

# Filling the Gap: The Subcontractor Exception

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# Insurance Primer

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- **Liability Insurance (Third-Party)**
- **Components of Policy: Declarations Page, Insuring Agreements, Exclusions, Conditions Definitions**
- **Form and Endorsements**
- **Insurance Services Organization (“ISO”)**
- **Duty to Defend v. Duty to Indemnify**

# Hypothetical Fact Pattern

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- **Owner:** Alexander Manufacturing (AL)
- **Project:** Warehouse in Charlotte, NC
- **General Contractor:** Taylor Contracting (TN)
- **Subcontractors:** South Plumbing (SC) and North Concrete (NC)

# Hypothetical Fact Pattern

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- 20,000 square foot addition to warehouse with fire protection system
- South Plumbing installed sprinkler system
- North Concrete installed concrete slab flooring
- After project completed, building settlement is noticed
- Alexander Manufacturing hires independent expert to determine cause of settlement

# Cause of Settlement

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Investigation revealed:

- **Sprinkler pipe coupling failed releasing water that caused settlement**
- **The sprinkler pipe that failed was flawed prior to installation as evidenced by the specific characteristics of crack in pipe**

# The Claim

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- Alexander Manufacturing sues Taylor Contracting, South Plumbing, and North Concrete for costs to replace defective pipe and alleged water intrusion issues
- Taylor tenders to his **CGL** carrier, who denies the claim on the basis of the “your work” exclusion

# Is Taylor Covered Under the CGL

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- 1) Is there “property damage”?
- 2) Is there an “occurrence”?
- 3) Is coverage otherwise excluded?
- 4) Is there an exception to the exclusion?

# The CGL Insuring Agreement

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**We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages."**

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# Is there Property Damage

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- a. **“Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it.”**
- b. **“Loss of use of tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it.”**

# Is there Property Damage?

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- No coverage for pure economic loss
- Must be “physical injury to tangible property” OR “loss of use”
- Analysis often involves search by the court for damage to property beyond what is considered the insured’s “work”

# Occurrence = Accident

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- **Because the definition of “occurrence” is an “accident,” which is not defined by the policy, determination of whether there has been an “occurrence” depends on how the state law has defined “accident.”**

# Is there an “Occurrence”?

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- This insurance applies to “bodily injury” and “property damage” only if: (1) The “bodily injury” or “property damage” is caused by an **“occurrence”** that takes place in the “coverage territory”
- Occurrence is defined in the CGL as “an **accident**, including continuous or repeated exposure to substantially the same general harmful conditions.”

# The Split on “Property Damage” and “Occurrence”

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- Is faulty workmanship an occurrence?
- Does faulty workmanship cause property damage?
- Choice of law/forum consideration:
  - Standard CGL Form does not contain choice of law or forum provision
  - Possibility for application of law (depends on forum)
    - Domicile, residence, place of incorporation of business of the insured
    - Where the claim or damage giving rise to the claim occurred (if third party claim)
    - Lex loci contractus
    - Restatement Most Significant Relationship

# The Split on “Property Damage” and “Occurrence””

- **AL – YES** (*Owners Insurance Company v. Jim Carr Homebuilder, LLC*,  
—So.3d—, 2014 WL 1270629 \*6 (Ala. March 28, 2014))
- **MS – YES** (*Architex Ass’n, Inc. v. Scottsdale Ins. Co.*, 27 So. 3d 1148  
(Miss. 2010))
- **SC – YES** (*Crossman Communities of North Carolina, Inc. v. Harleystown  
Mutual Insurance Co.* 2011 WL 3667598 (S.C. 2011)); statute
- **NC – NO** (*General Casualty Co. of Wis. v. Image Builders, Inc.*, 2010 WL  
4449084 (W.D.N.C. 2010))
- **TN – YES** *Travelers Indem. Co. of America v. Moore & Associates, Inc.*,  
216 S.W.3d 302 (Tenn. 2007))

# Exclusions

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- **CGL Exclusion I provides:**

**“This insurance does not apply to:**

**I. Damage To “Your Work”**

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

# What is “your work”

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## 22. “Your work”:

### a. Means:

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

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



# What is the Products Completed Operations Hazard?

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

# Exception to the Exclusion

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- **“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.”**
- **If you are a general contractor, it is crucial that you have this Exception in your CGL – because the entire project is “your work”**

# What is a Subcontractor

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- **Is a supplier of a component a subcontractor?**
- **What about a design professional?**
- **Insurers want to define narrowly who constitutes a subcontractor**

# Who is a subcontractor?

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- ***National Union Ins. Co. of Pittsburgh, Pa. v Structural Systems Technology, Inc.*, 964 F2d 759 (8th Cir 1992) – one of the first cases to address the issue**
- ***Mosser Constr. Inc. v. Travelers Indemnity Co.*, 430 Fed. App'x 417 (6th Cir. 2011) – representative of modern trend, and applies even broader – test**
- **Our hypothetical – what if the pipe coupling that failed was defective?**

# Arguments for Supplier to be Subcontractor

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- Definition of “your work”
- Materials were fabricated by a third party for the named insured
- Subcontractor is not defined and is ambiguous

# Rip and Tear Costs

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- **Costs attributable to damaging or destroying non-defective work to obtain access to repair defective work**
- **In hypothetical case, after defective pipe is discovered, Turner decides to remove North Concrete's non-defective work to have all pipes replaced**

# Read Your Policy

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- Exception to the Exclusion is in the standard ISO GL form, but some insurers are not using the ISO GL form and are removing the exception
- Endorsement - **CG 22 94 EXCLUSION—  
DAMAGE TO WORK PERFORMED BY  
SUBCONTRACTORS ON YOUR BEHALF**

# What about a Wrap?

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- **CR 02 04 08 04**
- If involved in a project with an OCIP, review the CGL Policy to see whether there is coverage for defective work, be careful that Endorsement CR 0204 08 04 entitled “CROSS LAWSUITS AND CLAIMS EXCLUSION



# Is there Coverage?

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- 1. Did the damage occur during the course of construction?**
- 2. If the damage occurred after completion, was it caused by an unexpected or unintended act of a subcontractor?**
- 3. Did the faulty workmanship of the subcontractor cause post-completion “physical damage” to insured property or “loss of use” of the property within the definition of “property damage” in the CGL policy?**

# Conclusion

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# Questions?

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