

Construction Insurance Trends in 2021

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Agenda

- Construction Insurance Overview
 - Insurance Programs
 - Caselaw Update OCIP/CCIP
- Industry trends
 - Hardening market
 - Disputed claims Know your LEG 1/2/3 Exclusions
 - COVID Update Business Interruption
 - COVID Update Obligation to procure



Types of Insurance for Construction Projects

- Commercial / Contractor General Liability
- Auto (Commercial)
- Workers' Compensation / Employer's Liability
- Excess / Umbrella
- Professional Liability (design-build)
- Marine
- Builders' Risk
- Delay In Start Up (often bundled with Builders' Risk policy)
- Insurance Programs: Owner-Controlled or Contractor-Controlled
- Subcontractor Default Insurance



Critical Clauses for Insurance Programs

- Policy types and limits
- Duration
- Additional Insured
- Separation of Insureds
- Waiver of Subrogation
- Responsibility for deductibles



OCIP/CCIP - Overview

- Owner/Contractor-Controlled (or -Consolidated) Insurance Program
- Also called Wrap-Up Insurance
- Owner/Developer, General Contractor, and subcontractors are all insured under the same policy(-ies)
- Tradeoffs:
 - Lower premiums
 - More complicated bidding, but no monitoring lower tier participants' coverage
 - Lower costs? (for the project)
 - Higher costs? (Contractors may be paying separately for their own policies)
- Special considerations:
 - OCIP Owner joint ventures
 - CCIP What happens in the event of termination?

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OCIP/CCIP – Caselaw update

- Timeliness of claims between owner/insurer/insureds
 - *Team Industrial Services, Inc. v. Zurich American Insurance Company*, 2021 WL 492882 (D. Kan. Feb. 10, 2021)
 - Plaintiff assumed a contract from an OCIP-enrolled contractor but was never itself enrolled. OCIP carrier denied coverage to Plaintiff related to two jobsite deaths because Plaintiff was not enrolled. Court allowed Plaintiff to assert claims for defense and indemnity against the OCIP carrier and other insurers, as well as breach of contract, breach of fiduciary duty, tortious interference with contract, and estoppel claims against the Owner.



OCIP/CCIP – Caselaw update

- Intersection of OCIP and individually-procured insurance
 - Liberty Mutual Fire Insurance Company v. Southern-Owners Insurance Company, 2020 WL 1069312 (S.D. Fla. Jan. 24, 2020)
 - Dispute over whether OCIP insurer or subcontractor's CGL policy under which contractor was an Additional Insured would indemnify and defend contractor. Subcontractor was not enrolled in the OCIP.
 - Subcontractor's CGL policy contained an OCIP exclusion.
 - The Court ruled that the OCIP exclusion in the CGL policy extended to the contractor as an Additional Insured and that, therefore, the CGL policy did not apply to the claim.



Industry Trends – Disputed Claims

- Market was tightening before the pandemic
 - Brush fires and flooding
 - Lack of skilled labor
- Construction productivity has stayed ahead of the overall economy
- Effect of the pandemic



Industry Trends – Builders' Risk & LEG 2/3 Denials

- Builders' Risk is the central policy in any project
 - First-party, primary insurance
- Broadest coverage
 - "All risks of direct physical loss of or direct physical damage to insured property"
- Everyone is covered for on-site activities
 - Anyone with an insurable interest in the project, materials, and equipment
- Highest limits
- But, no standardized forms. Each insurer(-group) will have its own policy language.



Industry Trends – Builders' Risk & LEG 2/3 Denials

- So where do disputes come in?
 - Other than fortuitous events, "physical damage" is typically caused by an actual or alleged defect in materials, workmanship, or design.
 - Every BR policy excludes faulty materials, workmanship, and design, but includes coverage for resulting damage.
 - The most common are the LEG 2/96 and LEG 3/06 exclusions.
- Anecdotally, we have noticed an uptick in the denial of claims on marginal arguments for claims under Builders' All-Risk Policies



- Insurers traditionally did not cover defective materials or workmanship, which was considered an inherent business risk
- Over the last several decades, new approaches to cost-of-making-good (COMG) exclusions.
- London Engineering Group (LEG) promulgates different standards, starting with LEG 1/96 and LEG 2/96
 - LEG 1/96: "The Insurer(s) shall not be liable for loss or damage due to defects of material workmanship design plan or specification."



• LEG 2/96: "The Insurer(s) shall not be liable for:

All costs rendered necessary by defects of material workmanship design plan or specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.

For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification."



• Updated in 2006 with LEG 3/06:

"The Insurer shall not be liable for:

All costs rendered necessary by defects of material workmanship design plan or specification and should damage (which for the purposes of this exclusion shall include any patent detrimental change in the physical condition of the Insured Property) occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.

For the purpose of the policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan and specification."



- What's the difference?
 - LEG 1 no coverage for faulty workmanship or resulting damage
 - LEG 2 no coverage for faulty workmanship; coverage for resulting damage; exclude whatever costs would have been incurred to have done the work correctly the first time
 - LEG 3 no coverage for faulty workmanship; coverage for resulting damage and costs to access defective workmanship; exclude what it would have cost to avoid to improve the original workmanship; "damage" is broadly defined
- Example: A faulty wire causes fire to part of an under-construction building.
 - LEG 1: No coverage at all.
 - LEG 2: Coverage for the damage to the building, but deduct what it would have cost to replace the wire had its fault been detected before the fire.
 - LEG 3: Coverage for damage to the building, but if only an improved wire would have prevented the fire, then deduct the cost of that improved wire.



- Confused?
- Despite the central importance of these exclusions to the most important policy in the project, these exclusions are applied arbitrarily <u>and</u> have generated almost no case law.
 - Zero (0) cases interpreting LEG 2 or LEG 3 in the US
 - One (1) case in Canada interpreting LEG 2



- Acconia Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Company, 2015 BCCA 347 (Ct. App. British Columbia August 5, 2015)
 - Concrete slabs in 8-story hospital project developed concave deflections after being poured. Structurally sound, but functionally useless. High spots had to silica-blasted down to level, at enormous cost.
 - LEG 2/96 excludes from coverage "the costs that would have been necessary to rectify a defect in workmanship immediately before that defect caused damage to the insured property."
 - Here, no costs were excluded. "[T]here was no defect <u>in the slabs</u> that could have been rectified in order to prevent the over-deflection, bending and cracking. The defect was <u>in the workmanship</u>. . . . [I]f the defect in the workmanship had been identified early enough, there would have been no material additional costs to implementing appropriate workmanship." (emphasis in original).

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- But beware, there are cases interpreting cost-of-making-good exclusions with different policy language:
 - Laquila Constr., Inc. v. Travelers Indemn. Co. of Ill., 66 F. Supp. 2d 543 (S.D.N.Y. 1999)
 - In *Laquila*, the policy excluded: "Cost of making good faulty or defective workmanship or material, but this exclusion shall not apply to physical damage resulting from such faulty or defective workmanship or material."
 - The court ruled in favor of Travelers, relying on the principle that the exception to the exclusion for ensuing damage should not swallow the exclusion itself.
 - Ledcor Constr. Ltd. v. Northbridge Indemn. Ins. Co., 2016 SCC 37, [2016] 2 S.C.R. 23
 - Window cleaners scratched windows, requiring their replacement. Insurers denied coverage under an exclusion for the "cost of making good faulty workmanship." The court ruled in favor of the insured, and determined that only the cost of recleaning the windows was excluded.

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Industry Trends – BI COVID Update

- Builders' Risk all risk of "physical loss <u>or</u> damage"
- No COVID construction cases yet, but many cases in the business interruption context, which also require "physical loss <u>or</u> damage"
- Scant caselaw from 1960s to 1990s on whether toxic substances such as mold and gasses constitute "physical loss or damage," but most ruled in favor of the insured



Industry Trends – BI COVID Update

- Early COVID cases went in favor of Insurers
- Later cases are coming in favor of Insureds
 - *JGB Vegas Retail Lessee, LLC v. Starr Surplus Lines Insurance Company*, No. A-20-816628-B (Nev. D. Ct. Clark Cnty. Nov. 30, 2020)
 - Denying Insurer's motion to dismiss because court must accept as true that virus droplets "are physical objects that attach to and cause harm to other objects."
 - *Goodwill Indus. of Orange Cnty., Cal. v. Philadelphia Indemn. Ins. Co.*, Case No. 30-2020-01169032-CU-IC-CXC (Cal. Super. Ct. Jan. 28, 2021)
 - Denying Insurer's motion to dismiss because court must accept as true allegations that COVID-19 "are contained in respiratory droplets called aerosols that stay on surfaces and in the air for up to a month, [and] physically alters the air and surfaces to which is attaches and causes them to be unsafe, deadly, and dangerous."

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Industry Trends – BI COVID Update

- Early COVID cases went in favor of Insurers
- Later cases are coming in favor of Insureds
 - In re Society Insurance Co. COVID-19 Business Interruption Protection Insurance Litigation, MDL No. 2964, Dkt. 20 C 5965 (N.D. Ill. Feb. 22, 2021)
 - Denying Insurer's motion to dismiss; rejecting Insurer's argument that government orders, rather than COVID-19, caused the loss; and ruling that the physical "limit" on usable space triggers the "physical loss" requirement



Industry Trends – Obligation to Procure re COVID

- Soundview Cinemas Inc. v. Great American Insurance Group et al., No. 605985-20 (N.Y. Sup. Ct. Nassau Cnty. Comm. Div. Feb. 10, 2021)
- Insured sued Broker for failure to procure business interruption insurance that would cover losses attributable to COVID-19.
- The Court granted Broker's motion to dismiss:
 - Insured never asked for pandemic-related coverage.
 - Insured cannot allege that any such insurance coverage existed prior to March 2020.



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