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I Rip, You Tear, The Carrier Pays? Insurance Coverage for Rip and Tear Expenses

I. Overview of Rip and Tear

"Rip and tear" costs are those costs required to access defective work or property damage. The issue is whether a commercial general liability (CGL) policy provides coverage for such costs. Rip and tear expenses should be treated as consequential damages that insureds become legally obligated to pay if they are liable for the damage or defect that needs to be repaired. With respect to insurance coverage, if the CGL policy covers the underlying damage or defect, then the consequential rip and tear expenses should be covered as well. And if the underlying damage or defect is not covered, the rip and tear should not be either as these costs should not be able to create a source of insurance coverage on their own. Courts do not always follow this straight-forward logic.

A. Policy Language of CGL Insuring Agreement

A CGL insuring agreement the insuring agreement unambiguously states that an insurance carrier is obligated to "pay those sums that the insured becomes legally obligated to pay as damages *because of* . . . '*property damage' to which this insurance applies*."

1. Property Damage

When the allegations against the insured are for only defective workmanship that merely diminishes the value of the property without causing physical injury or loss of use, there is no insurance coverage because defective work in and of itself is not "property damage" under the insuring agreement in most states. *See, e.g., Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 11 (Tex. 2007)*. In this situation, the costs to get to the insured's defective work should likewise not be covered because there are no "damages because of . . . 'property damage'" since there is no "property damage" but only uncovered defective workmanship. *Cf., Lennar Corp v. Great Am. Ins. Co.*, 200 S.W.3d 651, 679-80 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (costs incurred to remove and replace EIFS as preventative measure were not covered because they were not "damages because of . . . property damage.").

2. To Which This Insurance Applies

The CGL insuring agreement's language "***to which this insurance applies***" means that the "property damage" must be covered before the consequential damages flowing from such "property damage" can be covered. *See, e.g.*, *Hartford Acc. & Indem. Co. v. Pac. Mut. Life Ins. Co*., 861 F.2d 250, 255 (10th Cir. 1988) ("Since the insured's products and installation are not property damage to which the insurance applies, any consequential damages caused by such products and installation are not covered."); *American Home Assurance Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 24-25 (1st Cir. 1986) (stating a CGL policy "would cover only consequential damages resulting from 'property damage to which this insurance applies'").

The operation of an exclusion should preclude the recovery for "rip and tear" expenses. For example, if the "your work" exclusion precludes coverage to the insured for the costs to repair the insured's completed work and there is no damage to other property caused by the insured's work, the policy will not provide insurance coverage to the insured. In this situation, the expenses incurred getting to the uncovered "property damage" should not be permitted to create coverage when coverage for repairing the uncovered "property damage" would not otherwise exist. Again, the insuring agreement grants coverage for "because of" damages, but only if there is "'property damage' to which this insurance applies."

Permitting "rip and tear" expenses to be covered where there is no covered "property damage" would result in giving no meaning to the phrase "to which this insurance applies."

3. Consequential Damages

The insuring agreement provides insurance coverage for damages "because of" property damage. "In light of [the insuring agreement] wording, all damages flowing as a consequence of bodily injury or property damage would be encompassed by the insurer's promise, subject to any applicable exclusion or condition. This includes purely economic damages, *as long as they result from otherwise covered bodily injury or property damage*." Donald S. Malecki, Commercial General Liability Coverage Guide, 2-3 (11th Ed. 2015) (emphasis added).

4. Plain Language Rule: Rip and Tear cannot create coverage

The plain language rule that the majority of courts follow can be summarized as follows "[T]he costs to rip out otherwise non-defective work in order to repair otherwise non-covered defective work is not "property damage," but the costs to rip out non-defective work in order to repair covered "property damage" is considered damages because of "property damage" and is covered. The rationale of many of these decisions is that the nature of the repairs cannot create coverage if none exists." Lee H. Shidlofsky, *Deconstructing CGL Insurance Coverage Issues in Construction Cases*, Journal of the American College of Construction Lawyers, Vol. 9, No. 2 (Summer 2015);

5. Example of Straight Forward Analysis: *Regional Steel Corp. v. Liberty Surplus Ins.*, 226 Cal.App.4th 1377, 173 Cal.Rptr.3d 91, 93-94 (2014)

In *Regional Steel Corp. v. Liberty Surplus Ins. Corp.*, the California Court of Appeals provided a good example of repair expenses for which the insured was liable were not covered because they did not flow from covered "property damage." 226 Cal.App.4th 1377, 173 Cal.Rptr.3d 91, 93-94 (2014). The insured subcontractor installed two types of seismic tie hooks (connecting rebar in buildings to prevent earthquakes damage). The tie hooks were then encased in concrete. The building inspector ordered that only one kind of seismic tie hook could be used. As a result, the concrete had to be torn out in order to correct the "inadequate installation" of the tie hooks. The California Court of Appeals relied upon the rule that incorporating the wrong product into a structure is not covered "physical injury to tangible property" unless the product causes physical injury to other property. Because there was no covered "property damage," the cost to get to the tie hooks were not covered either.

II. <u>Examples and Courts' Analysis</u>

A. Pool – *Colorado Pool Systems, Inc. v. Scottsdale Insurance Company*, 317 P.3d 1262 (Colo. App. 2012).

In Colorado Pool Systems, a general contractor brought claims against its insurer after the insurer refused to indemnify the contractor for losses associated with demolishing and replacing an improperly constructed pool. The court there considered two types of property damage: "(1) the cost of demolishing and replacing the defective pool; and (2) consequential, or 'rip and tear,' damage to nondefective third-party work, which occurred during the replacement project." The court concluded that the "policy does not cover damage incurred in demolishing and replacing the pool itself.... [but the] rip and tear damage to nondefective third-party work (including damage to the deck, sidewalk, retaining wall, and electrical conduits) is covered. Thus, the court determined that "property damage" does not include costs of repair or replacement of defective workmanship, but does include consequential damage to other parts of the property.

B. Balcony - *Carithers v. Mid–Continent Casualty Company*, 782 F.3d 1240 (11th Cir. 2015).

In *Carithers*, the Eleventh Circuit held that "rip and tear" costs are covered property damage, even when the rip and tear is to remove defective work. A defectively constructed balcony permitted water intrusion that caused damaged to the attached garage. The district court found as a fact that, in order to repair the garage (which the parties agree constituted property damage), the balcony had to be rebuilt. The Eleventh Circuit agreed that the cost to remove and replace the defectively installed balconies was covered even though the balcony was originally defective. The court determined that "[s]ince the district court determined that repairing the balcony was part of the cost of repairing the garage, which was defective work, the Carithers were entitled to these damages."

C. Soil - *Desert Mountain Prop. Ltd. Partnership v. Liberty Mutual Fire Insurance Co.*, 236 P.3d 421 (Ariz. App. 2010), aff'd, 250 P.3d 196 (Ariz. 2011)

In *Desert Mountain Prop. Ltd. Partnership v. Liberty Mutual Fire Insurance Co.*, 236 P.3d 421 (Ariz. App. 2010), *aff'd*, 250 P.3d 196 (Ariz. 2011), the court held that a CGL policy does not cover damage to non-defective property during the repair and replacement of defective work. Desert Mountain's constructed homes experienced settlement problems, drainage issues, and patio cracks. After paying to have the soil issues corrected and damages repaired to these homes, Desert Mountain sent a notice of claim to its CGL carrier, Liberty Mutual. After Liberty Mutual denied coverage, Desert Mountain sued. The trial court found that Desert Mountain could not recover the cost of repairing the poorly compacted soil but could recover amounts that Desert Mountain spent to repair property damage that resulted from the soil issues.

On appeal, Desert Mountain argued that the superior court erred in ruling that the Liberty Mutual policies did not cover the expenses Desert Mountain incurred in repairing damage to non-defective property that occurred during the repair of the defective soil. Specifically, in order to repair some of the poorly compacted soil, Desert Mountain had to damage or destroy walls, floors, slabs, and other portions of the homes that had not been affected by the poorly compacted soil. In rejecting Desert Mountain's argument, the court explained that, even though there was destruction of non-defective property, the expenses for removing and repairing the non-defective property required to repair poorly compacted soil was more akin to the cost of repairing defective work. The court stated:

> The removal or destruction of non-defective property required to repair poorly compacted soil is not damage caused by the poorly compacted soil. Rather, it is damage caused by the repair of the poorly compacted soil. Therefore, because the cost of repairing the defect is not recoverable under a CGL policy in Arizona, the superior court did not err by ruling that costs incurred in "getting to" the defect were not covered under the policies at issue.

D. Flanges - *U.S. Metals, Inc. v. Liberty Mut. Group, Inc.*, 490 S.W.3d 20 (Tex. 2016).

The insurance coverage dispute arose from U.S. Metals' sale of approximately 350 custom-made flanges to ExxonMobil for use in constructing non-road diesel units at ExxonMobil's refineries. The flanges were supposed to meet industry standards and were designed to be welded to piping. The pipes and flanges were then covered with a special high temperature coating and insulation after they were welded together. In post-installation testing, several flanges leaked. Upon further investigation, it was determined that the flanges did not meet industry standards. ExxonMobil decided it was necessary to replace all of the flanges to avoid the risk of fire and explosion. For each flange, this process involved stripping the temperature coating and insulation (destroyed in the process), cutting the flange out of the pipe, removing the gaskets (also destroyed in the process), grinding the pipe surfaces smooth for re-welding, replacing the flange and gaskets, welding the new flange to the pipes, and replacing the temperature coating and insulation.

ExxonMobil sued U.S. Metals for the cost of replacing the flanges and damages for the loss of use of the diesel units while investigating, removing, and replacing the defective flanges. U.S. Metals settled with ExxonMobil for $2.2 million and then sought indemnification from its CGL carrier, Liberty Mutual Group, Inc. Liberty Mutual denied coverage.

Although the Court concluded that the "your product" exclusion precluded coverage for the flanges and the "impaired property" exclusion precluded coverage for the big ticket item of the diesel units' loss of use ($16,656,000), the Court found there was coverage for the destroyed insulation and gaskets. Critically, the Court first determined that those items suffered physical injury to tangible property (i.e., property damage) in order to fix the diesel units. Then, the Court determined that Exclusion M did not apply to those items by stating, "But the insulation and gaskets destroyed in the process were not restored to use; they were replaced. They were therefore not impaired property to which Exclusion M applied, and the cost of replacing them was therefore covered by the policy." Thus, under the Court's *U.S. Metals* analysis, the destruction of the insulation and gaskets in order to repair the defective flanges generated new property damage that triggered the CGL policy.

E. Other Examples – including stucco and concrete

There are numerous other examples of when it is necessary to remove non-defective work to access property damage. For instance, a contractor may need to remove the stucco on a house in order to get to the damaged framing. The question is whether the removal of such stucco should be covered and the extent to which it should be covered. An insurer will likely argue that even if there is covered property damage, the insurance policy should provide coverage only for the limited amount of stucco that needs to be removed. The insurer will likely further argue that the insurer is not on the hook to make that the limited new stucco to be an aesthetic match of the old stucco.

Another example involves a concrete subcontractor who provides defective concrete for a foundation. After a couple of months, the owner determines that the concrete is not strong enough. Ultimately, the concrete has to be removed. During the removal, the rebar, electrical, and plumbing work are damaged and now need to be replaced. If the concrete is not covered because it is not property damage or is excluded property damage, the insurer will argue that the rip and tear costs (damage to rebar, electrical, and plumbing) should not be covered either.

III. Future Issues

Courts treating damage caused by rip and tear as new property damage instead of consequential damage (e.g., U.S. Metals and Colorado Pool leads to critical uncertainties that courts will have to grapple with in future cases.

A. Can Rip and Tear Be an "Occurrence"?

One uncertainty created by the courts is whether rip and tear can be an "occurrence." If damage caused by rip and tear is entirely separate property damage, then a court will need to determine whether those damages were caused by an occurrence. Under a standard form CGL insuring agreement, property damage must be caused by an occurrence. The policy defines an "occurrence" as an "accident, including continuous or repeated exposure to substantially the

same general harmful conditions." The term "accident" is not defined by the policy. However, Black's Law Dictionary defines an "accident" as "an unintended and unforeseen injurious occurrence; something that does not occur in the usual course of events or that could not be reasonably anticipated." The Texas Supreme Court has previously stated that "[a]n accident is generally understood to be a fortuitous, unexpected, and unintended event . . .. An accident occurs as the culmination of forces working without design, coordination, or plan." *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 8 (Tex. 2007) (internal quotations omitted).

For example, in *U.S. Metals*, damage to the insulation and gaskets was not accidental because it was caused intentionally to access the defective flanges. Thus, it is unclear how the intentional destruction of the insulation and gaskets involves an occurrence.

Other courts have concluded that the intentional act of ripping and tearing into non-defective property is not an "occurrence." *See, e.g., OneBeacon Ins. v. Metro Ready-Mix, Inc.*, 427 F. Supp. 2d 574, 577-78 (D. Md. 2006), aff'd, 242 Fed. Appx. 936 (4th Cir. 2007) (concluding demolition and reconstruction of pilings and columns necessitated by repair of defective grout work not an "occurrence"); *Nas Sur. Group v. Precision Wood Products, Inc.*, 271 F. Supp. 2d 776, 783 (M.D. N.C. 2003) (finding the costs incurred to repair drywall, repaint walls and reinstall sinks, wiring and plumbing incident to the replacement of defective workmanship were foreseeable and therefore not an "occurrence").

B. Which Policy is Triggered?

Under the majority rule injury-in-fact trigger, property damage due to faulty workmanship "occurs" occurs when actual physical damage to the property occurred. *See, e.g., Don's Bldg. Supply, Inc. v. OneBeacon Insurance Co.*, 267 S.W.3d 20, 24–30 (Tex. 2008). As a result, the insurance policy that is in effect at the time the property damage occurs is the policy that is triggered.

With respect to property damage caused by rip and tear, this new property damage may not occur until years later. Thus, what happens if these repairs do not get started until a different carrier is on the risk? Is the carrier on the risk at the time of the original property damage responsible or is the new carrier responsible?

If the damages caused by the rip and tear are treated as new property damage, then the answer appears to be that the new insurer is responsible because the damage did not occur until the second insurer was on the risk. But if the insured is aware of the need for future property damage, how could the new damage caused by the rip and tear be unexpected or fortuitous?

C. Applicability of Exclusion A?

In addition, Exclusion A may apply to property damage caused by rip and tear. This exclusion precludes coverage for property damage if the property damage is "expected or intended from the standpoint of the insured." In examining whether this exclusion applies, courts focus on whether it is alleged that the insured had the intent to injure, rather than focusing strictly on whether the conduct was voluntary and intentional. *See, e.g., State Farm Fire & Casualty Company v. S.S. & G.W.,* 858 S.W.2d 374, 378 (Tex. 1993). Under the definition of intent, an insured intends to harm another if he intends the consequences of his act, or

believes that they are substantially certain to follow. With respect to property damage caused by rip and tear, this exclusion may apply if the insured intended the damage. But this exclusion may not apply if someone else performs the rip and tear because the insured presumably did not intend the damage.

D. Carriers Respond with Rip and Tear Endorsements

In light of the uncertainties created by courts around the country, some insurers have created rip and tear exclusions that limit their exposure for rip and tear costs. The following exclusion (Form AGL04250611) is an example of a rip and tear exclusion for a concrete insured, which precludes coverage for:

> Damages arising out of:
>
> (1) Any expenses incurred in removing concrete or concrete products from any structure or building due to defective concrete or for improperly mixed, manufactured, poured, formed, cured, or installed concrete;
> (2) Any expenses for replacing forms, reinforcements, piping and wiring that are destroyed during the course of removing defective concrete products; or
> (3) Any expenses for returning the structure or building to the condition that existed prior to the installation of concrete products.

Policies with such rip and tear exclusions may ultimately provide less coverage to policyholders than what many thought was covered under a standard form CGL policy. Thus, if insurers react to the uncertainties created by the courts by incorporating exclusions similar to the one listed above, the insured may end up with no rip and tear coverage at all.