



Construction Industry Update

MSP Construction Update 05/2003: "The Right Way to Write Builders Risk Insurance"

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The Right Way to Write Builders Risk Insurance

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Builders risk insurance (also known as course of construction), is designed to cover real property when it's being built. Construction involves a complex array of interrelationships among the parties working on a project, and entails various types of property as well as numerous ownership interests. Therefore, unique policy forms are required to adequately cover the exposure.

In addition, the policy needs to be purchased by one party, but ideally should cover the interest of all the parties that work on the project. Finally, there should be waivers of subrogation amongst the parties to the project to avoid any litigation for damages that would be covered by the builders risk policy.

Because of their complexity, builders risk policies are often written incorrectly. This is made even more challenging by the fact that each insurance company generally writes its own policy and there is no common form. Therefore, it is imperative that you work with an insurance broker that understands builders risk insurance so that it can be tailored correctly.

Your Construction Contract

The key to an effective builders risk policy is an understanding of the construction contract, particularly the insurance requirements and indemnity sections.

The insurance section, among other things, will specify who is responsible for buying the builders risk insurance and exactly what coverage is to be included. The indemnity section of the construction contract establishes which of the parties will be responsible for various losses that could conceivably occur during the course of construction, and under what circumstances the parties to the contract have waived their recovery rights against one another. It is also helpful to review the project financing documents (lender's requirements) to determine what coverage the lender requires.

Covered Parties

Normally, either the owner or the general contractor is responsible for buying the builders risk

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policy (note that we always recommend that owners buy the coverage on their buildings). Regardless of who is responsible for arranging the coverage, all stakeholders to the project, including the project owner, the general contractor, and all the subcontractors and design professionals should be included as named insureds.

The reason to include all the stakeholders is that the ownership of a construction project is much more complicated than the ownership of a completed operating facility. During the course of construction, the project owner is seldom the sole owner. The general contractor and the subcontractors often have an interest in the property until it is installed and they are paid. As owners or part-owners of the insured property or as creditors of the insured to the extent of the labor and materials advanced, the contractors and subcontractors have a valid insurable interest.

Including all the stakeholders on the policy also helps to prevent the builders risk insurer from attempting to recover from the general contractor or any of the subcontractors for losses allegedly caused by their negligence. However, simply naming the stakeholders on the policy, may not be enough to preclude the insurance company from subrogating in every case.

Waiver of Subrogation

As mentioned, including all the contractors and subcontractors as insureds on the course of construction policy may not preclude the insurance company from subrogating against them if, in fact, they caused the damage to the building. To avoid subrogation by the insurer, a waiver of subrogation should be included in the construction contract. Basically, each party to the contract agrees to waive their right of subrogation against the other to the extent that the damage is covered by the course of construction policy. Such an agreement can be found in either the AGC or AIA standard form agreements and the AIA provision is shown below. This is from the AIA Document A201-1997.

Waivers of Subrogation

The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and em-

ployees, each of the other, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Paragraph 11.4 or other property insurance applicable to the Work, except such rights as they have to proceeds if such insurance held by the Owner as fiduciary.

The Owner or Contractor, as appropriate, shall require of the Architect, Architect's consultants, separate contractors described in Article 6, if any, and the subcontractors, sub-subcontractors, agents and employees of any of them, appropriate agreements, written where legally required for validity, similar waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

Covered Property

The definition of covered property is important. In addition to the building or structure being constructed, the description of covered property normally includes all fixtures, materials, supplies, machinery and equipment. You can also add endorsements to include scaffolding, false work, fences and temporary structures incidental to the construction. You can also cover office trailers and, in most cases, you will want to extend the definition to include underground works, sidewalks, paving, the value of site works and excavation works.

Coverage can be extended to include property of others to which the insured may be liable, and soft costs, loss of rents and delayed opening costs should be evaluated as well.

Covered Locations

Needless to say, the course of construction policy provides coverage for a specific location. How-

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ever, there is exposure for both property in transit and property temporarily at other locations. It is imperative that appropriate limits be established for these coverages.

Excluded Property

There is a relatively short list of property that is not covered under a builders risk form. This includes things such as automobiles, landscape, money, contractors tools, equipment and machinery

(these should be covered under a contractors equipment floater.)

Summary

Builders risk is a complex insurance coverage. An appropriate builders risk policy will include all stakeholders as named insureds. The construction contract will include waivers of subrogation to the extent damage is covered by the builders risk policy, and the policy itself will include a broad definition of covered property and provide adequate limits for both off premises and transit exposures.☒

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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