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Nina R. Mack

Richardson, Plowden, Grier & Howser (Columbia, SC)

Francis M. Mack

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CONSTRUCTION CLAIMS UNDER THE COMPREHENSIVE GENERAL LIABILITY POLICY

NINA REID MACK*
FRANCIS M. MACK**

I. INTRODUCTION

Construction litigation often prompts an inquiry into the scope of insurance coverage. A defending contractor may look to its comprehensive general liability (CGL) policy for coverage of claims involving personal injury, property damage, breach of warranty, faulty workmanship, or loss of use or diminution in the value of a building or structure.

Litigation over property damage claims has given rise to a large body of case law interpreting and defining certain provisions of the CGL policy.¹ One of the most litigated claims in this area is the allegation of faulty or defective workmanship. An increasing majority of jurisdictions now hold that the CGL policy does not indemnify insureds for the cost of correcting or replacing their own work product. The rationale behind this view is that the consequences of poor workmanship should be a business expense on the part of the insured contractors. CGL coverage, on the other hand, is designed to protect against personal injury or damage to property other than the insured's own work product.² A minority of jurisdictions hold that the CGL policy is

* Associate, Richardson, Plowden, Grier & Howser, Columbia, S.C. B.A., 1972, Mary Baldwin College; J.D., 1975, University of South Carolina School of Law.

** Partner, Richardson, Plowden, Grier & Howser, Columbia, S.C. B.S., 1970, University of South Carolina; M.E., 1974, University of South Carolina; J.D., 1982, University of South Carolina School of Law.

1. Personal injury claims are included within the coverage of a CGL policy. See *Heyward v. American Casualty Co.*, 129 F. Supp. 4 (E.D.S.C. 1955).

2. See *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979); Henderson, *Insurance Protection for Products Liability and Completed Operations - What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 418 (1971); Tinker, *Comprehensive General Liability Insurance - Perspective and Overview*, 25 FED'N INS. COUNS. Q. 217, 218-21 (1975).

ambiguous as to coverage of breach of warranty claims, and therefore, claims for breach of an insured's warranty of good workmanship are covered.³

II. MAJORITY VIEW: FAULTY WORKMANSHIP CLAIMS EXCLUDED

The leading case espousing the majority view is *Weedo v. Stone-E-Brick, Inc.*,⁴ a New Jersey Supreme Court decision. The *Weedo* court was confronted with a common situation in construction litigation — that of a dissatisfied property owner complaining of unworkmanlike performance of a construction contract.

In *Weedo* the owner alleged that a masonry contractor breached its contract due to faulty workmanship. The owner sought recovery of costs in connection with the repair or replacement of the defective construction. The masonry contractor requested its CGL insurer to take over the defense and provide indemnification with regard to the complaint. The New Jersey Supreme Court held, however, that the CGL policy did not indemnify the insured against damages in an action for breach of contract and faulty workmanship when the damages sought were for the cost of correcting and replacing the insured's own work product.⁵ The Court concluded that the CGL policy "does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident."⁶ To distinguish between excluded business risks and included accidents, the court offered the following example:

When a craftsman applies stucco to an exterior wall of a home in a faulty manner and discoloration, peeling and chipping result, the poorly-performed work will perforce have to be replaced or repaired by the tradesman or by a surety. On the other hand, should the stucco peel and fall from the wall, and thereby cause injury to the homeowner or his neighbor standing below or to a passing automobile, an occurrence of harm arises which is the proper subject of risk-sharing as provided by the type of policy before us in this case. The happenstance

3. See, e.g., *Federal Ins. Co. v. P.A.T. Homes, Inc.*, 113 Ariz. 136, 547 P.2d 1050 (1976); *Worsham Constr. Co. v. Reliance Ins. Co.*, 687 P.2d 988 (Colo. Ct. App. 1984).

4. 81 N.J. 233, 405 A.2d 788 (1979).

5. See *id.*

6. *Id.* at 249, 405 A.2d at 796.

and extent of the latter liability is entirely unpredictable — the neighbor could suffer a scratched arm or a fatal blow to the skull from the peeling stonework. Whether the liability of the businessman is predicated upon warranty theory or, preferably and more accurately, upon tort concepts, injury to persons and damage to other property constitute the risks intended to be covered under the CGL.⁷

The exclusion of poor workmanship claims from CGL coverage is supported by the rationale that the contrary result would enable a contractor to receive initial payment for his work from the property owner and then be indemnified by his insurer for the cost of repairing or replacing his own work. Many courts are reluctant to encourage such disincentives to workmanlike performance.⁸ Moreover, the CGL policy does not purport to serve the purpose of a builder's performance bond,⁹ which shifts the risk of poor performance away from the owner but not away from the contractor.¹⁰

The CGL exclusion of liability for business risks is found primarily in the so-called "business risk" or "work product" exclusions, which in the standard CGL policy reads as follows:

This [insurance] does not apply . . .

(n) to property damage to the named insured's products arising out of such products or any part of such products;

(o) to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.¹¹

An analysis of coverage should begin with the question: "What is the insured's work product?" From this perspective,

7. See, e.g., *Weedo* at 240-41, 405 A.2d at 791-92.

8. See, e.g., *G.L. Shaw Builders, Inc. v. State Auto Mut. Ins. Co.*, 182 Ga. App. 220, 355 S.E.2d 130 (1987); *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229 (Minn. 1986).

9. See *Consumers Constr. Co. v. American Motorists Ins. Co.*, 118 Ill. App. 2d 441, 451, 254 N.E.2d 265, 270 (1969); *Nationwide Mut. Ins. Co. v. Wenger*, 222 Va. 263, 269, 278 S.E.2d 874, 877 (1981).

10. See *Knutson Constr. Co.*, 396 N.W.2d at 234.

11. See *Tinker*, *supra* note 2, app. B at 301, 303 (emphasis omitted). These are the standard exclusions in the CGL policy as revised, effective January 1, 1973. These exclusions appeared as exclusions "(1)" and "(m)" in earlier versions of the policy. See *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 241 n.3, 405 A.2d 788, 792 n.3 (1979).

many of the cases that determine that CGL coverage is available can be harmonized with the majority position. For example, in *Frankel v. J. Watson Co.*,¹² a property owner contracted with an insured contractor to move an old farmhouse to an alternate site and to construct a new concrete foundation. The property owner alleged that the insured contractor's negligent construction of the building's foundation caused damage to the superstructure of his building. The owner further alleged that the superstructure was substantially intact when lowered onto the new foundation constructed by the insured. Shortly thereafter, according to the owner, the superstructure began to sag, causing extensive damage. The court held that the CGL policy provisions covered the damage because the superstructure was *not* the insured's work product. The court pointed to the distinction between defects in the insured's work product (the foundation) and damage to larger units of which the insured's work product is but a component (the entire structure).¹³

This distinction between "work product" and "other property" is clearly illustrated by a comparison of a general contractor's CGL coverage and the CGL coverage afforded a subcontractor. The general contractor's work product is the building itself; the subcontractor's or supplier's work product is the component part that he constructed or furnished.¹⁴ The Indiana Su-

12. 21 Mass. App. Ct. 43, 484 N.E.2d 104 (1985). See also *Simons v. Great Southwest Fire Ins. Co.*, 569 F. Supp. 1429 (E.D. Mo. 1983) (coverage denied because defective roofing system installed by insured was considered to be work product), *aff'd*, 734 F.2d 1318 (8th Cir. 1984); *Indiana Ins. Co. v. DeZutti*, 408 N.E.2d 1275 (Ind. 1980) (explaining that some cases construing pre-1966 policies found the exclusion did not apply to the insured's entire product and excluded only coverage for damages to the defective part out of which the loss arose).

13. *Frankel*, 21 Mass. App. Ct. at ___, 484 N.E.2d at 106.

14. See *Indiana Ins. Co. v. DeZutti*, 408 N.E.2d 1275 (Ind. 1980); *B.A. Green Constr. Co. v. Liberty Mut. Ins. Co.*, 213 Kan. 393, 517 P.2d 563 (1973) (policy did not include building because it was contractor's work product); see also *Simons v. Great Southwest Fire Ins. Co.*, 569 F. Supp. 1429 (E.D. Mo. 1983) (damage to roof not covered by insurance because roof was considered insured's work product), *aff'd*, 734 F.2d 1318 (8th Cir. 1984); *Western Employers Ins. Co. v. Arciero & Sons*, 146 Cal. App. 3d 1027, 194 Cal. Rptr. 638 (1983) (damage to retaining wall and condominiums was excluded from coverage because it was part of general contractor's "work product"). Some courts, construing CGL policy language prior to the 1966 revision, did not consider products as a whole but as being comprised of components. Under this view, it was held that the insurer would be liable for damages caused to one component by another component. Therefore, cases such as *S. L. Rowland Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 72 Wash. 2d 682, 434 P.2d 725 (1967), holding an insurer liable for damage to a home con-

preme Court explained the distinction in *Indiana Insurance Co. v. DeZutti*:¹⁵

[The insured in this case] is a general contractor and his product or work must be the entire project or house which he built and sold. The exclusion for damages to his work arising from the product or work itself will necessarily be broader than a subcontractor's exclusion. A subcontractor's product or work is merely a component part of a larger work or product. Thus, a subcontractor's exclusion would be less encompassing and any damage to the larger work or item caused by his product or work would be damage to other property which would fall outside exclusions (n) or (o) and be covered. In both situations the exclusion applies to what the insured or those on his behalf worked upon or produced.¹⁶

In this regard, one court has held that the work product exclusion applies not only to the insured's defective work, but also to the insured's satisfactory work that is damaged by the work that fails.¹⁷

A variation in the wording of the standard business risk or work product exclusion is found in policies containing the Broad Form Property Damage (BFPD) Endorsement.¹⁸ Despite insured contractors' efforts to exact coverage from this variation in the policy, the BFPD endorsement generally is held to exclude faulty workmanship claims for the cost of repairing the insured's own work product.¹⁹

structed by the insured caused by defective placement of one component, are inapplicable where post-1966 language is being construed. See *Adams Tree Serv. v. Hawaiian Ins. & Guar. Co.*, 117 Ariz. 385, 573 P.2d 76 (Ct. App. 1977).

15. 408 N.E.2d 1275 (Ind. 1980).

16. *Id.* at 1280.

17. See *Western Employers Ins. Co. v. Arciero & Sons*, 146 Cal. App. 3d 1027, 194 Cal. Rptr. 688 (1983).

18. Under the BFPD Endorsement, exclusion (o) of the standard CGL policy is replaced by language excluding property damage to "that particular part of any property, . . . upon which operations are being performed by or on behalf of the insured at the time of the property damage arising out of such operations." *C. D. Walters Constr. Co. v. Fireman's Ins. Co.*, 281 S.C. 593, 598, 316 S.E.2d 709, 712 (Ct. App. 1984) (quoting trial court order).

19. See *Taylor-McDonnell Constr. Co. v. Commercial Union Ins. Cos.*, 744 P.2d 892 (Mont. 1987) (damages for contractors faulty workmanship on museum roof was property excluded from policy); *C.D. Walters Constr. Co. v. Fireman's Ins. Cos.*, 281 S.C. 593, 316 S.E.2d 709 (Ct. App. 1984) (insurer not obligated to defend contractor for faulty workmanship); *but see Southwest La. Grain, Inc. v. Howard A. Duncan, Inc.*, 438 So. 2d

In some variations of the BFPD, exclusion (o), which refers to “work performed by or on behalf of the named insured,” is replaced by an exclusion in which the words “or on behalf of” are deleted. One may argue that in removing these words, the variation provides additional coverage to general contractors who subcontract all or a portion of their work. Several courts, however, have rejected this line of reasoning, concluding that this slight difference in wording does not affect CGL coverage when the general contractor is fully responsible for the entire project.²⁰ At least one court has disagreed, stating that the modified language of the BFPD creates an ambiguity in the policy.²¹

Similar arguments for coverage of damages attributable to faulty workmanship could be made with respect to the optional Completed Operations (CO) Endorsement.²² The CO endorsement protects insureds against liability arising due to bodily injuries or property damage in projects already completed by the insured contractor. In contrast, standard CGL coverage extends only to on-going operations or projects provided by the standard coverage.²³ Courts consistently have rejected the argument that the CO endorsement covers faulty workmanship and have held that the completed operations coverage is also subject to the work product exclusions.²⁴

215 (La. Ct. App.) (exclusions inapplicable to builder of defective grain elevator and storage facility), *cert. denied*, 441 So. 2d 1224 (La.), *cert. denied*, 442 So. 2d 447 (La. 1983).

20. *See, e.g.*, Tucker Constr. Co. v. Michigan Mut. Ins. Co., 423 So. 2d 525 (Fla. Dist. Ct. App. 1982); Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co., 396 N.W.2d 229 (Minn. 1986).

21. *See* Southwest La. Grain, Inc. v. Howard A. Duncan, Inc., 438 So. 2d 215 (La. Ct. App. 1983), *cert denied*, 441 So. 2d 1224, *cert. denied*, 442 So. 2d 447 (1983).

22. The optional Completed Operations Endorsement provides coverage for projects the insured had completed. The endorsement generally includes the following language:

“completed operations hazard” includes bodily injury and property damage arising out of operations or reliance upon a representation or warranty made at any time with respect thereto but only if the bodily injury or property damage occurs after such operations have been completed or abandoned and occurs away from premises owned by or rented to the named insured. “Operations” include materials, parts or equipment furnished in connection therewith . . .

Henderson, *supra* note 2, at 437.

23. *See* Dabbs v. Cincinnati Ins. Co., 293 S.C. 234, 237, 359 S.E.2d 521, 522 (Ct. App. 1987).

24. *See, e.g.*, Southwest Forest Indus. v. Pole Bldgs., Inc., 478 F.2d 185 (9th Cir. 1973); Swan Constr. Co., Inc. v. Bituminous Casualty Corp., 588 F. Supp. 65 (E.D. Mo.

III. MINORITY VIEW: POOR WORKMANSHIP CLAIMS ARE COVERED

A minority of jurisdictions hold that claims of an insured's deficient workmanship, particularly when expressed in terms of breach of warranty, are covered by the standard CGL policy.²⁵ Courts adhering to this view reason that coverage is warranted due to ambiguous language in the policy. These courts, following basic contract construction principles, typically resolve the ambiguity against the insurer responsible for drafting the policy. Arguably, an ambiguity exists between the work product exclusions and the exclusion relating to liability assumed by the insured under a contract or agreement. The latter exclusion reads as follows:

This [insurance] does not apply . . . (a) to liability assumed by the **insured** under any contract or agreement except an **incidental contract**; but this exclusion does not apply to a warranty of fitness or quality of the **named insured's products** or a warranty that work performed by or on behalf of the **named insured** will be done in a workmanlike manner²⁶

Arguably, the exception for warranties of fitness or quality is in conflict with the CGL work product exclusions. Courts following the minority view, therefore, resolve the ambiguity in favor of the insured and hold that the work product exclusions do not operate to deny coverage to an insured when the claim against him is based on breach of warranty.²⁷

Several jurisdictions, however, initially adopted this view but later disapproved it. For example, a Florida court of appeals

1984), *aff'd*, 767 F.2d 929 (8th Cir. 1985); Tucker Constr. Co. v. Michigan Mut. Ins. Co., 423 So. 2d 525 (Fla. Dist. Ct. App. 1982); Western Casualty & Sur. Co. v. Brochu, 122 Ill. App. 3d 125, 460 N.E.2d 832 (1984), *aff'd*, 105 Ill. 2d 486, 475 N.E.2d 872 (1985); Quality Homes, Inc. v. Bituminous Casualty Corp., 355 N.W.2d 746 (Minn. Ct. App. 1984); Thos v. Employers Mut. Casualty Co., 215 Neb. 424, 338 N.W.2d 784 (1983).

25. See, e.g., Worsham Constr. Co. v. Reliance Ins. Co., 687 P.2d 988 (Colo. Ct. App. 1984); Baybutt Constr. Corp. v. Commercial Union Ins. Co., 455 A.2d 914 (Me. 1983); Fresard v. Michigan Millers Mut. Ins. Co., 97 Mich. App. 584, 296 N.W.2d 112 (1980), *aff'd*, 414 Mich. 686, 327 N.W.2d 286 (1982).

26. Tinker, *supra* note 2, app. B at 301 (emphasis omitted).

27. See, e.g., Worsham Constr. Co., 687 P.2d 988.

adopted the minority view in 1974;²⁸ six years later the Florida Supreme Court held to the contrary. In so doing, the supreme court adopted the logic and reasoning of the majority view: that the CGL policy was not intended to protect the insured from claims arising due to their own faulty workmanship.²⁹

Ironically, before the Florida Supreme Court later disapproved the appeals court decision, that decision was relied on by the Arizona Supreme Court, which adopted the minority approach based on the perceived ambiguity in the policy.³⁰ Nevertheless, two recent Arizona appeals courts' decisions appear to follow the majority approach on this issue.³¹

New Hampshire is another jurisdiction that has shifted direction toward the majority view. The New Hampshire Supreme Court initially ruled for the insured contractor, holding that the exception contained in exclusion (a) was irreconcilable with the work product exclusion.³² The same court later distinguished that decision on the basis of the precise issue presented and, in accord with the majority view, held that the policy did not cover claims for defective workmanship.³³

The ambiguity argument frequently surfaces in litigation of this nature. For example, the South Carolina Court of Appeals in *Engineered Products, Inc. v. Aetna Casualty & Surety Co.*³⁴ recently was confronted with an argument that South Carolina should adopt the minority reasoning. Instead, the court followed the majority position and held that no ambiguity exists when the exclusions are read independently.³⁵ In support of its holding, the court of appeals quoted from the *Weedo* case:

If any one exclusion applies there should be no coverage, re-

28. See *Fontainebleau Hotel Corp. v. United Filigree Corp.*, 298 So. 2d 455 (Fla. Dist. Ct. App. 1974), *overruled*, 390 So.2d 327 (1980).

29. See *LaMarche v. Shelby Mut. Ins. Co.*, 390 So. 2d 325 (Fla. 1980); see also *Tucker Constr. Co. v. Michigan Mut. Ins. Co.*, 423 So. 2d 525 (Fla. Dist. Ct. App. 1982) (exclusion applied to subcontractor's work that general contractor accepted as its own).

30. See *Federal Ins. Co. v. P.A.T. Homes, Inc.*, 113 Ariz. 136, 547 P.2d 1050 (1976).

31. See *Adams Tree Serv. v. Hawaiian Ins. & Guar. Co.*, 117 Ariz. 385, 573 P.2d 76 (1977); *Continental Ins. Co. v. Asarco, Inc.*, 153 Ariz. 497, 738 P.2d 368 (Ct. App. 1987).

32. See *Commercial Union Assurance Co. v. Gollan*, 118 N.H. 744, 394 A.2d 839 (1978); see also *Commercial Union Assurance Co. v. Gilford Marina, Inc.*, 119 N.H. 788, 408 A.2d 405 (1979) (following *Gollan*).

33. See *McAllister v. Peerless Ins. Co.*, 124 N.H. 676, 474 A.2d 1033 (1984).

34. 295 S.C. 375, 368 S.E.2d 674 (Ct. App. 1988).

35. *Id.*

ardless 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.³⁶

In short, most courts that find coverage for the insured contractor do so based on a finding of damage to property other than the insured's work product. Although the end result may be the same, the minority position — that coverage exists because of an ambiguity in the policy — appears to be losing support.

IV. COVERAGE AS AFFECTED BY TYPES OF DAMAGES

A. *Loss of Use*

Generally, consequential damage claims, such as loss of use or loss of revenue, are not covered under the standard CGL policy if the claims arise from damage to the insured's own work product rather than from damage to other property. In *T.E. Ibberson Co. v. American & Foreign Insurance Co.*,³⁷ a 1984 Minnesota Court of Appeals decision, the issue was whether an owner's claim for the loss of use of a concrete grain elevator was covered under the CGL policy issued to the contractor who built the elevator. The court held that the claim was merely an element of the damage to the work product and, therefore, was excluded. The court stated:

Construction of the elevator was solely the work and product of the insured. Negligence of the insured in construction, giving rise to the claim of loss of use, is excluded by the work product exclusions of the insurance policy. The insurance company has no duty to defend the insured.³⁸

36. *Id.* at 378, 368 S.E.2d at 675 (quoting *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 248, 405 A.2d 788, 795 (1979)).

37. 346 N.W.2d 659 (Minn. Ct. App. 1984).

38. *Id.* at 663. Similarly decided was *Quality Homes, Inc. v. Bituminous Casualty Corp.*, 355 N.W.2d 746 (Minn. Ct. App. 1984), a decision from the same jurisdiction. It should be noted, however, that the Supreme Court of Minnesota, in an earlier decision, indicated in dictum that the CGL would cover a claim for loss of rental had it been asserted. See *Bor-Son Bldg. Corp. v. Employers Commercial Union Ins. Co.*, 323 N.W.2d 58, 64 (Minn. 1982). The case cited by the Minnesota Supreme Court in support of cov-

Loss of use of property other than the insured's work product, however, may constitute a covered claim.³⁹ In *Commercial Union Insurance Co. v. R.H. Barto Co.*,⁴⁰ a Florida District Court of Appeals decision, an office building owner sued the subcontractor who had installed air conditioning equipment. The owner alleged that the equipment required constant repair and eventual replacement, and it caused the owner to lose tenants and rental income. He then sought damages for the loss of use of parts of the building.⁴¹ The court noted that replacement or repair of the faulty equipment was not covered under the subcontractor's CGL policy. The court, however, went on to say that the owners' claim for loss of use of *other tangible property*, caused by the defective equipment and its repair, fit within the general CGL coverage.⁴² The court, nevertheless, denied recovery because other exclusions within the CGL policy applied. In this case, the policy excluded recovery for tangible property not physically damaged or destroyed.⁴³

B. *Diminution in Value*

The same dichotomy is seen when the claim is for diminution or depreciation in value. If recovery is sought for the diminution in value of the building due to the general contractor's poor workmanship in constructing the building, the claim generally is excluded.⁴⁴ On the other hand, if the defective work product of an insured contractor is incorporated into a larger structure and causes a diminution in value of the larger structure as a

erage involved a situation in which the loss-of-use claim arose out of damage to property other than the insured's own work product. See *Ohio Casualty Ins. v. Terrace Enters.*, 260 N.W.2d 450 (Minn. 1977). That case was distinguished in *Quality Homes*. See *T.E. Ibberson Co. v. American & Foreign Ins. Co.*, 346 N.W.2d 659, 662 (Minn. Ct. App. 1984).

39. See *American Home Assurance Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22 (1st Cir. 1986); *Commercial Union Ins. Co. v. R. H. Barto Co.*, 440 So. 2d 383 (Fla. Dist. Ct. App. 1983); *United Properties, Inc. v. Home Ins. Co.*, 311 N.W.2d 689 (Iowa Ct. App. 1981); Henderson, *supra* note 2, at 445.

40. 440 So. 2d 383 (Fla. Dist. Ct. App. 1983).

41. See *id.* at 385.

42. See *id.* at 387.

43. See *id.*

44. See *Baugh Constr. Co. v. Mission Ins. Co.*, 836 F.2d 1164 (9th Cir. 1988); *Qualls v. Country Mut. Ins. Co.*, 123 Ill. App. 3d 831, 462 N.E.2d 1288 (1984).

whole, coverage has been found.⁴⁵ Courts have held, however, that a diminution in value claim, even if related to the depreciation in value of property other than the insured's product, is not covered by the CGL policy as revised in 1973, which changed the way the way "property damage" is defined.⁴⁶

V. CONCLUSION

Recent South Carolina cases place this jurisdiction clearly within the majority position in the construction of the work product exclusions of the CGL policy.⁴⁷ The rationale behind the majority view of this issue is well articulated in the various cases.⁴⁸ The majority view of the question of coverage under a contractor's CGL policy follows a "business risk" analysis. The courts are seeking to protect innocent third parties from the results of poor workmanship while making contractors bear the consequences of their poor performance.

This analysis is effective when applied to a traditional general contractor; however, difficulties arise when other factual situations are presented. The rationale of the work product exclusion is that it will encourage better performance by a contractor by denying him reimbursement for correction of defective work. If a subcontractor is involved, the general contractor is placed in the position of having no coverage under his own policy for any defective work on the contract, while being able to seek indemnity for damage to the work product caused by a subcontractor's poor performance. Thus, if the foundation installed by a subcon-

45. See *Missouri Terrazzo Co. v. Iowa Nat'l Mut. Ins. Co.*, 740 F.2d 647 (8th Cir. 1984); *Western Casualty & Sur. Co. v. Polar Panel Co.*, 457 F.2d 957 (8th Cir. 1972) (applying Minnesota law); *Hauenstein v. St. Paul-Mercury Indem. Co.*, 242 Minn. 354, 65 N.W.2d 122 (1954). See also *Rafeiro v. American Employers' Ins. Co.*, 5 Cal. App. 3d 799, 85 Cal. Rptr. 701 (1970).

46. See *Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d 751 (Minn. 1985).

47. See *Stroup Sheet Metal Works, Inc. v. Aetna Casualty & Sur. Co.*, 268 S.C. 203, 232 S.E.2d 885 (1977); *Engineered Prods., Inc. v. Aetna Casualty & Sur. Co.*, 295 S.C. 375, 368 S.E.2d 674 (Ct. App. 1988); *C.D. Walters Const. Co. v. Fireman's Ins. Co.*, 281 S.C. 593, 316 S.E.2d 709 (Ct. App. 1984); see also *Heyward v. American Casualty Co.*, 129 F. Supp. 4 (E.D.S.C. 1955) (bodily injury claim covered by policy, but policy excluded repair or replacement of defective work).

48. See, e.g., *G. L. Shaw Builders v. State Auto. Mut. Ins.*, 182 Ga. App. 220, 355 S.E.2d 130 (1987); *Knutson Constr. Co. v. St. Paul Fire & Marine Ins.*, 396 N.W.2d 229 (Minn. 1986); *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979).

tractor failed, the general contractor could recover the cost to reconstruct the entire building.

The policy language does little to encourage a general contractor to hire competent subcontractors. The business risk of the general contractor is shifted to the subcontractors' insurance carriers. Carried to the extreme, the general contractor could act simply as a broker on a project, using the lowest quality subcontractors that are insurable. When problems arise, the general contractor would turn to the subcontractors' insurance companies and demand indemnification for costs associated with the repairs. By careful division of subcontracts, a general contractor could maximize the profit on the initial construction of a project by undercutting more responsible bidders, while minimizing the long-term risk.

The policy language will have to be changed if the public policy discussed by the various courts is to be supported. The work product exclusion should be modified for subcontractors so that damage to the work of other subcontractors or the general contractor would be excluded under the policy. The contractor then would be responsible for the cost to correct defective workmanship, while the insurance carriers would bear the risk of loss by third parties.

A trend in the opposite direction can be seen in the Broad Form Property Damage (BFPD) Endorsement. The change in exclusion (o) deletes the words "or on behalf of" so that work performed by the named insured is excluded from coverage. While courts have generally held that this does not change the scope of the exclusion, some commentators disagree.⁴⁹ If the courts apply a literal reading to this language and allow coverage under a general contractor's policy for the work product of its subcontractors, the business risk of a general contractor will be altered significantly. By maximizing the use of subcontractors, a general contractor can shift the risk of both poor performance by subcontractors and his own poor supervision to an insurer. If the quality of the completed project is not in compliance with the applicable standards, the general contractor's insurance carrier would be required to replace the substandard work, with no right of subrogation against his own insured.

49. See cases cited *supra* note 19; see also J. SWEET, SWEET ON CONSTRUCTION INDUSTRY CONTRACTS: MAJOR AIA DOCUMENTS § 23.7 (4th ed. 1989).

The general contractor, thus, would have reaped the reward of the use of a low-cost, poorly performing subcontractor, but would not be required to pay the cost to bring the work up to the original standard paid for by the owner. Why the language of exclusion (o) was changed is unclear; however, it is illogical to assume that general contractors' insurers intended to insure the subcontractors' performance. Further analysis by the courts will be required to clarify the impact of the changes made by the BFPD.

One development that has changed the nature of the risk assumed by casualty insurers in the construction process is the expanding role of Construction Managers (CMs). CMs have assumed many of the duties of supervision and coordination historically performed by general contractors. They perform no actual construction with their own forces. When the concept first developed, most CMs were spin-offs from architectural and engineering firms. They presumably were covered by professional errors and omissions insurance. Due to this competition, many general contractors have formed construction management divisions. These divisions continue to be covered by the contractors' CGL policies, even though the nature of the risk has changed dramatically. In that the CM does no actual construction work with his own forces and does not engage any subcontractors directly, the work-product exclusion does not apply. Since a CM is contracted solely to provide inspection and coordination services, he does not have the legal defenses that an architect or engineer would. The insurer for a CM faces potential liability for the entire cost to correct any defective work on a project.

The construction industry has undergone substantial changes in the last twenty years. The industry as a whole faces more litigation. New theories of liability have been developed that expand the potential exposure of casualty insurers, and the increasing use of construction managers has changed the traditional relationship of the parties in the industry. The language of the CGL policy has not been altered in light of these developments. Courts most likely will find expanding coverage under the current language to protect third parties. An unintended result of this may be that general contractors will have less incentive to select their subcontractors carefully and to supervise their work properly.

