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More Confusion Regarding the "Damage to Property Exclusion"

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“Damage to Property” Exclusion

2. Exclusions

This insurance does not apply to:

j. Damage To Property

"Property damage" to:

(5) 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; or

(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

Source: Insurance Services Office, CG 00 01 04 13

History of the Exclusion

- Pre-1985 standard ISO CGL policy forms excluded coverage for, among other things:

> (k) property damage to
>
> (1) property owned or occupied or rented to the insured,
>
> (2) property used by the insured, or
>
> (3) property in the care, custody, or control of the insured or to which the insured is for any purpose exercising physical control;
>
> . . .
>
> (o) to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts, or equipment furnished in connection therewith;

- Broad exclusionary language potentially excluded coverage for anything within the named insured's scope of work.

History of the Exclusion

- In 1976, ISO offered an endorsement that included Broad Form Property Damage Liability Coverage (BFPD), which replaced exclusions (k) and (o), narrowing their scope. The new exclusions included the following property damage exclusion:

> (2) except with respect to liability under a written sidetrack agreement or the use of elevators
>
> (d) to ***that particular part*** of any property, not on premises owned by or rented to the insured,
>
> (i) upon which operations are being performed by or on behalf of the insured at the time the property damage arising out of such operations, or
>
> (ii) out of which any property damage arises, or
>
> (iii) the restoration, repair or replacement of which has been made or is necessary by reason of faulty workmanship thereon by or on behalf of the insured;

- The phrase “that particular part” first was introduced in the BFPD endorsement.

History of the Exclusion

- In 1979, ISO released a Circular explaining that the intent of the BFPD endorsement was to expand coverage:

> [W]hen [the BFPD] endorsement is used in connection with a Comprehensive General Liability Policy, the result is to broaden and clarify property damage coverage for any risk covered thereunder. Although the effect of [the] endorsement is to extend property damage coverage, the approach is to modify the application of the property damage exclusion.
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> INSURANCE SERVICES OFFICE, INC., ISO CIRCULAR GENERAL LIABILITY GL 79-12 (Jan. 29, 1979)

- In other words, the BFPD endorsement broadened coverage by narrowing the scope of the property damage exclusions in the CGL policy form.

- One way in which the exclusions were narrowed, was the use of the phrase "that particular part" in paragraph (d).

History of the Exclusion

- ISO explained that paragraph (d) of the BFPD endorsement was intended to "precisely define the extent to which damage to property on which the insured is actually working is to be excluded."

- ISO further stated that "The exclusion is intended to apply only to **the** part of the property on which the operations are being performed. In this context, 'property' is intended to mean any unit of property which may become the subject of liability."

- In other words, the BFPD endorsement was narrowing the standard exclusions, which potentially included everything within the insured's scope of work, to only the portion of the property being worked on at the time of the damage.

History of the Exclusion

- Examples from ISO's Circular:
  - "For example, consider an insured subcontractor who is erecting steel beams furnished to him by the general contractor. Having erected four steel beams, the subcontractor is in the process of erecting a fifth steel beam and this beam falls, resulting in damage to all five beams. 'That particular part' of the property would be the fifth beam."
  - "As another example, if the insured were an electrical subcontractor and, in the process of installing a switch which was furnished to him, he damaged the switch which resulted in burning out the electrical system, the switch would be 'that particular part' of the property."

History of the Exclusion

- In 1985 ISO introduced a new CGL policy form, which modified the "business risk exclusions." The new exclusions included exclusion j(5) & (6), which included the "that particular part" language previously found in the BFPD endorsement.

- ISO's intent was to incorporate the narrowed scope of the exclusions from the BFPD endorsement into the new CGL policy form.

- As explained by ISO when the 1985 CGL policy forms were introduced:
  - "How does ISO's new General Liability Program improve things? Here's how: . . . ***The coverages provided by the old Broad Form Endorsement are built right into both new forms***. . . . Thus, the new forms automatically provide the scope of coverage most commonly sought by buyers and made available in today's insurance marketplace." *Introduction to Insurance Services Office, Inc.'s New Commercial General Liability Program,* INSURANCE SERVICES OFFICE, INC. (ISO) (April 1985)

How Courts Have Treated the Exclusion

- Courts have taken three approaches in construing the exclusion:

- **Narrow approach** (*i.e.*, the exclusion only bars coverage for that specific portion of property on which the insured is working at the time of the damage)
  - *Fortney & Weygandt, Inc. v. Am. Mfrs. Mut. Ins. Co.*, 595 F.3d 308 (6th Cir. 2010) (find the words "that particular part" are "trebly restrictive, straining to the point of awkwardness to make clear that the exclusion applies only to building parts on which defective work was performed, and not to the building generally")
  - *Gore Design Completions, Ltd. v. Hartford Fire Ins. Co.*, 538 F.3d 365 (5th Cir. 2008) ("[The insurer's] reading of the exclusion reads out the words 'that particular part.' If work on any part of a property would leave an insured exposed for damages to the entire property, the exclusion should state: 'Property damage to property that must be restored, repaired or replaced because your work was incorrectly performed on any part of it.'")
  - *Mid-Continent Cas. Co. v. JHP Dev., Inc., 557 F.3d 207 (5th Cir. 2009)* ("The plain meaning of the exclusion . . . is that property damage only to parts of the property that were themselves the subjects of the defective work is excluded. . . . The narrowing 'that particular part' language is used to distinguish the damaged property that was itself the subject of the defective work from other damaged property that was either the subject of nondefective work by the insured or that was not worked on by the insured at all.")

- This approach is consistent with ISO's drafting history and with the general rule of construction that exclusions are to be construed narrowly.

How Courts Have Treated the Exclusion

- Courts have taken three approaches in construing the exclusion:

- **Broad approach** (*i.e.*, the exclusion bars coverage for damage to any property within the insured's scope of work, even if the insured was not working on the property at the time of the damage)
  - *Lafayette Ins. Co. v. Peerboom*, 813 F. Supp. 2d 823 (S.D. Miss. 2011)
    - Insured hired to excavate beneath a home, install hydraulic jacks and raise the structure up several feet.
    - During operations, the house fell, damaging the entire structure of the home.
    - Court held there was no coverage, reasoning that the insured's work consisted of raising the entire home, and therefore the exclusion barred coverage for damage to the entire home.
  - *Jet Line Servs., Inc. v. Am. Empls. Ins. Co.*, 404 Mass. 706 (Mass. 1989) (damage to entire storage tank excluded)
  - *American Equity Ins. Co. v. Van Ginhoven,* 788 So.2d 388 (Fla. App. 2001) (damage to entire pool excluded)
  - *Vinsant Elec. Contractors v. Aetna Cas. & Surety Co.*, 530 S.W.2d 76 (Tenn. 1975) ("We cannot so construe this provision as to limit the exclusion to the precise and isolated spot upon which work was being done")

- Courts that take this approach typically base their construction on the general principal that CGL insurance is not a performance bond and is not intended to cover an insured's faulty workmanship.

How Courts Have Treated the Exclusion

- Courts have taken three approaches in construing the exclusion:

- **Middle ground approach** (*i.e.*, the exclusion is ambiguous)
  - *Roaring Lion LLC v. Nautilus Ins. Co.*, 2011 U.S. Dist. LEXIS 100666 (D. Mont. July 15, 2011)
    - Insured hired to build a cabin, and one of its subcontractors incorrectly poured the foundation of the cabin, causing significant damage to the entire cabin, including the collapse of the framing.
    - Insurer argued that the exclusion barred coverage for all damage to the cabin.
    - Policyholder argued that the exclusion barred coverage only for the damage to the foundation.
    - The court noted that the insurer's argument "overlooks the exclusions' opening reference to 'that particular part,'" yet held that, because the phrase was undefined, it could be read broadly to encompass the entire cabin, or narrowly to encompass only the foundation.
    - Accordingly, the court held that the exclusion was ambiguous.

- Practical effect of this approach is the same as the narrow approach, because ambiguities in insurance contracts are typically construed against the insurer.

How Courts Have Treated the Exclusion

MTI, Inc. v. Employers Ins. Co. of Wausau, 913 F.3d 1245 (10th Cir. 2019)

- Insured hired to repair corroded anchor bolts in a cooling tower. After removing old bolts, but before installing new bolts, tower was hit by high winds, causing structural damage to tower and requiring replacement of entire tower.
- Insurer denied coverage, arguing that cost of replacing tower was excluded under the damage to property exclusion.
- District Court held the claim was excluded.
- 10th Cir. found that the exclusion was ambiguous:

> "[I]t is the responsibility of the insurer desiring to limit liability to employ clear language. Wausau has failed to do so in this case. The phrase "that particular part" could be read to refer solely to the direct object on which the insured was operating. Alternatively, it could apply to those parts of the project directly impacted by the insured party's work. We agree with those courts that have held the former interpretation is a reasonable one, although we acknowledge that the latter is also reasonable."

- Because the exclusion was ambiguous, the Court held that it should be construed against the insurer; accordingly, the court reversed the District Court's decision and held that the exclusion only barred coverage for the cost of replacing the anchor bolts, not the cost of replacing the entire tower.

How Courts Have Treated the Exclusion

MTI, Inc. v. Employers Ins. Co. of Wausau, 913 F.3d 1245 (10th Cir. 2019)

- Court reasoned that both a broad and narrow reading of the exclusion were reasonable:
  - Narrow reading was reasonable because the phrase "that particular part" is "narrowing language."
  - Broad reading was reasonable because other courts had applied the exclusion broadly, citing:
    - *William Crawford, Inc. v. Travelers Ins. Co.*, 838 F. Supp. 157 (S.D.N.Y. 1993); *Jet Services, Inc. v. Am. Employers Ins. Co.*, 404 Mass. 706 (Mass. 1989)
    - In these cases, the courts held that the exclusion barred coverage for damage to any property within the insured's scope of work.

How Courts Have Treated the Exclusion

MTI, Inc. v. Employers Ins. Co. of Wausau, 913 F.3d 1245 (10th Cir. 2019)

- The reasoning of the courts applying a broad interpretation of the exclusion appears to conflict with the drafting intent reflected in the ISO Circulars.

- It also appears to ascribe no meaning to the phrase "that particular part."
  - For example, in *William Crawford, Inc. v. Travelers Ins. Co.*, 838 F. Supp. 157 (S.D.N.Y. 1993), insured was hired to renovate 7,000 sq. ft. apartment. While installing plaster walls, insured used fans to help plaster dry, one of the fans ignited, causing fire and smoke damage throughout the apartment. Court held that all of the damage was excluded under the Damage to Property exclusion.
  - Would result have been different if the exclusion omitted "that particular part" and barred coverage for "property damage to any real property on which you are performing operations"?

How Courts Have Treated the Exclusion

MTI, Inc. v. Employers Ins. Co. of Wausau, 913 F.3d 1245 (10th Cir. 2019)

- 10th Cir. acknowledges the phrase "that particular part" is narrowing and that it must be given effect.

- Court, however, does not offer any alternative explanation reconciling that position with the narrow interpretation of the exclusion; instead, court relies on the fact that other courts have held that the exclusion applies broadly.

- Courts applying the broad interpretation also have relied on the general maxim that CGL insurance is not a performance bond and is not intended to cover faulty workmanship.

Travelers Indem. Co. of Conn. v. Richard McKenzie & Sons, Inc., Hermanns Real Estate Ventures, LLC, Case No. 18-13172

- 11th Circuit currently is hearing an appeal concerning the Damage to Property exclusion. *Travelers Indem. Co. of Conn. v. Richard McKenzie & Sons, Inc., Hermanns Real Estate Ventures, LLC,* Case No. 18-13172

- Facts:
  - Plaintiff owned a citrus grove, hired the defendant to manage the grove. After discovering that the defendant was overcharging for services and goods, plaintiff sued for breach of contract, breach of fiduciary duty. Plaintiff also alleged a claim of negligence, asserting that defendant's mismanagement caused the citrus orchard to be impacted by a blight, resulting in millions in lost profits and costs to remove trees.
  - Case settled, with defendant agreeing to a $2.9M consent judgment on the negligence claim; defendant assigned rights to coverage to plaintiff, who agreed not to execute on the judgment against defendant but to seek coverage from defendant's insurer, Travelers.

Travelers Indem. Co. of Conn. v. Richard McKenzie & Sons, Inc., Hermanns Real Estate Ventures, LLC, Case No. 18-13172

- Defendant had a CGL policy with Travelers that included a "farm care-taker liability" endorsement. Travelers denied coverage, asserting, among other things, the claims were excluded under the Damage to Property exclusion.

- District Court applied a broad construction to the exclusion, holding that it barred coverage for damage to all property within the insured's scope of work and, since the defendant was hired to maintain the entire 265-acre grove, there was no coverage.

- District Court rejected the argument that the phrase "that particular part" limited the exclusion to something less than the entire 265-acre grove, finding that defendant "cleared debris, planted trees, installed and repaired the irrigation system, sprayed pesticides, and applied (or sometimes misapplied) fertilizer to the entire grove."

Travelers Indem. Co. of Conn. v. Richard McKenzie & Sons, Inc., Hermanns Real Estate Ventures, LLC, Case No. 18-13172

- Plaintiff argued that courts applying Florida law have applied the exclusion narrowly:
  - *Essex Ins. Co. v. Kart Constr., Inc.*, 2015 U.S. Dist. LEXIS 104514 (M.D. Fla. Aug. 10, 2015). During welding operations on a portion of a cell tower, a fire broke out, damaging other parts of the tower. Insurer argued that damage to entire tower was excluded, because in addition to welding operations on a small portion of the tower, the insured had a separate agreement regarding fire safety that required it to remove debris from the entire tower, wet the entire tower before welding, and monitor the tower for fires. The insurer argued that those activities, which included the entire tower, constituted the insured's operations.
  - The court held that j(5) barred coverage only for those parts of property on which the insured was performing operations at the time of the damage. The court found that the wetting of the tower and the debris removal were completed at the time of the fire, and that monitoring the tower was not an "operation" and the fire did not arise out of the monitoring. Accordingly, the court held that j(5) barred coverage only for damage to the ten-foot portion of the tower that was being welded at the time of the fire.
  - The court held that j(6) barred coverage only for repair or replacement of property if the insured's work was incorrectly performed on it and there was no indication that the insured's fire prevention activities on the entire tower were incorrectly performed.

Travelers Indem. Co. of Conn. v. Richard McKenzie & Sons, Inc., Hermanns Real Estate Ventures, LLC, Case No. 18-13172

- Travelers argued that courts applying Florida law have construed the exclusion broadly:

  - *Am. Equity Ins. Co. v. Van Ginhoven*, 788 So. 2d 388 (Fla. 5th DCA 2001). The insured was hired to make minor repairs to the surface of a swimming pool and replace six tiles. While draining the pool to perform the work, the pool popped out of the ground, causing damage to the entire pool. The court held that exclusion j(5) barred coverage for damage to the entire pool, not just the specific areas the insured was hired to repair.

  - *Amerisure Mut. Ins. Co. v. Am. Cutting & Drilling Co.*, 2009 U.S. Dist. LEXIS 21077 (S.D. Fla. Mar. 17, 2009). Insured was hired to cut plumbing holes in concrete. In the process of chipping away the concrete, the insured damaged a number of tension cables. The project owner sued the insured for, among other things, the cost of repairing or replacing the tension cables, the cost of breaking into walls and floors to get access to the cables, and overtime and delays to perform the repair work. The court held that the exclusion j(5) was not ambiguous, and barred coverage for the entire claim. The court reasoned that the phrase "that particular part" included both the cables and the concrete, because the cables were running through the concrete that was being cut.

Travelers Indem. Co. of Conn. v. Richard McKenzie & Sons, Inc., Hermanns Real Estate Ventures, LLC, Case No. 18-13172

- Oral argument was scheduled for August 2019.
- Court may chose to decide the case without reaching the issue of the scope of the Damage to Property Exclusion.
- If court construes the exclusion broadly, there likely would be no coverage, as the insured's scope of work included maintaining the entire citrus grove.
- Even if court construes the exclusion narrowly, whether there is coverage will depend on the facts in the record.
  - What property was being worked on at the time of the property damage? Did the property damage arise out of that work?

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Questions?

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