

The Real Property Exception to the "Your Product" Exclusion

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The Real Property Exception to the "Your Product" Exclusion in the CGL Policy¹

There has been a considerable amount of construction defect litigation against builders in the past several years. While insurers are often quick to deny coverage for such claims, builders have a significant weapon to challenge denials of coverage: the real property exception to the product exclusion.

Most builders have a Commercial General Liability insurance policy. The CGL has a 'product' exclusion for damage to products supplied by the insured: e.g., "This insurance does not apply to 'property damage' to 'your product' arising out of it or any part of it".

Insurers often rely on this exclusion, amongst others, to deny coverage for construction defect claims.

Policyholders, however, have a relatively unknown and under-utilized weapon to fight such denials. *The definition of 'your product' was amended in 1986 so that 'your product' does not include real property.* This is known as the real property exception to the product exclusion.

The real property exception can be very valuable to builders. It can help to restore coverage for construction defect claims arising out of allegedly faulty products. A number of American and Canadian courts have held that the 'your product' exclusion does not apply to products that are incorporated into a building, since the building and its components become real property.

In *Wanzek Construction Inc. v. Employers Insurance of Wausau*, 679 N.W.2d 322 (2004), the Supreme Court of Minnesota applied the real property exception in favour of a general contractor, Wanzek Construction. Wanzek was building a municipal swimming pool. A subcontractor had installed coping stones to cover perimeter overflow. The coping stones cracked and caused personal injuries. The city demanded that Wanzek replace the coping stones.

Wanzek submitted the claim to its insurer under its CGL policy. The insurer denied coverage on a number of grounds, including the 'your product' exclusion. The Supreme Court endorsed the usual and accepted meaning of the words real property, as found in the Black's Law Dictionary, as "land and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land." The exclusion for property damage, therefore, did not apply to the failure of the coping stones because of the exception for 'real property'.

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The Kansas Court of Appeals recently commented in *Lee Builders, Inc. v. Farm Bureau Mutual Insurance Company*, 33 Kan. App. 2d 504 (2005), that the real property exception to ‘your product’ ought to be broadly construed, especially where the insured is a contractor. In that case the court held that a builder’s work and materials were not the builder’s ‘product’ due to the real property exception.

This interpretation of the exception has been applied in Canada. In *Westridge Construction v. Zurich Insurance Co.* (2005), 25 C.C.L.I. (4th) 182, the Saskatchewan Court of Appeal considered the real property exception as it applied to a roof that had failed. The Court held that the exclusion did not apply, as the product in question had been incorporated into a building, which became real property when completed.

Some American district court cases, such as *Scottsdale Insurance C. v. Tri-State Insurance Co.*, 302 F. Supp. 2d 1100 (2005), have held that fixtures are to be considered real property for the purposes of the exception to the exclusion.

On the other hand, some American cases have held that materials incorporated into buildings are not real property within the meaning of the exception to the exclusion (e.g. *McMath Construction Company, Inc. vs. Glen Dupuy*, 897 So. 2d 677 (La. App. 2003)).

In *American Home Assurance Company v. AGM Marine Contractors, Inc.* 467 F.3d 810 (1st Cir. 2006), the U.S. Court of Appeals for the First Circuit emphasized the importance of severability in determining whether the property at issue is real property for the purposes of the exception to the exclusion.

AGM was the contractor responsible for floating docks, planted in the bottom of the ocean by piles running through brackets on the sides of the docks. The floating docks had been irreparably damaged and required replacement by AGM after a strong winter storm. AGM claimed against its insurer for, *inter alia*, the cost of replacing the docks.

The Court determined that the real property exception to the ‘your product’ exclusion did not apply: “the ‘severability’ aspect implicit in Black’s definition of real property contemplates that some items which are conceptually or even physically ‘connected’ to real property may be so readily removable that they never lose their nature as personal property”.

The impact of the real property exclusion is not very well known in Canada. It can provide a very valuable weapon that builders can use to fight denials of coverage for construction defect claims.²

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² After this article was originally published, the authors successfully argued that the real property exception applied to faulty concrete foundations, in *AXA Insurance (Canada) v. Ani-Wall Concrete Forming Inc.* (2007), 87 O.R. (3d) 764 (S.C.J.), affirmed (2008), 91 O.R. (3d) 481 (C.A.).