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Transferring Risk

Going beyond boilerplate when selecting insurance.

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PERHAPS Benjamin Franklin was not quite complete when he warned Jean-Baptiste Leroy that death and taxes were the only two certainties in life. Experience has shown us that there is a third: Accidents do happen. Anyone involved in the construction industry knows this all too well.

Modern construction projects are complex, expensive and dangerous. Developers, architects and contractors are constantly implementing larger and more innovative designs. As projects increase in complexity, so too do the risks of injury to individuals or property, a reality made unfortunately clear in recent months in New York City. It is therefore critical that contractors at each level of a project, from the design professionals and general contractor down to the smallest trades, have sufficient insurance in place to protect themselves in the event that an accident takes place while they are on the job.

Often, the type of insurance required of each party is dictated by contract. For example, the AIA's General Conditions of the Contract for Construction (Document A201-2007) require the contractor to maintain insurance for Workers' Compensation claims, bodily injury, injury to or destruction of tangible property, claims arising from the use of motor vehicles and completed operations (and general contractors pass these same requirements down to their subcontractors), and the owner is obligated to obtain a builders' risk policy. But counsel must avoid the temptation to accept these boilerplate provisions. The nature of the project and work should guide the selection of insurance. This article introduces the practitioner to the range of available insurance products and the risks that each is designed to protect against and discusses some common troublesome areas that are often encountered in practice.

Insurance companies offer a wide range of products to the construction industry. Available policies include general liability, umbrella/excess liability coverage, completed operations, Workers' Compensation, builders' risk, professional liability and subguard insurance. Each of these policies is discussed briefly below.

• Commercial General Liability (CGL). This is generally considered the broadest source of protection available to the contractor. Here, the provider agrees to pay any amount that the contractor is legally obligated to pay as damages because of "bodily injury" or "property damage" that occurs during the contractor's "ongoing operations" up to the policy limit. An important feature of CGL policies obligates the insurer to assume the contractor's defense in any action seeking damages under the policy. The duty to defend is "exceedingly broad"[1] and extends beyond cases where the insured is

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ultimately found liable. "The duty to defend arises whenever the allegations in a complaint against the insured fall within the scope of the risks undertaken by the insurer, regardless of how false or groundless those allegations might be."[2] The broad duty has led the Court of Appeals to characterize CGL insurance as both "liability insurance" and "litigation insurance."[3]

However, policy exclusions often substantially limit the scope of coverage. For example, under one common exclusion, the insured is not protected against claims by its own employees.[4] The contractor and counsel must pay careful attention to the areas that the insurer has carved out of the policy, and then select from among the other available products to fill in those gaps.

• Completed Operations. Completed operations coverage picks up where the CGL policy leaves off. Most CGL policies cover only the insured's "ongoing operations" and cease coverage once the contractor has completed work. The completed operations policy provides added protection for bodily injury or property damage that occurs within a specified period after the contractor has left the jobsite.

• Umbrella/Excess Coverage. Such coverage is available to contractors to provide additional protection above and beyond the limits of the CGL policy.[5] Contractors are prone to purchasing this coverage based upon cost alone. This practice, however, can have dire consequences, because umbrella coverage exists in a life-and-death environment for the contractor—where the CGL policy leaves the contractor inadequately protected. Contractors should give critical attention to the coverage being provided and the anticipated risks when selecting an excess policy.

• Workers' Compensation. All New York employers are generally required to maintain Workers' Compensation insurance for their employees.[6] Failure to provide required insurance will expose the employer to criminal and civil penalties, including a stop work order, which could constitute a default under the construction contract.[7] Indeed, owners and contractors are required to present proof of insurance before being issued a permit or license from a municipality or state agency.[8] Workers' Compensation insurance requires the insurer to pay any benefits required of the insurer by the statute, as well as reasonable expenses incurred, bond premiums, litigation costs, attorney's fees and interest.

On larger projects, there are typically two levels of Workers' Compensation insurance at play: the general contractor (GC) procures a single policy, known as a wrap-up, covering all workers on the jobsite,[9] and each contractor obtains a separate policy covering employees that are not directly engaged at the project site, such as home office workers.

• Builders' Risk. Usually required by lenders as a precondition to extending construction financing, builders' risk insurance covers the risk of loss to the building while under construction. This policy covers the interests of the owner, contractor, subcontractors, engineer and architect up until the day that final payment is made to the contractor.[10] Many policies also extend coverage to materials before they have been incorporated into the building, including materials stored offsite or in transit to the project.

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Typical builders' risk policies are written on an "all-risk" basis, which protects against fortuitous damage or destruction to covered property, subject of course to the policy's exclusions.[11] Most builders' risk policies are required to cover against the perils of fire, theft, vandalism, malicious mischief, collapse, earthquake, flood, windstorm, falsework, testing and startup, temporary buildings and debris removal, as well as reasonable expenses for design professionals' services incurred as a result of these perils.[12]

Many contracts require the owner to obtain the builders' risk policy.[13] However, counsel representing experienced contractors should consider procuring their own policy. Sophisticated contractors are often more knowledgeable about the risks of construction and more capable of identifying necessary coverages than the owner. Moreover, some cost-conscious owners may purchase the cheapest coverage, which will have exclusions or gaps that dwarf the actual risks that should be covered. In addition, owners sometimes contractually eliminate their obligation to provide coverage until materials arrive on the jobsite; such provisions must be scrutinized and either removed or coverage for such materials otherwise obtained.

• Professional Liability. Professional liability coverage protects architects and engineers, design-build entities and construction managers from potential malpractice claims. Professional liability covers sums that the insured is legally required to pay as a result of any negligent act, omission or error. Unlike the other coverages discussed, professional liability coverage typically extends beyond property damage or bodily injury and reaches pure financial loss as well.

• Controlled Insurance Programs. It understates the case to note that insurance costs can be substantial, a reality exacerbated by the fact that traditionally each involved party obtained its own insurance. This results in several levels of sometimes overlapping coverages and indemnifications. Since the costs of each contractor's insurance must be factored into its bid or negotiated price, total insurance costs can increase dramatically where there are multiple subcontractors.

Multiple policies and contractual indemnifications create fertile ground for disputes about which contractor's policy should defend and indemnify a loss. For example, one area that has been litigated frequently is the extent of the protection provided by additional insured endorsements. Owners and GCs often require this endorsement, which provides the owner or GC with coverage as an insured under the subcontractor's liability policy for claims arising out of the sub's operations. But as recent cases demonstrate, when a claim "arises out of" such operations can be disputed and may not result in coverage.[14]

At least on larger projects, one response has been a controlled insurance program, frequently called a "wrap-up." Wrap-ups, which include Owner Controlled Insurance Programs (OCIP) and Contractor Controlled Insurance Programs (CCIP), involve a single insurance program covering most of a project's players. By eliminating duplication and concentrating purchasing power with the owner or GC, wrap-ups allow for costs of coverage and claims processing to be reduced, and (theoretically) claims disputes minimized since all project

players are covered by one policy. Another benefit often seen with wrap-ups is a more centralized project safety plan, potentially reducing costly accidents.[15]

However, wrap-up programs must be carefully examined because they often do not provide coverage for all project-related risks. Typically, wrap-ups provide general liability, Workers' Compensation, employer's liability, builder's risk and umbrella coverages, as well as completed operations coverage for three to five years.[16] However, wrap-ups usually do not provide auto or contractors' equipment coverage, and often exclude offsite work, such as steel fabrication, and frequently exclude high-risk parties, such as demolition or abatement contractors. Time periods covered must also be reviewed, because many wrap-ups exclude work performed after a contractor's work is substantially completed, thus providing no coverage if the contractor returns for warranty work.[17]

Therefore, if an owner is planning to employ an OCIP, the prudent contractor will need to carefully determine what is covered and what is not, and independent coverage purchased to fill in the gaps.

• Subguard Insurance. The policies described above provide coverage for bodily injury and property damage. But projects are often hampered by claims of defective construction, where the GC, for instance, alleges that the concrete contractor supplied the wrong type of concrete or failed to let the material cure properly, or some other claim that a contractor failed to follow specifications.[18] Eager to secure fast payment from a party with deep pockets, owners and contractors have turned to the subcontractor's liability policy. But the overwhelming majority of New York courts have sided with the carrier and denied coverage. Despite the breadth of coverage, it is now "well-settled" in New York that general liability policies provide no coverage for a contractor's defective work.[19]

Defective work claims have historically been the province of the surety's performance bond; however, in recent years, insurance companies have entered the game and designed products that shift the risk of performance defaults. The first such company was Zurich U.S. Construction, which in 1995 launched its subguard policy. This policy directly indemnifies the insured for costs that result from a default in performance by an unbonded subcontractor. Typically covered in subguard policies are completion costs incurred as a result of defaulting contractors, corrective or remediation costs, legal costs, investigative costs and overhead, job acceleration costs and liquidated damages.[20]

Subguard insurance advocates highlight the greater control afforded to the insured after a default when compared to a performance bond. Unlike a bond, the insured is free to take immediate action that it deems to be in its own best interests and the interests of the project. The contractor is not required to wait while the surety undertakes an investigation of the default's cause, which often results in the surety contesting the default. Rather, the contractor can act immediately to keep the project moving toward completion and recover a lump sum payment from the carrier.

The surety industry counters that sureties are more competent than owners to assess contractor performance and capabilities prior to issuing a bond, and better able to judge the quality of subcontractors than general contractors. Sureties point out that after a default they stand by willing to complete the project by putting actual shovels in the ground, while the subguard carrier only holds a checkbook. Finally, the surety industry points to the substantial deductibles required by subguard policies as compared to performance bond premiums.

When considering which type of protection against performance defaults to choose, counsel must fully consider the size and nature of the project, the sophistication of the parties and the project's time requirements.

• Green Development: What Lies Ahead. One rapidly developing area that has produced significant uncertainty in the industry is the increasing fixation with developing sustainable buildings. Insurers have not been quick to address the needs of green projects.[21] Commentators suggest that insurers are scared to death of the risks associated with green building,[22] partly because they do not fully comprehend the risks. This is particularly troubling because existing products do not appear up to the task of handling green construction. For example, standard exclusions in existing professional liability policies deny coverage for warranty claims. Therefore, an architect who designs a building to meet a particular certification level of the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED) program, for example, will not be covered if the building achieves only a lesser level than represented. Similarly, a GC failing to deliver a building with a contractually promised LEED rating could face substantial uninsured exposure, because traditional liability policies do not cover losses caused by breach of contract.

Managing risks associated with green building has and will become more important for all project players. Until carriers can tailor policies to meet green building challenges, a premium must be placed on proper contract drafting. Counsel must draft contracts that accurately address project goals, the party responsible for each phase of the construction that will earn the building LEED rating points, and the availability of products to be incorporated into the project.

1. *Continental Cas. Co. v. Rapid-American Corp.*, 80 NY2d 640, 648 (1993).
2. *Seaboard Sur. Co. v. Gillette Co.*, 64 NY2d 304, 310 (1984).
3. *Continental Cas. Co.*, 80 NY2d at 647.
4. See *Guachichulca v. Laszlo N. Tauber & Associates LLC*, 37 AD3d 760 (2d Dept. 2007) (court denied coverage to the owner notwithstanding it being named an additional insured on the contractor's policy, based on the policy's employee exclusion).
5. See *Bovis Lend Lease LMB Inc. v. Great American Ins. Co.*, 53 AD3d 140, 148 (1st Dept. 2008).
6. See NY WCL §10 (McKinney's 2008).
7. See NY WCL §131, 141-a.
8. Id. §57.
9. NYSICB Employers' Manual, at 35.
10. Palmer, Maloney, Heffron III, "Construction Insurance, Bonding & Risk Management," Ch. 7, at 113.
11. Id. at 119.
12. See AIA Doc. A201—2007 §11.3.1.1.
13. See, e.g. id. §11.3.1.
14. See, e.g. *Worth Constr. Co. Inc. v. Admiral Ins. Co.*, 10 NY3d 411 (2008).
15. Sirany and O'Conner, "Controlled Construction Insurance Programs: Putting a Ribbon on Wrap Ups," Construction Lawyer, 30 (Winter 2002).
16. Id.
17. Id.
18. See *Bonded Concrete Inc. v. Transcontinental Ins. Co.*, 12 AD3d 761, 762 (3d Dept. 2004).
19. *George A. Fuller Co. v. United States Fid. & Guar. Co.*, 200 AD2d 255, 260 (1st Dept. 1994).
20. Gray, "Point/Counterpoint: Default Insurance—An Alternative to Traditional Surety Bonds," 22 Construction Lawyer, 17 (Winter 2002).
21. Some carriers, such as Aon, Fireman's Fund and Argo, are writing policies to cover repair and replacement of green buildings after a casualty.
22. See Tulacz, Engineering News-Record, at 10-11 (July, 2008); see also Del Percio, "Green Construction Law: As Legislation Proliferates and Insurance Issues Emerge, Is Green Building's Future Being Compromised?" Green Building Law (Feb. 19, 2008).