

# **MANAGING BUILDER'S RISK INSURANCE ISSUES ON CALIFORNIA CONSTRUCTION PROJECTS**

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# Introduction and Overview

- Public Policy Theme
  - Only significant difference is the Contractor buys the Builders Risk policy on public project
- Overview of Role of Insurance on Construction Projects
- Bob Mahan for a few words
- Then talk about Builders Risk
- If any time left over, Additional Insureds
- Encourage interruptions for questions, comments

# Introduction and Overview

- Different Insurance Policies
  - Need to be addressed in the prime contract
  - Commercial General Liability (Ker and Subs)
  - Builders Risk
  - Workers compensation (Owner, Ker and Subs)
  - Equipment (Ker and Subs)
  - Professional Liability (Architect and DB Subs)
  - Pollution (maybe Owner or Ker or Subs)
    - Needed because CGL and Builders risk all exclude pollution and mold

# Introduction and Overview

- Mahan Issues
  - A201 Provisions
  - AGC Owner/General and Subcontract
  - Waiver of subrogation clauses
  - Deductibles
  - Perils to be insured
  - Act of God Quake Statute

# Builder's Risk Insurance

## Builder's risk insurance

- Contract Negotiations
- Claims Management

# 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 ALA-A201 – Owner is empowered to settle claims as fiduciary of Contractor, but policy is supposed to protect the interests of the Contractor and Subcontractors)
  - 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 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* (9<sup>th</sup> Cir. 1991) 929 F.2d 447 – Faulty workmanship exclusion vague – applies to a finished product not to faulty processes
- *Tento International, Inc. v. State Farm Fire & Casualty Co.* (9<sup>th</sup> Cir. 2000) 22 F.3d 660 – Hole in the roof clause not applicable where contractor negligence caused damage; rain not efficient proximate cause

## **Strategy for Claims Against CAR Policies**

- 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**

- Bridge Collapse in Thailand Case Study
  - 190 meter launching girder collapsed
  - 43 page policy, one page of coverage and 42 pages of exclusions, restrictions and limitations

# Strategy for Claims Against CAR Policies



# Strategy for Claims Against CAR Policies



## **Strategy for Claims Against CAR Policies**

- \$10 million builder's risk claim
- Insurer denied based on an exclusion for defective design or defective construction
- Insurer never really established causation, basically took position these things do not happen by themselves, like a *res ipsa loquitar* defense.
- To apply the defective design exclusion, the burden was 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.
- The case eventually settled



# Strategy for Claims Against CAR Policies

- 79 Unit Apartment Building Case Study
  - October 19: Found mold had formed a 6" strip at the bottom of sheet rock. Moisture from 1/1/2" lightweight concrete had wicked up into the sheetrock and caused mold. Had to tear out 2' strip of drywall on every interior unit on 79 unit apartment complex.
  - October 31: Fire in the garage caused smoke damage to every unit and the garage and commercial unit on the ground floor
  - November 14: Discover wet sheet rock on the 4<sup>th</sup> floor. Although the roof was on, a parapet wall around the perimeter of the roof was not completed. Although it was covered, rain got into the building and caused mold.
- Claims totalled around \$7 million with 6 months of delay damages

## **Strategy for Claims Against CAR Policies**

- Apartment Building Case Study, continued
  - Tendered all three claims to Builders Risk carrier. Paid \$250,000 on account of fire claim, then took the position that the remedial work should have only taken 3 weeks and cost less than \$200,000 instead of 6 months and close to \$2 million
  - Builders Risk denied the 4<sup>th</sup> Floor water intrusion claim and the gypcrete mold claim based upon negligent sequencing of the work in installing drywall before the roof was complete and relying on faulty workmanship exclusion.
  - Lawsuit is pending where insurer seeks declaratory relief that the claims are not covered, and Owner and Contractor seek declaratory relief that claims are covered.

## **Strategy for Claims Against CAR Policies**

- Apartment Building Case Study, continued
  - Two claims other than fire involved mold. Builders risk policy limited mold remediation damage to \$10,000 per occurrence
  - Contractor submitted mold costs to the carrier on the pollution liability policy obtained by contractor.
  - Pollution carrier denied based on the fact that the pollution policy only covers cases where a written demand is made to the insured for pollution cleanup, even though the contract had the usual provisions requiring the contractor to protect the work, etc. and where Owner in writing had asserted that these two claims were the Contractor's responsibility.
  - Lawsuit is pending where insurer seeks declaratory relief that the claims are not covered, and the Contractor seeks declaratory relief that claims are covered.

## **Strategy for Claims Against CAR Policies**

- Apartment Building Case Study, continued
  - Last but not least, tendered to the general liability carrier for the lightweight concrete subcontractor.
  - Denied coverage because the policy excluded work on a “new residential development”, even though it was undisputed that this was a mixed use development involving apartments and commercial space.
  - Lawsuit is pending where Contractor seeks to recover the \$2 million spent to remediate the moisture damage to the drywall – type I “arising out of” indemnity clause with a prevailing party attorney’s fees clause.
  - Subcontractor’s CGL policy will contain a broad mold exclusion.

## **Strategy for Claims Against CAR Policies**

- Apartment Building Case Study, continued
  - This project illustrates the interplay between the various insurance policies that may be available on a construction project.
  - Fire will only be covered by Builders Risk
  - 4<sup>th</sup> Floor should be covered by Builders Risk and Pollution
  - Gypcrete should be covered by Builders Risk, Pollution and Subcontractor's CGL

# Strategy for Claims Against CAR Policies

- Summary on Builders Risk
  - Need to understand the limits to the faulty workmanship exclusion – does not cover negligence or defective means and methods, and the efficient proximate cause test
  - This will allow most construction lawyers to issue spot on where there may be coverage for a given claim, and whether to involve coverage counsel to review the claim and tee up the insurance company for bad faith.

# 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 11 – 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