



Published by the NationWide Contractors' Alliance, Inc.

Volume IV, Number 6

December 2010

\$1.00 per Copy

Welcome to NWCA's Top Drawer Program!

USING THIRD-PARTY ENGINEERS --- DO THEY REALLY HELP BUILDERS?

Many insurance carriers require third party engineers for onsite inspections to help avoid construction defect claims, especially on tract and multifamily projects. Most times this expense is born by the builder to access the insurance for a difficult coverage placement. What the builder gets out of the requirement is a matter of interest.

Too many times builders find themselves spending hours and hours finding the right pictures on digital video to respond to a Title 40 or SB 800 claim in a 30-day response period. Third party quality engineers do produce easily referenced records sorted by unit and check point via a simple digital search. Easy reference is a key advantage. What's more, when an attorney wants to see destructive testing ordered to detect possible defects (as opposed to those that really exist, right?) the digital documentation of key pre-determined check points behind the drywall or inside the structure are easily referenced...and such destructive testing can be avoided. These are major benefits.

If properly integrated, these same records will be available to assist builder customer service and help pinpoint specifics for the repair or service crew to expedite problem solving. Further, these same records can assist a warranty company in mitigating problems as well. More Benefits.

If the records and the engineering inspections are a part of the regular operations of the builder on a given project, they may be admissible evidence and subject to discovery should litigation be a later issue. Presuming a good engineer, this would be advantageous to the builder.

(See "Third Party Engineers" on Page 3)

INTRODUCTION FEATURES BUILDER LIABILITY INSURANCE SOLUTION

The NationWide Contractors' Alliance (NWCA) has worked hard to develop a builder liability solution for small to mid-sized builders. Its introduction is the featured attraction in the NWCA's new Top Drawer Program that will provide a series of new, comprehensive programs for both contractor and subcontractor members of the NWCA. The official launch offer was made with the help of WISE, a wholesale brokerage member of the NWCA

Eligible builders will be in the initial launch states of California, Oregon and Washington. The solution will make sense for builders with annual sales of 11+ units on either a policy in the builder's name or on a per-project basis (includes up to a 10 year tail). The Top Drawer builder solution is not a WRAP but allows subcontractor participation and hence improved accountability on problem claims.

Most claims, though, will be easily handled with the required solution components that are built into the program. NWCA endorsed warranty provider, Professional Services Warranty Corporation (PWC), is "baked in" as a part of the solution and not only improves customer problem solving, but acts as a selling feature. With this HUD approved warranty, Top Drawer builders can assure FHA, VA and other subsidized homeowner financing options - likely enabling builders to sell units faster for more money.

Couple this with the basic digital documentation system and customer service is then well enhanced, including GPS and time stamped photographs of all major construction defect check points with specific notes.

(See Top Drawer on Page 2)

OREGON COURT RULES INSURER MUST DEFEND SUBCONTRACTOR

(Editor's Note: The basic material in this story was provided by Scheer & Zehnder LLP, a law firm with offices in Seattle and Portland. The section of the story entitled "Editor's Comments" is additional comment provided by the editors of this newsletter and does not necessarily reflect the position of Scheer & Zehnder. Please note that the editors are not attorneys and their comments should not be treated as legal advice which should be obtained from law firms such as Scheer & Zehnder. They can be contacted at scheerzehnder@scheerlaw.com

A recent decision by an Oregon Court of Appeals had some good news for subcontractors doing business under a Vendors endorsement. The bottom line was that the Court of Appeals upheld a lower court decision that a general liability insurance carrier had a duty to defend a subcontractor stemming from installation of defective products under the insurance policy's vendor endorsement. The specific case involved was Fred Shearer & Sons, Inc. v. Gemini Insurance Co. 2010 WL 3768022 (September 29, 2010).

Facts: Defendant Gemini Insurance Company ("Gemini") insured TransMineral, a distributor of a defective stucco product. Fred Shearer & Sons, Inc. ("Shearer") installed the stucco on the exterior of a residence. The stucco product failed, and the property owners sued the general contractor, who then sued Shearer and TransMineral. Thereafter, Shearer tendered the defense of the underlying action to Gemini, based upon a provision of the insurance policy that included coverage for "vendors" of TransMineral products. Gemini rejected the tender, and Shearer brought a lawsuit seeking, among other things, a declaration that Gemini owed Shearer a duty of defense. The trial court granted Shearer's motion for partial summary judgment, which Gemini appealed.

The insurance endorsement at issue provided coverage to "all vendors" but "only with respect to 'bodily injury' or 'property damage' arising out of 'your products' ... which are distributed or sold in the regular course of the vendor's business," subject to certain exclusions.

Gemini rejected Shearer's tender, on the grounds that "[i]f there is any fault in this matter, it will bear a relationship to the negligent 'mixing' of the [stucco] and/or the application thereof."

(See "Sub Contractor" on Page 5)

TOP DRAWER (Cont. from Page 1)

The ability to respond to customer service issues is further enhanced by three other solution components. One is with the COR2 subcontractor document management system. Another is that subcontractor compliance with insurance requirements is monitored and reviewed. Lastly, all of this is centrally accessible through the NWCA Risk Management Evaluation System for Contractors, which can be utilized by the builder, the agent, the underwriter and permissible vendors.

"With all these features, it is no wonder Top Drawer builders will save money, not only on insurance costs, but also on warranty and repair expenses as well," said Doug DeForest, President of the NWCA.

Starting at under \$2,000 per house (cost varies based on unit price and builder history/practices), the economics of the solution make good sense. In California, the Top Drawer solution is also AB 2738 compliant and strives to reintroduce appropriate subcontractor accountability and fair treatment.

Subcontractors can also take advantage of this "A rated" solution with low minimum premiums, broad coverage using ISO forms, and a flexible appetite to include roofers and other harder to place trades. Subcontractors can obtain coverage and required additional insured language for projects insured by the above Top Drawer builder program. Eligible trades should have 3+ years minimum experience, utilize the NWCA Risk Management Evaluation System and work with a retail agent appointed by WISE.

More information can be obtained by contacting Treacy Duerfeldt, Strategic Development at 866-491- 9722 X 15. The Top Drawer program is in addition to already endorsed liability programs including the Tennant Special Risk Contractors Excellence Program and the NuWay zero- self- insured retention Wrap program for large builders.



Need Capital? Try Private Financing Option

NWCA MEMBER SERVICE PROVIDER EXPLAINS LARGE PROJECT FUNDING

Developer's Financial Solutions (DFS), one of the Member Service Providers of the NationWide Contractors' Alliance (NWCA), is offering an unparalleled opportunity to builders and developers unable to find traditional financing for apartments/multifamily housing.

"Team DFS has relationships with lenders that are actively looking for new construction project financing up to 90% loan to cost for apartments, senior housing and student housing," said Doug Shipman, President & CEO of DFS. "If you have the right project and need additional equity, DFS has several experienced investors who are looking for joint venture opportunities. They are selective; but have the ability to fund."

Shipman went on to say, "Everyone is asking themselves, 'OK next time, how do I make sure and know that funds will be there as the draws are requested and submitted?' or 'How can we be sure that our borrowing entity is not overtaken by the FDIC?'"

In answer to these questions and others of a similar nature, Shipman went on to identify some of the key factors that differentiate banks from the private funding market:

1. Private Project Financing:

- Is not subject to extreme FDIC or banking regulations as a whole
- Does not borrow money from the government for next to nothing
- Cannot match terms provided by banks (if banks were lending)
- Has not opened branch locations everywhere around the city

2. Private Project Financing Does Not:

- Show proof of funds
- Deposit all funds in escrow (they might if you want to pay all the interest)
- Provide guarantees outside the funding contract
- Meet with you, one on one, and negotiate terms (like a bank may have done)
- Have a loan officer at a convenient office location Monday – Friday

3. Private Project Financing Will Often:

- Take longer than banks to fund loans
- Fund projects in today's market
- Be more creative with programs and terms
- Syndicate the funds, raising the stability and probability of funding all draws
- Not tell you what you want to hear, but will tell you what you need to know

Shipman concluded, "The project financing process is forever changed. When banks get back into the game, the rules will have changed so significantly, everyone who obtained financing before 2008 will no longer recognize the process. New programs are and will be emerging constantly; costs will vary along with new and unforeseen security risks. Business plans that used to appear profitable now need to emphasize drivers that impact financing and interest reserve costs."

For those with project financing requirements of one million dollar and up, private project financing may be a viable alternative. To obtain more information, contact Treacy Duerfeldt, Development Specialist at NWCA, at 866-491-9722 X 15 or email at treacy2@comcast.net.

Third Party Engineers (Cont from page 1)

Builders, though, need to be careful that such engineering documentation is a regular part of their operation and could be discoverable, so if a report recommends changes be made, the builder should have documentation that the changes were made.

The NationWide Contractors' Alliance (NWCA) endorses two programs that require the involvement of third party engineers. Both the NuWay and Top Drawer programs utilize QB Builder Link, a personal digital assistant (PDA) customized to use with GPS and by both location and time stamping all major checkpoints in a project. Unlike the actual engineer who visits, the PDA doesn't directly communicate with the trades nor require scheduling or surprise inspections; it's all managed by the builder's site supervisor. Records and notes are reviewed by engineers remotely. With this in mind, all the above benefits can be realized without many of the typical drawbacks. For more information on this topic, contact Treacy Duerfeldt, NWCA Strategic Development by phone at 866-491-9722 X 15 or by email at treacy2@comcast.net.

Liability Insurance vs. Builder Warranties

WHERE DOES ONE BEGINS, AND ANOTHER STOP IS QUESTION FOR INSURERS AND INSURED

For over thirty years the home construction industry has had the ability to offer third party warranties, but confusion still exists among both builders and their insurance suppliers about the relationship, if any, between general liability insurance and new home warranties.

While third party home warranties were originally offered for a variety of reasons, one of the driving factors was the warranty requirement in HUD approved financing. In addition to the other benefits of HUD approved financing, the warranty not only provided certain consumer protections but also typically limited builder construction defect risks.

In the ensuing years, a number of third party companies began offering home warranties with a variety of program features. One of those features was a warranty that is “insured” - but that doesn't make them insurance. Insured warranties have the backing of an insurer as to their enforceability and may also insure the builder against structural claims and builder solvency problems. One must remember, though, that the warranty is between the builder and the homeowner. The warranty is a limited promise of service made by the builder to the homeowner. The warranty outlines boundaries as to builder obligations and process by which such obligations are met and disputes settled. Hence, a primary purpose of that form of warranty is to limit risk between the builder and the homeowner.

Risk Transfer to Third Party

The risk of builder insolvency and structural defect may also be transferred to a third-party insurer. Insurance is defined as risk transfer, not risk limitation. A liability policy can transfer risk of construction defect from the builder to the insurer but does nothing to limit the risk. Insurance people tend to say that those risks transferred are “covered.”

“Covered” is where the confusion begins. For a situation to be “covered” by a warranty likely means the risk is described and obligations defined, thereby

limiting the risk between the builder and homeowner but in no way transferring it to an insurer. Structural warranties are typically structured to meet minimum HUD warranty standards. This format suggests a one year “fit and finish” promise where the builder is obligated to make most any defect right during the first year of home ownership. After this first year, the builder is then obligated to correct system defects (“inside the wall coverage”) for things like heating systems, plumbing, electrical and the like. This limited obligation lasts through the second year. After the second year and through year ten, the builder is obligated to correct and/or mitigate structural defects.

Using “Insured” Warranty

If the warranty provided by the builder is “insured” then the specified obligations with respect to the builder’s solvency and willingness to perform are guaranteed by the insurer during the first two years. The builder is still required to perform the obligations outlined for the first two years at his/her own expense, but the warranty will limit what those obligations are – especially in comparison to implied warranty rights if such things aren't outlined. Structural claims may be rectified by the builder, but the expense is usually that of the warranty's insurer.

In one case, a warranty's insurer also provides a limit of coverage to transfer the risk of legal defense of the warranty or the limitation of the builders’ obligations to the homeowner. In this particular case, the \$100,000 limit does not act as a liability program, but more as a guarantee that the warranty language and prescribed alternative dispute resolution language associated with the warranty will not fail.

By contrast, a liability carrier's obligation to the same builder can be applicable when a transferred risk is “covered” and such coverage is triggered. What's tricky in figuring out how an insured warranty like the one above might limit risk to the insurer is how “covered” means two very different things. If an item is covered by the warranty and thereby limited, then there should be no trigger for the liability policy directly associated with the claim.

(See “Contractor’s Risk” on Page 5)

Contractors Risk (Cont. from Page 4)

Conversely, the word “tricky” applies in another sense in that the warranty could describe how the builder needs do nothing and the liability trigger continues to be eliminated.

For example, a homeowner during the third year wants their water heater fixed. Per the above, the builder and homeowner agreed by way of the warranty contract that all systems are the homeowner's responsibility after the second year

The defect IS topically covered by the warranty contract (described therein with a course of action outlining (responsibilities) – and the builder needs do nothing. If the builder is off the hook because of this contract, then so should the builder's liability insurer.

Of course, homeowners may seek recovery by way of other methods and may be able to trigger defense or indemnification provision of the builder's liability program. SB 800 claims in California can be construed to side step a third-party warranty and further be structured to avoid or trigger liability coverage depending on the legal strategy. Economic damage is not property damage, for example.

In conclusion, a warranty may best limit risk while the liability program transfers risk. The only risks that may be transferred to an insurer by way of a typical warranty are the risks of structural defect repair and builder insolvency. What's covered topically under a warranty contract is far different in function and meaning than what's “covered” by an insurance policy.

Sub Contractor (Cont. from Page 2)

Holding: The Court of Appeals affirmed the trial court and found that under the applicable insurance policy allowing for coverage for vendors, ambiguity in the insurance policy will go against the insurer and the insurance company could consider materials extrinsic to the complaint and the insurance policy to determine the duty to defend based on the facts presented.

The Court stated that “[r]ead together, the allegations in the complaint and third-party complaint make out a claim against Shearer for, among other things, recommending and supplying a stucco product...that was defective when designed and manufactured by TransMineral. The exclusions in... the vendors endorsement do not exclude coverage for that conduct. Therefore, Gemini owed a duty to defend Shearer against the claim, even if other theories of recovery against Shearer would be excluded under the policy.”

Editor’s Comment: In the past, all too often manufacturers have been let off the hook on their responsibility for defective products, particularly when they can raise some doubts about proper application. This case stresses the responsibility of the manufacturer with respect to defective products. It also clarifies responsibilities when policy language concerning responsibility is not clearly defined. The Court ruled that if there is doubt, the benefit of the doubt goes to the subcontractor, not the manufacturer.

While the Court did not specifically say so, the case also underlines the importance of subcontractors instructing their own insurance agents that they need to obtain appropriate Additional Insured endorsements on all vendor products that they regularly use.

Don’t Forget - Learning Center Open For Business

Membership records of the Nationwide Contractors’ Alliance (NWCA) show that many members are not taking advantage of one of the key benefits available to them --- access to the NWCA Learning Center. This educational program provides courses that range from avoiding litigation to selecting warranty programs. Courses are designed both to improve contractor knowledge of important issues affecting their businesses and to qualify them for potential discounts upon renewal of their liability insurance policies. The two major sections that have been completed deal with Alternative Dispute Resolution/Warranty and with Subcontractor Management. Many of the courses contain new approaches and new tools for resolving issues that contractors (and subcontractors) have struggled with for many years. Courses are priced at the nominal fee of \$19.95 each and are available either online or by snail mail. To obtain further information, contact Joyce Duerfeldt by phone at 866-491-9722 X 19 or by email at jduerfeldt@nwcalliance.com.