January 26, 2011

Insurance for Major Design and Construction Projects
Presented by Josh Leavitt, Tim Walsh, Vincent Zegers, Darren Black and Dan Rosenberg
What We Are Going To Cover

• What is the traditional insurance approach to projects?
  – What are the advantages of this traditional approach?
  – What are the disadvantages of the traditional approach?

• Insurance Alternatives & Solutions
  – Wrap-Ups (OCIP’s & CCIP’s)
    • Workers’ Comp + GL + Umbrella
  – Builders Risk
  – Professional Liability

• Insurance Claim Strategies
A Hypothetical to Build Upon

• Hospital building a new medical campus
• Located in a medium sized northern town (think cold winters)
• Plan is for multiple buildings, in three phases
  – State of the art, architecturally significant and unique main building
  – Surrounding buildings to architecturally complement main building
• Connecting raised and/or underground walkway system
A Hypothetical to Build Upon (cont)

• Owner has been working with a small, renowned architectural firm for two years on conceptual design and planning

• Owner considering less expensive architect to design surrounding buildings

• Owner sensitive to need to involve local contracting community
A Hypothetical to Build Upon (cont)

• Owner is considering various contract delivery methods
  – Traditional design-bid-build with CM
  – Design-Build
  – Integrated Project Delivery (IPD)

• Owner has major liability and property insurance programs in place, but little experience with new construction
The Hypothetical Goes Wrong

• Catastrophic collapse of walkway section during phase two
• Catastrophic injuries and damage to walkway, main building (completed) and surrounding building (under construction)
• Investigation to date
  – Flaws in the design of the walkway connections
  – Possible contributory construction flaws
  – All designers and contractors received critical (flawed) shop drawings
• Repairs
  – Will require structural changes to all walkway connections
  – Will delay complimentary buildings’ completion significantly
    • Lost revenue
  – Huge cost
Traditional v. Non-traditional Insurance
The Traditional Insurance Approach

• Each party separately insures
• Typically, risk is pushed down as much as possible
  – Owner to GC / A/E
  – GC to Sub
• Accomplished in three basic ways
  – Contractual indemnification
  – Contractually mandated minimum insurance
  – Contractually mandated additional insured provisions
## Traditional Risks & their Potential Insurance Solutions

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<th>Possible Insurance Solution</th>
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<td>Builder’s Risk/Property/Cargo/GL</td>
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<td>GL/Excess Liability/Builders Risk</td>
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Advantages of the Traditional Approach

• Familiar
• Easy to administer
• Possibly offers significant limits and protection
• Each party insures their own risk
Disadvantages of the Traditional Approach

• Lack of control / knowledge over other parties policies
  – What does the downstream / upstream policy include / exclude?
  – Additional insured problems

• Coverage Gaps

• Additional insured endorsements are much more complicated and difficult to obtain
  – What owners want
  – What owners can get

• Possibility of the requirement of horizontal exhaustion
  – The insured does not get to pick
Disadvantages of the Traditional Approach
(cont)

• Fosters litigation
• A claim on one project can affect the availability of your operational insurance and the premium paid on that insurance
  – Owners
  – Contractors
  – Subs
OCIP/CCIP Discussion

• “Wrap-Up” Insurance Concept
• Sponsor Responsibilities
• CIP Regulatory Issues
• Contractor Controlled Insurance Programs
• Owner’s Perspective – Traditional/OCIP/CCIP
• CG/CM Perspective – Traditional/OCIP/CCIP
• Role of the Insurance Broker
Wrap-Up Concept

• Used Since 1941 (U.S. Defense Projects)
• Project & Site-Specific Coverage
• Can be Sponsored (Purchased) By:
  – Owner Controlled Insurance Program (OCIP)
  – Contractor-Controlled Insurance Program (CCIP)
• “Wrap-Up” is generic term that can apply to OCIP or CCIP
• OCIP Coverage is in lieu of GC & Subcontractors Providing Coverage to Owner
Insurance Coverages

• **Wrap-Up Coverages**
  • Workers’ Compensation/Employer’s Liability
  • Commercial General Liability*
  • Excess Liability*

• **Other Project-Specific Coverage Available**
  • Builder’s Risk
  • Professional Liability
  • Contractor’s Pollution Liability
  • Marine Cargo
  • Railroad Protective Liability

*Residential Wrap-Ups Typically insure only these coverages*
Wrap-Up Concept

Traditional Insurance

Wrap-Up Insurance

K&L GATES  Aon
Wrap-Up Concept

Three Types (OCIP or CCIP):

- **Single Project**
  - Typically > $100M Commercial Projects
  - Residential Projects Vary by State (Low as $10M)

- **“Rolling”**
  - Multiple Projects Insured in Single Program
  - Typically 3 Years in Duration
  - Typically > $250M in CV

- **“Maintenance” or “Gate”**
  - Blanket Facilities Contractors (Plants)
  - Typically > $25M WC Payroll Annually
Wrap-Up Program Advantages vs. Traditional Insurance

- Isolates Construction Risk away from Corporate Insurance Program
- Known & Dedicated Coverage, Insurers & Limits
- Completed Operations Coverage
- May Prevent “Horizontal Exhaustion”
- Greater Control of Claims Process
- Reduced Litigation Amongst Trades
- Increased Scrutiny and Coordination of Safety
- Enhanced Bid Environment for Subcontractors
- Potential for Cost Savings (.5% - 1.0% of CV)
Sponsor Responsibilities

• Provide Broker with Underwriting Information
• Participate in Meetings - Underwriting, Kick-Off
• Review & Approve OCIP Documents
• Decide on Wrap-Up Coverages and Insurers
• Execute Insurance Documents & Post Collateral
• Negotiate Insurance Credits (Procurement)
• Quarterly Claim Reviews - Settlement Decisions
• Review Monthly Project Reports
• Enforce OCIP Contractual Requirements
• Responsibilities Continue 2-5 Years After Project
Wrap-Up Regulatory Issues

• WC Prior Approval (12 States)
• Project Size Restrictions
• Project Duration Restrictions
• “Rolling” Project Exclusions
• Requirements – Disclosures, Penalties
• Prohibited States – ND, WA, WY
Contractor-Controlled Insurance Programs (CCIP)

- Many GC/CM’s Now Have “Rolling” CCIP Programs
- CM/GC Motivations:
  - Better Protection From Subcontractor Exposure
  - Additional Profit
  - Better Control Over Claims
  - Defensive Tool Against Participating in OCIP
  - Sales Tool for Prospective Owner’s
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Role of the Insurance Broker

- Feasibility Studies
- Assist with Regulatory Approvals
- Contract Review
- Program Design and Implementation
- Insurance Marketing
- Program Documents
- Program Administration
- Training
- Safety
- Claims
Wrap-up Key Takeaways

• Flaws in Traditional Insurance Approach Have Led to Significant Utilization of Wrap-Ups
• A Key Benefit of OCIP is Isolating Construction Risk Away from Corporate Program
• Coverage Must be Tailored for the Project and Coordinated with Other Project Policies
• Utilize a Qualified Agent/Broker
Builders Risk
Builders Risk Approaches

• Traditional
  – Project specific policy
  – Owner obtained and controlled

• Non-traditional
  – Master builders risk
    • Owner or contractor
  – Contractor obtained and controlled
    • We have the risk of loss, we should control the policy
Builders Risk Critical Considerations

• What does the construction contract say?
  – Read the contract insurance requirements before setting the BR terms
  – We can’t help you as much once the contract is signed

• Which parties are covered under a BR policy?

• How is the “waiver of subrogation” defined?

• Who are
  – “Named Insureds”
  – “Additional Insureds”
  – “Additional Named Insureds?”
Builders Risk Critical Considerations (cont)

• What are “Soft Costs”
  – where should they be covered (as part of the “hard costs” or part of the Delay Cover)?

• Delay Damages
  – Does a sublimit for a Cat cover (e.g. a $50 M for earthquake) also include the Delay Cover if added to the Hard Costs?
  – Named Insured under a Delay Cover
  – Offset LD’s against DSU proceeds (potential “double dipping”)

• Expediting Expenses versus Contractor’s Extra Expenses
 Builders Risk Critical Considerations (cont)

• Cost of making good exclusion
  – Differences outside the U.S. (DE/LEG)

• Cancellation provisions
  – Don’t agree to them

• Contributing Insurance/Other Insurance
  – Normally all parties want BR primary
  – This must be in the policy
Professional Liability Insurance
Professional Liability/Indemnity: An Essential Component of the Risk Matrix on Large Projects

• In the absence of a sudden, accidental occurrence giving rise to bodily injury or property damage, it is only the professional indemnity (“PI”) policy or policies that will respond.

• PI coverage responds to damages, regardless of type
  – BI and PD, as well as purely economic losses such as increased costs of construction, lost profits, loss of use, decreased output, etc.
  – Must be attributable to wrongful acts (negligence) in the performance of “Professional Services”
    - architect, engineer and possibly the construction manager
Common Examples of Professional Negligence

• erroneous or ambiguous design
  – whether attributable to architectural, civil, structural, MEP, geotechnical, accoustical, process or other engineering disciplines;

• mistaken specification of equipment (piping, pumps, etc.);

• failure to properly review and/or clarify shop drawings;

• inadequate testing and data to establish and respond appropriately to relevant conditions
  – soil composition, wind and snow loads, humidity levels, etc.;

• failure to mitigate against noise pollution within or near a project;

• misinterpretation of codes or ordinances;

• failure to identify and avoid interferences with easements;

• failure to properly coordinate software and ownership of document issues relative to Building Information Modeling; and

• the failure to promptly identify (and mitigate against increased costs attributable to) non-conforming work during the construction phase.
Traditional Approach: Reliance Upon Designers’ “Practice Policies”

- Subject to erosion or exhaustion on unrelated claims arising from services rendered by the design firm within the last ten or more years.
- Inability to name owner or developer as an Insured
- Such policies are taken out to cover the litany of “typical” projects on which the design firm provides services.
  - Limits and terms/conditions (scope) are often inadequate for a large or complicated project
- Very limited customization available to satisfy the needs of the unusual project, whether due to size or design complexity
Non-traditional PI Structures: Project-Specific Professional Indemnity ("PSPI")

• Benefits:
  – Covers entire design team under a single policy.
  – Provides dedicated limits (and a single retention) for the project through substantial completion, plus an extended reporting period, typically of three to five years.
  – Can dramatically expedite the dispute resolution process by eliminating the “finger pointing” or allocation of fault arguments between different members of the design team.
  – Like any project-specific policy, the scope of coverage can be customized or manuscripted to meet the unique needs of the project.

• Disadvantages:
  – Cost. Very few PI markets have offered PSPI for the past decade, and premiums can exceed 20% of the limits purchased.
Non-traditional PI Structures: Owners Protective Professional Indemnity ("OPPI")

• Owner is Named Insured

• First-Party Coverage for Owner (will provide a defense and indemnity for third-party claims alleging Owner’s direct involvement in design or construction management)

• Sits excess and DIC of lead designer’s PI policy, but will drop down as primary coverage (subject to an SIR that doesn’t apply in an excess scenario) if designer’s policy is unavailable due to cancellation or exhaustion of limits on an unrelated claim
Non-traditional PI Structures: Owners Protective Professional Indemnity (“OPPI”) (cont)

• Can be manuscripted to provide coverage excess of a Limitation of Liability clause in the prime design contract or other project-specific considerations

• Coverage can be extended to owner’s real estate development activities

• Significant cost savings and more market competition as compared to PSPI
  – the more capacity/limit that is available from the lead designer, the lower the premium for OPPI coverage
Claim Considerations
Traditional v. Non-traditional: A Litigator’s Perspective

• Many of the “non-traditional” products are designed to minimize the time spent with (and on) lawyers

• Potentially
  – Less finger pointing
  – Fewer coverage disputes
    • More possibilities for customization

• Need a sophisticated construction broker

• Regardless, triggering coverage is crucial!
The Basics

• Obtain copies of the policies that cover you or are supposed to cover you

• Make a timely claim
  – As soon as reasonably practicable
  – Notice of a claim does not necessarily mean getting sued

• Put all the carriers on notice
  – Do not decide what type of claim it is too early
  – Defect might be GL or Builders Risk or Professional

• Duty to defend v. duty to indemnify
  – A little bit of duty goes a long way

• Don’t accept the first no
  – Some would say to expect it
Reservation of Rights & Conflict of Interests

- In IL and many other states where an insurer’s and insured’s interests do not fully align
  - independent counsel is mandated

- Law:
Reservation of Rights & Conflict of Interests (cont)

• Examples of conflicts:
  – Multiple count complaint, not all counts covered (fraud / intentional acts)
  – Multiple types of damages, not all covered
  – A potential dispute regarding whether the conduct in question fell within the covered time period
  – Plaintiff potentially seeking damages in excess of limits, but demand within limits
  – Vicarious liability v. direct liability
Reservation of Rights & Conflict of Interests (cont)

• What does “independent counsel” mean?
  – You control the defense and strategy of the case; the insurer pays for it
  – In some states, the case law suggests the insurer has no right even to have input into the case (practically speaking this may not be a good idea)
Reservation of Rights & Conflict of Interests (cont)

• Rates that Are Reimbursable Varies
  – CA = rate the insurer would ordinarily and customarily pay to panel counsel
  – IL = “reasonable rate”
    • Federal decisions clear, reasonable = what the market will bear
Reservation of Rights & Conflict of Interests (cont)

• Are there consequences if an insurer fails to identify conflict?
  – Yes, could be estopped from raising coverage defenses later on
General Construction Defect Considerations

• Ramifications of when loss occurred or was discovered

• Property policies / builders risk might apply
  – Normally exclude workmanship / design issues
  – But, ensuing loss clause might create coverage
    • i.e. defect results in other damage to the building
    • Today, possible to obtain coverage for “cost of making good”
General Construction Defect Considerations (cont)

• GL is tricky
  – Exclusion for work in progress
  – Completed operations
    • Insurers drafted the to offer broad coverage and they market it accordingly
    • Subcontractor exception to “your work” exclusion
    • Carriers have taken a narrower view in court and that narrower view has on occasion carried the day
    • “Accidental” v. “intentional” property damage
The Occurrence Issue

- Must have an occurrence in order for a GL policy to offer coverage
  - Occurrence generally = “an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured”
  - On its face would seem to include any property damage
The Occurrence Issue (cont)

• Significant Variance in Court Interpretation
  – IL, HI, OR, PA and an increasingly limited number of other states
    • Allegations of damage only to the building itself are not property damage
    • E.g., West Bend Mutual Ins. Co. v. The People of the State of Illinois, 929 N.E.2d 606 (Ill. App. Ct. (1st Dist.) 2010)
  – FL, IN, SC, TN, TX, and an increasing majority of states
    • Defect in the work itself is an occurrence
    • E.g., Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007)
The Occurrence Issue (cont)

• Practical Solutions to the Occurrence Issue
  – Start selecting other forum’s law to govern your policy
    • May not be enforceable in all states
    • Careful that the selected state is favorable on other issues
  – Make an express change by endorsement (but you should not have to pay for it)
  – Purchase other insurance products
    • Warranty insurance
The Occurrence Issue (cont)

• Systematic Solutions to the Occurrence Issue
  – Resolve the issue before the state Supreme Court
    • Favorable trend
  – Statute
    • CO has done it
The Occurrence Issue (cont)

• Colo. Rev. Stat. § 13-20-808
  – “In interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured.”

• Worth a try?
Insurance Coverage for Delay Claims?

- Covered in part under builders risk policies (if purchased)
- May even be possible under GL policies
  - Often includes language providing coverage “because of” property damage
- Often covered under professional liability
  - Consider requiring for GC / CM?
Resolving the Claim

• Duty of cooperation and reporting
• Mediation and settlement strategies
• In the end
  – Your goal should be to resolve the claim with as little of your money as possible
Questions?
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