

UNDERSTANDING PROPERTY DAMAGE AND THE BUSINESS RISK EXCLUSIONS

Wes Johnson

Cooper & Scully, P.C.

April 8, 2016

© 2016 This paper and/or presentation provides information on general legal issues. It is not intended to provide advice on any specific legal matter or factual situation, and should not be construed as defining Cooper and Scully, P.C.'s position in a particular situation. Each case must be evaluated on its own facts. This information is not intended to create, and receipt of it does not constitute, an attorney-client relationship. Readers should not act on this information without receiving professional legal counsel.

THE CGL POLICY GENERALLY:

- Commercial General Liability Policies (“CGL”) are the primary insurance tools relied upon by business owners against claims of liability for bodily injury, property damage and personal/advertising injury brought by third parties

NATURE OF CGL COVERAGE

- Provides protection for owners of businesses, along with developers, contractors and subcontractors against third party claims (claims by parties other than the parties to the contract, for example, claims by injured employees of the contractor against the owner)
- CGL insurance is thus commonly considered to be third party insurance

PROPERTY DAMAGE DEFINED

- “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”
- More on this later...

BUSINESS RISK V. INSURABLE RISK

- “Business risks” involve a success or failure of the particular business, based upon factors such as management's ability to gauge the market, product development/research, performance and logistics
- “Insurable risks” do not hinge on the success or failure of the business; rather, they turn on fortuitous losses

BUSINESS RISK V. INSURABLE RISK

- An insurable risk can also be gauged by statistical loss probability; a process the industry refers to as “underwriting”
- Business risks involve known decisions by management of the business and cannot be accurately measured by the underwriting process
- CGL policies cover only "insurable risks" and exclude business risks as insurance coverage is bottomed on the concept of fortuity

BUSINESS RISK V. INSURABLE RISK

- An prime example is in the construction industry
- Truly accidental property damage generally is covered because such claims and risks can fit within the statistical abstract
- However, faulty workmanship claims generally are not covered because they are not fortuitous

EXCLUSION “J”: DAMAGE TO PROPERTY

- The specific exclusion and its discrete subparts that deals with property damages is contained within the standard CGL form as Exclusion “J”.
- The J Exclusion contains 6 subparts excluding coverage for “property damage” as follows:

J(1) EXCLUSION

- J(1): Property you own, rent, or occupy, including any costs or expenses incurred by you, or any other person, organization or entity, for repair, replacement, enhancement, restoration, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another's property
- This is also known as the “property insurance” exclusion since it is intended to exclude losses that would be covered by a first party property damage policy

J(2): ALIENATED PREMISES

- “Premises you sell, give away or abandon, if the property damage arises out of any part of those premises”
- Example: an insured sells a building with a fire hazard that is not disclosed
- If there is property damage arising from this fire risk, the insured would have no coverage

J(3): PROPERTY LOANED

- “Property loaned to you”
- Pretty self-explanatory with little case law discussing the J(3) exclusion, likely because of the language is not open to interpretation
- Much as J(1) it is intended to prevent the conversion of the CGL policy into a quasi first party property policy

J(4): PERSONAL PROPERTY

- “Personal property in the care, custody or control of the insured”
- The care, custody or control exclusion is generally held to apply to damages caused by the loss of or damage to property over which the insured is exercising possession, dominion or control. See e.g. *Mid-Continent Casualty Co. v. Third Coast Packaging Co., Inc.*, 342 F.Supp.2d 626, 627 (S.D.Tex. 2004); *Blue Marlin Construction Co. v. General Star Indemnity Co.*, 16 F.Supp.2d 762 (S.D.Tex. 1998).

J(4): PERSONAL PROPERTY

- Controversy over the applicability of the exclusion usually centers on whether the exclusion applies only when the insured has the *exclusive* right to exercise control over the property, or the scope and extent of property over which the insured is exercising control. *Id.* See also *Goswick v. Employers' Casualty Co.*, 440 S.W.2d 287 (Tex. 1969); *Frito-Lay, Inc. v. Trinity Universal Ins. Co.*, 2010 WL 4705526 (Tex.App.-Dallas, Nov. 22, 2010).

J(5): PROPERTY BEING WORKED ON

- “...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”
- J(5) focuses on the particular part of the property the insured works on or that a subcontractor performs work on for the insured.
- Does not include “other property”

J(5): PROPERTY BEING WORKED ON

- The key language in (j)(5) is “that particular part,” often given a narrow interpretation, and “performing operations,” which is generally interpreted broadly
- The exclusion only applies to real property damage that occurs while the insured is performing operations
- Is frequently analyzed in tandem with...

J(6): FAULTY WORKMANSHIP

- “That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.”
- Exclusion j(6) does not apply to “property damage” included in the “products completed operations hazard.”

J(6): FAULTY WORKMANSHIP

- “Your work” is defined as “work or operations performed by you or on your behalf.”
- “Products completed operations hazard” is defined as “property damage” occurring away from premises you own or rent and arising out of your product or your work except:
 - (1) products that are still in your physical possession;
 - (2) work that has not yet been completed or abandoned

J(6): FAULTY WORKMANSHIP

- Serves to exclude risks that are typically covered by business risk insurance
- Only applies to projects that are not completed, as it excepts from the exclusion property damage included in the products completed operations hazard
- Unlike (j)(5), (j)(6) does not exclude the work that a subcontractor performs for the insured

L: DAMAGE TO YOUR WORK

- I. “Property Damage” to “your work” arising out of it or any part of it and included 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.

Alternate Form: Endorsement CG 2294

- 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.”

RECENT CASE LAW UPDATE

J(5): *MID-CONTINENT CASUALTY CO. V. JHP DEVELOPMENT, INC*

- Deals with “ongoing operations”
- Performing Operations:” active performance of work.
- What if the insured halts work for a period of time?
 - A total cessation of work for the foreseeable future does not fall within the definition.
 - Temporarily halting work for a day or a few days meets the definition, i.e. work stoppage due to weather.

557 F.3d 207 (5th. Cir. 2009)

J(6): *MID-CONTINENT CASUALTY CO. V. JHP DEVELOPMENT, INC*

“That Particular Part”

- Will refer to the part of the project on which the insured performed defective work.
- Does not apply to entire project, even if the insured’s contract calls for it to work on the entire project.
- Only excludes property damage to those parts of the property that were themselves the subject of the defective work.
- To exclude damages to the entire property after the insured worked on part of the property, the exclusion needs to state:
 - Property damage to property that must be restored, repaired or replaced because your work was performed on *any part* of it

J(6): *MID-CONTINENT CASUALTY CO. V. JHP DEVELOPMENT, INC*

- To exclude damages to the entire property after the insured worked on part of the property, the exclusion needs to state:
 - Property damage to property that must be restored, repaired or replaced because your work was performed on *any part* of it

J(5)

DALLAS NATIONAL V. CALITEX

- Duty to indemnify case
- Calitex contracted with Turnkey to build condo building in Dallas
- Prior to completion, Calitex encountered problems with defective exterior stonework and leaking windows
- Calitex filed suit, DNIC denied relying upon Exclusion J(5)
- Trial court held that some property was covered and some excluded

458 S.W.3d 210 (Tex. App. – Dallas 2015, no pet.)

J(5)

DALLAS NATIONAL V. CALITEX

- 5th District Court of Appeals reversed applying a burden of proof standard
- J(5) excludes coverage for property damage that occurred during ongoing operations
- That some of the damage may not have been discovered until after Turnkey was no longer doing any work was irrelevant, the court held, because property damage under a CGL policy occurs when the actual physical damage occurs, not when it was or could have been discovered
- Effectively required insured to prove that the damage occurred after operations ceased

EXCLUSION L: *GREAT AMERICAN V. HAMEL*

FACTS:

- Insured hired to inspect and complete home construction
- Used contractors
- Duty to defend issue

Great Amer. Ins. Co. v. Hamel, 444 S.W.3d 780 (Tex.App.-El Paso 2014 pet. filed)

EXCLUSION L:
GREAT AMERICAN V. HAMEL

ALLEGATIONS:

- Home constructed initially by GSM and then by insured
- Insured retained the right and had the duty to control and supervise the subcontractors

HOLDING:

Exclusion I does not eliminate duty to defend because of “subcontractor” exception.

EXCLUSION L:

OKLAHOMA SURETY CO. V. NOVIELLO

FACTS:

- Lawsuit against designer and developer of townhome
- Water infiltration resulting in flooding
- Duty to defend
- ISO 2294 Form

ALLEGATIONS:

- Negligently constructed townhome
- Failure to cap roof
- Failure to properly install and seal windows resulting in extensive flooding
- Home and Plaintiff suffered damages

EXCLUSION L: *OKLAHOMA SURETY CO. V. NOVIELLO*

HOLDING:

- “Your Work” Exclusion precludes duty to defend
- Rejects insured’s argument that exclusion only applies to insured’s defective work – concludes it applies to all of insured’s work – defective or not
- Rejects insured’s argument that allegations could have reasonably included damage to appliances, rugs and other products not insured’s work
- Although must construe allegations liberally, Court cannot create allegations that are not contained in the pleadings

2014 WL 7497987 (Tex.App.-Dallas 2014, no pet.)

EXCLUSION L: *FEASTER V. MID-CONTINENT*

FACTS:

- Home built in 2005
- Home purchased in 2006
- Several years later, home encounters structural and cosmetic damages
- Duty to defend and indemnify
- ISO 2294 Form

620 Fed.Appx. 300 (5th Cir. 2015)

EXCLUSION L: *FEASTER V. MID-CONTINENT*

HOLDING:

- Exclusion I precludes duty to defend.
- Fifth Circuit upheld district court's rejection of insured's argument that exclusion is unenforceable because it makes coverage illusory. Notes form approved by Texas Department of Insurance and policy provides coverage to damage other than insured's work.
- Validates legitimacy of Endorsement 2294