

Workshop P

Wednesday, November 9, 1:30-3 p.m. and 3:30-5 p.m.

OCIP LIABILITY CLAIMS CHALLENGES

Presented by



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Owner controlled insurance programs (OCIPs) present unique challenges in settling claims. Critical aspects of the underwriting process directly affect how coverage will apply to covered contractors and subcontractors. This session examines critical policy provisions that will impact the claims process and offers strategies for smoothing the claim resolution process. A variety of challenging OCIP scenarios will be used to guide brokers, claim professionals, and underwriters in the settlement of claims.



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Mr. Griffith, a copresenter for Workshop P, "OCIP Liability Claims Challenges," on Wednesday afternoon, is a partner in the Branson, Brinkop, Griffith & Strong law firm, where he specializes in insurance coverage, contractual liability, and insurance and brokers professional liability litigation. He was formerly managing partner of Branson, Brinkop, Griffith & Strong, LLP, and the senior partner of the Coverage Group. A substantial portion of his practice is devoted to construction claims and litigation principally involving insurance disputes including ongoing operations and completed operations claims. Representative cases include OCIPs, CCIPs, additional insureds/contractual liability disputes as well as builders risk and subcontractor liability claims. He is a frequent speaker at industry events concerning construction insurance disputes.

He was admitted to the California Bar in 1984, California, and all U.S. District Courts. Mr. Griffith holds a bachelor of arts, *summa cum laude*, from California State University at San Jose (1981), and a juris doctorate, *magna cum laude*, from the University of San Francisco. He is a member of the San Mateo County Bar Association, State Bar of California, California Association of Defense Counsel, and the Defense Research Institute.

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Mr. Podesta is a copresenter for Workshop P, "OCIP Liability Claims Challenges," on Wednesday afternoon. He specializes in insurance coverage, bad faith, and insurance agents' professional liability litigation. He previously worked in the claim department of a major insurer as adjuster and supervisor of litigated cases.

A substantial portion of his practice is devoted to construction claims and litigation, principally involving insurance disputes regarding ongoing operations and completed operations. Representative cases include OCIPs, additional insured, contractual liability disputes, and builders risk/subcontractor liability disputes. He is a frequent speaker at events on construction insurance disputes.

He was admitted to the California bar in 1991 and the Nevada bar in 2001, including U.S. District Courts. He is a member of the San Mateo County Bar Association, the State Bar of California, and the State Bar of Nevada. Mr. Podesta earned an A.B. from the University of California at Berkeley and a J.D. from the University of San Francisco.

Notes

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OCIP LIABILITY CLAIMS CHALLENGES

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I. Critical Underwriting Issues

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IV. Presentation of Liability Claims under OCIP, How To "Package" the Claim Most Effectively

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OCIPs: Liability Claims Challenges

I. INTRODUCTION

Owner controlled insurance programs, or OCIPs, are the logical consequence of insurance underwriters and project owners trying to control costs and speed the resolution of construction-related insurance claims (including builders risk, workers compensation, and liability claims). Indeed, it would be difficult to find an experienced claim manager who has not slapped his head (or someone else's) in exasperation over the amount of time and money that it takes to resolve a construction bodily injury or construction defect claim.

For owners, there is a built-in incentive to find a better way to more efficiently manage the claims that inevitably occur on a large construction project. The amount of money spent on insurance premiums is a significant portion of the cost of construction. Moreover, the amount of money spent, not to mention the time commitment, is substantial because of the number of people and interests to protect.

From an insurance company's perspective, an OCIP premium is significant. Further, the ability to receive the premium for all parties on the job site while simultaneously eliminating the allocated expense makes OCIPs an attractive underwriting risk.

An OCIP, or wrap-up policy, may include all or part of the insurance needed on a project, including builders risk, workers compensation, and liability insurance. Experienced professionals in each line of insurance each have their own unique perspective on the process and the effect of insuring all parties on the project. Here, we concentrate on liability claims and policies.

As viewed from the perspective of the people who are attempting to resolve liability claims under an OCIP, the industry is maturing. Underwriters, owners, contractors, construction managers, and brokers are becoming more sophisticated with regard to underwriting and claims presentation. Specifically, in our practice we have noted the following trends in the handling of such claims "in the trenches":

1. Owners, as the sponsor of the program, assert control over claims under the insurance program, which can create tension with the insurance company and the contractors on the project.
2. Brokers are increasingly sophisticated and acting as coverage advisors for the insureds to maximize recovery under the OCIP policies.
3. There are often differences between the insurance policy issued by the company and the coverage as represented to enrolled subcontractors.

4. There is an increasing tendency for owners, brokers, and contractors to treat the OCIP as a single program, a concept that is sometimes at odds with the concept of liability insurance.
5. Inconsistencies between liability policy language, OCIP manuals provided to contractors, and the actual subcontracts blur the definition of what is the governing OCIP contract.
6. Lack of complete enrollment by all subcontractors on the project or phase complicates the claims process and impacts the cost of the program.
7. The timing of the inception of a “rolling wrap” can create hybrid liability claims that are partial wrap and partial non-wrap for purposes of a construction defect claim.
8. Lack of sophistication by subcontractors and their counsel creates tension in the claims process.

The insured contractors must bear in mind what an OCIP is and what it is not. An OCIP *is* an insurance policy, intended to provide all of the contractors on a job site with necessary coverage. From the perspective of the claims department, the OCIP is *not* a new kind of insurance. Therefore, this workshop concentrates on applying existing rules in the context of an all-encompassing policy.

II. LIABILITY OCIP FROM THE UNDERWRITING PERSPECTIVE

In the context of underwriting risks associated with an owner controlled insurance program, there are four critical issues: (1) marketing, (2) determining who qualifies as named insureds under the program, (3) remembering that the policy protects the contractor rather than the owner for many claims, and (4) how the liability policy interacts with other OCIP coverages.

A. Marketing

The starting point for any insurance relationship between a sophisticated carrier and a project owner is through brokers in an arms-length transaction. The insured (or its broker) presents a risk to the insurance company and requests that coverage be quoted. The insurance company decides whether it is interested in that risk and the amount that it will charge in its premium.

In marketing the OCIP, however, the underwriter may become actively involved in convincing the client that the insurance company is the best to underwrite such a large and sophisticated risk. As discussed below, the owner is often the party seeking damages from an

enrolled contractor for damage caused by the latter's work. The owner is thereby *a potential claimant* as well as the named insured.

Statements concerning coverage therefore need to be measured carefully. The underwriter or marketing representative is an employee or an authorized representative of the insurance company. He or she is an agent of the insurance company binding the principal to his statements. (*Marsh & McLennan of California, Inc. vs. City of Los Angeles* (1976) 62 Cal.App.3d 108.) A statement made by an agent is binding upon his or her principal, as if the principal itself had made the statement. (California Civil Code §2298, et seq.; *House of Grain vs. Finerman & Sons* (1953) 116 Cal.App.2d 485.) Statements made in the marketing of an OCIP have the potential to create confusion and resulting tension.

Some of the more common areas of misunderstanding we have encountered include the following:

Who is responsible for explaining the OCIP coverage, deductibles, etc., to the prospective insureds? As to the sponsor of the program, the owner, the broker will have the relationship and ordinarily represent their interest in the transaction. However, what about the contractors? We have experienced claims where contractors claim that simply setting foot on the OCIP insured project entitles them to coverage.

Exactly what is the process to become enrolled in the insurance program, and when does coverage become effective? In many cases it is the issuance of a workers compensation policy. However, sometimes there is a lapse in the paperwork, and a job site accident occurs before the enrollment is completed. There are ways that OCIP administrators have created to document enrollment. As a general matter, problem areas exist whenever there is an issue beyond the terms of the insurance policy as issued. The owner, broker, and underwriter need to be aware that the ultimate "insureds" under the program are not a part of the marketing and program design. Communications that do not clearly spell out the rights and responsibilities of all the program participants can lead to confusion or, worse, to coverage gaps and uninsured losses which in turn lead to litigation for all of the parties, including the broker, the sponsor, and the carrier.

B. Who Qualifies as Named Insureds?

Deciding *who* qualifies as an insured has a great impact on what risks are ultimately assumed. Does the policy apply to damage caused by contractors at the project; does it include material suppliers; does the program cover design liability, including reworking portions of the project that do not meet the intended strength and stability requirements? Deciding who is *not* an insured is also important. Any party that is not a part of the OCIP is a source of recovery or offset to a loss covered by the OCIP.

There is a distinction in the policies, discussed in more detail below, between a “named insured” and an “insured.” The rights of the contractor and the application of the policy may be very different if each contractor is a “named insured” or an “insured.”

C. *Liability Insurance Protects the Contractor, Not the Owner Presenting a Claim.*

The purchaser of the OCIP is the owner. However, the “insured” under a wrap-up policy that is entitled to defense and indemnity is the contractor. There is a natural tension between the owner who wishes to purchase complete protection for himself and the contractors, who are entitled to that protection. Under a liability policy, the carrier defends the *insured* (each contractor) against claims by others (i.e., the owner) for bodily injury or property damage. Thus, in providing liability coverage, the owner is assuring that the contractor can defend himself and that he has the financial ability to pay the claims.

Since the policy covers the contractors, who are entitled to be “defended” against covered claims, the investigation must be conducted on behalf of the “insured,” and all privileges maintained. Accordingly, a liability investigation would be conducted on the part of the contractor, not the owner; absent an agreement to the contrary, the owner is not entitled to any reports on the investigation. In some cases, there is a claim for damage to a portion of the building under construction. In that case, the owner will want that damage repaired and will point to the OCIP, as carrier for the contractors, to do so. It may ask the carrier for the status of the investigation, including the results of any testing that has occurred. However, no liability insurer wants to be accused of waiving its insured’s privileges by sharing the reports of investigation with the plaintiff, who is in that case the owner of the project. Therefore, the carrier must be very careful to guard those privileges while promptly handling the claim and in making sure the owner of the project understands this relationship at the outset.

D. *Do the OCIP Coverages Work Together?*

The broker and underwriter need to address the unintended consequences of insuring all parties on the project, while assuring that the endorsements to the liability policy are consistent with the underwriting intent. By way of example, the typical OCIP may contain builders risk, workers compensation, and general liability/umbrella coverage. Here are a few examples of overlapping coverage:

1. The workers compensation claim by an employee of a subcontractor and a “third party” liability claim by that same employee against the general contractor or another subcontractor (overlapping workers compensation and general liability);
2. A builders risk claim by the owner for damage to the structure caused during construction and a liability claim against the subcontractor who caused the damage in the first instance (overlapping builders risk and general liability); and

3. An alleged poor design causes a “loss of use” claim because an affected business is shut down after construction; for example, due to a redirected street. This claim may generate an eminent domain lawsuit (overlapping design E&O and general liability).

The decisions concerning the basic scope of coverage and the overlap with other policies, to the extent they can be anticipated by underwriters, need to be addressed in the policy contracts.

III. OCIPs FROM THE PERSPECTIVE OF LIABILITY CLAIMS

An OCIP general liability policy is, in most respects, similar to the industry standard general liability policy. An OCIP claim is analyzed by taking the same systematic approach that is used with other insurance claims. Companies and insureds alike should resist the temptation to treat the OCIP differently and/or disregard the policy language. Only in taking consistent approaches will the insurance company make sure that the most appropriate legal and business decisions are made.

From a legal perspective, the insurance company will be questioned on its policy interpretation and claims handling. The insurer’s obligation to the insured to defend and indemnify is measured by the policy as issued. Coverage under the policy is not based on side agreements, or understandings between the sponsor, the broker, and the underwriters. If there are unintended claims being paid, the underwriters need to be alerted and the policy language changed.

An insurance company can waive reliance on a restrictive policy and provide greater benefits than the contract provides. *Waller v. Fire Insurance Exchange* (1995) 11 Cal.4th 1. However, the company may not unilaterally narrow the coverage and provide less than that provided by the policy. The exception to this rule is, of course, if there is proof that the policy as issued failed to comply with the mutual intent of the parties, in which case the policy may be reformed. (See, e.g., Cal. Civ. Code Sec. 3399; *Truck v. Wilshire Insurance* (1970) 8 Cal.App.3d 553.) The following are some of the highlights of the commercial general liability form that are particularly applicable to construction claims involving OCIPs.

A. Separation of Insureds

A general liability policy contains a condition, titled “Separation of Insureds.” That provision provides:

Except with respect to the limits of insurance, and any rights and duties specifically assigned in this coverage part to the first Named Insured, this insurance applies:

- a) As if each Named Insured were the only Named Insured; and

- b) Separately to each Insured against whom claim is made or “suit” is brought.

In the typical OCIP, each contractor and subcontractor qualifies as a “named insured.” The insurance company must view each named insured separately, as if that contract were the only contract to apply. Each named insured under the policy is given equal coverage. The carrier’s duty to provide a defense and indemnity exists separate and distinct from every other contractor under the policy. Each named insured has an obligation to tender the loss to the insurer and must cooperate with the insurer in the investigation of the claim or suit, and in its own defense.

B. Covered Damage

The first issue that the carrier and the policyholders must address is whether the loss resulted in “covered damage.” However, with an OCIP, the analysis with regard to the particular insured is critical. There are numerous exclusions in the commercial general liability coverage form that apply differently, depending on whether the named insured enrolled contractor is an owner, general contractor, or subcontractor. The following exclusions illustrate why the policy may provide coverage or not, depending on which insured is seeking coverage:

- *Expected or Intended Injury Exclusion*

This insurance does not apply to:

- a) **Expected or Intended Injury**

“Bodily injury” or “property damage” expected or intended from the standpoint of *the insured* ...

Use of the phrase “the insured” refers to the insured seeking coverage. This phrase is contrasted to an exclusion that applies to an injury which is expected or intended from the standpoint of “an” or “any” insured, which would preclude coverage entirely under the policy if an insured or any insured intended the act. (See, e.g., *National Union Fire Insurance Company vs. Lynette C.* (1991) 228 Cal.App.3d 1073—a wife who negligently failed to prevent molestation by her husband was covered; *Fire Insurance Exchange vs. Altieri* (1991) 235 Cal.App.3d 1352—parents sued in connection with their son’s arson of a school building.) The phrase “the insured” also is contrasted to exclusions that apply to “you,” which is the named insured. In the context of an OCIP, where virtually every contractor is an insured, particular attention has to be paid to whether the claims of “supervision,” “vicarious liability,” or other non-direct liability could create coverage where the exclusions apply to “the insured.”

For example, in a claim that a contractor's employee intentionally damaged another contractor's work, the employee would be an insured, but the exclusion would bar coverage. His employer, assuming it was enrolled, would likely be a named insured; the exclusion would not apply to the employer, or any other enrolled contractor on the project.

- Contractual Liability Exclusion

A second example is the contractual liability exclusion, which provides:

This insurance does not apply to:

...

- b) Contractual Liability

“Bodily injury” or “property damage” for which *the insured* is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

...

- (2) Assumed in a contract or agreement that is an “insured contract” ...

The typical construction project contains indemnity flowing uphill in favor of the owner and general contractor. The liability of the owner or general contractor is generally passed down to the lowest level subcontractor.

Under contractual liability coverage, the OCIP assumes every enrolled contractor's indemnity obligations upward to the general contractor and owner. Contractual liability coverage allows owners/sponsors to settle claims with third parties and seek recovery from responsible subcontractors under the indemnity agreement. Thus, the insurance company must be mindful that any enrolled contractor may be both an insured as well as a claimant against the downhill subcontractors for any uncovered damages.

- Damage to Project Work

The next series of exclusions are those dealing with damage to the work which is the subject of the OCIP:

This insurance does not apply to:

...

j. Damage to Property

“Property Damage”

- 1) Property you own, rent or occupy;
- ...
- 4) Personal property in the care, custody or control of the insured;
- 5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf or performing operations, if the “property damage” arises out of those operations; or
- 6) That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.

Paragraph 6 of this exclusion does not apply to “property damage” included in the “Products-Completed Operations Hazard.”

k. Damage to Your Product

“Property Damage” to “your product” arising out of it or any part of it.

l. 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.”

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.¹

...

¹ The terms “you” and “your” refer to the named insured, not to anyone qualifying as an insured.

With regard property damage claims arising out of “operations” (as distinct from “completed operations”), Exclusion “j.” is critical. In light of the “separation of insureds” condition, Exclusion j(1) would exclude coverage to the program sponsor for damages occurring to the construction project itself. (Assuming the sponsor is the owner.)

Exclusions j(5) and j(6) preclude coverage for damage to the construction project, but not entirely. Viewing the construction project from the standpoint of a general contractor, the entire project is “real property” on which the named insured (defined alternatively as “you”) or its subcontractors are performing operations. As to the owner or general contractor, virtually any damage would be excluded if it is within the basic scope of the construction project and the project is not completed.

However, each enrolled contractor must be viewed separately. If there is an allegation of damage caused by a subcontractor to work other than its own, this exclusion would not bar coverage. An example would be a residential developer with an OCIP covering its projects that experiences a fire at a home under construction caused by the negligence of the roofer. As to the owner/developer, exclusion j. precludes coverage entirely. As to the roofer, exclusion j. only precludes coverage for damage to the roofer’s own work, but not resulting property damage caused by the roofer, i.e., the burned down home.

This scenario constitutes the primary overlap with builders risk coverage. The owner/general contractor may pursue a subcontractor for negligence arising out of performance of work under its contract, and the subcontractor’s liability will be covered by the OCIP. This gap presents an exposure to the liability OCIP insurer for the builders risk deductible (since the amount is not covered by builders risk insurance).

This scenario also illustrates that for owners or insurance companies, the proper analysis is to review any “operations” loss—those that occur while the project is under construction—first from the perspective of the responsible contractor (from the bottom up) rather than from the perspective of the owner (from the top down).

C. Voluntary Payments by the Insured, and Right and Duty To Defend

There are two “conditions” to the policy which are particularly relevant to the typical OCIP claims. When property damage claims occur at an OCIP location, there is an added incentive for prompt remedial action on the part of enrolled contractors, as well as the owner. Assuming there is a retention or retrospective premium applicable to the policy, the owner has an immediate concern to rectify problems as soon as they occur. Furthermore, assuming that it is an “operations” type loss, it is typical that the contractors are mobilized performing work at the time the loss occurs. Therefore, there is a built-in incentive to use the contractors that caused the loss to repair the damage.

Take, for example, the situation where there is an accident causing property damage that relates to work performed by a subcontractor. The owner takes control of the loss and hires contractors to remediate the problem. The owner then seeks reimbursement from the OCIP for costs incurred, ostensibly as a claimant against the responsible subcontractor, and separately as an insured facing liability to the third party.

Presenting a claim against the enrolled contractors, while simultaneously using them to repair damage, can create some challenges for the claims department. It can also create friction between the interpretation of the policy as a stand-alone insurance contract and the expectation of the sponsor or owner with regard to reimbursement of costs relating to damage caused by subcontractors.

The liability policy provides that the company has a duty to defend any “insured” in any “suit” seeking covered damages. As to the enrolled subcontractor, therefore, the insurance company has the right to defend that subcontractor and assert liability defenses on that subcontractor’s behalf to defeat liability to the claimant/sponsor of the program. The separation of insureds provision requires the carrier to defend the rights of each insured separately. In contrast to the defense, the carrier’s duty to indemnify that enrolled subcontractor occurs only when liability for damages is assessed against it, at least under California law. *Certain Underwriters at Lloyds of London vs. Superior Court* (2001) 24 Cal.4th 945. Assertion of these defenses will, however, create friction.²

In addition to pursuing the enrolled contractors, OCIP sponsors/owners also may pursue the insurance company directly, on the theory that what was settled and paid for was a claim by a third party against the owner/sponsor. As a direct claim by the owner/sponsor, in addition to the coverage issues raised above, the following are the critical coverage issues under a liability policy:

1. Did the owner settle a “claim” and not a “suit” such that the claim by the third party triggered a defense by the insurance company;
2. As far as indemnity, was the owner/sponsor’s liability to the third party ever finally determined;
3. To the extent that the owner/sponsor, an insured, agreed to pay any sums or make repairs, it may constitute a violation of the “voluntary payments” condition of the policy.

² Other jurisdictions may require the insurer to be more proactive, and require the carrier to try and effect settlement of a claim where liability is clear.

In one unpublished decision in California, arising out of claimed construction deficiencies at hotel/casino in Las Vegas, Nevada, the court found that the general contractor was not entitled to indemnity under the OCIP for amounts incurred to make repairs at the request of the owner.

IV. LIABILITY DEFENSES UNIQUE TO OCIP'S

A. *Waiver of Subrogation/Insurance Clauses*

In the construction contract, there will be contractual language relating to the procurement of insurance and the operation of the OCIP. In the context of property damage claims for damage occurring to the project itself, those contracts may articulate defenses available to the enrolled contractors. Two of the most important would be the waiver of subrogation clause and the identification of builders risk insurance.

With regard to the waiver of subrogation, the clause would typically find that the owner, as part of procuring the OCIP, would waive its right to subrogation on behalf of the builders risk carrier against the enrolled contractor. Under this scenario, the builders risk carrier could not satisfy a loss on behalf of the contractor for damage occurring during construction, then turn around and sue the subcontractor causing the damage. (See, e.g., *Affiliated FM Insurance Co. vs. Patriot Fire Protection, Inc.* (2004) 120 WN App. 1039 (Washington).) In that case, Patriot Fire Protection, Inc., installed a fire sprinkler system at the OCIP insured premises. As part of the OCIP, the builders risk policy issued through Affiliated FM Insurance contained a waiver of subrogation clause. In the subcontract agreement, there was a waiver of subrogation granted in favor of the subcontractors by the owner. The court found in this instance that the builders risk carrier had no rights against the enrolled contractors.

A second contractual defense would exist where the owner promises to obtain builders risk coverage in favor of the enrolled contractors with a set deductible. Under that scenario, the enrolled contractor may be able to assert that the owner's claims against it are limited to amounts which are not covered by the builders risk policy. Such amounts would include the deductible (which is an uninsured loss) stated in the contract would be the amount, which is not covered by the builders risk policy.

While there are no cases that directly address the second point, the issue arises frequently. The enrolled contractors believe that there is builders risk coverage available and that there will be a set amount deductible. Lack of adequate builders risk coverage creates a number of interlocking questions which will have to be clarified through subsequent case law including:

1. If the owner changes the builders risk program to a higher deductible and/or more narrow coverage, what are its rights against the enrolled contractors who understood that broader coverage was being provided?

2. Does a waiver of subrogation condition apply to limit the owners' claims against enrolled contractors for losses not covered by the builders risk policy or which are within the deductible of the builders risk policy?
3. If the owner chooses not to present a builders risk claim, may it still pursue a liability claim against the enrolled subcontractor; and what is the effect of the waiver of subrogation clause in that event?

To answer these questions under any particular fact setting, we suggest the following will have to be reviewed by the liability underwriters:

- a. The builders risk policy, to see the terms of the waiver of subrogation clause and/or the deductible clause and named insureds under the policy;
- b. The construction contract and OCIP manual to determine whether there was a mutual intent between the enrolled contractors and the owner concerning risk of loss occurring at the job site; and
- c. The marketing and enrollment documentation, to the extent that the relationship between the owner and enrolled contractors concerning insurance and risk of loss were not spelled out in the contract or insurance policy.

B. Owner's Waiver by Using OCIP Contractor for Repairs

One of the most problematic claim scenarios that occurs is that of emergency repairs. When there is a large loss that requires immediate repair, there may be insufficient time to document and present a formal insurance claim. The owner will be inclined to use the contractors already mobilized to repair the damage that they just caused.

In some instances, the owner issues a change order to the enrolled contractor for the increased work that they have performed. Assuming that is the case, what is the legal effect of the change order? Is it an acquiescence or agreement by the owner that the contractor was not at fault? Certainly, it would be a strange claim or lawsuit indeed that has the plaintiff (owner) paying the defendant (contractor) to perform work at the job site caused by the contractor's negligence. In that event, the plaintiff's damages would be the amount that they already paid the contractor for the work that was done.

A second problem can occur when the enrolled contractor performs the work as requested by the owner, but the owner then refuses payment. Let us assume that the condition is one that is otherwise covered by the policy and one for which the enrolled contractor is liable. Should the

carrier assume that the costs incurred by the enrolled contractor are roughly equal to that which would be paid to an outside vendor and adjust the claim accordingly? Alternatively, should the liability carrier view the claim as one for partial payment by the owner? In this scenario, the subcontractor may enjoy a liability defense to the owner's claim, since the owner acquiesced to any additional work being performed and agreed to pay for it. Simultaneously, there may be no coverage for the owner for this enrolled contractor's claim because it is one for contractual damages due under the contract.

The topic of emergencies and emergency repairs must be discussed with the sponsor at the time of the policy issuance. If the parties intend that the contractor should mitigate the damages and repair the loss as quickly as possible while reserving all rights under the liability policy, and modifications to the "Voluntary Payments" conditions, the reporting conditions and the like can be designed into the program. Clearly, however, most carriers will not agree to pay uncovered claims and damages as part of the concession.³

V. PARTICULAR CHALLENGES OF OCIP CLAIMS.

A. Uncovered Damages

Under a typical general liability policy, if a claim presented against an "insured" is partially covered by the policy, the insurance carrier issues a reservation of rights. The reservation of rights letter identifies those claims, causes of action, or damages that are not covered by the policy. The insurance carrier also notifies the insured whether it will defend and whether it will allow the insured to use its choice of counsel in doing so. Significantly, however, where the insurance company does not agree to indemnify the insured for all claims and damages, the insured retains the right to pursue other responsible parties to recover those sums. In the liability OCIP, there are two consequences of reserving rights to deny uncovered claims.

First, in underwriting an OCIP, the insurance company hopes to enjoy cost savings by using a limited number of attorneys to defend the enrolled contractors against claims by the sponsor or by a third party. If the carrier reserves its rights to, however, it is possible, and indeed likely, that the enrolled subcontractor will seek recovery from other enrolled subcontractors under indemnity contracts. The indemnity claims a conflict preventing the retention of a single defense counsel. Second, each enrolled contractor has a right to pursue indemnity claims against other enrolled contractors for covered and uncovered claims.

³ For example, we think it unlikely that a carrier would agree that the discovery of defective work constitutes such an urgency, assuming such a condition would not otherwise be the liability of a subcontractor and/or be one for covered damages under the policy.

Therefore, in a complex liability claim presented against the general contractor and/or several subcontractors, the insurance company must recognize early the potential for conflict between the enrolled contractors and the likely value of the uncovered claims.

B. Post Construction Premises Claims

In numerous OCIPs, the sponsors request products-completed operations coverage for a period of time after construction. Premises liability claims arising after construction of the project create a particular challenge to underwriters attempting to limit their risk to construction-related liability. A typical extension endorsement provides coverage for liability occurring after construction and arising out of the construction. Under California and most states' laws, the term "arising out of" connotes a minimal causal connection between the liability and the construction activities. *Acceptance Insurance Company vs. Syufy Enterprises* (1999) 69 Cal.App.4th 321. An additional insured endorsement requiring that liability "arise out of" the subcontractor's work needs only a minimal causal connection between the subcontractor's work and the liability of the additional insured to trigger coverage.

In a premises liability claim, the claimant alleges that the ground is slippery, uneven, or otherwise defective. In fact, in order to establish liability against the landowner, the plaintiff must establish that the premise is defective in some fashion. Accordingly, it is very likely that a premises liability claim will at least implicate a products-completed operations tail under an OCIP. In large projects where the owner is self-insured, such as large hotels or public entities, it is likely that the only insurance coverage will be the OCIP. An insurer may not seek contribution from its insured nor may it seek contribution against a carrier with a self-insured retention. (*Truck Insurance Exchange vs. Amoco Corporation* (1995) 35 Cal.App.4th 814.) Accordingly, notwithstanding that there may be both a "condition" component of the loss as well as a "maintenance" component of the loss, there may be a more significant exposure to the OCIP than the underwriters contemplated.

C. Contractual Disputes and Mechanics Liens

Liability insurance is designed to cover damage caused by the defective work or negligence of an insured contractor; it does not become involved when the only dispute concerns completion of work and payment for work. In OCIPs, the distinction between a liability insurance claim and a contractual claim often becomes blurred or obliterated when the claimed basis for nonpayment is defective work that *may* be partially covered by insurance. The scenario is usually presented by a suit to enforce a mechanics lien by the subcontractor, which is answered by the claim that, as a result of defective and/or incomplete work, the contractor's lien is offset to some degree. There are a number of specific issues to consider.

First, assume that the property owner chooses to answer the complaint and raise, as an affirmative defense, that the contractor is not entitled to the full amount of the lien because of defective work. The assertion of an affirmative defense is not recognized as a claim for damage against the insured contractor, which the insurance company would have to defend. The owner, who is likely the sponsor of the insurance program, may not want to trigger coverage, because in many programs the sponsor is responsible for a sizable retention. In many instances the contractor's liability for the deductible is set by contract at a much smaller amount. Thus, because of the way an owner chooses to proceed, the insured contractor may be left with no assistance with the legal expense or payment of damage.

Second, if there is an answer only, there is no separate pleading seeking damage such as a third-party complaint, which would make the presentation of evidence logical (first, claim for money under the contract; second, offsets for construction defects; third, defense to construction defect claims). Therefore, dividing the responsibilities between liability defense counsel and the insured's mechanics lien attorney is more expensive and critical. In many instances, it is in the insured's interest to allow the insurance company to participate in defeating construction defect claims, given their experience in litigating and trying such claims.

Third, however, the insurance company *may* ultimately be liable for some portion of the award, if it chooses not to defend. In the only California case to address the problem directly, *Construction Protective Services, v. TIG Specialty* (2001) 29 Cal.4th 189, the Supreme Court acknowledged that an affirmative defense is not by itself a claim for damages, but can share attributes with a cross-complaint that is such a claim for damage. The court acknowledges that an affirmative defense could result in an offset, for damages that are within the scope of coverage, to which the insurance company might be obligated to provide coverage. The holding of the case is suspect, since it was based on a limited factual record and the court could not rule on the ultimate issue as to whether the policy *as issued* would be obligated to defend. However, insurance companies and insureds should not discount the possible implication of liability insurance in a mechanics lien claim.

In short, mechanics liens claims present every complication of an OCIP. The sponsor/owner is the insurance company's adversary if there is a covered claim against an insured contractor. The insurance claims may not be procedurally separate from the contract claims, which makes assigning counsel and representation of the contractor more difficult. To successfully resolve such claims, communications and clear objectives between the enrolled contractor and the insurance company are critical, if there is to be a voluntary contribution to the settlement by the insurance company. The insurance company may also be able to use its direct business relationship with the owner to try to work out an acceptable solution for all three parties.

D. Contractors Partially Enrolled

In residential construction, a wrap-up policy that covers all of the builders' projects under construction are becoming increasingly popular. These are sometimes referred to as "rolling wraps," since they "roll" from one project to the next. Individual contractors and subcontractors enrolled in the home builders' wrap-up plan for work pursuant to a specific subcontract or project. The difficulty can occur when a rolling wrap is created while projects are ongoing.

Imagine, for example, a multi-phased development project that takes several years to complete. The project begins at a time when the builder has a traditional risk management structure, including the requirement for additional insured endorsements and indemnity agreements running in its favor from each of the contractors performing work. Midway through the project, the builder changes its liability program to a "rolling wrap," which then insures all of the contractors on the job site. The change in programs does not pose particular difficulties with regard to operations claims; however, completed operations are a different matter.

In the typical construction defect claim, a group of homeowners will band together to file a single lawsuit against the developer. The homes in litigation can be from all phases of the development. Therefore, there can be homes at issue in the litigation that were developed under the traditional insurance program and claims completed under the rolling wrap. This presents ethical and administrative problems that need to be addressed early in the resolution process.

Under a rolling wrap-up, the builder as well as all of the contractors are "insureds" under the program. Most states follow the rule that the carrier may not satisfy a loss and sue its insured in subrogation to recover (e.g., *Affiliated FM Insurance Co. vs. Patriot Fire Protection, Inc.* (2004) 120 WN App. 1039, 2004, Wash.App.Lexis 340.) Thus, the homes insured under the wrap, the carrier could not satisfy the loss on behalf of the builder and then pursue recovery from the contractors insured under the same policy.

Partial wrap insurance also creates an ethical dilemma for the wrap carrier and counsel retained. One of the basic premises underlying a wrap or OCIP is to eliminate the infighting and be able to retain one lawyer to represent all parties under the OCIP. Thus, a homeowner who sued the builder would have one source of recovery. If the builder's attorney now filed a third-party complaint against the subcontractors relating to homes which are not part of the Wrap, it potentially undermines the effectiveness of the wrap-up. The target subcontractors would then seek coverage from all of their carriers potentially providing coverage for the homes in litigation, including the wrap-up. Hiring separate lawyers for each of the subcontractors is costly, and the avoidance of same is one of the reasons to consider a wrap-up program. However, the carrier is faced with two contrary goals. On the one hand it wants to minimize the amount of legal expense it has to incur by paying multiple lawyers to fight each other; on the other hand, it wants to seek recovery against the subcontractors for the ones that are not enrolled in the wrap-up.

The solution that most carriers are adopting requires the cooperation of the plaintiff's bar, which is never a certain thing. Prior to filing cross-complaints against the subcontractors, the builder tries to sever or resolve the wrap-up homes first. While it is possible that this claims handling could be viewed as settling out only the covered portions of the loss, and therefore depriving the insured of a defense, our prediction is that, if handled properly, it will in fact be a partial satisfaction of the enrolled contractors' liability and therefore acceptable. (See, for example, *Hartford Casualty Insurance Co. vs. Dodd* (D.MD 1976) 416 F.Supp. 1216.) We compare that with *Brown vs. United States Fidelity and Guaranty Co.* (2d Cir.1963) 314 F.2d 675, 681-682, which recognized that the insurer who exhausted its policy limits by settling two of the four claims may have acted in bad faith if there was "over eager" settlement of those claims. Most rolling wrap policies are triggered by either a project designation or a close of escrow date. Thus, under a correctly written wrap, there will be no coverage and no duty to defend or indemnify for homes that are not a part of the wrap. Therefore, if it is feasible to do so, it should be possible to settle only the wrap homes.

Of course, if the carrier is unable to settle the wrap homes only, it will have to set up multiple claim files. For each contractor that is involved in non-wrap homes as well as wrap homes, the carrier will likely have a claim file open for each.

This problem presents itself only in those wraps that will cover some but not all of the homes in a given project. Where the enrollment in the wrap is commensurate with the beginning of the project, then all of the contractors should be "enrolled contractors" and this problem would not present itself. For design purposes to avoid this problem, however, the issue is *enrollment*, in combination with *the project*.

VI. PRESENTATION OF LIABILITY CLAIMS UNDER AN OCIP.

The preceding portions of this article outline the analysis of liability claims under an OCIP, but principally from the perspective of the insurance carrier. There are ways that insureds and claimants can present claims under an OCIP that will speed the resolution process and avoid gridlock.

The claimant that has incurred a loss should remember "point of view" in the presentation of a claim. Since an owner controlled insurance program is, in effect, a liability policy insuring each and every contractor, the tendering party should bear in mind that the insurance company must set up a claim file to protect the rights of its "insured." To the extent that privileged materials are obtained which could benefit that "insured" in subsequent litigation with any third party, the insurance carrier has to protect those rights and privileges against disclosure to third persons. In *Soltani-Rastegar vs. Superior Court* (1989) 208 Cal.App.3d 424, the court recognized that the statements made to the insurance carrier by an insured are privileged and within the work-product and "attorney-client privilege" of that insured.

Therefore, if the tendering party recognizes that the insurer must maintain those rights and protect those privileges, it can assist the process by clarifying against whom the claim is being presented. Since each insured must be treated separately, it may receive multiple positions from the same insurance company with regard to coverage under the policy. For example, the sponsor of the program may get a denial of coverage as to their claim that they made repairs to a work site as a result of an onsite accident. It could then receive an acceptance of liability on behalf of a subcontractor.

Given the difference in coverage limitations that apply to different enrollees of an OCIP, a detailed factual record is critical for the insurer to understand the liability and coverage. Only where there is liability of an “insured/enrolled contractor,” the claim against that enrolled contractor is covered by the policy, will there be any indemnity paid. Therefore, the insurance carrier will need to be able to address the following questions:

1. What happened?
2. Who was present at the time of the incident?
3. For operations losses, what work was supposed to be done by the responsible subcontractor, and what was deficient, incomplete, or negligently performed?
4. Who was injured as a result of the work by an enrolled contractor? Whose employee, what contractor’s work, etc.?
5. What was the response to the incident?
 - a) Who organized the response?
 - b) Who investigated the loss?
 - c) Who decided what work or response was to be made to the incident?
 - d) What alternatives were considered?
 - e) Was a notice of liability given to the responsible subcontractor, and was there any response to that notice?
 - f) Was the builders risk carrier notified—for an operations loss?
6. Document all direct and indirect costs which are the subject of a liability claim.
 - a) Work orders for the repair of damage caused by the incident.

- b) Bills/invoices for outside contractors used, including detailed description of the work performed.
 - c) Estimates obtained, if any, or explanation as to why a course of conduct was engaged in.
 - d) Notes concerning progress of the repairs.
7. Complete documentation of the loss elements that could be presented to a court to establish liability against an enrolled contractor.

In addition to the basic factual record and documentation surrounding the damages, the party compiling the package should bear in mind the coverage limitations contained within the policy as outlined above. Understanding the basics of CGL coverage and the carrier's duty to defend or indemnify will assist greatly in setting up the correct claim file or files, and evaluating the claim from a perspective that will maximize the recovery from the standpoint of the sponsor or tendering party.

Notes

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Hypotheticals

Hypothetical No. 1: Uncovered Damages

Project: Large multi-story residential construction.

Description of Loss:

During construction, a rainstorm occurred which caused damage to the interior of the elevator shaft, which had been finished in drywall. The cause of the damage was a combination of scheduling (since the area was not watertight prior to the rainstorm) and some deficiencies in the work of the envelope subcontractor (sheet metal, glazier, the exterior cladding).

Involved Parties:

1. Owner
2. General contractor (scheduling, supervision, overall quality)
3. Drywall subcontractor: damage to drywall elevator shafts some interior finishes
4. HVAC subcontractor
5. Glazier

The damages include:

1. Damage to the drywall and the elevator shaft, and some interior finishes
2. Mold and fungus growth behind the drywall and elevator shaft
3. Delay damages, lost revenue from the push back in the project completion date
4. Costs to redo the drywall, glazing and exterior cladding to properly attach and seal panels

Other information:

1. The builder's risk policy is "all risk" but only covers the owner and general contractor, not the subcontractors.
2. The builder's risk policy contains a \$250,000 deductible.

Questions:

1. Is there coverage for this loss for the owner? general contractor? Drywall subcontractor? Glazier? Exterior cladding?
2. Assuming that the mold damage is excluded by the pollution exclusion (pursuant to this policy), what are the owner's option and exposures to the OCIP liability carrier?
3. Assuming that the HVAC's work is defective but did not cause any resulting property damage ... what are the likely consequences of taking a "no coverage" position to the HVAC subcontractor?

Hypothetical No. 2: Post-Construction Premises Claims

A patron at a large hotel casino in Las Vegas, Nevada, slips and falls in the pool area. She claims that the surface was too slippery and that the deck was steeply sloped and as a result she fell and suffered severe personal injuries.

The hotel/casino was built under an OCIP with a completed operations tail that covers the date of loss. The general liability policy names the owner, general contractor, and all subcontractors as named insureds.

Investigation reveals that the cause of the fall is principally lack of maintenance of the pool deck area by the casino. The non-stick surface that had been put in place during construction had worn away. The owner carries a \$1 million self-insured retention on its general liability policy.

Questions:

1. When the hotel patron sues the hotel/casino, is it entitled to coverage under the OCIP pursuant to products-completed operations tail?
2. Given the lack of maintenance by the owner, what is the obligation to provide coverage under the OCIP to the owner and contractors?
3. If the surface was slippery due to a premature degradation in the non stick surface, what options exist?
 - a. To pursue the manufacturer?
 - b. To obtain vendors coverage under the product manufacturer's policy?

Hypothetical No. 3: Emergency Repairs

Project: A public works project involving construction of a railroad line through an urban environment. The project is coordinated by a public entity, with multiple prime contracts for different sections of the project. The project is in California.

Claim facts: During a road widening project, while installing caissons for retaining wall, a drill penetrates a clay sanitary sewer line. When the hole is filled with concrete, it fills the sewer line, causing a backup.

The general contractor, for that phase of construction, mobilizes the emergency cleanup and redirection of the sewer line. The general contractor, in association with the public entity, reviews the situation and decides on a method of repair. The method of repair is to place a sleeve over the sewer line, which is demanded by the local public authorities as a condition of agreeing to the repairs.

The insurance company is notified of the loss promptly. The investigator is assigned and begins the process of gathering data regarding what happened. While not uncooperative, the public entity is working with the local government to find an agreed repair scheme and to implement that scheme. By the time the documentation is created and supplied to the carrier, the sponsor of the OCIP has already agreed to make the repairs. It has in fact paid the original subcontractors to perform repairs by change order to the original contract.

The OCIP sponsor makes a claim to the liability policy to recover the engineering and repair expenses, and the subcontractors who are only partially paid a separate claim to the liability OCIP relating to the incident.

Questions:

1. Are the owners' claims covered?
 - a. Is there a "suit" or claim against the owner?
 - b. Has the owner been found legally liable to pay damages to a third party?

- c. Did the owner voluntarily assume liabilities to a third party which would render the costs unrecoverable?
 - d. Is this a covered damage claim?
 - e. Is this result different in other states?
2. Is this a covered claim as to the original subcontractor?
 - a. Is there a claim or suit presented against the subcontractor?
 - b. Is the subcontractor liable to the owner for the remediation and repair expenses?
 - c. Does the subcontractor have any defenses to assert since the owner agreed to the change order for the repair efforts?
 - d. May the subcontractor collect its own unpaid invoices from the liability policy?
3. What are the options available to the owner?
4. What are the options available to the insurer?

Hypothetical No. 4: Rolling Wrap with Contractors Partially Enrolled

A large residential developer undertakes a “rolling wrap.” All projects developed during the term of the wrap, contractors are all insured under the wrap-up policy.

The problem arises with certain developments that were under construction at the time the wrap-up began. In at least one project, a portion of the work was performed before the wrap-up inception, and a portion developed after the wrap-up inception. A lawsuit against the developer involves houses that are “pre-wrap” and “post-wrap.”

Questions:

1. Does the carrier have the right to settle with the plaintiff and pursue subcontractors on the pre-wrap homes, while accepting coverage for them on the post-wrap homes, or is the carrier barred from pursuing subrogation from its own insured?
2. How can the carrier and the sponsor achieve the benefits of an OCIP when legitimate indemnity claims exist against non-wrap subcontractors and additional insured carriers?