

Contractor Liability Insurance

(provided by the Building Industry Association of WA)

The Problem

The insurance industry is pulling out of the contractor liability insurance market in Washington State. New contractors, both general and subcontractors, are being refused coverage, and existing contractors are finding renewals extremely difficult to obtain. If renewals are offered, they often come with severe restrictions and/or extreme rate hikes. The market pull-out is targeted primarily at contractors that build more than 10 homes a year, multifamily residences, or condominiums. As a result, contractors are turning their back on multifamily development, despite the Growth Management Act's call for dense urban infill.

Background

The Washington insurance market is extremely competitive, and competitive pricing has, until recently, overpowered the need for sustainable rates. Ultimately, the insurance market must reflect its exposure and capture its losses with adequate premiums charged to its customers. Recent and ongoing events in the construction industry, coupled with a sagging economy, are forcing many insurance companies to abandon the contractor liability insurance market. This pull-out has been fueled by the following:

Builders are increasingly subject to strict liability.

Prior to the 1960's, real estate was sold on a caveat emptor basis—"let the buyer beware." However, looking to modern markets where the parties have less contact and knowledge of each other, the courts are overturning caveat emptor in favor of strict liability. This standard is the lowest finding of fault. Someone suing for a defect does not need to prove that the builder was negligent, only that the house or condominium was defective as built. Washington law, at its most expansive, allows six years to discover a defect and another six years from discovery to commence action in court.

High risk exposure of general contractors.

General contractors are currently 51% liable for construction defects. If a subcontractor goes out of business, the general contractor is fully liable. The general is also fully liable if the subcontractor or one of the subcontractor's employees is hurt on the job.

Condominium construction defect cases.

Condominium construction defect litigation has spread like wildfire up the West Coast and into other states such as Arizona, Colorado, Nevada, and Florida—anywhere there is a demand for multifamily housing. In most cases, condominium associations are prompted to sue their contractors after receiving letters warning of personal liability from zealous law firms specializing in construction defect cases. The letters claim that condominium association officers have a fiduciary duty to find and correct potential construction defects. When faced with the threat of personal liability for failure to bring action, most association members reluctantly agree to rip apart finished units in the hunt for defects. Sometimes the contractor is sued before defects are even discovered. Condominium construction defect cases prove profitable for the attorneys involved because builders and insurance companies are often forced to settle out of court in a desperate effort to save legal expenses. According to insurance brokers, rampant construction defect lawsuits are expected to cause a 300 to 400 percent increase in 2002 renewal rates, if renewals are offered at all.

Mold litigation.

Mold growth inside residential buildings has recently burst onto the scene, with much media attention on multi-million dollar jury awards to homeowners in Texas and California. Initially, the presence of mold was only an issue in non-residential, public dwellings, especially schools. However, consumer groups and some researchers have recently identified a specific "black" mold found in residences. They point to this mold as the alleged cause for serious illnesses. Black mold, while more prevalent in humid environments, can grow in homes where moisture enters the house and cannot escape, the result of an

energy-efficient, air-tight house and insufficient air circulation. Although mold is not generally the result of a construction defect, inevitable mold litigation will certainly make this claim. Insurance companies are comparing the impending black mold claims and litigation to asbestos, for which the industry has paid out \$21.6 billion with no end in site. In fact, the three largest carriers in Texas, State Farm, Farmers, and Allstate, have stopped writing homeowners insurance policies because of their costly, uncontrolled exposure.

Impacts

No insurance for new and existing contractors or impossibly high premiums and severe policy restrictions.

Higher premiums and the cost of defending against construction defect claims dramatically increase building costs and decrease the availability of affordable housing.

Quality contractors are leaving the multifamily market, including low-income housing projects, in favor of single family home construction.

GMA goals of dense urban development are left unfulfilled. (In California, where dense development is expected to house an ever-increasing population, condominium development dropped from 25,000 units in the early 1990's to 3,600 in 1998.)

Contractors cannot be registered contractors (as required by state law) without insurance, forcing new and existing contractors "underground."

Goals

Bring insurers back into the contractor liability insurance market.

Eliminate frivolous construction defect litigation.

Save time and money for the homeowner and contractor, as well as preserving the limited resources of state courts.

Create a process to fix those homes or condominiums that are truly damaged and prevent further damage.

Increase availability of affordable housing.

Increase construction of condominiums, particularly in urban growth areas.

Ensure that law-abiding, registered contractors are not forced underground or out of business by unregistered, "fly-by-night" operations.

Solution

The following represents the first step towards provided the certainty and predictability that insurers need to write contractor liability policies. These also ensure that coare a variety of options to reduce unnecessary litigation while protecting valid defect claims:

Allow the contractor an opportunity to fix or pay for residential construction defects before a lawsuit is filed.

Require an initial list of construction defects to be filed with a construction defect lawsuit.

Before filing the lawsuit, the officers of a condominium association must notify all unit owners of the lawsuit and its anticipated costs.