



# CONSTRUCTION RISK MANAGEMENT

## WEATHER DAMAGE TO THE PROJECT INTERIOR

by Tracy A. Saxe and David G. Jordan  
Saxe Doernberger & Vita, P.C.

**Tracy A. Saxe** is a partner at Saxe Doernberger & Vita, P.C. in Hamden, Connecticut. He has more than 20 years of litigation experience in insurance coverage issues, the majority of which has involved representation of policyholders. Mr. Saxe has handled cases involving coverage for construction defects, completed operations, product liability, property damage and bodily injury related to mold and asbestos, bodily injury related to construction, "sick building" syndrome, environmental claims, business interruption, employment disputes, patent infringement, contempt, RICO, unfair practices, breach of fiduciary duty, bad faith, and professional malpractice. He is well versed in issues relating to late notice, allocation, subrogation, contribution, indemnification, and the duty to defend.

In addition to his litigation experience, Mr. Saxe has successfully mediated and arbitrated many disputes. He has taught a variety of insurance law courses at Quinnipiac University School of Law and is a frequent lecturer nationally on insurance coverage topics. Mr. Saxe earned his J.D. from Georgetown University Law Center in 1983 and a B.A. in policy studies, *magna cum laude*, Phi Beta Kappa, from Syracuse University in 1980. Mr. Saxe can be reached at (203) 287-8890 or [tas@sdvlaw.com](mailto:tas@sdvlaw.com).

**David G. Jordan** is an associate at Saxe Doernberger & Vita, P.C. in Hamden, Connecticut. He has been a practicing attorney since 1999, the majority of such time focusing his practice in the area of complex commercial litigation. Mr. Jordan has had extensive involvement representing policyholders in a wide array of insurance disputes including construction defect claims, third-party liability claims, first-party property disputes, business interruption losses, and environmental coverage issues.

Mr. Jordan earned his J.D. from the University of Connecticut, School of Law in 1999, where he served as an Executive Editor of the *Connecticut Insurance Law Journal*, and earned a B.A. in Economics from Fairfield University in 1996. He can be reached at (203) 287-8890 or [dgj@sdvlaw.com](mailto:dgj@sdvlaw.com).

# WEATHER DAMAGE TO THE PROJECT INTERIOR

Builders risk insurance protects against the risk of damage to property intended to become a permanent part of a completed project structure. Naturally, this includes materials located within the interior, such as carpeting, drywall, ceiling tiles, molding, electrical fixtures, etc. As a general notion, interior property is more vulnerable to weather damage than are the stronger, more resilient materials associated with a building project, including the foundation, framing, and exterior walls. Perhaps for this reason, insurance policies often contain coverage restrictions with respect to interior property damage caused by weather-related perils.

In many builders risk policies, for coverage to apply to interior property damaged by weather elements, the interior property must be adequately protected. Some policies, for example, require the interior property to be contained within a fully enclosed structure. Many policies also limit the allowable means through which a weather related peril, be it rain, sleet, snow, etc., enters the project's interior. To illustrate, the insuring agreement may cover damage from a weather-related peril only when its access to the interior structure is through windstorm-created openings.

Generally, the greater the protection afforded to the interior property during the course of construction, the more likely a loss sustained from weather damage will be covered. For most claims involving weather damage to interior property, coverage will hinge on two factors: (1) the method of construction implemented by the insured, including procedures to safe-guard the interior property, and (2) the strictures of the applicable builders risk policy language. Both of these elements of coverage are discussed below.

## Method of Construction

The degree of risk associated with interior property damage depends in part upon the method of construction utilized by the insured. As a matter of sequence, a building is typically erected in one of two fashions. The traditional method is to complete the exterior component of the building project and thereafter undertake the interior work. The alternative method, sometimes referred to as the "fast track" method,<sup>1</sup> is to perform both the interior and exterior work simultaneously.<sup>2</sup> Accordingly, under the fast track approach, the interior components of one floor could be complete or near-complete while the erection of a higher floor is underway. Fast track construction is most likely to be employed on projects that involve stringent deadlines or where the potential revenues to be earned by completing the project sooner outweigh the potential costs

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<sup>1</sup>"Fast track" is generally understood to mean the performing of various components of construction work simultaneously rather than in distinct phases, including planning and design work. Thus, its usual connotation is somewhat broader than the usage applied in this article. See, e.g., Arthur O'Leary, *Fast Track Construction Is It Too Good To Be True? Can It Really Deliver?*, [www.dcd.com/oleary/oleary\\_marapr\\_2006.html](http://www.dcd.com/oleary/oleary_marapr_2006.html).

<sup>2</sup>There is likely some overlap between the conventional construction method and the fast track method for any given project. In other words, while some interior work may be installed before complete window installation, roof installation, and sealing are performed, the interior/exterior work might not be completely simultaneous.

associated with completing a project on an accelerated schedule, e.g., overtime, higher insurance, etc.

Working on interior and exterior components of the project simultaneously subjects the interior materials to a higher risk of loss because they are not fully protected from the elements. If windows, doors, and roofing are not fully installed, or the building has not been sealed or waterproofed, temporary measures are often taken to protect the otherwise exposed interior from weather damage. Temporary protections may include plastic sheeting, tarps, or otherwise covering openings in the structure. While these measures reduce the risk of loss, they are not 100 percent effective.

Caselaw suggests that courts are more inclined to find coverage for interior damage where the exposure to the risk cannot be avoided by implementing a different construction method. This outcome is illustrated in the contrasting outcomes of two cases discussed under “Mode of Access to Interior Property” below.

## **The Policy Language**

Given the increased risk of loss to interior property when installed prior to the sealing of the building envelope, builders risk policies often contain specific coverage conditions for losses concerning damage to interior property caused by stormy weather. Although builders risk insurance is a nonstandard coverage line, the terms of coverage vary widely from one policy to the next, but the general requirements tend to be (1) the interior property must be sufficiently enclosed and (2) the inclement weather must gain access to the project’s interior because of a covered cause of loss. In some cases, a third requirement—that damage must be the result of the entry of a specified element—will also apply.

Not surprisingly, the particular language of the policy in question is crucial in determining coverage for any loss to interior property. Caselaw regarding builder’s risk coverage for interior property damage is limited, but a handful of decisions demonstrate the issues that can arise when interior damage occurs at a construction site.

### **Sufficient Enclosure**

An “enclosure” requirement with respect to weather damage to interior property limits coverage to property located in an enclosed structure. The strictness of the requirement can vary. The sample provision in Exhibit 1 provides that coverage will only apply if the structure is “fully enclosed.”

# EXHIBIT 1

## CONDITIONS—WEATHER DAMAGE TO INTERIOR PROPERTY

We will not pay for loss caused by or resulting from ... rain, snow, ice or sleet, whether driven by wind or not, unless located within a *fully enclosed structure*; and then, only for such loss that is caused by or results from rain, snow, ice or sleet entering through an opening caused by a covered cause of loss. [Emphasis added.]

Source: ACE Ins. Form BB-5W60b

Some policies use the term “enclosed,” which has been interpreted by at least one court as more liberal than the stricter “fully enclosed.” In *Hanover Bldg. Materials, Inc. v. Guiffrida*, 748 F.2d 1011 (5th Cir. Tex. 1984), the court spoke to the ambiguity of the term “enclosed” in the context of a fraud insurance policy. The same argument can be used to demonstrate a distinction between the terms “enclosed” and “fully enclosed” in a builders risk policy.

In our view, the word “enclosed” is susceptible of different constructions. Certainly, a building with a roof and walls on all sides and with no openings would be enclosed. Certainly, too, a building with no roof and no walls would not be enclosed. Just how much of a roof and how many walls are needed, however, is unclear. We cannot say, by referring solely to the policy term “enclosed,” whether a partially enclosed storage building, not subject to further walling without destroying its functional purpose, is sufficiently or not “enclosed” so that damage to its contents is within the policy’s coverage. Thus, we conclude that the policy term “enclosed” is ambiguous. [*Id.* at 1014 (internal quotations and citations omitted).]

## Mode of Access to Interior Property

Some builders risk policies also limit the type of opening that the weather must enter through, such as damaged windows or doors, or a hole in the roof. Exhibit 2 illustrates this type of restriction.

## **EXHIBIT 2**

### **RESTRICTION ON TYPE OF OPENING**

We will not pay for loss of or damage to: the interior of any building or structure, or to personal property in the building or structure, caused by or resulting from rain, snow, sleet, ice, sand or dust, whether driven by wind or not, unless: a. The building or structure first sustains damage by a Covered Cause of Loss *to its roof or walls through which the rain, snow, sleet, ice, sand or dust enters* ... [Emphasis added.]

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Source: ISO Form CP 10 30 10 91

Some builders risk policies not only restrict coverage based on the location of the point of access, but the manner in which such access points are created. For example, both of the sample provisions reproduced in Exhibits VII.L.1 and VII.L.2 require the opening through which access is gained to be caused *by a covered cause of loss*. Some policies are even more restrictive, responding only to damage caused by weather elements that enter through an opening caused by specific perils, such as windstorm or hail. In such policies, any other cause of loss would not trigger the exception to the interior property exclusion.

In *Homestead Fire Ins. Co. v. DeWitt*, 245 P.2d 92 (Okla. 1952), the court examined the issue of access to the interior. Homestead Fire involved damage to the interior of a school building during the construction of an addition. In the process of attaching the roof of the addition to the roof of the existing school building, it was necessary to leave a temporary opening in the existing building at the location where the new roof was to be joined. This temporary opening was covered by a protective tarp. The tarp was blown off by wind, allowing rainwater to enter the insured structure. The insurance policy in question provided as follows:

[T]he company shall not be liable for loss to the walls of the building, or the insured property, caused by rain ... unless the building insured or containing the property insured shall sustain actual damage to the roof or walls by the direct force of wind or hail. [*Id.* at 93.]

The insurer argued that coverage did not apply because the roof was not damaged by wind, as required by the policy, but rather the protective tarp blew off and exposed an opening in the roof that was created during the construction process. However, concluding that the intent of the parties was to afford coverage for this specific risk of damage to the interior during the erection of the new roof, the *Homestead* court held that the loss was covered:

It was understood that as a part of the construction it would be necessary for plaintiffs to attach the roof of the new building to the roof of the old; that this operation was a necessary part of the work to be done by the plaintiffs, and that therefore the parties intended and contemplated that plaintiffs would be protected in that operation as well as in the actual erection of the walls and other portions of the new building. [*Id.* at 94.]

Contrasting *Homestead* is the case of *Ace Prop. and Cas. v. Vegas VP, LP*, No. 2:07-CV-00421, 2008 U.S. Dist. LEXIS 37495 (D. Nev. 2008). In *Vegas VP*, the insured project sustained rain damage when temporary visqueen tarps had been disturbed by a windstorm, enabling rain to enter the project's interior. The policy in question contained language similar to that involved in *Homestead*, which limited interior rain damage coverage to instances where the "building or structure first sustains Windstorm or Hail damage to its *roof, windows, or walls* through which the rain ... enters." [*Id.* at 4.] (Emphasis added.) The insurer argued that the interior damage was excluded because the rain did not enter through a "roof" or "window," nor had the walls themselves been torn open from windstorm or hail damage. In response, *Vegas VP* asserted that the visqueen tarps were, in essence, temporary windows and roofing, and that the water damage resulting from the openings in those tarps was covered. As the court noted:

VVP ... suggests that the expectations here were different [than instances involving a completed structure] because a building that is being constructed is unlikely to have a permanent roof or walls in place for any significant period of time covered by the policy. As a result, VVP argues that its expectation was that the term "roof" would be construed as including any covering that performed a similar function. In that same vein, VVP contends that visqueen tarps may serve as "windows" or "walls." [*Id.* at 22.]

To support its claim, *Vegas VP* further pointed out that the permanent walls and roof would not be installed until the very end of the construction project. Therefore, it argued that the provision of coverage for interior rain damage, if it is to have any meaning in the context of builders risk insurance, must apply when the rain enters through openings in the temporary protective coverings.

Ultimately, the court was not persuaded by the insured's arguments. First, it held that the temporary visqueen tarps did not constitute a roof, windows, or walls and, as a result, the rain did not enter through a manner prescribed by the policy:

Visqueen tarps ... do not constitute "roof, windows, or walls" within the meaning of the Policy. The tarps were used as a temporary precaution, presumably in the event of a rainstorm, precisely because the Building's permanent "roof, windows, or walls" had yet to be completed. Any wind damage to the visqueen tarps resulted in damage to temporary weather covering, not the "roof, windows, or walls." Accordingly, as to any rainwater that entered through wind-damaged visqueen, the Building did not first sustain wind or hail damage to its "roof, windows, or walls." Therefore, coverage is excluded and soft costs cannot be recovered. [*Id.* at 17-18.]

Second, the court acknowledged that the application of coverage for interior property damage was narrow, but that such fact alone did not render the policy illusory. Significantly, the court pointed out that the insured voluntarily chose to perform interior work simultaneous with the construction of the exterior, rather than utilize the more conservative approach of completing the shell before starting work on the interior. Therefore, it would not agree to expand the scope of coverage as a consequence of the contractor's chosen construction method:

*[T]he building process requires a critical decision: the builder may either complete the exterior, "drying-in" the interior, before beginning work on the interior, or begin interior*

*work before permanently enclosing it.* ... [Moreover] that the Policy does not explicitly refer to the permanent “roof, windows, or walls,” is irrelevant insofar as the plain and ordinary meaning of those words includes a permanency requirement. [*Id.* at 21–22.]<sup>3</sup> [Emphasis added.]

The diverging outcomes reached in *Vegas VP* and *Homestead* are plausibly explained by the fact that permanent enclosure of the interior property was not possible in *Homestead* due to the fact that the work performed upon the roof was to an existing structure. In contrast, *Vegas VP* involved an entirely new construction project, and thus the option to utilize the conventional “dry-in” construction method was available. The *Vegas VP* court intimates at such a distinction by stating:

Knowing that the project required this measure, the parties in *Homestead* were more likely to have negotiated for a *broader understanding* of the term “roof”—specifically, one that included any temporary precautions taken to cover the finished interior. *The project at issue here, however, did not require the exposure of the finished interior.* [*Id.* at 21.] [Emphasis added.]

The two cases accordingly suggest that one factor influencing the issue of coverage for interior damage is whether the exposure to the risk can be avoided by implementing a different construction method. If it can, it is more likely that a draconian view of the policy language, concerning “walls, windows and roofs” will be applied, unless the policyholder can otherwise demonstrate that the insurer understood the method of construction and thus had a “broader understanding” of the scope of coverage. If it cannot, a court may be more inclined to assume that the policy intended to cover the risk of weather damage resulting from damage to the temporary protective coverings installed at the project.

## Specified Elements

Coverage for weather damage to interior property is typically provided by exception to an interior property damage exclusion. Coverage can therefore be restricted by limiting the exception to damage caused by specified elements of weather. For example, the provision in Exhibit 1 stipulates coverage for damage caused by rain, snow, ice, or sleet that enters the structure through an opening in the external structure (assuming the other conditions provided in the exception are satisfied). The provision in Exhibit 2 allows coverage for all of these, plus sand or dust.

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<sup>3</sup>See also *D.B. Jeremy & Sons Inc. v. Commercial Union Ins. Co.*, 398 F. Supp. 375 (N.D. Ohio 1975) wherein the court declined to extend coverage under a builder’s risk policy for flood damage to skylights stored in the partially-completed building.

## Proximate Cause of Loss

As previously noted, coverage for weather damage to interior property typically depends on whether there is an applicable exception to an interior property damage exclusion. Most of the time, disputes revolve around the scope of the exception to the exclusion, as demonstrated above. However, it is also possible to argue that the exclusion is not triggered in the first place. That was the approach taken by the insured in *Century Theaters, Inc. v. Travelers Prop. and Cas. Co.*, No. C-05-3146JCS, 2006 U.S. Dist. LEXIS 15766 (N.D. Cal. 2006).

In *Century Theaters*, the plaintiff's construction project sustained interior damage from rain as a result of the contractor's failure to install any protective coverings. The insurer denied the claim on the basis that the loss was excluded by the policy's "hole in the roof" limitation which stated:

The Company will not pay for loss or damage to, or any loss that is a consequence of loss or damage to the interior of any building or structure, or to personal property in the building or structure, caused by or resulting from rain, snow, sleet, ice, sand or dust, whether driven by wind or not, unless: a. The building or structure first sustains damage by a covered cause of loss to its roof or walls through which the rain, snow, sleet, ice or dust enters....

The insurer's position was that the policy excluded coverage for damage to the interior caused by rain (and other elements) *unless* there is damage to the structure through which the rain is able to enter. Because no such external damage was present, the exception to the exclusion did not apply. The plaintiff, however, countered this argument by asserting that the efficient or proximate cause of the loss was not the rain itself, but the contractor's negligence in failing to provide any protective covering of the interior work. The court agreed with this position:

[T]he efficient proximate cause of the loss was the fact that the roof was left uncovered even while work on the interior proceeded. This was the most important cause of the loss, even if the damage was also caused by the rain. As a result, the Court concludes, as a matter of law, that the Hole in the Roof Provision does not provide a basis on which Travelers was entitled to deny coverage. [*Id.* at 20.]

*Century Theaters* points out that when interior damage is directly attributable to a covered cause of loss other than inclement weather, it is possible that the damage, which would otherwise be excluded by stringent policy limitations associated with damage directly caused by inclement weather, may be covered.<sup>4</sup>

This is consistent with the general notion that insurance policies are to be interpreted with an eye towards coverage. Moreover, the policy language in this case, as it concerned the hole in

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<sup>4</sup>Interestingly, and perhaps ironically, the insured may have benefited from its contractor's lack of prudence, i.e., improper construction methods. That is, if the contractor had properly installed temporary coverings, and those coverings failed to prevent rain damage, it is possible that the outcome of the case would have been different (unless the use of temporary coverings was considered unavoidable, as was the case in *Homestead*).

the roof limitation, did not preclude coverage in instances where damage is attributable to a concurrent cause of loss, such as failure to cover exposed work areas (i.e., it did not contain anti-concurrent language).

## Conclusion

Inherent in any construction project is the risk that damage will occur as a result of unforeseen circumstances, including damage to the project's interior caused by elements of weather, including rain, snow, ice, sleet, and possibly dust or sand. The likelihood of weather-related damage to interior property is magnified when the structure is not yet enclosed, and for that reason builders risk insurance may not cover such damage if the structure is not satisfactorily enclosed.

The fast track method of construction may increase the likelihood of an uninsured loss, especially if interior work is started before the building envelope is sealed. Caselaw on these issues is limited, and thus far from settled. Although it can be argued that the insurer has knowingly underwritten the risk when a building project necessarily involves a nonenclosed structure which utilizes temporary coverings as protection, such argument has been deemed to ignore the insured's own decisions regarding the selected construction method. Nevertheless, to the extent a "broader understanding" of coverage can be demonstrated given the distinction between a building under construction and a completed dwelling, as pointed out by *Vegas VP*, coverage for weather damage resulting from flaws in the temporary coverings may be achieved.

Subtle differences in policy language can have a significant impact on coverage. Intuitively, broader language affords a greater likelihood that interior damage will be covered. For example, a clause which requires interior property to be contained within an "enclosed structure" may be interpreted more loosely than one that requires a "fully enclosed structure," which can be the difference between a covered loss and an excluded loss. Likewise, requiring that the openings through which the weather elements gained access be caused by a "covered cause of loss" is more favorable than one that requires such access to be created by specific perils, such as windstorm or hail.

Finally, coverage may also be found if the primary cause of the damage to the interior can be attributed to some act or event other than inclement weather, thereby steering the claim away from the policy provisions addressing weather-related causes of loss altogether.

