

Workshop W1

Wednesday, October 29, 9:00 a.m.–noon

VITAL SIGNS—EMERGING TRENDS IN CONSTRUCTION INSURANCE

Presented by

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Insurance coverage terms and conditions fluctuate in response to certain key events and in anticipation of others. Insurers' appetite for risk changes based on past loss experience, economic conditions, and court interpretations of policy provisions. This workshop outlines trends in construction insurance—from the use of coverage-restricting endorsements and coverage enhancements to crucial court decisions that impact contractors' coverage.

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William R. Joyce
Partner/Practice Area Leader Construction Law
Faegre & Benson

Mr. Joyce is copresenting Workshop W1, "Vital Signs—Emerging Trends in Construction Insurance," on Wednesday morning. He is head of the construction law practice at Faegre & Benson. He has successfully prosecuted and defended cases in arbitrations and lawsuits on behalf of owners, general contractors, subcontractors, material suppliers, and design professionals. Mr. Joyce has represented various general contractors and subcontractors prosecuting delay and disruption claims against public and private owners as well as defended contractors against liquidated damage claims.

Mr. Joyce has had significant experience representing various construction company clients in various alternative dispute resolution proceedings, including arbitrations and mediations. Mr. Joyce is a member of the Construction Specifications Institute and has served as vice president of its Communications Committee. He writes a periodic column for the CSI newsletter (the *Specifics*) regarding recent developments in the law that affect contractors and design professionals. His practice areas include all phases construction law, including arbitration and litigation, owners representation, contract termination, design/build claims and litigation, differing site conditions, claims, contract delay, mechanic's lien claims and litigation, mediations, management liability, product liability litigation, design professionals liability, surety bond claims and litigation, trial practice, international law, bid protests, and contract drafting. He represents the construction, design professionals, general contractors, material suppliers, owners, and subcontractors industries.

Mr. Joyce earned a B.A. degree, *summa cum laude*, from Bemidji State University in 1981, and a J.D. degree in 1985 from the University of North Dakota, where he was senior editor of *Law Review* and named to Order of the Coif, with distinction.

He has been named a Super Lawyer by *Minnesota Law & Politics* and was included in Chambers USA, *America's Leading Lawyers for Business, Construction*, 2008. He wrote "Design Build in the Public Sector" for the Lexington Insurance Company Newsletter. His presentations include "Construction Defect Claims," American Bar Association, Forum Committee (1999); "Changes in the New 1997 AIA Contract Documents," American Institute of Architects, Minnesota chapter; and "Subcontracting Issues," Association of General Contractors. He is Communications Committee Vice President of the Construction Specifications Institute, a member of the Hennepin County Bar Association, and is a member of the Construction Law Section of the Minnesota State Bar Association. He is admitted to practice in the state of Minnesota and the U.S. District Court for the District of Minnesota.

Karen A. Reutter
Senior Vice President
Aon—Construction Services Group

Ms. Reutter is a copresenter for Workshop W1, “Vital Signs—Emerging Trends in Construction Insurance,” on Wednesday morning. She has over 20 years of experience in the construction risk management and insurance fields. She began her career at IRMI in Dallas, prior to joining St. Paul Construction in St. Paul, Minnesota, in the early 1990s. While at St. Paul Companies, she served in several roles including national director of casualty underwriting, senior officer of construction risk management services, as well as senior officer of strategy and planning for the corporation. Ms. Reutter subsequently joined Zurich Construction in its home office of Minneapolis, Minnesota, as a national director of project risk underwriting. During the past several years, Ms. Reutter has worked on the brokerage side of the business, in national roles, including production, product development, and management. She was with the Willis national team for Construction prior to joining Aon’s construction team in a national role in 2008. Ms. Reutter is a frequent speaker and writer on topics related to the construction risk management field. She holds B.B.A. and M.B.A. degrees from the University of North Texas and has her CPCU and ARM designations.



Vital Signs—Emerging Trends in Construction Insurance

Presented by:

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Senior Vice President
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National Construction Practice Group

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Discussion Overview



- What Drives Coverage Changes
- Industry Numbers: Hard vs. Soft Market
- Strategies for Coverage in Current Market
- New Products
- Conclusion

What Prompts Coverage Changes?



- Coverage changes can be broadening or restricting
- Hard vs. Soft market
- Attempts to delineate coverage by defined insurance products
- Court interpretations

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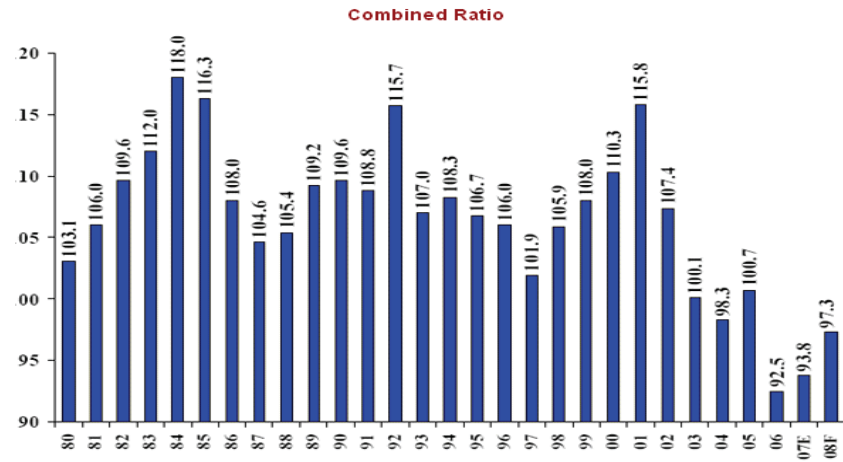
Broadening vs. Restricting Coverage



- Insurer-driven changes
 - Via endorsement or via management
 - Examples
 - Notable restrictions
 - Less notable restrictions
- Broker/Buyer-driven changes
 - Manuscript endorsements

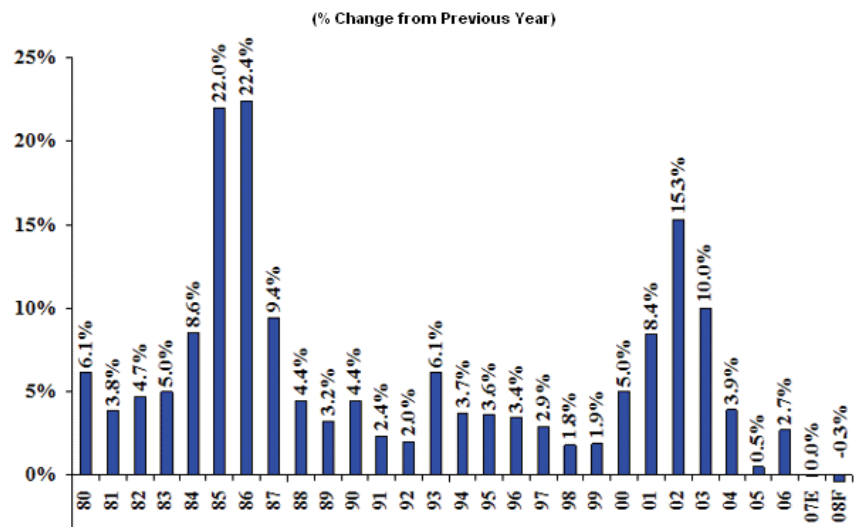
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Industry Profitability: Hard vs. Soft Market?



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Insurer Net Written Premium



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Disciplined Underwriting

Construction Risks



- Number of carriers
- Lessons learned from prior years
- Ability to manage data
- More scrutiny from rating agencies
- Probably more discipline than in past soft market cycles

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Business Risk Doctrine



- Exclusions
 - Historical perspective
 - Your work exclusion
 - Impaired property exclusion
 - Use, custody, and control exclusion

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Business Risk Doctrine *(cont'd)*



- Certain types of business risks that are not covered risks under CGL Policy
 - Allegations amount to breach of contract/warranty claims
 - Damages amount to economic losses to the project itself
 - Insured must be motivated to vigilantly construct projects free of defects
 - Insured should not profit from performance of shoddy work by being paid twice—once for the work performed and again to repair his own work

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Business Risk Doctrine *(cont'd)*



- **Insurance is different from performance bonds**
 - Liability insurance is for third-party claims for personal injury or property damages where the liability can be limitless
 - Performance bonds are for the failures of performance under contract that will ultimately be the contractor's responsibility under the indemnity agreements it has with its surety

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Business Risk Doctrine *(cont'd)*



- Coverage is denied because project is viewed as the insured's own product or work as a whole regardless of whether the insured self-performed all the work
- Coverage is denied because the work is performed intentionally, not accidentally, so there is no occurrence
- Coverage is denied because there is no property damage to anything besides insured's own work

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Insurers' Reaction



- Revise exclusions for your product to be applicable to only personal not real property
- Provide Broad Form Property Damage Endorsement that restricts your work exclusion to just work self-performed not on insured's behalf by subcontractors

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Courts' Reaction



- Business risk doctrine while wrapped up with various exclusions under the policy relates to types of risks and public policies that will not allow contractor to be insured for shoddy work
- Coverage denied to claims that work was not done in accordance with the project plans and specifications by subcontractors; general has control over the whole project
- BFPD has no effect on the business risk doctrine; elimination of the “or on your behalf” phrase is given no effect

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Insurers' Reaction



- 1986 CGL policy changes
 - Brings language within body of policy
 - Your work exclusion includes exception if the property damage arises out of work performed on insured's behalf by subcontractors

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Courts' Reaction



- If analyze occurrence to be everything involving instances where the insured did not intend the damage caused and get to exclusions to coverage, generally find coverage
- If analyze at insuring clause stage may still find that contract vs. tort claims are not insurable occurrences because acts/omissions are intended and controllable
- Courts viewing business risks as public policy concern vs. freedom of contract concern is key to current policy analysis

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Courts' Reaction *(cont'd)*



- Lamar Decision
 - Found occurrence for defective work
 - Defects were not intended from standpoint of insured
 - Policy did not distinguish between contract and tort liability
 - Policy did not distinguish between property damage to building itself and third-party property damage
 - Basement floor defects caused physical injury to drywall and stonework
 - Work performed or work damaged was by subcontractors
 - Your work exclusion has express exception for subcontractor's work that cannot be written out of the policy

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Sample Endorsement Language:

Business Risk Doctrine

- Definition of “Occurrence”
 - The following is added to the definition of “occurrence” in Section V Definitions, but only for the purpose of determining whether property damage to Your work caused by the work of one of Your subcontractors is caused by an “occurrence” as defined under the Policy:
 - Defects in “Your Work,” neither expected nor intended by any “insured” performed on Your behalf by any subcontractor, shall also be deemed an “occurrence.”

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Sample Endorsement Language:

Business Risk Doctrine

- Another example of amending “occurrence”
 - “Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions, including but not limited to property damage caused by your negligent actions or performance of your work done by or for you.

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Mold and EIFS Risks



- New risks enter construction projects through the use of new materials and building processes
- Energy efficient home design created wall cavities that could not weep out or evaporate condensation and water infiltration
- Contractors faced with significant liability claims related to new materials and building processes attempted to find coverage under traditional CGL policies
- Insurers attempted to apply traditional exclusions like pollution exclusion to new risks and types of property damage

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Mold and EIFS Risks *(cont'd)*



- Courts refused to read traditional exclusions expansively to cover new risks
 - Mold is not a pollutant
 - Ensuing damages covered under impaired property exclusion
 - Contractors did not intend to use wet drywall that would cause mold to grow in the wall cavities
 - Your work exclusion did not preclude coverage for water infiltration causing damage to other aspects of work on project
- Insurers created new specific exclusions to cover new risks

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How To Handle Mold, EIFS in Current Market

- Coverage
- Underwriting
- Risk management practices

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Strategies for Coverage in Current Market *(cont'd)*

- General liability coverage *(cont'd)*
 - DIC/DIL of wrap-ups
 - Intent of endorsement
 - Relevance in today's market
 - Sample language

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Sample Endorsement Language: DIC/DIL of Wrap-ups



EXCESS PROVISION – CONSOLIDATED (WRAP-UP) INSURANCE PROVISION

This endorsement modifies insurance provided under the following:

Paragraph 4.b.2 of the Other Insurance Condition – (Section IV – Commercial General Liability Conditions) is replaced by the following:

b. Excess Insurance

This insurance is excess over:

.... (2) Any primary or excess insurance available to you through a Consolidated (Wrap-Up) Insurance Program.

...When this insurance is excess, we will have no duty under Coverages A or B to defend the insured against any “suit” if any other insurer has a duty to defend the insured against that “suit”. If no other insurer defends, we will undertake to do so, but we will be entitled to the insured’s rights against all those other insurers.

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Strategies for Coverage in Current Market *(cont’d)*



- General liability coverage *(cont’d)*
 - Premises “gap” coverage for wrap-ups
 - Intent of endorsement
 - Historical perspective
 - Sample language

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Sample Endorsement Language:

Premises “gap” coverage

Separate Endorsement: Limited Coverage Repair Work

This insurance is extended for an additional period of time with respect to liability for “bodily injury” or “property damage” arising out of “repair work”. This extension shall commence as of the date that “your work” is deemed to be completed and shall end as of the expiration of any express warranty for “your work”, or the statutory time period for such “repair work”, or 10 years from the date of completion of “your work”, whichever comes first.

- Notes: attached to CIP, definitions of “Policy Period”, “Repair Work”, and “Enrolled” are modified.

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Strategies for Coverage in Current Market *(cont’d)*

- General liability coverage *(cont’d)*
 - CG 2279 vs. CG 2280, professional services exclusion
 - Intent of endorsement
 - Recent underwriting history
 - Which endorsement should apply
 - Sample endorsement language

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Green Buildings and Sustainable Designs



- Buildings account for 70% of electricity use, 39% of overall energy use, 39% of carbon dioxide emissions, and 40% of raw materials
- Leadership in Energy and Environmental Design (LEED)
- U.S. Green Building Council

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Green Buildings and Sustainable Designs

(cont'd)



- Certification and rating systems to reduce the environmental footprint of building projects both during and after construction
 - Considers designing and constructing buildings to use less energy for heating, air conditioning, water usage
 - Considers using recyclable and regenerating building materials for construction
 - Considers management of project's waste so as to reduce impact on environment during construction
 - Considers air quality and indoor air environment

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Green Design Risks



- Additional warranties by architects and contractors with regard to building design and construction meeting certification standard
- Additional risks of cost overruns and delays attributable to attempting to meet certification levels during and after construction
- Certification not verified until months after construction complete
- Use of new and untested technologies can lead to increased chance of design and construction defect claims
- Guaranties related to performance and outputs that cannot be tested until project is near or beyond completion

Industry Response



- Contract provisions related to guaranties and warranties given related to performance
- Contract provisions related to more specific monitoring and testing responsibilities of contractors and designers
- Design or material modifications made during construction change performance of building that remains undetected
- Integrated systems create greater risks of defects in one system affecting more building systems with catastrophic results

Insurers' Response



- Liability expanded for contractual/warranty claims for economic losses
- Property damage coverage for upgrading to green technologies and materials
- Changes in building codes and ordinances for green concerns covered by building and personal property coverage forms

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Green Property Insurance



- Pays percentage of loss to be used for green upgrades
- Pays percentage of loss to upgrade certification levels
- Pays for interior materials that improve indoor air quality
- Pays for recycling during reconstruction
- Pays for indoor air testing and flush out procedures

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Building Information Modeling



- Using 3D models to design and virtually construct project before actual construction
- Increasing collaboration among the designers and contractors
- More detailed integrated design earlier in process
- Reduction in clashes in design documents
- Blurring the lines between design liability and means and methods liability
- Expanding the professional services role of the contractors

Building Information Modeling *(cont 'd)*



- Managing the model process through contractual protocols
 - Model manager is a new position of authority with control over shared model site
 - Model access limitations—read only models uploaded by maker of model and downloaded to create derivative models on contractors own IT system
 - Derivative models can be downloaded into the model sharing site for further collaboration by designers and contractors
 - Reliance for downstream users that models are consistent with contract documents and may be relied upon to produce own models

BIM's New Risks



- Contractors and designers collaborating on design models throughout development of models
- Who controls and tracks changes made to models to ensure the party making changes is identified
- Who is responsible for changes made downstream to models
- Who controls and tracks model process to ensure models are consistent with contract documents

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BIM's New Risks *(cont'd)*



- Who controls the use of disclaimers limiting rights of reliance on models for use in creation of derivative models
 - Architect disclaims any responsibility for the accuracy and completeness of the model
 - Contractor disclaims any responsibility for the accuracy and completeness of the model
- Who controls the release of confidential information
- Elimination or restrictions on the implied warranty doctrine
- Contractors' means and methods liability expanded to that of design consultant
- Model managers' liability for corrupted model sharing site

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Industry Response



- BIM process defined in protocol contract exhibit
 - Model manager identified and obligations defined
 - Model sharing site processes defined and IT capabilities determined
 - Models to be created identified and obligations defined
 - Access to models defined
 - Warranties that digital data is consistent with contract documents described
 - Reliance in use of models for creation of derivative models defined
 - Reliance on derivative models defined

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Insurers' Response



- Expanded coverage to contractors and subcontractors for professional services resulting in economic losses
- Expanded coverage for technology errors and omissions related to creation, transmission, and storage of digital data

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Rework Insurance



- Insureds with leverage bargain for extended coverages in a soft market
- Seek manuscript policies eliminating many of the business risk exclusions for their own work
- If work is structurally defective or unfit for its intended use, policy provides coverage to repair defective work
- Very few temporal limitations to policy—may only speak of project not being completed before effective date of policy
- May not require adjudication that work is structurally defective or unfit for its intended use

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Sample Language: Rework



INSURING AGREEMENT:

1. COVERAGE

Defective Work

Underwriters will indemnify the Insured the necessary and reasonable costs that the Insured incurs to repair or replace “your work” at a covered location that is determined to be “defective.”

The amount Underwriters will indemnify in any one loss shall be limited to the lesser of:

- a. the cost of one attempt to repair “defective” work; or
- b. the cost for one attempt to remove and/or replace “defective” work; or
- c. the cost for one attempt to mitigate or correct “defective” work; or
- d. if repair, removal or replacement is impractical or more expensive than installing a new () in place of the () in which the defective work was performed or installed, the costs of installing a new replacement ().

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Sample Language: Rework



I. Insuring agreement

A. We will indemnify you for those sums that you pay as “damages” that exceed the deductible stated in the Declarations because of “contractor rework” to which this insurance applies. The amount we will pay for “damages” is limited as described in Limits of Insurance (Section VI).

No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided.

For purposes of this insurance, “damages” paid by you and our indemnification of such “damages” will be attributed to the “policy period” in which “your work” was put in place, not the year(s) in which “damages” are actually paid by you.

B. This insurance applies to “contractors rework” only if:

1. “Your work” is part of an “insured contract” entered into after the inception of this policy;
2. “Your work” was performed during this “policy period”; and
3. The removal, repair, alteration or replacement of “your work” has been initiated during the “policy period” or within 90 days after expiration of this policy.

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Conclusion



- Even though we’re in a soft market cycle, we have more disciplined underwriting
- Attempt to regain coverage that may have been restricted during the last hard market
- Consider construction-industry trends and what impact they may have on your insurance and risk management program
- Be creative in today’s market for risks you identify and would like to transfer

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Notes

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