

Construction Insurance 101: Builders Risk

Eric M. Gold

Stephen S. Asay

Pillsbury Winthrop Shaw Pittman LLP

Washington, DC



Types of Insurance

- “First party”
 - Loss to the insured’s own property
 - E.g.: Commercial Property, Builders Risk, Contractor’s Equipment
- “Third party”
 - Third party claims and suits against the insured
 - E.g.: Commercial General Liability, Professional Liability, Workers Compensation/Employer Liability
- Combined First Party and Third Party
 - Certain insurance policies may include first and third party coverages.
 - E.g.: Automobile, Pollution

Crane Collapse



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Principal Construction Project Insurance

- Builders Risk/Permanent Property Insurance
- Commercial General Liability (CGL)
- Professional (OPPI, E&O)
- Pollution

What the Fine Print Says

- Insurance Policies are NOT Fungible
 - Insurance policies are not exciting reading until a claim arises
 - Policies are often issued after coverage is bound and a commission is paid
 - Always read insurance policies after they are procured—no matter who purchases the coverage (OCIP vs. traditional insurance programs)
 - Underwriters do not adjust claims—make sure your policy is clear
- “The difference between a good word and the right word is like the difference between fire and firefly.”

-- *Mark Twain*

Builders Risk Insurance

- Insures against risk of loss to work during construction
- Property to be installed in final construction
 - In transit
 - Off site
 - Temporary work
 - But equipment is often insured through a separate Equipment Policy
- Typically on insurer-specific forms, not ISO forms
- Two varieties: “all risk” or “named peril”
- Typically one policy covers all project participants

Navigating a Builders Risk Policy: The 3 P's

- Parties
- Property
- Perils (aka “Causes of Loss”)

Parties: Named Insured

- Example:

NAMED INSURED & Mailing Address
Owner LLC, a Delaware Limited Liability Company
1234 Main Street
Anytown, FL 00000

Parties: Additional Insureds

- Example:

1. Additional Insureds

To the extent required by any written contract or subcontract for the INSURED PROJECT, and then only as their respective interests may appear, all owners, all contractors and subcontractors of every tier of the INSURED PROJECT, and any other individual or entity specified in such written contract or subcontract, are recognized as Additional Insureds hereunder. As respects architects, engineers, manufacturers and suppliers, their interest is limited to their site activities only.

Parties: Who Should Be Insured

- Should include owner, general contractor and all subcontractors
- Best practice: name all of the above as named insureds
 - Builders Risk policy declarations page
 - Named Insured Endorsement to the policy
 - Can be identified by position: “contractor and subcontractors of every tier”

Property: Covered Property

- Building, meaning buildings and structures including:
 - Property under construction
 - Completed additions
 - Fixtures, including outdoor fixtures
 - Foundations of buildings, structures, machinery or boilers
 - Property in transit
 - Property at site or in temporary storage that will become part of the installation, erection, or fabrication
 - Temporary work

Property: Property Not Covered

- Covered property does not include:
 - Accounts, bills, currency, etc.
 - Automobiles, motorcycles, motortrucks, motorhomes, tractors, and similar vehicles, held for sale, lease, loan or rent
 - Equipment (?)
 - Existing property (adjacent property)
 - Land, water, growing crops or lawns

Perils: All Risk v. Named Peril

- Two basic types of property insurance:
 - All risk: insures against all perils except for those specifically excluded
 - Named peril: covers only those perils specifically enumerated within policy

Perils: Basic Insuring Agreement

- Coverage: We will pay for direct physical loss of or damage to Covered Property at “covered locations” caused by or resulting from any Covered Cause of Loss
- Insurance to English Dictionary: “Covered Cause of Loss” – A cause of loss which results in coverage under a first party insurance policy. Syn., Peril.
- All risk policy: Covered Causes of Loss means Risks of Direct Physical Loss unless the loss is: . . . Excluded . . . or . . . Limited.

Perils: Exclusions

- Critical exclusions:
 - Faulty workmanship or design
 - LEG 2/96
 - Cost of making good
 - Earth movement (from what cause?)
 - Settling, cracking, shrinking or expanding (normal?)
 - Corrosion (sudden?)
 - Water damage
 - Mold
 - Consequential damages/delay
 - Penalties
- But many excluded coverages can be bought back

Perils: Chain of Events

The peril that started a chain of events that lead to your loss is excluded, so you can never have coverage.

True or False?

Perils: Chain of Events



Earthquake =
Excluded Peril

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Perils: Chain of Events



Fire =
Covered Peril

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Perils: Chain of Events



What if the earthquake causes a fire?

Perils: Chain of Events

Broad Exclusion

Excluded Peril → Covered Peril → Damage =



Medium Exclusion

Excluded Peril → Specified Peril → Damage =



Narrow Exclusion

Excluded Peril → Covered Peril → Damage =



Perils: Chain of Events

- Example of broad exclusion



C. Exclusions

1. We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss or damage.

Perils: Chain of Events

- Example of medium exclusion



2. We will not pay for loss or damage caused by or resulting from any of the following:

But if loss or damage by the specified causes of loss results, we will pay for that resulting loss or damage.

Perils: Chain of Events

- Example of narrow exclusion



3. We will not pay for "loss" caused by or resulting from any of the following. But if "loss" by a Covered Cause of Loss results, we will pay for that resulting "loss".

Perils: Applying the Resulting Loss Exception

- Example: Is there coverage for damages resulting from the crane collapse?
- We will not pay for loss or damaged caused by . . .
 - Faulty workmanship, design, materials
 - But if loss by a Covered Cause of Loss results, we will pay for that resulting loss.

Perils: Applying the Resulting Loss Exception

- Example: Is there coverage for water damage resulting from errors in flashing installed around windows and doors?
- We will not pay for loss or damaged caused by . . .
 - Faulty workmanship, design, materials
 - But if loss by a Covered Cause of Loss results, we will pay for that resulting loss.

Perils: Applying the Resulting Loss Exception

- Example: Is there coverage for glass windows damaged by welding slag from installing steel beams in upper floors?
- We will not pay for loss or damaged caused by . . .
 - Faulty workmanship, design, materials
 - But if loss by a Covered Cause of Loss results, we will pay for that resulting loss.

Expanded Coverage

- Expanded coverage for damages resulting from faulty workmanship
 - London Engineering Group Provisions
 - LEG 2/96 or LEG 3/96
 - Cost of Making Good Provisions

Expanded Coverage: LEG 2/96

The Insurer shall not be liable for:

All costs rendered necessary by defects of material workmanship design plan specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.

For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.

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Expanded Coverage: LEG 3/96

The Insurer shall not be liable for:

All costs rendered necessary by defects of material workmanship design plan specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.

For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.

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Expanded Coverage: Cost of Making Good Exclusion (American Equivalent of LEG 2/96)

This Policy does not insure Loss caused directly or indirectly by any of the following, and such Loss is excluded regardless of any other cause or event that contributes concurrently, or in sequence to the Loss:

19. Cost of Making Good:

The costs that would have been incurred to rectify [faulty workmanship] had such rectification been effected immediately prior to the LOSS[.]

....

However, if direct physical LOSS by an insured peril ensues, then this Policy will provide cover for such ensuing LOSS only.

For the purpose of this Policy and not merely this Excluded Cause of LOSS, insured property, or any portion thereof, shall not be regarded as damaged solely by virtue of the existence of [faulty workmanship].

Expanded Coverage: Key Coverage Extensions

- Expediting Expense
- Contractor's Extra Expense
 - Definition should be broad enough to cover ongoing general conditions
- Delay in Completion/Delay in Start-Up (DSU)
 - Loss of Revenue/Profit
 - Increased Costs by Reason of Delay
 - Soft Costs
 - Liquidated Damages
 - Others
- Debris Removal

Expanded Coverage: Key Coverage Extensions

- Demolition and Increased Cost of Construction
- “Sue and Labor” Expense/Minimization of Loss
- Existing Property
- **Beware of Limits & Sub-limits!**
 - Adequate sub-limited amounts
 - Sub-limits on a percentage of loss basis

Key Policy Conditions

- Notice
- Voluntary Payments
- Contractual Suit Limitation (1-2 years)
- Proof of Loss Requirement
- Subrogation

Key Policy Conditions: Subrogation

19. Subrogation

If the Company pays a claim under this Policy, it will be subrogated, to the extent of such payment, to all the NAMED INSURED's rights of recovery from other persons, organizations and entities. The NAMED INSURED will execute and deliver instruments and papers and do whatever else is necessary to secure such rights.

The Company will have no rights of subrogation against:

- A. any person or entity, which is an Additional Insured;
- B. any other person or entity, against which the NAMED INSURED has waived its rights of subrogation in writing before the time of LOSS.

Notwithstanding the foregoing, it is a condition of this Policy that the Company shall be subrogated to all the NAMED INSURED's rights of recovery against:

- A. Any Architect or Engineer, whether or not a NAMED INSURED or Additional Insured, for any LOSS arising out of the performance of professional services in their capacity as such and caused by any error, omission, deficiency or act of the Architect or Engineer, by any person employed by them or by any others for whose acts they are legally liable, and;
- B. Any manufacturer or supplier of machinery, equipment or other property, whether or not a NAMED INSURED or Additional Insured, for the cost of making good any LOSS which said party has agreed to make good under a guarantee or warranty, whether expressed or implied.

The NAMED INSURED will act in concert with the Company and all other interests concerned in the exercise of such rights of recovery.

If any amount is recovered as a result of such proceedings, the net amount recovered after deducting the costs of recovery, will accrue first to the Company in proportion to their respective interests. Any excess of this amount will be remitted to the NAMED INSURED. If there is no recovery, the interests instituting the proceedings will bear the expense of the proceedings proportionately.

The NAMED INSURED will do nothing after LOSS to prejudice such rights of subrogation.

Key Policy Conditions: Subrogation

(AIA A201-2007 General Conditions of the Contract for Construction)

§ 11.3.7 WAIVERS OF SUBROGATION.

The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, subsubcontractors, agents and employees, each of the other, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, subsubcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Section 11.3 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance held by the Owner as fiduciary. The Owner or Contractor, as appropriate, shall require of the Architect, Architect's consultants, separate contractors described in Article 6, if any, and the subcontractors, subsubcontractors, agents and employees of any of them, by appropriate agreements, written where legally required for validity, similar waivers each in favor of other parties enumerated herein. The policies shall provide such waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

Practice Pointers

- Delay-in-Completion Coverages
- “Sue and Labor” Inherent in Policy
- Overhead & Fee
 - Potentially recoverable even if not identified in policy
- Extra Expense
- Avoid Water Damage Exclusions

Practice Pointers

- Number of Occurrences/Deductible
- Waivers of Subrogation
- Typically Primary to General Liability Coverage
- Expiration and Replacement by Permanent Property Coverage