

## WELCOME

We hope you enjoy this edition of our newsletter. If you have any comments or questions about any of the articles, please feel free to contact the attorneys in our [construction law group](#). Autry, Horton & Cole, LLP is a construction and energy law firm located in Atlanta, Georgia. With nine experienced attorneys, we provide exceptional service at small-firm rates. For more information about our attorneys or our construction and energy practice groups, please visit our website at [www.ahclaw.com](http://www.ahclaw.com).

## CURRENT EDITION

This edition of our newsletter focuses on a complex and often misunderstood area of construction law: insurance coverage for property damage arising from defective construction. Many of our construction clients are surprised to find out that some liability policies provide coverage for certain property damages arising from defective construction. As indicated in the article below, coverage depends on a variety of factors. In any event, general liability policies may provide a source of recovery that should not be overlooked.

## CONTENTS

[Click title to jump to article](#)

### OWNERS AND CONTRACTORS BEWARE:

#### Policy Endorsement Diminishes Commercial General Liability Coverage for Defective Construction

## OWNERS AND CONTRACTORS BEWARE: POLICY ENDORSEMENT DIMINISHES COMMERCIAL GENERAL LIABILITY COVERAGE FOR DEFECTIVE CONSTRUCTION

A recent endorsement to the ISO form Commercial General Liability ("CGL") policy eliminates insurance coverage for property damage that is caused by defective work performed by subcontractors.

### A) Background: CGL Policies and Construction Defects

A general contractor's CGL insurance may provide coverage for property damage that is caused by or arises out of certain construction defects. Whether a general contractor's CGL insurance provides coverage for property damage caused by a construction defect is a complex question that turns on the interpretation of policy language under applicable state law. Because the courts of each state interpret policy terms differently, and courts within the same state often interpret policy terms inconsistently, the question whether coverage exists is complex, and the answer is often different depending upon which state's law applies.

## OWNERS AND CONTRACTORS BEWARE: POLICY ENDORSEMENT DIMINISHES COMMERCIAL GENERAL LIABILITY COVERAGE FOR DEFECTIVE CONSTRUCTION

Setting aside the nuances of state law, as a general proposition, property damage that is caused by or arises out of construction defects may be covered under a CGL policy as “property damage” resulting from an “occurrence” unless an exclusion applies. An exclusion that often acts to bar coverage for such property damage is known as the “your-work” exclusion.

This exclusion precludes coverage for property damage to your work and property damage that arises out of your work. “Your work” is typically defined as work you perform or work performed on your behalf. On its face, the your-work exclusion eliminates coverage for property damage caused by work performed by the general contractor and its subcontractors. The your-work exclusion, however, contains an exception that extends coverage to damages arising out of work by a subcontractor (the Subcontractor-Work Exception). Through the Subcontractor-Work Exception, contractors have successfully argued that their CGL policy provides coverage for property damage caused by or arising out of their subcontractors’ faulty work.<sup>1</sup>

### **B) The Problem: A Recent Endorsement Removes the Subcontractor-Work Exception to the Your-Work Exclusion**

Recently, carriers have issued endorsements that remove the Subcontractor-Work Exception from the your-work exclusion. (See ISO Forms CG 22 94 10 and CG 22 95). These endorsements modify the your-work exclusion by eliminating the carve-out for subcontractor work.

In recent litigation over insurance coverage for property damage that arose out of defective work performed by subcontractors, carriers have successfully argued that the new endorsement excludes coverage under the your-work exclusion. For example, in *Builders Mutual Ins. Co. v. Wingard Properties, Inc.*,<sup>2</sup> a carrier asked a court to declare that a general contractor’s CGL policy did not provide coverage for property damage caused by defects in the work of a subcontractor. Interpreting the CGL policy at issue, the court initially concluded that the damage was “property damage” caused by an “occurrence,” which fell within the Subcontractor-Work Exception to the your-work exclusion. Thus, without more, coverage existed. The court, however, ultimately concluded that the your-work exclusion eliminated coverage for such defects. In reaching this conclusion, although the general contractor argued that the your-work exclusion contained a Subcontractor-Work Exception, the court accepted the carrier’s counter-argument that an endorsement (CG 22 94 10) rendered the exception ineffective.

1 - See e.g., *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 11-13 (Tx. 2007); *Mid-Continent Cas. Co. v. Titan Const. Corp.*, 281 Fed.Appx. 766, 769 (9th Cir. 2008); *Stratton & Co., Inc. v. Argonaut Ins. Co.*, 220 Ga. App. 654 (1996).

2 - 2010 WL 3699989 (D.S.C. 2010); see also 2010 WL 3069544 (D.S.C. 2010)(recommended order accepted in 2010 WL 3069513 (Aug. 3, 2010)).

## **OWNERS AND CONTRACTORS BEWARE: POLICY ENDORSEMENT DIMINISHES COMMERCIAL GENERAL LIABILITY COVERAGE FOR DEFECTIVE CONSTRUCTION**

### **C) The Effect: The Endorsement Excludes From Coverage Property Damage Caused By or Arising Out of Defective Work Performed By Subcontractors**

These endorsements effect a dramatic reduction in a general contractor's CGL coverage. They eliminate coverage for property damage caused by or arising out of defects in the work performed on general contractors' behalf by subcontractors. To illustrate, consider a general contractor on a typical commercial project. While the general may self-perform some work, more than likely the vast majority of project work will be performed by subcontractors. If the contractor's CGL policy includes the endorsement, the insurance carrier will likely deny coverage for all property damage caused by or arising out of defective work on the basis of the your-work exclusion, including damage caused by defective work performed by subcontractors.

The practical effect of the recent endorsement is twofold. First, it virtually eliminates coverage under CGL policies for property damage arising out of or caused by construction defects. Second, by eliminating this area of coverage, the endorsement also eliminates the insurers' duty to defend its insured in litigation concerning construction defects.

### **D) The Solution: A Risk-Benefit Analysis**

Given the frequency of construction defects and related litigation, even if a substantial premium savings can be achieved, it is difficult to see any benefit in these endorsements to owners or general contractors.

Owners should be just as concerned as contractors. Because typical construction contracts require general contractors to name project owners as additional insureds, the endorsements eliminate owners' CGL coverage as an additional insured. Further, under CGL policies containing these endorsements, general contractors are uninsured for some of the primary risks attendant to construction defects. Thus, owners might be relying solely on the financial viability of its general contractor to recover damages and costs incurred as a consequence of construction defects. The owner can mitigate these risks by requiring its general contractor to provide a performance bond covering contractual warranty periods.

If possible, owners and contractors should seek CGL coverages that do not include these endorsements or that do not otherwise eliminate the Subcontractor-Work Exception to the your-work exclusion.

If faced with CGL coverage that includes this endorsement, owners and contractors must consider the risks and benefits of coverage – weighing the benefit of any premium savings against the risks attendant to construction defects. In making this assessment, owners and contractors should consider the following: (continued on page 4)

## OWNERS AND CONTRACTORS BEWARE: POLICY ENDORSEMENT DIMINISHES COMMERCIAL GENERAL LIABILITY COVERAGE FOR DEFECTIVE CONSTRUCTION

- (1) The degree to which the risks attendant to construction defects can be mitigated by requiring contractors or subcontractors, as the case may be, to provide performance bonds;
- (2) The degree to which these risks can be mitigated by purchasing subcontractor default insurance;
- (3) The courts in some states have held that the endorsement eliminates coverage for property damage arising from defective work performed by subcontractors. This appears to be the current trend in the law;
- (4) Even though the duty to defend is generally considered broader than the duty to indemnify, because the endorsement virtually eliminates all coverage for property damage arising out of construction defects, insurers are likely to deny defense to the owner or contractor;
- (5) In most construction contracts, contractors remain liable to the owner for all defects and deficiencies irrespective of source;
- (6) While under its subcontract a contractor may have indemnity and other rights against a subcontractor that performs faulty work, the contractor's ability to recover is largely based on the subcontractor's solvency;
- (7) Contractors have limited control over the work of subcontractors; and
- (8) Subcontractors may order and install defective materials without inspection or review by the contractor.

### ABOUT THE AUTHORS:



David represents construction-industry clients in a wide variety of construction litigation, including breach-of-contract claims, defective and deficient construction, delay and acceleration claims, termination and bond claims, and coverage matters. He recognizes that the key to a successful and long-term attorney-client relationship is to align the interest of both the attorney and client. As a result, David finds practical and low-cost solutions for clients' difficult problems.



Mark represents owners and contractors throughout the life-cycle of a project, from contract drafting through project close-out. He has extensive experience drafting and negotiating construction contracts, including tailoring AIA and other industry form contracts to meet the needs of specific clients and projects. Mark also represents owners and contractors in mediation, arbitration and litigation. He has handled a wide range of construction disputes, including defaults and terminations, change order and extra work claims, payment bond claims, mechanics' liens, schedule accelerations, impacts and delays, defects, site access and differing site conditions.

Contact [David](#) and [Mark](#).