

EIFS: You Should Be Covered!

By Cathleen Cinella Tylis

Commercial and residential home builders are facing an increasing number of lawsuits arising out of faulty workmanship or defective products used in building construction. A recent spate of cases involve construction defects stemming from a product known as exterior insulation finishing systems ("EIFS"). As litigation involving EIFS has risen, insurance premiums for companies purchasing specialty EIFS coverage have increased dramatically. According to The Business Journal (January 27, 2003), companies looking to get EIFS coverage written into their policies face premium increases of 15%, while some insurance companies are selling very expensive "specialty" EIFS policies. Before looking into purchasing specialty EIFS coverage, builders potentially facing EIFS-related claims should look to their own commercial general liability ("CGL") insurance policies as well as the policies sold to their subcontractors. These policies may very well provide all the coverage needed.

EIFS-Related Claims

EIFS is an exterior cladding system that became a builder favorite in the late 1980's and early 1990's as an alternative to brick, wood, traditional stucco or vinyl siding. EIFS was developed in Germany in the 1940's following World War II to help restore bombed-out buildings. It functions as a barrier between the outside elements and the remainder of the building structure and works well in desert climates. The elaborate facades of Caesar's Palace and the Bellagio Hotel in Las Vegas both use EIFS. Problems with EIFS, however, crop up in moist climates where homeowners allege that the defective installation of EIFS has caused moisture problems damaging the structural integrity of their homes. The typical defendants in an EIFS case include the general contractor (hereinafter, the "builder"), the subcontractor, the EIFS distributor, and the EIFS manufacturer. This article will address some of the coverage issues that builders facing potential EIFS-related liabilities may encounter.

Whose Insurance Applies?

Claims against builders for EIFS-related defects should be covered under the builder's own CGL policy. The insuring
"EIFS..." continued page 2

Four Things Every Real Estate Professional Should Know About Environmental Insurance

By John G. Nevius

These days almost any property carries with it the possibility of environmental contamination. Even "virgin" agricultural land may be contaminated by pesticides, herbicides, animal waste or that forgotten underground storage tank Farmer Brown used to gas up his tractor. Even if there are no pollution sources on-site, contaminants can migrate from almost anywhere—mold spores and groundwater know no boundaries. Historic liability insurance policies may still have tremendous value in addressing environmental problems. However, even insurance companies that in the past may have reflexively denied any sort of "environmental" claims now offer a variety of products that can address these environmental concerns and facilitate all types of real estate transactions.

Facilitating Deals

Purchasing any one of a number of new environmental insurance products can minimize the need for elaborate indemnity agreements between a buyer and a seller. At properties where potential environmental risks are considered minimal, certain types of insurance are being used in place

"Four Things..." continued page 2

"Four Things..." continued

of traditional Phase I Assessments. Bringing environmental insurance into the equation can provide all parties to a transaction, including lenders, the level of comfort they need to get the deal done and in real time at the speed with which most businesses would like to operate.

Capping Cleanup Costs

When contemplating the reuse of contaminated land, *i.e.*, turning Brownfields into green fields, insurance can be purchased to cap projected clean-up costs or cover the costs of the entire investigation and remediation. So-called Cleanup Cost Cap and Finite Risk insurance policies can be used to provide an element of certainty to stakeholders when cleanup is necessary. A general rule of thumb is that the projected cleanup costs total approximately \$2 million or more or there has to be some other significant sticking point on the part of at least one of the parties to make the purchase of these products worthwhile. The underwriting process may also take more time than expected and uncover new problems. Local, state and federal Brownfield initiatives, including tax breaks and accelerated approval by environmental regulators, however, make reuse of land—even industrial property—increasingly attractive.

Toxic Mold

Most insurance policies sold today attempt to exclude liability for mold contamination. Anywhere there is water, there may be mold. This means that when a tree falls on your house in a storm, residual water can cause significant expense if not promptly addressed. In addition to purchasing a tarpaulin and a dehumidifier, mold coverage can be "added back" by endorsement to address this issue before a loss is sustained. Of course, less coverage should mean lower premiums. Insurance companies and insurance professionals should inform you of any changes in coverage and your options for dealing with them.

"Four Things..." continued page 3

"EIFS..." continued

agreement of a builder's general liability policy typically provides that the insurance company "will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies." Claims against builders for EIFS-related defects generally satisfy the requirements of the policy's insuring agreement.

In addition to their own CGL policies, builders also may be covered as Additional Insureds under the CGL policies sold to their subcontractors working on the project. Many builders must be insured by the subcontractor under standard contracts between the builder, subcontractor and the subcontractor's insurance company, and such insurance may be confirmed by policy endorsements to the Additional Insured parties. In many cases, the Additional Insureds do not receive the actual endorsement, but are notified by way of a certificate of insurance.

The "Your Work" Exclusion Does Not Preclude Coverage

The standard CGL policy contains a number of exclusions sometimes referred to as "business risk" or "work product" exclusions. One of the principal business risk exclusions is the "your work" exclusion. This exclusion is often raised by insurance companies in connection with claims against builders for defective work. The insurance companies argue that the CGL policy is not intended to serve as a warranty against a policyholder's own defective workmanship and that builders are expected to assume this responsibility as a "business risk."

It is well-established, however, that the "your work" exclusion does *not* apply where the defective component has damaged other parts of the building, causing independent third-party property damage. An example of this is where defective EIFS has allowed water to damage a home's wooden or other substrate. The majority of courts have further held that the mere incorporation of a defective component that causes physical injury into a larger component gives rise to covered damages to the larger component.

The distinction between an uninsurable "business risk" and an insurable risk is best illustrated by the following example. Suppose a tradesman applies EIFS to an exterior wall of a home in a faulty manner. Insurance companies would argue that the costs to repair and replace the tradesman's *own* defective work product is not covered under the tradesman's policy. If, however, the EIFS causes independent collateral property damage to another's work product, then the claim for those damages would be covered.

In 1986, the insurance industry carved out another exception to the “your work” exclusion with the addition of the subcontractor exception:

This exclusion does not apply if the damaged work or the work out of which the damages arises was performed on your behalf by the subcontractor.

This revision put to rest any confusion over the scope of the “your work” exclusion and clearly acknowledged that builders are afforded coverage for property damage that either arises out of or is the work of a subcontractor. The rationale for providing coverage for claims arising out of a subcontractor’s defective workmanship is that a subcontractor’s performance is not within the builder’s control and therefore presents an insurable risk.

Conclusion

Builders potentially facing EIFS-related claims need not rush to purchase specialty EIFS policies. Before purchasing expensive “add-on” coverage, builders should carefully examine their own CGL policy, which, in many cases, may provide coverage. In addition, there may be coverage for the builder under its subcontractor’s policy. Insurance companies will routinely challenge significant claims by arguing that certain business risk exclusions, namely the “your work” exclusion, preclude coverage. Builders should not accept these arguments because the “your work” exclusion does not apply to coverage for property damage claims arising out of their subcontractor’s work or where the defective EIFS allegedly caused independent collateral property damage to another’s work product. ■



Cathleen Cinella Tylis is an attorney in the New York office of Anderson Kill & Olick, P.C. Ms. Tylis regularly represents policyholders in insurance coverage disputes.



John G. Nevius is an attorney in the New York office of Anderson Kill & Olick. Mr. Nevius successfully has resolved and litigated numerous insurance coverage actions on behalf of policyholders and provides advice and technical expertise on a wide range of environmental matters. Mr. Nevius also is a registered Professional Engineer.

“Four Things...” continued

Old Liability Insurance Can Fund Redevelopment

Historic Comprehensive General Liability (“CGL”) insurance can respond to today’s environmental liabilities. Prior to approximately 1985, liability insurance routinely provided coverage for an “occurrence” taking place during the policy period. If activities giving rise to pollution occurred during the insurance policy period, the policy is designed to respond today to address any remaining historic damage to property that may have taken place decades ago.

Certain exclusions periodically have been introduced by the insurance industry purporting to exclude coverage for environmental liability. Pre-1973 liability insurance typically is free of these exclusions, but, as with all purported exclusions, whether and how they apply is often a very complex question involving industry intent, contract interpretation, the facts on the ground and state law. The bottom line: when an insurance company cites an exclusion to avoid coverage, never simply take their word for it.

Another issue with historic coverage involves locating the insurance policies and determining what entity or entities is or are covered. “Missing” policies can be found in insurance company files or established based on secondary evidence from accounting, government or insurance broker records, etc. Moreover, changes in corporate structure or nomenclature can be addressed through proper research. Insurance is designed to cover liabilities. Insurance companies should not be able to avoid their coverage obligations merely because of corporate name changes or mergers and acquisitions. Even the most tenuous claims may have some value as insurance companies may be willing to “buy-back” old coverage merely to take potential liabilities off the books for good. Of course, old insurance may have value over and above simply addressing environmental liabilities and partial “buy-backs” may be a better option than simply selling back all potential coverage. So pull those records back from storage and call your retired broker in Florida—old insurance policies can be worth more than their weight in gold. After all, you paid for them. ■

Real Estate & Construction Advisor
Anderson Kill & Olick, P.C.
1251 Avenue of the Americas
New York, NY 10020-1182

The AKO *Real Estate & Construction Advisor* is published periodically by Anderson Kill & Olick, P.C. to inform clients, friends, and fellow professionals of developments in the real estate and construction laws. This newsletter is available free of charge to interested parties. The articles appearing in the *Real Estate & Construction Advisor* do not constitute legal advice or opinions. Legal advice and opinions are provided by the Firm only upon engagement with respect to specific factual situations.

AKO's *Real Estate & Construction Focus Group* is a group of attorneys from various AKO departments, including the Insurance Coverage, Real Estate, and Corporate departments who have an interest in legal issues in the real estate and construction fields. The *Real Estate & Construction Focus Group* meets periodically to share insights on new developments in insurance, construction and real estate law, in the belief that an inter-disciplinary approach to legal problems will often maximize client profitability or recoveries, while minimizing costs.

To subscribe to the *Real Estate & Construction Advisor* or any of the Anderson Kill & Olick Newsletters and Alerts, please go to: www.andersonkill.com/subscribe.

Copyright © Anderson Kill & Olick, P.C., 2003.
All rights reserved.

AKO Real Estate & Construction Advisor Member Information

We hope you have enjoyed this issue of the *Real Estate & Construction Advisor*. We invite you to contact the members of our Group, listed below, with your questions and concerns.

Lawrence J. Bartelemucci	(212) 278-1883	lbartelemucci@andersonkill.com
Arnold L. Bartfeld	(212) 278-1511	abartfeld@andersonkill.com
Jonathan Bauer	(973) 642-5133	jbauer@andersonkill.com
John B. Berringer, Co-Chair	(212) 278-1500	jberringer@andersonkill.com
Robert S. Cook, Jr.	(212) 278-1203	rcook@andersonkill.com
James P. Cullen, Co-Chair	(212) 278-1565	jcullen@andersonkill.com
Jean M. Farrell	(212) 278-1222	jfarrell@andersonkill.com
Robert E. Frankel	(215) 568-4295	rfrankel@andersonkill.com
Jody L. Googel	(212) 278-1815	jgoogel@andersonkill.com
Thomas A. Neufeld, Editor	(212) 278-1840	tneufeld@andersonkill.com
John G. Nevius	(212) 278-1508	jnevius@andersonkill.com
Cathleen Cinella Tylis	(212) 278-1390	ctylis@andersonkill.com
Mark Weldon	(212) 278-1201	mweldon@andersonkill.com

**GET IT FIRST,
GET IT FAST**

If you are presently receiving our newsletters via regular mail but would like to receive them via e-mail, visit our website at <http://www.andersonkill.com>.

**NEWSLETTER
READER'S SURVEY**

Your opinions matter to us, visit our website at <http://www.andersonkill.com> to complete our survey.