

Faulty Workmanship – Are You Covered?

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In recent years the number of faulty workmanship or construction defect claims has spiked dramatically. Are you covered by your commercial general liability (CGL) policy? Yes, no or maybe? Whether you are an owner, developer or contractor, you should ask yourself this important question and understand how new litigation in Ohio is affecting CGL policies.

The Changing Landscape of CGL Policies

For developers, contractors and subcontractors, insurance helps them manage the risks inherent in construction. To cover these risks, contractors and subcontractors rely on their insurance policy for which they pay substantial premiums.

In the past decade, the question of whether property damage that arises out of defective or faulty construction work is an “occurrence” of “property damage” under a standard CGL policy has been the subject of much litigation.

The first coverage determination is whether faulty workmanship is a covered occurrence according to the state’s case law. Case law by state falls within three broad categories: covered, not covered or inconclusive, and is a major factor in construction defect loss activity.

Case Law Creates Gaps in CGL

Higher tier contractors and developers face a potential coverage gap in states where case law has ruled that the CGL policy does not apply to property damage caused by completed faulty work performed by subcontractors. In some states, the courts rule such claims are either a breach of contract, do not meet the unexpected or unintended criteria, or are merely an economic loss. None of these are an “occurrence” or “property damage” as defined in the CGL.

Westfield vs. Custom Agri Systems: What You Need To Know

On October 16, 2012 the Ohio Supreme Court ruled on this very important issue. The Court put Ohio in the minority of states by ruling that claims of defective construction by a property owner are not claims for property damage that are covered by a standard CGL policy. In other words, CGL policies do not cover claims for defective construction or workmanship brought by a property owner against the contractor who performed the work.



What this New Law Means For Ohio Contractors

With this ruling, Ohio CGL insurers have no duty to defend or indemnify builders for construction defect claims. According to dissenting Supreme Court Justice Pfeifer, the “strong recent trend in the case law interprets the term ‘occurrence’ to encompass unanticipated damage to non-defective property resulting from poor workmanship.” Furthermore, Justice Pfeifer stated that the decision was too broad and improperly “forecloses too many other potential cases” where the insurance policy should provide coverage, including cases where faulty construction resulted in unintentional damage to other work.

How Do Developers and Contractors Protect Themselves

There are ways that developers and contractors can protect themselves now, including:

- Discuss this with your insurance broker. Many insurance companies have issued new coverage endorsements redefining the Insuring Agreement for property damage.
- Review and update your contractual risk transfer with proper indemnification and insurance requirements.
- Implement a quality control program to prevent or reduce faulty workmanship.
- Implement or improve your contractor pre-qualification process.

How insurance companies and the lower courts interpret and apply the recent Ohio ruling is yet to be seen. Implementing best practices is imperative to protecting your company’s financial bottom line.

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