

Insurance Buyers' News



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Court Clarifies Definition of Property Damage in Landmark Construction Defects Case

The Massachusetts Appeals Court has held for the first time in any venue that “construction defects, standing alone, do not constitute property damage within the meaning of a commercial general liability policy.”

This ruling represents a significant shift in how property damage under commercial general liability (CGL) policies is addressed in insurance law. The decision arose from a case in which a property owner sought coverage for damages stemming from construction defects. The court concluded that construction defects alone, without resulting damage to other property, do not qualify as property damage under a typical CGL policy.

To illustrate this, the court provided an example:

an improperly installed window would not be considered “property damage,” but any resulting water damage to the surrounding wall would be. The court stated that this interpretation is “persuasive and consistent with the general purpose of commercial general liability policies.”

Background

1. **CGL Policies:** Commercial General Liability insurance is designed to cover various liabilities that businesses might face, including bodily in-

This Just In ...

House Judiciary Subcommittee Chairman Darrell Issa has introduced legislation, the “Litigation Transparency Act of 2024,” which calls for disclosure of third-party litigation funding in civil litigation.

“The misuse of the legal system fueled by third party litigation funding has formed a litigious culture, ultimately burdening every consumer and business through increased costs, including the cost of insurance throughout the country,” noted Nat Wienecke, senior vice president of federal government relations for the American Property Casualty Insurance Association (APCIA)

Third-party litigation funding (TPLF) is a form of financing for legal expenses in which an investor provides money to attorneys or clients in exchange for a financial stake in the settlement or winnings of a lawsuit or arbitration. This money is of-

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jury and property damage claims. However, these policies often have specific definitions of what constitutes “property damage,” typically excluding coverage for defects in the work itself.

2. **Case Context:** The case involved a construction project where numerous defects were identified, including structural issues with missing supports, improperly installed counter flashing on a roof deck, improperly fastened siding, and various problems with the metal roof installation. The property owner filed a claim against the contractor’s insurance for property damage. The contractor’s insurer denied coverage, arguing that the defects did not result in damage to property beyond the construction itself.
3. **Court’s Rationale:** The panel’s ruling emphasizes the need to distinguish between in-

herent defects in construction and actual damage to other property. The court held that, without external damage or consequential loss, the defects themselves are not sufficient to trigger coverage under the policy.

Controversial Aspects

1. **Impact on Coverage:** This ruling is controversial because it limits the scope of CGL policies for property owners and contractors alike. If construction defects are not covered, property owners may face significant financial burdens in addressing these issues without insurance support.
2. **Risk Allocation:** The decision raises questions about risk allocation in construction projects. Contractors and developers may be less incentivized to ensure quality in their work, knowing they might not face liability for defects if no additional property damage occurs.
3. **Potential for Increased Litigation:** Property owners may find themselves pursuing more lawsuits against contractors to establish that damages exist beyond the defects. This could lead to an increase in construction litigation, complicating the resolution of disputes and raising costs for all parties involved.
4. **Insurance Market Implications:** Insurers may respond to this ruling by adjusting policy terms and pricing, potentially making it more difficult for property owners to secure adequate coverage. There may also be a push for specialized policies that more directly address construction defects.

This Just In

ten described as a non-recourse loan because it does not have to be repaid to the investor if the legal case is lost or never resolved. Also known as legal financing, legal funding, third-party litigation finance, or alternative litigation financing (ALF), this booming global industry is valued at \$17 billion dollars and may expand to \$30 billion by 2028, according to a Swiss RE report. Research shows TPLF can contribute to social inflation by enabling more lengthy litigation, ultimately making insurance coverage more expensive.

“APCIA appreciates Chairman Issa’s leadership for introducing legislation that would require disclosure of third-party litigation funding in civil litigation,” said Wienecke. “APCIA encourages members of Congress to support this legislation.”

5. **Impact on Extended Property Damage Liability Endorsements:** These CGL coverage extensions typically cover damages arising from occurrences that result in damage to property other than the insured’s own work. The Massachusetts Appeals Court ruling indicates that if the construction defects themselves are not legally considered property damage, then the extended property damage coverage may not be triggered.

Overall, this ruling establishes a significant legal precedent that could reshape the landscape of liability insurance in construction, presenting challenges for property owners and contractors navigating the complexities of coverage and defect management. ■

Reputation: How to Protect a Priceless Asset

Many events can damage an organization's reputation: a financial scandal, a highly publicized discrimination case, a product malfunction, and more.



Part I: A lesson from Boeing "Quality Escape"

Following the incident earlier this year, when part of a plane's door blew off during an Alaska Airlines flight, Boeing's CEO Dave Calhoun referred to the cause as a "quality escape," meaning a lapse in Boeing's production and inspection processes allowed a defect to pass undetected. Boeing cooperated with the FAA,

which grounded all Boeing 737 MAX 9 planes, demonstrating their commitment to addressing the issue. However, critics noted that Boeing's crisis communication was once again reactive rather than proactive, a continuation of its slow and detached responses from previous crises, such as the 737 MAX incidents in 2019. While safety protocols have improved, rebuilding public trust remains an ongoing challenge.

Boeing's Crisis Management

Boeing's crisis management efforts have included grounding the fleet, investigating what went wrong, and conducting thorough inspections to prevent future occurrences. Even so, experts have suggested that Boeing has struggled with public perception since the larger 737 MAX crisis in 2019, and the company's response to these crises has been seen as lacking the speed and assurance needed to restore public trust quickly.

Overall, Boeing has faced challenges in managing its reputation post-crisis. While they have improved safety protocols and cooperated with authorities, their communication strategy has often been criticized as insufficient in calming public fears and rebuilding trust. The company's long-term recovery depends heavily on sustained transparency and action to assure the public of its commitment to safety.

Part II: Is your company prepared to protect its reputation? Insurance

Specialized crisis containment or brand protection insurance can provide a layer of protection. These policies provide coverage over and above your "traditional" liability coverages to help you recuperate quickly from a reputational

failure. For example, crisis containment insurance will reimburse you for the fees and costs of expert consultants needed to respond to one of the many crises specified in the policy. You can often buy endorsements, or policy additions, that add crisis management coverage to your product liability and recall policy.

Unfortunately, such insurance is designed to help with the financial impact of a crisis but cannot fully restore a company's reputation, which is a long-term process involving public relations and management strategies. No insurance policy can restore a corporation's stock or a company's reputation to its pre-loss levels after a highly publicized crisis, such as Boeing's. Preparedness is key. A speedy and appropriate response can often prevent a small crisis from becoming a larger one. The hotel industry is a good example of preparedness. In a well-run hotel, every on-duty manager can access a binder with response guidelines for adverse events, each tailored to the operations of the particular hotel, addressing specific risks such as health scares, fire safety, or guest incidents.

Your Crisis Management Plan

To develop your crisis management plan, analyze your risk exposures and identify actions to manage them. A thorough analysis will require the input of various departments and possibly outside experts. For example, what vulnerabilities and risk exposures do your company's legal department or legal counsel see? What risk factors does the company include in public disclosures? What are other potential sources of reputational risk?

In addition to securing insurance coverages, your insurance broker can offer loss prevention suggestions and strategies. If necessary, your broker might even recommend an outside risk manager with a particular area of expertise.

A public relations firm that specializes in crisis management can help your firm create crisis communication plans for various scenarios, including training spokespeople and simulating crisis scenarios. Having well-considered responses ready will give you one less thing to worry about when an emergency occurs. For more information on protecting your firm's reputation, please contact us. ■

What's the Difference between Professional Liability and Errors & Omissions (E&O)?

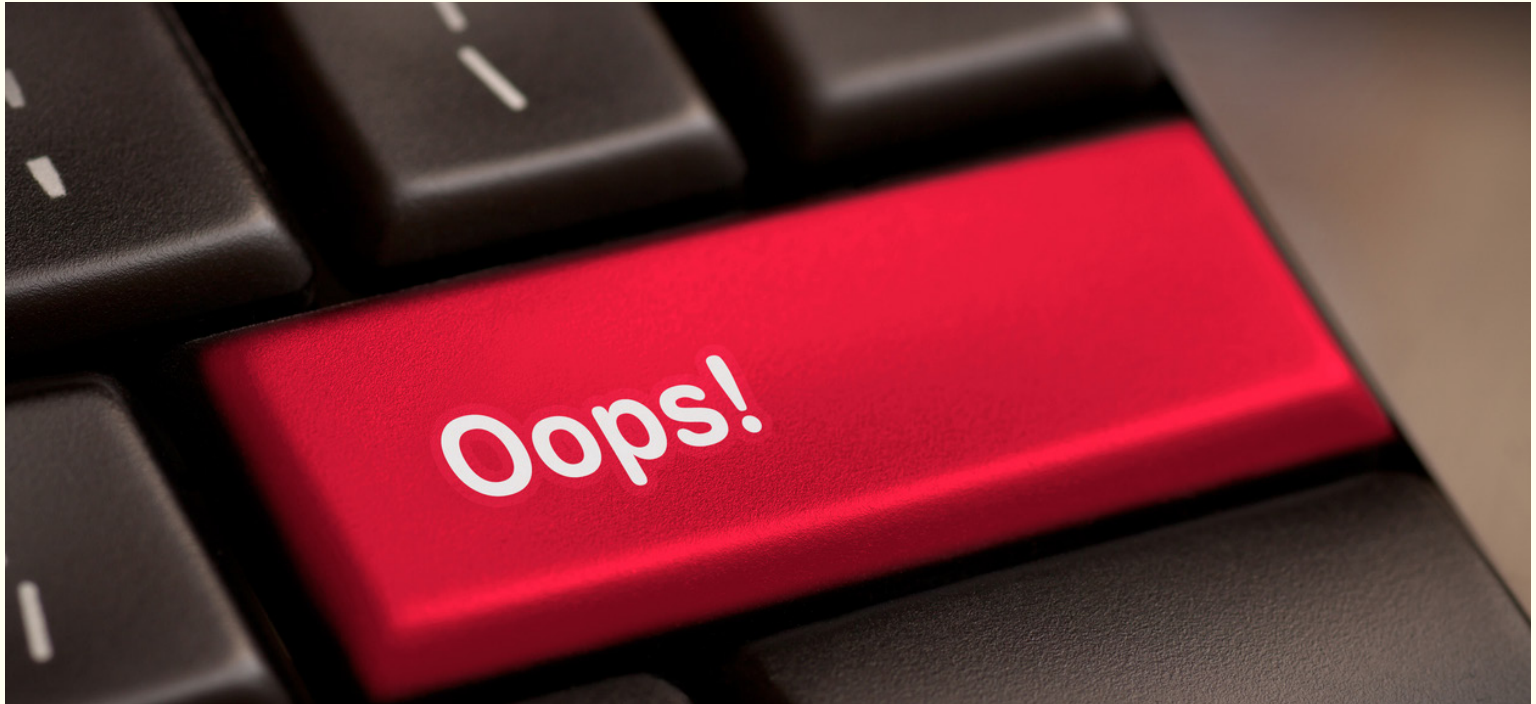
What do an ice sculptor and a real estate agent have in common? Both may need insurance to protect against errors in their services, typically in the form of Errors & Omissions (E&O) coverage.

Standard commercial general liability insurance does not cover professional liability, so professions like doctors and attorneys carry malpractice insurance to protect against lawsuits.

Historically, insurance for traditional professionals (lawyers, doctors) was called Professional Liability (PL), while quasi-professionals had E&O policies. However, insurers now often use the terms interchangeably. Both PL and E&O policies cover financial losses incurred by third parties but exclude property damage and, often, bodily injury, with exceptions like medical malpractice insurance.

Who Needs Coverage? Beyond doctors and lawyers, many professionals, including those offering advice or creating products, need liability protection. For example, an ice sculptor creating a swan for a wedding may face a lawsuit if a client deems the result unsatisfactory.

Defense Costs E&O insurance is crucial for covering defense costs, which can bankrupt small businesses even if a claim is ultimately dismissed. In the medical field, defending against frivolous



lawsuits can still cost \$120,000 on average.

Tailored Coverage Policies are typically customized for specific professions. For instance, real estate brokers may get coverage for failing to advise on environmental risks, while accountants may be covered for acting as trustees. Additionally, coverage may include things like inadvertent data corruption or transmission of viruses.

Lately, even more elaborately designed add-ons are appearing in E&O policies. For example, a London-based specialty insurer recently announced it was launching a package coverage for U.S. manufacturers that combines errors and omissions coverage with cyber (including threat intelligence, security alerts, and risk management services), pollution (including liability at third-party sites resulting from the manufactured product), liability, media and advertising injury (including defamation

and licensing breaches) and intellectual property protection against trademark and copyright infringement claims—all under one policy.

The coverage is designed to address potential gaps in coverage for losses that may not be fully addressed by a manufacturer's general liability or product recall insurance policy, the company, CFC, said in a statement.

Claims-Made vs. Occurrence-Based Policies Most PL and E&O policies are “claims-made,” meaning they only cover claims filed during the policy period. Some companies offer “occurrence-based” policies, which cover incidents that happen during the policy period, regardless of when a claim is filed. Special provisions may extend the claims period for retirees or those permanently disabled.

If you have concerns about your business's liability coverage, contact us for advice. ■

How Do Insurance Cases Decided in One State Affect Cases in Other States?

Understanding case law as precedent in the U.S. is crucial, particularly regarding insurance coverage. The Massachusetts Appeals Court ruling discussed in our lead article, while specific to Massachusetts, has broader implications due to the common law tradition that we inherited from England:

- 1. Legal Precedent:** Although not binding outside Massachusetts, this ruling can be cited as persuasive authority in other jurisdictions, guiding courts facing similar legal issues related to construction defects and CGL policies.
- 2. Uniformity in Insurance Practices:** The ruling may lead insurers in other states to adopt similar policy language or interpretations, potentially limiting coverage for construction defects and fostering a more uniform approach across the industry.
- 3. Litigation Trends:** If the ruling gains traction, it might influence litigation strategies in other states, resulting in more disputes about coverage interpretations as contractors and property owners encounter

similar defenses in lawsuits.

- 4. Legislative Responses:** The decision may prompt legislative reviews or changes in other states regarding insurance coverage for construction defects, especially if stakeholders express concerns about the ruling's implications.
- 5. Increased Awareness:** This ruling raises awareness of CGL coverage nuances among attorneys, contractors, and property owners, leading to proactive measures in contract drafting and insurance procurement for adequate coverage.
- 6. Judicial Trends:** If similar cases arise, the Massachusetts ruling could influence judges and court decisions, particularly if its reasoning aligns with the legal framework of other jurisdictions.

Overall, while Massachusetts law is not directly applicable elsewhere, the principles established could significantly impact how courts interpret similar issues, insurers structure their policies, and parties manage construction and liability risks nationwide. ■

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