

Builder's Risk Insurance: Who and What are Covered?

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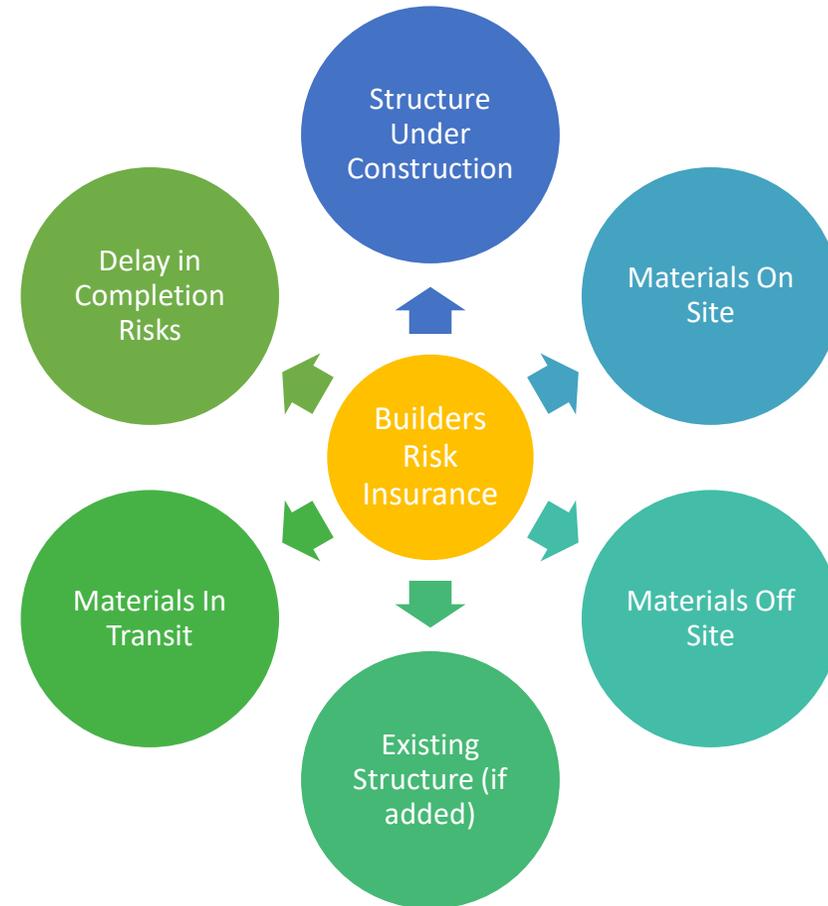
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What is Builders Risk Insurance?

- Builders risk insurance is a form of property insurance that covers property that is being constructed or renovated, against physical loss or damage from a covered cause.
- Sometimes referred to as Course of Construction coverage.
- It is temporary insurance in that coverage ends once the construction is considered completed, as defined in the policy.

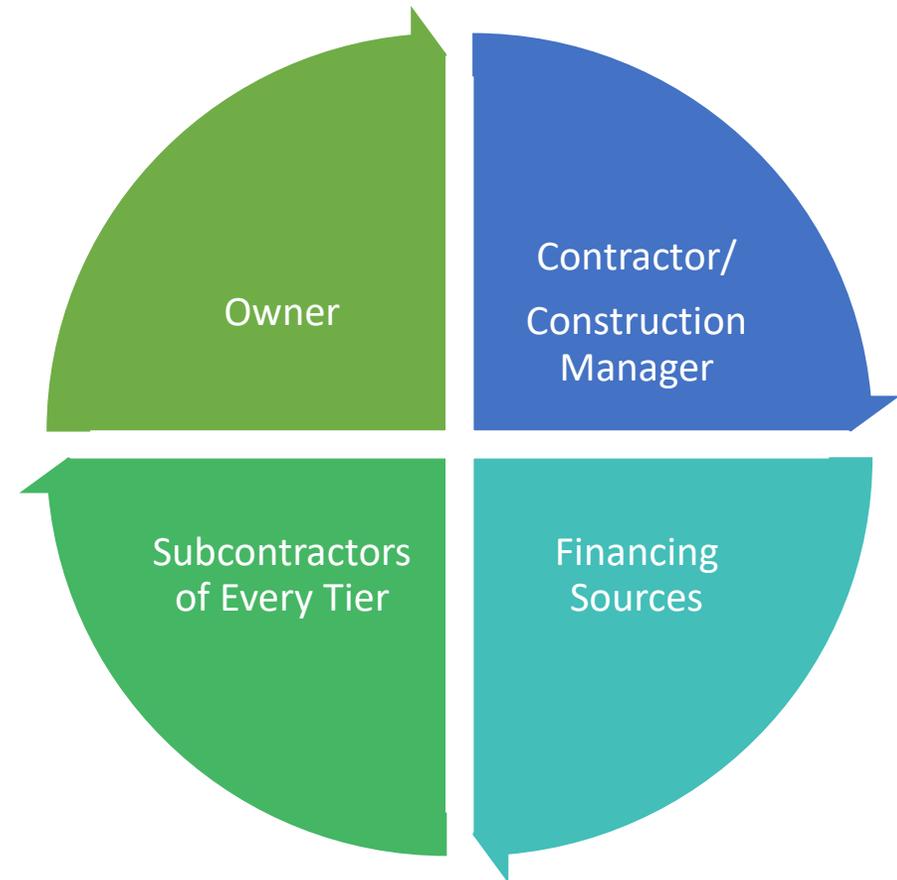


Why Builders Risk vs. Commercial Property Coverage?

- Coverage for Foundations and Underground Property
- Coverage for Other Property
 - i.e. retaining walls, seawalls, bulkheads, pilings, piers, wharves, docks, falsework, forms, scaffolding, temporary buildings or structures, fencing, antennas, and materials either stored outdoors or stored outside of a predesignated distance from the project.
- Coverage for Land Improvements
- Coverage for Property Off-Site and in Transit
- Large deductibles under Owner's Property Policy
- Other Specialized Coverages (i.e. testing)

Why is a Broad Builders Risk Policy Best for All Parties?

- A Builders Risk policy is a risk transfer tool for those involved in a construction project. The broader the builders risk policy, the lower the risk to all insured parties.
- It is in the best interest of the contractor, to require broad builders risk coverage since the contractor is likely to be held responsible for any uninsured damage to the project.
- It is also in the best interest of the owner & financing sources to have broader coverage and, as a result, insurance proceeds to continue construction following a loss, than to maintain reduced coverage and have to litigate with a contractor over uninsured losses.
- This slows down the momentum of the project and the funding needed to continue the project.



Who Should Be Covered Under a Builders Risk Policy?

- Regardless of who is responsible for arranging for the coverage, the project owner, the contractor, and all subcontractors should be **Named Insureds**. This is the standard approach taken in most construction contracts.
- Ownership of a construction project is a complicated issue.
- Although the project owner usually holds title to the land and will ultimately be the owner of the completed building, the project owner is seldom the sole owner of property under construction until the general contractor (at least) has been paid.
- Most often the contractor or the various subcontractors purchase the construction materials and are reimbursed only periodically during the construction process.
- As owners or part-owners of the insured property, the contractors and subcontractors should rightly have a claim to the builders risk insurance proceeds.
- Including all parties to the construction project as named insureds ensures that they will all have a valid claim to any builders risk insurance proceeds.

My Contractor Has Liability Insurance, Why Do We Need Builders Risk Insurance?

- General Liability and Umbrella Policies overall do not do a good job of covering the risks of accidental jobsite property damage
 - Exclusions for: Property Being Worked On, Exclusions for Property of Others Under Care, Custody or Control, etc.
 - Property damage risks associated with renovation projects in particular can *easily* exceed a Contractor's General Liability and Umbrella Liability policy limits.
 - Disputes over legal liability can slow down project progress

Covered Property

- Coverage—"We" cover direct physical loss caused by a covered peril to "buildings or structures" while in the course of construction, erection or fabrication.
- Existing structures are not covered but can be added.
- Source: American Association of Insurance Services Builders' IM 7050 08/12

DEFINITIONS

1. "Buildings or structures" means:
 - a. buildings;
 - b. structures;
 - c. materials and supplies that will become a permanent part of the buildings or the structures; and
 - d. foundations, excavations, grading, filling, attachments, permanent fencing, and other permanent fixtures.

Property Not Covered

- In most builders risk forms, the list of property not covered is a fairly short one.
- This exhibit shows some types of property that are commonly excluded from coverage.
- Some of these coverages can be purchased if an exposure exists.

Exhibit 6.1 Commonly Excluded Property Categories
<ul style="list-style-type: none">• Existing property• Contractors tools, equipment, and machinery not destined to become part of the structure• Motor vehicles, aircraft, and watercraft• Signs• Land and water• Trees, grass, shrubbery, and plants• Animals• Accounts, bills, currency, money, and securities• Waterborne property• Maps, plans, blueprints, and drawings• Property being used or installed in any bridge, dam, tunnel, or similar construction

Civil Works coverage can be added for infrastructure projects

Common Exclusions

Exhibit 7.1 Common Builders Risk Excluded Perils
<ul style="list-style-type: none">• War, nuclear hazard, and seizure or destruction of property by governmental order• Dishonest acts of the insured, the insured's employees, and those entrusted with property (except carriers for hire)• Mysterious disappearance or shortage found when taking inventory• Wear and tear, gradual deterioration, corrosion, rust, rot, mold, inherent vice, latent defect, insects, rodents, birds and other animals, except resulting unexcluded loss• Settling, cracking, shrinking, or expansion of walls, ceilings, floors, roofs, foundations, etc. (except ensuing unexcluded loss)• Changes or extremes of temperature and humidity• Damage by rain, snow, sleet, or ice to personal property in the open• Damage caused by freezing (unless proper precautions have been taken)• Fungus, wet or dry rot, and bacteria• Asbestos removal• Release of pollutants, unless resulting from specified perils• Delay, loss of use, loss of market, fines, penalties, and other consequential losses• Operation of building ordinances or laws*• Flood, mudslide, sewer backup, and seepage of water*• Earthquake, volcanic activity, and other earth movement*• Mechanical breakdown, electrical injury, boiler explosion*• Testing*• Design error, except resulting damage• Faulty workmanship or materials, except resulting damage• Collapse, except from specified causes• Loss covered under guarantee, warranty, or obligation of manufacturer or supplier
<p>*Coverage may be available by endorsement or coverage option.</p>

Defects, Errors or Omissions

Defects exclusion from AAIS IM 7050 08/12 policy form

- Although the A201 requires coverages for ensuing loss or resulting damage from error, omission, or deficiency in construction methods, design, specifications, workmanship or materials, the vast majority of builders risk policies only cover loss arising out of these areas if they result in a covered peril.

c. **Defects, Errors, And Omissions --**

- 1) "We" do not pay for loss or damage consisting of, caused by, or resulting from an act, defect, error, or omission (negligent or not) relating to:
 - a) design, specifications, construction, materials, or workmanship;
 - b) planning, zoning, development, siting, surveying, grading, or compaction; or
 - c) maintenance, installation, renovation, remodeling, or repair.

But if an act, defect, error, or omission as described above results in a covered peril, "we" do cover the loss or damage caused by that covered peril.

- 2) This exclusion applies regardless of whether or not the act, defect, error, or omission:
 - a) originated at a covered "building or structure"; or
 - b) was being performed at "your" request or for "your" benefit.

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Delay in Completion Coverages

If a delay in completion is the result of an covered peril, Delay in Completion can provide coverage for these losses in addition to the direct property loss as long as appropriate limits and coverages are provided.

Builders Risk Insurance			
Delay in Completion Coverage Worksheet			
Additional Construction Expenses			
Advertising	▼	\$ -	
Design Fees	▼	\$ -	
Financing	▼	\$ -	
Lease Administration	▼	\$ -	
Professional Fees	▼	\$ -	
Permit Fees	▼	\$ -	
Total		\$ -	
Additional Soft Costs			
Interest Payments	▼	\$ -	
Realty taxes	▼	\$ -	
Lease Expenses	▼	\$ -	
Insurance Premiums	▼	\$ -	
Total		\$ -	
Rental Income	▼	\$ -	
Income Coverage	▼	\$ -	
Total		\$ -	

Underwriting Factors

- Construction type
- Square footage
- Location & site protection
- Proximity to coast
- Neighboring properties
- Protection class
- Completed value
- Length of project
- Selected contractor
- Protective Safeguards
- Specialized property being shipped from other countries (special transit coverage considerations)

Additional issues for Renovation Projects

- Age of Existing Structure
- Condition of Existing Structure – is there any pre-existing damage?
- Construction type - very specific with regard to **any** frame structural elements
- Any occupancy during construction?
- Will any structural modifications occur during renovation (i.e. removal of load-bearing walls, foundation work)?
- Has a structural evaluation been done?

Renovation Projects

- Renovation projects pose special risks; including collapse, fire and other causes of loss
- Occupancy during renovation can pose additional risks
- Determining the value of the existing structure can be difficult
- Need to have agreed value or stated value on existing structure to avoid coinsurance issues
- Many insurers will not cover an existing structure being renovated on a Replacement Cost basis, but rather on an Actual Cash Value basis.
- Historic tax credit coverage may be necessary/required
- Coverage on existing structure, along with waivers of subrogation, are important for contractors since 1) CGL coverage doesn't fully cover damage to property while being worked on 2) property damage exposures associated with existing buildings and historic tax credits can *easily* exceed a contractors CGL & Umbrella limits.

Residential Renovation Challenges

- Residential renovation projects often pose challenges.
- In many cases, it is acceptable for a residential renovation project to remain insured on a homeowners policy.
- However, many carriers, especially high-value home insurers, will refuse to cover renovation projects if the owner has waived subrogation rights against the general contractor, leaving the contractor exposed to subrogation claims by the owner's insurer.
- For larger homes, this can be a significant exposure.
- Builders risk coverage can be purchased on a contingent basis to cover the contractor's property damage liability exposure, but this can drive cost, especially for high-value coastal property.

Other topics

- Understand policy conditions defining when coverage ends
- Special water damage deductibles
- Limitations on coverage for damage due to rain, sleet, hail while building envelope is incomplete
- Matching policy term to project term for projects longer than one year
- Deductible buyback policies
- Security/Sensor Requirements

Insurance Takeaways

- Jobsite property damage exposures are complex and can vary from project to project.
- There are many risks involved with a construction project, many are uninsurable. However, jobsite property damage and associated delay risks are risks that can be insured.
- Builders risk policies are not created equal; there can be a wide variance in the scope of coverage amongst various policies.
- Collaboration between owners, contractors, attorneys and insurance professionals to review construction contracts, identify exposures and structure appropriate insurance protection will yield the best results.

Legal Discussion

Determining Builder's Risk Coverage

Measure Thrice, Cut Once

- Builder's risk insurance is perhaps the least understood insurance product in the construction world.
- Even sophisticated construction participants are not quite sure what a builder's risk insurance policy covers.
- Who has rights to recovery?
- How builder's risk coverage dovetails with other insurance like comprehensive general liability and worker's compensation insurance. See *General Electric v. Zürich American Insurance D. Maine* September 27, 1996, 952 F. Supp. 18

Be Methodical—Measure Three Times!

- The three “measurement” steps are the same here as for any insurance policy:
 - Is there coverage?
 - Is there an exclusion?
 - Is there an exception to the exclusion?

Measurement No. 1: Is There Coverage in the First Place?

- Builder's risk policies cover damage to the work of the project and items related to that work, often arising out of extraneous causes like fire, collapse, or other physical calamities.
- There are all sorts of variations of builder's risk insurance policies, and typically the prospective insured is presented with a varied menu of possible coverages.
- Of note: this is different from comprehensive general liability insurance, which typically does not cover damage to or defects in your work.

Examples of No Coverage

- There are some losses that simply do not qualify for coverage right out of the gate.
- No coverage for parts of the structure or building not involved with the work. See Builders Concrete Services, LLC v. Westfield National Insurance Company N.D. III. | September 14, 2020 | 486 F.Supp.3d 1225.
- A dam is not a structure covered by the policy. See Bergeron v. State Farm Fire and Cas. Co. N.H. | November 15, 2000 | 145 N.H. 391.
- Grouting and patching a wall to meet municipal ordinance requirements was not covered physical damage. See Tocci Building Corp. v. Zurich American Ins. Co. D.Mass. | September 25, 2009 | 659 F.Supp.2d 251.

Builders Risk is Not a Liability Policy

- It is a first-party policy, protecting the insured from property damage to the work rather than a third party policy that provides defense and indemnification to the insured from claims of third parties.
- It is more like auto collision insurance than auto liability insurance. A condo contractor is not entitled to defense and indemnification from a poor workmanship claim. See 689 Charles River, LLC v. American Zurich Insurance Company D.Mass. | September 04, 2018 | Not Reported in Fed. Supp.

Measurement No. 2: Is There an Exclusion?

- Is there an exclusion that takes coverage away?
- A common exclusion is the faulty workmanship exclusion. Here is a sample from a Zurich policy: “We will not pay for a loss caused by or resulting from any of the following. But if loss by a Covered Loss results, we will pay for the resulting loss caused by that Covered Cause of Loss.
 - Faulty, inadequate, or defective:
 - Planning, zoning, development, surveying, siting.
 - Design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction.
 - Materials used in repair, construction, renovation, or remodeling.
 - Maintenance of all or any part of any Covered Property wherever located.”

Example of a Fatal Faulty Workmanship Exclusion

In *Rocky Mountain Prestress, LLC v. Liberty Mutual Fire Insurance Company* C.A.10 (Colo.) | June 02, 2020 | 960 F.3d 1255, the whole claim was based on the faulty workmanship itself. The distinction to keep in mind is between the bad work versus the consequences of bad work. In *Rocky Mountain*, the contractor improperly grouted precast concrete pillars and columns. Simply stated, there was no coverage that would fund making poor work right.

Measurement No. 3: Is There an Exception to the Exclusion?

- Just as an exclusion can punch a hole in coverage, an exception to that exclusion can fill that hole. Such is the case with the “resulting loss” exception to the faulty workmanship exclusion. An exception should not swallow the exclusion.
- In *Joseph J. Henderson & Sons, Inc. v. Travelers Property Casualty Insurance Company of America* C.A.8 (Iowa) | April 20, 2020 | 956 F.3d 992, the issue was whether the faulty workmanship exclusion was fatal to a claim for roof damage caused by both a windstorm and faulty workmanship. The insurer argued that there was no coverage for the windstorm because that cause of loss was subject to an “anticoncurrent-cause,” a clause that essentially destroyed coverage if any other event contributed to the loss, in this case faulty workmanship. The faulty workmanship exclusion contained an exception similar to the resulting loss exception in the Zurich policy quoted earlier in this article and, unlike the windstorm-triggered clause, did not contain an anticoncurrent-cause clause. The insured prevailed. Had the faulty workmanship exclusion contained an anti-concurrence provision, as there was for the windstorm clause, the insured may have prevailed. There was no such clause.

What to Do?

Owners and contractors should take these three “measurements” before buying the policy and not proceed blindly until there is a loss of coverage, exclusions, and exceptions. In both timeframes, before policy purchase and after a loss, it is best to simply read the policy, better yet with the assistance of a seasoned insurance agent, with the particular challenges and risks of each project in mind.

The AIA Approach

For a thorough survey of the approach adopted by
AIA A 201 General Conditions (2017):

<https://www.irmi.com/articles/expert-commentary/builders-risk-new-aia-requirements>