

HOT AND HUMID

COVERAGE FOR EIFS CLAIMS UNDER THE STANDARD CGL POLICY

Introduction

Exterior insulation finish system (EIFS, sometimes known as artificial stucco or fake stucco) is a building system which integrates a resinous exterior cladding with a continuous layer of insulation, wrapped around the exterior of buildings. These systems are usually comprised of five component layers: an exterior finish, a reinforcing mesh to protect the system, an insulator (normally expanded polystyrene), an adhesive substance binding the insulator to the building and a substrate to which the insulator is attached.

Generally, EIFS products are marketed as systems by different manufacturers. The system is only one component of a weather envelope or system. Unlike most other wall cladding products (such as siding or brick), the EIFS system is actually created on site and combined with other materials, such as wall framing, flashings, etc.

The product, originally developed in Europe, became popular with American builders in the early 1980s. Unlike other exterior systems, it adjusts readily to the particular design of the building, making it very popular with architects and builders looking for new designs. The function of EIFS is to act as a barrier between the outside elements and the remainder of the structure.

In many parts of the country, especially areas with high heat and humidity, property owners began experiencing problems with moisture entering the structure. A rash of litigation ensued in which, typically, it is claimed that installers of EIFS failed to put a base coat at the termination of the EIFS system, failed to install sealant and failed to install flashing. It is also usually alleged that the installer failed to backwrap entrances and windows and did not use proper caulking techniques where the EIFS terminated.

A typical complaint will allege that the defective installation of EIFS has caused moisture intrusion, damaging structural members, flooring and other parts of the building. Further, byproducts of moisture, such as mold and mildew, are usually alleged. Generally, it is claimed that the only way to fix the problem is to re clad the entire structure.

The usual defendants in an EIFS case are the EIFS installer, the EIFS seller or distributor, the general contractor and the EIFS manufacturer. The building owner usually claims that the EIFS product was defectively manufactured and/or sold as a defective product. Frequently, it is claimed that the local seller had a duty to verify the ability of the installer. It is usually alleged that the general contractor had overall responsibility and, in particular, failed to supervise the EIFS installer or verify that party's ability to install the EIFS system.

As in other construction defect cases, the problems may not appear until many years after the installation. The Plaintiff may not be the original owner of the structure. Termite infestation sometimes is alleged as an additional problem caused by the defective installation of EIFS. In those cases, it is not unusual to find a pest control company included as a defendant.

Typical Allegations in Complaint

In an EIFS case, the following causes of action are frequently found:

1. Negligence and/or negligent supervision (EIFS installer, seller, general contractor and manufacturer);
2. Breach of express warranties (EIFS installer, seller, general contractor and manufacturer);
3. Breach of implied warranty of habitability (general contractor);
4. Breach of implied warranty of merchantability (EIFS seller and manufacturer);
5. Breach of implied warranty of fitness for particular purpose (EIFS seller and manufacturer);
6. Breach of implied warranty of workmanlike service (EIFS installer and general contractor);
7. Unfair or deceptive trade practices, usually based on deception of consumers (EIFS installer, seller, general contractor and manufacturer);
8. Strict liability (EIFS seller).

Policy Provisions

Various versions of the ISO Commercial General Liability form policy may be involved (since the construction may have been completed years before the suit). The 1986 and subsequent versions (herein the “Policy”) usually have the following provisions:

The Insuring Agreement says that the insurer:

“ . . . 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 any “suit” seeking those damages.”

The Policy applies to “bodily injury” and “property damage” only if they are caused by an “occurrence” and if the injury or damage occurs during the policy period.

The Policy contains the following exclusions:

- a. “Bodily injury” or “property damage” expected or intended from the standpoint of the insured . . .
- b. “Bodily injury” or “property damage” for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
 - (1) 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; or
 - (2) That the insured would have in the absence of the contract or agreement.
- k. “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.
 - . . . Paragraph (6) of this exclusion does not apply to “property damage” included in the “products-completed operations hazard.”
- l. “Property damage” to “your product” arising out of it or any part of it.
- m. “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.

- n. “Property damage” to “impaired property” or property that has not been physically injured, arising out of:
 - (1) A defect, deficiency, inadequacy or dangerous condition in “your product” or “your work;” or
 - (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to “your product” or “your work” after it has been put to its intended use.

The Policy contains the following pertinent definitions:

- 3. “Bodily injury” means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.
- 5. “Impaired property” means tangible property, other than “your product” or “your work,” that cannot be used or is less useful because:
 - a. It incorporates “your product” or “your work” that is known or thought to be defective, deficient, inadequate or dangerous; or
 - b. You have failed to fulfill the terms of a contract or agreement;if such property can be restored to use by:
 - a. The repair, replacement, adjustment or removal of “your product” or “your work;” or
 - b. Your fulfilling the terms of the contract or agreement.
- 6. “Insured Contract” means: . . .

- f. That part of any other contract or agreement pertaining to your business . . . under which you assume the tort liability of another party to pay for “bodily injury” or “property damage” to a third party or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.
9. “Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.
11. a. “Products-completed operations hazard” includes all “bodily injury” and “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; or
 - (2) Work that has not yet been completed or abandoned.
- b. “Your work” will be deemed completed at the earliest of the following times:
- (1) When all of the work called for in your contract has been completed.
 - (2) When all of the work to be done at the site has been completed if your contract calls for work at more than one site.
 - (3) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed.

12. “Property damage” means:
- 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; or

- b. Loss of use of tangible property that is not physically injured. All such loss shall be deemed to occur at the time of the “occurrence” that caused it.

14. “Your product” means:

- a. Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:

(1) You . . .

“Your product” includes:

- a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your product;” . . .

15. “Your work” means:

- a. Work or operations performed by you or on your behalf; and
- b. Materials, parts or equipment furnished in connection with such work or operations.

“Your work” includes:

- a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your work;” and
- b. The providing of or failure to provide warnings or instructions.

General Rules of Policy Construction

Exclusions in a policy are to be read independently of each other, and not cumulatively. Engineered Products, Inc. v. Aetna Cas.& Sur. Co., 295 S.C. 375, 368 S.E.2d 674 (Ct. App. 1988); Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 405 A.2d 788 (1979); "If any one exclusion applies there should be no coverage, regardless of inferences that might be argued on the basis of exceptions or qualifications contained in other exclusions. There is no instance in which an exclusion can properly

be regarded as inconsistent with another exclusion, since they bear no relationship with one another." 81 N.J. at 248, 405 A.2d at 795; LaMarche v. Shelby Mut. Ins. Co., 397 So.2d 325 (Fla. 1980).

The duty to defend is broader than the duty to indemnify under an insurance policy. The insurer's duty to defend depends upon whether or not the facts alleged in a complaint, if proved, would afford coverage. United States Fidelity & Guaranty Co. v. Wilkin Insulation Co., 144 Ill.2d 64, 578 N.E.2d 926 (1991); General Ins. Co. of America v. Palmetto Bank, 268 S.C. 355, 233 S.E.2d 699 (1977).

General Overview of Construction Defect Coverage

Since construction defect claims are typically found to be within the Insuring Agreement of the CGL Policy, coverage disputes concerning such claims often focus on the Policy exclusions, which limit the coverage granted in the insuring agreement. The exclusions address a basic issue: How does the policy exclude from coverage damages resulting from "business risks?"

Generally, a liability insurer is not obligated to pay for the faulty workmanship of its insured. Stroup Sheet Metal Works, Inc. v. Aetna Cas. & Sur. Co., 268 S.C. 203, 232 S.E.2d 885 (1977). The risks insured under the CGL policy are distinct from the simple risk of doing business. Western Employers Ins. Co. v. Arciero & Sons, Inc., 146 Cal. App. 3d 1027, 194 Cal. Rptr. 688 (1983); Weedo v. Stone-E-Brick, Inc., 81 N.J. 233, 405 A.2d 788 (1979); Aetna Ins. Co. v. Pete Wilson Roofing and Heating Co., Inc., 289 Ala. 719, 272 So.2d 232 (1972); C.D. Walters Const. Co. v. Fireman Ins. Co. of New Jersey, 281 S.C. 593, 316 S.E.2d 709 (Ct. App. 1984); C.D. Walters Const. Co. v. Fireman Ins. Co. of New Jersey, 281 S.C. 593, 316 S.E.2d 709 (Ct. App. 1984). Hartford Acci. & Indem. Co. v. Pac. Mut. Life Ins. Co., 861 F.2d 250, 253 (10th Cir. 1988) (CGL policy is not intended to extend to ordinary business risks such as those relating to the repair or replacement of faulty work or products but is to protect the insured from liability for damages to property other than his own work).

Most of the business risk exclusions draw the line between covered and uncovered claims according to the nature of the harm caused, rather than the nature of the conduct causing the harm. Construction defects are generally the result of poor workmanship or poor design. The coverage determination usually depends on whether the resulting harm was damage to the insured's own work, which is generally not covered, or damage to the work of others, which is covered.

For example, in C.D. Walters, the South Carolina Court of Appeals said that the CGL policy does not cover faulty workmanship but rather faulty workmanship which causes an accident. In that case, the insured had agreed to excavate and prepare a pond on the claimant's property. The Complaint against the insured alleged that the insured cut and damaged trees which he had been instructed to avoid and that he had dug a ditch against the claimant's specific instructions. The Court concluded that the damage sought by the claimant was to that particular part of the claimant's property on which the insured was working, and did not involve accidental injury to other property. See also Isle of Palms Pest Control Company v. Monticello Insurance Company, 319 S.C. 12, 459 S.E.2d 318 (S.C. App. 1994), aff'd 321 S.C. 310, 468 S.E.2d 304 (1996). "A general

liability policy is intended to provide coverage for tort liability for physical damage to the property of others; it is not intended to provide coverage for the insured's contractual liability which causes economic losses. ... It is for this reason that a general liability insurance policy typically does not cover claims of faulty workmanship, but instead covers claims of faulty workmanship that causes an accident." 459 S.E.2d 319.

Insuring Agreement and Definition of Occurrence

"Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

The Policy requires the happening of an "occurrence" which is defined as an accident including continuous exposure to conditions. Some courts have found that negligent performance of work by a contractor is an occurrence. Green Construction Co. v. National Union, 771 F.Supp. 1000, 1003 (W.D. Mo. 1991). In Stroup Sheet Metal Works, Inc. v. Aetna Cas. & Sur. Co., 268 S.C. 203, 232 S.E.2d 885 (1987), the South Carolina Supreme Court held that a Complaint alleging faulty workmanship did not allege an "occurrence" or accident. In Stroup, it is important to note that there were no allegations of negligence against the insured. Therefore, the Supreme Court had an easy time in concluding that the action was only for breach of contract for faulty workmanship, and therefore not covered under the policy. In the EIFS cases, the definition of "occurrence" includes continuous exposure to conditions which is usually the situation alleged to have caused the damages in question.

Definition of "Property Damage"

"Property damage" means:

- 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; or*
- b. Loss of use of tangible property that is not physically injured. All such loss shall be deemed to occur at the time of the "occurrence" that caused it.*

If the faulty workmanship causes physical injury to tangible property other than the work itself, courts generally find "property damage" within the policy. See, e.g., Maryland Cas. Co. v. Reeder, 270 Cal. Rptr. 719, 724 (Cal. Ct. App. 1990).

The issue of whether "property damage" has occurred may arise in the context of a defective product being incorporated into tangible property. Some courts have held this constitutes "property damage". Tobi Engineering, Inc. v. Nationwide Mutual Insurance Co., 574 N.E.2d 160, 163 (Ill. App. Ct. 1991). Generally, coverage for the incorporation of defective products into tangible property is determined not on the basis of whether a defect exists, but rather by whether consequential damages have occurred as a result of the defect. Fresno Economy Import Used Cars, Inc. v. USF&G, 142 Cal. Reporter, 681, 1977 (defective head gasket in auto is not property damage)

even though a property had no physical injury requirement; no other part of auto was damaged by defective part); Hamilton Diecast, Inc., v. USF&G, 508 F.2d 417, (7th Cir. 1975) (incorporation of defective component does not constitute property damage, since there was no harm to other parts).

In EIFS cases, the complaint usually alleges that the incorporation of the allegedly defective EIFS caused damage to other components of the structure.

Diminution in Value of the Structure

The Policy defines property damage as “physical injury to tangible property, including all resulting loss of use of that property”. There appears to be a split of authority as to whether the term “property damage” includes tangible property which has been diminished in value irrespective of any actual physical injury to the tangible property. Usually, the complaint alleges physical damage to components of the structure in addition to depreciated value.

The majority of courts which have construed the 1973 version of the CGL Policy have held that intangible damages, such as diminution of value, do not constitute property damage. See Wyoming Sawmills, Inc. v. Transportation Ins. Co., 282 Or. 401, 578 Pac.2d 1253 (1978) holding that the intention to exclude such coverage could be the only reason for the addition of the word “physical”; Federated Mutual Insurance Company v. Concrete Units, Inc., 363 N.W.2d 751 (Minn. 1985); New Hampshire Ins. Co. v. Vieria, 930 F.2d 696 (9th Cir. 1991); Baywood Corp. v. Maine Bonding & Cas. Co., 628 A.2d 1029 (Me. 1993).

For example, in Aetna Life and Cas. Ins. Co. v. Patrick Industries, Inc., 645 N.E.2d 656 (Ct. App. Ind. 1995), the insured, a supplier, sued its CGL insurer which had refused coverage for the supplier’s settlement with a manufacturer to whom the insured supplied defective particle board that was incorporated into the manufacturer’s campers. The Court of Appeals, reversing the lower court, held that the CGL policy did not cover diminution in value of the campers which contained the defective components supplied by the insured. The Indiana court recited the history of the “property damage” definition under the 1966 and 1973 versions of the ISO policy. The prior version did not include the word “physical” which was added in 1973. The majority of courts construing the 1966 version held that depreciation was included under that policy’s definition of “property damage”. See also Hartford Accident & Indemnity Co. v. Pacific Mut. Life Ins. Co., 861 Fed.2d 250 (10th Cir. 1988) (1973 revision was intended to preclude coverage for intangible injuries such as diminution in value).

In Marathon Plastics, Inc. v. International Ins. Co., 161 Ill. App. 3d 452, 514 N.E.2d 479, 485 (1987), the court held that damage to the completed product exclusive of the value of the defective component did constitute damage to tangible personal property within the meaning of the policy.

Allegations of Strict Liability

A complaint may allege an insured seller is strictly liable for any defects caused by the allegedly defective product. As previously noted, the policy exclusions focus on the nature of the

harm caused, rather than the specific basis for the claim. In other words, if the insured's product causes damage to other property, then coverage may exist. Consequently, coverage for the strict liability claim should depend upon the nature of the damage alleged.

The "Contract" Exclusion

- b. *"Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:*
- (1) *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; or*
 - (2) *That the insured would have in the absence of the contract or agreement.*

This exclusion says that the Policy does not apply to property damage for which the insured is obligated to pay by reason of the assumption of liability in a contract or agreement. The exclusion does not apply to liability that the insured would have in the absence of the contract or agreement.

Causes of action for breach of express and implied warranties are frequently alleged in EIFS cases. The contract exclusion was relied upon by the Court in TGA Dev., Inc. v. Northern Ins. Co. of NY, 62 F.3d 1089 (8th Cir. 1995). In that case, applying Minnesota law, the Court found no coverage for a claim arising from the construction of a unit in an office building. The claim against the insured included allegations of breach of warranty. The appellate court affirmed the lower court grant of summary judgment to insurer, based upon the contractual liability exclusion. It should be noted there was no negligence claim against the insured.

The contract exclusion says that it does not apply to liabilities the insured would have in the absence of a contract or agreement. This exclusion, therefore, may not apply to implied warranties alleged to have arisen by law, rather than by contract. This exclusion, however, should avoid coverage for the claim for breach of express warranties.

The "Your Product" Exclusion

- l. *"Property damage" to "your product" arising out of it or any part of it.*
14. *"Your product" means:*

- a. *Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:*

- (1) *You . . .*

“Your product” includes:

- a. *Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your product;” . . .*

This exclusion says that the Policy does not apply to property damage to “your product”, arising out of it or any part of it. “Your product” is defined in part as including warranties or representations with respect to the fitness, quality, performance of “your product.”

The South Carolina Court of Appeals upheld a denial of coverage based, in part, on this exclusion in Nautilus Ins. Co. v. Long, 315 S.C. 79, 431 S.E.2d 624 (Ct. App. 1993). There, the insurer brought a declaratory action against its insured, a roofing contractor. The insured had contracted to put a new roof surface on an existing building. During the work, rainwater from a heavy storm leaked through the roof “because the roofing company failed to cover the roof surface.” The rainwater allegedly caused considerable damage to the building (a hospital) and the equipment in the building.

The building owner sought a declaration that the insurer could be liable for the loss of a warranty from the roofing material manufacturer based on the roofer’s failure to cover the roof. The lower court ruled the insurer had a duty to defend the negligence action against its insured but that the policy did not cover the loss of the warranty from the roofing manufacturer. The Court of Appeals agreed, relying on the “your product” and “your work” exclusions. The property damage in question, the loss of the right to the 20 year roof warranty, was to the very work performed by the insured and it arose out of the work.

Although the Court did not reference a contract exclusion, the Court said that the insurer did not provide coverage for “contractual liability of the insured for any type of economic loss resulting from the failure of the product or completed work not being that for which the building owner bargained.”

The Court went on to hold that the “product” that the insured contracted to supply was the roof which was to carry a 20 year warranty. The Court held that the insurer was not responsible for the loss of this warranty.

This exclusion should avoid coverage for any claims of damage to the EIFS product itself. It probably does not avoid coverage for damage to other portions of the residence as a result of “product” defects.

The “Your Work” Exclusion

- m. *“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.

15. *“Your work” means:*

- a. *Work or operations performed by you or on your behalf; and*
- b. *Materials, parts or equipment furnished in connection with such work or operations.*

“Your work” includes:

- a. *Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your work;” and*
- b. *The providing of or failure to provide warnings or instructions.*

The more difficult determination is usually whether the claim alleges damage only to the insured’s work or other property damage caused by the insured’s work. Two recent cases illustrate this problem.

In Sapp. v. St. Farm Fire & Cas. Co., 226 Ga. App. 200, 486 S.E.2d 71 (1997), the appellate court affirmed a lower court judgment in a declaratory action brought by a contractor’s insurer. The insured was hired to conduct repairs and renovations to the claimant’s home. As part of the work, the insured made repairs to floor joists and installed hardwood flooring. Apparently, the insured failed to adequately protect the hardwood flooring from a moisture problem under the home. The court recited the general principle that the “business risk” exclusions are designed to exclude coverage for defective workmanship by the insured.

“The insured, as a source of goods or services, may be liable as a matter of contract law to make good on products or work which is defective or otherwise unsuitable because it is lacking in some capacity. This may even extend to an obligation to completely replace or rebuild the deficient product or work. This liability, however, is not what the coverage is in question or designed to protect against. The coverage applicable under the CGL policy is for tort liability for injury to persons and damage to other property.

The claimant argued that the only “work” that would fall under the exclusion would be the failure of the insured to address and correct the water problem prior to installing the hardwood floor. The Court disagreed, holding that all the claimed damages related directly to the cost of repair or replacing the alleged negligent work of the insured – the failure to correct the moisture problem and the negligent installation of the floors. Any damages to the house during the removal of the floor (and the restoration of the house to its condition prior to the work) were merely incidental to the claimed damages that the insured negligently performed the services for which he contracted.

A contrasting decision is Pekin Ins. Co. v. Richard Marker Assoc., Inc., 289 Ill. App. 3d 819, 682 N.E.2d 362 (1997). There, the appellate court reversed a lower court judgment in favor of the insurer in a declaratory action. The underlying Complaint alleged that the insured negligently installed a HVAC system which did not operate properly so that resulting condensation caused extensive water damage to window trim, furniture, carpeting, flooring and walls.

The Illinois court also recited the basic rule that the CGL policy is intended to provide coverage for damage other than the costs associated with repairing or replacing the insured’s defective work. The court went further and said that the CGL policy does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident, and found that such was alleged by the underlying Complaint. The claim was that the faulty workmanship caused an accident in the form of continuous or repeated condensation which dripped and damaged furniture. The court said this was more than an allegation that the building itself was defective. Therefore, the court held that the allegations of the underlying Complaint potentially fell within the policy coverage so that the insurer had a duty to defend.

The EIFS applicator traditionally puts on the foam board and the “lamina”/acrylic glue coating which is about a sixteenth of an inch thick. In most cases, the structural sheathing to which the foam board is applied and the studs supporting the sheathing are generally done by others. In residential construction the framing crew would do the studs and the sheathing board and the EIFS installer would then attach the foam board and the synthetic coating. In all probability the only components included within the EIFS installer’s work would be foam board and the lamina and everything else would be other subcontractor’s work. This division of work is crucial to coverage under a number of the exclusions.

The Policy’s definition of “your work” includes “warranties . . . made at any time with respect to the fitness, quality, durability, performance or use of ‘your work’ . . .”. If the “contract” exclusion does not exclude coverage for the allegations of breach of implied warranties of fitness and use for a particular purpose, then the “your work” exclusion should accomplish this, and prevent such causes of action from being covered.

The “Property Damage” Exclusion

Exclusion (h) is generally referred to as the property damage exclusion. It probably will not affect the typical EIFS case. Courts have limited exclusion (j)(5)’s application to damage which

occurs while operations are being performed by the insured. Action Auto Stores, Inc. v. United Capital Ins. Co., 845 F. Supp. 428 (W.D.Mich. 1993) (Phrase was found to be ambiguous and was construed in favor of insured to require that excluded damage occur during the time work was being performed.)

The Impaired Property Exclusion

- m. *“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.

Exclusion (m) is sometimes referred to as the “impaired property” exclusion. This exclusion avoids coverage for property damage to “impaired property” or property that has not been physically injured arising out of the insured’s work. “Impaired property” is defined as tangible property, other than the insured’s work, that is less useful because it incorporates the insured’s work which is claimed to be defective if such property can be restored to use by the repair or replacement of the insured’s work. While other “business risk” exclusions focus on the cost of repair of the insured’s own work, the general focus of this exclusion is the insured’s work causing non-physical damage to other property.

Generally, to qualify as “impaired property”, the property must be capable of being restored to use by the “repair, replacement, adjustment or removal of ‘your work’”. If the property in question cannot be restored by repair or replacement of the insured’s work, it will not qualify as “impaired property.” For example, in Action Auto Stores v. United Capital Ins. Co., 845 F. Supp. 417 (W.D. Mich. 1993), the court held that this exclusion did not preclude coverage where the insured was sued for negligent installation of a gasoline container system, which resulted in pollution of surrounding property, as there was no evidence that the damage done to surrounding property could be remedied by the repair or replacement of the insured’s work.

Some courts have ruled that earlier versions of exclusion (m) precluded coverage only for breach of contract or warranty claims. See, e.g., Guerin Contractors, Inc. v. Bituminous Cas. Co., 636 S.W.2d 638 (Ark. App. 1982); Alert Centre, Inc. v. Alarm Protection Services, Inc., 967 F.2d 161 (5th Cir. 1992).

Exclusion (m) contains an exception for the loss of use of other property arising out of “sudden and accidental physical injury to your work after it has been put to its intended use.” This exception has not been analyzed in detail by the courts so there are few clear guidelines as to when it will apply.

The impaired property exclusion may preclude coverage for any alleged diminution in value of a structure. This would be true if the structure could be restored to use by the repair or replacement of the insured’s work.

Intentional Act Exclusion

- a. *“Bodily injury” or “property damage” expected or intended from the standpoint of the insured . . .*

In some jurisdictions, application of the intentional act exclusion requires a two-step analysis. The first question is whether the act causing the loss was intentional, and the second is whether the results of the act were intended. See Miller v. Fidelity Phoenix Ins. Co., 268 S.C. 72, 231 S.E.2d 701 (1997).

It can be seen that this reasoning makes it very difficult to opine that the intentional act exclusion will avoid coverage. However, if a complaint alleges intentional misrepresentations by an insured seller as to the effectiveness of the EIFS product and the installer’s ability to apply the insulation system, the logical result of such misrepresentation could be the insured’s selling the product. It can certainly be argued that any consequences which flowed from the insured’s product could have been anticipated by the insured.

Trigger of Coverage

Although a variety of coverage trigger theories have been used by various courts, the current trend (for an occurrence policy) seems to be a continuous trigger approach.

Coverage Triggered Continuously From Time of Injury - Causing Event While Damage Progresses

Under this theory, coverage may be triggered at any point from the time of the underlying injury-causing event until the damage is complete, allowing coverage under any policy in effect during this entire time. Some courts have adopted this theory because of the language in the policy providing coverage for “continuous or repeated exposure to conditions”. See, e.g., Montrose Chemical Corp. v. Admiral Ins. Co., 42 Cal. Rptr.2d 324, 10 Cal. 4th 645, 913 P.2d 878 (1995); Gruol Construction Co. v. Insurance Co. of North America, 11 Washington App. 632, 524 P.2d 427 (1974). This approach can conflict with the policy language providing that damage must occur during the policy period.

Coverage Triggered at the Time of Injury-In-Fact

Under this theory, coverage is triggered whenever the damage can be shown in fact to have first occurred, even if it is before the damage became apparent, and the policy in effect at the time of the injury in fact covers all the ensuing damages. Sentinel Ins. Co. v. First Ins. Co. of Hawai'i, LTD, 76 Hawaii 277 875 P.2d 894 (1994); Abex Corp. v. Maryland Cas. Co., 790 F.2d 119 (D.C. Cir. 1986).

Coverage Triggered Continuously From Time of Injury-In-Fact While Damage Progresses

Some courts have found that an injury-in-fact/continuous trigger does not penalize the insured by requiring a manifestation of damage during the policy period nor penalize the insurer by extending coverage from the time of the underlying event when no injury has yet occurred. Of course, this theory will allow the allocation of risk among insurers when more than one policy is in effect during the progressive damage. See Joe Harden Builders Inc. v. Aetna Cas. & Surety Co., 326 S.C. 231, 486 S.E.2d 89 (1997); U.S. Gypsum Co. v. Admiral Ins. Co., 268 Ill. App. 3d 598, 205 Ill. Dec. 619, 643 N.E.2d 1226 (1994).

Conclusion

Although the allegations of individual complaints will vary, the following general observations of coverage may be appropriate.

Negligence causes of action will be covered for allegations of damage to components of the building other than the EIFS system. Depreciation of the building may not be covered, depending upon the particular jurisdiction.

Allegations of breach of express or implied warranties should not be covered.

Allegations of strict liability should be covered for consequential damages to components of the building other than the EIFS system.

Allegations of unfair trade practices involving the deception of consumers generally should not be covered since such allegations necessarily involve intentional conduct. In some jurisdictions, however, courts may require higher standards for denial of coverage, based upon claims that the conduct, although intentional, caused unexpected consequences.

It should be obvious from the preceding discussion that EIFS cases are rife with coverage and trigger of coverage issues. Courts will continue to grapple with methods of determining and allocating risk in this burgeoning area of construction law.

(This article was published in the Federation of Insurance & Corporate Counsel (FICC) Quarterly, Vol. 51, No.2, Winter 2001)