

**WHITE PAPER ON RISK
TRANSFER FOR TRADE CONTRACTORS**

**Prepared for the
National Association of Home Builders**

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having finding affordable “reinsurance,” by which they distribute the risks they cover to other insurers.

Builders are responding to the increased risks of construction litigation and the decreased availability of affordable liability insurance in a number of ways. Builders are placing a heightened emphasis on quality control during construction and on customer service after the sale. They are working to become more attractive risks to insurers, in part by selecting trade contractors with strong records of quality construction, responsive customer service, strong financial stability, and adequate liability insurance. And builders are using their contracts with trade contractors to allocate fortuitous losses to the trade contractor and to impose requirements on the trade contractor that enhance the builder’s ability to obtain liability insurance.

Tip: Trade contractors with strong records of quality construction, responsive customer service, strong financial stability, and adequate liability insurance will find themselves increasingly in demand by builders, who are being forced to manage risks by means other than insurance.

B. Allocation of Risk in the Contract Between a Builder and Trade Contractor

Builders enter into written contracts with their trade contractors to record the terms of their agreement, to avoid misunderstandings, and to allocate the risk of fortuitous losses between the builder and the trade contractor. The parties are generally free to negotiate the allocation of such risks as they see fit, but contracts between a builder and trade contractor often address similar issues in similar ways. The American Institute of Architects publishes a form of contract for use between contractors and subcontractors



expand the coverage provided by general liability insurance, but such policies can also be purchased to increase the limits of other types of insurance.

A. General Liability Insurance -- What Protection is a Trade Contractor Buying?

The insuring agreement in a general liability policy provides insurance coverage for sums that the policyholder becomes “legally obligated to pay as damages” because of “bodily injury” or “property damage” that takes place during the “policy period” and is caused by an “occurrence,” if none of the policy’s “exclusions” from coverage is applicable, and if the policyholder complies with the policy’s several “conditions.” The following are the key terms, exclusions, and conditions in a general liability policy that usually determine whether the policy covers a trade contractor for a particular claim or suit.¹

1. **“Legally obligated to pay as damages.”** The trade contractor must be “legally obligated” to pay a claim before the payment will be covered by the trade contractor’s liability policy. For example, payments in satisfaction of a court judgment

Tip: *Before making a settlement payment to a claimant who has not yet filed a lawsuit, a trade contractor should consult with its attorney to determine whether the payment would be covered.*

2. **“Bodily injury or property damage.”** A liability policy covers only damages that are caused by “bodily injury” or by “property damage.” What constitutes “bodily injury” is usually apparent. If a homeowner, neighbor, or visitor is injured at the jobsite or in the house by the trade contractor’s work, this requirement for coverage is satisfied. What constitutes “property damage” is sometimes less clear. The term is defined to mean “physical injury to tangible property,” or “loss of use of tangible property that is not physically injured.” If damage to the wood substrate results from synthetic stucco, or if a homeowner can’t use the house because faulty electrical wiring presents a safety hazard, the claims against the stucco contractor and electrician would meet the “property damage” requirement. A closer question is presented if the trade contractor’s work suffers physical injury only to itself, e.g. exterior hard board siding warps but does not damage other property. This should meet the definition of “property damage,” but a few courts have held that the damage must be to property other than the trade contractor’s work, even though there is no such requirement in the definition of “property damage.”

3. **“During the policy period.”** The bodily injury or property damage must take place during the period of time that the policy is in effect. It does not matter when the lawsuit is brought. In the case of hidden or undetected bodily injury (e.g. asbestosis) or property damage (e.g. wood rot), it is sometimes difficult to determine

Other courts hold that damage caused by defective work or materials can never be accidental because the trade contractor can control the quality of its own work. The “occurrence” issue can be complex and often depends on the particular facts of the claim at issue.

Tip: Consult with your insurance agent, consultant, or lawyer regarding whether faulty workmanship satisfies the “occurrence” requirement under the law of your state.

5. **Exclusion for property damage prior to completion of**

construction. A general liability policy excludes coverage for property damage that takes place while the policyholder is still performing operations. A trade contractor is covered, however, if its workmanship or materials cause property damage that takes place after the trade contractor’s work has been completed. (Work that may later need service or repair but is otherwise complete is still 0 1 Tf-0.0003 Tc -0.0009 T t-0.0014 Tw 13.29 0 Tdsnamag ay



1. The first part of the document discusses the importance of maintaining accurate records of all transactions and activities related to the business.

2. It then goes on to describe the various methods used to collect and analyze data, including surveys, interviews, and focus groups.

3. The next section outlines the results of the research, highlighting the key findings and trends that emerged from the data.

4. Finally, the document concludes with a series of recommendations and suggestions for future research and action.

5. The overall goal of this document is to provide a comprehensive overview of the research process and findings, and to serve as a guide for future research and action.

6. The document is organized into several sections, each focusing on a different aspect of the research process.

7. The first section, titled "Introduction," provides an overview of the research project and its objectives.

8. The second section, titled "Methodology," describes the various methods used to collect and analyze data.

9. The third section, titled "Results," outlines the key findings and trends that emerged from the data.

10. The fourth section, titled "Conclusions," provides a summary of the research findings and offers recommendations for future research and action.

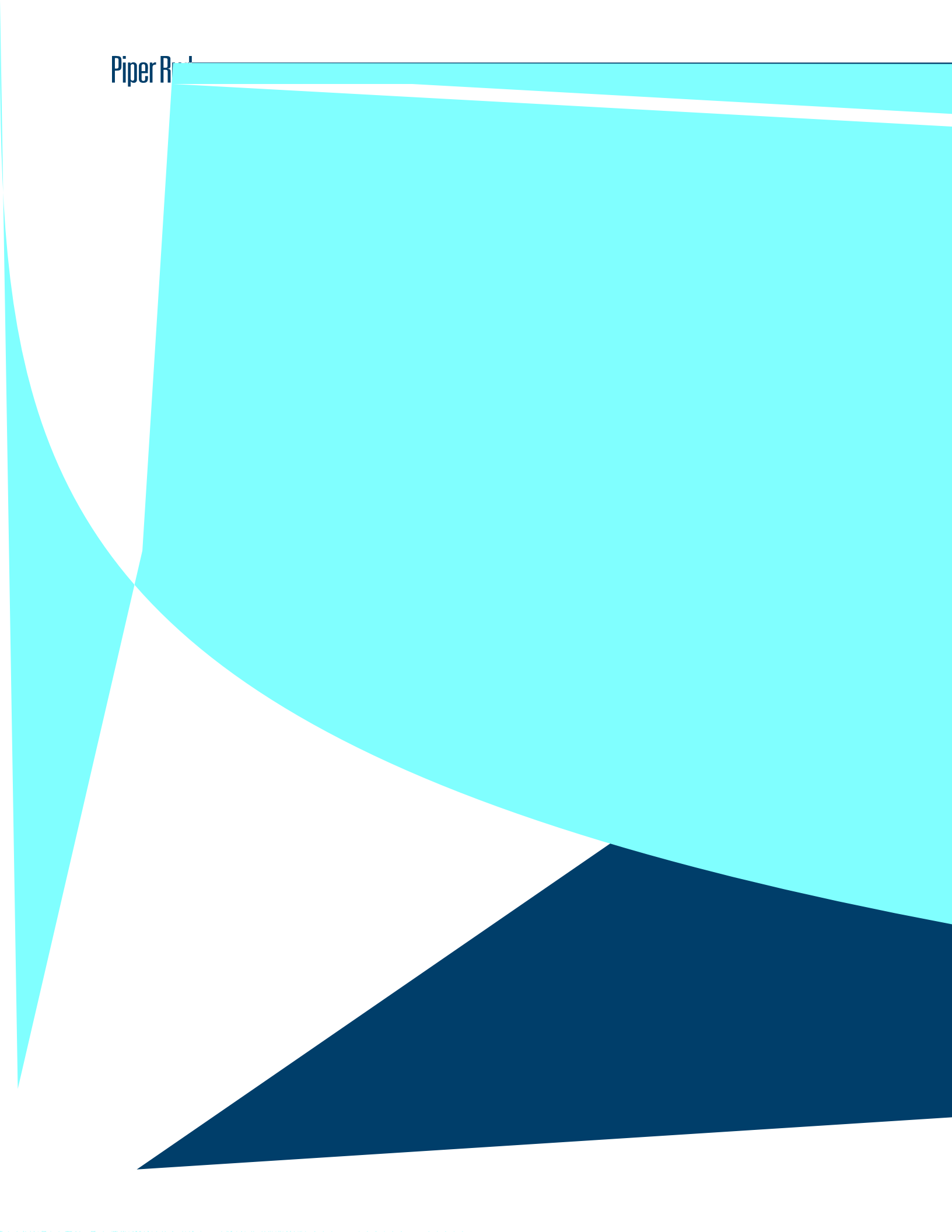
11. The fifth section, titled "References," lists the sources of information used in the research.

12. The sixth section, titled "Appendix," contains additional information and data related to the research.

13. The seventh section, titled "Index," provides a list of topics and page numbers for easy reference.

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obligation. There are other potential paths to insurance coverage for the trade contractor in this situation. The bottom line, unfortunately, is that it is very difficult to predict whether the trade contractor will be insured for the builder's claim for indemnity against the trade contractor.



excavation, or cranes; no installation of high risk materials, such as asbestos or synthetic stucco (“EIFS”); and no work on attached units; and (vii) no history of cancellation of insurance by another insurer.

Tip: Contact the NAHB Research Center about its Trade Contractor Certification Program.

Tip: Review the factors that will determine whether you are a good insurance risk and spend the necessary time and energy to enhance your compliance with these criteria.

Ã **“Wrap” and “captive” insurance programs.** The increased cost and lack of availability of liability insurance for trade contractors has led some builders, especially large builders, to use their economic strength to obtain insurance for their trade contractors. In a “wrap” insurance program, the builder buys builders risk and liability insurance for itself and its trade contractors. This can result in lower premiums than if the builder and the trade contractors all bought insurance separately. Alternatively, the builder may create or participate in a “captive” insurance company, which is owned and controlled by the policyholders who supply all its business. A captive insurer can provide coverage that would not otherwise be available, reduce claim expenses, and obtain “reinsurance” against large losses. In either case, the builder will obtain reimbursement from the trade contractors for providing such insurance, either through reductions in the cost of the trade contractors’ bids, which will not include insurance costs, or through a charge to the trade contractors in the nature of an insurance premium. With traditional liability insurance becoming increasingly difficult to obtain, trade contractors are participating more frequently in such alternative forms of insurance.

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