



# Issue Alert

## CONSTRUCTION DEFECTS: THE IMPACT OF EXCLUSIONS AND THEIR EXCEPTIONS



**If it is determined that a construction defect (CD) claim is property damage that is caused by an occurrence, the insured has met their initial burden – they have established the construction defect claim falls within the CGL insuring agreement. As noted in case of *Travelers v. Moore & Associates*, this is but the first step in determining coverage within the CGL. Exclusions may apply that eliminate coverage from the CGL policy.**

While it is possible one of many exclusions may apply, in most cases the extent of coverage for construction defects is determined by just three CGL exclusions – j(5), j(6) and l.

### During the Course of Construction - Exclusions j(5) and j(6)

Exclusions j(5) and j(6) apply only if the property damage takes place *during the course of construction* – that is, the property damage takes place before the work is finished (and thus the work not is considered to be within the “products-completed operations hazard”). In other words, if the property damage takes place *after* the work is finished (and thus the work is considered to fall within the “products-completed operations hazard”), exclusions j(5) and j(6) do not apply.

**Exclusion j(5)** This exclusion states the CGL insurance does not apply to property damage to:

The 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; [Emphasis added]

First, this exclusion only applies to *real* property – buildings and other structures affixed to the land. Second, the exclusion applies to only the *specific* part of the real property that the named insured (or their subcontractor) is actually working. Finally, the phrase “are performing operations” is present tense – clearly indicating the property damage must occur *while* the work is actually being done.

### Illustration of j(5)

Acme Masonry is engaged to repair the chimneys at Bucolic Meadows condominium association. While Acme is heating some sealant to be applied between the chimney and the roof, a fire breaks out, damaging the chimney and roof. Exclusion j(5) excludes only damage to the chimney – the particular part of real property on

which operations were being performed – and not the roof damage as Acme was not fixing the roof.

**Exclusion j(6)** This exclusion states the CGL insurance does not apply to property damage to:

The particular part of any property that must be restored, repaired or replaced because your work was incorrectly performed on it. [Emphasis added]

As with j(5), this exclusion limits the exclusion to that *specific* part of property which is damaged. However, unlike j(5), j(6) excludes damage to *any* type of property – real or personal. Further, the property damage must be because “your work,” (which includes operations of the named insured as well as operations performed on behalf of the named insured by a subcontractor) was incorrectly performed on the specific part of the property that suffered damage. The CGL expressly states that exclusion j(6) does not apply if the property damage falls within the “products-completed operations hazard.”

### Illustration of j(6)

As in the above illustration, Acme Masonry is engaged by Bucolic Meadows condominium association to repair several chimneys. Acme finds that of the twelve chimneys to be repaired, six must be completely rebuilt. After rebuilding the third chimney, Acme leaves the jobsite for the day. Overnight, wind gusts cause one of the rebuilt chimneys to topple over, damaging the roof and some of the unit owners’ cars in the parking lot below. Acme discovers the mortar was not properly mixed, which caused the mortar not to properly adhere to the bricks.

Bucolic Meadows makes a claim against Acme for the cost of rebuilding the chimney, to repair the roof and to fix the unit owners’ cars. Exclusion j(6) of Acme’s CGL policy excludes only the cost of rebuilding the toppled chimney as the property damage to

the chimney (its collapse is property damage) resulted because Acme's work was incorrectly performed on the chimney (the mortar was the defective work). While the roof and cars suffered damage, they were not that particular part of property on which work was incorrectly performed – Acme was fixing neither the roof nor the unit owners' cars.

### After Construction is Completed – the Products-Completed Operations Hazard - Exclusion I

**Exclusion I** This exclusion is entitled “Damage to Your Work” and removes coverage from the CGL for:

Property damage to your work arising out of it or any part of it and included within 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]

This exclusion only applies if the work that is damaged is *finished work* – and thus work fits within the definition of the “products-completed operations hazard.” Further, exclusion I applies only to “your work” (which includes work performed for the named insured by a subcontractor) and the cause of the damage must be *the work* – the finished work or some part of the finished work (including parts and materials that go into the work) must cause damage to itself.

**Exclusion I – Important Exception** Exclusion I *does not apply* if the work that is damaged is the work of a subcontractor or it is the subcontractor's work that damages your work. While this exception to exclusion I is often dismissed as contrary to the “business risk” doctrine, it is important to keep in mind that a named insured can control the performance of its own work, but often cannot control the work of its subcontractors. In other words, liability imposed because of a subcontractor's faulty work is not a business risk and thus insurable.

#### *Illustration of I – Exclusion Applies*

ABC General Contractors is engaged by Bucolic Meadows condominium association to repair the chimneys, roof, and gutters (including downspouts) on all of the buildings controlled by the association. ABC uses its own employees to perform the roof and gutter work, but subcontracts the chimney work to Acme Masonry. As in the prior illustration, Acme Masonry completely replaces three of twelve chimneys and repairs the other nine chimneys.

Six months after the job is complete, the aluminum gutters installed by ABC begin to pull away from the building and fall off, some landing on patios and damaging unit owners' outdoor furniture. The gutters twist and are damaged as are the downspouts. It is discovered the method of fastening the gutters to the building was faulty, ultimately resulting in the pulling away of the gutters. Bucolic makes claim against ABC for the cost to replace the gutters, downspouts and unit owners' outdoor furniture.

As the gutters and downspouts are finished work and the property damage took place in the “products-completed operations hazard,” ABC's CGL exclusion I applies to all costs except the unit owners' furniture. The gutters and downspouts were damaged as a result of the work itself – failure to properly fasten the gutters to the building caused the damage. The unit owners' furniture is not “your work” and the cost to replace is not excluded by ABC's CGL policy.

#### *Illustration of I – Exception to I Applies*

ABC repairs and replaces all of the damaged work, including

the gutters and downspouts and unit owner's outdoor furniture (the later cost is paid by ABC's CGL insurer). Similar to the previous illustration in j(6), but several months after the gutter damage, high gusts of wind cause one of the rebuilt chimney's to topple, causing damage to the roof and some unit owners' cars parked below. There are two major differences between this and the J(6) illustration – in this illustration, the property damage is to *finished work* and the chimney work was done by Acme as a subcontractor to ABC General Contractors.

Bucolic makes a claim against ABC General Contractors for damage to the roof (work performed directly by ABC), the chimney, (work performed by Acme as a subcontractor), and for the cars. The insurer for ABC General Contractors will pay for all damage being claimed by Bucolic. Even though the roof work was performed by ABC, the exception to exclusion I allows for coverage for the roof damage as the exception to exclusion I allows coverage for damage to the ABC's work caused by their subcontractor, Acme. Further, the damage to the chimneys, which is considered the work of ABC (as “your work”), is also covered by ABC's CGL insurer – the exception to I. allows coverage for damage to the subcontractor's work – in this case the chimney. As the cars of the unit owners are not “your work,” exclusion I. does not apply.

### Conclusion

Once a CD claim is determined to be property damage caused by an occurrence, three CGL exclusions should be carefully reviewed to determine the extent of coverage provided for the specific CD claim. While damage to “your work” is generally excluded if the work damages itself, the subcontractor exception to exclusion I. provides a significant amount of coverage, even for damage to “your work” caused by “your work.”

**Editor's Note:** Colemont has access to many markets that continue to write contractors who may face exposure to CD litigation. Please contact your Colemont broker to discuss the specific markets most appropriate to your client's needs.

### About Colemont Insurance Brokers

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