

Is now really the time to bare it all? An analysis of the decision to discontinue insurance coverage in times when no new homes are being built.

With the downturn in the economy over the last few years, and the fact that the homebuilding industry has been particularly hard hit, I have heard from clients and colleagues that more and more builders are discontinuing their annual renewable commercial general liability insurance programs, deciding instead to go bare. This absolutely scares the crap out of me, and it should scare you too.

The two factors which militate against going bare can be traced to two Colorado appellate court decisions. The first of these is *Public Service Company of Colorado w. Wallis and Companies*.¹ While not a construction defect suit, this case adopted the time-on-the-risk analysis for the allocation of risk in cases involving continuous and progressive losses, such as construction defect suits. The way that the time-on-the risk analysis works is this, a court will divide the total amount of liability by the number of years at issue. The court will then allocate liability accordingly to each policy year. To determine the total number of years at issue, you typically add up the number of years between substantial completion of a home and the date of the statutory notice of claim under the Construction Defect Action Reform Act. For instance, if you received today a notice of claim on a home substantially completed on this date in 2006, there would be five years of time on the risk. Allocating the risk across the five years of time-on-the-risk would result in 20% of the claim being attributed to each year. Now here's the rub. For each year during which you do not renew your CGL policy, you create an uncovered exposure. For instance, if you carried insurance for only year one from the example above, then had four years of uncovered exposure, your carrier would cover 20% of the ultimate indemnity award (assuming it is covered by the policy) and the remaining 80% of the loss would be uninsured and, as a result, the risk of that loss would fall on you.

The second factor which militates towards continuing coverage is the *Hoang v. Arbess* decision.² In that case, the Colorado Court of Appeals held that in cases involving construction defects, homeowners can hold corporate officers of the contracting company personally liable for the construction defects if they are directly involved in the tortious conduct either by approving of, directing, actively participating in, or cooperating in the negligent conduct of the corporation. In other words, while an officer of a corporation cannot be held personally liable for a corporation's tort solely by reason of his or her official capacity, an officer may be held personally liable for his or her individual acts of negligence even though committed on behalf of the corporation, which is also held liable. In the *Hoang* case, Mr. Arbess was held personally liable because he "approved of, directed, actively participated in, or cooperated in the negligent conduct. For example, plaintiffs presented evidence that defendant was personally involved in each step of the construction, chose the individual home sites, oversaw the subcontractors, set policies and procedures for the subcontractors to follow, and visited the construction sites at least once a week." How does this differ from your role in the homes you have built? Mr. Arbess was also found liable because of his decision to use slab-on-grade basement floors instead of the structural floors recommended by the geotechnical engineer.

¹ 986 P.2d 924 (Colo. 1999).

² 80 P.3d 863 (Colo. App. 2003).

When you combine these two concepts, the results can be devastating. It is not a situation where you will be leaving homeowners with judgments against only insolvent entities or single-purpose LLCs. They may well end up with a judgment against you personally. If you have personal liability for uncovered exposures, you will wish that you kept your annual renewable commercial general liability policies in place. It is a small price to pay in comparison to having to defend yourself from, and pay any judgment in, a construction defect lawsuit. If you have discontinued your insurance coverage, or are considering doing so, I urge you to talk with your insurance agent about the decision. Instead of leaving the annual renewable program in place, there may be other options, such as purchasing tail coverage. It is not the time to bare all.

-- David M. McLain