



RISK MANAGEMENT

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CONSTRUCTION CALAMITY

Risk Transfer Tips for Contractors
After a Catastrophic Loss

by Will Bennett



From structural collapses to fires, the construction industry has experienced a number of high-profile catastrophes over the past decade. These disasters test the mettle of even the most experienced risk professionals and the strongest insurance programs. Issues can arise in all facets of the company's contracts and insurance policies, and dealing with the aftermath is an extensive and demanding process that can involve many players.

As overwhelming as the task may seem, however, it is possible for general contractors to get through the disaster with minimal uncovered exposure if proper steps are taken. By understanding some of the exposures a general contractor faces after a catastrophic loss and implementing key risk transfer strategies from the outset of a project, risk professionals can minimize the impact of a loss on the company in the short and long term.

UNDERSTANDING POSSIBLE RISK EXPOSURES

When a catastrophic loss occurs, contractors face a wide array of potential exposures. Unfortunately, many large catastrophic losses involve serious bodily inju-

ries and even loss of life. If such a tragedy occurs, the general contractor can reasonably expect to be named in a flurry of personal injury and wrongful death lawsuits. Depending on the scope of the project and the area associated with the loss, the catastrophe may also prompt a wide range of bystander claims, from dust inhalation to emotional distress.

The contractor can also expect claims from nearby businesses for business interruption losses. Generally, these will be based on either being forced to shut down after the loss or experiencing reduced foot traffic as a result of the dangerous state of the building.

In addition to private claims, there may also be significant liabilities to the municipality. These can include costs for security measures for the project site

to prevent unauthorized entry or the addition of new infrastructure to change traffic flow. If the municipality cannot pass these costs directly to the owner or contractor immediately, it will certainly seek to do so in a later claim.

There will also be massive first-party losses from the project itself, including extensive repairs. In more extreme situations, the building may be a complete loss, requiring demolition of the existing structure before the owner either walks away or starts rebuilding.

Determining the cause of the loss will be another major component. This includes the collection and preservation of evidence,

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which will be necessary both for addressing any liability lawsuits and for dealing with insurers whose available coverage may be shaped by the investigation. The plaintiffs' lawyers, and potentially the municipality, will likely insist that certain protocols be put in place to preserve components of the building that may inform the investigation.

KEY RISK TRANSFER STRATEGIES

Companies can use several risk transfer strategies to help control the range of exposures that may result from a catastrophic construction loss, including:

Give Notice Immediately

Worker and civilian safety should, of course, be the first priority for the construction company's risk manager after a catastrophic loss. From there, you should immediately think about facilitating risk transfer. This means providing notice of the loss to every potentially implicated insurance company to which you have a connection. This is the simplest and most proactive step you can take to cross a potential future issue off your list.

Communicate with your broker immediately. Some coverages have explicit, time-sensitive notice requirements. Often found

in excess liability policies, crisis-related coverage extensions can be a valuable source of quick cash in the wake of a significant loss—typically around \$200,000 to \$500,000. This generally covers costs associated with securing the site, providing medical services to injured victims, and engaging with consulting services such as public relations and crisis management. Frequently, these provisions will have very short notice periods—sometimes as little as 24 hours. Your broker should be able to help you identify what coverage is available in your policies and assist you in the notice process.

Even if you are unsure whether a particular policy could be connected to the loss, it is better to give precautionary notice than risk giving late notice, especially in a state where late notice is a strong defense against coverage. Try to imagine if there is any scenario—no matter how unlikely—where the policy could be implicated and, if there is, submit precautionary notice as soon as possible. For example, if your project experienced a crane collapse, consider whether someone could have hacked into the crane's operating system and contributed to the collapse, potentially triggering your cyber policy. Is it possible there was an operator error that could have criminal implications? If so, perhaps your crime policy is a potential target. If you cannot rule it out with certainty, you should strongly consider giving precautionary notice.

Tender to Every Potentially Involved Subcontractor

The liability insurance model for the project will be a determining factor in the complexity of managing the liability arising from the loss. The claim will be infinitely simpler to manage if the project is insured under a contractor-controlled insurance program (CCIP), owner-controlled insurance program (OCIP) or even a project-specific general liability policy issued to the owner and general contractor. Although there will still be some finger-pointing among the insureds due to the likely presence of some uncovered liability, in this scenario, there will be ample opportunity for cooperation, as all parties will seek coverage from the same insurer. This is not to say that this will make the process easy, but it will likely prevent, or at least simplify, one massive component of the process: the inevitable declaratory judgment action for additional insured coverage.

If the project is insured under a traditional risk transfer model, this will likely be a messy process. At the outset, it will not be clear who is responsible for the loss. Everyone, including the subcontractors' insurers, will seek to blame someone else. The additional insured tenders are vitally important in this process and should be made promptly to any subcontractor who could have some responsibility for the loss. Depending on the scope of the loss, many subcontractors could be involved, dictating dozens of tenders. The more insurers you can involve in the process, the more sources

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you will be able to call on at the eventual settlement tables. Ideally, your contracts will require additional insured coverage without any requirement of contractual privity on a primary and non-contributory basis, dictating that the subcontractors' insurers must pay before your own policy. Collecting certificates with current and consistently updated policy information for all subcontractors will also help to facilitate this process.

It is crucial to remember that, if there is even a possibility for coverage under a subcontractor's policy, that insurer is obligated to defend the claim in full. This means even seemingly baseless allegations made regarding a particular subcontractor's role could

A good builders' risk policy from an insurer with a collaborative approach can be vital to minimizing the impact of the loss.

on their "other insurance" language.

If you are fortunate, you may get some of these insurers to accept your tender and pick up your defense from the initial tender. However, the majority of these subcontractors will likely deny your tender, at least initially. Some of these may warrant responsive letters, but it is highly likely that the scope of the loss and the number of denials will warrant a declaratory judgment action to clarify the scope of coverage available from each policy. Considering that each subcontractor will likely have one or two excess policies in addition to their primary general liability policy, this can mean a lawsuit with dozens of insurer defendants. Contractors should work with their own insurers to try to develop an arrangement in which the insurer either undertakes or funds the insured to undertake this action, as it directly benefits the contractor's insurer.

Focus on the Builders' Risk Policy

On the first-party side of the loss impact, the builders' risk policy will be the main focus. A good builders' risk policy from an insurer with a collaborative approach can be vital to minimize the impact of the loss. Some insurers are more cooperative than others in this process. With respect to coverage under these policies, there are several coverage provisions that can have a tremendous impact



give rise to a complete duty to defend the entire case against you. In some instances, that question may even be determined through extrinsic evidence, meaning your own knowledge of a subcontractor's potential liability could be used to invoke a duty to defend, even without pleadings implicating them. The burden is on the defending insurers to determine how to allocate the costs, based

for your company:

- **All Risks.** The policy should be written to cover all risks of direct physical loss rather than specified perils. This limits the insured's burden of proof to showing there was a loss and shifts the burden to the insurer to prove it was the result of some specified excluded cause.

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- **LEGIII Faulty Work Exclusion.** LEGIII refers to the third iteration of the London Engineering Group policy forms' faulty workmanship and/or design exclusions. Under this exclusion and accompanying exception, when defective work or design cause damage, the insured is entitled to coverage for the resulting damage and for the repair of defective work itself, provided the defective work is repaired according to the original standards, without any improvement.
- **Extra Expense.** Typically sublimited, this feature varies somewhat among forms, but generally provides coverage for the extra costs necessary to maintain the course of construction after the loss with minimal impact.
- **Expediting Expense.** Similar to extra expense, this feature typically provides coverage for extra costs necessary to get a delayed project back on its pre-loss schedule.
- **Protection of Property/Sue and Labor.** Protection of property typically covers costs associated with securing the site after a loss to prevent further loss and/or minimize any potential additional impact of a loss event. This is typically sublimited.
- **Soft Costs/Delay in Completion.** Varying in scope, these common provisions can cover costs aside from those directly associated with the physical loss. Common covered costs include interest on extended loans, additional insurance premiums and additional real estate taxes. Coverage typically takes effect after a waiting period (often 30 days), which begins the day of expected project completion. From a contractor's perspective, an owner-placed builders' risk policy should contemplate this coverage, as it will likely reduce claims brought by the owner.
- **Valuation Provision.** The insured should look for a policy that values the loss based on the actual cost to rebuild or, alternatively, the cost to rebuild immediately before the loss. Actual cash value provisions can significantly limit the available coverage.
- **Demolition and Debris Removal.** While demolition is typically considered part of the general cost to rebuild, debris removal is generally a separate sublimited coverage extension. The policy should explicitly contemplate debris removal, and not limit demolition.

Work with Your General Liability Insurer to Bucket Costs

As the general contractor, your own general liability insurer will be a vital resource in the risk transfer process. Even if you can convince a subcontractor's insurer to accept an additional insured tender from first tender, that will likely still be months after the loss occurs. By that point, there will likely already be numerous lawsuits filed against you, the city will be demanding additional infrastructure to secure the site and prevent further issues, and

evidence collection and preservation will already be underway. You will be looking to your own insurer to fund these costs.

Communicate with your general liability insurer early and often. Many of the costs early in the process can be fairly attributed to your defense. The standard ISO CG 00 01 general liability policy form covers "all expenses [the insurer] incurs" and "all reasonable expenses incurred by the insured at our request to assist us in the investigation or defense of the claim or 'suit.'" Crucially, under this language, if the insurer is not incurring the cost itself, such costs are to be incurred only at the insurer's request. Before you incur them, consider how to present a compelling case to your insurer that these early costs are defense expenses. Evidence preservation will prevent spoliation claims. Site security will prevent people from entering an unsafe building and potentially becoming additional plaintiffs. If the insured can obtain coverage for these costs as defense expenses, the insurer will likely pay them.

THE IMPORTANCE OF PLANNING AHEAD

Ultimately, there are far too many risk transfer considerations at play after a catastrophic loss to highlight here. However, the most valuable actions a contractor can take to facilitate risk transfer after a catastrophic loss must take place far in advance through careful scrutiny of contract language, policy language and loss procedures. Any party facing a significant degree of responsibility for a catastrophic loss will be overwhelmed by the sheer volume of issues to address on a daily basis. It is imperative to keep the big picture in mind and institute a plan to maximize all of the available avenues of risk transfer available. Doing so can get the company through the aftermath of the loss with minimal out-of-pocket exposure. ■

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