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HEALD & LEBOEUF, LTD. Attorneys At Law

606 Old Colony House • 58 Weybosset Street • Providence, RI 02903 • 401.421.1500

ADVERTISEMENT

INSURANCE COVERAGE OF CONSTRUCTION DISPUTES

Contractors involved in construction disputes should understand when they can utilize their insurance coverage to help resolve certain problems that arise during the course of a project. The understanding of when there may be insurance coverage is an important part of construction law. The importance of insurance coverage is underestimated. The existence of insurance will help to solve some difficult problems that contractors and their counsel may encounter.

Consider the following example. An electrical subcontractor supplies certain electrical components to the project. The general contractor owes the subcontractor $50,000. The general contractor has offered no legitimate reason for nonpayment, but has nevertheless refused to pay. The subcontractor files suit against the general contractor for the $50,000 owed. However, immediately after suit is filed and to the subcontractor's surprise, the government suddenly refuses to accept some of the subcontractor's electrical work. The government is arguing that the subcontractor's electrical components are causing damage to the remainder of the electrical system in the building and to other portions of the building. The general contractor is suddenly asserting a potentially legitimate $250,000 counterclaim against the subcontractor.

The subcontractor and the subcontractor's attorney now have a serious problem. They thought that they were prosecuting a simple collection action against the general contractor. Now, in addition to prosecuting that action, they have to defend a complex counterclaim that will involve expert witnesses and an extensive amount of additional documentation and trial time.

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Firm Profile:

The practice of Heald & LeBoeuf, Ltd. is concentrated in the area of construction law. The firm is dedicated to the delivery of the highest level of legal services to construction related business concerns.

Heald & LeBoeuf, Ltd. practice areas include:

- Construction Law and Litigation
- Arbitration and Mediation
- Public Bidding
- Public Contract Law
- Mechanics' Lien Law
- Surety and Bond Law

Rhode Island does not have a procedure for certification or recognition of specialization by lawyers.

RHODE ISLAND ANNUAL REPORTS DUE ON MARCH 1

Annual reports for all Rhode Island corporations and foreign (out of state) corporations doing business in Rhode Island must be filed in the Secretary of State's office by March 1, 2006. The filing fee remains $50.00.

All Rhode Island corporations and foreign corporations must file annual reports each year. The annual report includes basic corporate information such as the corporate name, business address, stock information and names of officers and directors. In the past, the Rhode Island Secretary of State has waited for a few months past the deadline before taking action against corporations who fail to file their annual report. However, a new corporations statute went into law this past July, and it is therefore unclear as to whether the Secretary of State will follow the same practice this year.

In any event, the Secretary of State will take action against those who fail to file by sending out a Revocation Notice. The Revocation Notice will state that the corporation's charter will be revoked within a certain number of days if the corporation does not file their annual report. If the corporation still fails to file an annual report, the Secretary of State will then revoke the charter. Upon revocation, the corporation loses its protection against personal liability. The individual officers of the corporation may be held liable for the debts of the corporation. However, even at this point, the corporation still has a certain period of time in which it can file its back annual reports and have its corporate charter reinstated. The reinstatement will normally be retroactive and will generally provide protection for acts that took place during the period that the charter was revoked.

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RHODE ISLAND ANNUAL REPORTS DUE ON MARCH 1 (continued from page 1)

The Rhode Island Secretary of State mails the annual reports each year to the corporation's Registered Agent. All corporations are required to appoint a Registered Agent. In addition to receiving annual reports, the Registered Agent may be served with law suits and other legal filings on behalf of the corporation.. The Registered Agent must have a Rhode Island street address. Some corporations appoint their attorney as Registered Agent. Other corporations appoint an officer of the corporation to serve as Registered Agent. The corporation's Registered Agent should be a responsible individual who will properly keep track of the corporation's annual reports and legal process that is served on the Registered Agent. If a corporation wishes to change its Registered Agent, the Secretary of State's filing fee for this transaction is $20.00.

INSURANCE COVERAGE OF CONSTRUCTION DISPUTES (continued from page 1)

The potential attorney's fees that they may incur are now well in excess of what they originally estimated. If the general contractor proves its counterclaim at trial, the subcontractor will be liable for a substantial judgment. For a small subcontractor, this could be enough to put the subcontractor out of business.

Fortunately, the subcontractor, like most, has a Commercial General Liability (CGL) policy. There should be coverage under that policy. The insurance company must hire an attorney and pay the legal fees (known as the duty to defend) when there is any possibility of coverage. Instead of paying thousands in attorney's fees at its own expense, the insurance company will defend the counterclaim, including the cost of necessary expert witnesses, at the insurance company's expense. If the subcontractor loses on the general contractor's claim, the insurance company will pay that judgment as well.

This is why contractors and their counsel should always consider whether there is any applicable insurance coverage. There are some potential disadvantages to securing insurance coverage. If the contractor submits a claim, the insurer may raise the contractor's rates in the future or refuse to renew the policy. Nevertheless, when needed, the Commercial General Liability insurance policy and the Builders' Risk policy can save contractors from dangerous financial losses or possible financial ruin.

There are two insurance policies that are most often relied upon in construction disputes. The most often utilized policy on construction disputes is the Commercial General Liability ("CGL") policy. The other often-utilized policy is the Builders' Risk policy.

I. COMMERCIAL GENERAL LIABILITY POLICY

As the name suggests, the Commercial General Liability ("CGL") policy provides certain general liability coverage. The insured contractor receives two main benefits from the CGL policy. First, the insurance company must defend law suits brought against the contractor at the insurance company's expense. This is known as the "duty to defend." Second, the insurance company must pay any judgment entered against the insured contractor. This is known as the "duty to indemnify." The law relating to both benefits is discussed in the sections below.

The insurance company will sometimes try to deny coverage for suits brought against contractors that allege defective work. The insurance company will rely on a number of confusing exclusions that are known in the industry as the "work product exclusions."

A. Duty To Defend

One of the fundamental duties that an insurer owes its insured is the duty to defend the insured against all lawsuits that may be covered by the insurance policy. The insurer's duty to provide a legal defense against lawsuits at the insurance company's expense is known as the "duty to defend." When the insurer has a duty to defend, the insurer must hire an attorney to represent the insured at the insurance company's expense. The insurer will also be responsible, "to pay all reasonable costs of the insured's defense." In addition to attorney's fees, this will include reasonable, "court costs, experts' fees, investigators' fees, etc." The insurer's duty to defend is therefore a significant right that the insured contractor has in the defense of certain construction disputes. This is particularly true for smaller contractors who lack the financial resources to defend complex construction disputes.

The insurers' duty to defend is generally based upon two documents: (1) the allegations of the Complaint filed against the insured contractor and (2) the insurance policy. After reviewing both documents, if there is any possibility that the plaintiff may be stating a covered claim against the insured, the insurance company has a duty to defend.

The actual facts of the case are usually irrelevant at this point. The focus is on the allegations in the plaintiff's complaint and whether the plaintiff may eventually try to prove a claim that could be covered under the policy.

An insurer who wrongfully refuses to defend the insured faces significant liability. The insurer will have to pay all reasonable legal fees incurred by the insured in the case that the insurer should have defended. If the insured contractor decides to settle the case, the insurer will have to reimburse the insured for the settlement amount paid to the plaintiff.

B. Duty To Indemnify

The insurer's other significant obligation is to pay any judgment entered against the contractor that is

covered by the insurance. This obligation to pay is known as the, "duty to indemnify."

It is easier to prove that the insurance company has a duty to defend under the CGL policy than it is to show that the insurance company has a duty to indemnify. The duty to defend is based on the vague allegations in the plaintiff' s law suit. If there is any possibility of coverage, the insurance company must provide a defense.

The duty to indemnify is based on the facts that the plaintiff actually proves at trial. If the plaintiff has alleged personal injury or property damage and there are no applicable exclusions in the policy (see Section "C" below), then the insurance company has to pay any Judgment entered against the insured contractor.

C. Work Product Exclusions

The CGL policy is confusing, but fortunately it is a uniform policy that is used by most insurance companies. The policy exclusions in most policies have therefore been interpreted in hundreds of court decisions nationwide.

In construction cases, the insurance companies will usually try to deny coverage based upon six particular exclusions in the insurance policy. Collectively, these exclusions are known in the insurance industry as the "work product exclusions." Some individuals in the insurance industry believe that these exclusions bar insurance coverage for property damage involving any work done by the contractor. If that was the case, the CGL would be almost useless. Only a small fraction of claims would be covered. To the contrary, the work product exclusions only bar certain defective work claims against the contractor. Other claims for property damage caused by the contractor's defective work are still covered.

As a general rule (subject to some noteworthy exceptions), the work product exclusions will bar coverage when the plaintiff has alleged that the only property that was damaged was the contractor's own work. Thus, if a roofing subcontractor installed a defective roof and the only damage to the home was the cost to repair and replace the subcontractor's roof, (e.g. no water damage into the home, did not have to touch another subcontractor's work in order to repair the roof), coverage will be barred by one of the work product exclusions and there would be no commercial general liability insurance coverage.

However, "property damage that is not to the insured's own work is not excluded. "Thus, these exclusions cannot exclude coverage when a subcontractor damages the work of another subcontractor, when a manufacturer's or supplier's product or work damages the work of another, when a prime contractor damages the work of another prime contractor on the job, and where an insured contractor damages property outside the scope of the construction project." "The damage to the other property may arise from the demolition of the adjacent work of others as required to gain access to and replace or repair the insured's defective work." See Scott C. Turner, Insurance Coverage Of Construction Disputes, § 33-8 at 33-16 (2nd ed. 2000).

In the case of the roofing subcontractor, the work exclusions in the roofing subcontractor's CGL policy would not apply to the extent that the homeowner's replacement contractor also had to rip off some of the siding, rip open the walls, paint water stained areas inside of the house, etc. as a result of the defective roof.

There is a logical reason why property damage to the insured's own work is not covered under the CGL policy, while property damage to other work is covered. The insured contractor's cost to repair and replace its own work is limited in that the greatest loss that the insured would incur is the cost to remove and replace the insured's defective goods. This cost is manageable. The cost for the contractor to fix his own work generally will not exceed the original contract price of his work. If the insured is willing to accept this limited risk, the insurer can provide insurance at a cheaper rate in that it will be freed from administering small third party claims related to the cost of simply removing and replacing the insured's defective work. On the other hand, when the insured's faulty workmanship causes damage to other's work or property on a construction project, the contractor could face significant liability well above and beyond the contract price of his work.

Thus, although property damage to the insured's own work is excluded, property damage to any other property caused by the insured's faulty workmanship is not. Courts in most states have held that the work product exclusions do not apply to property damage to another contractor's work. This includes instances where it is necessary to demolish other's work or property in order to fix the insured's faulty work.

II. BUILDERS' RISK INSURANCE

Builders' Risk insurance is a form of property insurance designed to cover property in the process of construction. The Builders' Risk Insurance policy will cover property damage that takes place during the course of construction if that damage took place as a result of one of several specific events set forth in the policy. Those events typically include perils such as fire, lightning, explosions, wind storm, hail, vandalism, sprinkler leakage, falling objects or the weight of snow, ice and sleet.

As with most policies, there are a number of exclusions in the Builders' Risk policy. The one exclusion that can be a problem for contractors is the faulty workmanship exclusion that often appears in the Builders' Risk policy. The exclusion applies to property damage that takes place as a result of defective work. The court decisions on this faulty work exclusion have been mixed.

Many contracts, such as those using the AIA A201 General Conditions, will call for the owner or general contractor to purchase Builders' Risk insurance that will remain in place during construction of the project. The owner or contractor who fails to procure Builders' Risk

insurance will be in breach of contract and will be liable for the damages that otherwise would have been covered by the insurance. Builders' Risk policies are important insurance policies that provide protection to the owner, general contractor and subcontractors if a catastrophe takes place during the course of construction. The parties should make sure that an appropriate insurance policy is in place during construction. If an accident takes place during construction that damages the owner's property or the contractor's work, the parties should investigate the possibility of coverage under the Builders' Risk policy.

III. CONCLUSION

Contractors who encounter problems on construction projects should remember that certain claims for damages may be covered by insurance. The contractor should always consider whether any potential claim may be covered by their Commercial General Liability or Builders' Risk insurance policies. There is no guaranty of coverage. There are a number of complicated exclusions in the policies. Those exclusions will bar coverage for some, but not all claims pertaining to the contractor's work. However, if coverage exists, the insurance company will provide a free legal defense and will pay any judgment entered against the insured. In many cases, the insurance will save the contractor from severe and sometimes catastrophic financial losses that can take place on a project.

Contractors should aggressively pursue all legitimate, potential insurance claims. Insurance companies sometimes deny coverage on legitimate construction claims. The key for contractors is not to simply take the insurance company's word that coverage does not exist. Contractors should retain knowledgeable counsel to carefully investigate whether the claim should be covered. If the claim is legitimate, the contractor should pursue the insurance company aggressively and should be prepared to protect the contractor's rights by filing suit if necessary.