Contractor Alert:
You're On Your Own For Faulty Work (Maybe)

Rick Meyer
rmeyer@dbllaw.com

Recent cases from the Supreme Courts of Ohio, Kentucky and Indiana raise the issue whether Contractors get any liability coverage at all when they purchase commercial general liability (CGL) policies. The Ohio and Kentucky opinions may be reversing coverages that contractors expected to have for at least the last 25 years. A typical claim in the past would involve, for example, defective flashing that allows water to damage interior wood members, drywall, etc. The insurance company under a CGL policy would typically provide the roofing contractor with a defense and, if causation was proven, would pay for the resulting damages to the wood members, drywall, etc., but would not pay to repair the defective flashing. In insurance policy lingo, the defective flashing is excluded from coverage because it is "your work" (that is, the insured's own work). Insurance is not intended to make up for substandard construction. However, insurance is intended to pay for "other property" which is damaged by the insured's faulty construction.

Contractors have come to rely on that approach and that is what they expect when purchasing their CGL liability policies, especially when the defective work was actually done by a Subcontractor, and suit is brought against the GC insured. However, that well-worn and accepted (and paid for) approach has come under attack (by insurance companies!) in recent years.

In 2010, the Indiana Supreme Court issued a pro-contractor, pro-coverage opinion in a case where the GC was sued for the damages caused by the faulty work of its Subcontractor. The opinion is well-reasoned and well-written. However, the opinion left the door open by stating that coverage or no coverage could vary from case to case depending on whether the defective work was "intentional" or "accidental." The result in Indiana may be that insurance companies will deny coverage until the Contractor proves the substandard work by its Subcontractor was "accidental." The proper question is whether the resulting damages were intended or accidental, not the performance of the work.

Supreme Court opinions in Ohio and Kentucky are much more troublesome. In 2010, the Kentucky Supreme Court held that the GC "intentionally" performs its own substandard work ***and that of its Subcontractors***. Therefore, the GC has no liability insurance at all for damages caused by any defective work on the project. Last year, the Ohio Supreme Court held that anyone's faulty workmanship is not an "occurrence" for purposes of CGL policies. This is a far-reaching opinion that could entirely eliminate any reason for a Contractor to ever purchase a CGL liability policy. Fortunately, the facts in that case make it clear that the damages were limited to the insured's own work. The insured in that case was a Subcontractor. It is therefore possible that the damage to "other property" argument may still be alive in Ohio.

In 1986, the insurance industry was forced to broaden and clarify CGL liability coverage in the construction industry. Now may be the time for the construction industry to force insurance companies once again to clarify policy language to guarantee that Contractors are getting what they pay for in liability coverage.