Faulty Workmanship Insurance

Ten Minutes with Berkley's Eric Smentowski

August 24, 2020
Scott Van Voorhis

Eric Smentowski is a senior vice president at insurer Berkley Construction Professional (an operating unit of W.R. Berkley Corp.) A veteran of the construction insurance sector, he joined the company in 2015 and last year, after hearing years of complaints from contractors about a gap in coverage for risks from workplace errors or faulty materials, Smentowski oversaw the rollout of faulty work coverage announced in late 2019 and available to brokers starting in February. He was recently interviewed by ENR Correspondent Scott Van Voorhis.

ENR: Why offer a new policy? What market niche or need are you looking to fill?

It's an innovation created by market forces. Whenever we talked to contractors and the brokers who represent them, one of the most common complaints was that there hasn't been an insurance solution for transferring the risk of having to repair or replace faulty workmanship. Those concerns caused us to reevaluate whether there was a way for our company to satisfy that need.

Technically, it is not a separate policy, but rather an endorsement to our professional and pollution liability policy. That coverage is the core of what Berkley Construction Professional offers. Faulty workmanship was a natural offshoot. We can offer an insuring agreement for that coverage via endorsement.

What about the risk involved? Haven't insurance companies been cautious about offering this faulty workmanship coverage because of the potential for significant losses?

The insurance business is about taking risks, but at the same time prudent risk selection is paramount. You have to be very careful in your deployment of the product and the exposure you accept.

The time was right and the situation was right for us to create our version of the solution. We had started Berkley Construction Professional five years ago to find a way to be innovative and serve our customers' needs.

Who is your target market? What types of contractors are you working with?

Our focus, our appetite, has been insuring contractors in the nonstructural trades, mechanical, plumbing, painting, interior finishes. We are targeting firms in the nonstructural trades generating up to $50 million in revenue in self-performed work.

General contractors generating up to $250 million in total annual revenue are also eligible for our faulty workmanship liability coverage, but the coverage would only apply to their "in-appetite" self-performed trades divisions that have up to $50 million in annual revenue.

We are looking at things like general liability loss runs to see if they have anything that harkens to faulty workmanship issues. We are making underwriting judgment calls for each and every contractor that applies for this insurance.

This new coverage applies solely to the insured's self-performed work. We are not looking to insure faulty workmanship that may have been performed by any of the insured's subcontractors.

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> **– Eric Smentowski, Berkley Construction Professional**

The general liability policy contains certain coverage provisions that can protect the insured against faulty workmanship caused by the insured's subcontractors, and we have no intention of disrupting the applicability of that GL coverage – we don't intend to overlap any of the typical coverage afforded by the ISO CGL policy or similar coverages arising out of faulty workmanship issues.

What are some of the scenarios under which your new faulty workmanship policy might provide coverage?

Say a painting contractor has been hired to paint the entire interior of a building. On all the concrete surfaces, the painting contractor failed to use the correct primer, or didn't apply the primer correctly. In that case, bubbling and cracking of the paint could occur. As a general matter, the cost to replace and repair that paint job is what our policy is designed to respond to.

Importantly the coverage requires a third party – perhaps a general contractor or the building owner – to see all that cracking and bubbling and make a faulty workmanship claim against the insured. That is a critical element – there has to be a third party making the claim and seeking money or services to repair that work from the insured.

That has yielded application submissions and the responses have been very positive. We have a healthy portfolio of clients.

Faulty Workmanship Insurance, Ten Minutes with Berkley's Eric Smentowski,
By Scott VanVoorhis, *Engineering News-Record*, August 24, 2020

What has been the response so far to your new product and how competitive is the market for faulty workmanship coverage?

The response has been very positive. There have been a couple of outlets announcing the coverage's existence. We have also issued announcements targeting our brokerage community. Overall, however, I would say faulty workmanship coverage is still not readily available in the marketplace. This type of coverage was only introduced and marketed in the insurance market in earnest in the last eight or nine years.

What does the policy cost and how does it compare with the price of the standard ISO GCL policy?

Each insurance applicant has its own risk profile and we will offer a policy at a premium based upon that risk profile. As example, the premium for the faulty workmanship coverage, for a $1 million limit, can start as low as $5,000. That premium can go up depending on a number of factors. However, the premium is largely derived as a function of two things – the type of physical trade work the applicant is performing, such as earth work, electrical work and so forth; and the annual volume of revenue earned through the applicable trade work. The riskier the type of work, and the more of it performed in a given year, the higher the premium will be.

In what cases would the policy cover defective materials and products?

The responsiveness of the policy would depend on the specific facts and circumstances but, as an example, let's take an electrical contractor who is hired to install the electrical system in a hospital, including all the light switches in every room. The electrical contractor installs all 40,000 of those light switches, but it turns out that the light switches are defective. The electrical contractor would likely be subject to a claim from the general contractor or hospital owner once the defective switches are discovered. Subject to the other particular facts of the situation, this is one of the type of claims that the policy would respond to.

What's the deal with the breach of warranty and breach of contract coverage angle in connection with this new policy?

Generally every contractor's work is subject to certain warranties: those can be either express warranties commonly written into their contracts (for example, that work on the project will be performed in a good and workmanlike manner and be free from material defects), or they can be implied warranties that apply to the contractor's work even without having been incorporated into the contract language involving fitness for a particular purpose, for example.

Contractor's faulty work may constitute a breach of contract based upon the warranties and it's possible that claimants would cite those particular causes of action to trigger a response from our faulty workmanship solution.

In our light switch example, if the switches installed by the contractor don't work, there could be a breach of express and/or implied warranties which could trigger coverage under the policy.

What are the limits and sublimits of the policy?

The maximum outlay we are looking to initially deploy on a particular policy is $2 million. After binding an account for several years, we could potentially move to a higher maximum. I have no reason to doubt that our appetite for limit deployment will continue to evolve over time.

Final thoughts about the future?

One thing I have heard from brokerage partners and contractors is that this type of insurance is still relatively new compared to most other lines of insurance a contractor would buy. We have not seen a tipping point yet in the industry where general contractors would start requiring coverage for faulty workmanship insurance in their contract specifications with their subcontractors. But I don't think it's out of the realm of possibility that the market will quickly move in that direction, either. As people start to perceive the availability of the insurance in the marketplace, it may start to become a requirement within subcontractor agreements.

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