

# Water Leaks Are an Ongoing Battleground for Insurance Coverage

BY CHANDRA LANTZ

**W**ater intrusion and leaks are common sources of frustration and rework on construction projects. Months of progress can be undone by the failure of a coupling, the discovery of mold behind a wall or in a chase, or a drill that finds an unexpected pipe. Fortunately, adequate insurance coverage can help offset the cost of remediating water damage, but the right policies and endorsements need to be in place. The time to understand coverage issues is before the failure of an inexpensive installation becomes a six- or seven-figure loss and delay claim.

The protection provided through an insurance policy ends at the four corners of the policy document itself. Insurance, after all, is a contract-based risk-sharing business, not a lottery. As a result, when the coverage language of a policy does not line up with a submitted claim, an insurer will fight to avoid payment.

Water claims are a common battleground. A review of cases reveals dozens of lawsuits in the past several months.

## Trouble Spots for Water Intrusion Coverage

Policyholders can be stymied by a variety of issues when pursuing coverage for water damage.

- The damage or its cause specifically is excluded from coverage (e.g., EIFS is not a covered product, mold is



excluded, boiler or machinery leaks are excluded, etc.).

- The leak or intrusion event is not considered an “occurrence” that would be covered, but rather is a result of lack of maintenance or defective workmanship.
- The damage to the contractor’s work is excluded by the “your work” exclusion (e.g., damage to new windows is excluded because the cause of the damage was leaks in the windows installed by the window contractor).
- The claimant discovers it has not properly been made an

“additional insured” on a builder’s risk or commercial general liability policy that might have covered the claim.

- The remediation was handled in a manner contrary to the guidelines and reporting requirements of the policy, so the cost is not covered.
- Debris removal and response costs exceed (often small) coverage limits for the work.
- Lost income, business interruption or delay damages are excluded from coverage.

These roadblocks are not limited to large damage claims. Insurers will push back on even minor

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claims if there is a possibility that the available insurance does not apply to the loss.

#### **‘Your Work’ Exclusions**

Last summer, the 11th Circuit Court of Appeals unrolled broad applications of the “your work” exclusion and the duty to defend obligation of a commercial general liability policy to find that an insurer could avoid coverage for a leaking roof. In *J.B.D. Const., Inc. v. Mid-Continent Cas. Co.*, a fitness center project opened with a soggy start when the roof, doors and windows began leaking shortly after construction finished.

The 11th Circuit found that MCC did not owe the contractor any coverage. The CGL policies purchased by the contractor contained the “your work” exclusion, which excluded coverage of damage “to ‘your work’ arising out of it or any part of it and included in the ‘products-completed operations hazard.’” Notably, the “your work” exclusion did not include the important “subcontractor exception,” by which work done by a subcontractor is not considered to be part of the general contractor’s work for purposes of the “your work” exclusion.

In analyzing what constituted the “work” for purposes of the exclusion, the court broadly

found that the entirety of the contractor’s scope of work—not just the defective installation of the windows, doors and/or roof—was the proper application because the contractor undertook construction of “the entire fitness center.” Therefore, the exclusion barred coverage for the completed fitness center and its components.

#### **Slow Leaks and Time Bars**

Sometimes small amounts of water over lengthy periods can cause substantial damage before being discovered.

In *Robinson Eye Center LLC v. State Farm Fire & Cas. Co.*, a policyholder made the first of several claims under a property and liability policy covering its leased office. The first claim arose out of damage from falling ceiling tiles due to water intrusion from rain. Water intrusion continued despite the landlord installing a replacement roof, with damages leading the policyholder to make four more claims for separate events of water damage. The insurer refused to pay any of the claims, choosing instead to terminate coverage.

The insurer alleged that the lawsuit was not timely filed because the water intrusion began several months before the first damage was reported. Essentially, the insurer argued that all of the claims began

with the very first leak, such that the lawsuit had to be filed within two years of the first leak. However, the court disagreed that the first drip was the insurable event. Rather, the court explained, the “physical loss” that triggered the two-year period was the first known damage to the property.

#### **Strong Exclusionary Language**

Insurers are not alone in stretching the boundaries of policy language. Policyholders also file claims despite what many could consider to be clear barriers to coverage.

In California, a claimant did not let an endorsement excluding residential properties stand in the way of making a claim for damages to a multi-unit apartment building.

In *Atain Specialty Ins. Co. v. North Bay Waterproofing, Inc.*, a waterproofing contractor’s commercial general liability policy carried a “total residential exclusion” endorsement that excluded coverage for “any condominium, townhome, single-family dwelling, and other residential or tract housing project.” The contractor was sued for defective work and water intrusion damages to “10 three-story apartment buildings containing 124 residential dwelling units.”

The contractor did not let the “total residential exclusion” stop it from submitting the lawsuit to its insurer for defense and indemnity. Rather, the contractor argued that “residential,” as used in the policy, should be interpreted to mean “shelter in exchange for monetary consideration without transfer of title,” and that the project was “commercial” because

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the developer and contractors hoped to profit from the endeavor. The court rejected the contractor’s strained definition of “residential” in favor of the ordinary, layperson definition. The court also found

that reclassifying the property as commercial would render the endorsement totally meaningless because every dwelling at one time was a commercial project for a contractor.

**Lack of Additional Insured Protection**

Perhaps the most dangerous ground for contractors is the tendency to rely on additional insured arrangements as the primary source of coverage for risks on a project. The additional insured mechanism is a great method of expanding coverage if and when the underlying parameters for such coverage are satisfied. However, doing so requires contractors to confirm that both the language of the construction contract and the language of the policy by which it seeks to be insured will extend additional insured protection to them.

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Being an additional insured has two important benefits, one of which is often overlooked. First, an additional insured can make a claim under the insuring policy for losses it has experienced. Equally as important, an additional insured may be able to avoid the insurance company filing a subrogation action against it if the additional insured actions contributed to the loss. Well-established anti-subrogation principles prevent an insurance company from accepting premiums, paying out on a covered loss, and then suing the insured who contributed to the loss to recover the insurer's costs to satisfy the claim.

Insurance companies are well versed in water damage claims. Because of their depth of experience, an insurance company can help a policyholder navigate the investigation and response process. However, that experience also means insurance companies can readily find exclusions and exceptions to coverage. In today's business climate, even common, relatively small claims for water intrusion can lead to courtroom battles.

The only way for a business to know that coverage is in place when it's needed is to have an insurance program that conforms to business pursuits and protects against the risks likely

to be encountered. As its often said, the "devil is in the details," and insurance policies are no exception. Coverage that is given on one page may be carved out through exclusions and exemptions on another page of the policy. Insureds need to review their existing coverage regularly to make sure it matches the risks they need to minimize. 

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