Legal Adviser

Liability Insurance

by Quenda Behler Story

A Kansas lawsuit, *Potomac Insurance of Illinois v. Huang*, provides a good illustration of the relationship between the contractor, his customer, and his liability insurance carrier.

Liability insurance, part of the standard builder's risk policy, promises to defend the contractor if he or she is sued, and promises to pay off any claim the contractor is legally obligated to pay because of recklessness, stupidity, or carelessness — in other words, because he or she injured someone and/or damaged property.

The Facts of the Case

Builder Anderson had installed windows that leaked like sieves. He kept trying to fix them but couldn't, and, eventually, a lot of water damage was done to the inside of the house. The reason he couldn't fix the windows, it turned out, was the design of the house, which called for the windows to be installed flush with the exterior walls. Oh, yeah, and this million-dollar house had no gutters.

The property owners believed the leaks to be Anderson's fault and threatened to sue him. He believed their threat, because they had sued him before, so he paid them $37,000 to have their floors and windows fixed. Then he put in an insurance claim against his builders' risk policy, asking for reimbursement. Potomac Insurance asked the court to decide if it had to pay (a kind of lawsuit called a request for a Declaratory Judgment).

The Questions

There are two questions here: First, can a builder settle a claim against him by his customer and get reimbursed by his insurance company, or does he have to wait until the insurance company either settles it or gives him permission to do so? Second, suppose this builder would not have lost in court if the property owners *had* sued him. Does that mean that his insurance company does not owe him $37,000?

Can the builder settle the claim? Potomac Insurance said that it didn't have to pay because Anderson had not actually been sued. Potomac lost on that question. The court said that Anderson had a common law right to settle the claim and that he could recover that money from his liability insurance carrier, Potomac, as long as he had acted in good faith and in a reasonable way.

What did the court mean by "good faith" and "reasonable way"?

The court said that those phrases meant keeping the insurance company fully informed, sending it a copy of all related paperwork, and paying an amount that did not exceed the real cost of fixing the floors and windows — about what the insurance company would have had to pay anyway.

What if the claim was doubtful? This is the more interesting question. Potomac Insurance said that if the property owners had sued Anderson, they probably would have lost because the leaks weren't his fault. Anderson paid off the property owners, Potomac said, only because they were threatening him with a lawsuit.

But the court ordered Potomac to reimburse Anderson for the $37,000 he paid to the property owners, because, if he had been sued, Potomac would have had an obligation to defend him even from false claims. Was the court saying that a builder has the right to settle a claim himself even if he knows it's false? The court's language certainly sounds like it, but the court kind of weaseled around the issue by saying that probably the builder had not caulked the windows correctly.

I think the court was uncomfortable with letting Potomac off the hook because Potomac had brought the lawsuit and, therefore, would not have been interested in presenting evidence that the property owners could have sued and won.

The court could have said that Anderson, as part of his claim against Potomac, had to show how the customers might have won if they had sued.

What Should You Do?

If you have a hassle with a customer, can you pay him off yourself and then claim against your insurance company? This case says that sometimes you can. But you should be careful. Insurance companies don't like clients settling claims themselves. The insurance company in this incident sued to avoid reimbursing the client.

So if you back the cement mixer into your customer's garage wall, how should you handle it?

If you decide to fix the garage yourself, expecting to get reimbursement from your insurer, keep the insurer in the loop *every foot of the way*. Take dozens of pictures or, better yet, yards of videotape of the damage and of everything you do to fix it.

If the customer's claim is dubious — suppose he says that your cement mixer cracked his driveway and you know it was cracked all along — does the Kansas case mean that you can go ahead and pay to fix the driveway, and the insurance company will reimburse you? After all, if insurance companies settle nuisance suits and doubtful claims every day, why can't you?

My opinion is that if you used that approach, your insurance company would give you a hard time. If the claim is doubtful, that's when you probably ought to let the insurance company deal with it. After all, they keep platoons of lawyers on staff for that kind of problem, and you'd rather those attack-trained lawyers were after the customer with the doubtful claim instead of you.

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