

6TH CIRCUIT CREATES BARRIER TO COVERAGE FOR WATER DAMAGE UNDER ENSUING LOSS EXCEPTION TO FAULTY WORKMANSHIP EXCLUSION

October 2010

The majority of decisions discussing ensuing loss conclude that, for there to be coverage under a resulting/ensuing loss clause, an insured must show that a peril separate and independent from the excluded peril caused damage to other property. However, the concept of ensuing loss, particularly when it involves water damage that results from faulty workmanship, is one over which courts struggle. In August, the Sixth Circuit revisited the issue of whether water damage caused by faulty workmanship came within an ensuing loss exception to a faulty workmanship exclusion. The majority found that it did not.

In TMW Enterprises v. Federal Insurance Company, 2010 U.S.App.LEXIS 17761 (6th Cir. 2010), TMW purchased all-risk coverage for its recently constructed condominium building. The policy excluded “loss or damage (including the costs of correcting or making good) caused by or resulting from any faulty, inadequate or defective: ... design, specifications, plans, workmanship, repair, construction, renovation, ...” The policy then went on to state that this “exclusion does not apply to ensuing loss or damage caused by or resulting from a peril not otherwise excluded.”

During a renovation of the building’s exterior, it was discovered that the original builder had improperly constructed the exterior walls, leaving them vulnerable to water infiltration. As a result, water had entered the facility via all four exterior walls, weakening the structural integrity of the building by corroding its steel structure. Without proper repair, the building faced the potential for mold growth and “catastrophic” structural failure due to moisture exposure. In order to correct this defect, TMW had to remove the building’s undamaged exterior masonry.

TMW submitted a claim to Federal, but after performing its own inspection, Federal denied the claim. In support of its denial, Federal attributed the damage to “construction defects” and “wear and tear,” both of which were excluded perils.

TMW responded to the denial by filing a declaratory judgment action. In that action, TMW moved for summary judgment arguing, *inter alia*, that even if faulty workmanship allowed water to seep into the walls, the water amounted to a “peril not otherwise excluded.” Thus, TMW argued that it suffered resulting water damage, which was a non-excluded ensuing loss.

The Court noted that there are two possible functions

served by the ensuing loss clause, both of which it found sufficient to defeat TMW’s argument. The first is that the clause simply means, that which is not excluded is covered. In other words, the clause functions as a form of redundancy for clarity purposes (*i.e.*, a “belts and suspenders” approach). The second function is to construe this clause as a “causation-in-fact-breaking link in coverage exclusions, establishing that independent, non-foreseeable losses caused by faulty construction are covered.” Accordingly, the “clause establishes that chronologically later-in-time damages ‘caused’ by ‘a peril not otherwise excluded’ remain covered.”

We note, however, that there was a dissent in the TMW Enterprises opinion, which ultimately concluded that the ensuing loss exception to the faulty workmanship exclusion was open to more than one reasonable interpretation and therefore ambiguous. In reaching this decision, the dissent relied on Blaine Construction Corp. v. Insurance Co. of North America, 171 F.3d 343 (6th Cir. 1999), another opinion from the Sixth Circuit. In Blaine, a subcontractor incorrectly sealed the edge tabs on the vapor barrier. As a result, moisture migrated above the barrier, trapping condensation in the cavities between the purlins (the structural steel framing members containing the insulation) causing property damage.

INA denied coverage based on policy exclusions for faulty workmanship and dampness or dryness of atmosphere. In response, the insured argued that, even if this was faulty workmanship, the ensuing loss exception afforded coverage for its damages. The Sixth Circuit held that a builder’s all-risk policy’s ensuing loss exception to a faulty workmanship exclusion was ambiguous because it was subject to conflicting interpretations. Thus, the insured’s damages were not barred by the faulty workmanship exclusion.

TMW Enterprises does not appear to have overruled Blaine, as the court noted that it was directed by the laws of a different state and by differently worded policy provisions. Nevertheless, TMW Enterprises reaches a starkly different outcome than Blaine, placing into question just how the Sixth Circuit will decide such issues in the future.

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