SPECIALTY CONTRACTOR’S INCIDENTAL DESIGN LIABILITY

By Peter R. Spanos

Specialty trade contractors who purchase standard-form comprehensive general liability insurance policies are probably not covered for the “hidden” design liability that accompanies performance of many subcontracts. Some insurers offer design-services-liability endorsements to plug this coverage gap, but the endorsement must be specifically requested (and at added cost).

The specialty contractor may have exposure to design liability, even though the contractor’s role does not specifically include construction project design. Examples of design functions include the creation of shop drawings, or slight modifications to an architect’s specifications during actual construction work to account for unforeseen conditions or for conditions not addressed by the plans or specifications. Some specialty contractors participate directly in the creation or revision of plans and specifications for the work, or aspects of the work.

Recent court decisions have imposed design liability on contractors and sub contractors in addition to and outside of these normal functions, where a contractor or subcontractor must use his own expertise and judgment. Examples of activities that require the exercise of expertise and judgment giving rise to “hidden” design liability issues include these:

- Meeting requirements of “performance” specifications (rather than design specifications).
- Preparing shop drawings that amplify and supplement the level of detail and specificity of the project drawings.
- Selection and submission of products, either as alternatives or in fulfillment of requirements to submit “suitable for use or installation” materials.
- Performing work where the project specifications are schematic or diagrammatic rather than complete.
- Coordination of plans, drawings or specifications of the work of allied trades.
- Contact provisions requiring checking plans and specifications for errors or discrepancies and notifying the contractor or owner of any errors or discrepancies noticed.
- Provisions requiring that the subcontractor calculate or verify the performance of assemblies (such as wind load resistance or sound transmission characteristics).
- Provisions requiring the subcontractor to meet all requirements of a product’s manufacturer.

Unfortunately these activities are customarily undertaken by specialty trade contractors, and it would be difficult to prepare a subcontract without engaging in at least some of them.

In short, common contractor activities include design responsibilities, but the professional negligence risk involved is normally not covered by industry standard general liability insurance policies.

Are You Covered?

Most specialty contractors rely on insurance coverage found in a standard CGL policy, but these policies often have one or more of the several errors
and omissions exclusions added. Examples would include exclusions with titles like the following: “Exclusion—Designated Professional Services;” “Exclusion—Testing or Consulting Errors and Omissions;” “Exclusion—Construction Management Errors and Omissions;” and “Exclusion—Engineers, Architects or Surveyors Professional Liability.”

Of these, the fourth is most commonly encountered, and any of these exclusions on a policy creates a defense to coverage for design liability.

In short, specialty contractors may be incurring “hidden” design liability without corresponding liability coverage. To assess your company’s exposure and possible need for this type of endorsement, consider these basic questions:

- Does performance of my subcontracts normally involve some exercise of judgment and expertise, such as those listed above?
- Does my current CGL policy contain an errors-and-omissions exclusion?

If the answers are “yes,” then your company may have uncovered design liability risks. In that event, there are two available options. The best option is to obtain an incidental design liability endorsement for your company’s CGL policy. In this way, there is a specific promise of coverage for this type of liability. Alternatively, you could consider obtaining a CGL policy without an exclusion for errors and omissions, which at least provides an argument that the policy covers such liability; however, this may not be as effective as the specific promise of coverage in a design-liability endorsement.

**Other Options**

Other ways of combating liability may not prove satisfactory. A contractual disclaimer of the design risk may not effectively limit a contractor’s liability for design issues because the risk is based on the actual performance of activities requiring expertise and judgment, which are facts of life that cannot be disclaimed away. Specialty contractors could consider purchasing the same professional liability policies as those purchased by architect/engineering firms. However, such coverage may not be offered to specialty contractors, and it probably is more expensive than an endorsement on a CGL policy.

Builders risk policies, which can be issued as either “named peril” or “all risk” types of covet-ages, exclude liability for design and specifications.

To handle the risk of “hidden” design liability, which is exclud-
ed from standard comprehensive GL policies, a subcontractor or contractor should purchase an endorsement adding this coverage to the policy from your CGL carrier. Not all carriers offer this endorsement. In evaluating this addition to a CGL policy, specialty trade contractors should consider the following:

- Whether the coverage is on a “claims made” or “occurrence” basis (generally, “occurrence” basis is preferable).
- Whether defense costs are in addition to the limit of liability, or included in (deducted from) the limit of liability.
- Whether the coverage includes repair of faulty work (common exclusions for “property damage” or “faulty workmanship” can seriously impair coverage).
- Whether there is a definition or description in the endorsement of the types of design services or of the specialty trade covered.
- Whether the endorsement covers employees or sub-subcontractors and supplies.
- Whether the endorsement covers punitive or exemplary damages.
- Whether the coverage is primary or excessive.
- Whether additional coverage over the policy limit is provided by the contractor’s “umbrella” policy.

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