

# Risk Insights

Provided by IDR Specialty

## Construction Defects - What You Can Do to Protect Your Business

Possibly no two words strike more fear in the hearts of architects, engineers and contractors than “construction defect.” A claim for construction defect can cost astronomical amounts to correct and defend. And then there’s the damage to your reputation and its impact on your future opportunities for work. It’s enough to break a business.

### Construction Defect Risks

Today, your risk of becoming involved in a construction defect claim is greater than ever. New technology, materials and applications have changed the way commercial buildings, homes and condominiums are constructed.

Advances are enabling the design and construction of buildings that are more attractive and less costly. Yet, many of these advances have yet to be tested in real application over time, where problems may be uncovered that were never anticipated in the lab.

At the same time, new applications require new skills from contractors, who may overlook important requirements for installation or take shortcuts that cause devastating consequences. When problems occur, it’s hard to know the cause without investigation, and everyone on the project is forced to become involved. Fingers point. Often, whoever has the deepest pockets or the most to lose becomes the primary target for plaintiff lawyers. Fairly or not, you could be left holding the bag for others’ mistakes.

Let’s consider two of the most costly recent examples of construction defects, EIFS and FRT plywood:

### EIFS

Architects love to design using EIFS (exterior insulation finishing systems). EIFS cladding systems resemble stucco, but are less costly to install and can be fashioned into a variety of architectural shapes, including soft curves and geometric designs. This unique flexibility makes EIFS treatments ideal for special elements such as porticos, archways, ornate overheads for windows, doors and decorative trim.

As with any exterior cladding, water can enter behind or around the system. Early applications often lacked drainage features more commonly used today. With no place to go, constant exposure to moisture can cause rot in wood and damage to other materials within the building or home. Moisture-related problems led to an avalanche of individual and class action lawsuits by consumers.

Are you using EIFS in your designs? If so, strict adherence to guidelines for materials and methods of application is your



best defense against a construction defect claim.

### **FRT Plywood**

Back in the early 1990s, FRT, or flame-resistant plywood, was touted as an alternative to fire walls in multi-unit buildings. It appeared to be a revolutionary product and was quickly adopted by architects and builders, especially in the Northeast. However, high temperatures in attics caused early and unexpected deterioration of the material. Suppliers went Chapter 11, and builders were left to face clients with major defects in their buildings, condominiums and homes.

What new building materials are you using in your projects? Have you done your research? How confident are you in the manufacturer and the testing? Are you comfortable with the risk?

### **Types of Construction Defects**

Generally, courts categorize construction defects in one of four categories:

1. Design deficiencies typically relate to building designs that do not meet code or perform to standard.
2. Material deficiencies occur when the use of inferior materials causes significant problems, such as when windows leak or fail to perform even when properly installed.
3. Construction deficiencies are problems created by poor-quality workmanship.
4. Subsurface deficiencies usually involve cracked foundations or other structural damage caused when soil is not properly compacted and prepared for adequate drainage.

The goal of the court is to determine fault and damages and require the party responsible for the defect to remedy the situation.

### **Insurance**

Under the standard commercial general liability (CGL) policy, your insurance company has a duty to defend you for construction defect claims if any damages are potentially covered under the policy. Coverage for construction defects only exists if there is an “occurrence” under the policy.

If the court finds against you and you are a subcontractor, the policy will frequently pay for property damage caused by the occurrence. It does not, however, cover the costs to remedy

your work – the faulty workmanship or material that led to the damage. In many cases, the cost to correct the construction defect will be greater than the actual property damages incurred. Keep in mind that if you are a general contractor, the whole project is your work.

Architects and engineers will want to consider the additional protection of a professional liability policy. Professional liability provides coverage when a design does not function as anticipated or promised. Ask IDR Specialty for details.

### **What You Can Do to Manage Your Risk**

Many risks you face are not typically covered by insurance. In addition to insurance, you can reduce your risk in two ways:

#### **1. Transferring Risk**

You can transfer some of your risk to a responsible third party. General contractors transfer risk to the subcontractors they use on a construction project through indemnification and hold harmless agreements as well as additional insured requirements in their construction contracts.

Indemnification and hold harmless agreements are typically included in standard construction contracts. Keep in mind that if the subcontractor lacks the financial resources to meet its obligations, you still could be obligated for any construction defect claims. That’s why it is important to check the financials of your subcontractors and choose wisely. And never under any circumstances use uninsured subcontractors. They put you at great risk and could increase the cost of your own insurance.

Whenever you hire subcontractors, have them add your business to their liability policy as an additional insured. You will be protected by the subcontractor’s policy for work the subcontractor does for you, up to the policy limits. It’s a good idea to require liability limits of at least \$1 million on the subcontractor’s policy.

Always request coverage as an additional insured on a primary basis. This way, you ensure that their insurance responds first to a claim. (Your insurance becomes excess coverage and responds only if the judgment exceeds the subcontractor’s policy limits.) Be sure to specify the length of time you will be added to the policy for completed operations. Construction defects often come to light long after a job is completed. You can verify coverage by requesting a copy of the certificate of insurance on an annual basis.

### 2. Risk Control

The best way to avoid a construction defect claim is through quality construction. Work only with architects, engineers and contractors who have good reputations and a track record of performance. Don't cut corners. Plan and perform work in the correct sequence and with proper supervision. Be sure to document any and all plan changes. Organized records are critical to your defense.

#### **Rely on Our Construction Expertise**

The legal landscape for the construction industry is complicated and changing. In today's legal climate, customers who are dissatisfied with work are increasingly resorting to litigation. The recommendations here are a starting point for understanding and avoiding construction defect claims. Sleep better at night by consulting IDR Specialty and your attorney. They are experts in their professions as you are in yours. Both will bring you good advice and recommendations and make them partners with your business.

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