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THE LEGAL PAD

Practice of Excellence

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A Newsletter of Current Business and Legal Matters

In This Issue:

Do You Know What's In Your Contract?

By Joseph A. "Joe" Davies

Arbitration, forum selection, governing law – these are all standard provisions found in many contracts. Too often, however, people are surprised when they learn just how those provisions can work against them when it comes time to enforce the other provisions of the contract – the ones they really care about. Obviously, the most important aspects of your agreements to your day-to-day business are those that involve price, delivery date, or other particular details. However, enforcing those provisions often involve the other terms, those that can be either overlooked if you are signing someone else's agreement, or terms that may have not been updated in some time within your own forms.

Arbitration provisions, for example, are extremely powerful – but that cuts both ways. For many disputes which could involve lengthy litigation, arbitration may be a much more economical method for recovering what you are owed. However, for smaller and more straight-forward cases, the significantly higher upfront costs of arbitration – namely the filing fees – can be cost-prohibitive. However, just because you might choose to forego the arbitration provision in the contract, the other party may choose to invoke it. Because arbitration provisions are routinely enforced by the courts, with very few exceptions, you could find yourself forced to arbitrate a simple dispute.

Forum selection provisions are also frequently overlooked but can have a significant effect on the costs of successfully litigating a claim. In most cases, a lawsuit can be brought in a number of different counties; however, a forum selection clause could significantly narrow your choices. That could mean the difference between filing a lawsuit in your backyard versus halfway across the state. Similarly, provisions dictating that another state's law will govern can introduce uncertainty and added cost to any case.

The takeaway is that, while these provisions may not seem as important as the "business terms" of those contracts, every part of a contract should be reviewed consciously to determine how it may affect your business.

CGL Policies

By Robert C. "Rob" Armstrong

All too often business owners believe that by procuring a commercial general liability policy, or CGL policy, they will be protected from almost all mishaps and accidents on any projects. However, few business owners take the time to understand what exactly they are purchasing and when the CGL policy's coverage will and will not apply. For example, what happens if you are welding on a project and the sparks ignite, causing a fire that damages substantial portions of the project? Does the CGL policy cover all of the damage? Does the CGL policy only cover damage to certain parts of the project? Will it cover consequential damages such as the loss of use of the damaged property? Does it matter whether you took every safety precaution possible to prevent the damage?

To determine what exactly your CGL policy does and does not cover depends on the language found in the policy. Unfortunately, many of these policies use complex language and terms of art that are all but indecipherable to those outside of the insurance industry. Of course, pleading ignorance regarding the terms of a policy after a claim has been denied is not the recommended course of action. So, what can you do on the front end to help mitigate your risks?

First, it is important to understand certain important coverage exemptions. For example, many CGL policies now contain an exclusion for "your work." Specifically, the policy language will read that an exclusion applies to "property damage to that specific part of any property that must be restored, repaired, or replaced because of faults in your work." This means that if you or an employee working for you fails to do the work correctly, the insurance company does not have to pay to fix the work not performed correctly. This should not be that controversial, as work that has been performed incorrectly is considered a business risk and has typically been excluded from CGL insurance coverage. See Builders Mut. Ins. Co. v. Mitchell, 709 S.E.2d 528 (N.C. App., 2011) (explaining liability insurance is not designed to function as a performance bond).

However, the "your work" exclusion has been coming up more frequently in insurance disputes because it is difficult to always determine what counts as "your work." For example, what happens when in the course of performing your work, you accidentally damage other parts of the property. The North Carolina courts have considered the above quoted "your work" exclusion language and held that such language will only exclude coverage to the specific part of the property on which you are working. See Alliance Mut. Ins. Co. v. Dove, 714 S.E.2d 782 (N.C. App. 2011). So long as your policy does not have different language, then it should cover damage to other parts of the property, even if it was caused by your faulty workmanship. Furthermore, the exclusion does not apply to consequential damages that flow from the accident.

Unfortunately, there are still gray areas that North Carolina courts have not yet addressed, such as what happens when a portion of your work that you have completed is damaged by the incorrect performance of additional work by you. For example, if you are hired to perform multiple tasks and an accident on one task damages other property on which you are working. In that instance, it is unclear what would be excluded. Oftentimes, a policy will include language stating that work you have completed and turned over to the owner is no longer considered "your work" but it is often difficult to prove what work qualifies as having been completed.

Second, if a claim is denied that you think should have been covered, don't give up. Ask the adjuster and your agent for clarification. Remember that insurance adjusters and agents can make mistakes. Also, if you were told by your agent at the time you procured insurance that you would be covered in similar situations and your claim is denied, you may have a claim on the agent's errors and omissions insurance. However, such cases will often come down to your word against their word, unless your agent provided you with an e-mail or other letter proving the agent mislead you.

So, what other steps can you take to protect yourself? The best course of action is to get a knowledgeable insurance agent that you trust. Also, try to get verbal and if possible, written confirmation that the insurance policy you are purchasing or have purchased will cover you for the situations you are most worried about. Also, ask about what other policies the insurance agent believes would be warranted for your type of business, or if an insurance company offers any additional protection for businesses like yours. Because insurance contracts can change, make sure you carefully read all notices sent to you by your insurance company, especially those notifying you of coverage changes. It is a good idea to review your insurance contracts regularly with your insurance agent to make sure they are still applicable and cover you adequately. You may also want to consider having your insurance contracts reviewed by an attorney to make sure that they adequately protect your interests and that you understand when they do and do not apply. In particular, if you are working on an unusual project, or a particularly dangerous project, take the time before bidding the project to make sure your insurance coverage will protect you in the event something happens.

In sum, it is important to understand what exactly you are purchasing in a CGL policy. A little time and effort on the front-end of insurance contracts can save a lot of work and heartache down the road.

Installed Sales: Are You Serving As A General Contractor, Subcontractor or Supplier?

By James R. Vann

Installed sales is a common place portion of real estate improvements today. Installed sales has steadily increased in sales volume over the years. Could a supplier or subcontractor be held to the standard of a general contractor with installed sales? If the costs of the installed sales surpasses the threshold to qualify as an improvement by a general contractor, is a general contractor's license required?

A recent North Carolina Court of Appeals case (Brown's Builders Supply, Inc. (the "Supplier") v Johnson) addresses some of these issues. We had the honor of representing the Supplier. North Carolina General Statutes defines "general contractor" as "a firm or corporation who...undertakes to...construct... any improvement or structure where the cost of the undertaking is thirty thousand dollars ($30,000) or more." Unlike subcontractors, general contractor must be licensed under certain circumstances.

General Contractor or Subcontractor

The distinction between a general contractor from a subcontractor typically is the degree of control exercised by the contractor over the construction of the project. Typically, the Court will review the contract between the contractor and the owner as well as the evidence to determine the degree of control to be exercised by the contractor. The degree of control to be exercised could subject the contractor to the licensure requirements of the laws of North Carolina.

In this case, the Supplier supplied cabinets, a hood to atop of the stove, cabinet hardware and a sink. The items were provided in installed sales contracts. Brown's Builders Supply is not a licensed general contractor. The total of the supplies, provided by separate contracts including tax, exceeded $30,000.00. The homeowner had hired a general contractor but the homeowner chose to hire and pay subcontractors directly to save on the cost of the general contractor's performance.

The homeowner contended that the Supplier was an unlicensed general contractor and thus payment should not be required to be made to the Supplier by the homeowner.

The Court disagreed with the homeowner. The Court reasoned that the Supplier exercised "minimal control" over the remodel project and thus, was not to be held to the same standard of a licensed general contractor. The Court concluded that the Supplier's role was limited to the sale and installation of the items identified in the installed sales contracts. The Court concluded that the Supplier did not oversee, direct or manage any work of other subcontractors.

Degree of Control

If a Supplier is involved with installed sales, it is wise to use caution to avoid similar potential problems. It would be wise to review the installed sales contracts and examine the "degree of control" being exercised on a project for improvement.

If you have questions concerning these issues, please feel free to contact us.

Regulatory Issues to Watch in 2015

By James A. "Jim" Beck

In recent years, small businesses have faced what seems like a never-ending barrage of new laws and regulations, particularly from the federal government and its numerous agencies. Today, more than ever, a business needs to have a competent team of accountants and lawyers to make sure it remains in compliance with the law. With that in mind, a look at a few major issues that are on the minds of legislators and bureaucrats might be a useful.

Online Sales Tax

Some members of Congress would like to pass the Marketplace Fairness Act, taxing online sales of goods. While it is unclear how this possible law will eventually operate, it has the potential to affect every business that sells goods online. Most notably, small businesses ability to function efficiently could be impaired, because of the administrative nightmare of dealing with the sales tax rates and compliance issues in fifty different states. A great deal of information on this can be found on the internet, and I would encourage any business selling goods online to spend some time researching this issue that could drastically affect the bottom line.

Immigration Reform

Both parties in Congress are interested in immigration reform of some kind, and the end result is unpredictable. Immigration reform will affect all businesses in some way. In particular, the most obvious ways employers will be affected involve the cost of employment, the process of hiring workers, and the paperwork or electronic filing requirements.

Employment

Minimum wage is a hot issue in 2015. Federal regulations on wages are already in place, and affect businesses that work on federal projects or whose work is part of a federal contract. Many lawmakers would like to raise the minimum wage substantially, driving up the cost of doing business. At some point, minimum wage will be addressed, so it is advisable to plan for this looming increase in the cost of doing business.

Laws and regulations affecting businesses change constantly, making it difficult to remain in compliance and to plan for the future success of a business. In addition, regulatory uncertainty and increasing costs can wreak havoc on an otherwise thriving company. If you need assistance understanding the impact of any current or potential regulation, and how best to minimize any negative outcomes, we would be pleased to talk with you.

Commercial Credit Application What Information Is Really Necessary?

By James R. Vann

The first step in any successful business relationship is starting out with clear expectations and understanding. When the business relationship involves business credit, it is important to collect as much useful information about the customer as possible. The credit application is usually the best source for obtaining valuable information and assets about the customer. If the necessary contractual formalities are in order (i.e. date, terms, signatures, etc.), the credit application can be an effective tool in commercial collections.

Credit Verification

Before credit is extended to any customer, steps should be taken to investigate the credit history of the applicant. One of the easiest and reliable methods of checking credit history is to ask for credit verification. Typically asking the customer to provide a number of references where credit has already been extended. Generally, between three and five references will be sufficient to verify the applicant's credit worthiness.

To facilitate the investigation of the applicant's credit history, including the credit history of the personal guarantor, the application should contain a statement that authorizes the creditor to verify the information included in the application, including contacting the applicant's and personal guarantor's references. For example:

> The applicant and guarantors hereby authorizes XYZ, Inc. (the Creditor) to take appropriate measures in verifying the credit of (the business to which XYZ, Inc. is to extend credit) and releases XYZ, Inc. from any obligations and restrictions imposed by law while researching this information.

Asset Disclosure

The primary purpose of the credit application is to determine whether the applicant's financial condition is stable enough to permit the creditor to risk an extension of credit. The application should state at the top of the form "The following statements and representations are made for purposes of procuring commercial credit from XYZ, Inc." (the Creditor).

All credit applications should request information regarding the assets of the applicant. Specifically, the applicant should be required to disclose where all operating bank accounts are located. This information should include the name of the bank, branch office and the mailing address and telephone number of the office, account numbers, and the type of accounts (e.g. payroll, checking).

Depending on the type of applicant, you may wish to consider having the applicant disclose its major customers or location of its major accounts receivables. In the event that a judgment is obtained against the debtor, the accounts receivable of the debtor can be garnished or levied. While it is possible to obtain information regarding a debtor's accounts receivable through a creditor's supplemental examination, these accounts may be levied more expeditiously, and less expensively, if this information is disclosed on the credit application.

Terms of Payment

The credit application should set forth the expected terms of payment. If interest or finance charges are to be charged on all accounts more than 30 days past due, this fact should be set out in the credit application. All invoices sent to the applicant should also contain information regarding interest and finance charges. In North Carolina, a creditor can assess and collect their contract rate of finance charges until paid in full compared to the legal rate which is currently eight percent in North Carolina. However, in order to do so, the creditor should reference North Carolina General Statute §24-5 specifically in the terms and conditions.

A provision permitting the collection of costs and attorney's fees incurred while pursuing collection of outstanding accounts should also be included in the credit application. Thus, the credit application should contain a statement such as the following:

> In the event credit is extended, the applicant agrees to pay all costs and expenses (including actual and reasonable attorneys fees) incurred by creditor in collection of any outstanding accounts.

Responsibility of Costumer to Provide Updated Information

There are times when a customer may complete a credit application and then the customer's business structure (sole proprietorship, corporation, partnership, etc.) may change. For example, your customer may complete the application as a sole proprietor and then incorporate the business. Or your corporate customer completes the application and then the business is sold to new owners without any notice to you, the creditor. It is a good suggestion to include language in the credit application stating that the customer is obligated to notify you, the creditor, within 30 days of any change in the ownership or corporate formation of the business.

Choice of Law and Venue

Your credit application should stipulate under which State any law disputes shall be governed. For example "Any dispute arising under this Agreement shall be governed by the laws of the State of "X" and the customer agrees that any civil action may be brought in the County of "Z", the State of "X" unless otherwise required by the laws of the State of "X"."

Personal Guarantees

Personal guarantees often will make the difference in actually collecting the past due account compared to simply obtaining a judgment. Obtaining personal guarantees should coincide with your credit policy. However, the following language is suggested to protect your company from personal guarantors withdrawing their guarantees while purchases are either being made and/or pending orders are fulfilled.

"This guarantee may only be revoked by written notice to XYZ, Inc. (the Creditor) served via certified or registered mail, and any such revocation shall become effective 30-days after receipt of said written revocation. Any revocation does not revoke the obligation of the guarantor(s) to provide for prompt payment for indebtedness incurred prior to the effective date of the revocation, including the principal amount, interest, costs, and such reasonable attorneys fees as shall be incurred pursuant to this guarantee and under any contract evidencing the indebtedness guaranteed herein."

Summary

A credit application can provide valuable information if properly utilized. Not only can this information be used to verify an applicant's credit history, but it can also be used to collect unpaid accounts. In addition, a well drafted credit application can do much more. By taking the time and effort to review and revise a creditor's credit application, the odds of recovering delinquent accounts can be increased dramatically.

VANN ATTORNEYS
ATTORNEYS AT LAW
Practice of Excellence

1720 Hillsborough Street | Suite 200 | Raleigh, NC 27605
Phone: 919-510-8585 | Fax: 919-510-8570

1200 East Morehead Street | Suite 251 | Charlotte, NC 28204
Phone: 704-496-7495 | Fax: 704-496-7480
www.vannattorneys.com