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Insurance Coverage for Construction Projects

By: Charles W. Miller III, Esq.

In today's litigious society, every construction project poses a risk of claims and litigation arising out of a multitude of sources, including project delays, injured workers, increased costs, and defective construction. The prudent businessman will make sure that he has effectively managed his risk to the maximum extent possible, including the use of insurance. This article will discuss some of the most common insurance policies available for construction projects and the insurance coverage provided by those policies. Although all of the types of policies discussed below are not necessary for all entities involved with a construction project, these are the types of coverages that should be considered and held up against the policyholder's risk exposures to decide if the coverages are necessary and economically feasible.

Builders Risk Insurance

Insurance coverage is needed during construction to cover the value of the building itself, should the building being constructed be damaged. Buildings under construction present several special problems from a property insurance standpoint. One problem is the changing values as the work progresses. The value of the property changes virtually on a day-to-day basis. Another insurance complication is the variety of interested parties involved – such as owners, contractors, and subcontractors.

In addition, buildings under construction also face some special hazards. Building materials are especially susceptible to loss by theft, since securing construction sites can be difficult. Moreover, because fire protection devices (sprinkler systems, etc.) may not be fully installed or operational and fire walls may not be in place, buildings under construction can be especially susceptible to fire damage. Collapse and windstorm damage are also more likely during construction.

Because of these issues, insuring a building under construction is not a simple task. One approach to insuring buildings under construction is the Builders Risk Coverage form. In general terms, the builders risk policy covers the building or structure being built, building materials and supplies intended to become a permanent part of the building, and temporary structures such as scaffolding and forms.

Builder Risk coverage is intended to cover buildings during the course of construction only. Once they are completed, another policy such as the BPP or a homeowners policy is needed.

Commercial General Liability (CGL) Insurance, Excess/Umbrella Liability Insurance

In addition to insuring the building, any party involved with a construction project must be sure to have third-party liability coverage in place. This coverage is generally supplied by coverage under a Commercial General Liability insurance policy (CGL). Coverage under CGL policies is generally limited to claims against the insured for "bodily injury" or "property damage" resulting from an "occurrence." An "occurrence" is generally described as an

721 Route 202-206
P.O. Box 1018
Somerville, NJ 08876
(908) 722-0700 *tel*
(908) 722-0755 *fax*

www.nmmlaw.com
info@nmmlaw.com e-mail

875 Third Avenue
18th Floor
New York, NY 10022
(212) 808-0700 *tel*
(212) 808-0844 *fax*

"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."

In the event of catastrophic liability claims, commercial umbrella insurance provides a broader level of coverage beyond the scope of the coverage provided by commercial property and liability insurance policies. Umbrella coverage provides a layer of protection above that afforded by underlying policies. When losses exceed the coverage limits of standard Business Auto, Business Property or Commercial General Liability policies, commercial umbrella policies take effect to cover the balance (subject to policy limits and other conditions).

Over the past 10 years, there have been countless lawsuits filed by property owners against contractors, subcontractors, and others who have worked on construction projects, alleging damages arising out of construction defects. These contractors have often tendered those claims to their insurers under their CGL policies in an attempt to obtain insurance coverage for their construction defect liabilities. These insurance claims have led to a great deal of coverage litigation debating the question of whether construction defect claims, particularly those based on faulty workmanship, fall within a CGL policy. The emerging consensus appears to be that construction defect claims are generally not covered under CGL policies.

This is consistent with the intent of most CGL policies, which were not designed to provide coverage for most types of construction defect claims.

Workers Compensation

Any party involved with a building under construction is generally required to carry workers' compensation insurance. Workers' compensation insurance covers injuries and occupational diseases picked up at work. Fault doesn't matter; employers are liable even if the employee may have contributed to the injury or illness. It will cover their medical bills, a portion of lost wages, vocational rehabilitation, and death benefits. The coverage amount is established by state law and benefits don't vary from company to company within the same state.

Not every employer needs workers' compensation insurance. In some states, small companies with fewer than three to five employees are not required to carry the coverage. Many states also give the employer the option to self-insure, that is, to cover the costs flowing from on-the-job injuries themselves.

Pollution

Many contractors assume that unless they are engaging in environmental remediation work, they have no pollution liability exposures. However, many courts have ruled otherwise, finding contractors liable for a wide range of pollution liabilities. Virtually every standard CGL policy contains a pollution liability exclusion, which is almost an absolute pollution exclusion. Therefore, it is imperative that a contractor understand the scope of pollution liability coverage under its CGL policy, the availability of limited pollution liability endorsements, and the existence of broad form pollution liability policies if needed.

Professional Liability

Project owners are faced with an array of hazards related to the professional services they seek from design and construction professionals (DCPs). DCPs, such as architects, engineers, agency construction managers, project managers and owners' representatives, are, of course, an integral part of the construction industry, but they may be involved in losses of many kinds, from cost overruns, delayed completion, bodily injury and sick-building syndrome to environmental pollution.

While most design firms carry Professional Liability Insurance (PLI) from a project owner's viewpoint, traditional PLI policies may have significant limitations. These limitations include:

1. Low Policy Limits — Most DCPs carry professional liability limits of $1 million or less;

2. Shared Limits — Most professional liability policy limits cover all projects undertaken by the firm and are subject to erosion by other claims and defense costs.

3. Claims-Made Coverage — Professional liability policies must be renewed annually to maintain coverage.

4. Limited Coverage Terms — Underwriters may restrict coverage for certain exposures, such as design/build, construction and project management, mold, and terrorism.

Knowledgeable project owners try to reduce their project risk through several means, including careful DCP selection, contract language, and the financial strength of the DCP's professional liability insurer. Unexpected events can quickly derail an otherwise successful project and the financial damages may exceed a project's contingency allowance or available insurance recovery. A project manager may be left with additional, unplanned financial exposure. There are insurance products available to provide financial backup for project owners for professional liability risks, such as Project-Specific Professional Liability policies and Owner's Protective Professional Indemnity policies.

Controlled Insurance Plan (CIP) or "Wrap-Up"

In today's economic and business climate, large construction projects are becoming more difficult to finance because of increasing costs, lack of control, and rising litigation. In recent years, "wrap-up" insurance programs have been used to help decrease the cost of construction while making the project safer.

With a wrap-up program, the owner furnishes a single insurance program for all parties involved in the project for the duration of the project term. This insurance relates to the exposures of the project and protects the project owner, contractor, and all tiers of subcontractors. Most wrap-ups include workers compensation, general and excess liability, and builders risk coverages (auto liability and contractors equipment are not included). Wrap-ups can include project architects/engineers errors and omissions coverage and other optional coverages.

Wrap-ups on large construction projects can be either Owner Controlled (OCIP) or Contractor Controlled (CCIP). OCIPs comprise about 90% of the wrap-up programs currently being performed in the U.S. Either wrap-up entitles the owner to reduce risks and provide a comprehensive insurance program for all participants in the project.

The strongest factor in favor of a wrap-up is the potential for significant savings in the overall costs of the project. The use of wrap-ups can provide substantial savings through dividends or return premiums payable to the owner. These are granted based on favorable project loss experience and consolidated premium volume generated under the wrap-up. In addition to cost savings, the owner also experiences other benefits from a wrap-up program. The owner has the benefit of a single, coordinated loss control and claims handling program, leading to a safer job site, which can result in a project completed on time and under budget.

OCIPs do have several disadvantages for the owner. These include the additional administrative, safety, and accounting burdens placed on the owner by the program, as well as the potential financial risk for the owner for premium cost increases and/or coverage reductions if the insurance market hardens.

Other Project Coverages

Depending on the type of construction project and the responsibilities of the various parties involved, parties may face additional potential liability exposures. Consideration should be given to the purchase of insurance to cover such additional exposures.

1. Equipment Breakdown (Boiler and Machinery)

One such potential exposure is that some of the equipment being installed as part of the construction project may become damaged in the course of construction. Equipment breakdown insurance, traditionally called boiler and machinery insurance, covers loss resulting from the accidental breakdown of almost any type of equipment that operates under pressure or that controls, transmits, transforms, or uses mechanical or electrical power. Some common examples of such equipment are steam boilers and other pressure vessels; electrical generating and transmitting equipment; pumps, compressors, turbines, engines; air conditioning and refrigeration systems; production machinery used in manufacturing operations; and all types of electrically powered office equipment such as copiers, computers, and telephone systems.

2. Contractors Equipment Coverage

Contractors equipment policies are specialized policies that are designed to address the mobile nature of contractors' equipment and the unique hazards to which the equipment is exposed.

3. Commercial Crime Coverage

Commercial crime policies are designed to insure against certain types of losses that are not covered by a standard commercial property policy, such as employee dishonesty/theft and forgery.

Given the complex and specialized nature of the typical modern-day construction project, it is imperative that any party involved with a construction project sit-down with its insurance agent and attorney and make sure that it has the proper insurance coverages in place to minimize its non-insured exposures. The time for that meeting is now, before there is a loss and you find that a loss exposure that you thought was covered is not insured.

*This article was authored by **Charles W. Miller III** is a member of the Insurance and Litigation Groups at Norris McLaughlin & Marcus. If you have any questions about this article or any other question, you can contact Chuck at 908-722-0700 or cwmiller@nmmlaw.com.*