

Payment of Overhead and Profit

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One common problem that has been arising is when overhead and profit should be paid in response to a property insurance claim. For those not aware, overhead and profit (generally estimated at 20% of the total amount of the estimate) is intended to cover the overhead/operating costs of a general contractor as well as the amount of profit that the general contractor typically receives. The two typical questions that arise are:

1. Whether overhead and profit is owed at all on a claim, and
2. Whether initial payments of actual cash value amounts should include these amounts.

The longstanding rule of thumb used in insurance adjusting for years is that overhead and profit is owed if more than three trades are involved in the repair process (e.g., a roofer, a stucco repair company, and an air condition contractor). Once there are three trades involved insurance carriers typically presume that a general contractor would be necessary to coordinate and oversee the repair process. Where and when this three-trade “rule” came into being will likely never be known, however it does not seem to have any binding authority in most states.

While jurisdictions take different approaches, Texas courts have answering overhead and profit questions in a common, but altogether unclear, way. In *Ghoman v. New Hampshire Insurance Company*,¹ the federal court addressed the issue from the perspective of the interplay between overhead and profit and the amounts owed under the actual cash value and replacement cost value provisions of the policy. In determining what constitutes the “actual cash value” of the damage, the court noted that Texas law equates the undefined policy term with the “fair market value,” or the price a willing purchaser would be willing to pay. In application, however, the court concluded that the actual cash value of the damage should be determined by taking the full replacement cost and deducting any applicable depreciation – the standard in most states.

Going further, the court stated that the replacement costs, from which any depreciation would be

deducted, should include any cost that an insured is “reasonably likely to incur” in repairing or replacing a covered loss. Overhead and profit and sales tax, it opined, clearly fit into this definition and should be included in both the replacement cost and actual cash value amounts.

While the issue is far from settled, the state of the law (in Texas, for now) is overhead and profit should be paid unless there is a finding that the services of a general contractor would never be necessary given the scope of the work to be completed. Even then, however, there is an argument to be made that the replacement cost of the property, which if factored in to determine the premiums to be paid, already includes overhead and profit. Therefore it would be inequitable to factor those costs in without taking it into account when a loss occurs.

See Ghoman v. New Hampshire Ins. Co., 159 F.Supp.2d 928 (N.D. Tex. 2001).

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