

## **INSURANCE FOR THE CONSTRUCTION PERIOD**

**OWNER CONTROLLED INSURANCE PROGRAMS, BUILDER'S RISK,  
CONSTRUCTION DEFECT COVERAGE, POLLUTION AND PROFESSIONAL  
LIABILITY, AND MUCH MORE**

**2009 Hospitality Law Conference  
February 9 – 11, 2009  
Houston Texas**

Rich Clark  
Managing Director  
Gallagher Hospitality Practice  
Arthur J. Gallagher & Co  
1900 West Loop South, Ste 1600  
Houston, TX 77027  
713.358.5930  
[rich\\_clark@ajg.com](mailto:rich_clark@ajg.com)

Scott R. Whiteside  
Executive Vice President  
Gallagher Construction Services  
One Market Plaza, Suite 200  
Spear Street Tower  
San Francisco, CA 94105  
415.288.1637  
[scott\\_whiteside@ajg.com](mailto:scott_whiteside@ajg.com)

J. Daniel Golden  
Vice President  
Gallagher Construction Services  
1900 West Loop South, Ste 1600  
Houston, TX 77027  
713.358.7808  
[danny\\_golden@ajg.com](mailto:danny_golden@ajg.com)



# Gallagher

Arthur J. Gallagher & Co. is one of the largest and fastest growing brokers and risk management service providers in the insurance industry. Since 1927, our company has been helping business and industry manage risk by performing the traditional insurance broker's function of planning and placing insurance. Basic to our success is a commitment to meeting each client's particular needs. This commitment has enabled the company to grow from a two-person organization to our present ranking as the fourth largest broker in the world with revenues in excess of \$1.6 billion.

Gallagher's retail broker operations are organized by geographical profit centers and with over 150 offices located throughout North America operating primarily within certain key Niche Groups. These specialized teams target areas of business and/or industries in which Gallagher has developed a depth of expertise and a large client base. Gallagher's specialized focus on these Niches allows for highly-focused marketing efforts and facilitates the development of value-added products and services for our clients specific to these industries or business groups.

Rich Clark, is the Managing Director for the Gallagher Hospitality Practice located in Houston Texas. With over 40 years of insurance experience specializing in Hospitality and Real Estate, Rich is responsible for the day to day operations of the group. The Niche consists of 20 Hospitality Specialists and provides Insurance and Risk Management for over 3000 properties and 400,000 rooms.

Scott Whiteside is the Executive Vice President of Gallagher Construction Services. Based in San Francisco, Scott manages the Western United States Wrap-up practice group. Scott has over 35 years advising Owners, Contractors and Developers on all risk management issues.

Danny Golden is a Vice President for Gallagher Construction Service Niche. Based in Houston, Danny's primary focus is providing construction expertise for companies within the Hospitality Industry on Owner or Contractor Controlled Insurance Programs (Wrap Ups) and Builder's Risk coverage. Danny's experience includes structuring Risk Management Programs for new construction of properties as well as renovation to existing sites.

## **TABLE OF CONTENTS**

### **I. CONSTRUCTION INSURANCE OVERVIEW**

- A. Protection of Assets**
- B. Risk Transfer**
- C. Indemnity vs. Insurance**

### **II. TYPES OF INSURANCE**

- A. Builder's Risk**
  - 1. Basic Coverage plus Earthquake, Windstorm, Flood**
  - 2. Delayed Opening Coverages**
  - 3. Soft Costs**
- B. General and Excess Liability**
  - 1. Contractors' Insurance – How Much?**
  - 2. Owner's Coverage**
  - 3. OCIP vs. CCIP Options**
- C. Professional Liability**
- D. Pollution Liability**
- E. Subcontractor Default Insurance [Subguard]**

### **III. CLAIM SCENARIOS**

## **I. CONSTRUCTION INSURANCE OVERVIEW**

Our goal is to address the various insurance issues that arise when a Hospitality Industry Owner or Developer makes the decision to build a new single site asset, renovate an existing property, or build a number of properties, such as a string of hotels. While we will focus on domestic issues, the basic information also applies to International projects.

The Hospitality, Construction, and Insurance industries have differing issues that often conflict with one another. For example, many General Liability Insurers include a “residential” exclusion in their policies. Unfortunately, there is no standard definition of “residential” so the project Owner may not know if the Contractor has insurance coverage or not for the project.

Owners are also building a variety of different project types. A Contractor must understand whether the project will include condominiums, timeshares, or the potential for future conversion into any “for sale” components. If so, they must address the liability arising from the “for sale” components in the contract documents as well as in the insurance policies carried by the contractor and all subcontractors. The Contractor must also address all potential liabilities arising from Professional and Pollution Liability exposures.

From an insurance perspective, the Owner/Developer must pay particular attention to the Indemnity and Insurance sections of the construction contract documents. The Contractor’s ability to respond to its Indemnity obligations is typically backed up by a combination of insurance, bonds, and corporate equity. The following information will assist the Owner in better understanding its construction related risks and the Insurance products available to protect the property.

### **A. Protection of Assets**

A property Owner considering construction of a new asset or renovating an existing property, has to consider the numerous construction risks and design the best Risk Management program to protect itself. For new construction, the project must be insured during construction for loss to the project itself, as well as any resulting loss due to the delay in completion. An Owner must understand the different types of Builder’s Risk insurance available and whether certain catastrophic risks, such as windstorm, earthquake, or flood are insurable. While coverage exists for “Soft Cost” losses, including loss of income from delayed opening, these coverages are not automatic and must be separately underwritten.

In addition to protecting the new project during construction, the Owner must protect itself against liabilities that may arise from the construction activities. These risks include injury claims to workers or the general public, damage to neighboring properties, damage to existing Owner property, environmental exposures and the risk arising from the inability of a contractor to complete its work.

A risk management exposure survey will help you identify risks to treat in the insurance and risk management program. This survey can be conducted by your risk management department, broker, or consultant. Understanding what the risks of loss are will assist you in developing the appropriate Risk Management program.

## **B. Risk Management**

An Owner has various techniques available to deal with the risks of construction. The first technique is to **avoid** all risk by not building the project. We have seen an increase in the use of this technique, particularly for projects involving a “for sale” component, because of the state of the economy. We expect to see an increase in the delay or cancellation of new Hospitality related projects because of the economy. Once a project begins, risks of loss can be **controlled**. Strong safety programs, third party inspections, and strong contract management are examples of how risks can be controlled. Another common technique for an Owner is to **retain** certain risks. Since not every risk is insurable, or reasonably insurable, an Owner will choose to self insure. Examples are the risk of loss from Earthquake or Windstorm which are often expensive to insure. While an Owner may chose to self-insure, it must take care to address this in the contract documents. If the Owner chooses to self-insure, will that relieve the contractor of responsibility if the project is damaged? Will the contractor be able to collect for work already in place but not yet paid for?

A final premise of Risk Management is to **transfer** risk of loss from one party to another. This is probably the most common type of technique used in construction projects. The construction contract itself transfers most risks to the Contractor. As with any contract, care must be taken to draft a comprehensive document and avoid conflicting clauses. For our purposes, it is critical that the Insurance requirements are well thought out, clear, and concise. Either the AGC or AIA contracts offer good templates for insurance requirements.

## **C. Indemnity vs. Insurance**

For construction related risks, the two critical clauses in the contract are the Indemnity Agreement and the Insurance Requirements. The Indemnity Agreement outlines the obligations of the Contractor to the owner for losses and claims arising out of the construction or construction related activities. These agreements tend to be very broad and require the Contractor to both defend and indemnify the Owner. The Indemnity obligation is only as good as the

Contractor's ability to respond. While Insurance does not cover the contractor for all Indemnity its obligations, it does provide coverage for most. If an Owner drafts Indemnity obligations that are overly onerous, it may restrict the Contractor's ability to secure insurance to protect both itself and the owner.

The contract Insurance obligations should provide clear instruction on not only the types of coverage required, but the limits of liability as well. The basic requirements include Auto Liability, General Liability, and Workers' Compensation. Optional coverages include Pollution Liability, Professional Liability [for any design related exposures], and Builders' Risk. The Contractor must understand that the absence of an Insurance requirement does not limit their Indemnity obligations in most states. If the Owner is providing any insurance for the project, typically Builders' Risk, any deductible obligations should be addressed in the contract.

Additional Insured obligations must also be carefully drafted. The typical contract language calls for the Owner to be named as a Primary, Additional Insured for any claim arising out of the work without contribution from any separate insurance carried by the Owner. However, some Jurisdictions limit the Owner's ability to get primary coverage if there are restrictions on Type I, II, or III Indemnity agreements. Also, many Insurers will attempt to limit the Additional Insured coverage to "Operations Only" and not provide the protection for "Completed Operations".

## **II. TYPES OF INSURANCE**

### **A. Builder's Risk**

This is a property policy that is designed to cover property during the course of construction. It is sometimes referred to as "Course of Construction" insurance or "All Risk" coverage. There are a variety of policy forms in the market with no single standard policy. While basic coverage is written on an "all Risk" basis, that is a misnomer and keen attention must be paid to all policy terms, conditions, and exclusions.

First, the construction contract should specify who buys the coverage and who is responsible for the deductible. The project Owner often buys the coverage so that it is the first Named Insured and can control the policy. If a dispute should arise with the Contractor, the policy can't be held hostage if the Owner purchased it. Builder's Risk is intended to be a type of No-Fault coverage with the purpose to provide immediate funds for reconstruction without worrying about allocation of fault. A properly constructed policy contains a Named Insured Endorsement including coverage for the Owner, the General Contractor, as well as all subcontractors and materialmen. A waiver of subrogation against any Insured [unnecessary in many jurisdictions that don't allow subrogation against an Insured] should also be included in the contract as well as in the policy form.

Builder's Risk policies can be written on a per project basis or a blanket basis. A developer planning construction of numerous projects over several years may want to consider a blanket program. This locks in pricing as well as terms and conditions so each project doesn't have to be separately underwritten and negotiated. Premiums are calculated on the estimated cost of the work with a final audit to determine the final values.

Covered Property typically includes labor, material, equipment, and fixtures that become a permanent part of the building. Coverage can be extended to cover materials placed in off-site storage facilities and materials in transit, subject to negotiated sublimits of liability. Property not covered includes contractor's tools and equipment, office trailers, temporary structures, and existing buildings. Exceptions can be negotiated for falsework, scaffolding, and temporary structures subject to underwriting review. Each policy provides different coverage so care must be taken to have coverage for the project site [land], foundations, underground utilities, excavations, etc.

Renovations and similar work in or around existing structures can be problematic if not properly addressed. The new work should be covered with a Builder's Risk policy. Existing structures can be included on the Builder's Risk policy but are most often insured under the Owner's Property Portfolio Program which insurers completed buildings against loss. If the existing structure is insured under the Owner's Property Portfolio, waivers of subrogation should be considered in favor of the contractors. Some Owners, and their Insurers, are reluctant to provide such waivers. In those cases, the General Contractor's General Liability policy may provide coverage if the contractor is legally liable for the damage. However, there are some potential exclusions that will be discussed later.

Keep in mind that many lenders have specific Insurance requirements for the project under construction and often dictate policy terms, conditions, limits of liability, and deductibles. Most lenders will provide a sheet listing their Insurance requirements during the loan application process.

Builders' Risk forms also contain a variety of valuation clauses. The most basic form will reimburse the Insured on an Actual Cash Value basis. This phrase is defined differently in different jurisdictions so you must understand the laws of the state wherein the project is located. Most policies reimburse the Insured based on Replacement Cost, subject to policy limits. However, there is another gap between policy forms. For example, some policies will provide coverage for the Contractor's reasonable overhead and profit while other Insurers believe that the repair contractor [often the original builder] shouldn't profit from a loss. Finally, Business Interruption and Soft Cost claims are often specific limits of liability and are adjusted based on actual loss incurred.

## **1. Basic Coverage plus Earthquake, Windstorm, Flood**

The basic policy Insuring Agreements vary. Typical language states that the policy will cover "...all risks of direct physical loss or damage to Covered Property...". While the phrase "all risk" is used, the basic policy forms contain numerous exclusions. Most notably, the policies exclude damages arising from earth movement, pollutants, consequential loss, liquidated damages, water, the cost of making good faulty workmanship, defective materials, or faulty design, or the enforcement of any ordinance or law. Many of these risks can be insured elsewhere. Some policy forms provide coverage for loss resulting from an excluded cause of loss if the loss is not otherwise excluded.

Earth Movement [quake] coverage is available but significantly increases the premium costs. It is possible to purchase separate, lower limits of liability for earthquake, and many Owners choose to do so based on a Probable Maximum Loss [PML] calculation. This is the anticipated value of the largest loss that could result from the destruction of property. If full project value earthquake limits are not purchased, the knowledgeable contractor will ask for Indemnity in the contract for damages caused that are in excess of the quake limits purchased.

Careful attention should be given to coverage for water damage or flood claims. There is a wide discrepancy in policy coverages for these perils. The broadest exclusions limit coverage for damage by water from any source; for example, flood, rain, sewer backup, water seeping through exterior walls, sprinkler leakage, etc. Many policy forms make a distinction between flood losses and water damage losses. For example, a rain damage claim may be covered depending on the definition of water in the policy. Many policies will cover interior damage by rain or snow only if the exterior of the building first sustains damage. Flood exposures can be insured depending on the property location and whether it is considered a Special Flood Hazard Area. The Owner needs to determine the flood zone category to determine how best to insure this exposure.

Flood exposures go hand in hand with Coastal Weather Events which can include the perils of flood and windstorm. Builder's Risk underwriters will exclude these perils from the basic policy coverages in certain Coastal areas or other areas susceptible to hurricanes. The recent hurricanes in the Gulf Coast Region led to substantial damages to projects under construction and significant litigation over the Builder's Risk policy coverage intent. There is no easy answer for these risks other than to understand the exposures and understand the policy terms and conditions.

Broad coverage for all Builders' Risk exposures is readily available in today's marketplace and is still relatively inexpensive, with the exception of Earth Movement and some Coastal Windstorm coverages. A



knowledgeable insurance broker or consultant can help the Owner work through all contract and coverage issues regarding this important coverage.

## **2. Delayed Opening Coverages**

This is also referred to as “Business Interruption” [BI] coverage and is not covered in the basic Builder’s Risk policy form. This is a separate coverage negotiated with underwriters and subject to a separate premium, limit of liability and deductible. In the event of an Insured Loss, this coverage will reimburse the Insured for lost revenues, for the length of the repair period, due to the delayed opening of the project. Coverage can be extended to include coverage for loss once the property is repaired but before income hits the pre-loss expected levels. This is a particularly important coverage for the Hospitality Industry. Careful calculations should be made prior to purchasing this coverage to determine estimated income for 6 months, 12 months, or longer.

In addition, some BI forms include, or can be endorsed to include, coverage for Extra Expense and Expediting Expense. Extra Expense provides coverage for Expenses that would not have been incurred but for the loss. Expediting Expense Coverage under a Builders’ Risk policy pays for expenses of temporary repairs and costs incurred to speed up the permanent repair or replacement of covered property. An example may be paying overtime wages or air shipping replacement materials to the site.

## **3. Other Soft Costs Coverages**

Because of the variety of coverage forms, traditional business interruption coverage, including extra expense and expediting expense, may not pay for certain economic losses, such as advertising and promotional expenses, commissions or fees for the renegotiation of leases, additional insurance premiums for the necessary property and liability coverage to be in force for the additional time it will take to finish the project, interest on construction loans, taxes, and rental of construction equipment not specifically involved in repairing the damaged property.

Each of these items can be covered under a soft costs endorsement. In addition, other soft costs include additional design and engineering fees, legal and accounting fees [but not to prove the claim], and project administration expenses. These items are typically covered with a sublimit agreed upon by the Insured. In addition, Contractors may also incur substantial uncovered soft costs expenses which can also be added to the policy. For example, if the project is delayed 3 months because of a fire, general conditions will continue. This may not be covered under the Builders’ Risk coverage or the business interruption coverage.

## **B. General and Excess Liability**

For a construction project, the Contractors need to provide Commercial General Liability [CGL] Insurance, a policy issued to protect them against liabilities arising from four major exposure groups: claims for bodily injury and property damage arising out of premises or operations; products, and completed operations; contractual liability; and, independent contractor liability. There are also coverage extensions for Personal Injury Liability, with some limitations. Most policies are referred to as “Occurrence” policies because they provide coverage for losses that “occurred” within their policy period, regardless when the claim was reported. There are some “Claims Made” policies which will be described later in the Professional liability section. Most contractors today have Occurrence forms.

The contract between the Owner and Contractor will specify the limits of liability and basic coverage terms that must be provided. The standard AIA and AGC contract forms provide good templates for the coverages that can be considered “industry standard”. The project lender may also require certain coverages and limits.

The CGL policy provides coverage for the Named Insured, in this case the Contractor, and any other person or entity with whom the Contractor has a contractual obligation to provide coverage, usually the Owner and Lender groups. There are various Endorsements granting Additional Insured status. The Owner must be sure that they receive an Endorsement naming them as an Additional Insured for both Ongoing Operations and Completed Operations. Often, the Owner provides a Certificate of Insurance and while the Certificate may include Additional Insured language, it should not be relied on for coverage. Only a policy Endorsement will act to add the owner as an Insured.

Many Insurers are issuing Additional Insured Endorsements [AIE] which limit coverage for the Owner to the percentage of fault of the Contractor. We are seeing this language in States which allow Type I Indemnity Agreements so there is potential for conflict between the Indemnity and Insurance obligations versus what policy documents are provided by the Insurer. Careful attention should be given to the documents provided to the Owner by the Contractors’ Insurers.

The construction contract should specify that the Insurance and Indemnity obligations also be passed through to the subcontractors. It should also state that any Additional Insured requirements by the Owner are passed through to the subcontractors. The Owner does not want the burden of reviewing subcontractor Certificates of Insurance and Additional Insured Endorsements but can insist that the General Contractor review and hold those documents.

While many Owners chose credit worthy contractors for their projects and rely heavily on the Indemnity Agreement, a prudent Owner will specify the minimum coverages required by the Contractor, for example:

- .1 claims under workers' compensation, disability benefit and other similar employee benefit acts which are applicable to the Work to be performed;
- .2 claims for damages because of bodily injury, occupational sickness or disease, or death of the Contractor's employees;
- .3 claims for damages because of bodily injury, sickness or disease, or death of any person other than the Contractor's employees;
- .4 claims for damages insured by usual personal injury liability coverage;
- .5 claims for damages, other than to the Work itself, because of injury to or destruction of tangible property, including loss of use resulting therefrom;
- .6 claims for damages because of bodily injury, death of a person or property damage arising out of ownership, maintenance or use of a motor vehicle;
- .7 claims for bodily injury or property damage arising out of completed operations; and
- .8 claims involving contractual liability insurance applicable to the Contractor's obligations under Paragraph 3.18.

While many CGL policies have standard exclusions for Expected or Intended Injury, Pollution, Aircraft, Watercraft, War, Product Recall, Professional Liability, and Liquor Liability, there are other exclusions that can be critical. For example, large General Contractors should not have a subsidence exclusion since this exposure can be a major cause of loss after the project is completed. Underwriters are also beginning to exclude losses arising from specific building products such as Exterior Insulating Finish Systems [EIFS] or Kitec Brass Plumbing Fittings. Underwriters are also taking a closer look at the type of cranes used on a project and in some cases putting certain warranties on the Contractor's CGL policy that certain safety standards must be met.

The biggest concern is whether or not the Contractor has a "Residential" exclusion on its CGL policy. There is no industry standard definition for "residential". We have seen definition ranging from "any project with a bed" to the more restrictive definitive of "any for sale product". We recommend that the Owner require the Contractor, in the contract documents, to disclose any residential exclusions, and exclusions related to specific building products, and any large deductibles. These are potential hot spots where an Owner might be left relying on the Indemnity Agreement in the event of a claim.

Owners that are looking at mixed use projects, for example, hotels with condominium, time share units, or condotels, have to be particularly concerned about potential residential exclusions for the General Contractor as well as subcontractors.

Since the exposure to loss extends well beyond the completion of the project, it is becoming standard to require the Contractor to provide Certificates of Insurance and an AIE for several years after the project is completed. Some Owners require that the Contractors maintain coverage through the local Statute of Repose for

Construction Defect Claims, typically 10-years. This creates an administrative burden for both the Contractor and Owner but having the requirement in the contract provides additional security for the Owner, even if the required documents are not provided by the Contractor. If there is a time limitation in the Indemnity Agreement, consideration should be given to having the same time frame apply to the insurance requirements once the project is completed.

### **1. Contractors' Insurance – How Much?**

The most difficult question to answer for a Broker is “How much Insurance Should We Have?” In the context of a construction project, Owner's tend to request fairly low limits of liability, relying on the Indemnity Agreement as the safety net. Since most medium to large General Contractors carry between \$10 Million and \$100 Million in liability limits, the Owner's should evaluate the potential exposures and request appropriate limits.

For example, the exposure from building a \$10 Million hotel in a smaller city is different than building a \$100 Million hotel in a downtown; tower cranes pose different risks than mobile cranes; wood frame is a different risk than commercial grade construction; etc. An analysis of the risks for each specific project should help select appropriate limits. Also, the risk of loss during construction is different than the risk of loss during the Completed Operations period and some Owners require higher limits during construction as a result. For example, a catastrophic crane failure can cause significant losses whereas a small construction defect claim, while serious, does not have the same potential for damages [think jury appeal].

Contractors, and design professionals, often attempt to limit their Indemnity obligations to the amount of Insurance that is required in the contract. Since the Indemnity obligations are usually broader than Insurance coverages, this limitation is not in the Owner's best interest.

### **2. Owner's Coverage**

The AIA Contract requires the following: “**11.2.1** The Owner shall be responsible for purchasing and maintaining the Owner's usual liability insurance.” Larger companies will have liability programs in place that provide CGL coverage. However, many of these programs exclude losses arising out of construction activities and that is why it's critical to require the appropriate coverages from the General Contractor. The Owner needs to have liability coverage in place that will protect it from losses that can't be tendered to the Contractor or that arise solely from the Owner's operations.

### **3. OCIP vs. CCIP Options**

Owner Controlled Insurance Programs and Contractor Controlled Insurance Programs can be useful tools to insure that all contractors on site have insurance coverage with the appropriate insurance terms, conditions and limits of liability. There are many other benefits including guaranteed insurance costs through the term of the project, Completed Operations coverage through the Statute of Repose, a safer project, reduced litigation between the parties, and potential premium savings. These programs, also called “wrap-ups” are becoming a standard delivery method for insurances on larger projects and in some cases may save the owner 1% or more of the construction costs in premium savings.

The major benefit of an OCIP is knowing that all contractors on-site will have the appropriate insurance coverage in the event of a loss. Without a wrap-up, Owners rely on the General Contractor to monitor the insurances provided by subcontractors. Subs tend to purchase the least expensive insurance available to meet their minimum contractual obligations. The Certificates of Insurance they provide do not disclose any policy limitations or exclusions such as subsidence exclusions, EIFS and other material exclusions, residential exclusions, etc. If the subcontractor or its Insurer goes out of business, the Owner or Contractor will have to step in and cover the losses caused by the subcontractor.

Wrap-ups can be used on any size project and there are a variety of wrap-up program structures that can be designed. A knowledgeable insurance broker can prepare a feasibility analysis to show which program may be the best wrap-up for any given project. For example, many projects, particularly projects with a residential component, use a “General Liability Only” wrap-up. This product is designed for smaller projects and provides General Liability coverage for all contractors working on the project. In addition, coverage is extended through the State’s Statute of Repose for construction defect claims.

Larger projects, single projects over \$100 Million, often include Workers’ Compensation coverage in the wrap-up. This product offers all of the benefits of a CGL Only wrap-up and offers the possibility of additional savings to the Owner.

The use of wrap-ups is regulated by each State. Some States restrict the use of wrap-ups based on project size or type of Owner entity, i.e. governmental agencies. There are also some states that do not allow wrap-ups under any circumstances. There is also a trend for States to pass disclosure laws that apply to wrap-ups to ensure that the contractors are made aware of all the program details before they submit a bid for the

work. This includes insurer names, policy limits, deductibles, terms and conditions, etc. These laws, regulations, and rules must be carefully investigated when considering a wrap-up.

An experienced insurance broker or consultant can assist with the evaluation to determine the feasibility of doing a wrap-up. Once the decision is made to move forward, certain processes must be completed. First, determine if the selected Contractor has its own CCIP program in place. If so, evaluate the cost of the program, the limits and terms and conditions, and the quality of the Insurers. Contractor CCIPs can provide all the benefits of a wrap-up and they handle all of the administrative tasks. They will take the risk that the program will be successful and they will work hard to control losses. The reward for the Contractor is keeping the potential savings from a good loss experience. However, an Owner will not have control over the project insurances and in the event of a dispute with the Contractor, the Owner will have to find replacement coverage if the Contractor is terminated from the job.

Owners are often told that they can “save” 2% to 4% of construction costs by implementing a wrap-up. This is a misleading approach and rarely do wrap-ups return the high rates promised. The more appropriate approach is to consider the overall benefits that a wrap-up provides to the project. The ultimate goal of the Owner and the General Contractor should be to bring the most comprehensive coverage package to the project at the best price. There is often a great deal of contentiousness between the Owner and GC over which entity should control the wrap-up because of the perceived profit from the premium savings. While a well run wrap-up should produce over all cost savings, that should not be the primary factor for initiating this type of program. The overall benefits of a wrap-up will produce savings for the Owner because of fewer claims, and a safer project site. Safe project sites contribute to the project being delivered on time.

It may be in the Owner’s best interests to use a Contractor which has its own CCIP in place. These rolling wrap-up programs often have below market pricing because of the project volume a Contractor can put into its program. Contractors will often negotiate a sharing of the savings with the Owner as well. This partnering approach gives the Owner a reduced cost for project insurances, gives the Contractor the potential for savings with good loss control, and minimizes the administrative burden for the Owner. However, many CCIPs share their policy limits with multiple projects and can be cancelled for reasons not in the control of the Owner.

The key to an OCIP or CCIP is good communication between the Owner and Contractor and working towards the common good of the project. Both approaches will be an effective tool for managing insurance costs

and both will bring the other referenced benefits to the project. Well drafted contract documents will address the wrap-up terms and conditions, address deductible responsibilities, and provide a dispute resolution mechanism.

### **C. Professional Liability**

Professional Liability Insurance protects a design professional from damages arising from the negligent acts, errors, or omissions of the design professional or others for whom the design professional is responsible. Unlike a CGL policy, the professional liability policy is not limited to coverage for just BI/PD but will respond to claims for economic damages as well.

The Owners relationship with its lead Architect is very similar to the relationship with the Contractor, although the Architect is working on the project long before a contractor is selected. In the classic scenario, there is a contract between the Owner and Architect and the Architect engages other design professionals needed for the project. The contracts contain Indemnity Agreements and Insurance Requirements and these clauses must be carefully drafted to insure the maximum protection for the project Owner.

Additionally, the General Contractor should be required to provide professional liability coverage if any scope of its work involves design. Unless the work is design-build, contractors have little design responsibility outside of the normal means and methods of their work with the exception of certain trades which are design build such as mechanical, electrical, plumbing, and sprinkler scopes.

An Owner has a number of options for managing this risk.

1. Require no insurance from the design professional. Some Owners think the risk of design error is small on some projects and chose to self-insure.
2. Require the design professional to evidence E + O insurance. This is the most common approach but raises issues about how much insurance to require. An architect's E + O policy provides limits for all of the firm's work, not just your project. Limits are eroded by defense costs so a claim on another project will deplete limits, often without your knowledge. The contract should have a provision that requires disclosure to the project Owner when the architect's limits are impaired by 50% or more of the required limits. Architects may also have restrictions on residential projects.

E + O policies are Claims Made so the Architect should have the contractual obligation to maintain its coverages for at least several years after policy completion. While most E + O claims occur within the first

year post-construction, construction defect claims occur several years after construction and that's when the coverage may be needed the most.

Required policy limits should reflect the size and complexity of the project. The standard AIA contract does not require project specific limits. Consider requiring project specific limits since this will eliminate the worry of eroding limits from other projects. Also, subconsultant insurance requirements should be spelled out in the prime contract. Finally, be wary of architects limiting their liability in the Indemnity Clause. Architects will negotiate these limitations if possible. There are many variations but the most common limitation is to a fixed dollar amount, typically no greater than the architect's fees. If such a limitation is agreed to, consider this limitation only for claims not covered by insurance.

3. A third option is to purchase a Project Specific Professional Liability policy. This policy is like a wrap-up in that it insures all licensed design professionals working on the project. Care must be taken to structure this policy to make sure all design professionals are properly covered. The benefits to the Owner include having consistent policy terms and conditions for all design professionals; limits of liability dedicated to the project; policies can include "tail" coverage for up to 10-years post construction; higher limits of liability can be obtained.

Project policies tend to be the most costly alternative for insuring the professional liability exposures on a project.

4. An alternative that is gaining popularity is the Owners Protective Professional Indemnity [OPPI] policy. This coverage is offered by only a few underwriters and is intended to provide protection for Owner's when the design professional's coverage is insufficient [i.e. impaired limits], or unavailable. The policy is in the Owner's name and acts as excess coverage over and above what is initially provided by the design firm.

The policy is similar to the designer's professional liability policy in that it indemnifies the Owner for losses arising from the design professional's negligent acts, errors, or omissions in performing its professional services. Advantages include providing additional protection for the Owner; it's less costly than a Project Professional policy; tail coverage is included; coverage can include design work that has already been completed.

This product works well for design build projects; hotels and resorts; casinos; and other commercial projects.



## **D. Pollution Liability**

The General Contractor should be required to provide Contractor's Pollution Liability [CPL] coverage. This policy provides coverage for BI/PD and cleanup as a result of a sudden and accidental pollution event arising from the performance of the contractor's work. These policies can be on a blanket basis or a project specific basis and include tail coverage for up to 10-years post construction. However, there are a variety of policy forms available. Pollution exposures exist on every project. Building materials are used that could be considered pollutants, contractors may hit utilities that carry pollutants, and mold may result from the work.

CPL coverage provides a funding mechanism for the defense and indemnity resulting from a covered pollution event. Many contractors purchase blanket coverage to protect their assets but most policies are purchased because of contractual obligations coupled with the fact that CGL policies contain absolute pollution exclusions for the most part. Mold coverage is relatively new and can be added to a CPL policy, usually by Endorsement. Habitational dwellings are considered high risk by Underwriters because of the large amount of time spent in a unit while Hospitality is viewed as a medium risk because of the transient nature of the occupants.

The second exposure for an Owner is liability arising from the site itself. There may be past exposures arising from historical conditions and future exposures from a pollution release or migration of an existing condition. Pollution Legal Liability [PLL] coverage is available for Owners to provide defense and indemnity coverage for various types of claims including sudden and gradual pollution conditions; BI/PD arising from on-site and off-site conditions; clean-up costs; and, tail coverage. If the early soils reports disclose the existence of any pollutants, a PLL policy should be explored.

## **E. Subcontractor Default Insurance [Subguard]**

Subguard is the proprietary name for a Zurich Insurance product also known as subcontractor default insurance. Many larger General Contractors use this product as an alternative to bonding subcontractors. It does not take the place of Payment and Performance Bonds from the General Contractor. This insurance is a first-party coverage which compensates the General Contractor if a subcontractor defaults in its ability to fulfill its contractual obligations. Unlike a bond, this insurance will respond to damages in excess of the subcontract amount, subject to the program policy limits.

This product will cover the cost of correcting defective work; completing the subcontractor's contractual obligations; the costs incurred to investigate disputes; and some indirect costs such as extended overhead and acceleration costs. The General Contractor must develop a thorough subcontractor prequalification program which means that a project using Subguard should have stronger, safer,

more qualified subcontractors on site which will benefit the project performance overall.

Owners presented with a Subguard option from their Contractor should consult with their insurance and legal advisors. The contractor should present a firm price for the coverage, usually a percentage of the contract amount, and provide a copy of the policy for your review.

## **II. CLAIM SCENARIOS**

The Owner should receive notice of all known claims or incidents that may give rise to a claim, regardless of the type of incident. A simple requirement for such notification can be put into the contract. The Owner can then control the claim notices to the appropriate Insurers and control the dialogue between the Insurer and the covered parties.

Construction claims are often complicated because of the multiple parties involved, the various construction contracts, and the various insurance policies that may pertain to the loss. Construction defect litigation is particularly complex and is often subject to special court rules, Special Masters, and other special handling regulations depending on the jurisdiction.

A construction claim often involves many different coverages. Let's look at a recent claim scenario and see what can happen.

### **FACTS:**

A tower crane is lifting a load of material to the roof of the project. The material slides out of the hoist sling and falls to the ground. The falling material injures three workers, damages the project itself, and punctures a fuel tank, causing fuel to escape into a storm drain. A number of spectators standing off-site, but watching the action, are overcome by the fuel fumes. Two of the injured workers sue the Owner and GC and Architect for their injuries. The project is delayed 30 days because of the loss.

### **AFTERMATH**

With any catastrophic loss, the construction teams are trained to assist any injured people, secure the site, and then begin their investigation. The Owner will often know about such an incident soon after it occurs but not every claim is so dramatic. In this case, we have a number of potential claims and policies that will respond.

- A. Injured Workers – Their first recourse is to their employer’s workers’ compensation insurance. This policy will provide coverage for medical treatment and time off work. The Insurer can subrogate against any responsible parties.
- B. Damaged Materials from Crane – This will be covered by the Builder’s Risk policy. The Insurer can subrogate against any responsible parties
- C. Damaged Project - This will be covered by the Builder’s Risk policy. The Insurer can subrogate against any responsible parties.
- D. Damaged Fuel Tank and Loss of Fuel – Insured by Contractor which owns tank, typically under a contractor’s equipment policy. The Insurer can subrogate against any responsible parties.
- E. Clean-up Cost of Fuel in Drain – Typically covered by the Contractors’ CPL policy. The Insurer can subrogate against any responsible parties.
- F. Injury to Spectators – The General Liability policy of the responsible contractor[s] will respond.
- G. Lawsuit by injured workers – Some States allow these “action over” type lawsuits even though workers’ compensation is the exclusive remedy for injured workers in many states. The general liability policy of each contractor defendant will provide defense and indemnity for its Named Insured. In addition, the Owner will seek Additional Insured protection from the General Contractor as well as any involved subcontractor. The Architect would be covered by its Professional Liability policy if there is a claim for professional negligence.
- H. Project Delays will be covered by the Builder’s Risk Insurer if the Owner purchased Soft Cost Coverage.

However, the Additional Insured claim from the Owner will only be as good as the contractual obligations of the contractors to provide such coverage and the Owners’ diligent efforts to secure the appropriate Additional Insured Endorsements from each Insurer. This demonstrates the importance of clear and concise contract language and non-conflicting insurance requirements.

As an added brain teaser, if this project were insured under a wrap-up, the claims listed in A, E, F, and G would be covered by the wrap-up Insurers as would any subrogation claims brought by the Insurers in B, C, D, and H with the caveat that most construction contracts contain mutual waivers of subrogation between the contractors and their Insurers.