

The Importance of Insurance Coverage (Part 1 of 2)

In last month's article I discussed the Contractors State License Board complaint process. In case you missed the article, please visit SFBA NARI's website and click on the link "In the News/Newsletter" under "For the Trade." As always, please note that my discussion in that article and all others is summary in nature; a heads up to you. Always be proactive about your legal rights and contact your attorney.

Commercial General Liability.

If you are a contractor and you have personal assets – a home, savings, and the like – you need to protect them by having a commercial general liability policy (CGL) in place. A CGL policy covers "consequential damages" resulting from defective work. The most common example in residential remodeling is water intrusion.

Consequential Damages.

Consequential damages are defined as those losses that do not flow directly and immediately from the injurious act, but result indirectly from the act. Translated into plain English, that means it is not the original foul up that's covered, it's the next thing that happens as the result of the foul up.

Again, the example of a leak – water intrusion – is illustrative. A window leaks because it was installed incorrectly; the leak then ruins a hardwood floor. The CGL policy will pay to replace the flooring but not to reinstall the window. The leaking window is defective work; the damage to the flooring is a consequential damage.

What Is Covered?

To the chagrin of some contractors contemplating and/or making their first claim, the range of things are covered is frequently less than one would think. That's the bad news. The good news is that if you can trigger coverage on one item among several claimed – a leak among a list of defects/damages – the insurance carrier will often cover everything.

What's Not Covered?

Every insurance policy I have seen has exclusions; CGL policies seem to have more than most. Two exclusions that often come up are the “pre-existing disputes” exclusion and the “craftsman” exclusion. A pre-existing dispute is just what it sounds like – if you had the problem with a client before you signed the insurance policy, the policy usually won't cover it.

The “craftsmen” exclusion applies to mere defective work where there is no consequential damage. If the contractor installs the wrong windows but they don't leak, the insurance policy will not cover their replacement.

When Do You Use It?

Some contractors will always make a claim (i.e. “tender” a claim) regardless of the nature or size of the dispute. Other contractors will go to almost any lengths **not** to make a claim; one of my contractor clients recently was prepared to pay up to \$50,000 out of pocket before he would even notify his insurance carrier of a dispute.

He was willing to pay out of pocket because he felt any claim would sully his record with his carrier and make his rates go up. And he was waiting for the Big One.

I thought this was a bit extreme. While one doesn't want to sully his or her good record for a de minimis claim, one buys insurance for protection and the rule of reason should apply.

What Happens If No Coverage?

If a contractor unhappily finds himself in a dispute and does not have coverage under his or her CGL policy, win or lose the contractor generally has to pay attorney's fees and related costs. If he is found at fault, he or she will also have to pay damages. If the business is a sole proprietorship or a partnership, the contractor is personally liable. If the business is a corporation, personal assets are protected but if the damages exceed the value of the corporate assets the company may have to go through a bankruptcy.

Moral of The Story – Obtain and/or maintain a CGL policy with a reputable insurance carrier. Be sure to properly tender a claim in a timely fashion.

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