"RIP AND TEAR" CLAIMS: THE CGL POLICY AS PERFORMANCE BOND

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Courts nationwide have grappled with coverage for "rip and tear" claims like the one against Zappo in the hypothetical below. The purpose of this article is to introduce and discuss the key concepts and rationales courts employ when addressing such claims, apply them to the hypothetical, and to ask whether modern trends in this area risk transforming the CGL policy into a performance bond.

THE HYPOTHETICAL

Zappo Electrical Contracting Corp. wired the new student union building at State University, including laying wire under the computer lab. After the wiring was completed, other trades closed the walls and put down a beautiful terrazzo floor, covering the wires. Later, the furniture and computer equipment were moved in, but the computers would not boot up. After a round of nondestructive testing, it was discovered that something was wrong with the wiring, now hidden by the beautiful terrazzo floor. State University demanded that Zappo fix the wiring or face legal action. Zappo would have to break through the floor to fix the wiring, however.

Zappo forwarded State University's demand to its liability insurer. Jim Juster, the claims professional, was pretty certain that there was no coverage for Zappo's faulty workmanship. After all, a liability policy is not a performance bond! What got Jim scratching his head, though, was the damage to the terrazzo floor. The floor was third-party property being damaged due to the Zappo's fault. Could that portion of State University's claim possibly be covered?

PROPERTY DAMAGE CAUSED BY AN OCCURRENCE

This first question to consider in any "rip and tear" claim is whether there is an "occurrence" of "property damage" such that would be covered under the standard CGL insuring agreement, where "property damage" means physical injury to tangible property of a third party and "occurrence" means an "accident, including continuous or repeated exposure to substantially the same general harmful conditions."

Most state courts recognize a well-settled rule that the issuer of a commercial general liability policy is not a surety for a construction contractor's defective work product.[1] Initially, this rule was based on the view that the standard CGL insuring agreement was never intended to provide indemnification to contractors from claims that their work product was defective. Rather, the "purpose of a commercial general liability policy . . . is to provide coverage for tort liability for physical damage to others and not for contractual liability of the insured for economic loss because the product . . . is not what the damaged [party] bargained for."[2]

This economic loss doctrine stands on the principle that purely economic loss (i.e., loss of the benefit of the parties' bargain) is contractual in nature and does not equate to tort damages for physical injury to tangible property. In other words, courts declining CGL coverage on this basis take the view that such claims are fundamentally contractual in nature and as such can never arise from an "occurrence," defined as an "accident."[3] This is not a universal view, however, with other courts reasoning that the crucial inquiry is not whether the claim is based in tort versus contract, but rather whether the claim is one for damages arising from "property damage" caused by an "occurrence."[4]

Many courts also recognize an "occurrence" of "property damage" where the insured's defective work product is a mere component of and causes damage to a larger structure.[5] Application of this rule requires a finding that the insured's defective work is having a deleterious effect on other components of the construction, which is the "occurrence" rather than the defective work itself. While courts continue to differ on whether the insured's faulty workmanship can constitute an "occurrence" in itself, it is virtually universal to require at least the possibility of third-party "property damage" to trigger coverage.[6] Under both constructions of an "occurrence," then, mere repair or replacement of the insured's own defective work does not constitute covered "property damage" for purposes of CGL coverage; there must be involvement of other property.[7]

"BUSINESS RISK" EXCLUSIONS

In addition to considering whether "rip and tear" expenses are within the CGL insuring agreement, consideration must also be given to whether the policy's "business risk" exclusions apply to bar coverage for expenses occasioned by the insured's defective work. The overall effect of the "business risk" exclusions is to bar coverage for repair and replacement of the insured's defective work, with variations noted below.

Of the standard "business risk" exclusions, the one barring coverage for damage to "impaired property" may be the closest fit with most "rip and tear" scenarios, because (as in the hypothetical) the claim arises not from property that is physically damaged but rather from non-defective work that must be removed to afford access to faulty work needing repair. Notably, the typical exclusionary wording requires that damage to "impaired property" arise from "a defect, deficiency, or inadequacy" in the insured's work or from the insured's "delay or failure to perform a contract or agreement according to its terms." This wording dovetails with those court rulings holding that the contractual nature of the claim does not preclude an "occurrence" based solely on the insured's faulty workmanship.

Also, potentially relevant are the standard exclusions barring coverage for "property damage" to property arising from the insured's ongoing operations, including damage to property that must be restored, repaired, or replaced because the insured's work was incorrectly performed on it. These exclusions could bar coverage for "rip and tear" claims to the extent the insured's defective work was detected before all of the insured's work was completed.

In addition, "rip and tear" facts may invoke the exclusion for property damage to "your [i.e., the named insured's] work," defined to include both operations performed by and materials supplied by the insured. Pursuant to this exclusion, coverage would be barred for damage to the insured's work but not to other property damaged by the insured's work.

Finally, the so-called "sistership" exclusion bars coverage for costs incurred to withdraw the insured's work or product from the market "or from use." It is at least arguable that removing the insured's defective work "from use" by ripping it out of the overall structure is within the exclusionary wording.

RESOLVING ZAPPO'S CLAIM

Having reviewed the key concepts, what can we say about Zappo's claim? Assuming coverage is governed by the law of a state holding that the insured's faulty workmanship constitutes the "occurrence," the question still remains whether deliberate destruction of the terrazzo floor equates to covered "property damage." The answer will likely be yes based a literal reading of the policy wording because—though intentionally done—ripping up the floor constitutes physical injury to tangible property of a third party (State University). The impaired property exclusion will not apply on these facts because the floor is physically damaged (albeit intentionally). The "ongoing operations" exclusions will not apply because the insured's work on the floor has been completed. Coverage will not be barred by the "your work" exclusion or the "sistership" exclusion because the terrazzo floor is not Zappo's work.

Although some courts today would adopt these principles to find coverage for "rip and tear" claims, the question remains whether this result is ultimately to be preferred. Enforcing "property damage" coverage for non-accidental destruction of non-defective property ignores two venerable insurance tenets, fortuity and the moral hazard. Clearly, neither faulty workmanship nor the deliberate destruction of property is fortuitous. While the notion of the moral hazard may sound quaint in today's world, it cannot be gainsaid that allowing a contractor to obtain coverage for faulty workmanship incentivizes shoddy work (at least absent market forces). When courts following this trend continue lip service to the old saw that a CGL policy is not a performance bond, the maxim rings hollow indeed.

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1 *See, e.g., Carl E. Woodward, L.L.C. v. Acceptance Indemnity Insurance Co.,* 743 F.3d 91 (5th Cir. 2014); *George A. Fuller Co. v. United States Fid. & Guar. Co.,* 200 A.D.2d 255, 613 N.Y.S.2d 152 (N.Y. App. Div. 1994), *lv. denied* 84 N.Y.2d 806, 645 N.E.2d 152 (N.Y. 1994).

2 *Hartford Acc. & Indem. Co. v. Reale & Sons,* 228 A.D.2d 935, 644 N.Y.S.2d 442 (N.Y. App. Div. 1996). *See also, Three Sombrero, Inc. v. Scottsdale Ins. Co.,* 28 Cal. App. 5th 729 (4th Dist. 2018).

3 *Keystone Filler & Mfg. Co., Inc. v. American Mining Ins. Co.,* 179 F. Supp. 2d 432 (M.D. Pa. 2002), *aff'd* 55 F. App'x. 600 (3d Cir. 2002).

4 *Desert Mountain Properties Ltd. Partnership v. Liberty Mut. Fire Ins. Co.,* 236 P.3d 421 (Ariz. Ct. App. 2010), *aff'd* 226 Ariz. 419 (2011).

5 *See, e.g., Apache Foam Products Div. of Millmaster Onyx group of Kewanee Industries, Inc. v. Continental Ins. Co.,* 139 A.D.2d 933, 528 N.Y.S.2d 448 (N.Y. App. Div. 1988).

6 *Dewitt Cons. Inc. v. Charter Oak Fire Ins. Co.,* 307 F.3d 1127 (9th Cir. 2002).

7 *OneBeacon Ins. Co. v. Metro Ready-Mix, Inc.,* 242 F. App'x. 936 (4th Cir. 2007) (applying Maryland law).