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Protect Your Association with Risk Management: Beware of the Myths

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Proper insurance in all forms is one of the most important means to protect your Association. But be careful of the many myths regarding insurance. For the associations pursuing a major remodel, repair or reconstruction project, these urban legends, if believed, can have rather harmful consequences.

Myth: Builders and contractors are all insured and have to be insured in order to build.

Unfortunately, this is simply not true. A contractor is required by most municipalities only to show proof of **workers compensation** insurance. This compensates only for injury to the builder's employees.

Myth: Contractors have a state-mandated insurance policy in place.

Contractors are required by the Business and Professions Code to have a license bond. This bond is maintained by contractors to compensate the victims of any violations of the Contractors Licensing Laws. The bond is currently $7,500 - less than the cost of building a brick patio. Contractor license bonds permit recovery to claimants who demonstrate a contractor has violated one of the licensing laws. Unfortunately, incompetent construction is not a violation of the licensing law, and so the bond will not pay for the repairs to correct it.

Myth: The contractor's insurance will finish the job and pay the subcontractors if they are not paid by the contractor.

Liability insurance issued to contractors does not cover breaches of contract, but only covers negligence. If one desires to insure the completion of a project, a "performance bond" is needed; for insurance against mechanics liens, and against non-payment of subcontractors and building material suppliers, a "payment bond". These two bonds are typically sold in a package and are usually not available from the liability insurance companies. Such bonds add 2-3% to the cost of a contractor's work; however, many contractors cannot qualify to be bonded- another good reason to insist upon a bond, if finances permit.

Myth: Insurance covers all negligent construction work.

Liability insurance typically covers only damages to persons or property from negligent construction which occurs during the policy period. If the negligent work has not yet resulted in any damage to the property, the insurance policy does not deem it to be an insured event. Furthermore, the insurance normally excludes damage to the insured contractor's own construction work. Under the "work product exclusion", there must be damage to some part of the building other than that constructed by the negligent contractor.

Myth: We had our contractor show proof of coverage when we had the construction three years ago, so we are covered now if anything goes wrong.

Contractors are usually issued insurance which covers the occurrence of loss during the policy period. As mentioned above, the loss is not the negligent construction, but the damages caused by that construction. Therefore, the policy in force during the construction project is not necessarily the policy that pays for damage caused by the negligent construction. If the contractor's insurance coverage has expired prior to the time the construction caused noticeable damage, the policy which was thought at the time of the construction project to protect the property owner may not be available.

Myth: If the owner does not collect from the original builder for the badly built roof, the owner's property insurance will pay for the repair.

Most (if not all) general liability insurance policies have a construction defect exclusion, in which the insurance company states that it will not cover damage caused by construction defects.

Myth: Mold damage is not covered by insurance.

Since the explosion of mold damage claims in recent years, insurance companies have all written mold damage out of property coverage. This has become so much the rule that many property owners and managers no longer even try. However, mold damage is often accompanied by a litigation threat, or may be caused by someone's negligence (in which case a litigation threat should be made). Threatened litigation is handled by a liability adjuster under the property owner's general liability coverage, which is usually different than the ones who handle property damage claims. In insurance parlance, first party mold claims are not covered, while third party usually are. The point here is that there is often hope for coverage, which otherwise is often overlooked.