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Builder's Risk Insurance for Construction Projects: Legal Issues

Evaluating Scope of Coverage, Policy Exclusions and Coverage Extensions and Sub-Limits

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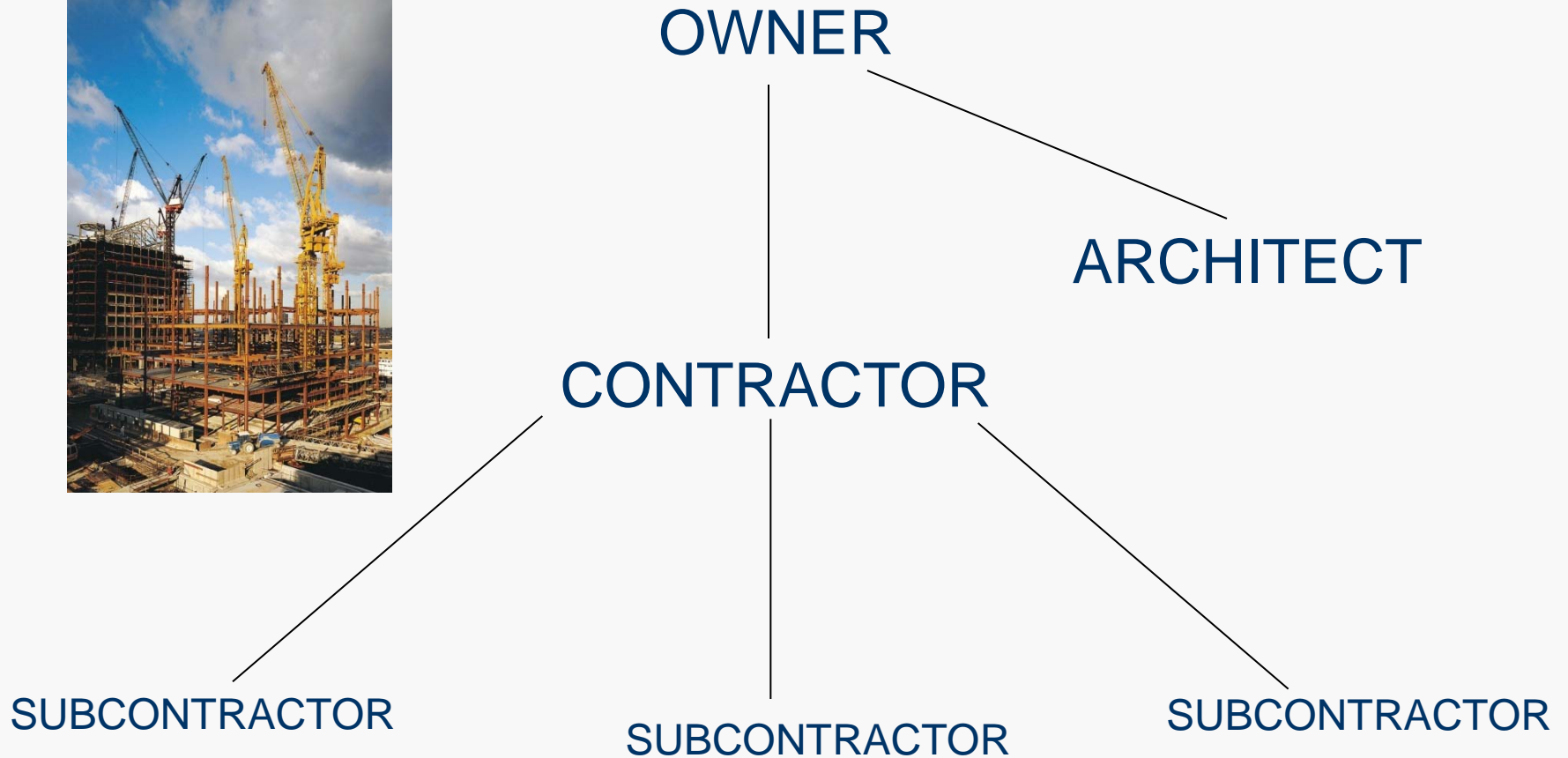


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Builder's Risk Insurance for Construction Projects

Melissa Lesmes and Michael McNamara

The Context: A Typical Construction Project



Types of Insurance for Construction Projects

- **“First party”**
 - **Loss to the insured’s own property**
 - Commercial Property insurance
 - Builders Risk insurance
 - Contractor’s equipment insurance

- **“Third party”**
 - **Third parties’ claims and suits against the insured**
 - Commercial General Liability
 - Pollution Legal Liability
 - Professional Liability/Errors and Omissions
 - Workers Compensation

Why Builders Risk?

➤ Purposes:

- To protect insureds against damage and resulting loss to work in the course of construction, before it is accepted and delivered to the owner;
- To insure against financial/economic losses arising in the course of construction.

What Is Builders Risk Insurance?

- **Generally covers damage to property during construction.**
- **Similar to property insurance for existing property.**
- **Generally offers broader coverage than normal commercial property insurance.**
 - **fewer exclusions;**
 - **greater coverage of materials off site and in transit; and**
 - **availability of earthquake, flood and testing coverage.**

What Is Builders Risk Insurance?

- **Two basic types of Builders Risk insurance:**
 - **All-risk** - insures against all risks of loss except for those specifically excluded.
 - **Named peril** - covers only those risks specifically enumerated within the policy.

- **Builders Risk almost always on “manuscript” forms – ISO form exists but rarely used**
 - In contrast to typical commercial general liability forms

Navigating a Builders Risk Policy

- **Conceptualize three things that are “covered” and you can navigate a Builders Risk Policy:**
 - **Parties**
 - **Property**
 - **“Causes of Loss” or “Perils”**

Who Is Insured?

- **Should include owner, general contractor and all subcontractors**
- **Best practice: name all of the above as named insureds**
 - On Builders Risk policy declarations page; or
 - On a Named Insured Endorsement to the Policy.
 - Can be identified by position: “contractor and subcontractors of every tier.

Who Is Insured?

➤ Problems with other methods

- “As their interests may appear”
- “Additional Insured”
- “Loss payee”



Anatomy of a Builders Risk Policy

- Insuring Agreement
- Exclusions
- Extensions
- Conditions



Insuring Agreement – All-Risk Policy

➤ Sample insuring agreement:

This *Policy*, subject to the Limit of Liability and the terms, exclusions, conditions, and limitations contained herein or endorsed hereon, indemnifies the Insured against all risks of direct physical loss of or direct physical damage to *Insured Property* occurring during the Period of Insurance while such *Insured Property* is at the construction site or in the course of transit to the construction site, or stored off-site, within the Territorial Limits specified in the Declarations.

All-Risk Form – What Is Insured Property?

➤ Sample definition of insured property:

Except as limited below, *Insured Property* shall mean all materials, equipment, machinery, and supplies owned by the Insured or for which the Insured shall be legally liable or shall have assumed liability, to be used in or incidental to the fabrication, erection, or construction of the Insured Project, provided the value of the *Insured Property* has been included in the estimated *Total Project Value* shown in the Declarations.

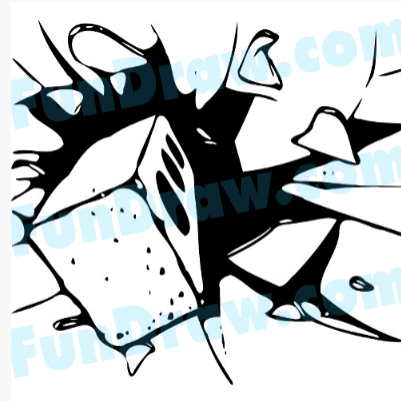
All-Risk Form – What Is Not Insured Property?

Insured Property shall not include:

- a. Contractors equipment, machinery and tools including spare parts and accessories whether owned, loaned, borrowed, hired or leased, or property of similar nature not destined to become a permanent part of the Insured Project but the foregoing shall not apply to formwork, fences, shoring and falsework as long as the value of these items are included in the estimated **Total Project Value** as stated in Item 2. of the Declarations;
- b. Automobiles or other vehicles, rolling stock, watercraft, or aircraft;
- c. Accounts, bills, currency, stamps, deeds, evidence of debt, checks, money, securities, precious metals, precious stones, books, records, manuscripts, other similar papers, data processing media or other property of a similar nature;
- d. Water, standing timber, growing crops and animals;
- e. Land, or the value of land, but this exclusion shall not apply to the cost of excavation and grading as long as the value of the excavation and grading is included in the estimated **Total Project Value** as stated in Item 2. of the Declarations;
- f. Owner supplied material, equipment, machinery, and supplies unless the value of such material, equipment, machinery, and supplies is included in the **Total Project Value** as stated in Item 2. of the Declarations;
- g. Existing buildings, structures or any other existing property unless specifically endorsed to the **Policy**;
- h. Above or below ground transmission and distribution lines, poles, towers and all equipment attached or affixed thereto, including supporting structures, transformers and appurtenant buildings located more than 1,000 feet from the construction site;
- i. All property, regardless of ownership, located at the premises owned, leased, rented or otherwise occupied by manufacturers or suppliers.

Insuring Agreement – Named Peril Policy

- We will pay for **direct physical loss** of or **damage** to **Covered Property** at
- the premises described in the Declarations caused by or resulting from
- any **Covered Cause of Loss**.



Named Peril Policy – What Is Covered Property?

1. Covered Property

Covered Property, as used in this Coverage Part, means the type of property described in this section, **A.1.**, and limited in **A.2.**, Property Not Covered, if a Limit of Insurance is shown in the Declarations for that type of property.

Building Under Construction, meaning the building or structure described in the Declarations while in the course of construction, including:

- a. Foundations;
- b. The following property:
 - (1) Fixtures and machinery;
 - (2) Equipment used to service the building; and
 - (3) Your building materials and supplies used for construction;
provided such property is intended to be permanently located in or on the building or structure described in the Declarations or within 100 feet of its premises;
- c. If not covered by other insurance, temporary structures built or assembled on site, including cribbing, scaffolding and construction forms.

Named Peril Policy – What Is Not Covered Property

2. Property Not Covered

Covered Property does not include:

- a. Land (including land on which the property is located) or water;
- b. The following property when outside of buildings:
 - (1) Lawns, trees, shrubs or plants;
 - (2) Radio or television antennas (including satellite dishes) and their lead-in wiring, masts or towers; or
 - (3) Signs (other than signs attached to buildings).

What Are Covered Causes Of Loss?

➤ Examples:

- Covered Cause of Loss means risk of direct physical loss to Covered Property, except those causes of loss listed in the Exclusions.
- Covered Causes of Loss, as used in this Coverage Part, means RISKS OF DIRECT PHYSICAL LOSS unless the "loss" is excluded or limited by other provisions of this Coverage Part.

Typically Excluded Perils

- **Delays**
- **Pollution**
- **Mechanical Breakdown**
- **Defective design or workmanship**
- **Settling, cracking, shrinking or expanding**
- **Flood and Earth Movement**

Typical Excluded Losses

- **Consequential damages**
- **Penalties**
- **Land**
- **Landscaping**
- **Existing structures**

Exceptions to Exclusions – Coverage restored (or not lost at all)

- **Exceptions make some seemingly large exclusions very narrow**
- **Example: Earthquake triggers fire which causes widespread damage.**
 - **Policy excludes damage caused by earthquake.**
 - **But, when damage caused by covered cause of loss results, damage caused by that covered cause of loss is covered.**
 - **Fire is covered cause of loss.**
 - **Damage caused by fire (triggered by earthquake) is covered.**
- **Excluded Peril → Damage = No coverage**
- **Excluded Peril → Covered Peril → Damage = Coverage**

Exclusions and Exceptions to Exclusions

- **Three types of Exclusions: Broad, Medium, and Narrow:**
 - **Broad:** Excludes loss caused by excluded peril regardless of any other cause that contributes concurrently or in any sequence to the “loss.”
 - **Medium:** Excludes loss caused by excluded peril, but resulting loss by “specified causes of loss” is covered.
 - **Narrow:** Excludes loss caused by excluded peril, but resulting loss by any covered peril is covered.

Delay In Start-up Exposures

- Soft Costs
 - Expenditures resulting from the delay that would not otherwise have been incurred
- Business Income
 - Lost income from a delay in start-up of operations
- Rental Value
 - Lost income associated with a delay in tenant occupancy

Period of Delay

- **Usually defined as the period of time between the anticipated completion date and the actual completion date.**

Soft Costs – Policies Differ Dramatically

POLICY I

- A. Interest on money borrowed to finance construction or repair;
- B. Real estate and property taxes;
- C. Architect, engineering and consultant fees;
- D. Legal and accounting fees;
- E. Advertising and promotional expenses; and
- F. Rental or lease of construction equipment

POLICY II

- Interest upon money borrowed to finance the contract work
- Other as accepted by the company

POLICY III

1. Extra construction costs incurred to continue construction and meet contract dates;
2. Construction loan interest on money borrowed to finance construction or repair;
3. Realty taxes and other assessments on the construction site accruing during the period of delay;
4. Architect, engineering, and consultant fees;
5. Legal and accounting fees;
6. Insurance premiums;
7. License and permit fees;
8. Title fees;
9. Additional general overhead;
10. Additional debt service payment;
11. Additional bond interest;
12. Additional refinancing charges;
13. Additional construction loan fees

Typical Business Income Provision

We will pay for the actual loss of Business Income which you sustain due to the necessary suspension of operations during the period of restoration. The suspension must be caused by direct physical loss or damage at the premises described in the Declarations, including personal property in the open (or in a vehicle in the open) within 1,000 feet, caused by or resulting from a covered cause of loss.

Business income means the net income (net profit or loss before income taxes) that would have been earned or incurred and continuing normal operating expenses incurred, including payroll.

Rental Income

Rental income, meaning the:

- Net rental income (net profit or loss before taxes) that would have been earned or incurred; and
- Continuing normal expenses incurred in your rental operations

Business Income

- Difference between Soft Costs and Business Income:
 - Business income covers only those earnings that would have been generated had the loss not occurred
 - Soft costs cover the additional cost irrespective of anticipated earnings

Builders Risk Insurance

- **Adequate limits**
 - **Hard costs**
 - **Soft costs**
 - **Coverage Extensions**
 - **Sub-limits**

Builders Risk Insurance

- **Coverage extensions**
 - **extra expenses**
 - **expediting expenses**
 - **soft costs**
 - **delay in completion**
 - **liquidated damages**
 - **sue and labor and mitigating expenses**
 - **debris removal**
 - **valuable papers and records**
 - **other extensions**

Who Buys the Builders Risk Insurance?

- **Either the Owner or the GC, usually specified in the construction agreement**
- **Owner – Facilitate conversion to permanent property insurance policy upon the completion of the project**
- **GC – Use GC’s superior contacts and expertise in purchasing and structuring Builders Risk insurance**
- **AIA Form A201 (General Conditions) requires Owner to obtain Builders Risk insurance, or notify GC it intends not to do so (if it does not so obtain or notify, liable to GC for all reasonable costs attributable thereto)**
- **If so notified, GC can obtain the insurance (for itself and its subcontractors) and charge cost to owner**
- **Form A201 is often modified to require GC to obtain Builders Risk insurance**
- **AIA Form A401 (standard form subcontract) permits Subcontractor to purchase additional Builders Risk insurance if A201 requirements are not met**

Common Builders Risk issues

➤ Scope of coverage

- Cause of damage – excluded or covered peril?
 - Does Resulting Loss Exception apply?
- Covered property?
 - Do coverage extensions apply?
- Covered party?

➤ Who does what?

- Responsibility for securing coverage
- Responsibility for submitting claim
- Responsibility for deductible

➤ Ripple effect to other parties and insurances

- Primary over other insurance?
- Subrogation by Builders Risk carrier?

Common Myths

- **Negligence**
 - Required
 - Bars coverage
- **Force majeure**
 - No coverage for force majeure events
 - Only force majeure events are covered
- **No coverage where faulty design or workmanship are at issue**

Notice

- **DO NOT FORGET OR NEGLECT TO PLACE YOUR INSURANCE BROKER AND INSURER ON NOTICE AS SOON AS YOU BECOME AWARE OF A CLAIM!**

Closing Points

➤ Know the Project

- Pre-existing structures at the Project Site
- Project duration
- Type of structure being constructed
- Other entities with interests in the property
- Machinery, equipment, etc.
- Underground works
- Landscaping
- Off-site storage of materials

➤ Obtain Sufficient Coverage

- Coordinate with construction contract
- Ensure that sub-limits, exclusions, and endorsements are consistent with potential exposure

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