractor damaged the hurricane shutters and motors, screens, sliders, paver bricks, sliding screen doors and door jams and roof. It is submitted, under the cases cited above, that the property damaged by the Contractor did not constitute “that particular part” of the property that was being worked on by the Contractor. Indeed, under the above cases, even if the entire project was being worked upon by the Contractor, only that part on which work was incorrectly performed would be excluded from coverage under the CGL policy.

Accordingly, under the scenario set forth above, there will be coverage for the various items listed above damaged by the Contractor during construction which do not constitute “that particular part” of the property being worked upon by the Contractor.

II. COVERAGE UNDER CGL POLICY FOR DAMAGE CAUSED BY THE CONTRACTOR AFTER WORK IS COMPLETED

A. Factual Scenario

Consider the following scenario: Contractor enters into a Contract with an Owner/Developer for construction of a ten-story condominium building on the Gulf of Mexico in the Florida panhandle. The Contractor is, in essence, a construction manager and subcontracts all work on the project. The Project is completed and accepted by the Owner/Developer. The Owner/Developer sells out the Project and turns over the Project to the Condominium Association. Not long after the turnover to the Association, unit owners start noticing problems with leaking and water intrusion in the building, deteriorating concrete in the sidewalks and parking area, and excessive corrosion and rusting in the covered parking stalls.

The Association hires an engineer to thoroughly examine the project. The engineer finds that the roof was improperly installed allowing water intrusion into the various units in the building. The engineer further finds that the curtain walls on the project were improperly installed which again allows water to accumulate inside the curtain walls and penetrate into the interior of the building. The engineer further finds that the windows in the project were improperly installed and do not meet the 100-mile per hour wind load requirement for projects located on the Gulf of Mexico. The engineer also finds that the concrete was improperly mixed and that the covered parking stalls were improperly installed allowing excessive corrosion on the metal beams and pilings of the stalls.

The Association sues the Owner/Developer which in turn sues the Contractor which is bonded by Surety. The Contractor goes out of business and has no assets. The Surety undertakes its defense of the action and files a third party complaint against in all of the various

subcontractors and material suppliers that actually constructed and furnished the materials for the building.

Following extensive discovery, a mediation session is held. At the mediation, Surety and all of the involved subcontractors and material suppliers contribute varying sums to settlement of the matter.

The Surety then brings an action against the CGL carrier for the general contractor seeking declaratory judgment that the damages paid by the Surety are covered under the CGL policy. After discovery, both the CGL carrier and the Surety move for summary judgment on the issue of coverage.

B. Initial Coverage Considerations

The initial analysis of the coverage issues pertaining to the above scenario are the same as those in the first scenario described above. Almost certainly the Surety will be able to establish the existence of “property damage” as defined in the CGL policy, the happening of “an occurrence” as defined in the policy, and the Surety’s standing to bring the action against the CGL carrier both as a first and third party claimant as described in detail above. Having established these basic positions, however, the issue of coverage for the damages to the condominium project under the CGL policy becomes quite complex.

C. Coverage Issues Under CGL Policy for Damages Occurring After Completion of Project

As pointed out earlier in this paper, when articulating the risks that will be covered by a CGL policy, common practice is “to cover a broad risk at the beginning of the policy but then to shift certain risks back to the insurance buyer by means of exclusions stated later in the policy.” *Maryland Casualty Co. v. Reeder*, 270 Cal.Rptr. 719, 722 (Cal. App. 4th Dist. 1990). The vast majority of the CGL carriers, when drafting their policies and endorsements, utilized standard form provisions prepared by the ISO. See the typical ISO Form CGL policy attached. In addition to drafting standard form provisions, the ISO also publishes interpretive circulars which describe the intent, purpose, and effect of the ISO standard form provisions. *Maryland Casualty Co.* at 722. Numerous courts have relied on language from these ISO circulars and other insurance industry publications interpreting standard ISO CGL provisions. *Id.*

In addition to the basic ISO Form CGL policy with the broadly defined coverage followed by exclusions intended to limit coverage, most CGL policies issued to contractors these days include an optional, additional risk altering mechanism called “completed operations coverage.” By paying an additional percentage of its basic CGL policy premium, contractors can purchase *expanded coverage that narrows the exclusions* set forth in the basic policy. This expanded protection actually shifts *back to the CGL carriers* some of the risks that were originally shifted to the contractor by way of the exclusions in the CGL policy.

D. Development of and Coverage Provided by Completed Operations Coverage

As will be discussed in detail below, the insurance industry, via the ISO, has significantly expanded the coverage of its CGL policies for construction defects. Unfortunately, however, many insurance counsel and adjusters refuse to acknowledge these changes made by their own industry and continue to recite the no longer valid

mantra that “defective construction is not covered by CGL policies.” Even more unfortunately, many attorneys representing contractors and sureties do not recognize that this expanded coverage exists. Worst of all, several courts, misled by uninformed counsel, have continued to follow the old rule despite the clear changes to the ISO CGL Form expanding coverage for construction defects.

1. Pre-1986 ISO Form CGL Policy

Prior to 1986, the basic form CGL policy *did not* include coverage for completed operations and included named insured’s “work” and “product” exclusions. The pre-1986 basic CGL policy “work performed” exclusion excluded coverage for:

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 materials, parts or equipment furnished in connection therewith...

(emphasis supplied).

The “products” exclusion in the pre-1986 CGL policy removed coverage for: property damage to the named insured’s products arising out of such products or any part of such products...

Therefore, in the basic, pre-1986 CGL policy, “property damage to work performed by or on behalf of the named insured” was excluded, as was “property damage to the named insured’s products.” These exclusions were often referred to as the “Business Risk Exclusions.”

2. The Broad Form Property Damage Endorsement

Prior to 1986, contractors who wished to purchase expanded completed operations coverage under the basic pre-1986 CGL policy did so by purchasing a separate endorsement, called a Broad Form Property Damage Endorsement (“BFPD”), to be added to the basic policy for an added premium. The BFPD deleted “by or on behalf of the Named Insured” from the “work performed” exclusion contained in the standard pre-1986 CGL policy and replaced it with the following exclusion for property damage:

[t]o work performed **by the Named Insured** arising out of the work or any portion thereof, or out of materials, parts or equipment furnished therewith.

(emphasis added). The pre-1986 BFPD did not, however, make any change to the standard policy’s above quoted “products” exclusion, though interpretations by courts nationwide have held that neither real estate nor a *completed* project are a “product.”

3. Majority Judicial View Interpreting Pre-1986 ISO Form CGL Policy with BFPD

Unfortunately, a judicial dispute arose (and continues to generate new cases) concerning the scope of completed operations coverage provided to general contractors under the *pre-1986 BFPD* for claims related to subcontractor work: for example, damage to general contractor work arising from subcontractor work; damage to subcontractor work

arising from the subcontractor's work; and damage to subcontractor work arising from another subcontractor's work.

The majority of courts from various jurisdictions have held, and continue to hold, that the language of the BFPD which reduced the scope of the "work performed" exclusion by limiting the exclusion to "work performed by the Named Insured" was deliberate; that "products" as used in the products exclusion did not include work on real property or completed work; and, therefore, that general contractors' CGL completed operations coverage in the BFPD protected general contractors against subcontractor work related claims but not against general contractors' own faulty work. See, e.g., *W.E. O'Neil Const. v. National Union Fire Ins. Co.*, 721 F.Supp. 984 (N.D. Ill. 1989); *Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648 (9th Cir. 1988); *Harbor Ins. Co. v. Tishman*, 578 N.E.2d 1197 (Ill. Ct. App. 1991); *McKellar Development of Nevada, Inc. v. Northern Ins. Co. of N.Y.*, 837 P.2d 858 (Nev. 1992); *Korossy v. Sunrise Homes, Inc.* 653 So.2d 1215 (La. App. 5th Cir. 1995); *Alaska Pacific Assurance Co. v. Collins*, 794 P.2d 936 (Ak. 1990); *Maryland Cas. Co. v. Reeder*, 270 Cal.Rptr. 719 (Cal. App. 4th 1990); *Green Constr. v. National Union Fire Ins. Co.*, 771 F.Supp. 1000 (W.D. MO. 1991); *Stratton & Company, Inc. v. Argonaut Ins. Co.*, 469 S.E.2d 545 (Ga. App. 1996); *Panzica Construction Company v. The Ohio Casualty Insurance Company*, 1996 Ohio App. Lexis 1975.

On the other hand, a minority of courts in other jurisdictions held that the *pre-1986* completed operations coverage in the BFPD is of no effect and that no coverage is afforded to a general contractor for completed operations claims arising from subcontractor work. See, e.g., *Knutson Const. Co. v. St. Paul Fire & Marine Ins. Co.*, 366 N.W.2d 738 (Minn. App. 1985).

O'Neil, *Fireguard*, and *Green*, *supra*, are the three leading cases, nationally, which represent the majority view that the *pre-1986* completed operations coverage in the BFPD was clearly intended to expand coverage to include coverage for defective work or damages caused by a subcontractor.

In *O'Neil*, *supra*, the Court held that under the *pre-1986* BFPD, the "faulty work exclusion"¹ does not apply to "completed operations" where the work involved a subcontractor:

O'Neil further argues that it has alleged sufficient facts to make applicable the policy's completed operations exclusion rather than the faulty workmanship exclusion. It argues that the faulty workmanship exclusion does not apply at all if the garage was a "completed operation" prior to the occurrence. Rather the applicable exclusion, if any, would be exclusion VI(A)(3), which excludes coverage:

with respect to the completed operations hazard and with respect to any classifications stated in the policy or in the company's manual as "including completed operations", to property damage to work performed by the named insured arising out of such work or any portion thereof, or out of

¹ Defined in the *pre-1986* BFPD at VI(A)(2)(d)(iii)(faulty work exclusion) and VI(A)(3)(completed operations exclusion) which excludes only work performed by the "insured" and does not exclude work performed on "his behalf" by a subcontractor.

such material, parts or equipment furnished in connection therewith.

As O'Neil correctly points out, the completed operations exclusion does not exclude coverage where the damage results from the work of a subcontractor rather than the work of the insured itself. See *Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648 (9th Cir. 1988); *Mid-United Contractors, Inc. v. Providence Lloyd's Ins. Co.*, 754 S.W.2d 824 (Tex. App. 1988).

The Court agrees that if O'Neil [general contractor] is able to present sufficient evidence that the garage [built by subcontractor] constituted a completed operation, the policy would not exclude coverage for the loss. This provides an alternative ground for rejecting National Union's argument that the faulty workmanship clause mandates dismissal of Count I.

721 F.Supp at 996.

The court in *Fejes v. Alaska Insurance Company, Inc.*, 984 P.2d 519, 526 (Ak. 1999), evaluated whether exclusion (n) to the standard pre-1986 ISO form CGL policy, which eliminates coverage for property damage to "a named insured's products arising out of such products" could be employed to prevent coverage when the building has been completed. The Alaska Supreme Court held that a completed building is not a "product" explaining:

We are of the view that a "product" under the policy does not include a completed building. Interpreting the term to include a completed building would negate the intended coverage of the broad form endorsement, which is meant to provide protection to completed work when damage arises from the work of a subcontractor.

(emphasis added). *Id.* The Alaska Supreme Court further analyzed other courts' holdings noting, as quoted in *Maryland Casualty Co. v. Reeder, supra*, that a National Underwriters' Association Bulletin states:

The editors have heard of instances in which insurers have denied coverage...on the ground that the policy exclusion of injury to the named insured's *products* (which is not amended by the Broad Form endorsement) eliminates coverage for any damage to the completed building, the completed building being a "product" of the named insured. In the opinion of the editors, that reasoning ignores the distinction between the "completed operations hazard" and "named insured's products" in the policy definitions. *Moreover, that reasoning precludes any possibility of recovery under the Completed Operations feature of the Broad Form endorsement, a feature for which the insured has presumably paid an additional premium.*

Maryland Casualty Co. at 728. (emphasis in original)

Thus, the majority of courts in this country have held that damage to a construction project occurring after completion of the project caused by a subcontractor *is covered* under the pre-1986 ISO form CGL policy with the BFPD.

4. Industry Publications Interpreting Pre-1986 ISO Form CGL Policy with BFPD

(a) ISO Circular Interpreting Pre-1986 ISO Form CGL Policy with BFPD

The majority judicial interpretation of the pre-1986 ISO form CGL policy with the BFPD is supported by the ISO's own publications designed to explain the intent, purpose, and effect of its standard form policy provisions. (The ISO is the drafter of both the pre-1986 form CGL policy and the post 1986 CGL policy at issue in the factual scenario above.) Notably, in one of its publications, the ISO explains that the pre-1986 CGL policy with the BFPD is intended to "exclud[e] only damages caused by the named insured to his own work. Thus,...[t]he insured would have coverage for damage to his work arising out of a subcontractor's work [and] [t]he insured would have coverage for damage to a subcontractor's work arising out of the subcontractor's work." *Fireguard* at 652.

(b) National Underwriters' Association Bulletin Interpreting

Pre-1986 ISO Form CGL Policy with BFPD

The pre-1986 ISO form CGL policy with the BFPD has also been explained by the National Underwriters' Association in its Fire Casualty & Surety Bulletin ("FC&S Bulletin") which is frequently used by insurance agents and brokers to interpret standard insurance policy provisions. *Fireguard*, 864 F.2d at 652. According to one such FC&S Bulletin, the work performed exclusion, as it appears in the pre-1986 BFPD,

eliminates coverage for property damage to work performed by the named insured if the property damage arises out of the named insured's work or any portion of it. Thus, an insured *has* coverage for his completed work when the damage arises out of the work performed by someone other than the named insured, *such as a subcontractor*. ... The usual Completed Operations Coverage (no Broad Form Property Damage endorsement attached) flatly excludes property damage to work performed by *or on behalf* of the named insured arising out of the work. Under the usual coverage, then, the insured has no insurance whatsoever for damage to a subcontractor's work or to his own work resulting from a subcontractor's work. **Therein lie the advantages of Broad Form Property Damage coverage including completed operations.** Consequently, if an insured does not anticipate using subcontractors, the value of purchasing Broad Form Property Damage coverage *with Completed Operations* is questionable, in view of the additional premium required for it.

National Underwriters Association, FC&S Bulletin, August, 1982. (emphasis added) See *also Green* at 1006 (under the BFPD "a general contractor would be covered for damages to work performed by itself or any other contractor if the damage arose out of another contractor's work on the project. And, even if damage arose out of the insured's own work,

the insured would be covered for damage to work performed by any contractor other than itself.”)

5. 1986 Revisions to ISO Form CGL Policy Expand Coverage

Because of the continuing confusion over the intended coverage of the pre-1986 ISO form CGL policy with the BFPD, the ISO changed the form in 1986 to clarify the intent of the coverage under the ISO form CGL policy. *Collett v. Insurance Company of the West*, 75 Cal.Rptr.2d 165 (Cal. App. 4th Dist. 1998), provides a history of the “completed operations coverage” up to the present time. It points out that the purpose of the changes in the 1986 policy was to reemphasize the industry’s intent with respect to the BFPD to afford coverage for subcontractors’ defective work. The new 1986 ISO form CGL policy made substantial changes to both the “products” and the “work performed” exclusions. These changes in large part reflected what the industry had intended to accomplish with the pre-1986 BFPD, and eliminated the misinterpretation of the BFPD exemplified by the Minnesota Court’s decision in *Knutson, supra*.

The first significant 1986 ISO form CGL policy revision was that the completed operations coverage and exclusions were now moved to the body of the standard policy itself. Post-1986, the ISO form CGL policy no longer contained the confusing language of the basic ISO form CGL policy which *excluded* coverage for work performed by or on behalf of the named insured, but then added the BFPD which *provided* coverage for work other than that performed by the name insured. The products exclusion is now modified by the definition of “your product”:

“Your product” means:

- a. Any goods or products, **other than real property**, manufactured, sold, handled, distributed, or disposed of by:
 - (1) You;
 - (2) Others trading under your name; or
 - (3) A person or organization whose business or assets you have acquired; and
- b. Containers....

(emphasis added)

The exclusion for the “insured’s work” now excludes:

“Property Damage” to “your work” arising out of it or **any part of it** and including 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)

The exclusion from the meaning of “property damage” for repair or replacement now reads:

- (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”.

(emphasis added)

The “Products-Completed Operations Hazard” is defined:

- 11 a. “Products-completed operations hazard” includes all “bodily injury” and “property damage” occurring away from premises you own or rent and arising out of “your product” or “your work” ...

“Your work” is defined as:

- a. Work or operations performed by you or on your behalf; and
- b. Materials, parts or equipment furnished in connection with such work or operations.

The effect of these post-1986 changes to the ISO form CGL policy is to eliminate the confusion caused by the addition of the BFPD to the basic pre-1986 form, and to clearly extend coverage *beyond* what was covered under the basic pre-1986 ISO form CGL policy. *Once the project is complete*, there is coverage under the completed operations coverage provision in the post-1986 ISO form CGL policy. It is this post-1986 coverage which is applicable to most cases arising today. Unfortunately, as set forth above, the insurance industry refuses to acknowledge the changes it has made to its own policies.

6. Industry Publications and Cases Interpreting Post-1986 ISO Form CGL Policy

(a) International Risk Management Institute Article

Interpreting Post-1986 ISO Form CGL Policy

With its redrafting of the ISO form CGL policy to the post-1986 ISO form CGL policy, the industry intended to adopt the holdings in *O’Neil, Fireguard*, and *Green, supra*. This is made clear in an International Risk Management Institute article authored by Jack P. Gibson in 1985. Mr. Gibson was then the Vice President and Managing Editor of International Risk Management Institute, Inc., a recognized insurance industry commentator on policy interpretation issues. With respect to the new 1986 completed operations coverage language, Mr. Gibson noted:

The BFPD endorsement of the current CGL is extremely confusing in that it appears to contradict certain property damage exclusions...The new policies

contain clarifications that should eliminate the problems that have arisen under the current form. The definitions of “your product” (previously “named insured’s product”) has been amended to clearly not include “real property”; this alteration should avoid the application of the “injury to products” exclusion to most construction property damage losses...

The incorporation of BFPD coverage into the basic form along with these amendments should help avoid coverage litigation between contractors and insurers. To summarize, the new policies will respond in the following ways...

- c. Once operations are completed, damage to the work of the contractor resulting from the contractor’s work is excluded. Covered are:
 - (i) damage to the contractor’s work resulting from a subcontractor’s work;
 - (ii) damage to a subcontractor’s work resulting from the subcontractor’s work;
 - (iii) damage to a subcontractor’s work resulting from the contractor’s work; and
 - (iv) damage to a subcontractor’s work resulting from another subcontractor’s work.

J. Gibson, *Contractors’ Guide to the 1986 Commercial General Liability Policy* (International Risk Management Institute, Inc. 1985) at 16-17. Industry interpretations of policy provisions are “strong evidence of the intent of the parties.” *Green* at 1007, *citing Fireguard* at 652.

(b) Judicial Interpretations of Post-1986 ISO Form CGL Policy

There are few cases dealing with the post-1986 completed operations coverage language of the ISO form CGL policy, but those cases have recognized that the purpose of the new language was to eliminate the confusion that existed about the “completed operations coverage” provided for in the BFPD. In *National Fire Ins. Co. of Pittsburgh, Pa. v. Structural Systems Technology, Inc.*, 756 F.Supp. 1232 (E.D. Mo. 1991), *modified on other grounds*, 764 F.Supp. 145 (E.D. Mo. 1991), the U.S. District Court held that the new exclusion for damage to “your work” did not exclude coverage for damage to the tower at issue, since the rod fabricator for the tower was a “subcontractor” and the exception to the “your work” exclusion for subcontractor work was applicable. However, the court subsequently modified its opinion to note that if the general contractor’s work, alone, was the *sole* cause of the tower’s collapse, the court would not find coverage. *This case demonstrates the importance of the distinction between the “insured’s work” and a “subcontractor’s work” in determining coverage under either the pre-1986 BFPD or the post-1986 CGL policy.*

Similarly, in *O’Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99 (Minn. App. 1996), the Minnesota Appellate Court held that property damage caused by a subcontractor was covered under the contractor’s CGL policy, correcting its erroneous ruling in *Knutson, supra*, and joining

the majority view that the work of a subcontractor is covered under the contractor's CGL policy. These cases make clear that the purpose of the new language in the post-1986 ISO form CGL policy was to adopt the decisions in *O'Neil*, *Fireguard*, and *Green*, *supra*, and their progeny, and to reject the interpretation in *Knutson*.

Two very recent cases have followed the holding in *O'Shaughnessy*, *supra*, and found coverage for damage to a completed project when the cause of the damage was work performed by subcontractors. In *Virgil Kalchthaler v. Keller Construction Company*, 591 N.W.2d 99 (Wis. App. 1999), the general contractor *Keller*, was the general contractor on a project to construct a residential facility for the elderly. *Keller* contracted out all the work to subcontractors. After the building was completed, leaks were discovered causing water damage to the interior of the facility. The owners of the facility brought suit against *Keller* and its CGL carrier, Aetna.

The Wisconsin Court of Appeals undertook an exhaustive and comprehensive analysis of the post-1986 ISO Form CGL policy which was issued by Aetna. The Court first found there was "property damage" as defined in the CGL policy. The Court then found that the defective construction by the subcontractors constituted "an occurrence" as defined by the policy. Having found both "property damage" and "an occurrence", the Court correctly stated that unless excluded there was coverage under the CGL policy for the damages claimed by the owner.

The Court then went through an extensive analysis of the history of the various changes to the ISO Form CGL policy and, in particular, focused on the post-1986 version of such policy. The Court found that the exclusion contained in the Aetna policy which excluded "property damage" to:

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

would have precluded coverage for the damages claimed were it not for the existence of an exception to such exclusion which provides:

- "1. This exclusion does not apply to 'property damage' included in the 'products-completed operations hazard'."

The policy contains the following definition:

- "11. a..'Products-completed operations hazard' includes all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work'.

- (1) Products that are still in your physical possession; or
- (2) Work that has not yet been completed or abandoned."

The Court in *Keller* held that since the "property damage" complained of in that case occurred when the project was completed and occurred away from premises owned or rented

by the contractor, that the exception to the exclusion applied, and, therefore, the exclusion did not bar coverage.

The Court went on then to construe the exclusion in the policy which excluded:

“1. ‘Property damage’ to ‘your work’ arising out of it or any part of it and including in the ‘products-completed operations hazard’.

Once again, the Court found that this exclusion, standing alone, would preclude coverage for the damages to the completed building. Once again, however, the Court construed the exception to the exclusion which provides:

“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.”

The Court stated:

“There is no need to construe or interpret this language: it unmistakably applies to the situation in this case.” 591 N.W.2d at 174

The Court went on to hold:

“For whatever reason, the industry chose to add the new 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.” (citation omitted) 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.” (emphasis added) *Kalchthaler*, 591 N.W.2d at 174.

The Court concluded its opinion by holding at 176:

“After review, we can come to no other conclusion than that the policy was designed to protect *Keller* in case it was called to account for work done on its behalf by a subcontractor.”

An even more recent case, *L-J, Inc. v. Bituminous Fire and Marine Insurance Company*, 567 S.E.2d 489 (S.C. App. 2002), went through a similar analysis and found coverage under a CGL policy for improper site preparation, improper drainage, and improper road installation in a subdivision, all of which work was performed by subcontractors of the general contractor for the project.

E. APPLICATION OF POST 1986 ISO FORM CGL POLICY TO FACTUAL SCENARIO.

If we now apply the expanded coverage afforded under the post 1986 ISO Form CGL policy to the factual scenario set forth above, it should be readily apparent that there is

coverage under the CGL policy for all of the damages which were paid by the Surety in that case. As set forth in the factual scenario, all of the defective construction or defective materials were furnished by the subcontractors of the general contractor. Therefore, the “subcontractor exception” to the “your work” exclusion contained in the post 1986 ISO Form CGL policy would grant coverage under the CGL policy for all of the defective work and materials furnished by these subcontractors. Note that in contrast to the “property damage” covered during construction which is limited to property other than “that particular part” upon which the contractor or subcontractors are performing work, the “property damage” covered once the project has been completed is for all “property damage” caused by subcontractors including “that particular part” of the work on which the general contractor may have been working.

Under the factual scenario above, therefore, all costs to repair the roof, to repair the curtain wall and to replace the windows, plus all the damage caused by leakage into the interior of the building as a result of the above defects would be covered under the CGL policy, along with attorneys fees and costs incurred “because of” such covered “property damage.”

Accordingly, the performance bond Surety under the scenario above, should be able to recoup nearly all of its damages, including attorneys fees and costs incurred in defending and paying the claims of the condominium association in such case.

CONCLUSION

CGL carriers generally will deny any and all claims arising out of defective or improper performance of construction work by their insureds. The mantra which is parroted is that “a CGL policy is not a performance bond, and a CGL policy only covers bodily injury and property damage caused by defective construction not the cost to repair or replace defective construction itself.”

In the case of “property damage” which occurs during construction, the CGL carriers are partly correct. CGL policies only cover damages to property other than “that particular part” of the property on which work is being performed by the contractor. However, as can be seen from the scenario above, the Surety “standing in the shoes” of its contractor may still be able to recover substantial damages from a CGL carrier for damage to “other property” caused during performance of the work on the contract.

Coverage under CGL policies for damages after completion of the project is even broader under the post-1986 ISO form CGL policy. While most CGL carriers still refuse to acknowledge liability under their policies for defective construction, in fact, the policies themselves clearly provide coverage for all damage to a completed project, so long as such work was performed by subcontractors and not the insured general contractor.

Once again, sureties “standing in the shoes” of their insured contractors should be alert to the possibility of making claims against CGL carriers for damages occurring after completion of the project is such damages were caused by subcontractors work on the project.