STATE OF SOUTH CAROLINA
IN THE
SUPREME COURT

Appeal from the Court of Common Pleas
For Charleston County
Honorable B. Hicks Harwell, Jr., Circuit Court Judge
Case No.: 2000-CP-10-1054

Auto-Owners Insurance Company, Inc.,

Appellant,

v.

Virginia T. Newman and Trinity Construction, Inc.,

Respondents.

BRIEF OF THE *AMICUS CURIAE*, BUILDERS MUTUAL INSURANCE COMPANY IN SUPPORT OF PETITION FOR REHEARING

Stephen P. Groves, Sr., Esquire
NEXSEN PRUET, LLC
205 King Street, Suite 400
Charleston, South Carolina 29401
Telephone: 843.720.1725
Telecopier: 843.414.8206

Attorneys for the Amicus Curiae, Builders Mutual Insurance Co.

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I. INTEREST OF THE *AMICUS CURIAE*

Builders Mutual Insurance Company (hereinafter "Builders Mutual" or "BMIC"), is a small privately held insurance company located in Raleigh, North Carolina licensed to write insurance coverage in South Carolina, North Carolina, Virginia, and Tennessee. Builders Mutual has provided more than 20 years of uninterrupted insurance coverage exclusively to the home building industry. While BMIC grew out of the North Carolina Home Builders Association to provide workers' compensation to eligible members, Builders Mutual's lines of coverage have expanded and our territory has broadened to include, among other lines, workers' compensation, commercial general liability, commercial automobile, commercial property, builders risk, and umbrella liability.

Builders Mutual maintains close ties to the Home Builders Association, both in North Carolina and in other states so as to ensure continuous financial stability and to maintain Builders Mutual's goal of providing superior coverage and customer service.

This appeal and the decision which this Supreme Court has previously rendered herein[1] is very important to Builders Mutual because it concerns a number of issues involved in a great many of the insurance policies Builders Mutual has already issued to general contractors and/or subcontractors located and/or conducting operations in the State of South Carolina. Equally importantly, the *Auto-Owners v. Newman* decision will certainly affect insurance policies which Builders Mutual may eventually write for South Carolina insureds from this date forward. This includes whether such coverage will be (a) offered in the future, (b) offered, but significantly restricted, and/or (c) offered, but otherwise diminished due to the *Auto-Owners v. Newman* decision.

As an initial point, Builders Mutual does not agree with this Supreme Court's legal analysis or the results in either ***Section A*** or ***Section B*** of the *Auto-Owners v. Newman* decision, especially in view of the historical development of the comprehensive general liability insurance policy (hereinafter the "CGL Policy"). Even this Supreme Court's "elucidation" of the meanings attributed to its prior reference to

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1 *See* Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___ S.E.2d ___ (2008) (2008 WL 648546, filed March 10, 2008).

High County Associates v. New Hampshire Insurance Company,[2] in the *L-J, Inc. v. Bituminous Fire & Marine Insurance Company*,[3] decision does not justify this Supreme Court's decision or conclusions.[4]

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2 High County Associates v. New Hampshire Insurance Company, 139 N.H. 39, 648 A.2d 474 (1994).

3 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 621 S.E.2d 33 (2005).

4 Interestingly, in Auto-Owners v. Newman, this Supreme Court stated the distinction in the insurance coverage for "faulty workmanship" discussion was, in essence "who caused the faulty workmanship" and "did the faulty workmanship harm the property of a third-party". This Supreme Court noted it had "phrased the distinction as 'a claim for faulty workmanship versus a claim for damage to the work product caused by the negligence of a third party,' noting that the latter could be covered under a CGL policy." Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___, ___ S.E.2d ___, ___ (2008 WL 648546 *3) (*citing* L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 123, 621 S.E.2d 33, 36). Moreover, this Supreme Court stated "it should [have] be[en] clear that this [Supreme] Court intended the "third party" language to refer to subcontractors who [were] not a party to the CGL policy between the insurer and the contractor." Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___, ___ S.E.2d ___, ___ (2008 WL 648546 *3). The fallacy in this conclusion is under several South Carolina cases, ***a CGL Policy was never intended to cover faulty workmanship*** regardless of whether it was performed "negligently", "intentionally", "recklessly, or otherwise by either a contractor or a subcontractor. L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 121-122, 621 S.E.2d 33, 35.

Additionally, in this same vein, the authorities have recently noted:

> The South Carolina Supreme Court . . . muddled the facts of [High County Associates v. New Hampshire Insurance Company] when it used the case to draw a distinction between "a claim for faulty workmanship versus a claim for damage to the work product caused by the negligence of a third party." The facts of [High County Associates v. New Hampshire Insurance Company] reveal that a ***third party did not cause the damage to the project*** (the

More importantly, Builders Mutual believes this Supreme Court's conclusions in ***Section C*** of the *Auto-Owners v. Newman* decision constitutes an unjustified, unwarranted, and unnecessary expansion of liability insurance coverage under a CGL Policy. This is particularly true since neither the CGL Policy language nor the judicial decisions interpreting that policy language support this conclusion. In fact, given the fairly common factual situations existing in a typical construction defects and/or faulty workmanship cases, there would be very few, if any, instances where liability coverage would be held to ***not*** cover the

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> construction of condominium units); instead, the complaint alleged the contractor defectively constructed the condominiums, leading to the loss of structural integrity. Based on those facts, two possibilities exist: either the South Carolina Supreme Court considers a subcontractor a third party, or the court failed to appreciate the factual background of High Country. The ***first possibility seems implausible because subcontractors work on behalf of contractors and, therefore, are not considered third parties***. Similarly, it seems unlikely that the supreme court was not well-acquainted with the specific facts of [High County Associates v. New Hampshire Insurance Company]. The ***implausibility of both explanations*** inevitably leads to confusion in attempting to discern the supreme court's purpose in utilizing [High County Associates v. New Hampshire Insurance Company].

James P. Sullivan, *L-J, Inc. v. Bituminous Fire & Marine Insurance Co.: A Comedy of "Occurrences"*, 58 South Carolina Law Review 533, 541 (Spring 2007) (Internal footnotes omitted and emphasis added).

costs of assessing whether damage existed, as well as removing, repairing, and/or replacing a contractors' and/or subcontractor's defective work when such assessment, removal, repair, and/or replacement is "found necessary" to either access or repair/replace the damaged work of third-parties.

Should ***Section C*** of the *Auto-Owners v. Newman* decision continue to remain in effect, Builders Mutual is and will be significantly affected as BMIC will be required, as a matter of law, to provide its insureds liability insurance coverage based upon premiums calculated on a risk analysis which did not contemplate the existence of such extensive additional coverage.

In contrast to the focused legal analysis contained in the appellate briefs, Petition for Rehearing, and/or Returns of the Appellant, Auto-Owners Insurance Company, Inc. (hereinafter "Auto-Owners"), and the Respondents, Virginia T. Newman (hereinafter "Ms. Newman"), and Trinity Construction, Inc. (hereinafter "Trinity Construction"), Builders Mutual has identified some of the broader concerns invoked by ***Section C*** of *Auto-Owners v. Newman*. Builders Mutual respectfully submits the following legal arguments in hopes to assist this Supreme Court in ultimately resolving this case.

II. ARGUMENT AND CITATION OF AUTHORITY

Summary Of The Argument

This Supreme Court's decision to award Ms. Newman all of the damages associated with the assessment of damage together with the removal and replacement of the defective stucco which had damaged third-party work constitutes an unnecessary expansion of liability insurance coverage neither intended nor contemplated under the CGL Policy. This Supreme Court should grant Auto-Owners' Petition for Rehearing in this appeal and, in turn, withdraw and vacate ***Section C*** of the *Auto-Owners v. Newman* opinion.

A CGL Policy Does Not Require An Insurer To Pay The Costs Associated With The Removal, Repair, And/Or Replacement Of Defective Work Even If Such Removal, Repair, And/Or Replacement Is Required To Access And/Or Repair/Replace The Damaged Work Of A Third-Party

This Supreme Court, in ***Section C*** of the *Auto-Owners v. Newman* decision, concluded and held that since the "underlying moisture damage [in Ms. Newman's home] could neither be assessed nor repaired without first removing the entire [defective] stucco exterior[, the arbitrator's award of a monetary damage] allowance [to

Ms. Newman] for [the] replacement of the defective stucco ***was covered*** by the CGL policy as a cost associated with remedying the other property damage . . . ."[5]

A. A General Contractor's CGL Policy Has Now Become A Performance Bond For The Subcontractors' Work

This Supreme Court's *Auto-Owners v. Newman* decision has effectively transformed a general contractor's CGL Policy into a performance bond[6] for all of the work of the general contractor's various subcontractors since, in almost all circumstances, the allegedly defective work will have to be removed and replaced to either inspect the building for underlying damage to a third-party's work and/or to repair and/or replace the damaged third-party work. Moreover, since virtually all general contractors[7] operating in this State use one or more

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5 *See* Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___ S.E.2d ___. ___ (2008 WL 648546 *5) (Emphasis added).

6 "A performance bond guarantees that the work will be performed according to the specifications of the contract by providing a surety to stand in the place of the contractor should the contractor be unable to perform as required under the contract." L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 124, 621 S.E.2d 33, 37 (2005).

7 *See* S.C. Code Ann. § 40-59-20(6) (Thomson/West Supp. 2007). South Carolina law defines the term residential builder [(*i.e.*; general contractor, contractor)] as follows:

> one who constructs, superintends, or offers to construct or superintend the construction, repair,

subcontractors[8] to actually perform the construction work on residential and/or commercial buildings, there will be few, if any, occasions when the subcontractors' defective and/or faulty work, undisputedly

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improvement, or reimprovement of a residential building or structure which is not over three floors in height and which does not have more than [16] units in any single apartment building, when the cost of the undertaking exceeds [$5,000.00]."

8 *See* S.C. Code Ann. § 40-59-20(7) (Thomson/West Supp. 2007). South Carolina law defines the term residential specialty contractor [(*i.e.*; subcontractor)] as follows:

> an independent contractor who is not a licensed residential builder, who contracts with a licensed residential builder, general contractor, or individual property owner to do construction work, repairs, improvement, or reimprovement which requires special skills and involves the use of specialized construction trades or craft, when the undertakings exceed two hundred dollars and are not regulated by the provisions of Chapter 11. Residential specialty contracting includes the following areas of contracting and other areas as the commission may recognize by regulation:
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> (a) plumbers;
> (b) electricians;
> (c) heating and air conditioning installers and repairers;
> (d) vinyl and aluminum siding installers;
> (e) insulation installers;
> (f) roofers;
> (g) floor covering installers;
> (h) masons;
> (i) dry wall installers;
> (j) carpenters;
> (k) stucco installers;
> (l) painters/wall paperers.

undertaken on behalf of the general contractor fails to provide general liability coverage for these types of construction defect/faulty construction claims.

This assessment/removal/repair/replacement cost allowance conflicts with this Supreme Court's pronouncements in *L-J, Inc. v. Bituminous Fire & Marine Insurance Company*,**9** as well as other appellate court decisions in this State.**10** This Supreme Court specifically noted, in *L-J, Inc. v. Bituminous Fire & Marine Insurance Company*, that both it and the South Carolina Court of Appeals had "addressed the issue of whether CGL policies [were] intended to cover faulty workmanship[, noting . . .] a CGL policy [wa]s ***not intended to cover economic loss resulting from faulty workmanship[, nor] any liability . . . incurred because of faulty workmanship*** [as that was] part of the insured's contractual liability,

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9 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 621 S.E.2d 33.

10 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 121-122, 621 S.E.2d 33, 35 (*citing* Century Indemnity Co. v. Golden Hills Builders, Inc., 348 S.C. 559, 563-64, 561 S.E.2d 355, 357 (2002); Isle of Palms Pest Control Co. v. Monticello Insurance Co., 319 S.C. 12, 16, 459 S.E.2d 318, 320 (Ct.App.1994), *affirmed*, 321 S.C. 310, 468 S.E.2d 304 (1996); C.D. Walters Construction Co., Inc. v. Fireman's Insurance Company of Newark, New Jersey, 281 S.C. 593, 596-597, 316 S.E.2d 709, 711 (Ct.App. 1984) (holding that faulty workmanship is a business risk that is not intended to be covered by a CGL policy)).

not an insurable event under a CGL policy."[11] This Supreme Court essentially acknowledged that such defective construction and/or faulty workmanship claims constituted a general contractor's "risks" of doing business.

Additionally, in *L-J, Inc. v. Bituminous Fire & Marine Insurance Company*, this Supreme Court also found there was no "occurrence" of an "accident"[12] on the basis that "[i]f [this Supreme Court was] to hold otherwise, the CGL policy ***would be more like a performance bond***, which guarantees the work, rather than like an insurance policy, which is intended to insure against accidents."[13]

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11 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 121-122, 621 S.E.2d 33, 35 (*citing* Century Indemnity Co. v. Golden Hills Builders, Inc., 348 S.C. 559, 563-64, 561 S.E.2d 355, 357; Isle of Palms Pest Control Co. v. Monticello Insurance Co., 319 S.C. 12, 16, 459 S.E.2d 318, 320, *affirmed*, 321 S.C. 310, 468 S.E.2d 304; C.D. Walters Construction Co., Inc. v. Fireman's Insurance Company of Newark, New Jersey, 281 S.C. 593, 596-597, 316 S.E.2d 709, 711) (Emphasis added).

12 This Supreme Court stated that "faulty workmanship [wa]s not something that [wa]s typically caused by an accident or by exposure to the same general harmful conditions . . . ." L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 123, 621 S.E.2d 33, 36. *See also* Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___ S.E.2d ___. ___ (2008 WL 648546 *2) (*citing* L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 123, 621 S.E.2d 33, 36).

13 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 124, 621 S.E.2d 33, 37 (*citing* State Farm Fire & Casualty Co. v. Tillerson, 334 Ill.App.3d 404, 268 Ill.Dec. 63, 777 N.E.2d 986, 991 (2002) (holding that if courts were to find that CGL policies covered faulty workmanship, courts would effectively transforming CGL policies into

Prior to *Auto-Owners v. Newman*, faulty workmanship was not an "occurrence" because it was not an "accident" under a CGL Policy. Additionally, even if it could have been viewed as an "occurrence" (*i.e.*; an "accident"), one or more of the "business risk" exclusions generally operated to eliminate coverage for defective construction and/or faulty workmanship. Such activities were viewed as the "business risks" a contractor accepted when it contracted with third-parties to construct a home or a commercial building.

After *Auto-Owners v. Newman*, the only "business risks" involved are as follows:

(a) the risks to the insurance industry of providing coverage the insurance industry never contemplated or intended to provide and for which premiums were never charged;

(b) the risks to the construction industry that (i) insurers will not offer liability coverage for construction defects/faulty workmanship claim or, if offered, (ii) will be cost prohibitive or significantly restricted; and

(c) the risk to consumers that their contractors and/or subcontractors will operate in an uninsured status.

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performance bonds)) (Emphasis added). As noted, this Supreme Court had recognized a "performance bond guarantees that the work will be performed according to the specifications of the contract by providing a surety to stand in the place of the contractor should the contractor be unable to perform as required under the contract." L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 124, 621 S.E.2d 33, 37.

B. Liability For Defective Work Has Been Shifted From The Responsible Subcontractor To The General Contractor's Liability Insurance Carrier

One of this Supreme Court's principal justifications for denying insurance coverage to the general contractor in *L-J, Inc. v. Bituminous Fire & Marine Insurance Company* was the very reasonable proposition that to do so simply

> . . . ensure[d] that [the] ultimate liability [for the defective construction] falls to the one who performed the negligent work - the subcontractor - instead of the insurance carrier. It will also encourage contractors to choose their subcontractors more carefully instead of having to seek indemnification from the subcontractors after their work fails to meet the requirements of the contract.[14]

With the advent of *Auto-Owners v. Newman*, virtually none of this Supreme Court's rulings in *L-J, Inc. V. Bituminous Fire & Marine Insurance Company*, appear to still ring either true or binding. This Supreme Court, in *Auto-Owners v. Newman*, has completely eliminated any of the stated assurances "that [the] ultimate liability

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[14] L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 124, 621 S.E.2d 33, 37. As a purely practical matter, given this Supreme Court's rulings in Auto-Owners v. Newman, it appears this Supreme Court has effectively, albeit without saying so, completely overruled L-J, Inc. V. Bituminous Fire & Marine Insurance Company.

[for the defective construction and/or faulty workmanship] falls to the one who performed the negligent work - the subcontractor - instead of the insurance carrier."[15] In fact, this Supreme Court has ensured that the liability for a subcontractor's defective work will, almost always, fall upon the liability insurance carrier for the general contractor – assuming the general contractor has liability coverage.

The authorities recognize why this proposition is effectively self-defeating and against public policy:

> Several public policy reasons disallow recovery under a CGL policy for property damage arising out of faulty workmanship. First, allowing recovery would provide for double payment to the contractor. If the contractor recovers for faulty workmanship after accepting payment for completing the job, the contractor is accepting payment from the insurer for correcting a job that should have been performed correctly in the first place.
>
> The second public policy reason for disallowing recovery for faulty workmanship arises from the feeling that allowing such recovery would provide a disincentive for contractors to perform their jobs well. Further, the intent of CGL policies is not "to serve the purpose of a builder's performance bond,

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[15] L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 124, 621 S.E.2d 33, 37.

> which shifts the risk of poor performance away from the owner but not away from the contractor." Finally, courts often feel that contractors are in the best position to avoid such damage "by properly performing the work."[16]

Assuming that *L-J, Inc. V. Bituminous Fire & Marine Insurance Company* is still "good law", this Supreme Court's decision in *Auto-Owners v. Newman*, has eviscerated the principle that a subcontractor should be responsible for its defective construction or faulty workmanship.

A subcontractor has no incentive to maintain insurance coverage – if valid at all in the first instance. A contractor has no incentive to carefully hire its subcontractors since quality, experience, and financial stability no longer carry any weight. A homeowner has no incentive to hire a reputable contractor since the contractor's CGL "performance bond" Policy guarantees satisfaction. All three know the general contractor's insurance carrier will be there with an open checkbook if anything goes wrong.

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16 Anne Marie McNeil, *L-J, Inc. v. Bituminous Fire & Marine Insurance Company*: *In Determining Coverage Under Commercial General; Liability Policies, Should Policy Language Or Public Policy Control?*, 56 South Carolina Law Review 791, 800 (Summer 2005) (Internal citations omitted).

C. Requiring The General Contractor's Liability Insurance Carrier To Cover The Costs Of Removing And Replacing Admittedly Defective Work Unreasonably Extends Liability Coverage

This Supreme Court's decision to extend liability insurance coverage to cover the costs of removing and replacing admittedly defective work (*i.e.*; defective stucco and/or EIFS) when it was necessary in order to (a) ***assess*** whether defective construction has damaged a third-party's work and/or (b) ***repair*** the third-party's work which had been damaged by the defective construction contravenes CGL Policy language, is against the vast weight of court precedent, and fosters improper building and lackadaisical hiring practices.

1. PROMOTES LACKADAISICAL CONSTRUCTION AND APATHETIC SUBCONTRACTOR HIRING

In *L-J, Inc. v. Bituminous Fire & Marine Insurance Company*,, this Supreme Court recognized it was well-settled law in this State that a CGL Policy was ***not intended to provide liability insurance coverage for faulty workmanship*** since the risks of a contractor or subcontractor performing defective construction or faulty workmanship was plainly one of the "risks" of doing business.**17** This

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17 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 121-122, 621 S.E.2d 33, 35 (*citing* Century Indemnity Co. v. Golden Hills Builders, Inc., 348 S.C. 559, 563-64, 561 S.E.2d 355, 357; Isle of Palms Pest Control Co. v. Monticello Insurance Co., 319 S.C.

Supreme Court exhorted general contractors to be careful in their selection process stating "[o]ur holding today . . . will . . . encourage contractors to choose their subcontractors more carefully instead of having to seek indemnification from the subcontractors after their work fails to meet the requirements of the contract."**18** Nevertheless, *Auto-Owners v. Newman* has turned this reasonable proposition "on its head." Under *Auto-Owners v. Newman* contractors no longer have any incentive to do anything to ensure their subcontractors are qualified, insured, trustworthy, or diligent. Regardless of the work done by the subcontractors and regardless of whether the subcontractors have insurance coverage,**19** the general contractor is

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12, 16, 459 S.E.2d 318, 320, affirmed ; C.D. Walters Construction Co., Inc. v. Fireman's Insurance Company of Newark, New Jersey, 281 S.C. 593, 596-597, 316 S.E.2d 709, 711 (Ct.App. 1984) (holding that faulty workmanship is a business risk that is not intended to be covered by a CGL policy)).

18 L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 124, 621 S.E.2d 33, 37.

19 While it is true many, many subcontractors are required to and do provide their general contractor with "proof" of insurance coverage via a Certificate of Insurance, the validity of this "proof" is often less than the value of the piece of paper it is printed/written on. The authorities note that:

> Insurance certificates are documents issued by or on behalf of insurance companies to third parties who have not contracted with the insurer to purchase an insurance policy. . . . . The most common type are certificates that are ***issued for informational purposes***, in

buoyed by the knowledge that his, her, or its general liability insurance carrier will be standing right there to pay, for all practical purposes, the entire costs associated with removing, remediating, repairing, and/or replacing any defective work or faulty construction performed by a subcontractor.

> particular, for advising the third party of the existence and amount of insurance that has been issued to the named insured, since the named insured's contractual relationship with the third party [may obligate] that the named insured have a particular amount and type of insurance. The information conveyed is not, however, limited to describing the insurance available to the named insured.

1 Allan D. Windt, Insurance Claims & Disputes: Representation of Insurance Companies & Insureds: Fourth Edition, § 6:37A (West Group 2001) (*citing* TIG Insurance Co. v. Via Net, 178 S.W.3d 10, 18-20 and note 8 (Tex. App. Houston 1st Dist. 2005), *rehearing overruled*, (Aug. 11, 2005) *petition for review filed*, (Oct. 10, 2005); General Accident Insurance of America v. American National Fireproofing, Inc., 716 A.2d 751, 756 (R.I. 1998) (Emphasis added). *See also* Douglas R. Richmond, *Liability Coverage Under Certificates of Insurance* , 23 No. 11 Insurance Litigation Reporter 313 (West Group 2001) (*citing* Midland Enterprises., Inc. v. St. Paul Fire & Marine Insurance Co., 745 N.E.2d 455, 459 (Ohio App. 2000); General Accident Insurance Co. of America v. American National Fireproofing, Inc., 716 A.2d 751, 756 (R.I. 1998); Blackburn, Nickels & Smith v. National Farmers Union Property & Casualty Co., 482 N.W.2d 600, 603 (N.D. 1992)). *See also generally* Bradley Real Estate Trust v. Plummer & Rowe Insurance Agency, Inc., 136 N.H. 1, 4, 609 A.2d 1233, 1235 (1992) (*citing* Broderick Investments v. Strand Nordstrom *et al.*, 794 P.2d 264, 266 (Colo.App.1990) (Court concluded "[i]n effect, the certificate [of insurance] is a worthless document; it does no more than certify that insurance existed on the day the certificate was issued.")). Moreover, even if the Certificate of Insurance was "good" on both the day it was issued and on the day it was presented to the general contractor as "proof" of, *inter alia*, liability insurance coverage, more often than not the subcontractor fails to make any additional premium payments and the coverage lapses.

2. CONTRAVENES RECOGNIZED PRECEDENT

The proposition that defective work or faulty construction should not be covered by a CGL Policy is completely defeated when coverage is extended to pay for the costs associated with removing and replacing admittedly defective work. When courts find defective work is not covered

> " '[i]ts effect is to make the manufacturer or contractor stand its own replacement and repair losses while the insurer takes only the risk of injury to other property. For example, suppose in [a typical construction defects case] the contractor had to remove the defective stucco and this could not be done without damaging the structure of the house. The injury to the house would be covered, but the loss caused by having to remove the defective stucco would not be. This distinction is significant. Replacement and repair costs are to some degree within the control of the insured. They can be minimized by careful purchasing, inspection of material, quality control[,] and hiring policies. ***If replacement and repair costs were covered, the incentive to exercise care to or to make repairs at the least possible cost would be lessened since the insurance company would be footing the bill for all scrap***. Replacement and repair losses tend to be more frequent than losses through injury to other property, but replacement and repair losses are limited in amount since the greatest loss cannot exceed the cost of total replacement. If the insured will stand these losses, insurance can be provided more

> cheaply since the company will be freed from administering many small claims for repairs, and it can set a rate for the more unusual risk of injury to property other than the contractor's work or product. [When removal, repair, and replacement costs are covered the] risk [to the insurance carrier] can be the hazardous one since there are ***no natural limitations on the damage the contractor might do to a homeowner's or a neighbor's property***.' "**20**

Likewise, the United States District Court for the Western District of Virginia, in *Union Insurance Company v. Williams Contracting Co.*,**21** noted, in a construction defects case involving faulty construction of a residential foundation, as follows:

> Generally liability policies. . . . are not designed to provide contractors and developers with coverage against claims their work is inferior or defective. The ***risk of replacing and repairing defective materials or poor workmanship*** has generally been considered a commercial risk which is ***not passed on*** to the liability insurer **22**

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20 Central Mutual Insurance Company v. Del Mar Beach Club Owners Association, 123 Cal.App.3d 916, 928-929, 176 Cal.Rptr. 895, 902 (4th Dist. 1981) (*quoting* Volf v. Ocean Accident & Guarantee Association, 50 Cal.2d 373, 325 P.2d 987 (1958), *quoting* Stewart Macaulay,13 Stanford Law Review, *Justice Traynor and the Law of Contracts*, 825-826 (July 1961)), *reversed on other grounds*, Pines of La Jolla Homeowners Association v. Industrial Indemnity Company, 5 Cal.App.4th 714, 7 Cal.Rptr.2d 53 (4th Dist. 1992) (Emphasis added).

21 Union Insurance Company v. Williams Contracting Co., 2006 WL 1582405 (W.D.Va., filed June 2, 2006) (Not reported in F.Supp.2d).

22 Union Insurance Company v. Williams Contracting Co., 2006 WL 1582405 *6 (*quoting* Maryland Casualty Company v. Reeder, 221

In *French v. Assurance Company of America*,**23** the United States Court of Appeals for the Fourth Circuit addressed an insured contractor's claim against its insurance carrier arising out of defectively installed EIFS which subsequently damaged a home. Five years after moving into their home, James and Kathleen French (hereinafter the "Frenches"), "discovered extensive moisture and water damage to the otherwise nondefective structure and walls of their home resulting from the defective cladding of the exterior of their home with EIFS."**24** The Frenches ultimately sued their homebuilder which, in turn, requested their various insurance carriers, including Assurance Company of America (hereinafter "Assurance Company"), to defend and indemnify it.**25** Even though three of the carriers, including Assurance Company, jointly defended the builder in the litigation, albeit under a reservation of rights, the builder eventually

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Cal.App.3d 961, 967-68, 270 Cal.Rptr. 719, 722 (Cal.App.1990)) (Emphasis added).

23 French v. Assurance Company of America, 448 F.3d 693 (4th Cir. 2006). This Supreme Court has recently cited French v. Assurance Company of America with approval. *See* Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___ S.E.2d ___. ___ (2008 WL 648546 *3).

24 French v. Assurance Company of America, 448 F.3d 693, 696.

25 French v. Assurance Company of America, 448 F.3d 693, 696-697.

settled with the Frenches by confessing judgment and assigning all of its rights and claims against, among others, Assurance Company.**26** The Frenches then sued Assurance Company and others in Virginia State Court and the case was removed to Federal Court. The District Court granted summary judgment to Assurance Company and the Frenches appealed.**27**

On appeal, the Fourth Circuit, noted that for "analytical purposes, . . . it [was] necessary to divide the property damage to the Frenches' home into two categories. The first category [wa]s the defective EIFS exterior. The second category [wa]s the damage to the nondefective structure and walls of the Frenches' home directly resulting from moisture intrusion through the defective EIFS exterior."**28** The Court of Appeals concluded that a CGL Policy did not provide coverage for the first damage category in that the "defective application of the EIFS exterior to the Frenches' home [did] not constitute an 'accident,' and therefore, [was] not an 'occurrence' .

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26 French v. Assurance Company of America, 448 F.3d 693, 698-699.

27 French v. Assurance Company of America, 448 F.3d 693, 699.

28 French v. Assurance Company of America, 448 F.3d 693, 703.

. . . "**29** In fact, the Fourth Circuit stated the "obligation to repair the [defective EIFS] facade itself [wa]s not unexpected or unforeseen under the terms of the sales contract. Therefore, the repair or replacement damages represent economic loss and consequently would not trigger a duty to indemnify under a CGL policy."**30**

On the other hand, the Court of Appeals concluded, since there was no evidence the builder "subjectively expected or intended that the nondefective structure and walls of the Frenches' home would suffer damage from moisture intrusion",**31** therefore, the "moisture intrusion into the nondefective structure and walls of the Frenches' home was an accident, and therefore, an "occurrence" under the initial grant of coverage of the [CGL Policy]."**32** In conclusion the, Fourth Circuit stated a CGL Policy "provides liability coverage for the

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29 French v. Assurance Company of America, 448 F.3d 693, 703 (*citing* Lerner Corp. v. Assurance Company of America, 120 Md.App. 525, 707 A.2d 906, 912-913 (1998)).

30 French v. Assurance Company of America, 448 F.3d 693, 703 (*citing* Lerner Corp. v. Assurance Company of America, 120 Md.App. 525, 707 A.2d 906, 911-912).

31 French v. Assurance Company of America, 448 F.3d 693, 704.

32 French v. Assurance Company of America, 448 F.3d 693, 704.

cost to remedy unexpected and unintended property damage ***to the contractor's otherwise nondefective work-product*** caused by the subcontractor's defective workmanship."**33**

No where in the opinion did the Fourth Circuit, unlike this Supreme Court, extend liability coverage to cover both the admittedly defective work performed by the builder's subcontractor ***and*** the damage to the non-defective work.

Likewise, in *OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated*,**34** the United States Court of Appeals for the Fourth Circuit addressed an insured's claim against its insurance carrier arising out of a defective grout product produced by the insured which required the "demoli[tion] [of] certain portions of . . . new construction and [the] installi[tion] [of] new pilings with new grout.**35** The Court of Appeals set forth the parties' respective arguments and positions:

> OneBeacon . . . contend[ed] that Metro's defective grout did not damage any other property. Metro, on the other hand, argue[d] that the defective grout effectively damaged other property because the

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33 French v. Assurance Company of America, 448 F.3d 693, 706 (Emphasis added).

34 OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936 (4th Cir. 2007) (*per curiam*).

35 OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 938.

> caps and columns that were placed on top of the [defective] grout were required to be removed. Because that [third-party] property had to be destroyed to repair the defect, Metro contend[ed] it represent[ed] unintended property damage.**36**

Neither the District Court nor the Court of Appeals agreed with Metro's position. Looking to the Maryland Court of Special Appeals' decision in *Woodfin Equities Corp. v. Harford Mutual Insurance Co.*,**37**, the Fourth Circuit stated:

> The caps and columns that had to be removed or destroyed to remedy the defect in Metro's [grout] product are on all fours with the carpeting and drywall that had to be removed or destroyed in [*Woodfin Equities Corp. v. Harford Mutual Insurance Co.*] to remedy the defect in the HVAC units.

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36 OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 940.

37 Woodfin Equities Corp. v. Harford Mutual Insurance Co., 110 Md.App. 616, 678 A.2d 116 (Md.Ct.Spec.App. 1996), *overruled in part on procedural grounds*, 344 Md. 399, 687 A.2d 652 (1997). In Woodfin Equities, the insured defectively installed an HVAC system in a hotel. In order to repair the HVAC system, certain "carpeting and drywall had to be destroyed to remedy the defect." OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 940, (*citing* Woodfin Equities Corp. v. Harford Mutual Insurance Co., 110 Md.App. 616, 678 A.2d 116, 121, 131). After the repairs were completed, the "insured sought coverage for the costs of the carpeting and drywall [and the] Maryland court [concluded] the insurer was not required to cover the property damage because pulling up carpeting and breaking through drywall to access the HVAC system was not property damage, but rather the '***cost incurred in replacing and repairing the HVAC systems***.' " OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 940, (*citing* Woodfin Equities Corp. v. Harford Mutual Insurance Co., 110 Md.App. 616, 678 A.2d 116, 121, 131) (Emphasis added).

* * *

> . . . any harm to the caps and columns occurred as a result of replacing the [insured's] defective grout. This damage was not unforseen [to the insured] insofar as the term has been interpreted with respect to CGL policies under . . . longstanding principles of insurance law **38**

Consequently, the Fourth Circuit concluded "[a]ny damage done to the pile caps and columns while remedying Metro's defective grout cannot be deemed caused by an occurrence under the CGL policy 'because the so-called damage was not accidental.' "**39** Moreover, the Court of Appeals also concluded "[j]ust as a company must be presumed to foresee that it will be forced to pay for any defects in its own property, the ***company must also foresee that it will be forced to pay for incidental costs that are incurred in remedying those defects***."**40**

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38 OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 940-941 (*citing* Macaulay, *Justice Traynor and the Law of Contracts,* 13 Stanford Law Review 812, 825-826; French v. Assurance Company of America, 448 F.3d 693, 701).

39 OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 941 (*citing* Woodfin Equities Corp. v. Harford Mutual Insurance Co., 110 Md.App. 616, 678 A.2d 116, 132 n.8).

40 OneBeacon Insurance Company v. Metro Ready-Mix, Incorporated, 242 Fed. Appx. 936, 941 (Emphasis added).

Additionally, the United States Court of Appeals for the Ninth Circuit, in *MW Builders, Inc. v. Safeco Insurance Company of America*,**41** addressed damages to a Candlewood Suites Hotel due to defectively installed EIFS and the insured's claims for coverage for those damages. The Ninth Circuit, interpreting Oregon law, concluded the applicable CGL Policy covered the "damages [which] occurred to the . . . . Hotel . . . as a result of the faulty installation of [the EIFS, but, on the other hand, did not cover] any damages associated with the actual replacement of the EIFS . . . ."**42**

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41 MW Builders, Inc. v. Safeco Insurance Company of America, ___ F.3d ___ (9th Cir. 2008) (2008 WL 422222, filed February 15, 2008).

42 MW Builders, Inc. v. Safeco Insurance Company of America, ___ F.3d ___, ___ (2008 WL 422222 * 1). *See also generally* Wausau Underwriters, Inc. v. United Plastics Group, 512 F.3d 953, 957 (7th Cir. 2008) (*citing* Viking Construction Management, Inc. v. Liberty Mutual Insurance Co., 358 Ill.App.3d 34, 294 Ill.Dec. 478, 831 N.E.2d 1 (2005)) (no coverage for cost of repairing or replacing defective product); Columbia Mutual Insurance Company v. Epstein, 239 S.W.2d 667, 674 (Mo.App. E.D. 2007) (same); Stewart Interior Contractors, L.L.C. v. Metalpro Industries, L.L.C., 969 So.2d 653, 661 (La.App. 4th Cir. 2007) (*citing* Gaylord Chemical Corp. v. Propump, Inc., 753 So.2d 349, 353 n.5 (La.App. 1 Cir. 2000)) (court recognized that a CGL Policy "unambiguously exclude[d] coverage for damage to the work or product itself or for repair or replacement of the insured's defective work or product.' ").

The Florida Supreme Court, in *United State Fire Insurance Company v. J.S.U.B., Inc.*,**43** addressed an insured general contractor's claims for coverage for damages caused to residential structures by certain subcontractors' defective work. While finding insurance coverage for property damages caused by the defective work,**44** the Florida Court declined to cover removal, repair, and/or replacement of the defective work itself.**45** In reaching this

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43 United State Fire Insurance Company v. J.S.U.B., Inc., ___ So.2d ___ (Fla. 2007) (2007 WL 4440232, filed December 20, 2007).

44 The Florida Supreme Court recognized its decision to find that a subcontractor's faulty work constituted an "occurrence" and an "accident" under a CGL Policy placed it in the minority of jurisdictions reaching such a position. United State Fire Insurance Company v. J.S.U.B., Inc., ___ So.2d ___, ___ (2007 WL 4440232 *11). Interestingly, the Florida Supreme Court cited L-J, Inc. V. Bituminous Fire & Marine Insurance Company, as one of the decisions holding the ***majority*** position of no "occurrence" and no "accident". United State Fire Insurance Company v. J.S.U.B., Inc., ___ So.2d ___, ___ (2007 WL 4440232 *11) (*citing* L-J, Inc. V. Bituminous Fire & Marine Insurance Company, 366 S.C. 117, 123, 621 S.E.2d 33, 35-36).

45 United State Fire Insurance Company v. J.S.U.B., Inc., ___ So.2d ___, ___ (2007 WL 4440232, *14). *See also generally* ACUITY v. Burd & Smith Construction, Inc., 721 N.W.2d 33, 41 (N.D. 2006) (Court found coverage applied to damages cased by defectively installed roof, but no coverage to repair or replace the defective roof); McDonald Construction Company, Inc. v. Bituminous Casualty Corporation, 279 Ga.App. 757, 761-762, 632 S.E.2d 420, 423-424 (2006) (Coverage exists for property damage caused by the defective product, not for repair or replacement of the defective product itself); Nabholz Construction Corporation v. St. Paul Fire & Marine Insurance Company, 354 F.Supp.2d 917, 921-922 (E.D. Ark. 2005) (no coverage to repair/replace defectively installed roof, although coverage for damages caused by leaking roof); Sawhorse, Inc. v. Southern Guaranty Insurance Company of Georgia, 269 Ga.App. 493, 496-497, 604 S.E.2d 541, 545 (2004) (same); DCB Construction Company, Inc. v. Travelers Indemnity

conclusion, the Florida Supreme Court stated " . . courts have also recognized that there is a difference between a claim for the costs of repairing or removing defective work, which is not a claim for 'property damage', and a claim for the costs of repairing damage caused by the defective work, which is a claim for 'property damage'."**46**

The same court on the same day, in *Auto-Owners Insurance Company, Inc. v. Pozzi Window Company*,**47** considered a claim for insurance coverage to repair damages to a house caused by a

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Company of Illinois, 225 F.Supp.2d 1230 (D.Colo. 2002) (no coverage for repairing and replacing defective walls installed in an airport hotel); United Capitol Insurance Company v. Special Trucks, Inc., 918 F.Supp.2d 1250 (N.D. Ind. 1996).

46 United State Fire Insurance Company v. J.S.U.B., Inc., ___ So.2d ___, ___ (2007 WL 4440232, *14) (*citing* Cincinnati Insurance Co. v. Venetian Terrazzo, Inc., 198 F.Supp.2d 1074, 1079 n. 1 (E.D.Mo. 2001) (concluding that costs of repair and replacement of an improperly installed floor was not covered "property damage"); Lennar Corp. v. Great American Insurance Co., 200 S.W.3d 651, 679-680 (Tex.App. 2006) (distinguishing between costs to remove and replace defective stucco as a preventative measure, which were not "damages because of ... property damage," and the costs to repair water damage that resulted from the application of the defective stucco, which were "damages because of ... property damage"); Travelers Indemnity Co. of America v. Moore & Associates, Inc., 216 S.W.3d 302, 310 (Tenn. 2007); American Family Mutual Insurance Company v. American Girl, Inc., 268 Wis.2d 16, 673 N.W.2d 65, 74-75 (Wis.2004)). *See also generally* Auto-Owners Insurance Company, Inc. v. Pozzi Window Company, ___ So.2d ___ (Fla. 2007) (2007 WL 4440389, filed December 20, 2007).

47 Auto-Owners Insurance Company, Inc. v. Pozzi Window Company, ___ So.2d ___ (2007 WL 4440389).

subcontractor's defective installation of the windows.**48** The Florida Supreme Court, looking to *United State Fire Insurance Company v. J.S.U.B., Inc.*, concluded that "[b]ecause the subcontractor's defective installation of the windows [wa]s not itself 'physical injury to tangible property', there [wa]s no 'property damage' under the terms of the CGL policies. Accordingly, there [wa]s no coverage for the costs of repair or replacement of the defective work."**49**

3. VIOLATES CGL POLICY LANGUAGE

This Supreme Court's decision to permit recovery of the costs associated with assessing and/or repairing/replacing third-party work damaged by the defective construction contravenes the clear language of the CGL Policy. Exclusion ***n*** of a CGL Policy completely bars , prohibits, eliminates, and/or excludes coverage for the costs required to either repair, replace, remove, and/or dispose of the

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48 Auto-Owners Insurance Company, Inc. v. Pozzi Window Company, ___ So.2d ___, ___ (2007 WL 4440389 *1) (The homeowner sued the general contractor, window manufacturer, and the subcontractor. The window manufacturer settled the case and received an assignment from the general contractor as to all rights and claims against the general contractor's insurance carrier).

49 Auto-Owners Insurance Company, Inc. v. Pozzi Window Company, ___ So.2d ___, ___ (2007 WL 4440389 *5). *See also* West Orange Lumber Co. v. Indiana Lumbermens Mutual Insurance Co., 898 So.2d 1147, 1148 (Fla. 5th DCA 2005) ("[N]o allegation of 'property damage' when the only damage alleged was the cost of removing and replacing the wrong grade cedar siding that had been installed.").

insured's product ("your product") or the insured's work ("your product") – even, as herein, where the work was performed on the insured's behalf by a subcontractor.

Exclusion ***n*** of the CGL policy, captioned **Recall of Products, Work[,] Or Impaired Property**, specifically provides that coverage under the **COMMERCIAL GENERAL LIABILITY COVERAGE FORM**, does not apply to:

> Damages claimed for any loss, cost[,] or expense incurred by you [(the insured)] or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal[,] or disposal of:
>
> (1) "Your product";
>
> (2) "Your work"; or
>
> (3) "Impaired property" . . .
>
> If such product, work, or property is withdrawn . . . from use by any person . . . because of a known or suspected defect, deficiency, inadequacy[,] or dangerous condition in it.

The CGL Policy, in the **DEFINITIONS** section, defines the term "your work" to mean "[w]ork or operations performed by you or on your behalf . . . ."

Accordingly, the plain language of the CGL Policy does not justify, much less support, this Supreme Court's decision to confirm the arbitrator's award to Mrs. Newman "for replacement of the

defective stucco . . . ."**50** It is clear that the CGL Policy does not cover the costs required to replace, repair, remove[,] or dispose of defective products even when and if another party (*i.e.*; a subcontractor) performed the work "on your behalf" (*i.e.* ; on behalf of the insured general contractor). This Supreme Court's approval, in *Auto-Owners v. Newman*, of coverage for the cost to remove, repair, or replace the admittedly defective stucco work must be reversed.

The decisions from courts across this country consistently find a CGL Policy does not and never was intended to provide liability insurance coverage to either remove, repair, or replace admittedly defective construction and/or faulty workmanship. Only when and if the same defective construction and/or faulty workmanship actually caused damage to the work of a third-party do a minority of courts conclude only certain coverage applies. Even those jurisdictions decline to extend coverage to pay for the costs associated with ***assessing*** whether the defective work damaged the work of third-parties and/or ***removing/repairing/replacing*** the damaged third-

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50 Auto-Owners Insurance Company, Inc. v. Newman, ___ S.C. ___, ___ S.E.2d ___. ___ (2008 WL 648546 *6).

party work. This Supreme Court has gone way beyond the precedent and the policy language to gratuitously create coverage where none previously existed.

III. CONCLUSION

Based upon the foregoing arguments and citation of authority, the Amicus Curiae, Builders Mutual Insurance Company, respectfully requests this Supreme Court to consider this amicus brief and to grant the Petition for Rehearing in this appeal.

Respectfully submitted:

NEXSEN PRUET, LLC

By:_____

Stephen P. Groves, Sr., Esquire
205 King Street, Suite 400
Charleston, South Carolina 29401
Telephone: 843.577.9440
Telecopier: 843.414.8206

Attorneys for the Amicus Curiae,
Builders Mutual Insurance Company

Charleston, South Carolina
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