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DON'T GET WRAPPED UP IN NAVIGATING WRAP UPS

Introduction

Construction projects, especially larger ones, are frequently insured under an owner-controlled insurance program ("OCIP") or a contractor-controlled insurance program ("CCIP"). Whether through an OCIP or a CCIP, the concept is frequently referred to as a "Wrap" or "Wrap-up" program, as it is intended to wrap a unified insurance program around an entire project. In some cases, questions have arisen whether a specific insurance program is a Wrap or not [*see, e.g.,* Welcome v. Just Apartments LLC, No. A-3650-06T2, 2008 N.J. Super. Unpub. LEXIS 2466 (App. Div. July 11, 2008) (Owner was required to add the general contractor as a Named Insured to a general liability policy covering the project, and the general contractor's CGL carrier denied coverage citing its exclusion for jobs covered by Wrap policies, and the court agreed)].

There is no standard Wrap policy form, and there is little case law on the working of Wrap programs that is different from the law applying to the constituent parts of the program. Accordingly, the following discussion focuses on what practitioners have experienced and accomplished in using various Wrap programs.

I. The mechanics of wrap up policies (30 minutes)

A. Types and differences – OCIP v. CCIP

OCIP - Owners and Contractors Protective Liability Coverage ("OCP") [not to be confused with "OCIPs" (owner-controlled insurance programs) discussed in § 30A.13, above] is a stand alone policy usually obtained by the contractor and insuring another participant, usually the owner. For example, ISO's CG 00 09 OCP policy is typically obtained where one construction participant is specifically obligated to provide another participant with OCP insurance. It is not usually combined with other ISO coverage forms. New Appleman Insurance Law Practice Guide, Ch. 30A Understanding Construction Insurance § 30A.31 (LexisNexis).

B. Benefits to members, sponsor, project owner

1. **cost savings**
2. **efficiency (single insurer)**
3. **streamlines claims / claim process**

Specific benefits include:

- The controlling entity (whether owner or contractor) can take advantage of what amounts to volume pricing for the insurance, and can avoid mark-ups on the cost of insurance from lower-tiered participants.
- Increased coverage limits may be obtainable.
- The controlling entity can be certain that other participants' coverages, to which it would otherwise require those participants to name it as an Additional Insured, have not lapsed or been canceled.
- The controlling entity can more easily track whether any of the available indemnity limits have been eroded (otherwise, an owner or contractor may have no idea whether lower-tier participants' indemnity limits have been eroded by payments of claims on other jobs).
- The controlling entity can control the type, amount, and payment of deductibles or retentions, thereby avoiding or reducing complications from another participant who cannot or will not pay its retention amount.
- The various contractors, and their insurers, can refrain from competing with one another to allocate liability in the event of a loss, thereby reducing the likelihood of cross-claims among parties to the project.
- All participants are relieved of obtaining and tracking additional insured status and documents, and claims administration can be streamlined by centralizing that function.
- The controlling entity can create and maintain a unified safety and security program, and set risk control standards for the project.
- Insurance for all construction participants may be ensured, even where some would otherwise face insurability hurdles.

Why Are CCIPs So Popular?

First of all let me explain what we mean by "contractor." We are referring usually to a construction manager at risk, a general contractor, or what may be referred to as a prime contractor. Generally, these will be the parties that have privity of contract with the trade contractors. Which brings us to the first question of "Why are CCIPs so popular now?" The contracting community has made a very compelling case to the owners that they (the contractors) are simply in a better position to control the procurement process because they are contractually controlling the subcontracting process. Makes sense, does it not?

In previous articles, we discussed how the sponsor of the wrap-up can save money by the wrap-up method. Because most wrap-up insurance programs are loss sensitive (the sponsor is responsible for the deductible losses), safety becomes priority number one. Although still contractually obligated to provide a safe site—wrap-up or no wrap-up—the contractors have opined that they are best able to control the claims through a safe work environment. If that is the case, then they should be rewarded with the savings. In other words, logically thinking, the procurement of a CCIP simply is nothing more than an extension of the contractors' scope of work responsibilities.

Not only will an excellent safety culture result in monetary rewards, so will the ability to extract the highest level of "deducts" from the trades. Remember, the final cost of the wrap-up insurance program will be compared to the final collected insurance deducts. The contractor is in a wonderful contractual position to control this process. By having a privity of contract with the trades, contractors are in the best position to negotiate the highest level of deducts. *"Have You Thought abouta Contractor Controlled Insurance Program?" Richard Resnick, President, Project Risk Consultants, Inc.*

C. Impact of wrap ups to regular insurance program

Owner specific - Isolating risk of construction away from core operational insurance
Contractor/member specific – eliminates duplication in coverages
General – avoid coverage gaps (with respect to workers' compensation and CGL); coverages); reduce potential litigation; allows for comprehensive and centralized safety programs

OCIP Coverage

Under the CG 00 09 12 07 (*i.e.*, 2007 version) OCP policy form, the Named Insured (*e.g.*, the owner) is insured against liability because of bodily injury or property damage occurring during the policy period and arising out of either (a) the contractor's operations at the locations specified in the declarations, or (b) the Named Insured's general supervision of the contractor's operations. The contractor is not insured under this policy. *New Appleman Insurance Law Practice Guide, Copyright 2015.*

OCIP Exclusions and Coverage Limitations

The CG 00 09 policy form includes a number of important exclusions. For example, it excludes liability for injury or damage occurring after the contractor completes its work for the Named Insured, or after the portion of the contractor's work out of which the injury or damage arises has been put to its intended use. Another exclusion is for contractual liability, subject to certain exceptions. The contractual liability exclusion should be reviewed carefully, as it differs from other IS" contractual liability exclusions.

▼Example:

As a general contractor entered into a construction contract to perform in a good and workmanlike manner, and no specific provisions enlarged that duty, it did not "assume liability" for damages arising out of its defective work, such that a contractual liability exclusion in an insurance policy was not triggered [Ewing Constr. Co. v. Amerisure Ins. Co., 420 S.W.3d 30 (Tex. 2014)].

The CG 00 09 policy form also excludes injury or damage arising out of the Named Insured's acts and omissions, other than general supervision of the contractor's work. Thus, a policy based on this form covers the contractor's negligence, not the negligence of the Named Insured (except in supervising the contractor). What constitutes the Named Insured's general supervision of the contractor, as opposed to the Named Insured's acts or omissions, is typically construed broadly to protect the Named Insured.

▼Example:

In *Western Cas. and Sur. Co. v. Southwestern Bell Tel. Co.* [396 F.2d 351 (8th Cir. 1968)], a telephone company hired a contractor to enlarge access holes to underground telephone lines. While excavating, one of the contractor's workers ruptured an underground power line, injuring several workers. The injured workers sued the telephone company for providing plans that omitted the power line. The OCP insurer denied coverage because the telephone company's alleged liability was based on its acts or omissions. There was coverage under the OCP policy because the telephone company's failure to warn the workers of the location of potential hazards at the work site, such as the location of the power line, fell within the telephone company's general supervision of the contractor.

An OCP policy typically has its own separate and additional limits (a per-occurrence limit and an aggregate limit), which means that the contractor's liability will not erode the policy's limits protecting the owner, as it would erode the limits of the contractor's own CGL policy.

Strategic Point:

Because there is only coverage for the contractor's operations at the locations specified in the declarations, it may be important to ensure that all locations where the contractor will be performing its work for the Named Insured are specified in the declarations page. *New Appleman Insurance Law Practice Guide,* The CG 00 09 policy form includes a number of important exclusions. For example, it excludes liability for injury or damage occurring after the contractor completes its work for the Named Insured, or after the portion of the contractor's work out of which the injury or damage arises has been put to its intended use. Another exclusion is for contractual liability, subject to certain exceptions. The contractual liability exclusion should be reviewed carefully, as it differs from other IS" contractual liability exclusions.

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Additional Insured Coverage Under an OCIP Policy

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Where an OCP policy has been procured, ISO's CG 20 31 01 96 AI endorsement provides a mechanism for adding an architect, engineer, or surveyor (engaged by the Named Insured) as an insured, "but only with respect to liability arising out of … [the Named Insured's] ongoing operations performed by the [Named Insured] or on [the Named Insured's] behalf." The endorsement excludes injury or damage "arising out of rendering of or the failure to render any professional services by or for" the Named Insured. A newer edition of the endorsement, Form No. CG 20 31 01 04, attempts to limit coverage for the additional insured's sole liability. *New Appleman Insurance Law Practice Guide, Ch. 30A Understanding Construction Insurance § 30A.34, Copyright 2015 (LexisNexis).*

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Effect on Completed Operations Coverage

One of the more critical differences between a CCIP and OCIP has to do with the completed-operations exposure. Completed-operations coverage extends typically 3 years beyond the construction period and quite often beyond the closing of the developer's/owner's construction loan. Although, coverage continues to be in place to protect all insureds in the event of a completed-operations claim, this coverage continues with the large deductible in place, which is the responsibility of the sponsor. Under an OCIP, the owner is the sponsor and remains exposed to the deductible for the completed-operations extension period. This exposure makes it difficult for owners to ultimately cap their project costs and close their construction loans within a year or so of the project completion. In addition, unlike an OCIP, owners need not concern themselves in a CCIP with the overall CCIP administration that can include:

- CCIP trade enrollment
- Project payroll reporting
- Claims management and administration
- Safety
- Meetings and communications with CCIP brokers/underwriters, etc.

Furthermore, insurance companies that write wrap-up programs are usually the same insurers that write the insurance programs for large construction managers and general contractors. These insurers have a high comfort level in writing CCIPs. Unlike most owners, the construction manager usually has significant critical mass in the insurance marketplace and can generate cost efficiencies for the mutual benefit of the owner and the manager.

As respects the loss-sensitive nature of wrap-ups, owners may not have an appetite for deductible reimbursement in controlled insurance programs; especially with deductibles in the range of $250,000 to $500,000. Moreover, the days of guaranteed cost CIP's (i.e., no deductibles) are gone.

Depending on program design, sponsors of wrap-up programs may elect **not** to pre-fund the losses in the premium payments. This deferral of loss payments means that the sponsor must provide some form of collateral to the insurance company guaranteeing that the losses will be paid when due. Owners have demonstrated less enthusiasm about providing letters of credit, collateral requirements, or surety instruments required by underwriters for future OCIP claims (i.e., actuarially projected and developed claims).

Contractors with large asset bases and substantial surety programs have more capacity to deal with carrier collateral requirements in CCIPs. Similar to the completed-operations issue noted above, the sponsor in an OCIP must bear the claims exposure until all claims are closed or a buyout is negotiated with the insurer. It may take upward of 3 to 5 years to close all claims and buyouts do not begin to be feasible until 18 to 24 months following project completion. Construction managers are familiar and stay involved with the ongoing claims management process well beyond project closure. Development firms contemplate operational concerns and, up until recently, were not very involved with construction claims. The due diligence and overall approach are different due to the nature of the contractor's operations. A CCIP is in many ways a natural extension of the construction manager's master risk management program and can add value by applying a more sophisticated insurance claims management process.

This is not to say that in every instance a CCIP is favorable over the OCIP. In the spirit of partnership, all parties should decide beforehand, which is the best way to proceed. Many owners may be quite comfortable assuming the risks inherent in procuring the wrap-up. They might even be willing to share a portion of the savings with the contractors for a job well done. By the same token, the contractor may be willing to do the same under a CCIP. Regardless, this does not have to be adversarial. Pick the most logical approach given the specifics of the project. It can be a win-win for all parties.

D. Cons and Pitfalls of Wrap Ups

Deductibles, fines and fees under the controlled insurance program;
Increased administrative costs/efforts on administrator of program; increased upfront premium;
Exclusion of design professionals;
Excluded Risks (e.g. off-site work, pollution cleanup, damage to other contractors' work) and/or inadequate limits, shorter effective periods

Wrap programs are designed to reduce costs and avoid headaches on major construction projects. While useful, they can be expensive and difficult for the controlling entity to administer. This extra cost, however, may be the right price to pay to gain peace of mind that comes with having the project risk "wrapped-up" under a unified program.

Other than potential coverage issues that arise under Wrap programs, some of which are discussed above, the fact that the Wrap insurer has no direct relationship with most of the parties insured could result in significant gaps. Usually, the insurer will have negotiated with a broker representing only the controlling entity, and neither insurer nor broker has any business relationship with or allegiance to the other participants. Therefore, when the claims come in, all participants have to rely on a program that was designed for the benefit of the controlling entity.

Further, all of the participants must rely on the controlling entity's decision as to which Wrap insurer to retain. Unfortunately, Wrap insurers, like other insurers, are not immune from insolvency and other financial problems. If the Wrap insurer goes insolvent, someone has to step in to cover that portion of any loss. Even when Wrap programs include umbrella insurance that drops down in the case of insolvency, or when a state guaranty fund takes over the claim, those entities frequently make claims or institute lawsuits to collect from the participants' other insurers, who have most likely excluded any risk arising from the Wrap-insured project. This process unravels one of the main reasons to obtain a Wrap program in the first place.

One additional risk to consider with Wrap programs is that they are largely untested by the courts. Insurers writing these policies have custom ("manuscript") language, much of which has never before been interpreted. Many such programs also include alternative dispute resolution provisions so that they may never be tested in court. The use of untested custom insuring language increases the risk of coverage uncertainties and disputes.

II. Transferring Risk: Contractual Obligations v. Coverage Obligations

A. Contractual obligations: defense, indemnification and duty to provide insurance coverage v. risk transfer under traditional insurance programs

B. Additional Insureds

C. Rights and duties when there is a loss and/or claim; differences in claim handling and defenses available

Typically, Wrap program premiums are allocated to the various contractors through a bid deduct process administered by the controlling entity. So, even though one controlling entity purchases the policy, each of the contractors on the job is effectively purchasing coverage because the premiums are allocated to them through a bid-deduct. In *National Union Fire Insurance Co. of Pittsburgh, PA v. American and Foreign Insurance Co.* [No. CV 04-7257 PA (PLAx), 2006 U.S. Dist. LEXIS 96778 (C.D. Cal. Feb. 9, 2006)], the court reviewed the "other insurance" provisions of the insured's own CGL policy and the umbrella portion of a Wrap, and held that the CGL carrier was liable to the Wrap carrier, notwithstanding that the Wrap policy had been issued specifically for the project on which the claim arose. The result for the insured contractor, not set forth in the opinion, is that its going-forward insurance premium was impacted by a loss that could have been covered in its entirety by a Wrap program that the contractor paid to participate in, but which would likely not affect its future premiums.

Strategic Point:

Contractors purchasing coverage through the bid-deduct process may wish to review the "other insurance" provisions of the Wrap policy and their own coverage carefully, to clarify which policy is likely to respond to a claim arising out of the specific project. [*See, e.g.,* Welcome v. Just Apartments LLC, No. A-3650-06T2, 2008 N.J. Super. Unpub. LEXIS 2466 (App. Div. July 11, 2008) (no designation of the program as a "Wrap," the project owner merely added the general contractor as an insured under its CGL policy procured specifically for the construction project).]

Consider:

Contractors purchasing coverage through the bid-deduct process should consider whether the Wrap program adequately replaces their Completed Operations coverage (as described more fully below), and should consider whether the deduction from the bid adequately accounts for any difference.

Cross References:

California has recently enacted statutory requirements that controlling entities disclose the method and amount of the calculated bid deduct in most Wrap programs. Cal. Civ. Code § 2782.9 *et seq.* These statutory requirements are discussed more fully below in § 30A.30, below. *New Appleman Insurance Law Practice GuideCopyright 2015*.

Statutory Regulation

Because the Wrap format is still in rapid evolution, states may pass regulations that have significant impact on the way they are administered and the coverage they provide. As an example, California recently passed legislation regulating indemnification, program coverage disclosures and premium collection and credit.

Cal. Civ. Code § 2782.9, enacted in 2009, renders indemnity obligations between contractors of all levels unenforceable when a residential project is covered by a Wrap program. Nevertheless, any party may make equitable indemnity claims for damages if the claims are ultimately not covered by the Wrap policy. Under this statute, the controlling entity may require other participants to pay a reasonable share of any retention associated with claims covered by the Wrap program if the maximum amount of each participant's contribution, and the method of collection, was disclosed in the contract with the participant. The contribution must be reasonably limited so a participant may have a financial obligation in the event of a claim allegedly caused by that participant's work. The contribution may only be collected when the deductible or self-insured retention is incurred by the builder or general contractor.

Cal. Civ. Code § 2782.95, also enacted in 2009, mandates disclosures when Wrap programs are used on private residential construction projects that begin construction after January 1, 2009. The controlling entity is required to disclose the total amount of, or method of calculating any credit or compensation for the policy premium sought from the subcontractor in the construction contract. The disclosure must include Wrap program policy limits, scope of coverage, policy term and other specified information regarding the coverage, including a copy of the policy if it is available. If the controlling entity fails to disclose the amount or method of calculating the premium credit or compensation charged before the participant submits its bid, then the participant is not legally bound by the bid unless it also has the right to increase the amount of the bid to make up the difference between the cost of the Wrap policy carried in its bid and the actual cost.

Finally, Cal. Civ. Code § 2782.96, also enacted in 2009, mandates disclosures when Wrap programs are used on public works or any project other than residential construction. The controlling entity must disclose the amount or method of calculating any credit or compensation for the policy premium in the bid documents. The contract documents must disclose the policy limits, known exclusions, and the length of time that the policy is expected to remain in effect. Covered entities have the right to obtain copies of the Wrap program documents. *New Appleman Insurance Law Practice Guide Copyright 2015.*