I.
Sheehan Construction

The Indiana Supreme Court decision in *Sheehan Construction v. Continental Cas. Co.*, 935 N.E.2d 160 (Ind. 2010) is the most important decision in the history of Insurance Law in Indiana. Traditionally, Indiana has been a non-occurrence state, meaning that defective workmanship – regardless of the nature of cause, or whether performed by the named insured or a sub-contractor – did not constitute an "occurrence" sufficient to trigger coverage under general liability policies. Hence, the coverage analysis of construction cases in Indiana was straightforward and simple. Damage to any portion of the insured's work, even if caused by a component of the work constructed by a sub-contractor, was not covered. Moreover, there was no need to apply the various, often confusing, exclusions applicable to construction cases.

In *Sheehan*, the Indiana Supreme Court decided to align Indiana with the jurisdictions which hold that "improper or faulty workmanship does constitute an accident so long as the resulting damage is an event that occurs without expectation or foresight. *Id* at 169. With defective work now defined as an occurrence, the various exclusions applicable to construction projects must be carefully analyzed.

Thus, in a nutshell, Exclusion J will not apply to construction defect cases because the exception to the exclusion states that it does not apply to "property damage" included in the "products-completed operations hazard." Exclusion K excludes coverage for "property damage" to "your product" arising out of it or any part of it, but does not apply to real property. Exclusion L excludes coverage for "property damage" to your work"…included in the "products-completed operations hazard." However, an exception to this exclusion provides that the "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." Thus in most cases coverage will turn on whether a sub performed the work. The definition of "products-completed operations hazard" includes "all… 'property damage'… arising out of …'your work except"'. The definition makes clear, as did the court in *Sheehan*, that general liability policies do not cover faulty work itself, but rather only "property damage" caused by the faulty work. *See, e.g. id* at 166, ("this appeal requires is to determine whether damage caused by faulty workmanship is covered under a standard CGL policy.") *Id* at 166. In short, *Sheehan* only addresses the issue as to whether an "occurrence" has happened; it does not affect the application of any policy exclusions. The subcontractor exception to Exclusion I does not require the insurer to pay for any workmanship or materials which were initially defective.

Lastly, the elusive and confusing exclusions for impaired property will often be applicable. Exclusion M applies to damage to impaired property or property not physically injured. In relevant part, it provides that physical injury and resulting loss of use to someone else's tangible property (not work the insured or its subcontractors did) that cannot be used because the insured's or its subcontractor's work was defective, if the property can be restored to use by repairing the work, is excluded. Therefore, on its face, Exclusion M clearly applies to any loss of use of impaired tangible property, property not constructed by the insured, impaired by the defective work or product of the insured. *Kenray Association, Inc. v. Hoosier Ins. Co.*, 874 N.E.

2d 406 (Ct. App. IN 2007) (unpublished decision); *Microvote Corp. v. GRE* Ins. Group, 779. N.E.2d 94, 96-97 (Ind. Ct. App. 2009).

II.

Application of Policy Provisions after Sheehan

The potentially relevant policy provisions of a typical Commercial General Liability ("CGL") Policy in construction cases are:

Section I - Coverages

Coverage A. Bodily Injury and Property Damage Liability

1. Insuring Agreement

a. We 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. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result. But:

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"; and

(2) The "bodily injury" or "property damage" occurs during the policy period;

[…]

2. Exclusions

This insurance does not apply to:

j. Damage to Property

"Property damage" to:

(5) That particular part of any real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations;

(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

Paragraph (6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".

k. Damage to Your Product

"Property damage" to "your product" arising out of it or any part of it.

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.

m. Damage to Impaired Property or Property Not Physically Injured

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

Section IV – Commercial General Liability Conditions

Section V - Definitions

[. . .]

8. "Impaired property" means tangible property, other than "your product" or "your work", that cannot be used or is less useful because:

a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

a. The repair, replacement, adjustment or removal of "your product" or "your work"; or

b. Your fulfilling the terms of the contract or agreement.

[. . .]

13. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

[. . .]

16. "Products-completed operations hazard":

a. Includes all "bodily injury" and "property damage" occurring away from premises you own or rent and arising out of "your product" or "your work" except:

(1) Products that are still in your physical possession; or

(2) Work that has not yet been completed or abandoned. However, "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.

(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.

17. "Property damage" means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

[. . .]

21. "Your product":

a. Means:

(1) Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:

(a) You;

(b) Others trading under your name; or

(c) A person or organization whose business or assets you have acquired; and

(2) Containers (other than vehicles), materials, parts or equipment furnished in connection with such goods or products.

b. Includes

(1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your product"; and

(2) The providing of or failing to provide warnings or instructions.

22. "Your work":

a. Means:

(1) Work or operations performed by you or on your behalf; and

(2) Materials, parts or equipment furnished in connection with such work or operations.

b. Includes:

(1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work"; and

(2) The providing of or failing to provide warnings or instructions.

III.
Coverage Under Basic Terms of Insuring Agreement

The threshold of determination in a coverage analysis in construction cases is whether the claims fall within the basic insuring agreement.

Indiana courts determine the extent and scope of insurance coverage in accordance with a set of established rules of construction. The first cardinal rule of policy construction in Indiana is that when interpreting a policy, the court's role is to ascertain the intent of the parties as manifested in the contract of insurance. *Lexington Ins. Co. v. Am. Healthcare Providers*, 621 N.E.2d 332 (Ind. Ct. App. 1987); *Great Lakes Chem. Corp. v. Int'l Surplus Lines Ins., Co.*, 638 N.E.2d 847 (Ind. Ct. App. 1992). In doing so, words and phrases in the insurance contract are to be given their plain and ordinary meaning. *U.S. Fidelity & Guar. Co. v. Bough*, 257 N.E.2d 699 (Ind. Ct. App. 1970). The question of coverage under a liability policy is determined from the claimant's allegations read in connection with the plain and ordinary meaning of the policy language. *Great Lakes Chem.*, 638 N.E.2d at 847; *Service v. Kopko*, 570 N.E.2d 1283 (Ind. 1991).

Under Indiana law, an insurer's duty to defend is considerably broader than the duty to indemnify. *Fed. Ins. Co. v. Stroh Brewing Co.*, 127 F.3d 563 (7th Cir. 1997). It is the nature of the underlying claim, not its merits, that establishes the insurer's duty to defend. *Nat'l Fire & Cas. Co. v. West By and Through Norris*, 107 F.3d 531 (7th Cir. 1997). An insurer's duty to defend arises from allegations of the complaint coupled with those facts known to, or ascertainable by, the insurer after reasonable investigation. *Trisler v. Indiana Ins. Co.*, 575 N.E.2d 1021 (Ind. Ct. App. 1991). However, when the underlying factual basis of a complaint, even if proven true at trial, would not result in liability under the insurance policy, the insurance company may properly refuse to defend. *Wayne Township Board of School Comm. v. Indiana Ins. Co.*, 650 N.E.2d 1205 (Ind. Ct. App. 1995).

In Indiana, prior to *Sheehan*, typical damages from a contractor's defective workmanship did not constitute "property damage" arising from an "occurrence." CGL policies covered the possibility that goods, products or the work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself. *R.N. Thompson & Ass., Inc. v. Monroe Guar. Ins. Co*., 686 N.E.2d 160, 162 (Ind. Ct. App. 1997). This coverage was for tort liability for physical damages to others, and not for contractual liability of the insured for economic loss suffered because the completed work was not what the damaged person bargained for. *Id*.

However, in *Sheehan*, the Indiana Supreme Court decided to align itself with jurisdictions "adopting the view that improper or faulty workmanship does constitute an accident so long as the resulting damage is an event that occurs without expectation or foresight." *Sheehan Constr. Co. v. Continental Cas. Co.*, 935 N.E.2d at 169. The Court noted that the *Sheehan* policies defined "occurrence" as "an accident, including continuous exposure to substantially the same general harmful conditions." *Id* at 170. While "accident" was not defined in the policies, the Court defined accident to mean "an unexpected happening without an intention or design." *Id*.

citing *Tri-Etch, Inc. v. Cincinnati Ins. Co.*, 909 N.E.2d 997, 1002 (Ind. 2009) quoting *Auto-Owners Ins. Co. v. Harvey*, 842 N.E.2d 1279, 1283 (Ind. 2006).

The Court stated that if the faulty workmanship was unintentional conduct, then Sheehan assumed the work on the homes would be completed properly. The resulting damage would therefore be unforeseeable and constitute an "accident" and therefore an "occurrence" within the meaning of the insurer's CGL policies. *Sheehan*, 935 N.E.2d at 170. The Court concluded, therefore, that "accident" within the meaning of the CGL policies at issue includes faulty workmanship. *Id*. at 171. Therefore, unless damage to structures appears to have been unintentional faulty workmanship, it would constitute an "occurrence" under the CGL policy, and coverage would be triggered.

Next, it must be determined whether the property damage occurred during the policy period. Initially, although coverage may be triggered by a plaintiff's allegations, it does not follow that the entirety of all alleged damages are covered by a CGL Policy, which covers all "property damage" that occurs during the policy period. Indiana courts and others provide the authority for determining which damages trigger coverage and which do not.

Courts typically use four popular approaches, depending on the language in a given policy. *See, e.g., Allstate Ins. Co. v. Dana Corp.*, 737 N.E.2d 1177, 1201 (Ind. Ct. App. 2000) (reversed, in part, on other grounds, *Allstate Ins. Co. v. Dana Corp*., 759 N.E.2d 1049 (Ind. 2001)). If coverage is triggered at the time that a personal injury or property damage becomes known to the victim or property owner, the approach is identified as the "manifestation theory." *Allstate*, 737 N.E.2d at 1177. If coverage is triggered when a personal injury or property damage first occurs, the approach is coined the "injury-in-fact theory." *Id.* If coverage is triggered when the first exposure to injury-causing conditions occurs, then the court is said to have chosen the "exposure theory." *Id.* Finally, if coverage is triggered in a manner such that insurance policies in effect during different time periods all impose a duty to indemnify, then the approach is labeled a "continuous" or "multiple" trigger theory. *See id.*

Indiana courts have settled on the "injury-in-fact" test, as well as the "multiple trigger" test, which is applied under extraordinary circumstances. *Huntzinger,* 143 F.3d at 14. A handful of Indiana courts have applied these tests.

Two key Indiana decisions addressing environmental cleanup claims establish the standards for applying the "injury-in-fact" test. First, *Dana* involved a claim for damages from groundwater contamination caused by chemicals that were dumped entirely during one policy period. The chemicals continued leaching into the groundwater during subsequent policy periods. The court was called on to determine whether coverage under successive insurance policies was triggered. The *Dana* court determined that the policies, which had language substantially similar to common language in CGL policies, were triggered by an injury-in-fact approach. Under this approach, the language of the policy requires an actual injury to occur during the policy period in order to trigger coverage for property damage. *Id*. at 1201-02. The policies in question provided the following:

> 'Occurrence' means an accident, event or happening including continuous or repeated exposure to conditions which results, during the policy period, in Personal Injury [or] Property Damage … neither expected nor intended from the standpoint of the Insured…. All such Personal Injury [or] Property Damage … caused by one event or by continuous or repeated exposure to substantially the same conditions shall be deemed to result from one Occurrence.

Id. at 1200. The court determined that repeated or continuous exposure to conditions that results in property damage can be an occurrence in one policy period, and, if those conditions persist, can constitute an occurrence for each consecutive policy. *Id.* at 1201. Under this language, the triggering event is an injury during the policy period caused by an occurrence. *Id.* (emphasis added).

Second, *PSI Energy, Inc. v. The Home Ins. Co., 801 N.E.2d 705 (Ind. Ct. App. 2004)*, applied *Dana* to determine whether and how successive insurance policies were triggered by an environmental contamination claim. In *PSI Energy*, the court considered a series of insurance policies, the 1961 to 1973 Policies, with certain policy language and a set of insurance policies from 1973 to 1983, with different policy language, to determine how coverage under each was triggered. The 1961 to 1973 Policies used language substantially similar to the *Dana* policies. The court similarly determined that the particular policy language required the use of the "injury-in-fact" trigger of coverage approach. *Id.* at 733. Therefore, property damage or bodily injury during the policy period was the triggering event. The subsequent policies, because they defined "occurrence" differently, required a different trigger. They defined an "occurrence" as "the happening, or series of happenings arising out of or caused by one event taking place during the term of the policy." *Id.* at 734. The court determined that under this language, the policies require that the causal events giving rise to the damage take place during the policy period. *Id.* (emphasis added). The claimant, therefore, was required to prove a subsequent chemical leak in each policy period in order to trigger subsequent policies. The policy trigger in *PSI Energy* was different between the two types of policies: one required proving injury during the subsequent policy period, and the other required proving the injury-causing event during the subsequent policy period.

Therefore, with the common language of the policies in *Dana*, the triggering event is the simple injury-in-fact during the policy period. Consequently, the plain language of the Policy requires not an additional occurrence during the policy period, but simply an injury — property damage, during the policy period. Where a construction defect causes damage over multiple policy periods, each subsequent policy may be triggered by damage ultimately caused by the initial defective construction event.

Furthermore, one Indiana case has addressed the issue of successive insurers and construction defects. In *U.S. Fid. and Guar. Co. v. Am. Ins. Co., 345 N.E.2d 267 (Ind. Ct. App. 1976) ("USF&G")*, an insured filed a declaratory judgment action to determine the respective liability of its insurers for damages caused by spalling of the insured's manufactured bricks that had been used in the construction of brick structures. Each of the three successive insurers had agreed to pay damages the insured incurred because of "property damage" caused by an "occurrence." An "occurrence" was defined as "an accident . . . which results, during the policy period, in . . .

property damage . . .." The court noted that each policy clearly provided that it only applied to property damage which occurred during the policy period. *Id*. at 268. All agreed that an insurer providing coverage only at the time of the product's manufacture and prior to it being incorporated into the structure has no liability for damage later caused by the product. *Id*. at 270. The court stated:

> The time of the occurrence of an accident within the meaning of an indemnity policy is *not the time the wrongful act was committed but the time when the complaining party was actually damaged*.

Id (emphasis added). Therefore, only those insurers which provide coverage at the time the complaining party suffers damage will be liable. *Id*. at 271; *see also Great Lakes Chem. Corp.*, 638 N.E.2d 847 (Ind. Ct. App. 1994) (applying rule to find that coverage triggered because damage occurred when pesticides applied to soil and contaminated groundwater, an event that occurred during the policy period). There was no dispute that the bricks had spalled during each of the three policy periods, so the issue before the court was whether each insurer was liable for the damage corresponding to the number of bricks spalling during its period of coverage or whether the insurer during whose period of coverage the spalling first discovered was liable for all loss to the structure. The court concluded that "property damage" occurred to the entire structure when the spalling first became apparent. *USF&G*, 345 N.E.2d at 271. Accordingly, only the insurer who provided coverage during such period was liable for the loss.

Under the "injury-in-fact" test, the CGL Policy is triggered upon proof that the insured caused an injury, in the form of property damage, to the structure or personal property inside, during the policy period. However, proof of a defect alone does not amount to "property damage," defined as "physical injury to tangible property." As the *USF&G* court recognized, the time of the occurrence within the meaning of an insurance policy is not the time the wrongful act was committed but the time when the complaining party was actually damaged. *USF&G*, 345 N.E.2d at 270.

The issue of when property damage is deemed to occur when a construction defect causes property damage is often complex and not easily answered as a matter of law. It is generally recognized that the issue of when an injury occurs is a question of fact which may require the use of expert evidence. *Hoechst Celanese Corp. v. Certain Underwriters at Lloyd's London*, 673 A. 2d. 164 (Del. 1996); *see also Joe Harden Builders, Inc. vs. Aetna Cas. and Sur. Co.*, 486 S.E. 2d. 89 (S.C. 1997). Nevertheless, this property damage must occur within the policy period. In *Parr v. Gonzalez*, 669 N.W.2d 401, 406 (Minn. Ct. App. 2003), the court held that to establish coverage under an occurrence-based policy, an insured must demonstrate that damage occurred while the policy was in effect. Consistent with *USF&G*, an occurrence, the *Parr* court held, takes place not when the policyholder engages in the wrongful act, but rather at the time the complaining party was actually damaged. *Id*. In *Parr*, a subcontractor damaged a vent cap on a homeowner's roof and later negligently repaired it. The negligently repaired vent cap eventually caused severe mold damage to the home. The court determined that coverage was triggered when the subcontractor negligently damaged and repaired the vent cap since that is the time when an "occurrence" caused "physical injury to tangible property." *Id*. at 406. Since the actual-injury trigger theory required the insured on the risk at the point of initial damage to pay for all

damages that followed and the mold was damage which followed damage to the vent cap, the insured was liable. *Id*. at 406-407.

Because pin-pointing a discrete date on which each element of alleged property damage occurred is often not possible due to the cause of the alleged damages involved, an Indiana court might employ the "continuous injury" test applied by other jurisdictions in cases involving progressive property damage to determine when the damage occurred. Indiana courts determine whether insurance coverage is triggered according to the specific language of the insurance policy.

i. Damage to Your Work Exclusion

However, even if there is coverage for damage caused by defective work, the CGL's various exclusions still apply and need to be analyzed. *See Sheehan Constr. Co.,* 935 N.E.2d at 169. Exclusion l. excludes coverage for "property damage" to "your work"…included in the "products-completed operations hazard." However, an exception to this exclusion provides that the "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." The definition of "products-completed operations hazard" includes "all…'property damage'…**arising out of**…'your work except…'" (emphasis added). The definition makes clear, as did the court in *Sheehan*, that general liability policies do not cover faulty work itself, but rather only "property damage" caused by the faulty work. *See, e.g. Sheehan*, which stated that "this appeal requires us to determine whether **damage caused by faulty workmanship** is covered under a standard CGL policy." *Id*. at 165 (emphasis added). This was illustrated by the *Sheehan* Court's citation to *Travelers Indemn.* for the proposition that faulty workmanship (the "occurrence") caused property damage (in that case, a shingle falling on a person), and its citation to *Lamar Homes* for the proposition that the insurance industry "specifically contemplated coverage for **property damage caused by** a subcontractor's defective performance." *Id*. at 171. In short, *Sheehan* only affects the insuring agreement issue as to whether an "occurrence" has happened; it does not affect the application of any policy exclusions.

However, the standard CGL your work exclusion excludes "'Property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard," but contains a subcontractor exception to the exclusion so that property damage caused by a subcontractor's work is covered.

ii. Breach of Contract Exclusion

Additionally, a breach of contract exclusion in CGL endorsements often exclude coverage, in relevant part, for "property damage" arising directly or indirectly from a breach of contract or breach of warranty. Indiana courts have not spoken on breach of contract exclusions in this context, however, the United States District Court for the Southern District of Indiana has predicted that "Indiana would follow the majority of other jurisdictions so that a breach of contract exclusion would apply only if the claim in question would not have existed but for the insured's alleged breach of contract. *Aearo Corp. v. Am. Int'l Specialty Lines Ins. Co.*, 676 F.Supp.2d 738, 750 (S.D. Ind. 2009). *See also Assurance Co. of A. v. J.P. Structures, Inc.*, 1997 WL 764498, at *3-5 (6th Cir. 1997); *Houbigant v. Fed. Ins. Co.*, 374 F.3d 192, 202-03 (3d. Cir.

2004); *Auto Owners Ins. Co. v. La Oasis, Inc.*, 2005 WL 1313684, at *11-13 (N.D. Inc. May 26, 2005). The District Court concluded this reading would be consistent with Indiana courts' narrower interpretation of the phrase "arising out of" in other commercial liability policy exclusions. *Id*. at 751.

In *Aearo Corp.*, the insured, Aearo, brought an action against its insurer under its CGL policy to recover costs of litigation and settlement after the insurer denied coverage and declined to defend in an underlying suit Climb Tech LLC brought against Aearo under an array of theories including trademark infringement, breach of contract, unfair competition, etc. *Aearo Corp.*, 676 F.Supp.2d at 742. The insurer alleged that Climb Tech would not have had a claim for trademark infringement but for Aearo's alleged breach of various distribution and confidentiality agreements between Aearo and Climb Tech. *Id*. at 751. However, the District Court found that the trademark infringement claim was based on a legal theory entirely different from a claim for breach of contract. The District Court stated that if the lawsuit had proceeded to trial, Climb Tech could have proven trademark infringement without proving breach of contract. *Id*. In fact, the Court stated that the trier of fact could have found that the agreements were invalid, but that nonetheless Aearo had still infringed on Climb Tech's trademark by using it without permission. *Id*. The Court said that "[p]erhaps that scenario was unlikely in view of the connection between the use of Climb Tech's trademark and the provisions of the agreements," but nevertheless, the suit "raised the possibility that Aearo could be held liable for a covered advertising injury based on a legal theory independent from breach of contract. *Id*.

In Indiana, the insurer's duty to defend is determined from the allegations of the complaint and from those facts known to or ascertainable by the insurer after reasonable investigation. *Wayne Township Bd. of Sch. Comm'rs v. Metro. Sch. Dist. of Wayne Township*, 650 N.E.2d 1205, 1208 (Ind. Ct. App. 1995). Only if the pleadings disclose that a claim is clearly excluded under the policy, is no defense required. *Id*. It is the actual substance of the complaint, not how the complaint is categorized, which determines the nature of the claim.

The nature of a cause of action is determined by the substance and central character of the complaint, not by its form or the labels a party affixes to the action. *Songer v. Civitas Bank*, 771 N.E.2d 61, 68 (Ind. 2002), *Hoosier Const. Co. v. Nat'l Bank of Commerce of Seattle*, 73 N.E. 1006, 1007 (Ind. Ct. App. 1905). However, the mere existence of a contractual relationship between the parties does not relieve either party from performing their contractual obligations in a non-tortious manner. *Flint v. Walling Mfg. Co. v. Beckett*, 79 N.E. 503 (Ind. 1906).

In *Flint*, Flint contractually agreed to build a windmill for Beckett. After Flint constructed the windmill, it came loose, fell, and caused damage to Beckett's barn and other property. Beckett's complaint against Flint recited the parties' contract for the building of the windmill and the payment of money as well as Flint's promises to erect the windmill in a "first-class manner." *Flint*, 79 N.E. at 504. The complaint also alleged several negligent acts Flint committed in constructing the windmill. *Id*. at 504-05. The Supreme Court of Indiana stated that the resolution of the questions at issue required a construction of the complaint and a determination of whether its nature was in tort or in contract. *Id*. at 504. In this regard, the court found that the complaint sounded in tort. *Id*.

> It is, of course, true, that it is not every breach of contract which can be counted on as a tort, and it may also be granted that if the making of a contract does not bring the parties into such a relation that a common-law obligation exists, no action can be maintained in tort for an omission properly to perform the undertaking. It by no means follows, however, that this common-law obligation may not have its inception in contract.
>
> If a defendant may be held liable for the neglect of a duty imposed on him, independently of any contract, by operation of law, a fortiori (the stronger argument) ought he to be liable where he has come under an obligation to use care as the result of an undertaking founded on a consideration. Where the duty has its roots in contract, the undertaking to observe due care may be implied from the relationship, and should be the fact that a breach of the agreement also constitutes such a failure to exercise care as amounts to a tort, the plaintiff may elect, as the common-law authorities has it, to so in case or in assumpsit (something he has undertaken).

Id. In essence, there is an Indiana line of cases which state that an action may be brought in contract or tort for the negligent performance of a contractual duty, especially when, as here, the duties between the parties is not defined in the contract. *Id*.; *Strong v. Comm. Carpet Co., Inc.*, 322 N.E.2d 387 (Ind. Ct. App. 1975); *Troxell v. Am. States Ins. Co.*, 596 N.E.2d 921 (Ind. Ct. App. 1992); *cmpr Sheridan Health Care Ctr. V. Centennial Healthcare Corp.*, 2001 WL 1029111 *8, (June 19, 2001) (when a contract, such as a lease agreement, defines all the duties between the parties, an allegation that a party failed to perform pursuant to the contract is a breach of contract).

In *Strong v. Commercial Carpet Co., Inc.*, the Strongs contracted with Commercial Carpet Co., Inc. ("Commercial") to install new carpet in their home. Due to a lack of sufficient materials and a change the Strongs requested, the total carpet installation was delayed for a few days. *Id*. at 388-89. Prior to final installation, Ms. Strong tripped over a tacking strip and sustained severe back injuries. *Id*. at 389. The Strongs sued Commercial both for breach of contract and for negligence. The Court found that a plaintiff may elect to bring an action in tort and contract, but an election of one claim over the other is not mandatory. *Id*. at 390. The Court found that a "line of division between tort and contractual liability developed early and has persisted despite the ridicule the distinction receives." *Id*. The most prevalent distinction between tort and contractual liability is that of nonfeasance and misfeasance. *Strong*, 322, N.E.2d at 390.

> This distinction draws a seemingly valid line between the complete nonperformance of a promise, which is said to be only a matter of contract, and a defective performance, which may also be a matter of tort. It is generally held that where the defendant has done something more than remain inactive and is charged with a misfeasance, the plaintiff may seek recovery in tort.

Id.

Accordingly, although a contractor and owner may enter into a relationship via a General Contract, the contractor will retain a duty, independent of the contract, to perform its work in a non-negligent manner. Therefore, the breach of contract exclusion would not apply to deny coverage in such a case.

IV.
Exclusion for Impaired Property

In light of Sheehan, Exclusion M, Damage to Impaired Property or Property not Physically Injured, must now be analyzed in cases where the your work exclusions are excepted for work done by subcontractors. While Exclusion M is complex, essentially there are two parts to the exclusion. The relevant part provides that physical injury and resulting loss of use to someone else's tangible property (**not** work the insured or its subcontractors did) that cannot be used because the insured's or its subcontractor's work was defective if the property can be restored to use by repairing your work is **excluded**. (Consequently, if the other person's property cannot be restored simply by fixing the insured's negligent work, then that other person's property would be covered).

As succinctly explained in *Bruner and O'Connor on Construction Law*, 4 Bruner & O'Connor Construction Law § 11:106 (October 2010)., citing Wielinski and Gibson, *Broad Form Property Damage coverage, International Risk Management Institute, Inc.*, at 119-120 (1992), assume the insured sells a product that is incorporated into airplane engines and that product is defective. As a result the airplanes are grounded by FAA. The planes are "impaired property" since they can be returned to use by replacing a defective product. Therefore, coverage for this "impaired property" is excluded. However, if we have this same situation, but this time, the airplane crashes before the defect is discovered, the plane is not "impaired property" because it cannot be returned to use by merely replacing the product. Therefore, the "impaired property" – the airplane – would be covered as it could not be repaired by fixing the defective product of the insured.

This analysis is complicated where the insured's work does not destroy tangible property of another, however, because the insured's work is such an integral part of the tangible property of another, there will be a total loss of use of that tangible property while the insured fixes its performance. Using our airplane example above, if the insured's product is so integrated into the engine that is removal will involve extensive work on the engine, the removal of the defective part results in "property damage" (loss of use) to the engine. Therefore, the exclusion should not apply, and there should be coverage for that property damage. If, for example, a warehouse floor is so integrated into the warehouse that removal and replacement of the floor will cause property damage (loss of use of tangible property not physically injured) to the warehouse, the exclusion should not apply and there should be coverage for that loss of use.