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**A Practical Guide to
Construction Insurance**

**C.A. (Joe) Davis
Lorinda Holloway**

C. A. (Joe) Davis
Brown McCarroll, L.L.P.
111 Congress Avenue, Ste. 1400
Austin, Texas 78701

cadavis@brownmccarroll.com
512-703-5780

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I. INTRODUCTION

Whether a lawyer is drafting a construction contract or litigating a construction dispute, a basic practical familiarity with the insurance policies and coverages commonly utilized for construction projects is essential to competent representation of one's client. This paper will provide definitions of certain terms and concepts which are prerequisite to a clear understanding of construction insurance, discuss some of the most common types of construction insurance coverage, identify some areas that deserve special attention and attempt to give an overview of how the various policies and coverages fit together.¹ This paper is an effort to lay a practical and useful foundation upon which the reader may begin to build a sound and thorough understanding of construction insurance, but it is not intended to be an advanced or complete disquisition on this complex topic. As demonstrated by the large and growing body of case law on coverage issues, there remains a substantial degree of uncertainty in coverage analysis, a full parsing of which would go far beyond the scope of this presentation of basic principles.

II. KEY TERMS AND CONCEPTS

Policy Forms: Modern insurance policies in general, and construction insurance policies in particular, are the descendants of contracts written in ages past for the ocean shipping trade, to transfer the risk of the loss of a shipment to the insurer. Historically, or traditionally at least, the business of insurance began in 1688 in Edward Lloyd's Coffee House in London, where customers laid wagers on whether particular cargo ships would return safely to port (as well as on such risks as the fate of criminals and highwaymen, and the possible death of peers of the realm.² Today, much of the world's commercial risks are still insured or reinsured by the members of the organization known as Lloyds, through syndicates which write policies on a wide range of forms, some relatively standard, and some entirely customized to address unique risks. Archaic language derived from old marine insurance forms, as well as the often cryptic verbiage common in policy terms can be serious obstacles to understanding modern insurance policies. An insurance trade association, the Insurance Services Office (ISO) was formed in 1971 to provide, among other things, standard form policy language. The standard ISO forms for general liability and commercial property insurance policies are frequently encountered in all types of businesses, including the construction industry. When an insurer does not use an ISO or other standard form, the carrier creates its own policy form known as a "manuscript" form. Endorsements modifying the terms of the policy are often manuscripted, even though they may

¹ The author acknowledges that much of the form and substance of this paper is drawn (with an eye on Texas law) directly from the excellent treatise, *Construction Insurance, A Guide for Attorneys and Other Professionals*, (Stephen D. Palley, Timothy E. Delahunt, John S. Sandberg, and Patrick J. Wielinski, eds., Am. Bar Ass'n 2011). This book treats the subject matter exhaustively and authoritatively, and can be relied on to correct and complete this article's shortcomings.

² Hugh Cockerell, *Lloyd's of London, A Portrait* 13 (1984). Cockerell further noted, "[O]ne could insure to receive a payment of money if Parliament should be dissolved or war declared, and the lives of persons accused of a crime could be insured." *See also*, <http://www.lloyds.com> (last visited September 12, 2011).

be attached to a standard form policy.³ It is dangerous to generalize about the coverage implications of a particular form, and in analyzing coverage for a particular loss, there is no substitute for a careful reading of the entire policy and all endorsements.

First Party v. Third-Party Coverage: First-party coverage applies to and protects an organization's own physical assets, such as buildings, equipment, and vehicles. If a covered event or "occurrence" damages these items, the insurance company pays the insured the promised compensation, usually the value of the property or the cost to repair or replace it. The hallmark of first-party coverage is that the insured party suffering an injury can submit the loss directly to the carrier for reimbursement. First-party policies generally do not protect the insured from claims by third parties. Notably, some policies do include both first-party and third-party protections.

Third-party coverage, on the other hand, is typically known as liability insurance and covers the insured's liability for damages to a third party. The two most common third-party coverages on a construction project are commercial general liability and professional liability policies. Many, but not all third-party policies provide two distinct types of protection: a duty to defend, and a duty to indemnify. The duty to defend, which is typically broader than the duty to indemnify, covers the cost of defending against potentially covered third-party claims, while the duty to indemnify encompasses the cost of paying covered third-party claims.⁴ Potential extra-contractual claims against an insurer generally arise out of a breach of either the duty to defend or the duty to indemnify.

The duty to defend exists when simply the *potential* for coverage exists. Texas limit the duty-to-defend analysis to a comparison of the four corners of the pleading with the four corners of the insurance policy. This is known as the "eight corners" rule, or the "complaint-allegation" rule.⁵ In other words, if the complaint alleges facts which, if true, would constitute a covered occurrence under the policy terms, the insurer has a duty to defend.

Because of the complexity of modern commercial litigation such as construction defect litigation, it is commonplace for a defense to be provided under a reservation of rights or nonwaiver agreement. A reservation of rights is a unilateral reservation by the insurer of its rights to contest coverage (and may assert a right to seek reimbursement of defense costs if coverage is ultimately negated). A nonwaiver agreement is a bilateral agreement between the insurer and insured regarding the potential application of coverage defenses. Reservation-of-rights letters are far more common than nonwaiver agreements, but the purpose of both is to alert the insured to potential coverage defenses.

The duty to defend generally begins upon the tender of a suit (or under certain pollution liability policies, upon tender of an administrative action) and ends when the insurer has paid a

³ David T. Dekker, et al., *Insurance and Risk Transfer Basics for Construction Projects in Construction Insurance: A Guide for Attorneys and Other Professionals* 17 (Stephen D. Palley et al. eds., 2011).

⁴ *Id.* at 11-12.

⁵ Lee H. Shidlofsky and Patrick J. Wielinski, *Commercial General Liability Coverage in Construction Insurance: A Guide for Attorneys and Other Professionals* 102-103 (Stephen D. Palley et al. eds., 2011).

judgment or settlement resolving the action (subject to policy limits) or when the suit no longer contains allegations that otherwise trigger a potential for coverage.⁶

Bonds v. Insurance: It is important to distinguish true insurance products from other construction-related instruments such as performance and payment bonds. Bonds stand behind, and financially guarantee, contractual obligations of general contractors to owners, and from subcontractors to general contractors, including completion and payment obligations. If a loss occurs under a bond, the surety is liable to respond to that loss. Nevertheless, the principal has not transferred the risk to the surety; rather the principal remains liable for the loss at issue, typically through an indemnity agreement with the surety.

On the other hand, true insurance effectively transfers risk to the insurer. By contract, insurers pay covered losses with no right of recourse against their insureds beyond deductible obligations.⁷ “No right of subrogation can arise in favor of the insurer against its own insured, since by definition subrogation only arises with respect to the rights of the insured against third parties to whom the insurer owes no duty.”⁸

Subrogation: A right of subrogation arises when a party’s insurer pays a loss that was the legal responsibility of another party. The paying insurer succeeds to the rights of its insured and can pursue a direct action in subrogation against that responsible party to recover that payment.⁹ Subrogation claims are generally brought in the name of the insured. Such claims can be complicated where the payment by the insurer does not cover the entire loss suffered by the insured (such as deductibles or other losses not covered). In such cases in Texas, where the policy is silent, the insured is generally entitled to be made whole before the insurer is entitled to subrogation.¹⁰ However, the policy language must always be considered because it may give the insurer a contractual subrogation claim, not just an equitable one, and thereby negate the application of the "made whole" doctrine.¹¹

In construction projects, subrogation claims are often waived by contract. The object of such waivers is to avoid the burden and inefficiency of multiple cross-claims in the event of an insured loss. Standard form agreements promulgated by the American Institute of Architects (AIA) contain waivers of subrogation “to the extent damages are covered by property insurance.”¹² It is very important to note that where such clauses are included in project

⁶ *Id.* at 103-104.

⁷ Dekker, *et al.*, 13.

⁸ 16 Couch on Insurance 2D § 61.133 (1983).

⁹ Dekker, *et al.*, 18.

¹⁰ *Ortiz v. Great Southern Fire & Casualty Insurance Co.*, 597 S.W.2d 342 (Tex. 1980) (the insurer has no right to subrogation unless the insured recovered a sum in excess of the amounts recovered from the insurer and the third party causing the loss); *Esparza v. Scott & White Health Plan*, 909 S.W.2d 548, 552 (Tex. App.—Austin 1995, writ denied).

¹¹ See *Fortis v. Cantu*, 234 S.W.3d 642, 645 (Tex. 2006) (the equitable made whole doctrine does not trump an insurer’s contract-based subrogation rights where the policy language stated that the insurer would be subrogated to “all rights” of recovery that the insured may have against “any person or organization” and that such right would extend to the proceeds of “any settlement or judgment”).

¹² See AIA Document B141-1997 Standard Form of Agreement Between Owner and Architect, §1.3.7.4, and AIA Document A201 (2007) General Conditions of the Contract for Construction, §11.3.7.

contracts, the parties must obtain acknowledgements from their insurers of such waivers, and agreement from the insurers to forego their rights of subrogation.

Since an insurer cannot seek subrogation against its own insured, cross claims over an insured loss can also be avoided by the common practice of adding all project participants as additional insureds on the other project participants' policies.

Coverage Triggers: The phrase, "trigger of coverage", does not appear in common policy language, but is used by lawyers as a shorthand to describe the circumstances under which the potential for coverage under an insurance policy arises. Third-party or liability policies are generally triggered in one of two ways. They are either "occurrence" or "claims made" policies.

A "claims made" policy is triggered by a claim made against the insured during the policy period, regardless of when the loss or damage occurs. Where a policy contains a "claims made and reported" requirement, a claim must be made against the insured *and* be reported to the carrier within the policy period.

An "occurrence" policy, on the other hand, is triggered where damage or loss covered by the policy takes place during the policy period, regardless of when a claim arising from that loss or damage is made against the insured. For sudden, one-time events like a fire, collapse or automobile accident, the date of trigger, and therefore the particular policy that is triggered, is clear. Progressive losses over a period of years present more difficult issues and may involve coverage under multiple policy years.¹³ Different jurisdictions have developed different rules for determining when an occurrence triggers coverage. In Texas, for purposes of triggering coverage, property damage occurs when actual physical damage to the property occurs.¹⁴ The date the damage is or could have been discovered is irrelevant.¹⁵ It should be noted that actually adducing evidence of the date(s) of injury-in-fact may be more difficult than articulating this legal standard for triggering coverage.

Project-specific insurance policies, as the name suggests, only insure claims arising out of the individual project or projects they are written to cover. Typically the policy period will be the anticipated length of the project, and the program will also include a completed operations tail (for occurrence policies) or extended reporting period (for claims-made policies) providing coverage for loss or damage occurring up to a specified number of years after project completion.

Per Occurrence, Per Claim, and Aggregate Deductibles and Limits:

Most insurance policies are covered or prefaced by a one or more Declarations pages which show in tabular form, a short (and therefore incomplete and possibly misleading) description of the coverages provided, the endorsements qualifying the coverages, the deductible or Self-Insured Retention (SIR) amounts, and the dollar limits of liability of the carrier. The

¹³ Dekker, *et al.*, 14.

¹⁴ *One Beacon Ins. Co. v. Don's Bldg. Supply, Inc.*, 553 F.3d 901, 902 (5th Cir. 2008).

¹⁵ *Thos. S. Byrne v. Trinity Universal Insurance Co.*, 334 S.W.3d 29 (Tex. App.-Dallas 2008), *vacated following settlement*, 2009 WL 3594057 (Tex.App.-Dallas, Nov. 3, 2009)..

insuring agreements in the body of the policy commonly refer to and incorporates the limits stated in the Declarations. The stated limits set the maximum the carrier will pay for all covered loss or damage, generally expressed both as a limit per occurrence or per claim, and on an aggregate basis. The limit per occurrence (or per claim) is the most the carrier will pay for all loss or damage arising out of a single occurrence or claim. The deductible or SIR amount stated is the amount of loss which must be borne by the insured as a result of each distinct occurrence or claim, *i.e.*, the amount which the carrier may deduct from the amount it must pay for each distinct covered loss.¹⁶

III. COMMON CONSTRUCTION INSURANCE COVERAGES

Builders Risk Insurance: Builders Risk insurance is first-party property insurance typically covering loss or damage to the work (the uncompleted building and materials stored at the project site) during the course of construction. Builder's risk coverage is often provided on an "all risk" basis, meaning that it covers all risks of physical loss or damage to the property unless that risk or cause of loss is expressly excluded. To avoid cross claims in the event of an insured loss, builders risk policies generally name the owner, contractors, and subcontractors of every tier, design professionals, and any necessary financing parties as insureds.¹⁷ (This aspect makes the builders risk policy essentially a property "wrap-up" policy. "Wrap-up" or "OCIP" programs are discussed in more detail below). Upon completion of the project, permanent property coverage should be put in place, with no gap in the effective dates of coverage.

"All Risk" builders risk policies cover costs incurred to repair or replace physical damage caused by a fire or other covered accident or event during construction. Coverage questions may arise over the extent to which the policy covers other costs flowing from the accident, such as delay-related damages, acceleration costs, disruption, and other "consequential" damages. Commonly, the basic terms of builders risk policies exclude "consequential" damages and similar losses unless added back by a coverage extensions.¹⁸ It is therefore necessary to consider and analyze carefully what coverage extensions are to be, or have been, purchased to supplement the coverage for cost of repair/replacement.

In this regard, the concepts of (1) covered property and (2) covered cause of loss must be understood. The first concept is generally addressed in builders risk policies by listing what property is *not* covered. Common examples of property excluded from coverage (unless specifically added by endorsement to the policy) are:

- Land (including land on which covered property is located) or water (usually subject to an exception for site preparation expenses such as grading, filling or backfilling, including the cost of dirt);
- Existing buildings or structures to which improvements or repairs are being made;
- Contractors' machinery, tools, and equipment that will not become a permanent part of the building;
- Electronic data processing equipment that will not become a part of the project;

¹⁶ Dekker, *et al.*, 15.

¹⁷ *Id.* at 19.

¹⁸ *Id.* at 19-20.

Trees, shrubs, laws, sod or plants;
Property in transit; and
Covered property left in the open or not contained in buildings or permanent foundations where damage is caused by exposure to weather conditions

The second concept, covered cause of loss, must be analyzed differently depending on whether the policy is an “all risk” (sometimes called “broad form”) policy, as is most common, or whether the policy limits its coverage to certain causes of loss, making it a “named peril” policy. Common causes of loss covered by “named peril” policies include fire, lightning, explosion, windstorm and hail, smoke, vandalism, sprinkler leakage, sinkhole collapse, and volcanic action.¹⁹

As with every type of coverage, it is critical to consider what exclusions are contained in the policy, including endorsements. Unlike commercial general liability policies, most builders risk policies are not written on standard industry wide forms. Therefore, it is especially important to review the exclusions in both the basic insuring agreement and those added by endorsement. Obviously, exclusions can belie the “all risk” label that might be assumed to attach to builders risk coverage.²⁰

Nearly every builders risk policy contains some form of workmanship exclusion. Common policy language applies this exclusion to the

Cost of making good faulty or defective workmanship, material, construction or design but this exclusion shall not apply to damage resulting from such faulty or defective workmanship, material, construction or design.²¹

As written, this common exclusion provides an exception for “resulting damage”. The importance of this exception cannot be overstated because it adds back coverage for “resulting damage.” A great many coverage disputes, with regard not only to builders risk policies but also third-party liability policies, turn on the “resulting damage” exception to the exclusion for workmanship.

When Texas courts interpret clauses such as the workmanship exclusion, they must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent. Exceptions or limitations on liability are strictly construed against the insurer and in favor of the insured, and an intent to exclude coverage must be expressed in clear and unambiguous language.²²

¹⁹ O'Connor and Knoll, 251-254.

²⁰ Dekker, *et al.*, 20.

²¹ O'Connor and Knoll, 259-260. This exclusionary language is from the American London Sturges (ALS) form issued by Lloyd's in 1967 and revised in 1972, and is discussed in *Rivnor Properties v. Herbert O'Donnell, Inc.*, 633 So. 2d 735 (La. App. 5th Cir. 1994).

²² *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, No. 03-0647, 2008 Tex. LEXIS 575, at *19-20 (Tex. June 13, 2008), citing, *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex. 1991).

Commercial General Liability Insurance: Commercial general liability (CGL) coverage is third-party coverage intended to protect the insured against claims by others for personal injury or property damage arising out of the insured's business operations. Commonly, CGL coverage is written on standard ISO forms, on an "occurrence" basis, and pays both indemnity against liability for covered claims, and the cost to defend against such claims. Under standard industry forms, defense costs are in excess of limits (i.e., do not reduce them), while indemnity payments exhaust coverage limits. The cost to defend third-party claims is a significant risk in connection with any construction project, and it is not unusual for defense costs to exceed indemnity paid for actual losses under the policy. This exposure should be carefully considered before an insured agrees to a CGL policy form that puts defense costs within, rather than in excess of, limits.²³

CGL insurance is not a construction-specific product, and CGL coverage may overlap with coverages that are construction-specific. For example property damage to the project during the course of construction is typically covered by builders risk insurance. Design professionals such as architects and engineers likely maintain professional liability coverage. Disputes can arise as to whether a property damage claim arising from construction work implicates CGL coverage, builders risk coverage, professional liability coverage, a combination, or none of these. For these reasons and others, construction-related claims frequently lead to coverage disputes under CGL policies, and such disputes can be complex and costly to resolve. The most frequently disputed CGL coverage issue in the construction context is coverage for defective work and resulting damage. Builders risk policies generally exclude coverage for defective work and design; therefore, claimants and insureds may look to the CGL policy for coverage in connection with such claims. Although standard CGL insuring agreements provide a very broad grant of coverage, the policy then shifts certain risks back to the insured through exclusions. The analysis of coverage under any insurance policy, including a CGL policy, begins with the insuring agreement.²⁴

The Coverage A insuring agreement of a standard form CGL policy²⁵ applies to bodily injury and property damage liability. It provides, in part:

We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" and "property damage" to which this insurance applies.

* * *

This insurance applies to "bodily injury" and "property damage" only if:

- (1) The "property damage" is caused by an "occurrence" that takes place in the "coverage territory"; [and]
- (2) The "bodily injury" or "property damages" occurs during the policy period.

²³ Dekker, *et al.*, 20.

²⁴ Shidlofsky and Wielinski, 67-69.

²⁵ References to the standard form CGL throughout this discussion are to the 2007 form, CG 00 01 12 07, which is the current form. © ISO Properties, Inc., 2006.

Disputes over the foregoing key language of the CGL insuring agreement have often centered on the significance of the following key terms: “because of”, “property damage” and “occurrence”.

The “because of” formulation has been found to be a basis for insureds to recover the costs to repair “property damage” (defined, in part as “physical injury to tangible property”) to the project and other consequential damages. Thus, in a Texas Court of Appeals case²⁶ where the insured homebuilder sought coverage for the cost to repair water damage to hundreds of homes due to defectively installed Exterior Insulated Finishing Systems (EIFS), the court determined that the damage to the homes arising out of water infiltration through the defective EIFS caused property damage, and the costs of repairs were damages incurred because of that property damage within the insuring agreement of the applicable CGL policies. However, the court held that the costs to remove EIFS on otherwise undamaged homes as a preventive measure were not covered because they did not constitute damages paid by the insured because of “property damage”.²⁷

The issue of whether a contractor’s defective work arises out of an “occurrence” has been hotly disputed in many court decisions. The Texas Supreme Court opinion in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*,²⁸ involving a suit against an insured homebuilder arising out of a subcontractor’s defective work, addressed several contentions of the insurer, and found coverage. The court in *Lamar Homes* recognized that not every case of faulty workmanship will result in coverage. For example, where faulty workmanship is intentional from the viewpoint of the insured, there is no “occurrence”, and where faulty workmanship merely diminishes the value of the damaged project without causing physical injury, there is no “property damage”; therefore there is no coverage. However, the court rejected any contract versus tort distinction for determining whether the occurrence requirement is satisfied, and rejected the application of the economic loss rule to determine coverage under a CGL policy. Similarly, the court rejected foreseeability as the boundary between accidental and intentional conduct. *Lamar Homes* appears to exemplify a recent trend among state courts finding that physical damage resulting from inadvertent construction defects constitutes an occurrence under a CGL policy. Even following this trend, of course, courts may continue to decide the issue differently in given cases based on their facts.²⁹

The court in *Lamar Homes* also addressed Exclusion I to the standard form CGL insuring agreements, which applies to the “products-completed operations hazard,”³⁰ and generally excludes coverage for “property damage” to the insured’s completed work, with one notable exception for work performed for the insured by a subcontractor. The exclusion provides that the CGL policy does not apply to:

²⁶ *Lennar Corp. v. Great American insurance Co.*, 200 S.W. 3d 651 (Tex. App.—Houston [14th Dist.] 2006, pet. denied).

²⁷ Shidlofsky and Wielinski, 71.

²⁸ 242 S.W.3d 1 (Tex. 2007).

²⁹ Shidlofsky and Wielinski, 72-74.

³⁰ Standard form CGL policies contain numerous distinctions in coverage for the period during construction of the project, as opposed to coverage for periods (if any) covered by the policy after completion, referred to as the “products-completed operations hazard”. Careful analysis of the facts and chronology of losses, and the policy language, must be undertaken to determine which coverage rules apply.

I. Damage to Your Work. "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."

The exclusion for "your work", however, is modified by the following "subcontractor exception":

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

The dissent in *Lamar Homes* argued that an exclusion cannot create coverage; however, the majority concluded that contrary to the dissent's accusation, the subcontractor exception to the "your work" exclusion does not create coverage; rather, it reinstates coverage that would otherwise be excluded under the "your work" exclusion.³¹

It should also be noted that the definition of property damage at Section V (17) of the CGL policy provides:

"Property damage" means:

- a. Physical injury to tangible property, including all resulting loss of use of that property. ... or
- b. Loss of use of tangible property that is not physically injured. ...

Thus, under the right circumstances, damages for the loss of use of property (even if not physically damaged), whether necessitated by an occurrence (including defective construction work resulting in physical damage to property), or necessitated by the repair of the physical damage, can constitute "property damage" covered as an occurrence.

A typical CGL policy for a contractor or developer usually provides for a \$1 million per-occurrence limit, with an aggregate limit of \$2 million. Often these limits are inadequate to protect an insured on a large project, and it is necessary to structure a program of additional liability coverage, accomplished by placing additional layers of coverage. The first layer is composed of the CGL or other primary policies, usually auto liability and employers' liability. Umbrella policies are typically used as the second layer of coverage to provide additional limits. Generally, the umbrella policies may include two components. The first is an "excess" component, providing the same type of coverage as the designated primary policies (except a duty to defend), which is triggered once the underlying primary limits are exhausted. In addition, the program may include a second umbrella component that provides coverage for risks beyond that provided in the primary policy.

Many programs included excess liability policies that provide coverage in addition to the umbrella layer. Often the umbrella policy will establish the scope of coverage for all policies above it since upper layers usually follow the form of the lead umbrella policy, thus providing

³¹ 242 S.W.3d 1, 32 (Tex. 2007).

pure excess coverage. This renders the umbrella policy a crucial component in arranging broad liability protection. Unlike the CGL policy, there is no standard umbrella form.

Because most umbrella policies are not of the form variety, instead relying on their own provisions to establish the scope of coverage, they, in many respects, provide coverage independent of the underlying CGL policy. In other words, an umbrella policy has been described as a hybrid policy providing excess coverage that applies after a predetermined amount of primary coverage is exhausted, but also certain coverages broader than those of the underlying policy that require the umbrella to “drop down” to provide primary coverage. As always, particular policy language and the specific facts of the case are crucial determinants of coverage.³²

Workers’ Compensation/Employer’s Liability: Workers compensation policies cover injuries to employees suffered in the course of their employment. Coverage must be in stutorily required limits, and should be extended to all project participants who have employees working on the site. This can be accomplished through a project-specific insurance program, or by each project participant’s own policies. Most CGL policies exclude coverage of claims arising from injuries to the insured’s own employees, but workers’ compensation policies do not cover all such claims. Employer’s liability policies issued as a part of the workers’ compensation policy can fill the gap between workers’ compensation and CGL policies.³³

Professional Liability Insurance: Coverage for loss arising from services deemed “professional” in nature, such as architectural, engineering, and other design services is provided through third-party liability insurance known as professional liability policies. Unlike CGL coverage, professional liability coverage commonly covers pure economic loss, such as a delay in completion of the work independent of any damage to it. Most professional liability coverage is written on a claims-made basis and the limit of liability is always stated in terms of a per claim limit and an aggregate limit.

Many professional liability policies include both a duty to defend and a duty to indemnify. Unlike GCG occurrence policies, however, defense costs are typically within (*i.e.*, reduce) the limits of professional liability policies. This characteristic, sometimes described as “self-consuming”, significantly impairs limits available to pay claims and has significant ramifications both for the insured and for third-party claimants.

While nearly all design professionals are required to have professional liability coverage by project agreements, many construction managers procure it as well. Some services performed by construction managers may be deemed to be professional in nature, and thus may be outside the coverage provided by CGL policies with professional liability exclusions. Subcontractors whose work includes a significant design element may also incur, and expose general contractors and construction managers to, professional exposures. Where a contractor provides design-build services, ensuring that the design-build entity has professional liability coverage is critical.³⁴

³² Shidlofsky and Wielinski, 99-100.

³³ Dekker, *et al.*, 22.

³⁴ *Id.* at 21-22.

Environmental/Pollution: Many environmental and pollution exposures, including mold, are commonly excluded from general liability, builders risk, and professional liability policies. Specialized policies covering environmental risks, sometimes called contractors' pollution liability (CPL) and pollution legal liability (PLL) policies, can provide coverage to fill those gaps. CPL and similarly named policies typically cover pollution conditions resulting from operations performed by or on behalf of the named insured at a jobsite, but do not cover existing pollution conditions at a site owned by an insured. PLL and similarly named policies typically cover pollution conditions at or extending beyond owned property or caused by transported cargo. Unless a project is on an undeveloped site, obtaining CPL and/or PLL coverage should be considered. Of course, the scope of the required coverage can be determined only in conjunction with environmental studies of the particular site.³⁵

Most environmental insurance coverage is written on a "claims made and reported" basis. Coverage under CPL policies for jobsite claims may also be available on an occurrence basis. Policies are frequently written for multiyear terms. CPL coverage generally affords both defense and indemnity coverage. Coverage is generally provided for "loss" arising out of claims for "bodily injury", "property damage", or "environmental damage" caused by "pollution conditions" resulting from "covered operations."

"Loss" is frequently defined as monetary awards or settlement, fines (where coverage for fines is allowed by law), remediation costs, defense costs, and emergency expenses. The definition of "pollution conditions" generally tracks the language of the pollution exclusion found in general liability policies: "the discharge, dispersal, release or escape of pollutants into or upon land, or any structure on land, the atmosphere or any watercourse or body of water, including ground water, provided such conditions are not naturally present in the environment." "Pollutants" is typically defined as "any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." Covered operations" generally means the physical operations and activities designated in the policy declarations that are performed at a jobsite by or on behalf of the insured.³⁶

Wrap-Ups or CIPS: Under a traditional construction industry insurance program, each project participant purchases its own insurance, and passes insurance costs to the owner in its bid. The contractor's and design professional's own insurance policies are typically called their "practice" policies. As an alternative, a sponsor (at times the owner, developer, construction manager, or general contractor) can purchase a master insurance program for an individual project or series of projects called a wrap-up or controlled insurance program (CIP), also referred to as a consolidated insurance program under the same acronym. An OCIP is simply a CIP sponsored by the owner of the project; a CCIP is a CIP sponsored by the general contractor or construction manager.

Under a CIP, the sponsor procures given lines of coverage for enrolled participants. Most CIPs include at least workers' compensation and general liability coverages (both primary and umbrella/excess liability insurance), although there are CIPs that provide general liability

³⁵ *Id.* at 21.

³⁶ Jeffrey Davis, Keith Bruett, and Michael Mostrow, *Pollution Insurance in Construction Insurance: A Guide for Attorneys and Other Professionals* 221-223 (Stephen D. Palley *et al.* eds., 2011).

coverage only. Builders risk, professional pollution, and other coverages can also be provided through the CIP. The sponsor of the CIP requires all enrolled parties to remove the cost of insurance from their bids, with respect to the lines of coverage being centrally purchased. These are significant sums since insurance costs can exceed 5 percent of the hard costs of construction. The CIP sponsor uses the deductions of enrolled parties to offset the costs of the CIP (premium, deductibles, administration, etc.). The difference between the contractors' traditional cost of insurance, as reflected in bids made on projects without a CIP, and the cost of the sponsor's CIP program can result in program savings.³⁷

In addition to the potential for cost savings, stated reasons for CIP implementation include: consistent coverage through use of single-project-specific forms instead of overlapping coverage on an additional insured basis; enhanced loss control and safety; higher limits that might not be available to smaller contractors and subcontractors, thereby facilitating the participation of minority or women-owned businesses; dedicated completed operations coverage available through project-specific policies; and reduced risk of nonrenewal/cancellation.

There are other considerations to bear in mind, including the following: (1) CIP programs typically entail high deductibles that, although usually capped at a fixed percentage of payroll, can result in program costs that exceed premium and other cost savings; (2) CIP policies often have premiums that can go up (or down) depending on loss frequency and audited payroll, presenting a potential financial risk to the sponsor; (3) significant collateral can be required to secure deductible loss obligations; (4) particularly for larger projects, the CIP model requires experienced administration for successful implementation, and this has a cost impact; (5) project-specific coverage is usually at least as robust as individual policies but there are exceptions, and it can be less favorable than some larger contractors' own practice policies, which may not be available if a CIP is used; and (6) determining actual cost savings requires that participants fully disclose their insurance cost and that they have a sophisticated understanding of that costs.³⁸

It should be noted that while CIPs normally include mutual waivers of claims among project participants as to losses covered by insurance, any loss is likely to include uninsured elements such as the deductible amount and losses in excess of policy limits. Further, all the enrollees in a CIP are generally named insureds, and the general liability coverage of a CIP is likely to exclude coverage for claims by one insured against another insured. In determining whether to sponsor or participate in a CIP, project participants must carefully evaluate the risks posed by such waivers and exclusions.

III. CONCLUSION

The construction industry necessarily involves very serious risks of bodily injury, property damage, environmental damage, and economic loss. The marketplace has evolved a complex set of insurance coverages tailored to shift certain of those risks from construction project participants to insurance carriers, and to share the risks, in an aggregate sense, among all construction project participants who pay premiums for insurance coverage. As lawyers

³⁷ Dekker, *et al.*, 24-25.

³⁸ Michael D. Hastings and Amy Hobbs Iannone, *Controlled Insurance Programs in Construction Insurance: A Guide for Attorneys and Other Professionals* 333-334 (Stephen D. Palley *et al.* eds., 2011).

representing construction clients in structuring insurance coverages for a project, or in asserting or defending claims arising from losses on a project, an awareness of potentially applicable insurance coverage is mandatory. Each of the common construction insurance coverages, builders risk, commercial general liability, professional liability, workers compensation and employer's liability, and pollution/environmental coverage, plays a distinct role in the management of construction risks. The free enterprise system that drives the economy, and the adversary legal system that protects and enforces the rights and obligations of individuals and corporate interests, continually test the limits of interpretation and application of insuring agreements and their exclusions and exceptions. The process inevitably creates uncertainty, resolves it at a new equilibrium point, and then finds new areas of uncertainty to resolve. Uncertainty and risk can never be entirely eliminated, but we can be certain that a solid understanding of the primary available construction insurance coverages, necessarily honed by a careful and thorough reading of the applicable policies, will optimize the ability to represent our clients' interests in managing, or utilizing, these risks and uncertainties.