

NEWSLETTERS

Listen To What The Insurance Policy Says: Construing Commercial General Liability Exclusions Without Preconceptions

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Barnes & Thornburg Construction Law Update, December 2017

Insurance companies have long contended that commercial general liability (CGL) policies do not cover property damage involving alleged deficient workmanship by the insured. In a number of early cases, courts held that deficient workmanship cannot be an accident within the meaning of an “occurrence,” reasoning that, whatever a CGL policy actually says, it is not intended to function as a business risk policy. As the trend has moved decisively toward treating deficient workmanship as an occurrence that can trigger coverage of resulting property damage, insurers have retreated to a backup position – that any loss arising out of deficient workmanship falls within the scope of one or more exclusions in the standard CGL policy. The recent decision by the Fourth Appellate District of the California Court of Appeal in *Global Modular, Inc. v. Kadena Pacific, Inc.*, 2017 Cal. App. LEXIS 778 highlights the movement toward narrowly construing the precise text of those exclusions in favor of coverage.

Global Modular arose out of a dispute of over water intrusion damages to structures that were not sufficiently protected from the weather. The U.S. Department of Veterans Affairs hired Kadena Pacific, Inc. as general contractor on a project to build a rehabilitation center in Menlo Park, California. The rehabilitation center would be comprised of 53 modular units, which would be built, delivered and installed by subcontractor Global Modular, Inc.. Because a different subcontractor was hired to install the roofing for the units, Global agreed to deliver the units covered by sheets of plywood and plastic tarps.

After the units were delivered and installed, but before the roofing was available, the rainy season began. The combination of plywood and tarps was unable to keep the rainwater out of the interior parts of the units, which sustained considerable water damage as a result. Eventually, the relationship between Global and Kadena broke down, the parties terminated their contract, and Kadena undertook the task of remediating the water damage. Kadena later filed a lawsuit against Global in connection with the water intrusion damages. The matter went to trial, and the jury found that Global was liable for more than \$1 million in damages related to water intrusion. Global’s CGL insurer, North American Capacity Insurance Company (NAC), filed a lawsuit seeking a declaration that Kadena’s damages were excluded under its policy. The trial court found that Kadena’s damages were not excluded, and NAC appealed.

The coverage litigation centered on two exclusionary clauses under the

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“Damage to Property” exclusion found in standard CGL policies, j(5) and j(6). Those exclusions apply to 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.

With respect to exclusion j(5), NAC argued it applies to any property damage that occurs before the insured’s work is completed. According to NAC, because the water intrusion damage happened before the work was completed, the exclusion applied. Kadena countered that the exclusion only applies where a specific part of the property is damaged while the insured is physically working on that part. Because Global was not physically working on the interior of the units when they were damaged, exclusion j(5) did not apply. The Court of Appeal agreed with Kadena, holding that “[w]e find it telling exclusion j(5) employs a much more narrow construction [than asserted by NAC], restricting the excluded damage to only that *particular part on which the insureds are performing operations*” (emphasis original).

Similarly, the court found that exclusion j(6) “applies only to the particular *component* of the insured’s work that was incorrectly performed and not to the insured’s entire project.” Because the “incorrect” work performed by Global was the plywood substrate, and not the damaged interior parts of the units, the exclusion did not apply to the property damage.

The court brushed back NAC’s argument that the policy does not cover business risks and therefore only covers damage to third-party property. “The problem with NAC’s argument is that it is based on its view of the underlying policy of commercial general liability insurance and not on an application of the policy language to the facts of the case.” The court pointed out that “the insuring clause makes no distinction between insured and third-party property,” and the exclusions at issue make no such distinction, either.

Global Modular represents an important win in a leading jurisdiction, as it signals courts are increasingly prepared to interpret coverage under CGL policies based on what those policies actually say, and not on preconceived notions of what they should or should not cover.

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