Commentary

BY CYNTHIA W. KOLB

Construction Firms Exposed

THE ARKANSAS SUPREME Court has held that faulty workmanship is not covered under most commercial general liability, or CGL, policies. Recently, federal courts in Arkansas have extended this line of reasoning and found that not only is damage to the work itself not covered, neither is any damage resulting from the faulty workmanship. This includes damages such as loss of use, loss of business expectancy, costs, attorney's fees and other damage.

If you have a construction company, you need to know that your CGL policy may leave you exposed. Here's why.

CGL policies provide insurance for property damage or personal injury arising out of an "occurrence." An "occurrence" is defined as an accident. The Arkansas Supreme Court in Essex Insurance Co. v. Holder focused on the accidental nature of an "occurrence" in holding that faulty workmanship is not an "occurrence" under Arkansas law. Therefore, there is no coverage for faulty workmanship because it is not an accident. But there did appear to be coverage for any damages resulting from faulty workmanship. For example, while repairs needed to correct the leaks in a poorly constructed roof would not be covered under a CGL policy, the carpet in the home damaged by the leaking would be covered. Recent court decisions may have changed this.

Federal courts in Arkansas have now found that both damage caused by and damage resulting from the faulty workmanship are not covered under a CGL policy. That would mean, in the example cited above, not only would the leaky roof not be covered under a CGL policy, neither would the water-damaged carpet. The federal court in the Western District of Arkansas in the case of Cincinnati Insurance Cos. v. Collier Landholdings LLC framed the resulting damages issue as follows: "If coverage is to exist, it must exist because these damages arise from an 'occurrence' other than defective workmanship." The court concluded that if the damages being alleged in the lawsuit came about from faulty workmanship — no matter what type of damages they were — they were not covered and the insurance company did not have to pay for the damages or provide a defense to the company being sued for faulty workmanship.

Likewise, the federal court in the Eastern District of Arkansas followed the holding of Collier in the case of Lexicon Inc. v. Ace American Insurance Co. The Lexicon case concerned a silo that collapsed due to alleged faulty welds performed by a subcontractor. The court in the Lexicon case held that the collapse of the silo was not covered and neither was the damage to the products stored in the silo, damage to adjacent silos and damage to other equipment.

The question becomes how does a construction company protect itself when its CGL policy may not? Although courts have suggested a performance bond may protect against claims for the cost of repair or replacement, the typical performance bond protects only the customer and gives the bonding company the right to recover its payments from the construction company.

Some insurance companies may offer endorsements that a contractor can purchase with a CGL policy covering property damage caused by work performed by a subcontractor. Such endorsements deem this property damage as being an "occurrence," or accident, and coverage would then be provided by the CGL policy.

Even with the policy endorsement described above, construction companies still face the prospect that in a lawsuit by a former customer, some or all of the damages being claimed will not be covered by their CGL policies. As such, more construction companies may be facing a fight on two fronts: a lawsuit with their customers over the projects and a lawsuit with their own insurance companies over their CGL policies. At that point, it is important for construction companies to seek legal counsel. ■

Cynthia W. Kolb is an attorney with the Barber Law Firm of Little Rock. Her practice focuses on civil litigation with an emphasis on insurance defense, including insurance coverage disputes. She can be reached at CWKolb@BarberLawFirm.com.