

“An Accident of Faulty Workmanship” or “Faulty Workmanship Which Causes an Accident”: Is There a Difference?

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As a standard form of protection, contractors¹ acquire commercial general liability (“CGL”) insurance coverage. Upon acquisition, many contractors and their agents believe that their insurance coverage extends to customer claims involving their faulty workmanship. However, recent Indiana appellate decisions have established that claims seeking damages for the poor workmanship of the insured contractor are not covered under the contractor’s CGL policy. As discussed below, the key to the determination of coverage under the CGL policy for poor workmanship focuses upon whether the claim involves “an accident of faulty workmanship” or “faulty workmanship which causes an accident.”

Most insurers use a standard CGL policy coverage form that has been issued by the Insurance Services Office.² When a faulty workmanship claim is presented against the insured, a number of questions must be addressed to determine if insurance coverage exists. These questions require a review of the CGL policy language, and include whether there exists an “occurrence,” whether there is “property damage” or “bodily injury,” and whether coverage is excluded by any of the “builders risk” exclusions commonly found in the CGL policy. In order to understand the scope of coverage afforded contractors under the CGL policy for faulty workmanship claims, the analysis of each of these issues must occur.

OCCURRENCE

Most CGL policies are “occurrence” type policies that require the liability producing event “to occur” within the policy period of coverage. The “Insuring Agreement” portion of the policy, where the scope of liability coverage is identified, generally provides:

I. Insuring Agreement

....

b. This insurance applies to “bodily injury” and “property damage” only if:

1. The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory;” and³

The policy defines “occurrence” to mean “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”⁴

The key phrase in defining an “occurrence” is the word “accident.” Insureds-contractors believe that any faulty workmanship claim is an “accident,” because they never intended to provide poor workmanship. However, a claim for the costs to repair a contractor’s poor workmanship is not an “accident” as contemplated within a CGL policy.

In *R.N. Thompson & Assoc. v. Monroe Guaranty Insurance Co.*,⁵ the insured was a builder-developer of a neighborhood housing development. Homeowners in the development sued the insured for breach of the implied warranty of habitability because of alleged improper home construction. The insured submitted a claim to its CGL insurer, which denied the claim by

contending that there was no “occurrence” and no “property damage.”

The trial court granted summary judgment to the insurer in the declaratory judgment action to determine coverage. On appeal, the trial court was affirmed. The appellate court concluded that there was no “accident” as required within the definition of “occurrence.” Instead, the losses sustained by the homeowners arose as the “natural and ordinary consequence of the [builders] work” flowing from a contractual relationship between the homeowners and the builder. Because the damages arose from an alleged breach of contract regarding the actions of the builder, the court found no “occurrence” existed to trigger a coverage obligation.

In the context of determining what is an “occurrence,” the *Thompson* court also incorporated the key language that guides in determining the scope of coverage for faulty workmanship claims. Relying upon the Indiana Supreme Court’s language in another faulty workmanship case addressing another policy provision, the *Thompson* court reflected the intent of the CGL policy by stating “[b]ecause a typical CGL policy ‘does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident,’ [there was no ‘occurrence’].”⁶

Recently, the Indiana Court of Appeals clarified the lack of CGL coverage for faulty workmanship claims in *Jim Barna Log Systems Midwest, Inc. v. General Casualty Insurance Co.*⁷ A seller-distributor of log homes was sued under various theories⁸ by a buyer. The seller sought insurance coverage from its CGL carrier for the buyer’s lawsuit. The CGL carrier refused to provide coverage, and the seller filed a declaratory judgment action to determine coverage. After summary judgment was granted to the insurer and denied as to the seller, an appeal was pursued.

The court of appeals affirmed the trial court’s granting of summary judgment to the insurer. The court expanded upon the *Thompson* court’s analysis in determining what a CGL policy covers in faulty workmanship claims, and addressed each of the theories asserted against the seller to determine whether coverage existed:

Imbedded within the analysis of commercial general liability coverage is the notion that there are two types of risk inherent in a contractor’s line of work (1) business risk, and (2) occurrences that give rise to insurable liability. [Citation omitted.] Business risk is a consequence of not performing well and is a component of every business relationship that is necessarily borne by the contractor in order to satisfy customers. [Citation omitted.]

[A] contractor holds himself out as being capable of completing the bargained-for construction in a workmanlike manner. At the same time, the property owner relies upon that representation and anticipates suitable goods and services. When the contractor’s work is faulty, either express or implied warranties are breached, and a dissatisfied customer may recover the cost of repair or replacement of the faulty work from the contractor as the standard measure of damages for breach of warranty.

[Citation omitted.] Conversely, in a CGL Policy,

The coverage is for tort liability for physical damages to others and

not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained.⁹

These decisions firmly establish that a CGL insurer is responsible only for potential tort liability of the contractor and not for economic losses required to repair or replace an insured's faulty workmanship. A simple example demonstrates this principle. If a contractor places a defective roof on a building, the CGL insurer is not responsible for the costs to replace the roof. However, if the defective roof leaks, and a computer is damaged by the leaking water, then an "occurrence" exists and a coverage obligation for those damages other than the repairs to the defective roof, exists.

PROPERTY DAMAGE

In addition to an "occurrence," in order to trigger coverage, there must be "property damage" or "bodily injury."¹⁰ "Property damage" is generally defined in the CGL policy as:

- a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
- b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.¹¹

At first glance, one may view that a faulty workmanship claim clearly involves "property damage" consisting of the damaged product itself. However, similar to the analysis of "occurrence," the intent of the CGL policy is to include property damage *other than* the work of the insured.

The court in *R.N. Thompson* analyzed this exact definition of "property damage" in a faulty workmanship case. The court reflected upon the intent of the CGL policy, and determined that it does not apply to claims for the repair and replacement of poor workmanship:

The great weight of authority is to the effect that CGL policies cover the possibility that the goods, products, or work of the insured, once relinquished or completed, will cause bodily injury or damage to property *other than* to the product or completed work itself, and for which injury or damage the insured might be exposed to liability. The coverage is for tort liability for physical damages to others, and not for contractual liability of the insured for economic loss suffered because the completed work is not what the damaged person bargained for.¹²

The court further stated that "a claim limited to remedying faulty workmanship, . . . does not involve 'physical injury to tangible property' or 'property damage.'"¹³

In order to trigger an obligation of the CGL insurer to provide coverage property damage from a faulty workmanship claim, there must be an "occurrence" and "property damage."

However, the claim must be for damages other than to the work performed by the insured. To hold otherwise, the CGL insurer becomes the guarantor of the workmanship of the insured, a risk clearly not contemplated to be covered under a CGL policy.

BUILDERS RISK EXCLUSIONS

If the insuring agreement of the policy is triggered, the next step of the coverage analysis is to determine whether any exclusions apply. Because the CGL policy was never intended to apply to cover the repair of the insured's faulty workmanship, various "builders risk" exclusions exist in the policy. Although a number of them may apply,¹⁴ the one that appears most applicable involves the "your work" exclusion which provides:

I. Damage to Your Work

"Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.¹⁵

"Your work" is defined as:

- a. Work or operations performed by you or on your behalf;
and
- b. Materials, parts or equipment furnished in connection with such work or operations.

"Your work" includes:

- a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work"; and
- b. The providing of or failure to provide warning or instructions.¹⁶

The builders risk exclusions, including the "your work" exclusion, were addressed some time ago by the Indiana Supreme Court in *Indiana Insurance Co. v. DeZutti*,¹⁷ and found to further limit CGL coverage in faulty workmanship claims:

These provisions clearly exclude insurance coverage for damages to the insured's product or work when such damages are confined to the product or work and caused by the product or work, or any part thereof. It is only damage to other property arising out of the insured's product or work which would be covered.¹⁸

The *DeZutti* decision interpreted a “your work” exclusion that lacked the exception for work done by subcontractors. After *DeZutti*, ISO modified the “your work” exclusion to add the exception. Because most contractors subcontract the actual work at a project, whether the “your work” exclusion applies must be closely analyzed for each case. Clearly, the intent that the CGL policy does not apply to faulty workmanship claim remains. However, by its plain wording, it cannot be applied if the work was done by a subcontractor. Instead, the remaining “builders risk” exclusions must be analyzed for application.

SUMMARY

The CGL policy is intended to apply to “faulty workmanship that causes an accident.” It is not intended to apply to “an accident of faulty workmanship.” Contractors need to be mindful of their insurance coverages, and be aware that the risk that their work must be repaired or replaced will only be covered by a performance or guaranty bond. CGL coverage will apply to address tort claims that produce damage or injuries which result from the work, rather than the work itself.

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1 “Contractors” will generally refer to contractors, subcontractors, builders and developers.
2 The ISO is “an insurance industry organization that, among other things, prepares and disseminates
standard form policies.” Robert J. Franco, *Insurance Coverage for Faulty Workmanship Claims Under
Commercial General Liability Policies*, 30 TORT & INS.L.J., 785,786, fn.2 (Spring 1995).
3 Miller & Lefebvre, *Miller’s Standard Insurance Policies Annotated*, vol. 1, p. 409 (“Miller’s”)
4 Miller’s, vol. 1, p. 419.
5 686 N.E.2d 160 (Ind. Ct. App. 1997) *trans. den.* 698 N.E.2d 1191 (Ind. 1998).
6 *Id.* at 164 (quoting *Indiana Ins. Co. v. DeZutti*, 408 N.E.2d 1275, 1279 (Ind. 1980)).
7 791 N.E.2d 816 (Ind. Ct. App. 2003).
8 Specifically, the counts asserted by the buyers and identified within the opinion included negligence in
hiring incompetent builders; breach of contract; conversion of materials; fraudulent misrepresentation; and
violation of Indiana’s Deceptive Consumer Sales Act, I.C. 24-5-.5-1 *et. seq.*
9 *Jim Barna*, 791 N.E.2d at 823-4 (quoting *R.N. Thompson*, 686 N.E.2d at 162, and *DeZutti*, 408 N.E.2d at
1275.)
10 “Bodily injury” is not treated within this article as whether it exists is usually ascertainable from whether
the claimant is physically injured.
11 Miller’s, vol. 1, p. 420.
12 *R.N. Thompson*, 686 N.E.2d at 162 (original italics).
13 *Id.* at 163.
14 The potential exclusions in the standard CGL policy that may apply to faulty workmanship claims include
“damage to property [that must be restored, repaired or replaced because of faulty work]; damage to [the
insured’s] product; damage to the [insured’s] work, and recall of products, work or impaired property
[because of repair or replacement].”
15 Miller’s, vol. 1, p. 411.
16 *Id.* at 420.

¹⁷ 408 N.E.2d 1275 (Ind. 1980).
¹⁸ *Id.* at 1280.