

Presenting a live 90-minute webinar with interactive Q&A

Construction Builders Risk and CGL Insurance: Scope of Coverage, Covered Losses, Exclusions, AI Endorsements

Mitigating Construction-Related Disputes; Key Challenges for Claims Under Builders Risk vs. CGL Coverage

TUESDAY, JANUARY 10, 2023

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Michael V. Pepe, Partner, **Saxe Doernberger & Vita, P.C.**, Trumbull, CT

Patrick J. Wielinski, Principal, **Cokinos | Young**, Dallas, TX

Christopher Yetka, Shareholder, **Larkin Hoffman Daly & Lindgren**, Minneapolis, MN

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CGL Coverage for Construction Claims: Property Damage, Occurrence and Notice

Christopher Yetka

**A Strafford CLE Video Seminar
January 10, 2023**

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Definition of Property Damage

Property damage means:

- a. *Physical injury to tangible property, including the loss of use of that property.* All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
- b. *Loss of use of tangible property that is not physically injured.* All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it.

Categories of Property Damage

1. Physical Injury to Tangible Property
2. Loss of Use of Tangible Property *Resulting From Physical Injury* to Tangible Property
3. Loss of Use of Tangible Property Which Has *Not* Been Physically Injured

Physical Injury to Tangible Property

- Not defined in standard ISO policy
- According to Illinois Supreme Court:
 - “Under its plain and ordinary meaning, the term ... unambiguously connotes damage to tangible property causing an alteration in appearance, shape, color or in other material dimension.”
 - *Travelers Ins. Co. v. Eljer Mfg. Inc.*, 757 N.E.2d 481 (Ill. 2001)

Consequential Damages

- Defective construction can cause economic losses
- For example:
 - Lost profits
 - Increased construction costs
 - Labor productivity impacts
 - Substantial delay costs



Consequential Damages

- By themselves, these items are only economic loss.
- **But**, lost profits or increased construction cost caused by other covered “property damage” should constitute covered damages
- The policy coverage grant says: “**because of** property damage”
- The CGL policy should cover “economic loss” -- when it is tied to **physical injury** to tangible property

Consequential Damages

- *Western World Ins. Co. v. H.D. Engineering*, 419 N.W.2d 630 (Minn. App. 1988)
 - Insured subcontractor stored materials on partially completed roof structure
 - Roof collapsed & construction stopped
 - GC sues sub for “delay damages,” “loss of productivity,” & “additional direct costs” caused by winter condition work



Consequential Damages

- Court held:
 - The collapsed structure satisfied the “property damage” element.
 - Consequential damages that flow from that property damage are covered under the CGL policy
- On other hand:
 - Purely economic losses **that are NOT tied to physical injury** to tangible property likely are not covered

Occurrence in CGL Policies

- Policy pays those sums that the insured becomes *“legally obligated”* to pay as damages because of *“property damage”* caused by an *“occurrence”*
- Unless coverage is removed by one of the *policy exclusions.*



Definition

- “Occurrence” means **an accident**, including continuous or repeated exposure to substantially the same general harmful conditions.
- **DOES NOT** say that inadvertent construction defects are somehow **not** “accidental,” or excluded from scope of the term “occurrence”
- Says all “property damage” caused by an accidental “occurrence” **is** covered, unless excluded by other policy terms



Resistance to Coverage

- CGL policies just aren't intended to cover this kind of claim
- The insured contractor is seeking coverage for sloppy construction
- The CGL policy is not intended to pay for “warranty work”
- The CGL policy is not a “performance bond”

Policy History

- CGL policy forms were materially changed during the past 40 years
- The changes **NARROWED** the construction-specific exclusions to provide **BROADER** coverage



Three Approaches to Occurrence

- **LACK OF SUBJECTIVE INTENT** - Unintentional defective construction work is an “occurrence.” If the insured *did not subjectively intend* to perform defective work and the *damages were not expected or intended*, then an “occurrence” exists.
- **DAMAGE TO PROPERTY OTHER THAN DEFECTIVE WORK** – Defective construction “standing alone” is not an “occurrence,” but faulty workmanship (by the insured or its subs) that causes *property damage to something other than the defective work itself* can be an “occurrence.”
- **ALL DAMAGES CAUSED BY WORK FORESEEABLE** - All damages caused by faulty workmanship *are reasonably foreseeable and are not fortuitous*; therefore faulty workmanship claims do not give rise to an accidental “occurrence.”

The Issue of Notice

- Read the Policy Language
 - As soon as practicable
 - Within XX days
 - Duty to report circumstances that may lead to a claim
 - Prejudice

NOTICE

QUESTIONS

Christopher H. Yetka

Email: cyetka@larkinhoffman.com

Phone: (952) 896-3308

ADDITIONAL INSURED COVERAGES

Evolution of ISO AI Forms



1985

CG 20 10 11 85
“arising out of”

1993

CG 20 10 10 93
Limits coverage to
“ongoing operations”

2001

CG 20 10 10 01
Excludes coverage
for completed
operations

CG 20 37 07 04
Includes completed
operations

2004

CG 20 10 07 04
Replaces “arising out
of” with “caused in
whole or in part.”

Excludes completed
operations

CG 20 37 07 04
Includes completed
operations

2013

CG 20 10 04 13
Adds:
“will not be broader
than”

Limits = contract
Permitted by law

CG 20 37 04 13
Includes completed
operations

Limitations upon the Scope of AI coverage directly impact the Horizontal / Vertical Exhaustion Debate.

2019 Forms



CG 20 10 12 19 and CG 20 37 12 19

Same as 2013 version, but remove reference to the limits “shown in the Declarations”

CG 20 39 12 19

New endorsement that extends Automatic Completed Operations coverage

Designed to work with the CG 20 33 which extends Ongoing Operations coverage to hiring contractor when there is contractual privity.

CG 20 40 12 19

New endorsement that extends Automatic Completed Operations coverage

Designed to work with the CG 20 38 which extends Ongoing Operations coverage to additional insureds even when there is no contractual privity, but it is required by the Contractor hiring you

Carrier-Specific Forms

- Slight differences from ISO language may be significant
- Language may not have been tested by courts
- Can lead to disputes about what “or equivalent” means when used in contractual requirements

Typical Issues

- Contractual Privity
- Causation Trigger
- Limits Required by Contract
- Priority of Coverage

Contractual Privity



Gilbane Bldg. Co./TDX Constr. Corp. v. St. Paul Fire & Marine Ins. Co.

2018 NY Slip Op 02117

Per the construction management contract between DASNY and Gilbane/TDX JV, any prime contractor was required to name the construction manager as an additional insured. Accordingly, Gilbane/TDX JV sought additional insured coverage from Samson's insurer, Liberty Mutual. Samson's Liberty policy contained a blanket additional insured endorsement that provided:

WHO IS AN INSURED (Section II) is amended to include as an insured any person or organization **with whom you have agreed to add as an additional insured by written contract** but only with respect to liability arising out of your operations or premises owned by or rented to you.

Liberty filed a motion for summary judgment, seeking a declaration that it had no duty to defend Gilbane/TDX JV because it did not have a direct contract with the named insured, Samson. The Court held that Liberty did not have to cover the JV because the contractual privity requirement had not been met.

Causation Trigger

Burlington Ins. Co. v. NYC Transit Authority

79 N.E.3d 313 (N.Y. 2017)

ON a NYC subway project, a subcontractor's employee drove an excavator into a buried electrical cable causing an explosion, and injuring the employee. The NYC Transit Authority failed to mark the buried electrical cable.

The Transit Authority sought coverage as an additional insured under the subcontractor's general liability policy, which had denied citing the causation trigger in its endorsement.

Such person or organization is an additional insured only with respect to liability for "bodily injury", "property damage" or "personal 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.

CG 20 33 07 04

The court held that the trigger language is narrower than "arising out of" language in earlier versions and that coverage applied only when the named insured's acts or omissions were the proximate cause of the injury.

Causation Trigger

Starr Indem. & Liab. Co. v. Excelsior Ins. Co.

516 F. Supp. 3d 337 (S.D.N.Y. 2021)

The “caused, in whole or in part, by” language merely required that the named insured be a proximate cause of the plaintiff’s injuries and if so, the additional insured carrier was responsible for indemnifying the additional insureds for the entire judgment. The court specifically rejected the insurer’s argument that the insurer was only responsible for its proportionate share of the liability as determined by a jury verdict in the underlying action - if the insurer is in for a penny, it is in for a pound. The Starr decision offers important guidance after the N.Y. Court of Appeals’ decision in Burlington.

Latest Cases

Travelers Prop. Cas. Co. of Am. v. AXIS Ins. Co.

No. 21-CV-4748 (LJL), 2022 WL 1807104 (S.D.N.Y. June 2, 2022)

Duty to defend case involving GC pursuit of AI coverage from sub-subcontractor (who wasn't named in underlying complaint).

N.Y. Marine & Gen. Ins. Co. v. Travelers Prop. Cas. Co. of Am.

No. 21-CV-6083 (JMF), 2022 WL 4585421 (S.D.N.Y. Sept. 29, 2022)

Addressing Travelers' AI endorsement

Foster Poultry Farms v. Contractors Bonding & Insurance Co.

562 F. Supp. 3d 1152 (E.D. Cal. 2022)

Duty to defend case involving comparative negligence allegations

OCIPs and CCIPs

CONTROLLED INSURANCE PROGRAMS

What is a CIP (“Wrap-Up”)

A single insurance policy for a large construction project that:

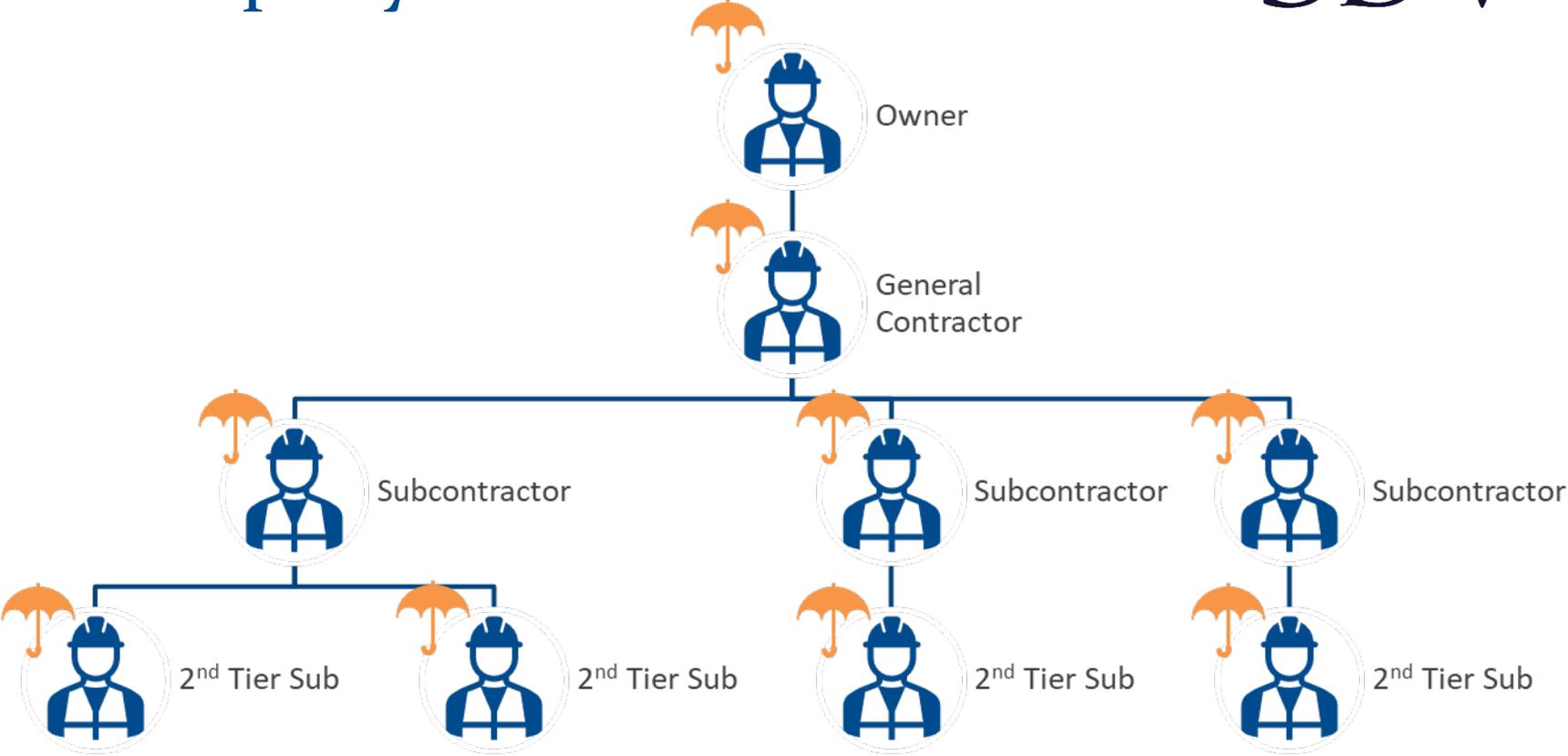
- covers all participants (owner, GC, subs)
- spans duration of the project and the completed operations period
- with limits designated to the project

Designed to avoid finger-pointing and allocation arguments

OCIP is sponsored by the Owner

CCIP is sponsored by the Contractor

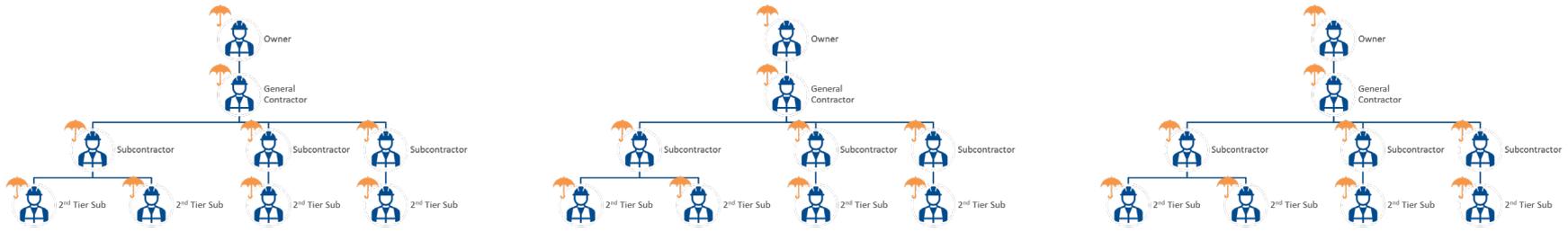
Traditional: Each party has own insurance



Traditional: All policies renewed annually



Limits may be eroded by losses on other projects



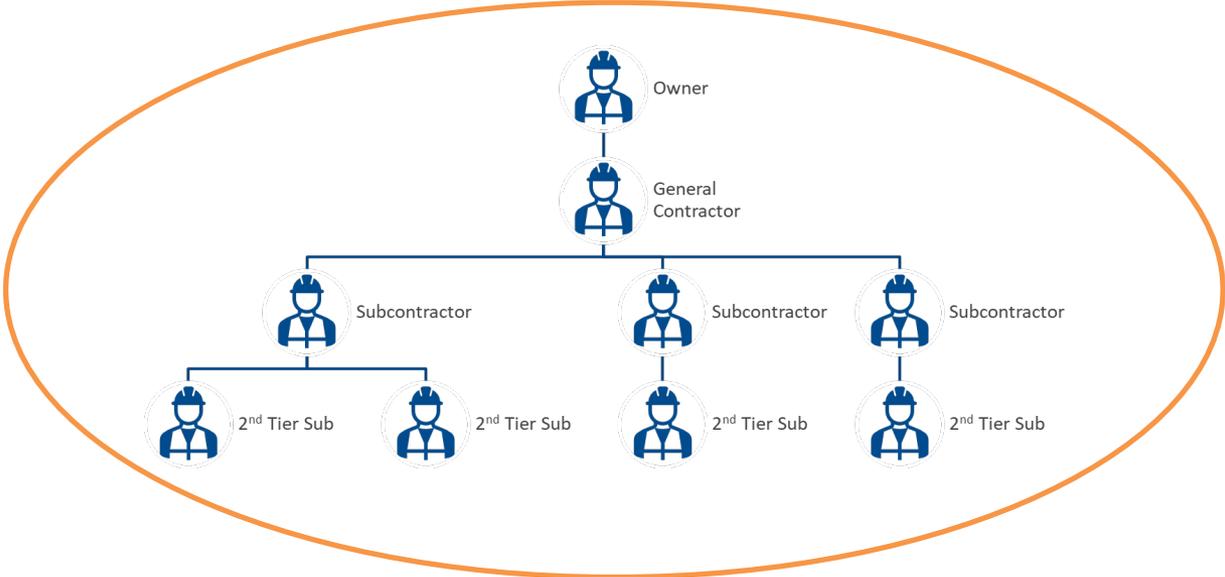
Year 1

Year 2

Year 3

Repeated throughout the Completed Operations Period

Wrap-up Replaces with a single policy



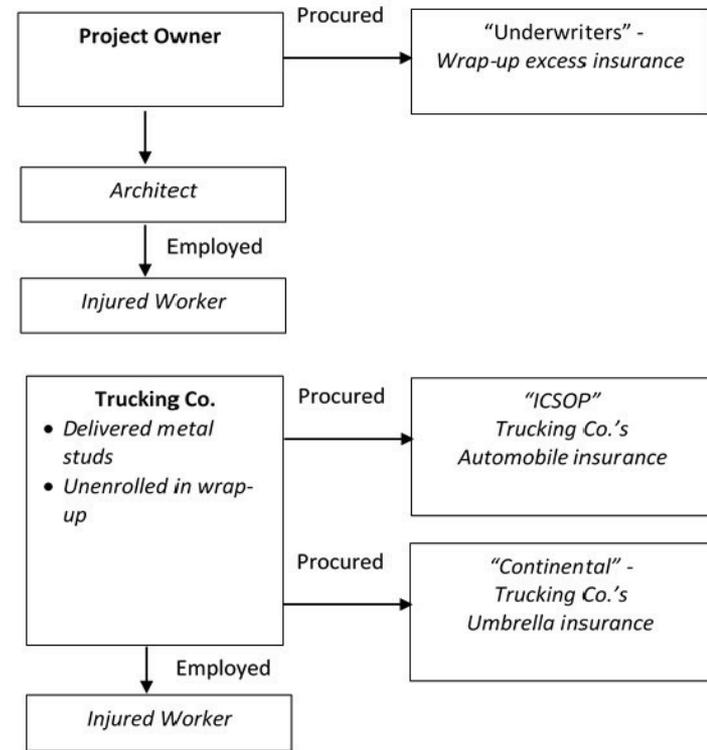
Dedicated Limits

Priority Dispute between Wrap and non-Wrap Insurers

Certain Underwriters v. Ill. Nat'l Ins. Co.

99 F. Supp. 3d 400 (S.D.N.Y. 2015)

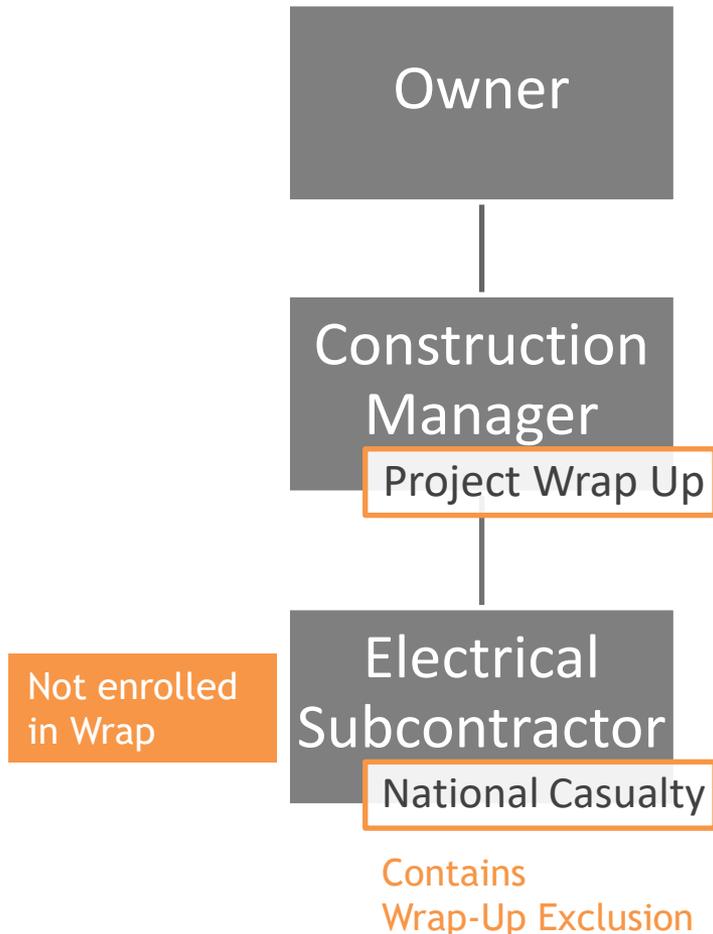
Neither “Wrap Manual” nor Policies’ “Other Insurance” clause caused either party to be primary



Court Decision on Priority of Coverage

1. Trucking Co.’s auto insurer: Full limits
2. Wrap-up Excess and Trucking Co.’s Umbrella Insurer: Pro-rata share of loss, in proportion to their respective policy’s limits

“Wrap-up Exclusions”



Structure Tone, Inc. v. National Cas. Co., 13 N.Y.S.3d 52 (N.Y. App. Div. 1st Dep’t 2015)

Electrical Sub’s employee injured while performing work on the Project sues Project Owner and Construction Manager

CM seeks AI coverage under Sub’s corporate CGL Policy

HELD: Wrap-up Exclusion in Sub’s policy applies to AIs, barring coverage for CM.

ISO 2019 Wrap endorsement



CG 21 54 01 96

This insurance does not apply to ‘bodily injury’ or ‘property damage’ arising out of either your ongoing operations or operations included within the ‘products-completed operations hazard’ at the location described in the Schedule of this endorsement, as a consolidated (wrap-up) insurance program has been provided by the prime contractor/project manager or owner of the construction project in which you are involved.”

CG 21 54 12 19

“Wrap-Up exclusion applies only if the downstream party is enrolled in a Wrap-Up insurance program with respect to the ‘bodily injury’ or ‘property damage’ described...”

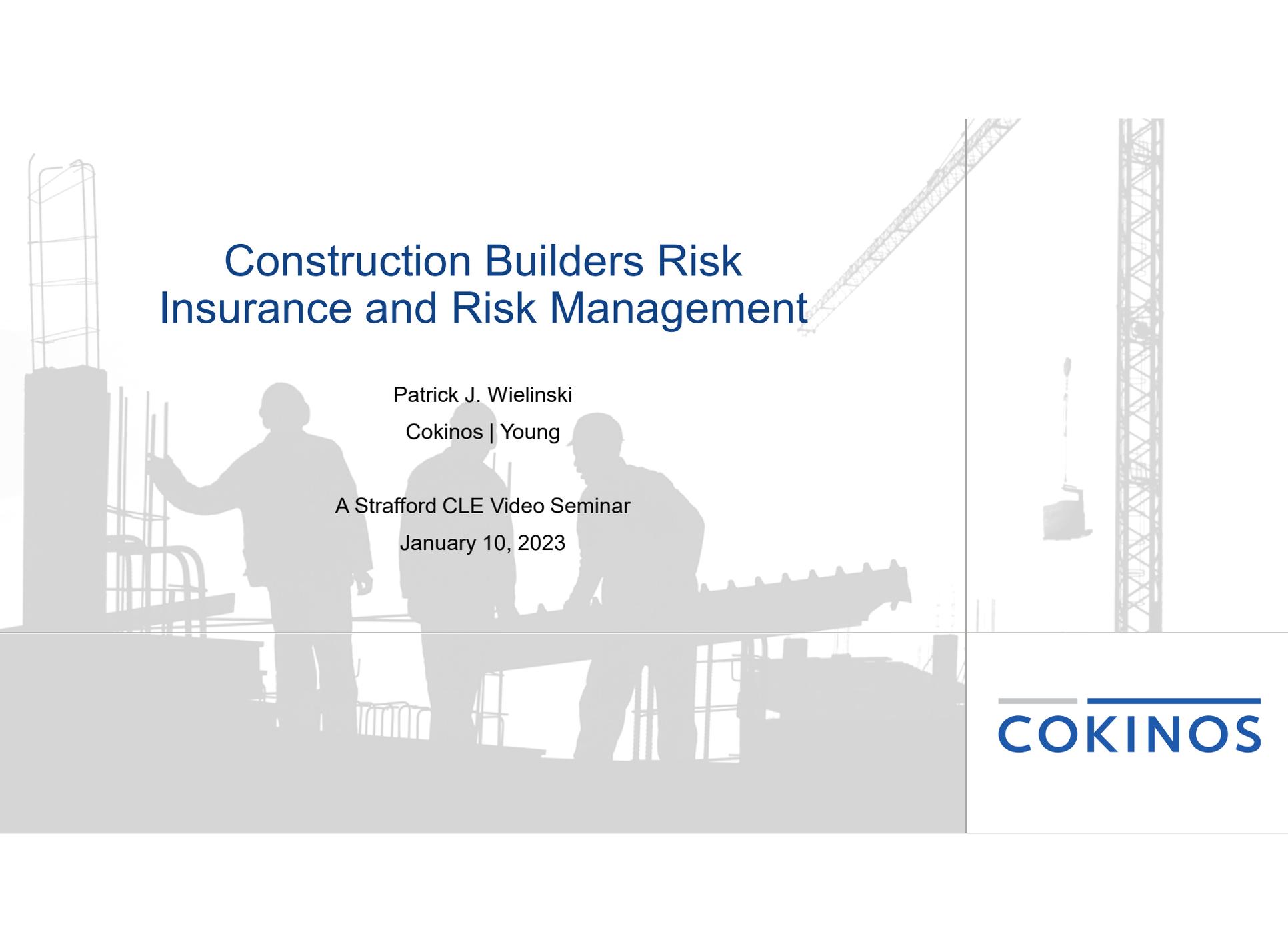
Thank you

Michael V. Pepe

Saxe Doernberger & Vita, P.C.

mpepe@sdvlaw.com

203-287-2123



Construction Builders Risk Insurance and Risk Management

Patrick J. Wielinski
Cokinos | Young

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COKINOS

Builders Risk Insurance

- Property/inland marine origins
- First party coverage
- Only covers projects under construction, renovation or repair

Builders Risk v. Liability Coverage

- Liability Insurance
 - Third-party coverage
 - Provides a defense against third party claims
 - Triggered by legal obligation based on fault of insured

Need for Builders Risk Insurance

- Liability insurance is not the primary means to protect against damage to the work
 - Liability policies contain property exclusions that limit coverage for property damage
 - Renders first-party policies more appropriate source of coverage
 - CGL policies are excess to builders risk coverage

Need for Builders Risk Insurance

- Advantages of first-party insurance
 - All risk coverage is available to cover loss or damage regardless of negligence of the parties
 - Theory: no need to prove legal liability, which expedites settlement while eliminating delays and expensive litigation
 - Insurable interests of all parties can be covered in a single policy

Builders Risk Perils

- Property is covered while at the construction site
- While stored off-premises (but intended for use in the construction)
- In transit

Builders Risk Insurance Premium Calculation

- Limit of insurance: 2 Methods of Calculation
 - Completed Value Approach
 - Most common
 - Reporting Form Approach
- Valuation Options
 - Replacement cost
 - Actual cash value

Builders Risk as a Risk Transfer Device – the Theory

- Contractual requirements for the builders risk policy should specify the broadest possible builders risk coverage
- In the interests of all contracting parties
- Avoid finger pointing and litigation
- See AIA Document A201, General Conditions of the Contract for Construction

Builders Risk as a Risk Transfer Device – the Reality

- Quick resolution of claims often degenerates into complex accounting exercises
- Consultant-intensive process
- Fault interjected through faulty/workmanship/design exclusions
- Finger pointing and litigation
- Emphasis on subrogation against the responsible parties

Builders Risk – Parties Insured

- All contractors, subcontractors, and project owners should be named as insureds under the policy
- Use of limiting or defining language (“as their interests appear”) in the naming of insureds should be avoided

Builders Risk – Waiver of Subrogation

- Construction contracts should specify a waiver of subrogation among participants on project to extent that damage is covered by insurance
- Backs up the concept that insurer cannot subrogate against its insured
- Policy should allow insured to waive recovery rights against others in writing prior to loss
- Beware of restrictive subrogation provisions in policy versus construction contract requirements

Builders Risk – Covered Perils

- While named perils builders risk policies are available in the market, all risk coverage predominates and is called for in most contract forms
- Coverage for collapse, earth movement, named storms, flood, etc. should be provided for in the contract and policy
- Consider coverage for specific exposures on project

Builders Risk – Covered Property

- Policy should include coverage for:
 - Materials, fixtures, supplies, machinery and equipment to be used in construction
 - Property to be used in connection with construction while stored at other locations
 - Property intended for use in construction while in transit

Builders Risk – Deductibles

- Builders risk deductible applies on a per-occurrence basis regardless of which insured under the policy suffers loss
- Number of occurrences is often an issue – cause test
- Responsibility for deductibles should be defined in construction contract insurance requirements

Builders Risk – Occupancy Prior to Completion

- Danger of voiding coverage if the project is occupied
- Construction contract should contain provisions that:
 - Neither owner nor contractor will take any action that might trigger occupancy restriction of builders risk policy
 - Both parties will seek to obtain permission of insurer before acting in a way that could be construed as occupancy

Builders Risk – Termination

- Builders risk insurance should not be terminated in favor of permanent property insurance on building unless all contracting parties agree
- Policy provisions as to termination vary

Fortuity Requirement

- All risk policies create special coverage extending to risks not usually covered so long as loss is fortuitous
- Losses arising out of design or construction defects may be regarded as fortuitous

“Direct Physical Loss” Requirement

“This policy insures against all risks of direct physical loss or damage to Covered Property, except as excluded.”

- Limitation on scope of coverage
- Merely detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property is not direct physical loss
- Change from satisfactory to unsatisfactory state
- Harmful change in appearance, shape, composition, or some other physical dimension of the "injured" person or a thing

“Direct Physical Loss” – Defective Work

- Do costs of repair of defective work give rise to a covered “direct physical loss?”
 - Courts may award the costs to repair accidents resulting from defective design or workmanship as damages, but not the cost of repairing the defect itself
 - Subject to terms of the policy

“Direct Physical Loss” – Mitigation of Damages

- Policies do not cover extra costs and expenses incurred in redesigning construction after discovery of defect
- Exceptions for avoiding further damage to project after discovery of defect:
 - Adding support beams
 - Removing and salvaging inventory from building in danger of collapse

Faulty Design/Workmanship Exclusions

- Three common types based upon restrictiveness of coverage allowed
- Roughly track the London Engineering Group (LEG) Clauses
 - Industry forum, primarily used by European Insurers
- Terminology and use is becoming more common in the United States

Restrictive Faulty Workmanship/Design Exclusions (LEG 1/96)

Example 1: Loss, damage, or expense caused by or resulting from error, omission, or deficiency in design, specifications, workmanship or materials . . .

Example 2: Cost of making good faulty workmanship or installation or errors in design or specifications . . .

- “Outright” exclusions, and all damage or loss arising out of defective design or workmanship, including damage to non-defective work, is excluded

Less Restrictive Faulty Workmanship/Design Exclusions – Ensuing Loss Clauses (LEG 2/96)

Example 1: The insurer shall not pay for loss or damage caused by or resulting from defective materials, faulty workmanship, error, omission, or deficiency in designs, plans, or specifications. But if loss or damage *by a covered cause of loss* results, we will pay for that resulting loss or damage.

Example 2: Cost of making good faulty workmanship, construction, or design, but this exclusion shall not apply to damage resulting from such faulty workmanship, construction, or design, unless specifically excluded elsewhere herein.

- “Consequences Defects Wording” preserves coverage for insured property damaged by the defect, except for the cost that would have been incurred if the replacement or rectification had been done before the damage.

Least Restrictive Faulty Workmanship/Design Exclusions (LEG 3/96)

All costs rendered necessary by defects of material workmanship design plan specification and should damage occur to any portion of the Insured Property containing any of the said defects *the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.* For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the *Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.*

- “Improvement Defects Wording” provides broadest coverage except for the cost incurred to improve the original material and workmanship.
- Covers the cost of repairing not only the ensuing loss, but also the defect itself.

Faulty Workmanship/Design Exclusions – Observations

- Coverage is limited to direct physical loss or damage per the insuring agreement
- Faulty design/workmanship exclusions enforce the notion that a pure defect is not direct physical loss
- Most frequent source of pure coverage disputes because it excludes insured property – the work

Latent Defect Exclusions

- “Wear and tear hidden or latent defect or any quality in property that causes it to damage or destroy itself . . .”
- Emphasizes the change from a satisfactory to an unsatisfactory state
 - Not property that was defective from the get go
- Latent defect exclusion, standing alone, is of little utility
- Usually applied together with the faulty workmanship or design exclusion

Inherent Vice Exclusions

- “Wear and tear, gradual deterioration, inherent vice, latent defect, corrosion, rust, dampness or dryness of the atmosphere”
- Excludes damage caused solely by internal decomposition without the application of an exterior force to cause the loss

Consequential Loss Exclusions

“Delay, loss of market or any other consequential loss.”

- Excludes coverage for economic damages that may arise out of physical loss or damage under the policy
- Often modified by purchasing Delay in Completion Coverage by endorsement
- The coverage is expressed in days of delay, with the “period of indemnity” set at a maximum number of days beyond anticipated date of completion for the project
- Deductibles are also calculated in days and apply to the initial days after the anticipated date of completion.
- Coverage applies only to the owner, as named insured, and no other contractors on the project

Soft Costs

- Coverage recognizes the time-sensitive nature of construction
- Costs result when a physical loss occurs during the course of construction, the damages of which usually go well beyond the cost of repairing the damaged work itself
- Examples of “soft costs”
 - Additional interest on money borrowed
 - Additional real estate and property taxes
 - additional legal, accounting, advertising

Soft Costs

- Coverage for soft costs must still result from “direct physical loss” to covered property
- Usually obtained through endorsement
- Also provided to owner through “delay in completion” endorsements

Difference In Conditions (DIC) Builders Risk Coverage

- Fills gaps left by owner-purchased insurance
- Usually purchased by contractors
- Written on reporting form basis
- Funds deductibles

Extra Expense/Expediting Costs

- Extension of coverage, subject to a sublimit
- Reasonable extra costs to make temporary repairs and to expedite the permanent repair or replacement of the insured property
- Must be incurred to expedite repair and return to normal operations

Thank you!

Patrick J. Wielinski

Cokinos | Young

pwielinski@cokinoslaw.com