

# Faulty Workmanship Coverage: an Evolving Oddity in Contractors Professional Liability Insurance



by:

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A new insurance coverage is emerging in the Contractors Professional Liability (CPrL) realm – and it's not related to professional services. While offered by one pioneering carrier for over five years, over the past 18 months a handful of carriers have joined to create a viable market for "faulty workmanship coverage" where it previously did not exist. Faulty work coverage or faulty workmanship liability coverage is being offered more and more to plug the gap that many specialty trade contractors live with in their commercial general liability (CGL) policy. Although coverage will always depend on the specific policy wording and the circumstances of a claim, there are general trends in the marketplace. Currently under the CGL, while coverage generally exists for resulting liability of work performed by subcontractors of the insured, typically no such coverage exists for replacement of the defective work installed by the insured, loss of use or recall of their defective products or impaired property. This faulty workmanship coverage will usually do just that – pay for damages (i.e., the cost to replace or repair) resulting from an actual or alleged act, error or omission in the workmanship or the use of defective materials or products in the named insured's work. Currently offered to smaller specialty trades and some general contractors for the work they self-perform, appetites are still being honed to ensure carriers are protecting the profitability of their current book of Contractors Professional Liability coverage.

Before we go any further, it's important to briefly discuss how the current CPrL policy typically addresses faulty work. Generally speaking and simply put, the cost to "repair or replace" faulty work of the insured is excluded from a typical CPrL policy. The operative phrase is "the cost to repair or replace." Nearly every faulty work exclusion in a CPrL policy applies the exclusion only to the "repair or replacement" of the faulty work or materials. This may sound very basic but it's important to point out that the resulting liability or damage caused by the faulty work itself would typically be covered, provided all other terms and conditions of the policy are met. So, resulting damages are usually covered.

Second, many, if not all CPrL carriers, offer an option or exception to the typical faulty work exclusion. It's an exception to the exclusion that reads something like, "this exclusion does not apply to negligent acts, errors or omissions in the performance of covered professional services." While it would appear to fill the gap created by the exclusion for the cost to repair or replace the faulty work or materials, be skeptical of those carriers that believe they are covering the cost to repair or replace faulty work of their insured with this exception. In our experience, however, this exception is often only intended to allow coverage for damages resulting from negligence in the performance of professional services, not faulty work performed on the part of the insured.

Consider the following hypothetical example. An insured has a CPrL policy that includes an exception to the faulty work exclusion for professional services as stated earlier. There are allegations against the insured that include "mismanagement of subcontractors" or "failure to properly inspect or direct the subcontractors" that resulted in damages to a third party. In the event the insured is found to be liable for damages associated with the subcontractors' faulty work as a result of not properly performing the services of managing, inspecting and directing subcontractors, coverage would generally be provided, including the cost to repair or replace the faulty work. However, such exception to the faulty work exclusion usually would only cover the cost to repair or replace the faulty work of *subcontractors*. The insured still does not have coverage for faulty work self-performed. In general, the wording of these exclusions covers the damages associated with the insured's negligent act, error or omission in professional services and not the faulty work of the insured. As always, it is important to note that coverage depends on the specific wording of the policy in question; most times, not always, "failure to inspect or identify faulty work" or "mismanagement of subs" are picked up through a policy's definition of professional services but only if the definition includes construction management, project management or some broader term or description of services. It's important to know such errors are not automatically covered without the inclusion of the above or comparable wording.

There are a couple of carriers that offer their CPrL program without a faulty work exclusion. On the surface this may get closer to picking up the damages associated with the cost to replace or repair a subcontractor's work; however, without allegations of negligence made against the insured resulting from performance of professional services, our experience is that coverage is generally limited at best, since policy language still typically limits coverage to the insured's actual or alleged negligent acts, errors or omissions.

### **True Faulty Work Coverage Terms & Conditions**

True faulty workmanship coverage forms commonly serve as a separate insuring agreement that can be offered in carrier-specific CPrL policies. In such agreements, the insuring document usually provides coverage for the claims arising out of the workmanship of "your work" or in the use of defective materials or products used in "your work." In our experience, these forms are usually specifically designed to cover self-performed work and not the work of third-party subcontractors. In these cases, the faulty work coverage is generally then triggered when a third-party claim is brought against the contractor by an owner or other third party. Commonly dovetailing with the exclusion for self-performed work found in most commercial general liability policies, the coverage, when fully applied and specified, also includes the materials, parts and equipment that are used to perform "your work" such as steel beams, epoxy activators, anchor bolts, etc. as well as the warranties or representations made in respect to "your work."

However, exclusions usually do apply. For instance, faulty work policies normally do not offer coverage for resulting bodily injury and property damage, which is typically provided under the insured's general liability policy. It also generally does not protect against the business risks arising from the decisions of unhappy customers. In other words, if the insured contractor follows the specs as agreed

by the owner and installs such products properly, it is the owner who is at risk for the finished product.

While professional services are generally excluded under the faulty work policy, they are often addressed through the insured's professional liability insuring agreement. Exclusions for project delays also often apply. Although it's important to fully understand the policy since "givebacks" do exist for project delays and the resulting consequential damages arising from professional services such as project management, design and construction management. In addition, here are some examples of where faulty workmanship terms and conditions would benefit the insured:

- As a contractor laid the concrete for a big box store in the Northeast U.S., workers applied a "shake-on" curing compound (aka accelerator) onto the floor, which started to delaminate two to three months later. A review found that the accelerator was improperly applied. The permanent fix involved placement of a vinyl flooring on top of the concrete at a cost of approximately \$400,000.
- A contractor was hired by a municipality to rehabilitate 13 manhole covers in a residential neighborhood. When complete, the new manholes sat two inches above street grade causing numerous complaints. The cost to remove and re-install the covers was \$125,000. The initial job cost was \$150,000.
- Drywall was installed throughout the new wing of a hospital. Unfortunately, the contractor's purchasing team accidentally ordered several truckloads of three-eighths-inch drywall, rather than half inch drywall which was specified. The contractor proceeded to install the incorrect drywall, and the error was eventually discovered, necessitating the drywall's removal and re-installation.

### **The Emerging Faulty Workmanship Marketplace**

The marketplace for true faulty workmanship coverage has grown from one carrier in 2014 to approximately six or seven today. Typically offered as part of a blended contractor's errors & omissions product or a totally separate insuring agreement via endorsement to a CPrL policy, faulty workmanship configurations designed to cover faulty workmanship and the defective products used in the course of "your work" are available in capacities ranging from \$250,000 to \$5,000,000, with premiums starting as low as \$2,500 to 3,500. In our experience, carriers are often selective when it comes to residential exposures and project type. While those markets offering both CGL and faulty workmanship coverage on a contractor's E&O form do so by mandating both be purchased by the same market, some others offer the faulty work coverage independent of writing the CGL.

It should be noted that special attention should be given to truly understanding what coverage is being offered under the title of "faulty work" as some markets offer coverage for manufacturing and fabrication errors but not installation errors.

### **Who's the best fit for Faulty Workmanship coverage?**

The beneficiaries of today's faulty workmanship coverage forms are artisans as well as general and trade contractors who are self-performing work. This includes electricians, plumbers, HVAC and mechanical contractors, interior finishers, masons, utility contractors and flooring contractors. Conversely, exterior insulation and finish systems (EIFS), roofing, structural and environmental contractors are often excluded. The other caveat is that the moment these contractors sub out their work, perform construction management or delegate design, the risk management or coverage usually automatically shifts toward professional liability exposures rather than faulty workmanship.

The benefit for most contractors, however, surrounds the ability to fill the policy gap for “your work” faulty workmanship claims triggered by third-parties against the insured – a true advantage for any construction professional who could neither afford or withstand the risks that accompany costly and time consuming claims.

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