

Outside Counsel

Expert Analysis

Faulty Workmanship Exclusion Not Applied to Losses During Construction

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Construction companies typically rely on “Builder’s Risk Insurance” to protect against the risk of damage during an ongoing construction project. This coverage is often written on an “all risk” basis, meaning that the insurance company agrees to provide coverage for all loss at a particular location, unless specifically excluded by the terms of the policy. Essentially, a builder’s risk insurance policy is “a form of property insurance that covers the interests of the owner, contractor, subcontractors, and others involved in the construction project, insuring them against risks of property damage to the project.”¹

Not surprisingly, insurance companies often try to avert their coverage obligations for losses claimed under

builder’s risk policies by relying on various exclusionary provisions and, in particular, the “Faulty Workmanship Exclusion.” A recent case decided by the U.S. District Court for the Southern District of New York, arising out of a tragic crane collapse on the Upper East Side of Manhattan in May 2008, examined the scope and limitations of the faulty workmanship exclusion. In *1765 First Associates, LLC v. Continental Casualty Co.*,² the district court held that the faulty workmanship exclusion excluded from coverage those damages arising from “problems with the property under construction itself, and not...losses incurred to ameliorate the effects of accidents during construction.”³

The Policy at Issue

In *1765 First Associates*, Continental Casualty Company (a member of the CNA

group of insurers) issued a builder’s risk insurance policy, which was written on an all-risk basis and contained the following faulty workmanship exclusion:

Unless otherwise provided for..., this Policy does *not* insure against physical loss or damage caused by or resulting from the following; however, if physical loss or damage from a peril not excluded herein ensues, then this policy shall cover only for such ensuing loss or damage:

a. Errors or defects in design or specification,...faulty workmanship or faulty materials; coverage for damage from an ensuing peril not otherwise excluded, shall apply to covered property other than the work or construction of the Insured.⁴

Crane Collapse

According to the complaint, 1765 First Associates was the owner and leaseholder of a construction project, the Azure Cooperative, on the Upper East Side.⁵ On May 30, 2008, a tower crane operated by a subcontractor at the construction project collapsed, causing significant physical damage to the building under construction and construction delays (as well as significant physical damage

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to adjacent properties and fatalities).⁶ Relying upon the faulty workmanship exclusion in its policy, Continental disclaimed coverage for the costs stemming from the resultant construction delays. In its declaratory judgment action, 1765 First Associates argued that this exclusion only excludes coverage for losses arising from errors or defects in the construction itself, and not the losses stemming from the resulting delays or cleanup costs arising from equipment failures that do not otherwise impact the quality of the insured's completed construction project.⁷

The District Court's Decision

The district court, relying on standard New York principles of insurance policy construction, reaffirmed that the insurer bears the burden of "establishing that the exclusions or exemptions apply in the particular case, and that they are subject to no other reasonable interpretation."⁸ The district court then rejected Continental's claim that the faulty workmanship exclusion precludes coverage for damages caused by the crane collapse based on the notion that the collapse was the product of faulty workmanship.⁹ Instead, the district court, relying on a series of cases analyzing similar exclusions, found that "faulty workmanship" "refers to the work done by the insured or its agents to the insured property itself, not work done by the manufacturer of the tools or equipment used on the premises."¹⁰ Thus, the court held that the exclusion "as it is most naturally read, does not apply to losses related to accidents or equipment malfunctions during construction."¹¹

Indeed, the district court noted that Continental purported to provide cov-

erage for "Builder's Risks" and exclude from that coverage loss attributable to the negligent work of the insured's builder.¹² The court held:

The titular purpose of the Policy is to cover "Builder's Risk," and the Faulty Workmanship Exclusion is designed to preclude recovery of losses attributable to the insured builder's negligent work. The insured builder here did not build that which Continental asserts was the product of faulty workmanship, namely, the crane. Because the Faulty Workmanship Exclusion applies only to losses attributable to the quality of the constructed property and arising from defects in the materials or process used by the insured or its agents to construct the property, that provision does not exclude losses incurred during construction associated with the crane collapse and otherwise owed... under the Policy.¹³

The court in '1765 First Associates' held that the exclusion 'as it is most naturally read, does not apply to losses related to accidents or equipment malfunctions during construction.'

Conclusion

The *1765 First Associates* decision is an important reaffirmation that, absent a showing by the insurer that a construction loss is attributable to the insured builder's negligent work, a "faulty workmanship exclusion" will not bar coverage. This case is equally important as it provides the most recent example of the New York courts rejecting an insurer's attempt to liberally and broadly construe

this exclusion to bar coverage for essentially all acts of negligence occurring during a construction project.

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1. *St. Paul Fire & Marine Ins. Co. v. Universal Builders Supply*, 409 F.3d 73, 84 (2d Cir. 2005).
2. No. 10 Civ. 9298(VM), — F.Supp.2d —, 2011 WL 4735373 (S.D.N.Y. Oct. 3, 2011).
3. Id. at *1.
4. Id. (emphasis in original).
5. See *1765 First Assocs., LLC v. Cont'l Cas. Co.*, No. 10 Civ. 9298(VM), Docket Entry 5, ¶2.
6. *1765 First Assocs.*, 2011 WL 4735373, at *1.
7. Id.
8. Id. (quoting *Cragg v. Allstate Indem. Corp.*, 17 N.Y.3d 118, 122 (2011) *Pioneer Tower Owners Ass'n v. State Farm Fire & Cas. Co.*, 12 N.Y.3d 302, 307 (2009)).
9. Id.
10. Id. at *2 (citing *242-44 E. 77th St., LLC v. Greater N.Y. Mut. Ins. Co.*, 31 A.D.3d 100, 106, (1st Dept. 2006); *Poulos v. U.S. Fid. & Guar. Co.*, 227 A.D.2d 539, 541 (2d Dept. 1996)).
11. Id.
12. Id. at *3.
13. Id.