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Construction Industry Advisor

Debunking Insurance Coverage Myths for the Construction Industry



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Key points:

Contractual liability exclusions in commercial general liability ("CGL") policies do not prevent coverage for work accidents.

An accident occurring in the course of, or as a result of, construction is not merely a contract breach excluded from coverage.

Insurance policy exclusions include a vital exception for insured contracts.

EDITOR'S NOTE: This article is the first in a series about insurance coverage for construction projects. Each short article addresses a common situation where an insurance company stated grounds for denial or limitation of coverage in an improper, overbroad, or misleading way. In such situations, policyholders should know their rights to coverage and assert them aggressively. Insurance coverage, when available, can be essential and necessary for a business to close out lingering liabilities.

Myth: Losses Related to Contractual Liabilities are Not Covered

Truth: The Policyholder is a Contractor, Not a Vandal

"The losses are related to contractual liabilities that are excluded from coverage." Fact or fiction? It's a misleading fiction that often discourages policyholders from fighting to obtain coverage. Don't be fooled!

No One Contracts to Create Damages

Contractors are just that: contractors. They work pursuant to a contract. They do not wrongfully enter upon the



property of others and alter its condition without permission. Doing that would be illegal trespassing and vandalism. Instead, contractors agree to contracts by which they are authorized to enter an owner's property and to perform construction work on it. Those same contracts tend to include provisions calling for the contractor to indemnify the owner for claims and damages arising out of the negligence of the contractor.

In the course of performing that construction work, accidents can happen. The accident was not what the owner hired the contractor to do. A lawsuit claiming damages for the accident ensues. Those damages include a request for payment under the construction contract. The contractor now faces liability arising out of, in the broad-

est sense, the performance of work pursuant to the contract. Sometimes that alleged liability is based on claims of negligence as well as breach of the contract's indemnity provision. The contractor prudently and promptly provides notice of the claims to its general liability insurance company.

The Myth

The contractor's insurance company responds that the policy should not pay for the contractor's contractual obligations. The insurance company references a policy exclusion for contractual liability and states that general liability insurance is limited to claims for bodily injury or property damage.

The Truth

If it seems that the contractor's mistake might be excluded from coverage, fear not. The policy's base insuring agreement provides that it will cover liability because of property damage that is caused by an occurrence. See *Vandenberg v. Superior Court*, 21 Cal. 4th 815, 841 (1999), in which the court held that a CGL policy's coverage agreement "is intentionally broad enough to include the insured's obligation to pay damages for breach of contract as well as for tort, within limitations imposed by other terms of the coverage agreement (e.g., bodily injury and property damage as defined, caused by an occurrence) and by the exclusions". The accident during the performance of work by the contractor results in property damage. As it is potential liability because of property damage resulting from an accident, it is not excluded from coverage.

The contractual liability exclusion in the policy does not exclude coverage in this situation. That exclusion has been widely held to apply "where the

insured has contractually assumed the liability of a third party, as in an indemnification or hold harmless agreement" (but even then, there are exceptions as noted below). *American Family Mut. Ins. Co. v. American Girl, Inc.*, 268 Wis. 2d 16, 48 (2004) (emphasis added). And courts typically caution against turning a CGL policy "into a surety for the performance of [a contractor's] work." *George A. Fuller Co. v. United States Fid. & Guar. Co.*, 200 A.D.2d 255, 260 (1994).

But in the scenario here, the contract merely required the contractor to assume a duty to perform work at the site. The loss is fortuitous. Consider this: unless the terms of the contract specified that the contractor was obligated to act negligently so as to cause property damage, then it cannot be said that the property damage was the result of a contractual obligation of the contractor. Rather, the property damage resulted from a mistake committed while performing work that had been authorized pursuant to the contract.

Yes, There is Coverage

Under the policy, the insurance company has committed to "pay those sums that [the policyholder] becomes legally obligated to pay as damages because of . . . 'property damage'", and the duty to defend the policyholder against those claims is triggered by "any 'suit' seeking those damages." The policy provides that it will apply to "property damage" that is "caused by an 'occurrence.'" An "Occurrence" is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." "Property damage" is "Physical injury to tangible property, including all resulting loss of use of that property."

The co-existence of a contract with the acts of negligence that resulted in third-party property damage does not absolve the insurance company of its coverage obligation. . .

The critical question for coverage is whether the lawsuit alleges property damage caused by an occurrence. “There is no requirement that the [policyholder] engage in negligent conduct, commit any other tort or even be at fault for the property damage, so long as it is ‘legally obligated to pay’ for it. Without such requirements, one cannot read into the policy an exclusion for contract-based liability that is not stated in the policy.” *Hotel des Artistes, Inc. v. Gen. Acc. Ins. Co. of Am.*, 9 A.D.3d 181, 192 (1st Dep’t 2004), abrogated on other grounds, *KeySpan Gas East Corp. v. Munich Reins. Am., Inc.*, 23 N.Y.3d 583 (2014); see also, e.g., *Desert Mountain Props. Ltd. Partnership v. Liberty Mut. Fire Ins. Co.*, 236 P.3d 421, 431 (Ariz. App. 2010) (“Instead, we hold that the ‘proper inquiry is whether an ‘occurrence’ has caused property damage,’ not whether the ultimate remedy for that claim lies in contract or in tort.”) (citation omitted), aff’d, 226 Ariz. 419 (2011); *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 13 (Tex. 2007) (“Any preconceived notion that a CGL policy is only for tort liability must yield to the policy’s actual language”).

Exceptions Make the Rule

Yet when the insurance company attempts to exclude contract liabilities, the insurance company nevertheless must make exceptions. The construction industry, as well as others, relies upon risk transfer through contract (as noted above). Indemnification clauses that transfer the risk of loss to the party most able to manage the risk are an essential risk management technique. The policy language provides for this by extending coverage for damages:

(1) That the insured would have in the absence of the contract or agreement; or

(2) Assumed in a contract or agreement that is an “insured contract”, provided the “bodily injury” or “property damage” occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an “insured contract,” reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of “bodily injury” or “property damage.”

An “insured contract” is one where the policyholder assumes the tort liability of another party to pay for “bodily injury” or “property damage” to a third person or organization. Tort liability is usually defined in the policy to be liability that would be imposed by law in the absence of any contract or agreement (i.e., mistake, accident, negligence). In our scenario described above, coverage is available not only because the construction contract’s indemnification clause is an “insured contract,” but also because the property damage is a liability the contractor “would have in the absence of the contract or agreement.”

The co-existence of a contract with the acts of negligence that resulted in third-party property damage does not absolve the insurance company of its coverage obligation as stated in the policy. The insurance company sold its insurance policy to a contractor, not to a vandal. ▲

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