A builder’s “All Risk” insurance policy is the traditional way that the construction industry insures against damage to the work in progress during construction. Despite its common namesake, “All Risk” does not literally mean that all risks of loss or damage are insured. Critical and subtle differences in the forms of all-risk insurance policies can determine whether there is, or is not, insurance coverage for certain types of construction defects, accidents, and the damage resulting from such defects and accidents. There is no one standard form of builder’s risk insurance policy. Accidents and defects on major construction projects can cause tens of millions of dollars in damage. Given the high stakes, battles over builder’s risk insurance coverage can be expected in many cases. Unfortunately, most often the parties to a construction project do not understand the precise nature of the builder’s risk insurance policy until after a loss or damage occurs resulting in disputes and extended battles over insurance coverage.

This article surveys these issues with the objective of helping those in the construction industry—contractors, owners, and design professionals — to understand these issues and to be in a better position to obtain favorable builder’s risk insurance coverage for construction accidents and damage. Our recent successful experience handling construction accident and defect cases highlights certain key issues and potential builder’s risk insurance pitfalls. Understanding these issues and the differences in policy language can make a real difference in protecting your project. Major construction accidents or defects will hopefully be at most a once in a lifetime event for most people in the construction industry. Insurance companies, on the other hand, deal with these issues routinely, and they have focused strategies and
Overview of Builder’s Risk Insurance

Builder’s risk insurance is a form of property insurance covering physical loss or damage during construction. Traditionally, builder’s risk insurance covers the “gap” in insurance coverage in the time period before the project is ready for use or occupancy. Typical commercial property insurance policies do not insure construction work in progress, so that is where builder’s risk insurance comes into play. Builder’s risk coverage usually terminates when the construction is completed, at which point a standard commercial or homeowner’s property insurance policy needs to be obtained or otherwise picks up coverage. In most states, builder’s risk insurance is subject to the same insurance statutes and regulations applicable to standard property fire insurance policies. Builder’s risk insurance is sometimes referred to by its initials, as “BRI,” or as “BARI” for “builder’s all risk insurance.”

BRI is almost universally an “occurrence” type of insurance rather than a “claims made” type of insurance. Insurance based on an “occurrence” means that the insured event (typically “physical loss or damage” in BRI) must happen during the time period the insurance policy is in effect. In BRI, this is usually the time period during construction and before occupancy. In “claims made” insurance, the insured event is the claim itself. Thus, while the underlying damage or accident can happen either before or during the term of insurance, unless the claim is made during the term of insurance there is no coverage. The definition of an “occurrence” under BRI insurance can be subject to different interpretations and can have a significant impact on the amount and existence of coverage. These topics are discussed in more detail below.

The traditional type of builder’s risk insurance is known as builder’s “All Risks” insurance. As stated by one court: “[I]t would appear that all risks insurance arose for the very purpose of protecting the insured in those cases where difficul-

objectives when underwriting policies and responding to builder’s risk claims. The construction industry needs to be equally well-informed and savvy.

Recent market forces also play an important role in the availability of traditional builder’s all risk insurance. The occurrence of 9/11 caused a tightening in the construction insurance markets, resulting in some projects opting to use contractual terms to assign the risk of construction accidents and defects as an alternative to purchasing builder’s risk insurance. Using contractual provisions instead of insurance has significant implications as regards the protection that may be available in the event of a serious accident or defect. Most important, there is no money being paid by a third party (i.e., there is no insurance company), and it is usually a matter of one side or the other accepting that it will not be compensated in the event of certain damage or losses.

Careful management of these complex issues can determine whether your builder’s risk insurance or a contractual agreement will cover the damage when an accident happens.
ties of logical explanation or some mystery surround the (loss of or damage to) property.”1 “All risks” insurance is contrasted with insurance that only covers specific and designated perils such as “fire,” “earthquake,” or “flood” insurance. “All risks” insurance covers all these perils and more, unless a specific peril is expressly excluded in the policy. This distinction explains why it is commonly said that the scope of “all risks” insurance is defined by its exceptions and exclusions, because otherwise “all risks” are insured.

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The reason that builder’s risk insurance is commonly “all risks” is partly historical. Marine insurance, including salvage work, was provided on an “all risks” basis, reflecting the inherent uncertainties and multiple perils that involve work at sea. When marine insurers first began underwriting builder’s risk insurance some created “inland marine” underwriting departments, which continued using “all risk” forms of insurance. Some states specifically consider builder’s risk to be “inland marine” insurance. “Builder’s risk covers a project … while its materials and components are being moved on-site … and can be insurable as inland marine, as many states and insurance commissioners allow.”3 The many uncertainties and different perils that threaten a construction project also explain the use and popularity of “all risks” coverage. “It would be folly to undertake [a construction] contract without insurance against any fortuitous loss that might occur by reason of the elements, the negligence of employees … ‘or from any other cause whatsoever.’ This is precisely why the Contractor obtained the ‘All Risk’ insurance policy.”4

A major construction accident or defect is also likely to involve other insurance issues and policies, such as comprehensive general liability (CGL) insurance or errors and omissions (E&O) insurance. Moreover, such events may be the subject of various other allocation mechanisms including contractual risk allocation provisions (e.g., force majeure clauses, indemnification provisions, differing site condition clauses, warranties, performance bonds, and guarantees). This article does not attempt to explain the types of risks covered by these various forms of risk allocation or how they might or might not overlap with BRI. Instead, the subject of this article is builder’s risk insurance.

Recent Case Experience Highlights

Key Issues and Concerns

Our recent experience with construction accident and defect cases provides valuable insight into the critical issues, arguments and defenses that insurers may raise in response to a BRI claim, and, yes, for the purpose of avoiding payment of claims. One case involved a partial tunnel collapse during construction of the subway beneath Hollywood Boulevard, in Los Angeles, California. Through litigation, the owner recovered over $15 million against the BRI insurer, although the insurer had reserved the claim at only six-figures. This recovery included a significant amount for the cost of getting access from the surface to the site of the underground damage and repair work. The owner overcame multiple defenses and exclusions asserted by the insurer, including the defective workmanship and consequential loss exclusions, and a statute of limitations defense. This case also involved contested issues like the definition of the insured property, and the insurer’s failure to notify the owner that the insurer’s renewal form of builder’s risk insurance provided less coverage than the previous form.

Another recent case involved construction of a new off-shore pipeline that had to be abandoned in place due to multiple leaks that were
detected in pre-operation pressure testing. There was no BRI insurance in this case. Instead, there was a contractual indemnity and limitation of risk provision in the construction contract. Contract terms were used to assign risk from the contractor to the owner as an alternative to the owner paying for builder’s risk insurance. The result in this case, however, was that because the contractual language was intended to be a substitute for BRI, the contractor was entitled to no more protection than a commercially available BRI policy would have given under the circumstances. That meant no protection for the pipeline contractor because the problem was mere defective welding and the contractor admitted that “offshore” BRI policies commercially available at the relevant time excluded defective welding and “buy backs” for resulting damage were not available.

Obtaining Builder’s Risk Insurance

There are several typical ways that builder’s risk insurance is obtained for a construction project: (1) Owner Controlled Insurance Programs (“OCIP”); (2) Contractor Controlled Insurance Programs (“CCIP”); and (3) a one-time policy.

As their names imply, OCIPs and CCIPs are insurance programs that are purchased by either the project owner (OCIP) or the general contractor (CCIP). Both OCIPs and CCIPs typically involve a laundry list of insurance products in addition to BRI, including CGL, E&O, real property, automotive, equipment, and even worker’s compensation. In many cases, an owner or general contractor will use an OCIP or CCIP “administrator,” which is likely to be the insurance broker that sold the insurance. The role of an administrator is to oversee the payment of premiums and the submission of claims, as well as to manage the various issues that can arise such as audits by the insurer. Many believe that there are perceived and likely actual benefits to having all necessary insurance products administered in a single program underwritten by a limited number of insurers.

Significantly, in most cases involving construction of a specific project, both the owner and general contractor (and subcontractors) will be insured under the same BRI policy whether it is an OCIP or CCIP. In an OCIP, the owner will have the insurer add the general contractor and subcontractors as named insureds or additional insureds to the BRI (and likely other policies), and in a CCIP the general contractor will do the same for the owner. In fact, it can easily be the case that the general contractor will be insured for a specific project under the OCIP, but that the general contractor also has its own CCIP. The converse can also happen, where an owner has an OCIP but the BRI on a specific project is insured under the general contractor’s CCIP.

The explanation for this is that large general contractors and owners with on-going construction work are likely to have a comprehensive OCIP or CCIP in place before a specific construction job is undertaken. So both the owner and general contractor for a new construction job already may have in place, respectively, comprehensive OCIP and CCIP insurance programs. The obvious question is whether the OCIP or CCIP will be used for the BRI and other construction-related insurance that is needed for the new job. The answer depends on various factors including the construction contract and the price of insurance. Some bid packages provide that the general contractor will participate in an OCIP and that the bid should not include the cost of any insurance; others may require an itemized bid for the cost of insurance, including BRI, which the owner is free to accept or reject. This latter option gives the owner the flexibility to price the cost of insurance from the contractor against the cost under the OCIP. Even without an express contractual option, there may be nothing that prevents the owner and general contractor from agreeing to change where the insurance will come from after the bid, although public contracting laws may restrict this flexibility on public projects.

It is also possible that the price of insurance may be different depending upon whether the
BRI is obtained through an OCIP or CCIP. A successful contractor, for example, may have a favorable premium rate for a certain type of work and be allowed to add a new project into its CCIP with relative ease by including the contract amount into its BRI premium base. An owner with a high claim history, a troubled project, or building a one-time project, can sometimes benefit by negotiating with the general contractor to obtain BRI through its CCIP. Conversely, an owner on a large infrastructure project may be able to obtain a favorable rate on all project-related construction work, in which case it is more cost-effective to insure the general contractor under the OCIP.

In cases where there is no CCIP or OCIP, a one-time BRI policy would have to be purchased for the project. If so, the owner or general contractor likely will purchase BRI for the new job through an insurance broker.

Regardless of how the BRI is obtained or which party buys it, it is important for insureds to understand that the terms and wording of a BRI policy can be negotiated and customized for a particular project. If an insured is cognizant of the key differences in BRI policies and the major exclusions, the insured can often obtain beneficial changes to the stock policy language offered by a particular insurer. Insureds also need to double check that the language they are examining is the actual language in the formal insurance policy, and not merely a certificate of insurance or summary “cover notes” to the policy.

BRI Coverage For Defective Workmanship

Perhaps no issue is more important or disputed in construction damage and accident cases than whether there is BRI insurance coverage for defective workmanship, design, materials, or construction, which is referred to herein as “defective workmanship” for short. There are a multitude of issues that affect the potential to recover for construction accidents or defects that are caused by defective workmanship.

• Mere Defective Workmanship

The “insuring clause” of common BRI policies requires that there be “physical loss or damage” to the insured property. In some cases, a key issue is whether a construction defect constitutes physical loss or damage, or whether it is a case of mere defective workmanship without “physical” loss or damage. This distinction can sometimes be very fine, because most defects have some sort of “physical” manifestation. Nonetheless, many courts attempt to draw this distinction because the policy language requires it.

One influential case involved construction of a vessel where modular hull sections were mistakenly misaligned, resulting in a twist in the vessel. The court rejected coverage under the builder’s risk policy, mainly because “physical loss or damage” “would not ordinarily be thought to encompass faulty initial construction.” The court expressed the concern that a contrary rule would make insurers responsible for “the costs of replacing or repairing crooked window frames or crooked door frames, even though the crookedness of the frame was undoubtedly the result of the insured’s negligence.” Other courts have similarly decided that “while the failure of a defective part qualifies as direct physical loss or damage, the defect itself, assuming the item has not yet failed, does not.” One such court therefore denied coverage for additional costs that resulted from errors in the designs, plans and specifications during the construction of a mixed-use commercial and residential property, because “a design defect, in and of itself, [did not] constitute an actual physical loss to the property.”

• Accidents and External Causes

It is commonly understood that the purpose of most insurance is to pay for damage caused by an “accident,” and this is true for builder’s risk insurance as well. Courts often discuss an accident as an event where the loss or damage is “fortuitous.” There is no universal definition of what it means to be “fortuitous.”
Some courts use an “objective” test and others use a “subjective” test to determine whether a loss is fortuitous. The objective test, which is more traditional, focuses on whether the damage was an inevitable result of inherent aspects of the design or workmanship. The subjective test, which is a more contemporary rule, focuses on the particular knowledge of the parties to the contract. “A fortuitous event … is an event which so far as the parties to the contract are aware, is dependent on chance.” In the builder’s risk context, courts in a variety of contexts have rejected an insurer’s argument that the contractor’s negligence could not be fortuitous because “[n]egligence on the part of the insured or his employees is no defense against his recovery for the loss he has suffered.”

Courts have struggled with the fortuity issue in the context of defective workmanship. A number of courts have reasoned that damage that results from an “inherent” aspect of the defective work is not fortuitous. The result in these cases is to impose a requirement—that may or may not be in the express language of the insurance policy—that the damage must be from some “external” cause. As phrased by one court, “there was an initial satisfactory state that was changed by some external event into an unsatisfactory state.” “The requirement that the loss or damage arises from a cause external to the insured property is a provision typically found in an all-risk policy.” However, a more “contemporary” interpretation is that “all-risk coverage … while extending only to fortuitous losses, is not, as such, limited to losses that have external causes.”

**Express Exclusions for Defective Workmanship**

Although categorical statements about BRI policies should be avoided, virtually every form of builder’s risk insurance policy issued today will have some form of express defective workmanship exclusion. However, the specific wording of this exclusion can vary in important respects. Carefully analyzing the applicable defective workmanship exclusion in a builder’s risk insurance policy is one of the keys to determining whether there is any insurance coverage for a construction accident or defect.

As a general rule, courts tend to interpret insurance policy exclusions narrowly, which should favor the insured in a BRI policy because absent an exclusion “all risks” are insured. Unfortunately, when the courts interpret defective workmanship exclusions, they do not always appear to acknowledge what may be significant differences in the policy wording. Insureds cannot count on the courts to give the insured the benefit of the doubt in cases of arguably ambiguous defective workmanship exclusions.

One of the more popular forms of a defective workmanship exclusion was drafted by part of the Lloyd’s of London market. These are the American London Sturges (“ALS”) forms issued in 1967 (ALS 67) and revised in 1972 (ALS 72). This policy form is generally considered to provide relatively broad coverage for defective workmanship. The defective workmanship provision in the 1967 form, which was widely used and only slightly revised in 1972, excludes the following: “[C]ost of making good faulty or defective workmanship, material, construction, or design, but this exclusion shall not apply to damage resulting from such faulty or defective workmanship.” This type of exclusion has been subject to several judicial interpretations. The key to this exclusion is in distinguishing between “making good faulty workmanship,” on the one hand, and “resulting” damage on the other hand. From the insured’s standpoint, it is easy to see that the insured would want to fall within the exception to the exclusion, i.e., an exception that establishes coverage for resulting damage.

One court found that the exclusion of defective workmanship, and not the exception thereto, applied where faulty initial construction created voids in a poured concrete wall and the wall did not collapse or otherwise result in
any other damage. Other cases, however, have emphasized the breadth of the exception to the exclusion. For example, during construction of a steam generating plant an issue was whether damage to the superstructure of the plant would be insured if caused by the sinking foundation that was found to be defectively designed. “In the instant case, the insurers, in plain and unambiguous language, assumed exactly that responsibility: to insure directly against ‘damage resulting from such faulty workmanship, construction or design.’ Damage to the superstructure was recoverable under the policy. This interpretation comports with the purpose of builder’s risk insurance, which is to compensate for loss due to physical damage or destruction caused to the construction project itself.”

Another case held that while the cost of replacing the defective waterproofing on a building was subject to the exclusion, other significant damages were insured by the exception. In that case, the court stated: “The policy-exclusion language did not provide an exception for all losses or damages stemming from faulty workmanship, nor did it except the cost of returning a project to its state at the time the defective workmanship was discovered; rather, it simply excepted the cost of making good faulty workmanship or materials.”

Another case that easily came within the exception was where a fire caused by a subcontractor’s negligence destroyed the project during the course of construction.

Again, one notable aspect of the ALS 67 form of exclusion is that it does not exclude loss or damage “caused by” or “resulting from” the defective workmanship. Instead, it merely excludes the “cost of making good” the defective workmanship, and specifically does insure the “resulting” damage. Insureds need to be aware, however, that there definitely are other less favorable forms of defective workmanship exclusions. At the other end of the spectrum, in terms of the language of defective workmanship exclusions, are provisions that insurers try to argue create a wholesale exclusion for any and all “loss caused directly or indirectly” by defective workmanship, and without any exception for “resulting” damage.

A broad exclusion for any loss or damage caused by or resulting from defective workmanship means that an insurer will argue that there is no insurance coverage for most construction damage cases. This follows because barring a natural disaster, construction accidents and defects typically are caused by some form of defective workmanship. As a practical matter, the insurer may try to identify some aspect of the construction work or design that was substandard then argue that there is no coverage because the loss was caused by the defect. At a minimum, this invites disputes and factual battles between experts and competing interpretations of the exclusionary language. But courts are likely to be skeptical of an insurer’s interpretation of the defective workmanship exclusion that would have the potential effect of transforming a BRI policy into a “no risk” coverage. Indeed, this has been alluded to by at least one court: “Defective workmanship can lead to the collapse of a cement dome or a brick wall. If an all risks policy did not cover accidents resulting from such negligence, then perhaps it would become a no risk policy.” Nonetheless, insurers have argued that some BRI forms do have a defective workmanship exclusion that effectively makes BRI a “no risk” policy for certain damage.

The broadest type of exclusion for defective workmanship has been the subject of several cases. An example of this type of exclusion is as follows: “loss or damage caused by faulty materials, improper workmanship or installation, errors in design or specifications.” While this type of exclusion poses a hurdle for an insured, it does not necessarily preclude any recovery in cases involving issues of defective workmanship. In any given case, the court could find that the contractor’s workmanship was not in fact defective. Also, there will often be significant disputes regarding whether the defective workmanship was a sole, predominant or contributing cause of the damage. There can also be important distinctions regarding the precise manner in
which a contractor’s work was defective. Insurance coverage was found in one case involving the collapse of a structure due to the contractor negligently failing to secure arches with sufficient temporary guy wires.27 “It is the quality of the product which is excluded from coverage, and not damage to the product caused by negligence during the construction period.”28 There are other cases, of course, where the defective workmanship exclusion was found to apply.29

Another general type of defective workmanship exclusion comes from a different London market form, which also excludes damage “caused by” defective workmanship but which then has an exception for resulting damage to other property: “[L]oss or damage caused by or resulting from faulty workmanship … but not excluding resultant physical loss or damage to other property insured hereunder.”30 This type of exclusion has the benefit of having the resultant loss exception, but it is likely to cause disagreements regarding what constitutes “other” property and the meaning of “resultant” damage. Yet another variant is an exclusion drafted by the Insurance Services Office (ISO) where the exception was even narrower and only applied to designated perils such as fire or explosion.

Thus, the specific form of the defective workmanship exclusion must be very carefully examined by an insured before BRI is purchased. In the event of loss or damage, the insured should not simply accept that there is no coverage without carefully examining the language of the exclusion and the nature of the events giving rise to the loss or damage.

• **Inherent Vice and Latent Defect Exclusion**

BRI policies often also have an exclusion for “inherent vice” and “latent defect.” In a construction accident case involving defective workmanship or design, the insurer is also likely to raise this other exclusion. An example of such a clause is as follows: “[W]here defective construction, design, or fabrication of property results in the property’s failure or deterioration before its normal life, and the defect is not apparent upon reasonable inspection but only after a postfailure examination by an expert, then the resulting loss is caused by a ‘latent defect.’”31

Insurers may argue that an inherent vice or latent defect exclusion can affect the insured’s BRI coverage even where the defective workmanship exclusion may not apply. One of the noteworthy aspects of most forms of the exclusion for inherent vice or latent defect is that there usually is no exception for resulting damages. This is the case, for example, in the ALS 67 and ALS 72 policy forms, which do have express “resulting” damages exceptions for the defective workmanship exclusion but not for the latent and inherent defect exclusion. In a fairly recent case, the court denied insurance coverage on the grounds that while all risk BRI policies are not limited to losses that have external causes, the exclusion for inherent vice and latent defect “was meant to opt out of this interpretative default and thus to exclude intrinsically caused losses from the policies’ coverage.”32 Other jurisdictions have interpreted the inherent vice and latent defect exclusion differently.33

**Consequential Loss Exclusion**

One of the key exclusions in a construction accident or defect case is likely to be the exclusion for consequential losses. This is a common exclusion that insurers use to deny coverage for economic costs or losses that do not reflect the narrow cost of the direct physical repairs of damaged insured property. Sometimes, the words “delay” and “loss of market” are specifically mentioned in the consequential loss exclusion, and sometimes they are not. The meaning and scope of which damages are, and are not, “consequential” can be vague and subject to different interpretations. Thus, this is a fertile ground for disagreement between the insured and the insurer. Insureds will want to argue that a consequential loss exclusion
should be narrowly applied so as not to exclude economic losses that were directly caused by damage to insured property.

Consequential losses are typically “lost profits” such as in the famous case of Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854), which rejected a claim for lost profits of an idle factory due to a delayed crankshaft shipment. But the word “consequential” has an inherently vague quality. “The term ‘consequential damage’ is ambiguous in character, and is not truly relevant to any discussion respecting different classes of damage. In the proper sense of the term, all damages must of necessity be consequential, since all damage is the consequence of an injurious act.”

“Under an ‘all-risk’ policy, economic damage proximately caused by an insured peril will be deemed ‘not consequential’.” Accordingly, there can be “all risk” insurance coverage for “loss of use” of a damaged fishing vessel notwithstanding an express “consequential loss” exclusion. Similarly, economic damages consisting of loss of the market value of fuel oil on a delayed ship can be “not consequential” under an all-risk policy.

On the other hand, there are certainly cases where the claimed damage was so remote or speculative that it was excluded by a consequential loss provision. For example, there was no coverage where an insured filed a claim under its all-risk policy for the cost of the company president flying to Japan to settle a damage claim. Nor was there coverage where the insured filed a claim under an all-risk policy for business interruption when it shut down its construction efforts to determine whether any damage had been caused by an explosion several blocks away.

The specific question of whether “delay” costs are automatically included as consequential damages is not well settled. However it is well-established that “[o]verhead is distinguished from lost profits and goodwill in that it represents not a potential asset of the business but an essential expense incurred in the performance of the work.” Thus, an insured’s claim for the overhead costs associated with performing repairs should not be automatically precluded by a consequential loss exclusion.

Role of “Project Value”

The calculation and composition of the “project value” that is used for purposes of BRI can lead to significant disputes regarding the scope of insurance coverage. Many BRI policies are underwritten or sold based upon a specified project value. The insurance premium will then be applied as a percentage price against the stated project value. For example, in a case of a $100 million project value, the insurance premium might be $.75 per $100 of project value, for a total premium cost of $750,000. Most BRI policies of this type also will require periodic updates to the project value along with a final audit of the project value at completion. This means that the total cost of insurance may rise as a function of certain increases to the cost of construction.

Importantly, the amount of the project value in the BRI is a different issue than the maximum value of the policy limits. While the project value may be $100 million, the policy limits may be significantly less, for example, $10 million. The insurer’s risk is arguably a function of both the project value and the policy limits. All other things being equal, the risk of a $10 million loss on a $100 million project would seem to be greater than a $10 million loss on a $10 million project, because in the latter case it would take a total loss to reach the policy limits.

In addition to the effect that the project value has on the cost of insurance, there can also be a relationship between the “project value” and the scope of BRI coverage. Certain policy forms link the definition of the “insured property” to the project value. For example, some policy forms define the insured property as the construction materials, equipment and supplies “provided that they are included in the project value.” This
format presents at least two issues in the event of an insurance claim. The first one is determining whether damaged property is part of the project value. In most cases this should be relatively straight-forward. For example, in the construction of a industrial park with multiple structures, was the specific structure that was damaged included in the calculation of the project value? The second issue is that certain cost categories may not have been included in the calculation of the project value. This can lead to disputes about whether those cost categories are recoverable as part of the cost of repair after the insured property has been damaged.

In a CCIP, determining the project value for purposes of BRI will usually be relatively simple, at least where the owner is not an additional insured. In a fixed-price bid, the contract value is typically used as the project value because that amount represents the valuation of the construction work as reflected by the bid amount. In a time and materials contract, however, the general contractor will have to use some other means to declare a project value to its BRI insurer, such as its internal estimate of the total cost of construction.

Determining the insured project value in an OCIP, or where the owner is an additional insured under a CCIP, however, may not always be as simple. Subjective judgments must be made about which cost elements to include and to exclude. Certain cost categories may be excluded from the calculation of the insured project value based on a determination that they do not seem to be part of the cost of construction, such as real property acquisition, engineering and design, and construction management. For example, a project with a $100 million total budget may have an $80 million BRI “project value” excluding these kinds of categories of costs. Where cost categories have been excluded in this fashion, however, the insurer may argue that the excluded cost categories should not be paid even when damaged property is otherwise insured. For example, if the project value stated in the BRI policy does not include the owner’s engineering and construction management costs, insurers have rejected claims for these costs as part of the cost of repair, even where the insurer otherwise accepts that the damaged property is insured.

The argument advanced by insurers is that it only accepts risk to the extent that it has been paid premium on the insured property, and that if the owner has not paid premium on a component of the insured property, that the insurer is therefore not liable for that cost as part of the repair. While this argument may have some superficial appeal, the specific policy language may not support this argument because the insurer’s obligation to repair property does not specifically exclude these types of costs. In other words, it is the property that is insured, not the individual cost elements. In addition, the assumption that the insurer has necessarily been short-changed in the payment of premium is not necessarily correct. In pricing the cost of insurance, the insurer can adjust its premium percentage upwards to account for using a project value that does not include certain cost elements. Thus, it is not necessarily true that the insurer has not been compensated for the risk it bears.

“Access Costs” As Part of Cost Of Repairing Damaged Property

The cost of accessing the damaged property is one of the costs of repair that should be considered whenever a BRI claim is considered. “[O]nce covered property is damaged ... the insured is covered for the cost of accessing the problem.” In other words, one of the insured “risks” in an “all risks” property damage policy is that damaged property will need to be accessed to evaluate and repair the damage.

While additional access costs will not always be involved, there are some cases where repairs cannot be made without special arrangements or causing damage to other property in the process. In such cases, the insured should be able to claim these additional access costs as part of the cost of
repair. For example, in the cleanup of a coastal oil spill, recoverable damages include the cost of access routes to move heavy equipment to the coastline, damage to beaches and dunes used in accessing the coastline, and damage to existing roads moving heavy equipment to access coastline. Another example where substantial access costs of repair will be involved is in underground repair work. Without access to the area of damage, the physical repairs to the underground insured property cannot be performed. The difficulties and high costs of underground work are sure to make the cost of access a significant part of the total repair cost.

Renewal Policies With Less Coverage

A potentially significant issue can arise if there is a change or renewal of a BRI policy during the course of a project. Typically, BRI insurance is underwritten for a specified period of time, ending by the date of project completion or occupancy. Delays in construction, however, may push the completion date past the original expiration of the BRI policy. In these cases, it may be necessary (depending on the language of the policy) to extend the term of the BRI. In most cases, an extension can be accomplished with relative ease through an endorsement to the existing policy that simply extends the term of the BRI. In other instances, however, the insurance company may not be willing to extend its risk under the current form of the BRI policy, and instead it may only offer extended coverage by issuing a new policy or by using an extensive endorsement that amends a number of other policy terms in addition to the term of insurance.

The insured has significant protection anytime an insurance company changes an insurance policy or renews a policy with less favorable terms for the insured. “It is a long-standing general principle applicable to insurance policies that an insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued but the insured is not notified of the specific reduction in coverage.” The law … requires notice of the specific reduction in coverage; a general admonition to read the policy for changes [in coverage] is insufficient.” While these doctrines derive from the consumer area, they are not necessarily limited to consumer cases and can also apply to commercial insurance contexts such as BRI.

Thus, it is possible that while a renewal BRI policy may not cover certain loss or damage, the insurance company will still be financially responsible because an earlier policy for the same project had broader coverage that would have insured the damage. If the insurance company has not communicated a clear warning in writing that the renewal policy has specific reductions in coverage, the insured may have a good argument that it is insured under the broader coverage in an earlier policy. This is an example of why it is so important for construction professionals to be knowledgeable about the BRI insurance they are buying.

“Sue And Labor” Clauses

Typically, one of the insured’s first obligations in the event of loss or damage is to perform immediate stabilization or salvage work under the “sue and labor” clause of the BRI policy. A typical “sue and labor” clause provides: “In case of loss or damage, it shall be lawful and necessary for the Insured to sue and labor in and about the defense, safeguard, and recovery of the Insured Property.”

“[The] purpose [of a sue and labor clause] is to encourage and bind the assured to take steps to prevent a threatened loss for which the underwriter would be liable if it occurred, and when a loss does occur to take steps to diminish the amount of the loss.” The reasoning behind the clause is that the insured is effectively working for the benefit of the insurance company by minimizing the total amount of damage that would otherwise result and for which
the insurance company would then be responsible. However, the risk to insured property need not necessarily be “imminent” in order for the insured to be able to obtain recovery of “sue and labor” expenses.47

“The law is well settled that the sue and labor clause is a separate insurance and is supplementary to the contract of the underwriter to pay a particular sum in respect to damage sustained by the subject matter of the insurance.”48 With this benefit to the insured, however, also comes the risk that if the insured fails to fulfill its obligation to “sue and labor,” the insurance company may seek to deny coverage for any additional damage that possibly could have been avoided by immediate corrective action by the insured.

**Notice Of Loss Or Damage**

Another thing an insured will need to do in the event of loss or damage is to give “prompt” notice to the insurer. This notification allows the insurance company to send representatives or adjusters to the construction site to survey the damage and potentially to assist in any immediate repairs that may need to be made. The precise contents of this first notification may or may not be spelled out in the insurance policy, but generally the insurer may require the date, location, description and cause of the damage. This last item — the cause of the damage — can have a significant impact on the applicability of exclusions, such as the defective workmanship exclusion. In many cases, the precise cause of the damage cannot reasonably be determined in the immediate aftermath of an accident. In all events, the insured must be aware that the information or characterizations included in this initial notification to the insurance company may have a significant impact upon its claim.

**Definition Of “Occurrence” And Its Importance**

The concept of “occurrence” as used in BRI policies is important for several reasons, only two of which are briefly discussed here. First, as noted above, BRI policies are ordinarily issued on an “occurrence” basis meaning that coverage exists for occurrences that occur during the period of the policy. This is in contrast to CGL policies that ordinarily provide coverage on a claims-made basis (i.e., a claim must be timely made during the period of covered by the policy.) Second, BRI policies ordinarily have one or more deductibles that apply to each “occurrence” under various insuring clauses. For example, a policy may have a $50,000 or $500,000 per occurrence deductible for loss or damage to property. The definition of the word “occurrence” as set forth in the policy, or the meaning of the word given to the occurrence in cases where there is no definition in the policy, can be the source of much dispute.49

The positions of the insurer and the insured on the breadth and nature of the definition of occurrence may vary depending on the issue. An insurer may try to argue that what the insured believes constitutes one occurrence actually constitutes many occurrences so that multiple deductibles exist and there is no coverage because the damage associated with no single event exceeds the deductible.50 In another circumstance, the insurer may argue that a series of individual events constitutes a single occurrence so that the insurer can exhaust “per occurrence” policy limits rather than having to pay “per occurrence” policy limits on multiple events. An evaluation of such issues hinges on analysis of policy language and an understanding of the different theories employed by courts in defining the term “occurrence” in the face of the particular policy language.

**• Occurrence as Defined in Policy**

In understanding the meaning of occurrence, the language of the policy must be considered. A typical BRI definition of occurrence is as follows: “One loss, accident, disaster or casualty or series of losses, accidents, disasters or casualties arising out of one event.” A typical CGL definition of occurrence is as follows: “An accident, including continuous and repeated
exposure to substantially the same general harmful conditions.” There are subtle differences between such definitions that may have substantial consequences both on the issue of coverage and number of deductibles. Policy language may vary and must be carefully considered in assessing how best to present a claim.

- **Common Cause Theory and Effects Theory of Occurrence**

In various insurance contexts, courts have applied either of two theories to evaluate the number of occurrences. “Courts in federal and [state] jurisdictions have applied either ‘cause’ or ‘effect’ analysis in determining whether a set of facts involved only one or several occurrences. The majority of courts have adopted a ‘cause’ analysis rather than ‘effect.’” Under the “common cause” approach, the definition of “occurrences” focuses on the event or events causing the injury and not on the injury itself. An occurrence has generally been held to mean the underlying cause of injury as opposed to the number of injuries or damages. By contrast, the effects approach focuses on the number of injuries or damages rather than whether a single common cause exists.

There are any number of cases involving CGL policies holding that on the facts of those cases only one occurrence occurred based on a common cause analysis. For example, in one case, a court concluded that there was one “occurrence” because one cause, the manufacturer’s failure to warn that plaster was unsuitable for indoor use, led all twenty-eight houses at issue to suffer pitted plaster. The undisputed facts in the case revealed that the plaster supplied contained lime that itself contained an excessive number of “periclase” pellets. The court noted that the plaster was not defective because high levels of periclase is suitable for outside use and the problem here was a failure to properly label the product to indicate that it was not suitable for inside use. The court rejected other arguments that there were multiple causes of the pitting such as production defects, mishandling and defective installation that led to the other property damage. The court held that the failure to warn constituted a single occurrence despite multiple batches of the lime having been sold. There are many other cases holding, under their specific facts, that a single occurrence occurred under the common cause theory.

Nevertheless, there are cases applying the common cause theory holding that multiple occurrences occurred. For example, another case found multiple occurrences under an insurance policy rising from negligent workmanship in installing a plumbing system. Defendants argued “that the undisputed facts show that the damage was the result of multiple different causes, including using the wrong type of pipes, improper sloping of pipes, various failures with respect to cleanouts, improper soldering and cleaning of pipes, and improper placement of pipes.” The court found that the plumber’s “negligent workmanship comprised a variety of different negligent acts, not a single act.” In addition, the court noted that there was no “evidence to suggest there was an underlying policy or even a common decision in [the plumber’s] many disparate acts of negligent workmanship.” Again, there are many cases finding multiple occurrences applying a common cause theory.

In sum, the cases applying the majority rule “common cause” theory are difficult to reconcile. There is much indeterminacy in the law in this area. The cases discussed in this section do not involve BRI policies so they need to be considered with that in mind. Further, from an insured’s perspective, the term “occurrence” and the common cause theory should be applied in a way that affords the insured the greatest degree of protection.

**Pursuing a BRI Claim**

A BRI policy will undoubtedly impose a number of obligations and deadlines on the insured
parties after the insureds first give notice of loss or damage to the insurance company. These may include: (a) submission of a “proof of loss”; (b) giving “examinations under oath”; (c) audits of books and records; (d) an appraisal of the amount of the loss; and (e) filing suit against the insurer within one year or some other specified time period.

In projects using a CCIP or OCIP, there likely will be an insurance administrator or broker that will be involved in submitting and processing the claim. This is typically helpful because such persons presumably have expertise in these matters and can ensure that all necessary steps are followed in the claim process. Nonetheless, an insured is well advised to take an active interest and to play an active role in the claim, especially where there is substantial damage to the project. The insured is the only party with a direct financial interest in being paid, and mistakes in the claim submission can adversely affect the BRI coverage.

Depending upon state law, the insurer may have an obligation to advise the insured of all applicable deadlines and procedures applicable in the event of loss or damage. If the insurer fails to advise the insured of these obligations, the insurer may be estopped or prevented from contending that the insured failed to follow the procedures.

A provision that the insured should submit a “proof of loss” is contained in most BRI policies and is typical of most standard property fire insurance policies. A proof of loss usually is supposed to be filed within 90 days of the damage. An insurer expects a proof of loss to be a statement and itemization of the property damage and the costs of repair. In a complex construction project, however, it can be very difficult for the insured to itemize all of the damage and to have reliable figures for the cost of repair just 90 days after the damage. As a practical matter, a detailed proof of loss often cannot be filed in that short time frame.

Most BRI polices require the insured to make its representatives available for “examinations under oath” at the request of the insurer. These examinations are essentially depositions under oath of the insured’s representatives that the insurer is allowed to take before any lawsuit is filed. Outside of the insurance area, it would otherwise be necessary for a lawsuit to be filed before a party has the right to take a deposition. Thus, the BRI policy may give the insurer a significant right that it would not have absent the policy language. As a kind of deposition, the examination under oath takes place before a certified court reporter and usually involves an attorney for the insurer asking questions of representatives of the insureds. The insurer will receive a written transcript of the questions and answers just as in a regular deposition.

The insurer typically has another significant right under the BRI policy in that it can require the insureds to produce the insureds’ books and records to be audited. This is roughly equivalent to the right of one party to ask another party to produce documents for inspection and copying in the civil litigation context. Here again, however, the insurer has the right to audit the insured’s books and records without any litigation being filed.

A BRI policy is also likely to have a provision requiring the parties to go through an appraisal process to resolve disputes about the amount of the loss or damage. The appraisal process most often is essentially a form of binding arbitration as to matters subject to the appraisal. Often the insurer and insured will each select an appraiser, and those two will select a third appraiser. The agreement of two of the appraisers will determine the amount of the damage. The insurance policy usually does not set forth much detail on the appraisal process and in practice the appraisers will determine the details such as the form of submissions to the appraisers and whether (and how many) hearings will be held to resolve the dispute. Significantly, the appraisal process determines the cost of damage but does not determine whether the BRI actually insures the damage. In other words, the
appraisers do not decide what damage is covered or insured, but only the cost of the damage that is being claimed by the insured.

Finally, BRI policies are likely to have a provision requiring that any lawsuit be brought within one-year from the loss or damage. For example, “[u]nder California law, all fire insurance policies must be on a standard form …. This standard form provides that no suit or action for recovery of any claim shall be sustainable unless commenced within 12 months after the ‘inception of the loss.’”66 Because a BRI policy insures fire as one of several risks, the standard “fire” insurance form in California, including its one-year statutory statute of limitations, applies. It is not technically necessary in California to use the standard fire insurance form, provided that the policy language used “is substantially equivalent to or more favorable to the insured than that contained in such standard form.”68

The one-year suit provision in the insurance policy is a special statute of limitations in California for property damage insurance claims. This is much shorter than the typical statute of limitations that would otherwise be applicable under California law. “The ordinary statute of limitations for breach of a written contract is four years. (Code Civ. Proc. § 337.) Insurance claims for property damage, however, have a one-year limitation period. (Ins. Code § 2071.)”69

Significantly, this one-year time period can be put on hold or “toll” while the insurer is considering the claim. There is “equitable tolling [when] the insurer … has received timely notice of the loss and thus is able to investigate the claim without suffering prejudice.”70 This tolling “postpone[s] the running of the one-year suit provision from the date of notice of loss is given to the insurer until formal denial of the claim.”71 “Under such a rule, it is the insurance company — not the insured — who controls the statutory clock. If it processes the claim quickly, the insurer shortens the overall time within which the insured must file his lawsuit. If it moves at a snail’s pace — as this company did — it extends the time within which it can be sued.”72 “[T]his same rule should apply in the context of a first party claim in a commercial all-risk insurance policy.”73

Obviously, an insured would want to consult with legal counsel before relying upon any “tolling” of the statute of limitations and not filing suit within one year. Moreover, an insured must be familiar with the contractual statute of limitations provisions in its policy and the applicable law of the jurisdiction.

Conclusion

Builder’s risk insurance is a crucial part of any construction project. Owners, contractors and other professionals should give significant consideration to whether to obtain builder’s risk insurance, and if so, which specific form of policy to use. Some projects have opted not to use builder’s risk insurance but to allocate the risk of loss amongst the parties. This saves the cost of the insurance premium, but will leave one party or the other bearing the cost of a serious construction accident or defect and does not necessarily avoid disputes over who bears the risk in a particular case. There are a number of different available forms of BRI policies. Differences in the forms of BRI policies can determine whether there is any insurance coverage for certain types of construction defects and accidents. While BRI is often sold as “All Risks” insurance, there will be a number of exclusions and exceptions limiting coverage. The defective workmanship and consequential loss exclusions are two of the most important. In the event of a claim, there will be a number of procedures and deadlines to take action and submit information and insureds need to be careful to avoid giving insurers more ammunition to resist an otherwise valid claim.
Guidelines

1. There is not a universally-used or “standard” form for a builder’s risk insurance policy. Insureds should recognize that they have options and that there are important differences in the types of builder’s risk insurance policies used by insurers. On larger projects, the insureds may have significant leverage and the policy terms sometimes can be customized.

2. Builder’s risk insurance is often issued using the name “all risk” insurance, but do not be fooled by the title because there will be significant exclusions and exceptions from coverage. The “defective workmanship” exclusion is likely to be one of the most important issues in the event of a construction accident or defect. While there will be some kind of “defective workmanship” exclusion in virtually all builder’s risk insurance policies, there are significant differences in the wording and scope of these exclusions in different policies. Insureds need to examine the wording of the defective workmanship exclusion with particular care when evaluating whether coverage exists and should not assume that any such exclusion is not without limits. Generally, the most favorable language for the insured excludes the “cost of making good” defective workmanship and does not apply to damage resulting from defective workmanship.

3. There are various ways to obtain builder’s risk insurance. Often it is obtained through an Owner Controlled Insurance Program (OCIP) or a Contractor Controlled Insurance Program (CCIP). In most cases, both the owner and general contractor (and subcontractors) on a specific project will be insured under the same insurance policy whether it is an OCIP or CCIP. It is also possible that both the owner and general contractor may come into a new project already having their own OCIP and CCIP insurance programs. In these cases, a decision must be made whether the OCIP or CCIP will be used for the builder’s risk and other construction-related insurance that is needed for the new job.

4. The term “occurrence” as used and defined in a BRI policy is important. The meaning of “occurrence” may influence whether coverage exists and determine the number of deductibles that must be borne by the insured. A common cause theory is employed by most courts in assessing the number of occurrences. Cases in this area of the law are difficult to reconcile and outcomes are highly fact intensive and arguably result oriented. Insureds should make sure that they carefully analyze the occurrence issue before characterizing events in a manner that could be used against them.

5. When submitting a claim for coverage under a builder’s risk insurance policy, insureds must be aware that there are various procedural requirements and deadlines. Because builder’s risk insurance includes (but is not limited to) fire insurance, it is subject to the standard requirements for property fire insurance in most states. These requirements may include: (a) submission of a “proof of loss”; (b) giving “examinations under oath”; (c) audits of books and records; (d) an appraisal of the amount of the loss; and (e) filing suit against the insurer within one year or some other specified time period.

References


5. Trinity Ind., Inc. v. Ins. Co. of N. Am., 916 F.2d 267, 269 (5th Cir. 1990).


7. City of Burlington v. Indem. Ins. Co. of N. Am., 332 F.3d 38, 44 (2d Cir. 2003), aff’d, 346 F.3d 70 (2d Cir. 2003).


9. Trinity Ind., 916 F.2d at 270.


13. Avis, 195 S.E.2d at 548-49.

14. Trinity Ind., 916 F.2d at 270-71 (emphasis added).


16. City of Burlington, 332 F.3d at 50.


23. Trinity Ind., 916 F.2d at 270 (citations omitted).

24. Kraemer Bros. Inc., 278 N.W.2d at 859.


28. City of Barre, 396 A.2d at 123.

29. St. Paul Fire & Marine Ins. Co. v. Murray Plumbing & Heating Corp., 65 Cal. App. 3d 66, 135 Cal. Rptr. 120 (1976) (because defective workmanship exclusion applied to work of both contractor and subcontractor, insurer was precluded from seeking subrogation against its own insured subcontractor).


32. City of Burlington, 346 F.3d at 75.


37. Interpetrol Bermuda, Ltd., 588 F. Supp. at 1203.


42. Insurance Co. of State of Pennsylvania v. ALT Affordable Housing Servs., Inc., 1999 WL 33290622, at *6 (W.D. Tex. Jan. 17, 1999) (‘aditional plumbing access and repair costs should also be covered’).


49. EOTT Energy Corp. v. Storebrand Int’l Ins. Co., 45 Cal. App. 4th 565, 52 Cal. Rptr. 2d 894 (1996) (interpreting the term “occurrence” in a CGL policy, the court held a scheme that is the proximate and continuing cause of a series or combination of losses is a single occurrence.)


53. Id. at 1243.


56. Id. at 1545.

57. Id. at 1547.

58. Id. at 1547-48.


61. Id.

62. Id.
63. Id.
64. See, e.g., Home Indem. Co. v. City of Mobile, 749 F.2d 659 (11th Cir. 1984); Eureka Fed. Sav. & Loan Assn. v. American Cas. Co. of Reading, Pa., 873 F.2d 229 (9th Cir. 1989).
68. Id.
70. Prudential-LMI Com. Ins. v. Superior Court, 51 Cal. 3d at 691.
71. Id. at 678.