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## COURT RULING EXPANDS INSURANCE COVERAGE FOR CLAIMS AGAINST GENERAL CONTRACTORS RELATING TO DEFECTIVE MATERIALS

General liability insurance policies cover the legal liability of the policyholder for damage to the property of others. Unfortunately, situations often arise alleging defects in the work the contractor was hired to perform. General liability policies do not intend or purport to operate as a performance bond or warranty of the work itself. They do, however, provide *some* coverage for defective work when the loss or damage is discovered after the work is completed ("completed operations" coverage). This coverage is triggered only if the defective work was performed by a *subcontractor* of the policyholder.

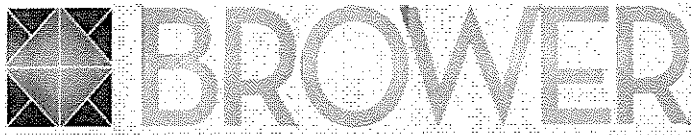
But what if the problems were caused by defective *materials*?

The U.S. Court of Appeals for the Sixth Circuit, applying Ohio law, recently analyzed whether a material supplier qualifies as a "subcontractor" for purposes of this important insurance coverage. In Mosser Construction, Inc. v. Travelers Indemnity Co., 2011 FED App. 0481N (6th Cir.), the GC was awarded a \$6.8 million contract for improvements to the city's wastewater treatment facility. Part of the contract included placing structural backfill beneath and around the foundation of a new building. The GC purchased \$30,000 of crushed limestone aggregate from its supplier for this purpose. The project was completed without incident.

After the building was complete, the walls began to crack. It was discovered that the backfill aggregate was defective because it contained gypsum that led to improper settling. The City looked to the GC to remediate the problems (basically, tear down and rebuild the building). The GC turned the claim in to its insurer, who denied coverage. Whether coverage existed under the policy turned on whether the aggregate supplier was a "subcontractor." If they were, the GC was covered for the loss.

The term "subcontractor" has historically not been defined in general liability insurance policies. It has been commonly understood to mean a tradesman who actually performs work at the jobsite, versus a "mere" supplier. The court stopped short of holding that all material suppliers are considered subs in this context. They did, however, expand what we might traditionally consider to be a subcontractor:

"For a material supplier who does not perform work at the site to be a subcontractor, the supplier must manufacture the material according to specifications supplied by the general contractor, and its materials contract with the general contractor must explicitly incorporate terms from the master contract or otherwise explicitly indicate that the materials at issue are manufactured or supplied specifically for the master contract's project."



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In this case, the court found that the specific nature of the grade of backfill, along with a reference to the prime contract in the purchase order "nudged the supplier over the line" separating material suppliers from subcontractors. Coverage was thus granted to the GC.

So what is the takeaway for Ohio contractors? The mass majority of policies do not define "subcontractor." Unless and until that changes, whether the supplier will be considered a subcontractor is a fact-specific analysis. You will not have control over some of these factors. You can, however, adopt simple risk management practices into your contracts that will help should a problem arise after job completion. Keep documentation describing the material you are ordering as that required by the specs of the particular job. By incorporating the prime contract into the purchase order, or at a minimum linking the purchase order to the prime contract by identifying the job on the P.O., the contractor will be in a better position to argue that the supplier is in fact a subcontractor. This will enhance your ability to obtain coverage for completed operations claims under your general liability policy.

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