



Construction Industry Update

MSP Construction Update 03/2003: "Properly Insuring Construction Projects"

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Properly Insuring Construction Projects

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Construction projects are extremely complex — properly insuring them doesn't have to be.

When you combine a rigid budget, tight schedule, and group of participants who may never have worked together before, the stress of such an undertaking may lead to finger-pointing when something goes wrong. However, if your construction project is appropriately insured to cover risks and damages, the results don't have to be detrimental to your project, your company, and above all, your reputation.

Is a General Liability Policy Enough?

A general liability policy is a great place to start, but there are several major reasons why it should not be relied upon as the primary source of protection on a construction project.

First, in order for general liability coverage to apply, the named insured must be "legally liable." The problem is that in many circumstances, such as an earthquake or wind storm for example, no one may be legally liable. Yet damage has been done to the construction site or project, and there is no specific coverage or guideline to measure accountability.

Secondly, liability policies contain a number of exclusions that could limit coverage. For instance, they will only cover bodily injury or tangible prop-

erty damage for which someone is legally liable. They often do not cover faulty workmanship, delay, cost overruns, and similar perils.

Finally, a general liability policy claim can be difficult to prosecute. It can be time-consuming, financially exhausting in terms of legal fees, and destructive to relationships.

Course of Construction Policy Supplement

Because a general liability policy may not cover all areas of concern for a construction project, first party coverage, called a "course of construction" or "builders risk" policy, should be the "backbone"

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and the first line of defense of any construction-related insurance program.

A well-written course of construction policy will provide broad first-party property coverage on the entire project and cover the interest of anyone with an exposure on that project. There is no need to prove legal liability, which expedites settlement and avoids delays and expensive litigation.

On the other hand, a course of construction policy should serve as a **supplement**, not a substitute, to a general liability policy, which does offer benefits in itself that a course of construction policy does not encompass.

Simply put, each policy is different. Most course of construction policies are unique, manuscripted by each insurance company. It is thus important to review and negotiate the coverage.

Coverage is generally purchased by the project owner or the general contractor, but it is critical that the policy be written to cover all parties involved in the project. To be effective, the course of construction policy, whoever buys it, must cover all property on the project regardless of who actually owns the property.

Furthermore, a course of construction policy does not cover property damage on a job site after a project is complete, nor does it cover bodily injury. When these situations arise, general liability coverage should respond. A general liability policy is mandatory for most contractors. It is usually triggered when there is a problem regarding bodily injury or tangible property damage.

How It Works

There are basically two ways to insure construction projects from a liability perspective. The first and most common way is to require each participant to carry its own liability insurance. Each entity purchases its own coverage and factors the cost of its insurance into a bid. In the event of a claim, each party stands on its own, and is usually represented by its own counsel if the problem degenerates into litigation. In a complex dispute in-

volving a number of different trades, the sheer number of people involved can be staggering, as are the costs. It is not uncommon for the collective expenses of a claim to exceed the ultimate settlement.

The second way to insure a construction project attempts to avoid such a fiasco. It involves purchasing an Owner-Controlled Insurance Program (OCIP), also known as a “wrap-up.” With an OCIP, everyone working at the project site is covered under one master liability insurance policy.

When the project is bid, each contractor subtracts out its line item for liability insurance, and the owner receives a portion of the cost of the

OCIP premium back in the form of lower construction costs. OCIPs typically provide coverage through substantial completion of the construction plus a period of years thereafter, typically 10 years, which is one statute of limitation in California.

The benefits to owners are significant because the OCIP guarantees that they will have coverage in force at the

limits they selected for the applicable statute, and they can be comfortable that any contractor setting foot on the site is covered. Additionally, in the event of a claim, owners will not have to seek out a number of different potential defendants – they will only have one source to pursue.

OCIPs do pose some difficulties. All policy forms are manuscripted and are heavily negotiated, which can be expensive and time-consuming. OCIPs are complicated policies with extremely long time horizons, and each participant (contractors usually) must be enrolled onto the policy. This can be time-consuming and occasionally confusing. As such, it is imperative that an OCIP be negotiated by an insurance broker experienced in this area and placed with an underwriter that understands the coverage.

The last major coverage area to consider is workers compensation. Occasionally, workers com-

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pensation coverage is incorporated into an OCIP. Generally, however, it is carried individually by each participant. When this is the case, it is recommended that each party to the project waive its rights of subrogation against the other parties on the project. Most underwriters will agree to do this for a nominal cost.

There are other exposures on a construction project for which insurance can be purchased. Environmental issues and professional liability for design error are two examples.

Insurance programs for construction projects can be as complex as the projects themselves. The key is to arrange a broad builders risk policy to cover the interests of everyone involved in the project. This should be supplemented with a well-thought-out liability insurance program, conceivably an owner-controlled insurance program.

Collectively these two coverages, in addition to workers compensation, should provide appropriate coverage for the majority of accidents that take place on a construction project.✕

Disclaimer: *This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.*



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