AGC
THE CONSTRUCTION ASSOCIATION

2023 Surety Bonding and Construction Risk Management Conference

A Survey of Recent Insurance Coverage Decisions Impacting Construction Risk

By:

Jeffrey J. Vita, Saxe Doernberger & Vita, P.C.

THIS PAPER WAS WRITTEN IN CONJUNCTION WITH A BREAKOUT SESSION AT AGC'S 2023 SURETY BONDING AND CONSTRUCTION MANAGEMENT CONFERENCE

A Survey of Recent Insurance Coverage Decisions Impacting Construction Risk

By: Jeffrey J. Vita, Saxe Doernberger & Vita, P.C.

As insurance plays a critical role in construction related risk transfer, understanding how courts interpret and evaluate various lines of coverage available to contractors will help general contractors and construction managers keep pace with the latest insurance trends. This program will identify and analyze recent insurance coverage decisions which impact construction risk. Relatedly, this knowledge will arm contractors with the information necessary to better protect their assets through contract drafting as well as insurance placement. The following recent decisions identify key coverage issues affecting general contractors and construction managers and should inform strategies to avoid potential coverage gaps and facilitate the mitigation of risk.

1. Professional Services

The distinction between a contractor's "means and methods" and professional services can sometimes be blurry. Work does not have to be performed under a design-build delivery method to be considered professional in nature. Recently, courts have tackled this issue with varied results.

Stonegate Ins. Co. v. Smith, No. 1-21-0931 (Ill. Ct. App. June 22, 2022).

Key Facts: John Smith, a carpenter by trade, was replacing a shower valve as a favor for a friend. As Smith was using a blow torch to remove old copper fittings from the shower valve, fiberglass insulation behind the bathroom wall caught fire. The fire spread to a neighboring townhouse causing substantial damage. A subrogation action was brought against Smith by the neighboring unit owner and the HOA's property insurers. Smith sought coverage under his homeowner's policy for the damage he caused. Smith's insurer denied coverage under the policy's "professional services" exclusion claiming plumbing constituted a professional service. Smith's homeowner's policy did not define "professional services." The Court addressed whether Smith was rendering "professional services" when the fire started at his friend's townhouse.

Holding: The Court held that the appropriate inquiry must focus on the nature of the conduct at issue when determining whether a "professional services" exclusion applies. Finding the term was not limited to services for which a contractor is licensed by a governmental authority, but rather any business activity that involves specialized knowledge, labor, skill, and is predominantly mental or intellectual as opposed to physical or manual in nature, the Court held that Smith's heating of the pipes that ultimately resulted in a fire was manual in nature, rather than mental or

intellectual. Because the Court concluded that Smith's work was manual in nature, it held that the professional service exclusion did not apply.

Savers Property & Casualty Ins. V. Rockhill Ins. Co., No. 1:21-cv-01802-MJD-TWP, 2022 WL 9461874 (S.D. Ind. Oct. 14, 2022).

Key Facts: Clark Floyd Landfill, LLC ("CFL") was hired to operate and maintain a landfill in Indiana. Residents within a three-mile radius of the landfill filed a class action lawsuit for injunctive relief and damages naming CFL as a defendant. The complaint alleged that because of CFL's negligent and/or intentional and improper construction, maintenance, and/or operation of the landfill, residents and yards were invaded by noxious odors, pollutants, and air contaminants originating from the landfill. CFL sought coverage under primary and excess commercial general liability ("CGL") policies, and Site-Specific Pollution Liability policies purchased from Rockhill Insurance Company ("Rockhill"). Rockhill moved for summary judgment arguing that coverage for the underlying lawsuit was precluded by a Professional Services Exclusion. The exclusion stated, in part, that the policy did not provide coverage for bodily injury "due to the rendering of or failure to render any professional service." Rockhill argued that CFL was hired as a "sophisticated landfill operator" to operate the landfill "in a highly regulated environment subject to operating permit regulations" and that "failure to control the migration of odors by allegedly failing to operate the landfill gas collection and odor migration systems properly" constituted a failure to properly apply specialized skill, labor, and knowledge.

Holding: The Court held that pursuant to Indiana law, professional services include "any business activity conducted by the insured which involves specialized knowledge or skill which is predominantly mental or intellectual as opposed to physical or manual in nature." Applying this definition to the allegations in the underlying complaint, which asserted that CFL "failed to reasonably construct, repair, operate, and/or maintain the Landfill" and "negligently and improperly constructed the, maintained, and/or operated the Landfill," the Court held the construction and maintenance of a landfill, generally, does not constitute a professional service stating, "While the gas collection and odor migration systems might be responsible for the migration of odors, so too could the simple act of improperly covering the waste with dirt, which would clearly be unsophisticated manual labor and thus not be a professional service." Therefore, the Court found that the broad claims alleged in the underlying lawsuit did not fall entirely within the professional services exclusion and Rockhill had a duty to defend CFL.

Impact for General Contractors/Construction Managers: Whether a contractor's conduct constitutes excluded "professional services" is a frequently litigated coverage question. Courts analyze policy language, specific conduct, and applicable state law to

determine whether coverage is precluded under a professional services exclusion. Although these decisions demonstrate cases in which courts found conduct that fell outside the scope of the exclusion, it is by no means a guarantee. General contractors should be mindful of whether their CGL policies contain professional services exclusions, whether their conduct may be considered a "professional service" under state law, and whether professional liability insurance is needed to protect them from risks not covered under a CGL policy with a broad professional services exclusion.

2. **Construction Defect as Occurrence**

Courts continue to apply different interpretations of "occurrence" for claims arising out of construction defects or faulty workmanship. A small number of states continue to find that defective or faulty workmanship is never an "occurrence." General Contractors who work in these states should be mindful of this risk and seek to amend the "occurrence" definition on their CGL policies to ensure coverage exists for defective construction claims.

Main St. Am. Assurance Co. v. Howard Lynch Plastering, Inc., 585 F.Supp.3d 737 (E.D. Pa. 2022).

Key Facts: W.B. Homes, Inc. built homes in Montgomery County Pennsylvania, using Howard Lynch Plastering, Inc. ("Lynch") as its subcontractor. As required, Lynch purchased liability insurance for its construction work from Main Street America Assurance Company ("Main Street"). The policy stated, in part, that Main Street would defend and indemnify Lynch for "bodily injury" or "property damage" caused by an "occurrence." The policy defined occurrence as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." A series of claims arose from Lynch's work. Each claim alleged damages caused by defective construction of the homes, failure to construct homes in a workmanlike manner, or failure to use proper construction techniques through improper caulking, gaps in sills, inadequate flashing, and faulty stucco installation, among other alleged defects. W.B. Homes sought defense and indemnification under Lynch's CGL policy. Main Street denied coverage and filed a motion for summary judgment claiming the effects of faulty construction were not a covered" occurrence" under the policy.

Holding: The Court held that Main Street did not owe defense or indemnification for claims arising from defective construction. The Court stated under Pennsylvania law, an "occurrence" generally does not include defective construction, reasoning commercial general liability policies define an "occurrence" as an "accident," but "faulty workmanship does not constitute an 'accident.'" The Court held a contrary interpretation would convert commercial general liability policies "into performance bonds, which guarantee the work, rather than . . . an insurance policy, which is intended to insure against accidents."

Admiral Ins. Co. v. Tocci Bldg. Corp., No. CV 21-10388-PBS, 2022 WL 899420 (D. Mass. Mar. 28, 2022) (appeal pending).

Key Facts: Tocci Building Corporation ("Tocci") entered into a Construction Management Agreement with Toll JM EM Residential Urban Renewal LLC ("Toll") to perform pre-construction and construction services for an apartment complex project in New Jersey. Tocci was responsible for managing all aspects of the project construction, including hiring and overseeing various subcontractors to perform work on the project. However, Toll terminated Tocci and filed suit alleging "significant workmanship issues" in the buildings constructed at the time. Tocci tendered the claim to its insurer, Admiral Insurance Company ("Admiral") seeking defense and indemnification against the Toll suit. Admiral denied coverage for the Toll Action, reasoning that the underlying lawsuit "[did] not include any allegations that Tocci [was] liable for property damage caused by an occurrence, as those terms [were] defined in the policy." The policy defined "occurrence" as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions." Admiral filed suit against Tocci seeking a declaratory judgment that it owed no coverage for Tocci in Toll's suit alleging faulty workmanship.

Holding: The Court held that under Massachusetts law, "faulty workmanship fails to constitute an accidental occurrence in a commercial general liability policy." The Court viewed faulty workmanship as the consequence of business risks as opposed to a fortuitous event. According to the Court, "[t]here is nothing about the general nature or purpose of a comprehensive general liability insurance policy that would lead an insured reasonably to expect that the policy covered a loss ... caused by his breach of contract and poor workmanship." Because the defects did not amount to property damage arising out of an occurrence within the meaning of the CGL policy, the Court held that Tocci did not meet its burden of establishing that the allegations in the Toll action fit within the covered risks of the Admiral Policy. Therefore, the Court held Admiral had no duty to defend Tocci.

Impact for General Contractors/Construction Managers: These decisions make the insurance landscape for construction defect claims much less favorable for general contractors in Massachusetts and Pennsylvania. General contractors cannot rely on CGL policies for defense of such claims, even if the damage is predominantly the result of a subcontractor's work. General contractors should carefully consider these risks when evaluating the cost associated with construction work in states with similar case law. General contractors who work in states where courts have held that construction defect claims do not constitute an "occurrence" should seek to obtain an endorsement on their CGL policies to clarify that "occurrences" include any circumstance where a defect or

deficiency in "your work" results in damages because of "property damage" so long as the "property damage" was not intended by them.

3. Additional Insured Endorsements & Contractual Privity

Being named as an "Additional Insured" gives "upstream" General Contractors rights to access the "downstream" subcontractors' insurance policies. When implemented correctly, additional insured status can insulate a General Contractor from defending or paying claims where the General Contractor's liability was caused at least in part, by the subcontractor's work. General contractors should be mindful of any obstacles to obtaining additional insured status, such as contractual privity requirements.

State Auto Prop. & Cas. Ins. Co. v. KIN, Inc., No. 3:21-CV-50171, 2022 WL 614942 (N.D. Ill. Mar. 2, 2022).

Key Facts: Kohl's Department Store ("Kohl's") entered into a contract with Divisions, Inc. to operate and manage the store premises. Divisions, Inc. then contracted with LCU Properties, Inc. ("LCU") to remove snow and ice from the store's parking lot. The contract between Divisions Inc., and LCU was governed by a Master Provider Agreement. The additional insured section of the Master Provider Agreement between LCU and Divisions Inc. provided that "additional insured parties shall include Divisions' client for the applicable project." LCU was insured under an insurance policy issued by State Auto. The additional insured section of the policy listed additional insureds as, "any person or organization for whom you are performing operations when you and such person or organization have agreed in a written contract or written agreement, that such person or organization be added as an additional insured on your policy." When a customer brought suit against Kohl's alleging she slipped and fell on snow or ice in the store parking lot, Kohl's sought defense and indemnification under the State Auto policy. State Auto moved for summary judgment arguing it did not owe Kohl's a duty to defend as Kohl's did not qualify as an additional insured.

Holding: The Court's decision hinged on the policy language defining an additional insured as "any person or organization for whom you are performing operations when you and such person or organization have agreed in a written contract or written agreement, that such person or organization be added as an additional insured on your policy." The Court found the plain language of the insurance policy required direct privity of contract between Kohl's and LCU. Where the record showed no evidence of an agreement in writing directly between Kohl's and LCU, the court reasoned that Kohl's was not an additional insured under LCU's policy.

Impact for General Contractors/Construction Managers: Upstream contractors should be aware of the specific wording of both their subcontracts as well as the language contained in the additional insured endorsements of those entities with whom they do business. There are AI endorsements available, such as CG 20 38 04 13, for example, which do not require contractual privity. In the event that the AI endorsements contained in any downstream parties' policies contain language requiring privity, upstream contractors should reject these endorsements and explain why such language is contrary to the parties' intent.

4. Anti-Indemnity Statutes & Waiver of Subrogation Clauses

Most states have enacted anti-indemnity statutes which limit the extent of indemnification that can be required by contract or agreement. If drafted incorrectly, an indemnification agreement that violates a state anti-indemnification statute may be rendered void, leaving General Contractors vulnerable. Familiarity with relevant anti-indemnity statutes ensures agreed upon indemnification provisions are compliant and enforceable.

2700 Bohn Motor, LLC v. F.H. Myers Construction Corp., 2021-0671 (La.App. 4 Cir. 4/20/22) 338 So.3d 500, *writ denied*, 2022-00800 (La. 9/20/22).

Key Facts: Owner, 2700 Bohn Motor LLC ("Bohn Motor") hired F.H. Meyers Construction Corp. ("F.H. Meyers") as general contractor for the construction of an automobile dealership building. F.H. Meyers then contracted with Orleans Sheet Metal Works and Roofing Inc. ("OSM") to serve as subcontractor. OSM sub-subcontracted with B&J Enterprises of Metairie, Inc. ("B&J") to assist with roof installations. Pursuant to its contract, Bohn Motor procured a commercial builder's risk insurance policy from Navigators Insurance Company ("Navigators") and Certain Underwriters in London ("Lloyds"). The Prime Contract between Bohn Motor and F.H. Meyers contained a mutual waiver of subrogation under which the contracting parties waived "all rights against each other and any of their subcontractors, sub-subcontractors, agents, and employees." While the project was underway, a fire ignited causing damage to the property. Bohn Motor filed suit, claiming negligence against F.H. Meyers, OSM, and B&J. The petition alleged that pursuant to the terms and conditions of the insurance policy, Navigators was subrogated to all of the rights that Bohn may have had in terms of its payment under the policy. The Defendants filed a Joint Motion for Summary Judgment asserting the mutual waiver of subrogation precluded Bohn Motor and Navigators from any negligence claims against the Defendants. In turn, Navigators, as subrogee, challenged the waiver of subrogation's validity under Louisiana's anti-indemnity subrogation statute.

Holding: The Court held that as a matter of law, the mutual waiver of subrogation clause contained in the Prime Contract between Bohn Motor and F.H. Meyers precluded Bohn Motor and Navigator's claims against the subcontractors. In reaching

its decision, the Court found that the waiver of subrogation was valid and coincided with the anti-indemnity statute which read, "any . . . agreement . . . affecting [a] construction contract which purports to indemnify, defend, or hold harmless, or has the effect of indemnifying, defending, or holding harmless, the indemnitee from or against any liability for loss or damage resulting from the negligence or intentional acts or omissions of the indemnitee, an agent or employee of the indemnitee, or a third party over which the indemnitor has no control is contrary to the public policy of this state and is null, void, and unenforceable." The Court found that by itself, the waiver of subrogation clause did not shift the liability nor did the waiver exclude or limit liability for any intentional or gross fault, therefore it was valid and enforceable against Bohn Motor. The Court also held under the terms and conditions of the Prime Contract, OSM and B&J were third party beneficiaries of the waiver. As such, the waiver of subrogation applied to them as well.

Impact for General Contractors/Construction Managers: Waivers of subrogation are commonly found in construction contracts. Waiver of subrogation provisions serve to transfer the risk of insured losses to a single insurer and can effectively minimize or preclude claims and lawsuits between the project participants. As demonstrated in this decision, broad subrogation waivers benefit contractors and the subcontractors they hire. However, narrow subrogation waivers may better serve Owners. General Contractors should ensure that all related contracts and insurance policies are carefully reviewed to confirm that the parties' intent with regard to subrogation and any waiver of subrogation is clearly aligned in all those documents. General Contractors should also be aware of the differing interpretations by courts of form waiver of subrogation provisions when negotiating their contracts so that they can effectively manage potential risks.

5. **Bar on Recovery for Work Performed by Unlicensed Subcontractor**
State statutes can interfere with sophisticated risk transfer contracts. In California, General Contractors must hire licensed subcontractors and cannot recover compensation for work performed by an unlicensed subcontractor. Familiarity with state statutes that may supersede risk transfer strategies is imperative.

Kim v. TWA Construction, Inc., 78 Cal.App.5th 808 (2022).

Key Facts: Sally Kim hired a licensed contractor, TWA Construction, Inc. ("TWA"), to build a home in Los Gatos, California. The project required TWA to remove a eucalyptus tree that straddled the property line between Kim and her neighbor. TWA hired a tree removal subcontractor, Martin Hoffman ("Hoffman") without verifying Hoffman's license status. Hoffman began removing the eucalyptus tree but stopped when a dispute concerning the tree arose with Kim's neighbors. Kim later terminated the contract with TWA because she could not secure a construction loan. The

neighbor sued Kim for trespass, negligence, and damage to the eucalyptus tree. Kim cross complained against TWA for comparative negligence, breach of contract, and express and equitable indemnity. In turn, TWA filed a cross-complaint against Kim for breach of contract. The neighbor settled with both Kim and TWA. However, the cross claims between TWA and Kim proceeded to trial. Prior to trial, Kim asked the Court to require TWA to make an offer of proof as to the licensure status of Hoffman, arguing that TWA had chosen to hire an unlicensed contractor to remove the eucalyptus tree, even though the state contractor's license board required a specialty tree service license for that type of tree work. Kim asserted that, pursuant to California statute, TWA had the burden of establishing proper licensure for its subcontractor. Kim argued that unless TWA could prove its subcontractor had the requisite license, TWA was barred from recovering any money paid or owed to the unlicensed subcontractor. The Court granted Kim's motion. The trial proceeded to a jury verdict, and the jury concluded that TWA was 100% liable for the neighbor's damages. The Court entered judgment in favor of Kim and ordered TWA to disgorge the amount paid for the tree-trimming service. TWA appealed.

Holding: The Appellate Court analyzed California Business and Professions Code Section 7031 and determined the purpose of the licensing law was to protect the public from unlicensed contractor work by withholding judicial aid from those who seek compensation for unlicensed contract work. Thus, "Section 7031 bars all actions regardless of the equities and however they are characterized which effectively seek "compensation" for illegal unlicensed contract work." The Court further interpreted 7031(a) to preclude a licensed general contractor from recovering from an *owner* for work performed by an unlicensed subcontractor. The Court of Appeal reasoned that allowing a general contractor to recover compensation for performance of unlicensed work because the work was accomplished by hiring a subcontractor would circumvent the purpose of Section 7031.

Impact for General Contractors/Construction Managers: California Business and Professions Code Section 7031 bars any recovery for compensation for work performed by an unlicensed contractor under any theory of recovery "regardless of the merits of the cause of action." Under *Kim v. TWA Construction, Inc.*, the California Court of Appeal expanded the effect of Section 7031 to bar a licensed general contractor from recovering from *an owner* for work completed by an unlicensed subcontractor.

6. Disclosure of Work Product and Waiver of Privilege

Work product privilege protects communications, written materials and tangible things prepared by or for in-house or outside counsel or prepared by or for the Company and its affiliates, in anticipation of or in connection with litigation, arbitration or other dispute resolution proceedings. Generally, work product materials are privileged, meaning they are

exempt from discovery. However, there are exceptions. The voluntary disclosure of pre-litigation "work" may waive some work product privilege. Consultation with in-house or outside counsel is recommended prior to disclosing information to third parties.

Brasfield & Gorrie, LLC v. Hirschfeld Steel Grp. LP, No. 2:20-CV-00984-LSC, 2021 WL 5449203, at *1 (N.D. Ala. Nov. 22, 2021).

Key Facts: Contractor**,** Brasfield & Corrie, LLC ("B&G"), was awarded a contract to repair a section of interstate in Alabama which included the erection of steel arches. B&G executed a purchase order with Hirschfeld Steel Group to purchase the structural steel. During installation there were nonconformances with the material purchased from Hirschfeld. B&G blamed Hirschfeld for the failure and subsequently informed the supplier of a potential breach. The parties disputed the cause of the nonconformance. Hirschfeld retained a third-party engineer, Genesis Structures, to examine the issue. Hirschfeld produced the engineering report ("Genesis Report") to B&G, however, B&G found the Genesis Report insufficient to cure Hirschfeld's default. B&G terminated the purchase order and initiated litigation. B&G issued a subpoena to Genesis Structures seeking all documents and information related to their investigation and the reports. They also sought to depose the engineer. Genesis Structures objected to the subpoena and depositions, claiming it was a non-testifying expert retained in advance of litigation and therefore protected from disclosure. B&G argued that the reports complied by Genesis were not work product, and even if they were, the underlying data was not protected by the work product privilege.

Holding: The U.S. District Court for the Northern District of Alabama held that work-product protection extends to documents "prepared by parties themselves and/or other non-attorney representatives, as long as the documents are prepared in anticipation of litigation, noting documents should receive work-product protection "as long as the primary motivating purpose behind the creation of the document was to aid in possible future litigation" but the court noted that "litigation need not necessarily be imminent." Where Genesis Structures was hired six months after the notice of defect was received by Hirschfeld, the court determined litigation was anticipated and thus the privilege applied. However, the court held that Genesis Structures waived privilege when Hirschfeld voluntarily shared the report with B&G. The court was careful to limit the waiver, holding Hirschfeld only waived its work product privilege for the actual reports given to B&G. All other information remained privileged.

Impact for General Contractors: Courts are divided on the issue of whether work-product protections for non-testifying experts are waivable and to what extent. Here, the

court held that the disclosure of work-product information such as an engineering report did not extend beyond what was actually disclosed. Although disclosure may be necessary, it is crucial for General contractors to be mindful of the jurisdictional rules before making a disclosure to an opposing party. General contractors should discuss any such disclosure with in-house counsel or outside counsel prior to making pretrial disclosures. General contractors should also consider proactively stipulating that disclosures in this sense are not waivers to avoid issues should litigation arise.