

# The Products-Completed Operation Hazard and Wrap-Up Insurance:

*Coverage for Subcontractor Bodily Injury Claims While Performing Warranty Work*

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Prepared by  
Saxe Doernberger & Vita, P.C.

## **I. Introduction**

Most insurance industry professionals are familiar with the concept of the “products-completed operations hazard” (“PCO hazard”) in a commercial general liability policy (“CGL policy”), yet the nuances of how the PCO hazard operates often elude even the most seasoned policyholders, brokers, and claims adjusters. Specifically, in the context of wrap-up insurance programs, sponsors often assume that bodily injury claims, which occur after a construction project is substantially complete, are *not* part of the wrap-up policy’s PCO hazard and thus, the claims should be covered by a subcontractor’s CGL policy. The definition of the PCO hazard itself, however, rejects this result and coverage is properly sought under the wrap-up policy.

Wrap sponsors and their brokers must correct this fundamental misconception, about how and when wrap-up coverage applies for warranty work, in order to appropriately manage and transfer risk. If a sponsor is displeased with the prospect of its wrap-up policy responding to claims arising out of a subcontractor’s warranty work, brokers may have the opportunity, at the time of policy placement, to work with the policyholder and insurer to draft manuscript endorsements to the policies and alter contractual agreements with downstream parties. This paper will explain why bodily injury claims arising out of warranty work fall within the PCO Hazard and why wrap-up sponsors should no longer look to a subcontractor’s CGL policy for coverage.

## **II. Understanding the PCO Hazard**

Consider the following hypothetical dealing with a bodily injury claim arising out of the performance of warranty work:

Main Street Realty LLC (the “Owner”) wants to build a high-rise condominium complex in Miami. Instead of relying on traditional risk transfer, it decides to procure an Owner Controlled Insurance Program (“OCIP”) to insure the project. The OCIP provides CGL coverage to all enrolled parties for the duration of the project and includes a 10 year Extended Products-Completed Operations Period endorsement. The Owner, General Contractor (ABC General Contractor), and all eligible subcontractors are enrolled in the OCIP. Subcontractors are also contractually required to procure CGL and excess coverage for off-site liabilities the OCIP does not cover.

Construction commences in 2012 and by July 2014 the condominium project is complete. Main Street Realty sells units to buyers and buyers begin moving into the complex. Unit owners quickly notice, however, that the air conditioning units are not functioning properly. Joe’s Air Conditioning Inc., the HVAC subcontractor, returns to the project to service the units pursuant to its warranty obligations. While performing the warranty work, an employee of Joe’s Air Conditioning trips on a piece of carpeting that was improperly installed by Mike’s Carpeting Inc., injuring his right knee and back. The employee brings suit against Main Street Realty and ABC Contracting Company to recover for his injuries.

The employee’s claim against Main Street Realty and ABC Contracting Company initiates a dispute amongst the parties as to whose policy should respond. Main Street Realty and ABC Contracting Company contend that they are each entitled to additional insured coverage from either Joe’s Air Conditioning or Mike’s Carpeting, because the employee’s injury arose out of warranty work on the completed project. The subcontractors’ insurers deny the claim, arguing

that the OCIP CGL insurer should defend and indemnify the upstream parties because of wrap-up exclusions in their respective policies. Who is correct?

The answer may be surprising: Main Street Realty and ABC Contracting Company should be afforded coverage under the OCIP. The coverage available under the subcontractors' CGL policies is limited by wrap-up exclusions, excluding additional insured coverage for the owner and general contractor. The wrap-up CGL policy, however, expressly covers the injury and there are no standard form exclusions that bar coverage.

#### **A. The PCO Hazard Defined: What's Included and What's Not**

As a preliminary matter, it is important to note where the PCO hazard is located within the policy. The PCO hazard first appears in the exclusion portion of a typical CGL form (e.g., ISO form CG 00 01 10 01) pertaining to an insured's property and work on the project (i.e., exclusions (j) and (l) under coverage part A). The PCO hazard is also referenced in the exclusions under coverage part C<sup>1</sup> ("Medical Payments") and in Section III "Limits of Insurance." Thus, although many insurance industry professionals refer to the PCO hazard as "PCO coverage," the term is not expressly used in the policy's insuring agreement. Rather, the PCO hazard serves two main functions: (a) to define a time period under which a separate limit of liability applies (referenced on the declarations page of the policy as the "Products Completed Operations Aggregate") and (b) to explain the application of certain exclusions.

The PCO hazard is defined as including "all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work.'"<sup>2</sup> This fairly broad definition also sets forth several enumerated exceptions which pare back coverage. The PCO hazard does *not* apply to bodily injury or property damage to:

- Products that are still in the named insured's physical possession;
- Work that has not yet been completed or abandoned;
- Bodily injury or property damage arising out of the transportation of property (with a limited exception for loading and unloading);
- Bodily injury or property damage arising out of the existence of tools, uninstalled equipment or abandoned or unused materials; and
- Any products or operations that are specifically identified in the Declarations as being subject to the general aggregate limit.<sup>3</sup>

For purposes of our hypothetical, the critical component of the PCO hazard definition is its exclusion of work that has "not been completed or abandoned." Initially, this would seem to suggest that warranty work is *not* within the PCO hazard, because the fact that work requires servicing or repair implies that it is not yet complete. However, the definition specifically states "your work" will be deemed *completed* at the earliest of the following times:

- (a) When all of the work called for in your contract has been completed.

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<sup>1</sup> Discussed further in section (2)(B)(ii) of this paper.

<sup>2</sup> See ISO form CG 00 01 10 01, Section V. "Definitions", subsection (16).

<sup>3</sup> See ISO form CG 00 01 10 01, Section V. "Definitions", subsection (16).

- (b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.
- (c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

*Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete will be treated as **completed**.*<sup>4</sup>

(Emphasis added). Therefore, the last provision under subsection (c) clearly states that warranty work (i.e., work that requires correction, repair, or completion) is expressly *included* in the PCO hazard. For example, in our hypothetical, the work being performed by Joe's Air Conditioning would fall under the PCO hazard and would be subject to the policy's PCO hazard limit of liability.

## **B. Standard, Non-Wrap CGL Policies: Coverage for Bodily Injury Claims Arising out of Warranty Work**

### **i. Coverage Part A – Bodily Injury**

Keeping the definition of the PCO hazard in mind, we turn to the CGL policy's insuring agreements to assess how a standard, non-wrap CGL policy would respond to a bodily injury claim arising out of warranty work. Coverage Part A addresses how the policy will respond to an insured's alleged liability arising out of "bodily injury" or "property damage." The insuring agreement states: "[w]e will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies."<sup>5</sup> The insuring agreement specifies that the coverage only applies to "bodily injury" or "property damage" that is: (1) caused by an "occurrence" (2) in the "coverage territory" (3) during the policy period.<sup>6</sup>

Presuming that Main Street Realty and ABC Contracting Company were properly named as additional insureds on the subcontractors' CGL policies, there is nothing in Coverage Part A's insuring agreement that would bar coverage for the employee's injuries. The employee's knee and back injuries clearly constitute accidental "bodily injury," satisfying the policy's "occurrence" requirement. The "coverage territory" requirement is also a non-issue, since the injury occurred at the project site in Miami, Florida (and coverage territory is defined as anywhere in the United States). Finally, we presume that the injury took place while the policy was in force and, thus, was within the policy period. Therefore, the employee's injuries trigger Coverage Part A's insuring agreement.

Further, there are no exclusions in Coverage Part A<sup>7</sup> which would bar coverage for the employee's claim against Main Street Realty and ABC Contracting Company. For example, the facts do not suggest that any party (i.e., Joe's Air Conditioning or Mike's Carpeting) in any way subjectively intended to cause harm to the employee and thus, do not implicate exclusion (a)

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<sup>4</sup> See ISO form CG 00 01 10 01, Section V. Definitions, subsection (16).

<sup>5</sup> See ISO form CG 00 01 10 01, Section I, Coverage A, subsection (1)(a).

<sup>6</sup> See ISO form CG 00 01 10 01, Section I, Coverage A, subsection (1)(a).

<sup>7</sup> See ISO form CG 00 01 10 01, Section I, Coverage A, subsection (2).

“Expected or Intended Injury.”<sup>8</sup> Nor does the injury relate to the upstream parties’ assumption of liability in a contract or agreement (i.e., exclusion (b) “Contractual Liability”). It is also important to note that the business risk exclusions, exclusions (j) through (m), only apply to liability arising out of “property damage,” and thus have no applicability to our hypothetical.<sup>9</sup> As such, there are no exclusions in Coverage Part A that apply to the bodily injury claim in our hypothetical.

*Thus, under traditional CGL policies, “bodily injury” occurring during warranty work is covered because there is nothing in either the insuring agreement or the exclusions which would indicate otherwise.*

Thus, under traditional CGL policies, “bodily injury” occurring during warranty work is covered because there is nothing in either the insuring agreement or the exclusions which would indicate otherwise. The only relevance of the PCO hazard with respect to warranty work “bodily injury” claims under a traditional CGL policy is which policy limit applies. Thus, in our hypothetical, because the “bodily injury” arose out Joe’s Air Conditioning’s warranty work, which is deemed completed under the definition of the PCO hazard, the limit of insurance for the PCO hazard will apply to the claim.

## ii. Coverage Part C – Medical Payments

Another section of the policy that is potentially implicated by our hypothetical employee’s claim is Coverage Part C. Coverage Part C addresses medical expenses and provides a separate limit of liability (usually a nominal amount in comparison to the overall policy limits) that provides coverage to the insured regardless of fault. The insuring agreement provides: “We will pay medical expenses . . . for ‘bodily injury’ caused by an accident . . .” on or next to premises the insured owns or rents or because of the insured’s operations, provided certain criteria are met (e.g., the injured person undergoes a physical examination).<sup>10</sup> Policyholders often utilize this coverage as a means of avoiding suit by paying for an injured claimant’s medical expenses up-front.

Notably, exclusion (f) in Coverage Part C states that the insurer “will not pay expenses for ‘bodily injury’ . . . included within the ‘products-completed operations hazard.’” Thus, with respect to our hypothetical, Main Street Realty and ABC Contracting Company may not use the Medical Payments limit of insurance to fund the employee’s medical care since the injury arose during the PCO hazard. This is likely not a significant problem for our hypothetical insureds as it is far more critical to secure defense and indemnity under Coverage Part A.

<sup>8</sup> See ISO form CG 00 01 10 01, Section I, Coverage A, subsection (2)(a).

<sup>9</sup> Note, however, that generally speaking the business risk exclusions contain a temporal component – certain exclusions apply only to ongoing operations claims, while others apply only to completed operations claims. For example, exclusion j(6) excludes coverage for “‘property damage’ to . . . (6) that particular part of any property that must be restored, repaired or replaced because ‘your work’ was incorrectly performed on it.” The exclusion, however, explicitly states that “paragraph (6) of this exclusion does not apply to ‘property damage’ included in the ‘products-completed operations hazard.’” Alternatively, exclusion (l) excludes coverage for “‘property damage’ to ‘your work’ arising out of it or any part of it and included in the ‘products-completed operations hazard.’”

<sup>10</sup> See ISO form CG 00 01 10 01, Section I, Coverage C, subsection (2)(f).

It is also important to note, however, that Coverage Part C is explicit in its disclaimer of coverage for medical expenses included in the PCO hazard, while Coverage Part A is silent. It is a fundamental principle of contract interpretation that “[i]f the parties in their contract have specifically named one item or if they have specifically enumerated several items of a larger class, a reasonable inference is that they did not intend to include other, similar items not listed.”<sup>11</sup> Coverage Part C’s exclusion (f), together with Coverage Part A’s silence on the issue, confirms that Coverage Part A of the standard CGL policy should *not* exclude coverage for “bodily injury” that falls within the PCO hazard.

## **C. Wrap-Up CGL Policy: Coverage for Bodily Injury Claims Arising out of Warranty Work**

### **i. PCO Hazard Extension Endorsements**

Ultimately, when a wrap-up program is utilized for a project, the result is the same: the employee’s claim triggers coverage under Coverage Part A of the wrap-up CGL policy. The analysis under a wrap-up, however, is slightly different. Recall that in order to trigger coverage, the “bodily injury” must occur during the policy period. Standard CGL policies are typically issued or renewed on an annual basis and thus, the policy in effect when the injury occurs will respond to the claim, regardless of whether the claim arose out of ongoing or completed operations.

Alternatively, wrap-up programs are typically issued for the duration of a project and often last several years. As a result, sponsors will usually procure a PCO hazard extension endorsement, which extends coverage from the date of substantial completion (or some other similar measuring date) to a point in the future (usually until the statute of repose<sup>12</sup> has run or 10 years). Therefore, the fundamental difference between the PCO hazard in a typical CGL policy and the PCO hazard in a wrap-up is that PCO hazard extension endorsement is a *grant* of coverage. Consider the following examples of manuscript endorsements<sup>13</sup>:

#### **Example 1: Completed Operations Extension Controlled Insurance Program**

“Coverage of the ‘products-completed operations hazard’ is extended for the project described in the above Schedule for a period of 10 years or the Statute of Repose, whichever is less (‘Extended Completed Operations Period’). The Extended Completed Operations Period will commence when that portion of the project is put to its intended use, or a temporary or permanent certificate of occupancy is issued.”

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<sup>11</sup> *Additional Maxims of Interpretation*, 5-24 Corbin on Contracts § 24.28.

<sup>12</sup> A statute of repose is “a law that cuts off a right of action after a specified time period has elapsed, regardless of when the cause of action accrues.” Glossary of Insurance & Risk Management Terms, International Risk Management Institute, <http://www.irmi.com/online/insurance-glossary/terms/c/statute-of-repose.aspx>. Most states have construction-specific statutes of repose prohibiting claims for construction defects beyond a specified number of years after the construction is completed. For an overview of construction-specific statutes of repose, see SDV’s 50 State Survey at [http://sdvlaw.com/state\\_by\\_state/Statutes%20of%20Repose.pdf](http://sdvlaw.com/state_by_state/Statutes%20of%20Repose.pdf).

<sup>13</sup> Note that PCO hazard extensions are, generally, carrier-specific manuscript endorsements. Although many adopt the standard ISO PCO hazard definition, not all do. Ultimately, whether warranty-related “bodily injury” claims are covered under a specific PCO hazard extension endorsement depends on the particular endorsement. Policyholders and brokers must carefully review such endorsements to determine coverage and identify any potential gaps in coverage.

**Example 2: Extended Products-Completed Operations Hazard Endorsement**

[Insurer's] PCO Extension – replaces section 1.b.(2) in the CGL policy: “The ‘bodily injury’ or ‘property damage’ occurs during the policy period, except for ‘bodily injury’ or ‘property damage’ included in the products-completed operations hazard. For ‘bodily injury’ or ‘property damage’ included in the ‘products-completed operations hazard’ the ‘bodily injury’ or ‘property damage’ will be covered only if it occurs during the policy period or within the ‘extended products-completed operations period; and

- (a) ‘Extended products-completed operations period’ means during the period of time allowed by the applicable law, in effect at the inception date of the policy, for claims or suits to be brought against the insured.
- (b) The occurrence period described in this endorsement is considered part of the original policy period for purposes of determining the Limits of Insurance. The Products-Completed Operation Aggregate Limit applies for the entire policy period including the ‘extended Products-Completed operations period’.”

In our hypothetical, if the policy period for the OCIP was January 1, 2012 to July 1, 2014 and the condominium project was substantially complete on July 1, 2014, then the 10 year PCO hazard extension endorsement would effectively extend the policy period for 10 years (only to include those claims which fall within the

definition of the PCO hazard). Under most PCO hazard extension endorsements—in particular, those like Example 2 above—there is an actual grant of coverage for “bodily injury” included within the PCO hazard. Assuming that the definition of the PCO hazard has not been altered from the standard ISO definition, any “bodily injury” arising out of completed work, which includes warranty work, will therefore be entitled to coverage under the PCO hazard extension. This is a critical point that many insurance industry professionals often overlook – because the definition of the PCO hazard provides that it includes “all ‘bodily injury’ occurring away from premises you own or rent and *arising out of* ‘your product’ or ‘your work,’” it is irrelevant whether the injury was caused by “old work” (i.e., previously completed work) or “new work” (i.e., the warranty work in progress) because of the breadth of the “arising out of” language. Thus, in our hypothetical, Joe’s Air Conditioning’s employee’s injuries arose out of the warranty work he was engaged in because he would not have suffered his injuries if he had not been at the site performing the warranty work. As such, the damages sought fall within the OCIP’s coverage.<sup>14</sup> Furthermore, as discussed previously, no exclusions or other provisions of the policy bar coverage for the employee’s suit.

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<sup>14</sup> Note that it is important to carefully align the applicable statute of repose with the PCO hazard extension endorsement. Failing to do so may result in gaps in coverage.

## ii. Repair Work Endorsements

A common misconception amongst professionals, who do not realize that the PCO hazard includes warranty work, is that “repair work” endorsements *enhance* coverage. In fact, the exact opposite is true. Repair work endorsements generally *narrow* coverage for warranty or repair work. Consider the following endorsement:

### **Example: Limited Coverage – Repair Work**

This insurance is extended for an additional period of time with respect to liability for ‘bodily injury’ or ‘property damage’ arising out of ‘repair work’ performed by employees of the Named Insured. The extension begins when the Designated Project or any part thereof has been put to its intended use or is occupied in whole or in part by any person or organization other than another contractor or subcontractor working on the same project, and ends at the earlier of:

- (a) The expiration of the statute of repose applicable to claims or ‘suits’ alleging defective construction, or
- (b) Limited Coverage – Repair Work Expiration Period : **1 year**

*Work performed under this coverage extension does not apply to liability included in the ‘products-completed operations hazard.’*

With respect to this endorsement, the following definition applies:

- 1.) ‘Repair work’ means the repair, correction or replacement of ‘your work’ which is performed after ‘your work’ was originally completed.”

This endorsement arguably *removes* warranty/repair work from the PCO hazard. In practice, this means two things for insureds: first, any claims arising out of warranty work will be subject to the policy’s ongoing operations limit of liability (as opposed to the PCO hazard limit of liability) and; second, most repair work endorsements, including the one excerpted above, restrict coverage for repair/warranty work to a short, defined period of time (e.g., 1-2 years). In our hypothetical, the wrap-up has a 10 year PCO hazard extension; if the OCIP also included this endorsement, repair and warranty work would be excluded after the 1 year period elapsed. Thus, policyholders and wrap sponsors must be aware that repair work endorsements are neither an adequate substitute for PCO hazard extensions nor are they true coverage enhancements.<sup>15</sup>

## **D. Subcontractor Policies and Wrap-up Exclusions**

While this result may be surprising, coverage under the wrap-up more or less *must* respond to warranty work “bodily injury” claims because the downstream party’s CGL insurance usually excludes coverage via a wrap exclusion endorsement. For example, the widely-used ISO wrap-up exclusion states:

**Example:** Exclusion – Designated Operations Covered by a Consolidated (Wrap-up) Insurance Program

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<sup>15</sup> Note that there are some exceptions; repair work endorsements must be carefully reviewed to assess their impact on coverage.

This insurance does not apply to “bodily injury” or “property damage” arising out of either your ongoing operations or operations included within the “products-completed operations hazard” at the location described in the Schedule of this endorsement, as a consolidated (wrap-up) insurance program has been provided by the prime contractor/project manager or owner of the construction project in which you are involved.

This exclusion applies whether or not the consolidated (wrap-up) insurance program:

- (1) Provides coverage identical to that provided by this Coverage Part;
- (2) Has limits adequate to cover all claims; or
- (3) Remains in effect.<sup>16</sup>

This endorsement clearly excludes coverage for the type of injury in our hypothetical (i.e., bodily injury included within PCO Hazard). Therefore, if our hypothetical OCIP did not provide coverage for the employee’s claims and the subcontractor’s policy likewise denied the claim based on the wrap exclusion, there would be a significant gap in coverage.

### **III. CONCLUSION**

Without modification, a wrap-up CGL insurance policy will provide coverage for claims of “bodily injury” arising out of warranty or repair work. It is, therefore, important for owners, contractors, and subcontractors to understand and acknowledge, at the time of policy placement, that such claims should be tendered to and covered under the project’s wrap-up policy. While that coverage could be removed by manuscript endorsement, the sponsor should consider that the typical downstream contractor or subcontractor will not have coverage (for themselves or for the sponsor as an additional insured) because of wrap-up exclusionary endorsements. Sponsors should consult with a knowledgeable broker to assess the appropriate insurance for their projects when it comes to warranty work and the PCO hazard.

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<sup>16</sup> ISO form CG 21 54 01 96.