

INSURANCE COVERAGE ISSUES ON CALIFORNIA CONSTRUCTION PROJECTS

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Introduction and Overview

- Subguard Insurance
- OCIPs
- Builder's risk insurance
 - Contract Negotiations
 - Claims Management
- Additional insured endorsements

Subguard Insurance

- Product issued by Zurich North America and its subsidiary, Steadfast Insurance Company
- Coverage: Insures against Subcontractor defaults. Covers defense costs.
- Usually a very high annual deductible (\$100,000 - \$500,000) –Self-insured retention
- Usually a substantial co-pay provision (20%)

Subguard Insurance

- Enrolled Contractors must use it on 100% of their projects
- Premium is based on the annual dollar amount of subcontracts.
- Began issuing about 5 years ago only to large, substantial contractors
- Past few years it is being sold to smaller contractors

Subguard Insurance

- No reported decisions on the Subguard product
- Only Zurich and its subsidiaries are writing it.
- There are fundamental uncertainties with this product
 - Is it insurance? (Probably = Bad faith)
 - Is it a bond? (Probably not, but if so, no bad faith)
- Does it only cover costs incurred by a Contractor arising out of a subcontractor default?

Subguard Insurance

- Subguard Policy is written in such a way as to suggest it only covers out of pocket costs
- But in its marketing, Zurich advertises that this insurance protects owners
- Subguarded general contractors tell owners that they do not need to bond the general because they are already paying for the contractors Subguard policy.
- Does this mean no coverage if a contractor is rendered insolvent due to subcontractor default?

OCIPs

Owner-controlled insurance programs or OCIPs

- OCIP or “wrap-up” coverage – owner purchases insurance for all participants on construction project
- Commonly, the Owner asks the contractor and subcontractors to reduce their bids price by the amount that has been included for CGL insurance that the contractor and subs will no longer be required to provide.
- Contractors typically pay their CGL premium based on gross revenues. The revenues on OCIP projects are not included in the reported gross revenues, so there is no coverage under the Contractor’s CGL policy for claims on OCIP projects

OCIPs

The OCIP package can include other coverages besides general liability

- Pollution Liability coverage. Almost all standard form Builder's Risk and General Liability policies contain broad pollution liability exclusions, which includes mold. For coverage (mold), you need an additional policy.

- Employer's Liability coverage. To provide coverage for the "claim over" injured worker scenario.

OCIPs

The OCIP package can include other coverages

- Errors and Omissions coverage for Design. This can be another separate policy with a separate deductible.
- Builder's Risk coverage. In the case of almost every OCIP, the package will include a Builder's Risk policy.

OCIPs

OCIP Issue Spotting

-You are negotiating a contract with an OCIP policy.

(1) What is the coverage of the OCIP?

(2) Who pays the deductible? Under AIA A201, the owner pays the deductible on the builders risk policy. The general and the subs pay the deductible under their CGL policies.

-Under an OCIP, there may be a \$50,000 deductible on the CGL policy.

OCIPs

CGL Deductible Issues

- On the CGL policy, if the deductible is paid in proportion to fault (the default position if the contract is silent), the Contractor, who under other provisions of the contract will be responsible for site safety and care of the work, will usually be at fault, as compared to the owner.
- But it is the owner who chose the OCIP and is presumably saving money by obtaining the OCIP
- Thus, it is not uncommon for Contractors to propose that the Owner pay the deductibles, for example, the first two claims covered under the CGL policy

OCIPs

OCIP Issue Spotting

- (3) How much are the deductibles?
- (4) Who allocates responsibility for payment of the deductible (at the Owner/Architect/Contractor level and at the Contractor/Subcontractor level)
- (5) How are the subcontractors enrolled in the OCIP CGL policy?

OCIPs

OCIP Issue Spotting

- (6) How much insurance should be provided by subcontractors who opt out of the OCIP program?
- (7) Provisions in the Subcontracts re: enrolling in the OCIP
- (8) Provisions in the Subcontracts re: responsibility for the deductibles in proportion to fault, up to the amount of the deductible or sub's normal deductible

OCIPs

-Errors and Omissions Coverage

- Standard CGL policies contain exclusions for professional services.
- For additional premium, can have this exclusion removed under an OCIP general liability policy
- This does not mean that there is now errors and omissions coverage under the CGL coverage.
- The CGL policy covers “occurrences” = claims for personal injury or property damage resulting from design deficiencies, not extra costs incurred by the contractor to perform the work

OCIPs

-The Action Over

- Common for general liability policies to exclude liability to the employees of the named insured.
- Under an OCIP, the named insureds will include the Contractor and subcontractors
- If an employee of a subcontractor is injured and tries to avoid the worker's comp exclusive remedy by suing the general contractor, the Employee Liability exclusion may preclude coverage
- Check to see if the CGL policy contains a Separation of Insureds clause – treat each insured like the only insured

Builder's Risk Insurance

- Builder's Risk Insurance, also known as Contractor's All Risk ("CAR") or Course of Construction Insurance
- CAR policies insure against physical loss or damage to works, plant, equipment and materials during the course of construction.

Builder's Risk Insurance

- The key characteristic is that, unlike other classes of insurance, the insurance clause is not limited by reference to specified perils – everything is covered unless it is excluded.
- The process of determining what is covered and what is not covered can sometimes be complicated: one page of coverage and 43 pages of endorsements and limitations.

Negotiating The Terms of the CAR Insurance Provisions

- The terms of the CAR policy are, like the terms of a Prime Contract, subject to negotiation.
- The first issue is, who buys the CAR policy?
- Contracts sometimes have the Owner buy it, sometimes the Contractor
- AIA-A201 the Owner buys it and pays the deductible

Negotiating The Terms of the CAR Insurance

Provisions (continued)

- Under ALL standard construction contracts, the Contractor will have care of the Work until completion and will own the equipment and materials.
- In other words, it is the Contractor who, in almost all instances, will be contractually responsible for any accidental damage to the Works, the very risk that CAR policies are issued to cover.
- As a result, as between the Employer and the Contractor, it is the Contractor who should be more keenly aware of the terms and conditions of the CAR policy. And therefore it is incumbent on the Contractor to ensure that a proper CAR policy is in place.
- Thus, if the Contractor buys the CAR policy, it will likely buy an expensive policy with low deductibles.

Negotiating The Terms of the CAR Insurance

Provisions (continued)

- Second issue is, how much is the deductible and who pays for the deductible.
- Can stipulate that the Owner pays, or the Contractor pays, or the parties pay in proportion to their comparative fault. Seen it all 3 ways.
- If it is comparative fault, the Contractor pays 99%
- But if it is in proportion to comparative fault, may want to include a mechanism for a quick binding resolution of the fault issue, which would be carried into the subcontracts, so that fault can be allocated quickly and cost effectively – binding arbitration.

Negotiating The Terms of the CAR Insurance Provisions (continued)

- Third Issue is, who is the named insured.
 - Owner, always (it is their property being insured)
 - Contractor, sometimes (not under AIA-A201 – Owner is empowered to settle claims as fiduciary of Contractor)
 - Subcontractors, usually not

Negotiating The Terms of the CAR

Insurance Provisions (continued)

- The Importance of Who Is the Named Insured.
 - Contractor, responsible for 99% of claims, is able to claim directly instead of going through Owner
 - No subrogation against named insureds
 - If Prime Contract requires Owner to procure CAR insurance, cannot subrogate against the Contractor, even if Contractor is not named insured

Negotiating The Terms of the CAR

Insurance Provisions (continued)

- Fourth Issue is, does this policy cover consequential losses (delay damages). Some do, some do not.
- This is an issue for Owners and Contractors, but more important for Owners
- Contractor can manipulate and characterize GCs as costs of remedial work – Owner's carrying costs are pure delay/consequential loss
- Usually there is a consequential loss provision that can be removed for small additional premium. It is worth it.

Strategy for Claims Against CAR Policies

- Insurance Code Section 530 and 532: In cases of concurrent causation, the claim is covered if the efficient proximate cause is covered, even if an excluded item contributed to the loss.
- Efficient Proximate Cause Test: *Garvey v. State Farm* (1989) 48 Cal.3d 395.
- Many CGL policies exclude coverage where an excluded matter “contributed in any way” to cause the loss.
- Use the “efficient proximate cause test” to avoid lack of coverage

Strategy for Claims Against CAR Policies

- Julian v. Hartford Underwriters Insurance Co. (2005) 35 Cal. 4th 747.
 - Weather conditions exclusion. Paragraph 1 contained an exclusion for landslides. Heavy rainfall caused a landslide that damaged houses.
 - HELD: the clause was enforceable - landslide damage claims caused by heavy rainfall were not covered.
 - Efficient proximate cause test was created so that insurers could not find some excluded cause in the chain of causation to avoid coverage. Here, insureds argued that to apply exclusion would not violate the efficient proximate cause test.
- Potentially creates great uncertainty, probably limited to this specific clause.

Strategy for Claims Against CAR Policies

- One of the most important exclusions is for defective design and workmanship.
 - c. Faulty, inadequate or defective
 - (1) Planning, zoning, development....
 - (2) Design, specifications, workmanship, repair, construction, ...
- However, in the event an excluded cause of loss that is listed in 3.a. through 3.c above results in a Covered Cause of Loss, the Company will be liable only for such resulting loss of damage.
- The impact is that the policy will not provide coverage if the damage resulted from defective construction.

Strategy for Claims Against CAR Policies

New Theater Construction in Monterey, California case study.

- Contractor installed interior finishes before roof completed
- Rain and \$2 million in interior damage
- In addition to defective construction exclusion, the policy contained an exclusion as follows:

Strategy for Claims Against CAR Policies

The company will not pay for loss of or damage to, or any loss that is a consequence of loss or damage to the interior of any building or structure, or to personal property in the building or structure caused by or resulting from rain, snow, sleet, ice, sand or dust, whether driven by wind or not, unless:

- a. The building or structure first sustains damage by a Covered Cause of Loss to its roof or walls through which the rain, snow, sleet, ice sand or dust enters

Strategy for Claims Against CAR Policies

- *Allstate Insurance Co. v. Smith* (9th Cir. 1991) 929 F.2d 447
- *Tento International, Inc. v. State Farm Fire & Casualty Co.* (9th Cir. 2000) 22 F.3d 660

Strategy for Claims Against CAR Policies

- Bridge Collapse in Thailand Case Study
- Insured has burden of showing a covered claim = An Accident. The claim is presumptively covered under the CAR policy. Any other rule would mean that the policies really are not “All Risk.”
- Burden shifts to insurer to prove the application of an exclusion
- Burden then shifts to the insured to prove that the exception to the exclusion applies.

Strategy for Claims Against CAR Policies

- For example, to apply the defective design exclusion, the burden would be on the insurer to prove BOTH that the design was defective and that the design defect is what actually caused the accident. This is a huge benefit for the insured making the claim.

Additional Insured Endorsements

A. Used to be handed out like candy, now difficult to get, and various limitations

1. Some policies for general contractors require that general obtain additional insured (AI) endorsements from subcontractors, otherwise no coverage under general policy
2. ISO 2009 – no coverage for completed operations
3. Pre-1993 ISO 2010 – coverage for completed operations
4. Post-1993 ISO 2010 – may or may not provide coverage for completed operations

Additional Insured Endorsements

B. PURPOSE

1. Adds an additional party as insured under someone else's policy
2. Accomplished via an endorsement to the policy
3. Benefits
 - a. No deductible
 - b. More available limits
 - c. No claims history

Additional Insured Endorsements

C. Scope of coverage is defined by additional insured endorsement

1. ISO 2009 – no completed operations coverage
2. ISO 2010 – may include completed operations coverage
3. Endorsements to incorporate contractual obligations
4. Coverage limited to liability arising out of the named insured's work
 - Note important difference between “arises out of” and “results from”

Additional Insured Endorsements

C. Scope of coverage is defined by additional insured endorsement (*cont.*)

5. How long should additional insured status be maintained?
6. Impact of ongoing operations to additional insureds
7. Is contribution between two primary carriers allowed:
Rossmoor Sanitation v. Pylon, Inc. (1975) 13 Cal.App.3d 622
8. Is an excess policy naming a party as an additional insured excess to the insured's own primary policy? *Reliance National Indemnity Co. v. General Star Indemnity Co.* (1999) 72 Cal.App.4th 1063

Additional Insured Endorsements

C. Scope of Coverage is defined by the additional insured endorsement (cont.)

Additional Insured Coverage Under CG 20 10 11 85

Name of Person or Organization

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of "your work" for that insured by or for you.

Additional Insured Endorsements

C. Scope of Coverage is defined by the additional insured endorsement (cont.)

2004 CG 20 10

- A. Section II – Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury,” “property damage” or “personal and advertising injury” caused, in whole or in part, by:
1. Your acts or omissions; or
 2. The acts or omissions of those acting on your behalf; in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

Additional Insured Endorsements

D. Additional insured coverage extends to additional insured's negligence

1. Additional insured covered for its sole negligence
2. Insurance Code § 11580.04 – public entity cannot receive additional insured coverage for its active negligence

Additional Insured Endorsements

E. AI contract provisions

1. Require AI coverage with specific endorsement
2. Specify criteria for insurer, limits, policy form, or required coverage
3. Require copy of endorsement
 - Contrast certificates of insurance and AI endorsements
4. Require additional insured coverage to be primary to coverage maintained by additional insured
5. Require named insured to act as insurer if policy contains layers of self insurance