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IN THE SUPREME COURT
STATE OF ARIZONA

DESERT MOUNTAIN PROPERTIES LIMITED PARTNERSHIP, Plaintiff-Appellee-Respondent, v. **LIBERTY MUTUAL FIRE INSURANCE COMPANY**, Defendant-Appellant-Petitioner.	**Case No. CV-10-0339-PR** Arizona Court of Appeals Case No. 1 CA-CV 08-0802 Maricopa County Superior Court Case No. CV 2003-009686 Hon. Robert E. Miles **AMICUS CURIAE BRIEF OF THE ARIZONA ASSOCIATION FOR JUSTICE/ARIZONA TRIAL LAWYERS ASSOCIATION AND UNITED POLICYHOLDERS**

Table of Contents

Table of Authorities

Page

Cases

Other Authorities

Treatises

I. Introduction.

The Court accepted review to examine several insurance-coverage questions arising from a construction defect claim. The specific coverage issues accepted for review are (1) whether a contract-tort distinction should apply to control coverage under a standard-form commercial general liability ("CGL") insurance policy, (2) the intended scope of the contractual liability exclusion in the CGL policy, and (3) the proper interpretation of the "legally obligated to pay" language in the CGL policy. The first issue also implicates the question of how—and whether—to apply the economic loss doctrine when deciding if there is coverage under the CGL policy. This brief addresses issues (1) and (2).

In large part, Amici submit this brief to emphasize the importance of the history and evolution of the standard-form CGL policy in resolving these issues. *American Family Mutual Ins. Co. v. American Girl*, 673 N.W.2d 65 (Wisc. 2004), and *Maryland Casualty Co. v. Reeder*, 270 Cal. Rptr. 719 (App. 1990), are two leading examples of well-reasoned cases discussing the history of the CGL policy regarding construction defect coverage. That evolution included, first, adopting the broad-form property damage endorsement and, later, replacing that endorsement with the subcontractor exception to the "your work" exclusion.

The point is, as discussed in greater detail below, the insurance industry *intended* to cover subcontractor negligence in construction defect cases when that

negligence results in property damage. Another case discussing that issue is *Wanzek Construction, Inc. v. Employers Insurance Co. of Wausau*, 679 N.W.2d 322 (Minn. 2004). In *Wanzek*, the Minnesota Supreme Court reversed earlier cases applying the so-called business risk doctrine because the literal language of the standard CGL policy provided coverage, and "the extent of the insurer's liability is governed by the contract entered into." *Id.* at 327. There are many other cases, but these three cases represent the more reasoned trend—the same approach that the Arizona Court of Appeals followed in *Lennar Corp. v. Auto-Owners Insurance Co.*, 214 Ariz. 255, 151 P.3d 538 (App. 2007).

In short, the arguments by Liberty Mutual, the insurance carrier in this case, are merely variations on a theme that the insurance industry has floated over the last 20-plus years. All of these arguments seek to undercut the very coverage the industry *intended* to offer in return for substantial premiums.[1]

II. The History and Evolution of the CGL Policy.

The CGL policy's insuring clause covers "those sums that the insured becomes legally obligated to pay as damages because of . . . 'property damage'" caused by an "occurrence." An "occurrence" is defined as an "accident" (including

[1] *Cf. Ohio Casualty Ins. Co. v. Henderson*, 189 Ariz. 184, 188, 939 P.2d 1337, 1341 (1997), where this Court relied on insurance industry materials to establish the original drafting intent behind the intentional act exclusion, noting that "insurance carriers should not be permitted to distort the meaning of the language" by ignoring such drafting intent.

continuous or repeated exposure to the same conditions), and "property damage" is defined as "physical injury to tangible property." *See* supplemental brief of Desert Mountain Properties ("DMP"), page 3; DMP Appendix, pages 72, 83, and 84.

As shown at the bottom of each page of the policy, CGL policies are boiler-plate, standardized forms that the Insurance Services Organization (the "ISO") has drafted, published, and copyrighted. The ISO is an insurance industry trade association that insurance carriers created.[2] Thus, the rule of strict construction against the insurance carrier / drafter is and should be fully operative.[3]

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[2] According to its web page, including the sub-category in that web page called "About ISO," entitled "Insurers Depend on the ISO Database," the ISO prepares form policies for use by insurance carriers ("For example, we consider actuarial analysis in developing standardized policy language and the rating and underwriting rules needed to write insurance policies."). As to the background and history of this insurance industry organization, one of the most widely-accepted treatises used by insurance carriers, the so-called "blue book," describes the ISO as "a national organization established by the property and liability insurance industry to provide a full range of insurance services . . . to insurers." PAUL I. THOMAS & PRENTISS B. REED, SR., ADJUSTMENT OF PROPERTY LOSSES at 24 (4th ed. 1977). The same treatise notes that the "ISO was formed January 1, 1971, through the consolidation of several national insurance industry service organizations." *Id.*

[3] The rule of strict construction is also called the *contra proferentem* doctrine. According to the Ninth Circuit, the "rule of *contra proferentem* has been called 'the most familiar expression in the reports of insurance cases.' [Quoting the Couch treatise on insurance.] A typical statement of the rule is that if, after applying the normal principles of contractual construction, the insurance contract is fairly susceptible of two different interpretations, another rule of construction will be applied: the interpretation that is most favorable to the insured will be adopted." *Kunin v. Benefit Trust Life Ins. Co.*, 910 F.2d 534, 539 (9th Cir. 1990). A simple way of applying the rule in this case is that the contract should be interpreted to

As demonstrated below, starting in the 1980s, the insurance industry decided to collect significant premium dollars from the construction industry by offering to cover developers and general contractors for their liability to home purchasers and other claimants for property damages caused by subcontractors who performed negligent, defective work. Yet later, many carriers professed to be shocked that there could possibly be such coverage for subcontractor negligence.

The present case offers a classic example of this type of "shell game" argument. DMP is not the general contractor (which would still have coverage), but is one step further removed, as the developer of the homes. The undisputed facts reflect that a subcontractor negligently compacted soil, and this caused damage to homes later constructed on the negligently-compacted soil. The record also appears undisputed that the damage was unintended, and thus "accidental" (a term not defined in the CGL policy). The damage for which coverage was sought was to the homes, so there was certainly "property damage" (*i.e.*, physical injury to tangible property). This, in turn, constituted an "occurrence," the event triggering coverage—*i.e.*, "accidental" damage to the homes. Thus, given that the insuring clause is triggered, the question is whether the policy contains some exclusion to eliminate the coverage provided under that insuring clause.

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cover that which the drafter intended to cover. *Cf. Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 682 P.2d 388 (1984).

In this factual context, when a CGL policy has broad-form property damage and products-completed operations coverage, and when the negligent work of a subcontractor causes property damage (such as, in this instance, damage to the homes), the ISO *intended* that there be coverage. Initially, the way the ISO accomplished providing such coverage was through a broad-form property damage endorsement (the "BFPD endorsement"). Later, as of the ISO's 1986 revision to the standard CGL policy language, the BFPD endorsement was replaced by new policy language. Specifically, the "your work" exclusion was revised to include the "subcontractor exception." As revised, that exclusion provided:

> This insurance does not apply to:
>
> * * *
>
> **l. Damage to Your Work**
>
> "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."
>
> **This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.**

(Emphasis added.)

This exact exclusion, with the subcontractor exception, is in the CGL policy at issue in this case. *See* DMP's Appendix and attached CGL policy, page APPX075.

The best case analyzing the historical evolution of the CGL policy is *Maryland Casualty Co. v. Reeder*, 270 Cal. Rptr. 719 (App. 1990). *Maryland Casualty* discusses the changes to the CGL policy form over time, including, first, the adoption of the BFPD endorsement, and later, the replacement of that endorsement with the subcontractor exception to the "your work" exclusion. As explained in *Maryland Casualty*, the "your work" exclusion, in its original form, excluded coverage for property damage to work performed *by or on behalf of* the named insured, which obviously included subcontractors. Subsequently, however, the ISO created the option of granting BFPD coverage through an "endorsement" (a policy amendment), in which case the "or on behalf of" language was omitted. The *Maryland Casualty* Court held that the clear effect of this endorsement was to include coverage for the negligence of subcontractors. *Id*. at 724-26. Nor was this conclusion much of a stretch by the *Maryland Casualty* Court. Quite the contrary, that Court relied on a circular issued *by the ISO* when it promulgated the new BFPD endorsement. Quoting from that circular, *Maryland Casualty* stated:

> [T]he broad form endorsement is intended to "exclud[e] only damages caused by the named insured to his own work. Thus, . . . [t]he *insured would have coverage for damage to his work arising out of a subcontractor's work* [and] [t]he insured would have coverage for damage to a subcontractor's work arising out of the subcontractor's work."

Id. at 725 (emphasis added). *Maryland Casualty* also quoted from a 1982 Fire Casualty & Surety ("F C & S") bulletin issued to explain the then-new BFPD en-

dorsement. That industry bulletin noted that with the new BFPD coverage, "'an insured *has* coverage for his completed work when the damage arises out of work performed by someone other than the named insured, such as a subcontractor.'" *Id*. at 725 (quoting from the industry bulletin) (italics in original). This industry bulletin also pointed out that the broader BFPD coverage came at the cost of additional premium dollars. *Id.*[4]

To a similar effect is the Wisconsin Supreme Court's 2004 decision in *American Family Mutual Ins. Co. v. American Girl,* 673 N.W.2d 65 (Wisc. 2004). As explained in that case, for purposes of covering claims arising out of the negligent, defective work of subcontractors, there were two significant changes to the CGL policy at two different times. First, in 1976, the BFPD endorsement was added as an optional endorsement to delete the "or on your behalf" language from the "your work" exclusion. As discussed in *Maryland Casualty,* the intent of this change was to grant coverage to the insured general contractor (or developer) for

[4] The operative language, first in the BFPD endorsement and, later, in the subcontractor exception to the "your work" exclusion, should be interpreted in the context of the broad grant of coverage under the products-completed operations coverage versus the much more restrictive coverage for problems that arise before operations are complete. *See, e.g., Spears v. Smith,* 690 N.E.2d 557, 559-60 (Ohio App. 1996) (discussing the differences in the exclusions where a claim is based on the broader completed operations coverage versus the more restrictive ongoing operations coverage). *See also* DMP's Appendix, attaching the subject CGL policy, the "declarations" page of which shows a separate aggregate limit for the products-completed operations coverage. The claim here, involving finished homes sold to consumers, involves the completed operations coverage.

the negligence of subcontractors if that negligence results in property damage. Later, in 1986, in order to make this coverage clear, the ISO promulgated the above-quoted subcontractor exception to the "your work" exclusion. This exception was meant to make clear that insurers *intended* to cover property damage caused by the negligent work of subcontractors. As stated in *American Girl*:

> This subcontractor exception dates to the 1986 revision of the standard CGL policy form. Prior to 1986 the CGL business risk exclusions operated collectively to preclude coverage for damage to construction projects caused by subcontractors. Many contractors were unhappy with this state of affairs, since more and more projects were being completed with the help of subcontractors. In response to this changing reality, insurers began to offer coverage for damage caused by subcontractors through an endorsement to the CGL policy known as the Broad Form Property Damage Endorsement, or BFPD. Introduced in 1976, the BFPD deleted several portions from the business risk exclusions and replaced them with more specific exclusions that effectively broadened coverage. Among other changes, *the BFPD extended coverage to property damage caused by the work of subcontractors. In 1986 the insurance industry incorporated this aspect of the BFPD directly into the CGL itself by inserting the subcontractor exception to the "your work" exclusion*.

Id. at 82-83 ¶ 68 (emphasis added) (in contrast to *American Girl*, the CGL policy at issue in *Maryland Casualty* had the BFPD endorsement, but not the subcontractor exception, although, of course, the result was the same, *i.e.*, coverage for property damage arising from subcontractor negligence).

Another well-reasoned case is *Limbach Co. v. Zurich American Ins. Co.* 396 F.3d 358, 362 (4th Cir. 2005) (as in *American Girl*, the "your work" exclusion in *Limbach* contained the subcontractor exception; citing to ISO materials and the

Comprehensive General Liability Policy Handbook, the Fourth Circuit held that "'[t]he 1986 revisions to the CGL policy significantly limit the effect of the work/product exclusions in construction defect cases,'" and given the 1986 revisions, "'the exclusions would likely apply only to the extent that *the contractor's own work* was damaged as a result of its *own faulty workmanship*'") (italics in original). *See also Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648, 651-53 (9th Cir. 1988) (quoting ISO circulars, the Ninth Circuit held the amended exclusion under the BFPD endorsement was only for "'damages caused by the named insured to his own work'" and the "'insured would have coverage for damage to his work arising out of a subcontractor's work'").

Therefore, since the standard-form CGL policies at issue in this case all have the subcontractor exception to the "your work" exclusion, the insured should be covered for property damage resulting from the negligence of subcontractors. To put it more generally, although many "business risk" arguments have been advanced by various carriers over the last 20-plus years, all of these arguments have a central theme: that the CGL policy is not intended to be a surety bond covering the cost of repairing damage caused by the substandard work of a subcontractor. Yet all of these arguments fly directly in the face of the stated intent of the ISO, the drafter of the standard-form CGL policy. That intent, to cover developers and general contractors for claims arising from property damage to their completed work

caused by negligent subcontractors, was made clear by the ISO, first with the BFPD endorsement, and later, when that endorsement was replaced by the subcontractor exception to the "your work" exclusion.

With the context of this historical background, the specific "business risk" arguments advanced by Liberty Mutual will now be addressed.

III. The "Business Risk" Arguments Are All Flawed.

A. The Tort Versus Contract Distinction.

A major thrust of the supplemental brief submitted by Liberty Mutual is that a contract claim cannot possibly be covered under the standard-form CGL policy because (1) the literal language of the contractual liability exclusion (the "CLE") precludes such coverage, (2) CGL policies were never intended to provide coverage for economic losses caused by a breach of contract, (3) such an economic loss is not an "occurrence" under the CGL policy, (4) the "fortuity" aspect of an occurrence is lacking in a claim for economic losses arising from a contract, and (5) finally, the oft-repeated "business risk" doctrine (no coverage for foreseeable business risks) precludes coverage. Yet each of these arguments, if accepted, would decimate the ISO's *intended* coverage for claims against insured developers and general contractors arising from the negligent work of subcontractors.

Carriers sometimes contend that the definition of "property damage" is not satisfied unless some third-party property is damaged. In its supplemental brief, at

page 6, note 5, using the economic loss doctrine (discussed in more detail below), Liberty Mutual advances a variation on this argument. However, this does not comport with the definition of "property damage" in the CGL policy. By its plain terms, the policy language simply requires "physical injury to tangible property." Obviously, if the drafter of the CGL policy (the ISO) wanted to require that the damage must be to tangible property *of a third party* or to tangible property *of others*, this could easily have been incorporated into the standard policy language. But this was not done because it would undercut the stated intent of the ISO, discussed above, which was to cover an insured developer or general contractor for claims arising from damage to its "completed operations" if the damage was caused by a subcontractor. *Cf. Fidelity & Deposit Co. v. Hartford Cas. Ins. Co.*, 189 F.Supp.2d 1212, 1220 (D. Kan. 2002) ("The definition of property damage in the policies does not limit the coverage to property that is not in the possession of or work product of the insured.").

Similarly, Liberty Mutual's argument that the "fortuity" aspect of an occurrence (*i.e.*, an accident) can never be established in a contract claim involving construction defects simply ignores the declared intent of the ISO when the 1986 CGL policy form was drafted. As stated in a well-regarded insurance law treatise:

> If the policy's exclusion for damage to the insured's work contains a proviso that the exclusion is inapplicable if the work was performed on the insured's behalf by a subcontractor, it would not be justifiable to deny coverage to the insured, *based upon the absence of an occur-*

> *rence,* for damages owed because of property damage to the insured's work caused by the subcontractor's work. *Reading the policy as a whole, it is clear that the intent of the policy was to cover the risk to the insured created by the insured's use of a subcontractor.* Moreover, if coverage were never available for damage to the insured's work because of a subcontractor's mistake, *on the theory that there was no occurrence* even under those circumstances, the foregoing subcontractor proviso to the exclusion for damage to the insured's work would be meaningless, and if possible, policies should not be interpreted to render policy provisions meaningless.

ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES, REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS § 11.3 at 11-64 to -65 (4th ed. 2001 & Supp. 2005) (emphasis added). The COUCH insurance law treatise makes the same general point:

> Due to the increasing use of subcontractors on construction projects, many general contractors were not satisfied with the lack of coverage provided under commercial general liability policies where the general contractor was not directly responsible for the defective work. *In 1976 the insurance industry responded by the introduction of the Broad Form Property Damage Endorsement, which extended coverage to insureds for property damage caused by the work of their subcontractors. The subcontractor exception to the "your work" [exclusion] was added directly to the body of the policy in 1986.*

9A COUCH ON INSURANCE § 129:18 (emphasis added).

The arguments asserted by Liberty Mutual are all variations on the "business risk" doctrine that some carriers have tried to use over the years since the ISO promulgated BFPD coverage. Many of these arguments rely on a 1971 law review article, *Insurance Protection for Products Liability and Completed Operations: What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1971), contending

that the intended coverage under a CGL policy "is for tort liability for physical damage to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained." While this may have been true in 1971, based on the then-existing CGL policy, this argument has no validity after the BFPD changes in the 1980s. As stated in a leading construction law treatise:

> Perhaps some of the confusion stems, in part, from reliance on [the Nebraska Law Review article] published in 1971 advising lawyers about insurance protection for products liability and completed operations. . . . The portion of the article that is invariably cited when this issue is addressed is the discussion regarding the type of risks insurers intended to cover when they issue CGL policies. *According to the article, CGL coverage is: "For tort liability for physical damage to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained."*
>
> *This distinction between "tort liability" and "contractual liability" has had unfortunate results.* Many courts have focused upon this distinction in rendering coverage decisions. *The CGL policy, however, makes no distinction between contract or tort claims.* Policy language speaks in terms of "property damage" or "bodily injury" which is caused by an "occurrence." . . . [T]he insurance industry and the coverages it markets have changed dramatically since the 1966 policy form, which was the subject of the article. . . . *The 1986 CGL policy form clearly provides coverage to general contractors for certain losses due to the defective work of their subcontractors.* . . . The only sure method for determining the extent of an insurer's obligations (or an insurer's duties) is to begin the analysis with a review of policy language rather than general concepts.

* * *

> *Courts that deny coverage for failure to meet the "occurrence" requirement simply because the injury is limited to the insured's work are making coverage determinations based on policy considerations rather than adhering to principles of contract interpretation.*

4 Philip L. BRUNER & PATRICK J. O'CONNOR, JR. BRUNER & O'CONNOR ON CONSTRUCTION LAW § 11:28 (2006) (emphasis added, footnotes omitted).[5]

That business risk arguments should not overcome drafting intent was noted by the Wisconsin Court of Appeals in *Kalchthaler v. Keller Construction*:

> For whatever reason, the industry chose to add the new [subcontractor's] exception to the business risk exclusion in 1986. We may not ignore that language when interpreting case law decided before and after the addition. To do so would render the new language superfluous. . . . *We realize that under our holding a general contractor who contracts out all the work to subcontractors, remaining on the job in a merely supervisory capacity, can ensure complete coverage for faulty workmanship. However, it is not our holding that creates this result; it is the addition of the new language to the policy. We have not made the policy closer to a performance bond for general contractors, the insurance industry has.*

591 N.W.2d 169, 174 (Wisc. App. 1999) (emphasis added, citations omitted). *Kalchthaler* relied extensively on insurance industry materials, including F C & S bulletins.[6]

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[5] *See also* SCOTT C. TURNER, INSURANCE COVERAGE FOR CONSTRUCTION DISPUTES § 6.8 (2d ed. 2003) ("Liability for breach of contract should qualify under the 'legally obligated' qualification of the insurance clause absent disqualification under some other term or provision of the policy. That is, the legal theory under which the claim against the insured is pursued, namely breach of contract, should have little or no relevance in the determination of coverage . . . ."); *Vandenberg v. Superior Court*, 982 P.2d 229, 244 (Cal. 1999) (rejecting the contract versus tort distinction for purposes of insurance coverage).

Finally, given the drafting history of the CGL policy, Liberty Mutual's argument about the CLE must be rejected, since it would eliminate the very claims that the ISO circulars say are to be covered. All or most real estate is sold by way of contracts, mostly written. If the CLE exclusion prohibits coverage for any claims against an insured developer because of such contracts, then the developer paid valuable premium dollars for coverage that the ISO intended to provide, but that same coverage is then eliminated by the CLE. This is not a logical interpretation of the CGL policy, sold to countless real estate developers over the years. Thus, not surprisingly, most cases limit the CLE to indemnity and hold-harmless agreements. As stated by one Court:

> "[C]ourts have consistently interpreted the phrase 'liability assumed by the insured under any contract' to apply only to indemnification and hold-harmless agreements, whereby the insured agrees to 'assume' the tort liability of another. This phrase does not refer to the insured's breaches of its own contracts."

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[6] *See also Erie Ins. Exch. v. Colony Dev. Corp.*, 736 N.E.2d 941, 947 (1999) (rejecting arguments that a CGL policy "is not a performance bond and, hence, does not cover claims for insufficient or defective work" because if there is to be an exclusion of coverage under business risk principles, it must be based on the actual exclusions in the policy); *American Girl*, 673 N.W.2d at 77-78 ¶¶ 41-47 ("There is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL's initial grant of coverage. 'Occurrence' is not defined by reference to the legal theory of the claim. The term 'tort' does not appear in the CGL policy.").

Ingalls Shipbuilding v. Federal Ins. Co., 410 F.3d 214, 222 (5th Cir. 2005) (quoting from 1 OSTRAGER & NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 7.05, at 460 (12th ed. 2004). *See also* the APPLEMAN treatise on insurance law:

> Although, arguably, a person or entity assumes liability (that is, a duty of performance, the breach of which will give rise to liability) whenever one enters into a binding contract, in the CGL policy and other liability policies, an "assumed" liability is generally understood and interpreted by the courts to mean the liability of a third party, which liability one "assumes" in the sense that one agrees to indemnify or hold the other person harmless.

21 HOLMES' APPLEMAN ON INSURANCE § 132.3 at 36-37 (2d ed. 2002).

This rule cuts in both directions. Although "assumed" contractual liabilities are not normally covered in a CGL policy, such coverage can be purchased through an endorsement, in which case the coverage is limited to indemnity and hold-harmless agreements. *See, e.g., Musgrove v. Southland Corp.*, 898 F.2d 1041, 1044 (5th Cir. 1990) (contractual liability coverage is "coverage of the insured's contractual assumption of the liability of another party" and it "typically" is in "the form of an indemnity agreement").[7] Conversely, if a carrier is attempting to use

[7] *See also Smithway Motor Xpress, Inc. v. Liberty Mutual Ins. Co.*, 484 N.W.2d 192, 196 (Iowa 1992) ("Liability assumed by an insured under an incidental contract refers to the assumption of another's liability, such as an agreement to indemnify or hold another harmless."); *Olympic, Inc. v. Providence Washington Ins. Co.*, 648 P.2d 1008, 1010-11 (Alaska 1982) ("'Liability assumed by the insured under any contract' refers to liability incurred when one promises to indemnify or hold harmless another . . . .").

the exclusion to avoid liability, the exclusion only applies if the claim against the insured is based on indemnity. *See, e.g., Provident Bank of Maryland v. Travelers Prop. & Cas. Corp.,* 236 F.3d 138, 146-47 (4th Cir. 2000) ("Typically, the [CLE] exclusion covers liability adopted . . . through an agreement to indemnify or hold harmless."); *Federated Mut. Ins. Co. v. Grapevine Excavation Inc.,* 197 F.3d 720, 726 (5th Cir. 1999) (the CLE exclusion "operates to deny coverage when the insured assumes responsibility for the conduct of a third party").[8]

In summary, the contract versus tort distinction should be rejected.[9]

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[8] Although not cited by Liberty Mutual, Arizona precedent adheres to this distinction. *See, e.g., Trus Joist Corp. v. Safeco Ins. Co.,* 153 Ariz. 95, 99-100, 735 P.2d 125, 129-30 (App. 1986) (rejecting an assumed contractual liability exclusion: "Since contractual liability for a third party's negligence is not at issue here, the exclusion does not apply and Trus Joist has coverage under the policy."); *Western Cas. & Sur. Co. v. Int'l Spas of Arizona,* 130 Ariz. 76, 78, 634 P.2d 3, 5 (App. 1981) (quoting with approval from AMERICAN JURISPRUDENCE for the proposition that exclusions "for assumed liability" apply "'only in situations where the insured would not be liable to a third party except for the fact that he assumed liability" and such exclusions are "'exemplified by an indemnity agreement'").

[9] The "resultant" damage issue is not one accepted for review. However, a very tenable argument can be made that if a claim under the products-completed operations coverage is based on property damage from the negligent work of a subcontractor, then applying the drafting intent of the ISO, there is coverage for both the "resultant" damage from the negligent work of the subcontractor and for the cost to repair the negligent work of that subcontractor. This is discussed in various insurance industry materials, such as ISO circulars, F C & S bulletins, and Insurance Risk Management Institute publications.

B. The Economic Loss Rule.

The economic loss rule is not applicable to this case. In *Flagstaff Affordable Housing Limited Partnership v. Design Alliance, Inc.*, 223 Ariz. 320, 223 P.3d 664 (2010), this Court held that the economic cost of curing an architect's negligent design was governed by the limiting provisions of the architect's contract. But there are no limiting provisions in the insurance contract in question, only a provision for coverage of the loss resulting from an occurrence, defined as an accident that causes property damage. And unlike *Flagstaff Affordable Housing*, the negligence here caused damage to other tangible property (in the context of the economic loss rule, this is often referred to as "secondary" property damage).

Moreover, there is absolutely nothing in the standard-form CGL policy to give any hint that a coverage determination should turn on the application of the economic loss rule. As stated by the Wisconsin Supreme Court in *American Girl*:

> The economic loss doctrine operates to restrict contracting parties to contract rather than tort remedies for recovery of economic losses associated with the contract relationship. *The economic loss doctrine is a remedies principle. It determines how a loss can be recovered – in tort or in contract/warranty law. It does not determine whether an insurance policy covers a claim, which depends instead upon the policy language.*

673 N.W.2d at 75 ¶ 35 (emphasis added, citations omitted).

The economic loss rule should not govern the coverage issues in this case.

C. The Narrow Policy Construction Advocated By Liberty Mutual Would Have Serious Results In Many Other Cases And Would Be Poor Public Policy.

Applying the economic loss doctrine to preclude coverage would actually run counter to the entire rationale of that doctrine, which is to allow contracting parties to agree on their respective rights and remedies in their contract. Yet if Liberty Mutual's economic loss argument is accepted, then perversely, the economic loss rule would *reverse* the declared intent of the standard-form CGL policy as it relates to BFPD coverage for completed operations. Nothing like this was ever intended by the economic loss doctrine.

Moreover, consider the effect on homeowners. This case happens to involve a solvent developer seeking to recover costs it expended in repairing property damage. In many cases, however, the developer and/or general contractor may be insolvent, in which event the dispute will often involve a group of homeowners (or a homeowners' association) and a solvent insurer (perhaps being sued under an assignment of rights from the developer or general contractor).

The narrow construction of the standard-form CGL policy advanced by Liberty Mutual would potentially leave thousands of Arizona homeowners faced with the necessity of making expensive repairs in a position where they are unable to do so. If the developer is insolvent, and if the homeowners cannot afford to make repairs with their own funds, then the repairs simply will not happen (worsening the

present real estate crisis), despite the fact that the developer paid premiums for such coverage, and the ISO *intended* there to be such coverage.

IV. Conclusion.

One of the major questions in this case is whether the CGL policy issued by Liberty Mutual provides coverage to a developer or general contractor where a subcontractor's work has caused property damage.

Such coverage exists because the authorities cited above make it quite clear that the insurance industry *intended* that the standard-form CGL policy cover the contractual or other liability of a developer or general contractor for property damage caused by the negligent work of a subcontractor. In this instance, there is no question but that the work of the subcontractor accidentally caused property damage; thus, the policy definition of "occurrence," which triggers coverage, is met. The policy exclusion for "your work" does not destroy that coverage. In fact, to the contrary, that provision makes it quite clear that the drafters of the standard-form CGL policy intended to provide such coverage. Nothing in the CGL policy permits application of the economic loss rule to exclude or limit such damages. Neither anything in the CGL policy nor any legal principle limits the coverage to tort theories rather than contract theories.

DATED this 14th day of April, 2011.

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