AGC THE CONSTRUCTION ASSOCIATION

2025 Surety Bonding and Construction Risk Management Conference

Times are Tough Now, Just Getting Tougher: Will CGL and Builders Risk Cover Me?

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THIS PAPER WAS WRITTEN IN CONJUNCTION WITH A BREAKOUT SESSION AT AGC'S 2025 SURETY BONDING AND CONSTRUCTION RISK MANAGEMENT CONFERENCE

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About the Authors

Pat Wielinski practices in the areas of construction, insurance coverage and risk management, having been involved with insurance coverage claims for defective workmanship for over 35 years. At the same time, his practice involves commercial general liability, additional insured, builders risk, wrap ups and controlled insurance programs, subcontractor default coverage, design professional, contractors protective professional liability, miscellaneous errors and omissions, environmental, oil and gas, property, directors and officers and other third-party and first-party coverages. Pat regularly lectures to construction, insurance, and legal groups on insurance coverage and risk management issues, having authored numerous publications, many of which are relied upon in the insurance and construction industries.

Travis Brown manages Cokinos | Young's Dallas office and chairs the firm's Insurance Coverage and Risk Management practice group. Travis handles a wide variety of matters that all share the common goal of ensuring that insurers meet their obligations under policies when claims arise. His primary focus is on pursuing coverage and the recovery of wrongfully denied policy benefits on behalf of his clients in the construction industry, whether under builders risk, CGL, commercial property, cyber, or other forms of first-party and liability policies.

Steve Coombs has over 35 years of insurance industry experience, including underwriting, consulting and litigation support. He joined Risk Resources, a risk management and commercial insurance consulting firm, as president in 1992. He has extensive knowledge and experience regarding various aspects of construction insurance and is an author and speaker. Mr. Coombs is a graduate of Western Michigan University with a Bachelor of Business Administration degree. He also holds a Master of Arts degree from DePaul University, with a concentration in risk management and insurance. He earned both Associate in Risk Management (ARM) and Associate in Claims (AIC) certificates from the Insurance Institute of America and a Chartered Property Casualty Underwriter (CPCU) designation. He is also coauthor of *The Builders Risk Book* (IRMI) and *Workers Compensation Guide: Coverage and Financing* (National Underwriting Co.).

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The authors acknowledge the executive editorial assistance of Robert J. MacPherson, a Principal at Cokinos | Young, who has been practicing construction law exclusively since 1981. Robbie is a Fellow of the American College of Construction Lawyers and former Chair of the American Bar Association's Forum on Construction Law. Robbie is admitted to practice in the state and federal courts in New Jersey and New York. In addition to his practice counseling clients on construction matters, he regularly serves as an arbitrator and mediator of construction disputes. He is on the Board of Building For Good and the Building Board of Directors of AGC of New York State. Robbie is a former board member of ACE Mentor (2012-2021), and serves on the ACE/CMiC Alan Berg Scholarship Review Committee. Robbie is a graduate of Brookdale Community College, Monmouth University, and Seton Hall University School of Law. He has taught ADR and Construction Law at Rutgers Law School. Robbie is a published author on construction law and ADR, and has presented programs nationally as Elvis, a Beatle, and other rockers.

Introduction[1]

> *"The uneducated person blames others for their failures; those who have just begun to be instructed blame themselves; those whose learning is complete blame neither others nor themselves."*
>
> –Arrian (from *The Handbook of Epictetus*)

The Stoics would have a hard time apportioning responsibility in today's world of construction defect disputes, wondering ever so stoically "who is to blame?"[2] Owners blame contractors, contractors blame architects and subcontractors, subcontractors blame contractors and sub-subcontractors, contractors blame owners, and on and on and on. Unfortunately, ever changing market conditions and variances in the law across multiple jurisdictions hamper the insured's ability to completely eliminate blame and risks. Various types of insurance products are used to mitigate and shift risks, such as commercial general liability ("CGL") and builders risk ("BR") policies. These policies are used to protect against property damage, construction defects, design defects, and business losses (among others). CGL and BR policies are relied upon by construction insureds for protection against these claims. Recent court cases seem to point to better times where the jurisdictions are more aligned with each other, providing increased clarity for insurers and insureds alike. Much like dominos, state laws restricting coverage have fallen one by one in the last 25 years. One of the last jurisdictional dominos limiting CGL coverage to fall is Illinois, where the Illinois Supreme Court recently held that CGL coverage for construction defects can give rise to an occurrence and property damage, even as to the work itself. At the same time, courts have applied the "LEG 3" exclusion to find coverage for defective work under a BR policy. Despite these gains, construction defect claims remain tough and seem to get tougher. This paper will discuss the pertinent issues surrounding CGL, BR, so called wrap-ups, and the LEG exclusions to BR policies; as well as recent case law updates and some viable means for the construction industry to avoid pitfalls and maximize coverage for these claims.

I. Commercial General Liability Insurance

> *"No man ever steps in the same river twice, for it's not the same river and he's not the same man."*
>
> – Heraclitus

[1] Pat Wielinski, a partner in the DFW office of Cokinos | Young, contributed to the authorship of these materials, which contain excerpts from Pat's book on this topic, *Insurance for Defective Construction Sixth Edition* (2023), published by International Risk Management Institute.

[2] "Stoicism" is a school of thought that flourished in Greek and Roman history of Classical antiquity. It was one of the loftiest and most sublime philosophies in the record of Western civilization. In urging participation in human affairs, Stoics have always believed that the goal of all inquiry is to provide a mode of conduct characterized by tranquility of mind and certainty of moral worth. BRITANNICA ONLINE, https://www.britannica.com/topic/Stoicism.

Overview of CGL Coverage in Construction

CGL insurance is a broad form of liability coverage widely applied to construction claims but not specific to the construction industry. Because CGL policies often overlap with construction-specific coverages like BR insurance—which cover physical damage to the project during construction—disputes frequently arise regarding which policy applies to specific property damage claims.

Common Disputes and Exclusions

CGL coverage disputes in construction often focus on defective work and resulting damage. BR policies typically exclude defective work and design, prompting owners, developers, and contractors to seek coverage under CGL policies. However, insurers argue that such claims are business risks excluded from CGL policies or arise from factors under the insured's control, making them uninsurable. Key points of contention include:

- Whether damage constitutes "property damage" arising out of an "occurrence" under CGL definitions.

- The role of policy exclusions, particularly business risk exclusions, in denying coverage.

Key Policy Provisions

The insuring agreement of the CGL policy obligates the insurer to "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." The damages must be caused by an "occurrence." An occurrence, defined as an accident, incorporates the principle that insurance does not cover intentional or controlled risks. The CGL policy excludes risks covered by other insurance types (e.g., auto, workers' compensation and usually professional liability). Business risk exclusions, particularly those addressing property damage claims, are central to construction-related disputes.[3]

Courts throughout the United States remain divided on whether defective work constitutes an occurrence. Approaches on this topic include the following:

1. Defective work is an occurrence, including coverage for the defective work itself, subject to the exclusions of the CGL policy.

2. Resulting damage to property other than the defective work itself, including other work on the project, is an occurrence.

3. Resulting damage to third party property only, i.e., to ***other than*** the work on the project

[3] The most prominent exclusions are Exclusion (j)(5), the operations exclusion; Exclusion (j)(6), the incorrect work exclusion; Exclusion k, the your product exclusion; Exclusion l, the your work exclusion (including the subcontractor exception); Exclusion m, the impaired property or property not physically injured exclusion, and Exclusion n, the repair of products exclusion. Many of these exclusions actually expand or preserve coverage through exceptions and limitations, but the CGL property exclusions are not the focus of these materials, unless specifically addressed in connection with the occurrence/property damage issue.

itself, is an occurrence.

4. Defective work is not an occurrence.

5. Case law is undecided or unclear.

Beware that pigeonholing each state's approach on coverage for defective work is not an exact science, and often requires judgment calls to be made as to which cases should be included and how they should be categorized. In other words, there is always room for disagreement.

"Property damage" is defined under the standard CGL policy to include, in relevant part:

> **a.** Physical injury to tangible property, including all resulting loss of use of that property, or
>
> **b.** Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

Recent Case Law Remains Split

Pro Coverage: Acuity v. M/I Homes of Chicago (Acuity I)

A recent and eagerly awaited case recognizing defective work as an occurrence is *Acuity v. M/I Homes of Chicago, LLC*, 2023 IL 129087, 234 N.E.3d 97, reh'g denied (Jan. 22, 2024) (hereinafter *Acuity I*). This case involved CGL coverage for construction defects causing water damage to a townhome project. The Illinois Supreme Court clarified the law, aligning with many other state supreme courts, by holding that such property damage constitutes an "occurrence" under Illinois law.

The decision marked a significant shift, as Illinois courts had, for over two decades, interpreted the terms "property damage" and "occurrence" in CGL policies to deny coverage for damage to a construction project in its entirety. Historically, Illinois courts only recognized an occurrence in rare cases, such as damage to unrelated real property, personal property or neighboring structures. This narrow interpretation provided minimal coverage for Illinois insureds and lagged behind the broader approaches in other jurisdictions.

In its ruling, the Illinois Supreme Court emphasized that such a limited view of coverage was unsupported by CGL policy language. It joined the majority of jurisdictions in holding that unexpected and unintended physical injury to tangible property resulting from defective work qualifies as an occurrence under a CGL policy. The court further explained that, once an occurrence is established, the scope of coverage must be determined by analyzing the policy's property damage exclusions.[4]

The court explicitly rejected the argument that property damage from defective workmanship is an uninsurable "business risk" borne solely by the insured contractor. In summary, in contrast to prior Illinois rulings, which narrowly interpreted CGL policies to exclude coverage

[4] See footnote 3.

for construction defects affecting the insured's project, the Illinois Supreme Court's opinion in *Acuity I* significantly broadened the scope of what constitutes "property damage" and an "occurrence." The court ruled that property "altered in appearance, shape, color, or other material dimension" qualifies as "property damage" under a CGL policy, and that "unintended and unexpected harm caused by negligent conduct" meets the definition of an "occurrence," regardless of whether the damage occurred within the insured's scope of work. The decision is widely regarded as a pivotal development for insureds in the construction industry. It brought Illinois into line after at least twenty years of challenge to the prior myopic view of coverage for construction defects. In other words, Illinois insureds can now enjoy the same level of coverage as insureds in other states, transforming unexpected and unintended construction defects from an uninsured business risk into a covered occurrence.

Cornice & Rose v. Acuity (Acuity II)

The *Acuity I* decision effectively overruled prior precedent, including U.S. District Judge Virginia M. Kendall's 2022 ruling in favor of Acuity in *Cornice & Rose Int'l v. Acuity*, 631 F.Supp.3d 551 (Issues cited included a non-compliant elevator, oversized kitchen cabinets, and attic ventilation failures causing rot).

Judge Kendall adhered to Illinois' outmoded interpretation that faulty workmanship only qualifies as an occurrence if it damages property outside the insured's project. This narrow view was rooted in the notion that CGL policies cover unexpected accidents, not contractual disputes arising from poor workmanship. Such claims were unlikely to trigger CGL coverage under prior Illinois law, as courts often viewed defective workmanship affecting the project itself as a business risk of a contractor and outside the scope of an "occurrence." Judge Kendall's 2022 ruling aligned with this precedent. However, *Acuity I* invalidated this restrictive interpretation, emphasizing that unexpected property damage—even within the insured's scope—constitutes property damage from an occurrence. This shift expands potential coverage for design professionals like Cornice, provided exclusions within the policy, such as those for specific property damage or faulty workmanship, do not apply. Following the sea change in Illinois insurance coverage law brought by *Acuity I*, Cornice appealed the trial court's judgment in favor of Acuity in *Cornice & Rose International, LLC v. Acuity, a Mutual Ins. Co.*, No. 23-1152, 2024 WL 4880102 (7th Cir. Nov. 25, 2024) (hereinafter *Acuity II*).

It is little wonder that Acuity sought to cut some of its losses from *Acuity I* in asking the Court to determine that *Acuity I* changed the law and therefore fell outside the presumption of retrospective application of a Supreme Court opinion. The Seventh Circuit flatly rejected that argument, stating "rather than changing the law, [*Acuity I*] reiterated the long-standing principle that contracts are to be interpreted as written" and that, at most, "it clarified Illinois law and abrogated decisions that interpreted insurance policies based on their generic purpose instead of their text." Therefore, the Seventh Circuit held that *Acuity I* did not change the law but rather reaffirmed the principle that contracts must be enforced as written, abrogating prior decisions that

departed from that principle based on vague notions of "policy intent," which were unsupported by the policy text.[5]

Little or No Coverage (Still) in Massachusetts: Lessard v. Havens & Sons Inc.

In *Lessard v. Havens & Sons Inc.*, 104 N.E. 3d 744, 2024 WL 3799483 (Mass. Ct. App. Aug. 14, 2024), the insured homebuilder sought coverage from its CGL insurer for a judgment in excess of $250,000 in damages for construction defects in a home it constructed, including structural defects, as well as defective installation of other elements of the roof and siding. The insurer intervened and sought a declaration that it did not have a duty to indemnify the insured under the policy and the court agreed, holding that CGL policies provide coverage for tort liability for physical damage to others and not for the contractual liability of the insured for economic loss and that replacement or repair of faulty goods and work is a business expense to be borne by the insured contractor in order to satisfy its customers.

The court rejected the argument that the damages were, at least in part, for the cost of repairing property damage that the construction defects caused, not the costs of repairing or removing the construction defects themselves. Specifically, the insured argued that the structural defects caused cracks in the walls and defects in the roof deck and siding, and defects in the roof and siding caused water damage. However, neither the insured nor the homeowners identified any sums to repair the cracks or the water damage.

Massachusetts remains one of a relatively small number of jurisdictions that, contrary to the definition of "property damage" in the CGL policy, limit coverage to only third-party property and deny coverage for damage to the work of the insured.

Admiral Ins. Co. v. Tocci Bldg. Corp.

In *Admiral Ins. Co. v. Tocci Bldg. Corp.*, 120 F.4th 933 (1st Cir. 2024), the insured contractor, Tocci, contracted to serve as construction manager on a residential project. The owner alleged deficient work and supervision on the part of Tocci, including failure to properly install the building envelope due to deficient installation of the primary weather-resistant barrier, and deficient installation and sealing of the windows in all five buildings, as well as numerous other items of faulty workmanship. Admiral, Tocci's CGL carrier, denied coverage, prompting dueling lawsuits in Massachusetts and New Jersey courts.

The Massachusetts district court held that construction defects within the insured's scope of work do not qualify as an occurrence under a CGL policy. While the court acknowledged contrary authority, such as *Cypress Point Condo Assn. v. Adria Towers LLC*, 226 N.J. 403, 143 A.3d 273 (N.J. 2016), that held that subcontracted defective work could be an occurrence, it declined to follow this reasoning. Instead, the court predicted Massachusetts would adopt a narrower view, consistent with earlier precedents like *Weedo v. Stone-E-Brick, Inc.,* 81 N.J.

[5] Acuity filed a petition for rehearing, arguing that the court, rather than granting judgment on the pleadings in favor of Cornice, should have remanded the case to determine whether certain of the "business risk" exclusions applied. The court recenlty denied the petition on the day after Christmas, December 26, 2024.

233, 405 A.2d 788 (1979), and Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know*, 50 NEB. L. REV. 415 (1971). Both of these outmoded authorities have since been discredited as to the 1986 CGL forms by many cases, including *Cypress Point*.

The First Circuit affirmed, but not by addressing whether faulty work could constitute an occurrence. Instead, the court sidestepped the rules of insurance policy interpretation—under which a court must first determine whether the insuring agreement and its definitions (occurrence and property damage) are satisfied—and skipped straight to the exclusions. The court applied Exclusion j.(6), stating that the insurance did not apply to "that particular part of any property that must be restored, repaired or replaced because your work was incorrectly performed on it." Unfortunately, the court undertook an extremely broad reading of "that particular part" as a reference to "the entirety of the project where Tocci was the contractor charged with supervising and managing the project as a whole," and refused to apply other case law that limited the scope of "that particular part" to only the defective portions of the work. In footnote 4, addressing whether a reading of the property damage/occurrence definitions to deny coverage for Tocci's work rendered the "your work" exclusion and its subcontractor exception meaningless surplusage,[6] the court appeared to accept Admiral's position that the exclusions were added as a backstop for use in jurisdictions that had found there was coverage for this type of claim. In other words, it would only be surplusage in jurisdictions that had concluded such damage is not property damage or does not arise from an occurrence. This comment is difficult to square with the district court's opinion, which predicted that Massachusetts was such a jurisdiction.[7] Nevertheless, the court concluded that it need not opine as to whether the your work exclusion and its subcontractor exception were surplusage because the court was applying a different exclusion—j(6).

[6] This was an important argument in the initial shift towards broader CGL coverage for construction defects. Simply stated, the argument is: (a) the your work exclusion excludes coverage for property damage to "your work," which the CGL form defines as work or operations performed by the named insured or on the named insured's behalf; but if property damage to the insured's own work can never be "property damage" from an "occurrence" under the policy's initial insuring agreement, an exclusion for such property damage is superflous, and therefore meaningless, in violation of the principle of contract interpretation that endeavors to give meaning to each provision of the contract; and (b) likewise, the "subcontractor exception" to the your work exclusion preserves coverage if the damaged work or the work out of which the damage arises is performed on the named insured's behalf by a subcontractor; but again, if the CGL form never contemplates coverage in the first place for any damage to an upstream contractor's work, the provision preserving coverage for damage to work performed by a subcontractor has no meaning or purpose. This argument was persuasive to the earlier wave of courts that found CGL coverage for defective construction. *See, e.g., U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871, 887 (Fla. 2007) (holding that "a construction of the insuring agreement that precludeds recovery for damage caused to the completed project by the subcontractor's defective work renders the … subcontractor exception to Exclusion (l) meaningless.").

[7] In *Endurance Am. Ins. Co. v. John Moriarty & Assocs., Inc.*, No. 1:23-CV-12550-JEK, 2024 WL 3849670 (D. Mass. Aug. 16, 2024), the court faced venue and choice of law issues as to Florida versus Massachusetts law. In choosing to apply Massachusetts law and denying the motion to transfer venue, the court noted the difference between restrictive Massachusetts law as opposed to the law of Florida as to coverage for faulty workmanship.

Unfortunately, even though it appeared to the court that the Massachusetts Supreme Judicial Court would eventually adopt the trend toward expanding coverage, it apparently failed to recognize the opportunity to make an *Erie* guess of its own accord.

Contrasts Between Illinois and Massachusetts Cases

Definition of "Occurrence":

- *Acuity I* (Illinois): Recognized that unintended and unexpected property damage resulting from faulty workmanship constitutes an occurrence, even if it occurs within the insured's scope of work. This marked a significant departure from Illinois' historically narrow interpretation.

- *Tocci* (Massachusetts): Rejected the notion that faulty workmanship within the contractor's scope of work constitutes an occurrence, adhering to the traditional, but now rejected, view that such claims are uninsurable business risks.

Scope of Coverage:

- *Acuity I* aligned Illinois with the majority of jurisdictions, emphasizing the plain policy language and broad interpretation of "occurrence" and "property damage."

- *Tocci* reaffirmed Massachusetts' restrictive interpretation, finding that damage to the insured's project is not covered, even when subcontractor work is involved.

Role of Exclusions:

- In *Acuity I*, the Illinois Supreme Court noted that exclusions, such as j(6), must be carefully analyzed to determine coverage after establishing an occurrence. The court left room for nuanced applications of these exclusions based on specific facts.

- In *Tocci*, the First Circuit sidestepped the occurrence issue entirely by relying on Exclusion j(6). It interpreted "that particular part" broadly to encompass the entire project, effectively precluding coverage for most construction defects under a general contractor's policy.

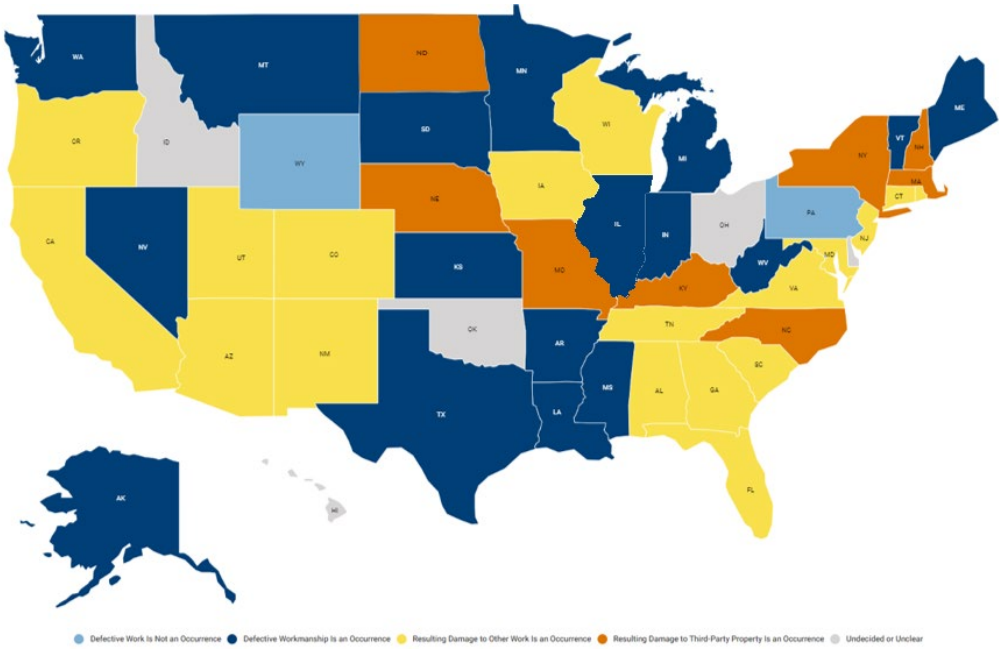
Trend Toward Coverage:

- *Acuity I* represents the ongoing shift toward broader CGL coverage for defective construction, reflecting the majority rule that faulty workmanship resulting in unexpected or unintended property damage is insurable.

- *Tocci* maintains Massachusetts as an outlier jurisdiction, resisting broader interpretations that align with the national trend.

While Illinois has joined jurisdictions favoring coverage for unintended construction defects, Massachusetts remains firmly aligned with the lingering minority view that faulty workmanship is a business risk outside CGL coverage. These contrasting rulings highlight the

persistent state-by-state divergence over whether defective construction qualifies as "property damage" caused by an "occurrence," creating a patchwork landscape for contractors and insurers operating across multiple states, as demonstrated by the map below.



What's Next?

The map above is constantly evolving. For an up to date and deeper discussion of these issues, see Pat Wielinski's soon to be published article, *When and if the Next Domino Will Fall (With a Nod to Van the Man)*, as to the progression of broadened coverage for construction defects across the United States.

II. Wrap-Ups (Controlled Insurance Programs) and Builders Risk Policies and Corporate Insurance: Failed Coordination?

"If a man knows not to which port he sails, no wind is favorable."

–Seneca

Controlled Insurance Programs ("CIPs" or "wrap-ups") are touted as particularly well suited for large construction projects where all eligible participants are insured under one plan. The CIP eliminates multiple carriers and duplicated coverages. However, depending on the entity in control (owner or contractor as "sponsor"), all boats may not be headed in the same direction, because it is the insurer that effectively maintains control. The project must be of sufficient dollar value to be eligible for CIP treatment, the sponsor must be capable of administering the CIP, and coverages must be adequate to apply to claims for the CIP to be effective. Some disadvantages of a CIP are the potential for gaps in coverage (specifically for construction defects), the duration of

the coverage as to the length of the extended completed operations period, and lack of coverage for offsite fabricators and suppliers.

Coordination of the Wrap-Up with Corporate Coverage

At the same time, the participating owner's and contractors' own corporate policies often include a standard wrap-up endorsement that excludes bodily injury and property damage under their respective CGL policies associated with projects covered by a CIP:

> **Exclusion-Designated Operations Covered by a Controlled (Wrap-Up) Insurance Program CG 21 54 12 19**[8]
>
> A. The following exclusion is added to **Paragraph 2. Exclusions** of **Section I – Coverage A – Bodily Injury And Property Damage:**
>
> This insurance does not apply to "bodily injury" or "property damage":
>
> 1. Arising out of either your ongoing operations or operations: or
>
> 2. Included in the "products-completed operations hazard";
>
> at the location(s) described in the Schedule of this endorsement, but only if you are enrolled in a "controlled (wrap-up) insurance program" with respect to "bodily injury" or "property damage" described in Paragraphs **A.1.** and A.2. above at such location(s).
>
> This exclusion applies whether or not the "controlled (wrap-up) insurance program":
>
> **a.** Provides coverage identical to that provided by this Coverage Part;
>
> **b.** Has limits adequate to cover all claims; or
>
> **c.** Remains in effect.
>
> B. The following definition is added to the **Definitions** section:
> "Controlled (wrap-up) insurance program" means a centralized insurance program under which on party has secured either insurance or self-insurance covering some or all of the contractors or subcontractors performing work on one or more specific project(s).
>
> Source: Insurance Services Office, Inc., Exclusion—Designated Operations Covered by a Consolidated (Wrap-Up) Insurance Program (CG 21 54 12 19), Copyright 2018

[8] The original version of this endorsement is CG 21 54 01 96. It was updated in 2019 to include three additional features: (a) the endorsement applies only if "you" are enrolled in a "controlled (wrap-up) insurance program", (b) the exclusion also applies when the "controlled (wrap-up) insurance program" remains in effect, and (c) a definition of"controlled (wrap-up) insurance program" was added.

This is a total exclusion for claims arising from accidents that occur during construction and after construction is completed. This exclusion and similar endorsements can be devastating if a CIP does not cover a particular claim or if the CIP limits are exhausted. For example, if a CIP's limits are exhausted early in the completed operations period, and another claim arises later, a CIP participant will find no coverage available under either the CIP or its own corporate CGL policy if the latter contains the exclusion.

In 2019, ISO updated another endorsement intended to mitigate the broad exclusion contained in CG 21 54 12 19 in that it is intended to preserve coverage under the insured's own CGL policy for the insured's work performed under a wrap-up when the wrap-up policy itself is cancelled, non-renewed or otherwise not available to insured participants. Endorsement CG 21 31 12 19 provides:

> **Limited Exclusion- Designated Operations Covered by a Controlled (Wrap-Up) Insurance Program CG 21 31 12 19**
>
> A. The following exclusion is added to **Paragraph 2.** Exclusions of **Section I – Coverage A – Bodily I jury And Property Damage:**
>
> **1.** This insurance does not apply to "bodily injury" or "property damage":
>
> **a.** Arising out of your ongoing operations; or
>
> **b.** Included in the "products-completed operations hazard";
>
> at the location(s) described in the Schedule of this endorsement, but only if you are enrolled in a "controlled (wrap-up) insurance program" with respect to the "bodily injury" or "property damage" described in Paragraphs **1.a.** and **1.b.** above at such location(s).
>
> **2.** This exclusion applies whether or not the "controlled (wrap-up) insurance program":
>
> **a.** Provides coverage identical to that provided by this Coverage Part; or
>
> **b.** Has limits adequate to cover all claims.
>
> **3.** However, this exclusion does not apply if the "controlled (wrap-up) insurance program" in which you are enrolled with respect to the "bodily injury" or "property damage" described in Paragraph **A.1.** above at the location(s) described in the Schedule of this endorsement has been cancelled, nonrenewed or otherwise no longer applies for reasons other than the exhaustion of all available limits, whether such limits are available on a primary, excess or on any other basis. You must advise us of such cancellation, nonrenewal or termination as soon as practicable.
>
> B. The following definition is added to the **Definitions** section:
> "Controlled (wrap-up) insurance program" means a centralized insurance

program under which on party has secured either insurance or self-insurance covering some or all of the contractors or subcontractors performing work on one or more specific project(s).[9]

Source: Insurance Services Office, Inc., Limited Exclusion—Designated Operations Covered by a Controlled (Wrap-Up) Insurance Program (CG 21 31 12 19), © 2018

Note that CG 21 31 12 19 preserves coverage only if a wrap-up is canceled, nonrenewed, or otherwise no longer applies for reasons other than the exhaustion of all available limits, whether primary, excess, or on any other basis. In other words, it is triggered only under a complete loss of coverage. However, the insured must notify its CGL insurer as soon as practical after knowledge of the coverage loss.

Even with this more limited exclusion, the potential for gaps in coverage still exists. To mitigate these risks, CIP sponsors often seek to endorse their corporate CGL and Excess Liability policies to provide excess/difference-in-conditions (DIC) coverage. Such policies would step in to address gaps caused by CIP limitations, exclusions, or termination, ensuring broader protection for the contractor. Such an endorsement might provide:

Wrap-Up DIC Coverage- Sample Language[10]

With respect to "bodily injury" or "property damage" arising out of either your ongoing operations or operations included within the "products-completed operations hazard" at a location that is covered by a controlled (wrap-up) insurance program, the policy to which this endorsement is attached shall apply as excess insurance over any coverage available under the wrap-up insurance policies.

Wrap-up exclusions may also lead to disputes over additional insured coverage, where higher-tier contractors argue that wrap-up exclusions improperly bar additional insured claims by the upper tier on the lower tier's policies where the wrap does not provide coverage. These disputes underscore the importance of clearly defined responsibilities between the CIP and individual policies.

Builders Risk Exclusions and Other Modifications in CIPs

Navigating gaps between the participant's corporate insurance program and a CIP is not the only coordination issue facing construction insureds. CIPs are designed to consolidate insurance coverage for all eligible participants in a construction project, offering CGL and excess liability insurance for an extended period, usually aligned with the applicable statute of repose.

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[9] Note that "controlled (wrap-up) insurance program" is a defined term in Endorsements CG 21 54 12 19 and CG 21 31 12 19:

Controlled (wrap-up) insurance program means a centralized insurance program under which one party has secured either insurance or self-insurance covering some or all of the contractors or subcontractors performing work on one or more specific project(s).

[10] Wrap-Up Difference-In-Conditions (DIC) Coverage, Construction Risk Management, International Risk Management Institute, Dallas, TX © 2024.

However, wrap-ups commonly include endorsements that eliminate important coverages for property damage during construction operations. Often, these endorsements operate in somewhat counterintuitive (some might say questionable) ways.

Deletion of Key Property Damage Exclusions

Most CIP policies utilize standard CGL forms. Those forms are then endorsed to add provisions to adapt the policy to the CIP platform, such as extending the completed operations period, including all tiers on the project as named insureds, limiting the insured location, etc. Initially, one may have the impression that these types of manuscript endorsements extend coverage for areas that are typically difficult to insure, such as construction defects. However, as with any insurance product, a prospective CIP participant should closely examine the terms of the CGL policy in a contemplated CIP to determine the scope of coverage provided.

One of the most pervasive and troublesome CIP modifications to the customary CGL property damage exclusions is an endorsement that eliminates Exclusions j.(5) and j.(6), the operations and incorrect work exclusions. Those exclusions apply to operations in progress, stating that the insurance does not apply to property damage to "***that particular part***" of real property on which the named insured or its subcontractors are performing operations, if the property damage arises out of those operations, or if the property must be restored, repaired, or replaced because the named insured's work was incorrectly performed on it. The policy also states that Exclusion j.(6) does not apply to property damage within the products-completed operations hazard.

One might be tempted to believe that deletion of these two exclusions is a win for the insured participants and that coverage would be increased. Not so fast! While these two provisions are framed as exclusions, many courts have relied on the "particular part" formulation to narrowly interpret the scope of them. In *Mid-Continent Cas. Co. v. JHP Dev., Inc.,* 557 F.3d 207 (5th Cir. 2009), water damage occurred to a condominium building prior to completion, so Exclusion j.(5) applied only to the "particular part" of the project on which operations were actively occurring at the time of the property damage. In addition, Exclusion j.(6) applied only to property damage to the "particular part" of the property that was defective and not to the damage to non-defective property. Thus, these exclusions are generally regarded as preserving a degree of coverage for property damage exposures during active operations.

Attachment of Replacement Endorsements

Further complicating matters, deletion of these exclusions from the CGL form is usually accompanied by attachment of a considerably more onerous endorsement to the CIP policy, stating that the insurance does not apply to property damage at or to the insured project during the course of construction or operations, up to the substantial completion of the project. This is often a stand-alone endorsement that may be labeled in various ways, such as "Property Damage to Work in Progress," "Course of Construction Endorsement," or even in an arcane manner such as "Property Damage to Contract Works." As often as not, this exclusion is buried in the lengthy endorsement schedule containing numerous revised terms, exclusions, or conditions in order to transform the CGL policy into a CIP policy insuring the eligible tiers on the project over an extended 10-year completed operations period.

Many underwriters refer to this type of provision as the "builders risk exclusion," apparently on the assumption that builders risk insurance, rather than liability insurance, should provide coverage for property damage to the work that occurs during the course of construction. This overly simplistic approach ignores the fact that builders risk policies contain many gaps in coverage versus a standard CGL policy, particularly as to defective construction. The exclusion can thus create a significant gap for participants in a wrap-up project for property damage occurring during the course of operations, depending on their ability to coordinate coverage with their own insurance program.[11]

Some version of a "builders risk exclusion" appears in most CIP CGL and excess liability policies. The original thought process behind this approach was to reduce the cost of CIPs (since builders risk policies are the primary insurance method of insuring accidental damage to buildings and other structures undergoing construction). But builders risk policies, like any form of insurance, contain exclusions and other provisions that eliminate or reduce coverage. In fact, there is a trend for builders risk policies to be more limiting compared to the past. Here are some examples:

- Additional exclusions overall.
- Additional exclusions being moved to a category of exclusions which contains anti-concurrent causation lead-in language.
- Differences in the scope/level of coverage between named insureds and additional insureds.
- "Property excluded" may encompass work that is part of the insured construction project.
- Policy provisions that link coverage to the contract documents (e.g., one must look outside the builders risk policy to the construction contract, for example, to determine coverage).
- Existing property scope or valuation limitations.

Case Law Addressing CIP Course of Conduct (Builders Risk) Exclusions

Courts so far have had little opportunity to interpret the effect of a course of construction exclusion on coverage under a CIP CGL policy. The manuscript exclusion quoted on page 9 is currently before the Eleventh Circuit in *Liberty Surplus Insurance Corp. v. Kaufman Lynn Construction, Inc.*, No. 9:22-cv-80203-DMM (11th Cir.). In that case, the Southern District of Florida granted summary judgment to Liberty Surplus, the CCIP insurer, finding no duty to defend or indemnify the general contractor, Kaufman, or its subcontractor, United Glass Systems. The underlying lawsuit alleged that water infiltrated an office building during a tropical storm due to a subcontractor's defective work, causing damage. *Liberty Surplus Insurance Corp. v. Kaufman Lynn Construction, Inc.*, 658 F.Supp. 3d 1239 (S.D. Fla. 2023). The court relied upon the course of construction exclusion, which was endorsed to the CIP policy. The primary issue was whether a project that was completed in phases was still within the "course of construction" as to damage

[11] For a case outside the wrap-up context that nevertheless demonstrates the interaction of broader coverage under a CGL policy than a more limited builders risk policy, *see Balfour Beatty Constr., LLC v. Liberty Mut. Fire Ins. Co.,* 968 F.3d 504 (5th Cir. 2020).

to occupied buildings that were completed in an earlier phase. Kaufman contended that the endorsement's description of the "insured location" was inaccurate and garbled, failing to distinguish between the completion of separate phases as called for in the construction contract.

The court ignored that argument and applied the dictionary definition of "complete" to determine that the project was still within the course of construction, and not completed, despite the standard definition of the products-completed operations hazard that remained in the policy. That definition provided that the part of the work that was put to its intended use would be regarded as completed. That same issue is before the court in the Eleventh Circuit, and oral arguments were held in mid-December. As of the date of submission, a decision had not been rendered. It should be noted that an amici curiae brief was sponsored and filed by the Associated General Contractors of America, the South Florida Chapter of the AGC, the AGC Florida East Coast Chapter, the National Association of Homebuilders, and the Florida Homebuilders Association in support of Kaufman and the existence of coverage for Kaufman under the CCIP. In addition to the completed operations issue, that brief called into question the overall efficacy of a builders risk/course of construction in a CGL policy issued as part of a wrap.

One must look to Canada for another court case interpreting a course of construction exclusion in a CGL policy issued as part of a wrap up. In *Kelly Panteluk Construction Ltd. v. Lloyd's Underwriters, et al,* 2024 SKCA 42, KPCL was an insured under a CCIP issued by Lloyd's for work on an embankment project at a railroad site. When the project was nearing completion, the embankment collapsed, causing damage to it and other railroad property. Lloyd's denied defense and indemnity for the claim, and in the coverage litigation that followed the court interpreted and applied the following exclusions:

> This Policy does not apply to:
>
> …
>
> 8. damage to or destruction including loss of use of:
>
> …
>
> (c) that particular part of any property:
>
> (i) upon which operations are being performed by or on behalf of the Insured at the time of the damage thereto or destruction thereof, arising out of such operation, or
>
> (ii) out of which any damage or destruction arises, or
>
> (iii) the restoration, repair or replacement of which has been made or is made necessary by reason of faulty workmanship thereon by or on behalf of the Insured;
>
> …
>
> 11. property either forming part of or to form part of the Project Insured. However, this Exclusion shall not apply with respect to such coverage as is afforded under the Completed Operations Hazard and the Products Hazard as defined;

…

ENDORSEMENT NO. 22

This Policy is amended in that Exclusion 8 shall not apply to Property Damage to the principal[`]s existing surrounding property, not forming part of the project works, but no coverage shall be provided for Property Damage to that part of property being worked upon when such Property Damage arises out of such work that is or would normally be considered as being covered by a Builders Risk/Course of Construction Insurance Policy.

Id. at 2.

The court extensively analyzed these three exclusions and affirmed the lower court's summary judgment in favor of Lloyd's. Exclusion 8 is substantially similar to Exclusions j.(5) and j.(6) in the standard ISO CGL form. The court concluded that the exclusion applied to property upon which KPCL was performing operations at the time of the subsidence and that the foundation soils were an integral part of the embankment. In doing so, the court determined that the embankment construction could not be separated into particular parts to limit the scope of the operations exclusion.

At the same time, the court addressed Endorsement No. 22, which exempted the owner's property not forming part of the "project works" from the application of the operations exclusion. Again, as the foundation soils were an integral part of the construction of the embankment, they did not fall into the exception for property not forming part of the project works.

Finally, the court addressed Exclusion 11, the Course of Construction Exclusion, which excluded from coverage property forming a part of, or to form part of, the project insured. Since the embankment collapsed prior to completion, the completed operations hazard and project hazard did not apply. While the court applied the course of construction exclusion, the claim was atypical because coverage would have been excluded anyway under the existing operations exclusion, i.e., the equivalent of Exclusions j.(5) and j.(6). Even had those exclusions been eliminated from the policy, it was a rare instance of a "no harm, no foul" application of the course of construction exclusion, because the "particular part" limitation on the exclusion did not apply due to the unified nature of the embankment project.

However, as to a more typical claim where the work can be divided into discrete "particular parts," the insertion of course of conduct or builders risk exclusions into the CGL wrap-up policy creates serious gaps in coverage versus what the insured participant may be accustomed to under its own corporate policies:

- A builders risk policy is a first-party property policy that does not include a defense obligation for the insurer. Therefore, when the insured looks to the wrap-up CGL policy for defense of a claim involving property damage during construction, it may be excluded.

- Lack of builders risk coverage for certain types of property damage.
- The typical builders risk policy contains exclusions for risks such as consequential damages, soft costs, and faulty workmanship/design that would otherwise be covered under a standard CGL policy.

In order to address these potential pitfalls:

- Contractors should negotiate for the removal or limitation of overly broad builders risk exclusions in CIP policies. Experience indicates that such a deletion or limitation of the endorsement is becoming more difficult to obtain.
- Ensure that any gaps in wrap-up coverage, including exhausted limits or exclusions, are coordinated with their own CGL policies.
- Arrange policies in the insured's corporate program that provide DIC coverage to supplement the wrap-up program.

III. Builders Risk Ensuing Loss Provisions and the LEG Exclusions

"Strikes and gutters, ups and downs."

–The Dude (from *The Big Lebowski*)

It is fair to say that various types of exclusions for faulty work, workmanship, or materials are the exclusions that builders risk insurers most frequently rely on to deny coverage for defective work. The rationale for these exclusions is to keep the insurer from having to pay for rectifying faulty work, as this is considered a risk of doing business. Because the exclusionary language varies from policy-to-policy, it needs to be studied carefully.

Faulty Design, Construction and Materials and Ensuing Loss Provisions

A significant majority of U.S. insurers incorporate an exception to the faulty work exclusion, often referred to as an ensuing loss provision. A typical ensuing loss provision specifies that if the faulty work results in a covered peril, which in turn causes physical loss or damage to the insured project, the cost of repairing the faulty work is excluded, but the resulting damage to other property is covered (provided no other exclusion applies to the ensuing loss or damage). Courts interpret ensuing loss provisions in two ways. Some courts require that the resulting peril be separate and causally distinct from the faulty work.[12] However, because most builders risk

[12] In *Balfour Beatty Constr., LLC v. Liberty Mut. Fire Ins. Co.*, 968 F.3d 504 (5th Cir. 2020), the Fifth Circuit held that an ensuing loss provision is triggered when one (excluded) peril results in a distinct (covered) peril, meaning there must be two separate events for the Exception to trigger, citing *Viking Construction, Inc. v. 777 Residential, LLC*, 210 A.3d 654 (Conn. App. Ct. 2019). In *Balfour*, a subcontractor's welding operation caused falling slag, which damaged the exterior glass of the project. The welding operation was inseparable from the falling slag; they were not two separate events. The falling slag was not an independent event that "resulted in a covered peril." Instead, the falling slag during the welding operation constituted damage, caused by an act of construction or installation to the

policies are written as "all risk" policies, other courts do not require a separate and causally distinct peril.[13] These distinctions are often based on nuanced and seemingly minor differences between the language of the ensuing loss provisions themselves.[14]

For a straightforward application of an ensuing loss provision as to property damage during construction from faulty work, although not strictly speaking a builders risk case, the Southern District of Texas's recent opinion in *Corval Builders & Erectors, Inc. v. Markel Am. Ins. Co.*, No. 4:21-CV-01268, 2024 WL 4354815 (S.D. Tex. Sept. 30, 2024) is instructive. In that case, a pipe fabrication subcontractor procured a property insurance policy that covered its custom-fabricated pipe that would form a part of the general contractor's pipe fabrication and installation project in Corpus Christi, Texas. After a dispute arose over the insured subcontractor's fabrication work, the general contractor subrogated and pursued a claim under the subcontractor's insurance policy. The insurer denied coverage on several bases, which the court quickly rejected before turning to an evaluation of the faulty work exclusion, "Exclusion (f)," and its ensuing loss clause.

Specifically, the policy covered all risks of direct physical loss unless limited or excluded, and Exclusion (f) applied to loss or damage resulting from acts, errors, or omissions in "construction" or "workmanship." Applying plain definitions, the court defined "constructing" as creating by combining parts or elements and "workmanship" as the quality imparted during the creation process. The court quickly concluded that all loss related to the insured's improper assembly or fabrication of the "assembled, fabricated" pipes, taken as a whole, related to the insured's construction or workmanship. The court noted, however, that there was also potentially covered damage to individual pipe components, which the insured did not make. The court noted, however, that Exclusion (f) applied broadly to all loss "which results from" defective work, and determined that the damage to the individual pipe components was also excluded.

The court then turned to the policy's "ensuing-loss" exception to Exclusion (f), which preserved coverage if a defect, error, or omission in construction "results in a covered peril." However, the court noted that all damages to the pipe were the "direct and unmediated result" of defective construction and workmanship, upholding the requirement from *Balfour Beatty* that an ensuing loss provision is "only triggered when one (excluded) peril results in a distinct (covered) peril." As a result, the ensuing-loss provision did not reinstate coverage for the defective pipes or related losses.

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exterior glass. Further, even if the falling slag was separable from the welding operation, it was not a "covered peril." Under the policy, the claim was not covered because it fell within the faulty design/workmanship exclusion in the builders risk policy.

[13] In *Bartram, LLC v. Landmark Am. Ins. Co.*, 864 F.Supp.2d 1229, 1232 (N.D. Fla. 2012), faulty work led to water intrusion, and the water damaged exterior and interior finishes, wood sheathing, framing, drywall ceilings, and stuccoed walls. The policy excluded loss or damage caused by faulty work, but the ensuing loss clause provided that "if loss or damage by a Covered Cause of Loss results, we will pay for that resulting loss or damage." The court held that, under that language, the cost of repairing the faulty workmanship itself was not covered due to the exclusion, but the damage from resulting water intrusion was covered under the ensuing loss clause. The court rejected prior cases that required a break in the causal link between the defective work and the ultimate loss or damage.

[14] The *Bartram* case cited immediately above has a helpful discussion of how these differences in policy language alter the analysis.

The *Corval* case underscores the difficulty in relying on a standard ensuing loss provision to provide coverage for defective work. Depending on the language of the provision, the state's law that applies, and the specific facts of the loss, there may or may not be coverage for property damage from defective work. As *Corval* further underscores, this includes states (like Texas) that have long upheld coverage for defective construction under a CGL policy. As can be seen, a builders risk policy with an ensuing loss provision typically does not provide the same level of coverage for defective construction as a CGL policy. Because of the uncertainty of coverage under this type of ensuing loss clause, and the significant variation among states in interpreting these clauses, there has been considerable interest in LEG clauses by insurance buyers. LEG clauses are thought to provide greater consistency and certainty.

The London Engineering Group (LEG) Clauses

LEG ensuing loss clauses have received increasing attention. Originally a creature of European underwriters, they have now begun to appear more frequently in U.S. builders risk policies. The clauses are promulgated by a consultative body for insurers of engineering risks that provides a forum for discussion and education. LEG has produced three ensuing loss clauses that provide varying degrees of protection for insurers for property damage resulting from construction/design defects.

1. LEG 1/96: "Outright" Defects Exclusion

    - Text of the Provision: Insurers are not liable for any loss or damage caused by defective materials, workmanship, design, plans, or specifications.

    - Impact: This is the strictest exclusion, denying coverage for both the defective work itself and any resulting damage.

2. LEG 2/96: "Consequences" Defects Exclusion

    - Text of the Provision: The Insurer(s) shall not be liable for: All costs rendered necessary by defects of material workmanship, design, plan, or specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage. For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.

    - Impact: This clause aligns closely with traditional ensuing loss provisions, covering broader damage while excluding only the costs directly related to fixing the defect itself.

3. LEG 3/06: "Improvement" Defects Exclusion

- Text of the Provision: The Insurer(s) shall not be liable for: All costs rendered necessary by defects of material workmanship design plan specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification. For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.

- Impact: This is the most comprehensive (and opaque) coverage option, with the exclusion limited to betterment costs—expenses incurred to enhance or upgrade the original work.

Understanding these clauses is crucial for contractors and property owners managing construction risks. Policies with broader LEG 2 or LEG 3 provisions offer better protection for unexpected losses while containing manageable exclusions. Conversely, LEG 1 clauses significantly limit recovery and may require supplementary insurance to address potential gaps.[15] By carefully reviewing the terms and advocating for balanced provisions, insured parties can better safeguard against financial exposure. Recent court struggles addressing LEG 2 and LEG 3 claims are discussed below.[16]

LEG Cases: Drawing Lines Between Faulty and Non-Faulty Work

A central challenge for courts addressing LEG clauses is defining when parts of the work are distinct versus when they are components of the same "thing." For example, in the *Acciona* case discussed below, the court separated the defective formwork from the damaged slabs and rebar, interpreting them as distinct elements for coverage purposes. This distinction, while conceptually clear to the court, introduces significant ambiguity, as no precise legal framework exists for consistently determining when parts are separate.

Given such ambiguity, courts often interpret exclusions in favor of the insured, as was the case in all of the cases discussed below. This outcome highlights the insurer's difficulty in drafting exclusion clauses that adequately avoid the scope of resulting damage claims while maintaining clarity. The court's interpretation effectively limited the exclusion to costs directly arising from correcting the defective formwork itself, not the damages caused by its failure.

A. *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Ins. Co.*, 2014 BCSC 1568 ¶¶ 133-153 (Can. B.C.).

In this LEG2 case, over-deflection in concrete floor slabs led to significant damage, including harm to the reinforcing bars, floor cracking, and a sloped surface requiring extensive sanding. These issues resulted in costs totaling $14 million. The court concluded that the cracking and over-deflection of the concrete slabs constituted "damage," which was caused by improper

[15] The use of LEG 1 in the U.S. and around the world is rare.
[16] The three LEG clauses, as well as other provisions, are available by accessing the London Engineering Group's website at https://www.londonengineeringgroup.com/

formwork and shoring/reshoring procedures. The insurer contended that all of the damage constituted a clear example of poor workmanship, excluded from policy coverage. However, both the trial court and court of appeal found otherwise, determining that the policy did cover these costs.

In doing so, the courts differentiated between the "defect in material workmanship"—defective formwork and wedging that caused the damage—and the rebar and concrete slabs themselves, which were ultimately harmed. After an exhaustive analysis of the intent and purpose and interpretation of the LEG2/96 clause, the Supreme Court of British Columbia concluded, "applying the [LEG2/96 clause], the excluded costs are those that would have remedied the defect before the cracking and over-deflections occurred, i.e. the costs of implementing proper formwork and shoring/reshoring procedures." Because there was no evidence to quantify these costs beyond that they were minimal, the court did not apply this exclusion to any part of the claim. They concluded that the exclusion clause was intended to preclude coverage for defects in workmanship but still allowed for coverage when one component (here, the formwork) caused damage to another part of the project (the slabs and rebar). This aligns with the principle of "resulting damage," where the faulty execution of one element damages another otherwise functional component. However, the court denied coverage for over $4,000,000.00 in subcontractor "impact costs" attributable to overcrowding, overtime, and subcontractor loss of productivity in having to work out of sequence and under less desirable working conditions than originally promised immediately following the slab repairs. The court's reasoning was that these were consequential rather than "direct losses to the property insured," and therefore fell outside the policy's initial grant of coverage.

The case underscores two key issues:

1. Challenges with Exclusions

    - The insurer attempted to sidestep the "resulting damage" principle with a specially worded exclusion. However, the courts interpreted this narrowly, effectively limiting its scope to costs for correcting the initial defect. Insurers may need to reconsider whether such exclusions are practical or if they create more disputes than they resolve. A broader exclusion or adjusted pricing may be a more effective strategy.

2. Subcontractor Costs and Coverage Gaps

    - The lack of coverage for the subcontractors' costs underscores the potential inadequacy of builders risk coverage to cover losses and damages arising from defective work, even with a broader LEG2 or LEG3 faulty work exclusion in place. Insured contractors should carefully evaluate a proposed policy's "Valuation" provision or purchase an additional "Increased Cost of Construction" coverage-extension to ensure that increased construction costs that flow directly from property damage from defective work are covered, particularly if CGL coverage will be unavailable because of a "builders risk exclusion" in the CGL policy, as discussed above.

- Additionally, moving forward contractors may be able to mitigate some of these issue by securing insurer approval for remedial work or ensuring that their policies explicitly address whether subcontractor repairs are covered.

B. *S. Capitol Bridgebuilders v. Lexington Ins. Co.*, No. 21-CV-1436 (RCL), 2023 WL 6388974, at *1 (D.D.C. Sept. 29, 2023).

In *S. Capitol Bridgebuilders v. Lexington Insurance Co.* (*SCB*), the U.S. District Court for the District of Columbia, applying Illinois law, ruled against the insurer. The case involved a dispute over coverage under a LEG 3 Defect Extension clause within a builders risk policy. The court found the LEG 3 clause ambiguous, interpreting it in favor of *SCB*, the insured contractor. This interpretation was later mirrored in the *Archer Western v. Ace American Insurance Co.*, case discussed below, which reached a similar conclusion.

As noted, the LEG 3 Defect Extension offers the broadest coverage of the three LEG clauses. Until this case, there was little authoritative guidance on its interpretation within U.S. courts. There, the general contractor SCB was constructing a bridge incorporating concrete substructures and steel arches when honeycombing (porosity in the concrete) was discovered after the removal of formwork. This defect reduced the weight-bearing capacity of key structural components, including abutments and piers. SCB filed a claim under its builders risk policy with Lexington Insurance, but the insurer denied coverage on the following grounds:

1. No Direct Physical Damage: Lexington argued that the honeycombed components were defective from the outset and not subject to an external event that constituted physical damage.

2. LEG 3 Defect Extension Exclusion: Lexington claimed the honeycombing fell under the LEG 3 exclusion, asserting that repairs addressed defects in workmanship and did not constitute "damage."

The court rejected Lexington's arguments and ruled in favor of *SCB*, determining that the LEG 3 clause was ambiguous.

Key Findings

1. Definition of Damage:

   - The court defined "damage" as any detrimental change to insured property. It concluded that the honeycombing, which visibly reduced the bridge's structural integrity, qualified as damage. By referencing dictionary definitions, including Black's Law Dictionary, the court interpreted damage broadly as "loss or injury" or "any bad effect."

2. Ambiguity in LEG 3 Clause:

   - The LEG 3 Defect Extension clause was deemed "egregiously ambiguous" due to convoluted language, inconsistent terminology, and drafting errors.

The court noted that the clause was susceptible to multiple reasonable interpretations. SCB argued that repairs brought the structure up to contractual standards rather than "improving" it, a position the court found plausible.

3. Policy Construction:

    - Under Illinois law, ambiguous clauses in insurance policies are interpreted against the insurer. The court ruled that the LEG 3 clause did not preclude coverage for SCB's claim and found Lexington liable for breaching the builders risk policy.

Comparison to *Acciona*

In *Acciona*, the courts similarly grappled with ambiguous language in builders risk policies and the interpretation of defect exclusions. However, there are key differences:

1. Nature of Defects:

    - *Acciona* involved damage resulting from defective formwork and over-deflection, which harmed other components (e.g., rebar and concrete). The court found coverage based on the principle of resulting damage.

    - In *SCB*, the defect (honeycombing) directly reduced the integrity of the same component (abutments and piers) without causing damage to unrelated parts. Recall, however, that *SCB* is a LEG 3 case, whereas *Acciona* was LEG 2. It is uncertain the damage in *SCB* would have been covered under a LEG2 clause absent resulting property damage beyond the defects themselves.

2. Ambiguity and Interpretation:

    - Both cases highlighted ambiguity in policy exclusions, with courts favoring the insured in the absence of clear language. In *SCB*, the LEG 3 clause's complexity became the central issue, while the analysis *Acciona* focused on interpreting whether the exclusion intended to cover resulting damage.

3. Broader Implications:

    - In both cases, the courts emphasized the need for insurers to draft clear exclusions. Ambiguity in LEG clauses and ensuing loss provisions has led to judicial interpretations favoring broader coverage.

    - The *SCB* ruling may prompt insurers to reconsider the structure and clarity of LEG exclusions, especially LEG 3, given its increasing use in complex projects.

C. *Archer Western-De Moya Joint Venture v. Ace Am. Ins. Co.*, 713 F. Supp. 3d 1260 (S.D. Fla. 2024).

A significant question following the *SCB* decision was whether the decision would remain an anomaly or set a precedent influencing future cases. The judgment in *Archer Western–De Moya*

Joint Venture v. Ace American Insurance Co. suggests the latter, as it adopts a detailed and expansive analysis of issues central to the builders risk market. Although *Archer* involved only a denial of summary judgment, the court's extensive 66-page opinion provides valuable insights, reinforcing *SCB's* broader implications for insurers and policyholders.

Like *SCB*, *Archer* concerned a builders risk claim involving defects in concrete used in bridge construction. In both cases, disputes arose over whether the insured property had sustained "damage" to trigger coverage or whether the defects rendered the property merely "unsatisfactory" and thus excluded under the policy. The *Archer* policy included a LEG 3 defects exclusion, and disagreements centered on interpreting its provisions, particularly regarding what constitutes "improvements" under LEG 3.

In *Archer*, the policyholder discovered that the concrete had insufficient compressive strength due to excessive fly ash in the mix. The insurer denied coverage, asserting that the concrete was defective from the start and therefore not "damaged." The court had to address two key questions:

1. Did the Insured Property Suffer Damage?
    - The *Archer* court defined "damage" as requiring a tangible alteration to the insured property. This aligns with the *SCB* court's analysis, which emphasized a physical change affecting the value or utility of the property, but *Archer* drew more heavily on prior case law.
    - Policyholder Argument: The excessive fly ash altered the cement, impairing its physical condition, value, and usefulness. The insured began with a material of a certain value that became compromised.
    - Insurer Argument: The concrete was inherently defective upon creation. Since no subsequent tangible alteration occurred, the property did not suffer "damage" as defined.
    - Court Analysis: The relevant property is the concrete—not the cement—since the claim sought coverage for repairing the concrete. This distinction mirrors *SCB*, where the court viewed damage holistically, focusing on the functional impact on insured property.
2. Is LEG 3 Ambiguous?
    - As in *SCB*, the court in *Archer* found ambiguity in whether LEG 3 acts as an exclusion or an extension of coverage. The policyholder argued it serves both functions, and the court agreed, noting that LEG 3 broadens coverage compared to the narrower exclusions it replaced.
    - The court also found ambiguity in the interpretation of "improvements." It reiterated *SCB's* conclusion that LEG 3's language left room for competing reasonable interpretations, construing this ambiguity against the insurer.

Comparison to *SCB*

1. Definition of Damage:
    - Both courts recognized ambiguity in defining "damage" due to the absence of a policy definition. However:
        - *SCB* relied primarily on dictionary definitions, concluding that reduced structural capacity due to honeycombing constituted damage.
        - *Archer* applied case law, emphasizing tangible alteration while addressing material interactions (cement vs. concrete). *Archer's* approach suggests a slight evolution toward a more nuanced framework for assessing physical changes in insured property.
2. Ambiguity in LEG 3:
    - Both cases highlighted LEG 3's duality as an exclusion and potential extension, finding the clause poorly drafted and inherently ambiguous. The courts similarly construed ambiguity in favor of coverage, reinforcing the insured's arguments.
3. Practical Implications:
    - *SCB* set the stage by raising questions about LEG 3's interpretation, potentially unsettling insurers.
    - *Archer* elaborated on those themes, providing a more detailed analysis and reaffirming *SCB's* precedent in treating LEG 3 as ambiguous.

The *Archer* decision confirms that *SCB* was not an isolated case. Together, these rulings send a clear message to insurers: ambiguities in policy language, especially in defect exclusions like LEG 3, will be resolved against the drafter.

The *Archer* court's detailed opinion builds on *SCB's* foundation, signaling a shift in U.S. builders risk jurisprudence. Both cases underscore the need for clear policy language and the judiciary's willingness to interpret ambiguities in favor of insured parties. As a result, the builders risk market is likely to see increased litigation and a demand for clearer guidance on the interpretation of LEG exclusions.

Impact of LEG Cases on the Insurance Industry

The LEG cases have caused an uproar in Europe because of how "damage" is interpreted in the U.S. LEG cases versus Europe. In Europe, "damage" is largely considered to be an adverse change in physical condition. English cases have drawn a distinction between "damaged" property and property that is merely defective when it is created. There is consensus with English experts that if the LEG cases were brought in Europe the results would be totally different and favorable to insurers.

Likewise, U.S. builders risk underwriters were surprised with the outcomes of the LEG 3 cases and are taking various actions to limit their exposure to future claims.

Some impacts on the insurance industry are:

- The London Engineering Group will ultimately revise LEG 2 and LEG 3 wordings to redefine "damage."
- U.S. insurers are rewriting those endorsements that have "LEG" in the title, but contain wordings different other than the London Engineering Group endorsements.
- U.S. insurers are drafting new endorsements that have some of the attributes of LEG wordings, but contain other provisions, including a requirement for damage to be caused by a resulting peril.
- U.S. insurers are largely reducing the availability of LEG 3 endorsements until they get a better handle on current court interpretations and how these impact the future.
- Those insurers that continue to make LEG 3 available are charging higher premiums and imposing higher deductibles. Still other are instituting sublimits instead of full policy limits.

Analysis of "Damage" or "Loss"

In all three cases, a key question was whether the issue at hand constituted "damage" or "loss" to the insured property. In *Archer*, the court grappled with whether defective work (i.e., concrete with excessive fly ash) amounted to "damage" under the builders risk policy. Just as in *Corval*, discussed above, the court questioned whether the defect in the fabricated pipes was sufficient to trigger coverage. Both courts examined the physical condition of the property and whether it had been altered in a way that would impair its value or usefulness, aligning the cases in their approach to defining "damage."

Defective Work

Both *Archer* and *Corval* involved claims arising from defective work, with the courts focusing on whether the defects (in concrete and pipes, respectively) were covered. In both instances, the court ultimately concluded that defects tied to construction and workmanship were excluded from coverage, reinforcing the concept that such defects fall outside the scope of standard property insurance.

The most significant difference lies in the nature of the policies involved. In *Archer*, the case was focused on builders risk insurance, specifically concerning construction defects and their coverage under a complex exclusion clause (LEG 3). In *Corval*, the issue was framed within the context of a general commercial property insurance policy and its exclusion for damages related to "construction" and "workmanship." The distinct contexts of builders risk versus commercial property insurance create a divergence in how the courts interpret coverage, though both hinge on exclusions for defective workmanship.

In *Archer*, there was a focus on the ambiguity of LEG 3 (defining whether it was an exclusion or extension), with the court finding it somewhat unclear but ultimately leaning toward a broad interpretation of the policy exclusion. Conversely, the court in *Corval* applied a more straightforward interpretation of Exclusion (f), using plain language definitions for "construction" and "workmanship," and found that the exclusion was unambiguous and applied to the defective pipes. This suggests that while exclusions may raise similar issues across cases, the level of ambiguity and interpretation varies.

In *SCB* and *Archer*, the courts involved deeper exploration of whether the damage could be classified as triggering coverage, particularly given the complexity of the construction processes involved. In contrast, the court in *Corval* reached a conclusion more quickly, with the court relying on the direct application of policy language to exclude coverage for defects in construction and workmanship. The *Corval* court's approach seemed more formulaic, while *Archer* presented a more nuanced discussion of policy wording and its broader impact on the builders risk market.

Overall, the core issue in all three cases revolves around the interpretation of exclusions for defective work, though the specifics of the policies and the courts' approaches differ. The Texas case reinforces the trend of insurers seeking broad application of exclusions to avoid liability for construction defects, a theme present in both *Archer* and *SCB*.

Conclusion

The recent cases examining CGL and builders risk insurance policies reveal a complex and evolving landscape of coverage interpretation, particularly regarding construction defects and property damage. Courts across different jurisdictions have demonstrated varying approaches to defining "occurrence" and "property damage," with some jurisdictions like Illinois (in *M/I Homes*) moving towards broader coverage interpretations that recognize unintended construction defects as potentially insurable, while others like Massachusetts (in *Tocci*) maintain more restrictive views. Much like the Stoic philosophers who emphasized understanding the inherent nature of things, these judicial interpretations seek to uncover the true essence of insurance contracts—recognizing that unexpected events and unintended consequences are part of the natural order of complex human endeavors.

The analysis of LEG clauses, particularly in cases like *SCB* and *Archer*, highlights the critical importance of precise policy language and the judiciary's tendency to resolve ambiguities in favor of the insured. These rulings underscore the challenges insurers face in drafting clear exclusions, especially for complex construction projects where defects can manifest in nuanced and interconnected ways. The courts have consistently emphasized that vague or overly broad exclusions may be interpreted against the insurance provider, potentially expanding coverage beyond traditional interpretations. In a manner reminiscent of Stoic wisdom, which advocates for clear reasoning and acceptance of what cannot be controlled, these rulings underscore the challenges insurers face in drafting clear exclusions, especially for complex construction projects where defects can manifest in nuanced and interconnected ways.

Moving forward, these cases signal a significant shift in builders risk and CGL insurance jurisprudence, suggesting that insurers will need to draft more precise policy language and carefully consider the scope of their exclusions. The trend indicates a growing judicial willingness

to provide coverage for unintended and unexpected property damage, even when such damage occurs within the insured's scope of work. Contractors and insurers alike must remain vigilant in understanding these evolving interpretations, as the landscape of construction insurance continues to adapt to increasingly complex project risks and legal scrutiny. The trend indicates a growing judicial willingness to provide coverage for unintended and unexpected property damage, reflecting a broader understanding that, as the Stoics would argue, resilience and adaptability are key to navigating the unpredictable nature of human enterprise.