

Is a Certificate of Insurance Enough Anymore?

Does your contractor really have the insurance needed to work on your apartment building?

Monday, March 29, 2004

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In a strange turn of events, apartment building owners need to be concerned that their contractor may not have liability coverage to work on multi-family projects, such as their apartment projects. This is a direct result, not on losses involving apartment buildings, but from 20 years of construction defect litigation in California, Arizona and Nevada involving condominium associations. Because apartments are occasionally converted to condominiums or cooperatives, the general liability insurance carriers don't want their contractors clients working on apartments either! As an apartment building owner, you need to exercise more caution to make certain your contractor has the right coverage to work on "multi-family" projects.



We're in the midst of a tight insurance marketplace. As a result, the annual premium for commercial general liability (CGL) coverage, which provides protection for the contractor for bodily injury and property damage that may arise from their completed construction operations, has increased by a reported 600%. CGL coverage is now the single largest expense for most contractors in California followed, interestingly enough, by the cost of workers compensation coverage. Coupled with higher rates, contractors are facing a shrinking number of insurance carriers willing to provide coverage and the scope of coverage now available is often significantly limited.

Why is a contractor's CGL coverage important to an apartment building owner? Let's take a look at the following example: A three-year old apartment a contractor built has an apparent leak where the balcony attaches to a wall. A missing component, such as a flashing detail omitted by the stucco subcontractor, resulted in the water penetrating to the interior of the unit – the resulting damage being covered under a CGL policy. The stucco contractor's liability policy typically will not cover their own defective work, but instead the resulting damage. In the case described above, the General Contractors policy would likely look to the stucco contractor's policy for the resulting water damages, but the stucco contractor would still be responsible to pay the out of pocket expenses to fix the omitted flashing detail.

For years well managed apartment building owners have taken advantage of a well-known risk control mechanism by transferring the risk to others. This transfer of risk is accomplished by (1) having work done on their project by licensed and insured independent contractor; and (2) having those contractors name the apartment building owner as an "additional insured" under the contractor's CGL insurance coverage.

This is a step further than just requiring the contractor to provide Certificate of Insurance (a standardized insurance form designed to evidence coverage, but typically extends no benefit whatsoever to the Certificate holder other than to provide information). Savvy apartment building owners actually require the contractor (and in some cases subcontractors) to name the Owner as an "additional insured." When successful, this additional step would require the contractor's CGL carrier to defend the Owner as well as the contractor for any resulting bodily injury or property damage as a result of poor workmanship or negligence.



Unfortunately the changing insurance environment of Post-September 11th, coupled with the prevalence of class-action construction defect lawsuits against common interest developments have caused insurance carriers to exclude or significantly limit the nature of coverage for contractors wishing to work on such projects. Not only are condominium associations, cooperatives and planned unit developments the target of these new specifically-tailored exclusions, but insurance companies recognize that even apartment buildings are potential defect targets. (Since apartments can be converted to condominium associations and these types of defect cases may take a couple of years to discover – and may be discovered after the conversion). Contractor's insurance underwriters are even reluctant to provide coverage for contractors wanting to work on "mixed-use" projects (such as live-work lofts and dwelling projects built over first-floor retail space) as they may well be the target of construction defect litigation.

While nearly all contracting trades will experience difficulty, the grading, foundation, framing contractors and contractors specializing in exterior finishings will likely experience the toughest time. These same contractors may have no problem working on other types of commercial structures such as light-industrial or even office buildings – but if they work on apartment buildings, they may be doing so without coverage. If the contractor is lucky enough to get the insurance, the coverage will likely have dump truck-sized limitations attached.

What should you be cautious of? Contractor's CGL policies can be issued based on one of these five alternatives:

- 1). A renewal, including coverage for work on multi-family projects, but at significantly higher terms and deductibles.
- 2). A renewal, containing an outright multi-family exclusion (eliminating coverage for work on apartments, condominiums and homeowners associations; or
- 3) A renewal including coverage for multi-family housing, but with a limitation on the number of units a contractor can work on in a calendar year or within a single project; or
- 4). A renewal including coverage for multi-family housing, but with a deductible which would apply to any CGL losses (including defense costs). These deductibles, which often are written in such a way as to be applied on a "per unit" basis (such as \$5,000, \$10,000 or even \$25,000 per unit), effectively eliminating coverage for many claims; or
- 5) A renewal including coverage for multi-family housing, but including a "building material" exclusion which would eliminate coverage for claims arising out of the use of a particular type of building material used in new or repair construction.

(Author's note: It probably goes without saying that the contractors are also seeing the same type of mold/fungi exclusions and/or limitations added to their policy as those cropping up on most apartment policies. If their negligent work results in water intrusion, the resulting mold or fungi would likely be excluded.)

All these limitations can drastically erode, and in some cases, completely eliminate protection being provided to the Owner under any "additional insured" extension the Owner may be able to negotiate. Further, it may well prohibit the Apartment Building Owner (or the Owner's general liability carrier) the ability to sue a negligent contractor for poor installation or workmanship and have the benefit of any

coverage under the contractor's CGL policy. Remember, if a general contractor or his subs go bankrupt, their insurance policy may be all you and your attorney has left to rely on.

For obvious reasons, then, just obtaining a Certificate of Insurance is not enough – and based on the amount of money involved, receiving the contractor's verbal warranty that he/she has been successful in getting coverage necessary to work on your project is not sufficient. There is much too much at stake here. (Note: In this marketplace, the contractor may not be able to get the insurance carrier to name the Apartment Building Owner as an "additional insured" or may only be willing to do so if the cost for the extension of coverage is passed on to the Owner.)

Unfortunately, there is no standard language, forms or endorsements used for these exclusions – so a simple review of the declarations page won't give you sufficient information to determine if such an exclusion has been attached – you're going to have to request a completed (unabridged) copy of the contractor's policy. This document should be reviewed carefully by your legal counsel to make certain that the contractor, indeed, has the coverage that he/she needs to work on your building. If exclusions exist that cannot be negotiated from the insurance carrier, it's time to find another contractor.



Don't stop there. After having your attorney exam the insurance policy to determine if the contractor's policy contains any deal-breaking exclusion, take the time to evaluate the financial standing of the carrier writing the coverage. Keep in mind that the majority of policies being written for contractors at this time will almost certainly be written by a non-admitted insurance carrier (admitted carriers are no longer willing to write most contractors). Besides not being subject to the same stringent rate, form and financial reviews by the California Department of Insurance as their "admitted" counterparts, consumers who purchase

coverage from non-admitted carriers also don't participate in California's Insurance Guarantee fund (called CIGA) which protects California policyholders should their insurance carrier become insolvent. As a result, you should request financial reports from their insurance broker for a contractor's insurance carrier to determine their rating and the adequacy of their financial reserve. (If your insurance agent isn't able or willing to provide this important information, copies of the "2003 A. M. Best Key Rating Guide for Property and Casualty Carriers" is available at most public libraries – or you can order a "Company Report" for \$75 via the Internet at www.ambest.com.)

Be cautious. Well-meaning contractors may continue to bid on multi-family projects being ignorant or unaware of exclusions in their own policies and there are even recent reports of contractors who continue to work on projects despite knowledge that they are, effectively, without this important coverage -- putting not only their company's assets, but the financial well being of their common interest development client on the line. Knowledgeable Apartment Building Owners and their managers will navigate these turbulent waters and find contractors who have the right protection, can provide evidence of same, and, when possible, add the Owner as an "additional insured."

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