CLM CLAIMS & LITIGATION MANAGEMENT ALLIANCE™

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2015 CLM Atlanta Conference
November 5-6, 2015 in Atlanta, GA

That's A Wrap – What Every Claims And Construction Professional Needs To Know About Wrap-up Insurance Programs

"In the construction industry, a wrap-up policy is an insurance vehicle purchased by an owner of a large construction project that generally provides consolidated on-site coverage for the entire project, including worker's compensation coverage." *Guarantee Ins. Co. v. Old Republic General Ins. Corp.*, 2012 WL 4468352 (S.D.Fla.,2012). "Wrap-up insurance programs provide a single source for construction insurance that covers all the contractors and subcontractors on a project." *Id.*

Wrap-up insurance programs (such as owner controlled insurance program (OCIP)'s and contractor controlled insurance program (CCIP)'s) were once reserved for megaprojects. But in recent years, these programs are being used more and more for smaller projects such as residential projects and smaller commercial projects. There are several factors contributing to this growth. These include the dwindling availability of affordable coverage for lower-tier contractors, the rise of construction defect claims and litigation, the desire to get a predictable insurance premium for a project, and the desire to streamline the handling of insurance claims arising from a project. Claims and construction professionals are increasingly required to navigate these unique and tricky insurance products.

This panel presentation focuses on the top 10 issues that every claims and construction professional needs to know when working on a project that involves a Wrap-up insurance program. The top ten issues are:

1. Named Insureds.

The starting point is determining who the named insureds are. Typically, coverage is provided to all "contractors with whom the [owner or contractor] contractually agreed to provide insurance, and all tiers of subcontractors of such contractors." Coverage can also be provided through an "enrollment" process where the contractors and subcontractors enroll into the program through the Wrap administrator. A failure to enroll or to meet the policy requirements of insured status can result in a lack of coverage. *See Hartford Underwriters Ins. Co. v. Am. Int'l Grp.*, 751 N.Y.S.2d 175 (N.Y. App. Div. 2002); *Workers' Comp. Fund v. Wadman Corp.*, 210 P.3d 277 (Utah 2009); *Cf Alpha Const. & Engineering Corp. v. Ins. Co. of the State of Pa.*, 402 Fed. Appx. 818 (4th Dist. Maryland 2010). Moreover, the Wrap insurer can seek subrogation / contribution against a contractor or subcontractor who is not an insured.

Furthermore, the broker or Wrap administrator may be exposed to liability for failing to enroll the contractor or subcontractor.

2. Additional Insureds.

Additional insured endorsements are typically not a part of the Wrap program. Wrap-up insurance generally eliminates the need for an owner to collect additional insured endorsements under the contractor's policy and each of the subcontractors' policies to protect an owner from liability claims. But sometimes, a contractor or subcontractor has agreed to make a party an additional insured. For example, a vendor or supplier. But a contractor or subcontractor has to be careful here. It is common that the following parties are excluded as insureds: "vendors, suppliers, fabricators, material dealers, truckers, haulers, drivers, and others who merely transport, pick up, deliver, or carry materials, personnel, parts, or equipment or any other items or persons to or from the project site."

Emerging case law in different jurisdictions (with the advent of more OCIPs being used) has addressed an interesting wrinkle: where, for example, a subcontractor is enrolled in an OCIP but as employer of the plaintiff also has a stand alone worker's compensation policy. Can the Additional Insured benefit from immunity if it had no role in the procurement process? Open question in Texas. Nebraska and Wisconsin say "no."

3. Insured Limits of Liability.

A benefit of Wrap programs is that higher policy limits are typically provided by the Wrap program than the typical general liability policy. But the limits of liability are different in several important respects. First, the limits of liability are often shared among the Wrap participants. Second, there is generally no annual aggregate on a Wrap program. Instead, one general aggregate typically applies. Third, defense costs may erode the limits of liability. The policy limits may also be restricted in other ways depending on the policy language.

Because the policy limits are shared, the policy limits may prove inadequate if a significant claim is made. Disputes can and often do arise concerning what insureds have priority to the limits of liability. Each jurisdiction takes a different approach as to who has priority to the limits. There are essentially three approaches taken: (i) the insurer cannot settle for one insured if that would leave another insured without a defense, (ii) first come first serve, so long as the insurer acts reasonable and in good faith, or (iii) the insurer can choose which of its insureds to pay for so long as it acts reasonably and in good faith (for example, the insurer could pro-rate the remaining limits across all of the insureds). *See e.g. In re Sept. 11 Litig.,* 723 F. Supp. 2d 534, 542 (S.D.N.Y. 2010) (applying first come first serve rule); *Christleib v. Luten*, 633 S.W.2d 139 (Mo. Ct. App. 1982) (remaining limits could be distributed pro rata); *Lehto v. Allstate Ins. Co.*, 36 Cal. Rptr. 2d 814, 822 (Cal. Ct. App. 1994) (cannot settle if it would leave other insureds without a defense).

4. Project / Site Descriptions.

Wrap insurance is typically limited to onsite risks. Sometimes, the Wrap may include offsite areas such as staging areas, fabrication facilities, warehouses, and incidental travel to and from those locations. Whatever the scope of the coverage, it is important that the project / site

description is defined clearly, and is consistent between the policy, contracts, and Wrap manual. There is at least one case where a project / site description was ambiguous and resulted in a contractor seeking coverage for an unrelated project. *Chase v. Terra Nova Industries*, 728 N.W.2d 895, 900 (Mich. Ct. App. 2006).

5. Coverage Duration.

Wrap policies normally terminate when the project is completed. However, the policy is usually endorsed with a completed operations extension endorsement. In general, the endorsement extends completed operations coverage for a certain period of time after the project is completed and the Wrap policy is terminated. Ideally, the endorsement will provide completed operations coverage during the period of the applicable statute of limitations and repose. Otherwise, the Wrap insureds may not be insured for completed operations claims that occur within the statute of limitations and repose, but after the completed operations extension expires.

Because the Wrap terminates when the project is completed, this raises issues concerning warranty work and callbacks. When warranty work and callback work is performed, the policy has expired and the completed operations endorsement is in effect, which only covers damage within the "products-completed operations hazard." Damage arising during the course of the warranty or callback work may not be covered because such damage arises during operations as opposed to out of a completed operation.

6. Priority of Coverage.

Additional problems can arise with respect to claims that impact the excess layers of coverage. Claims and construction professionals must pay close attention to the underlying exhaustion requirements in the excess policy. Many excess Wrap policies will apply only after proper exhaustion of underlying insurance through actual payment of claims by the insured, and generally will not "drop down" to provide coverage if the underlying policy limits are not properly exhausted. *E.g. Zieg v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2nd Cir. 1928) (and progeny). Priority of coverage is often linked to the language of the construction contract, as well as looking to the other insurance clauses of the policy. Does the construct contract require primary non-contributory OCIP coverage for certain dollar amounts?

7. Deductibles and Self-Insured Retentions.

A threshold issue is to determine how many deductibles or retentions are owed. Once it is determined how many deductibles or retentions are owed, then it needs to be determined: (i) who is responsible for satisfying a deductible or retention, and (ii) how the deductible or retention is satisfied. The policy language will answer these questions.

Where the policy language does not expressly require the insured itself to pay the retained amount, the excess insurer's obligations can be implicated by another person's or business's payment. *Continental Cas. Co. v. N. Am. Capacity Ins. Co.*, 683 F.3d 79 (5th Cir. 2012) But sometimes the policy will be very specific about who must pay the deductible or retention, and how it is paid, as was the case in *Forecast Homes v. Steadfast Ins. Co.*, 181 Cal. App. 4th 1466 (2010).

In the *Forecast Homes* case, subcontractors were required to add the general contractor (Forecast) to their general liability insurance policies as an additional insured. Several subcontractors obtained their required insurance coverage from Steadfast, who later refused to indemnify Forecast when a lawsuit was filed by several homeowners against Forecast for construction defects. Steadfast maintained the subcontractor did not pay the policy's self-insured retention (SIR), which was a precondition for coverage. Steadfast argued that only the named insureds, not Forecast, could satisfy the policies' SIR and trigger coverage.

Some of Steadfast's policies contained the following language: that "you," referring to the named insured, must "make actual payment" of defense costs and/or damages. Some of the other policies contained the following language: "it is a condition precedent to our liability that you make actual payment;" and "payment by others, including but not limited to additional insureds or insurers, do not serve to satisfy the self-insured retention;" and "satisfaction of the self-insured retention as a condition precedent to our liability applies regardless of insolvency or bankruptcy by you." The court held that all of the policies required (i) the named insured, (ii) to make actual payments that satisfied the retention amount. The court concluded that Steadfast did not have coverage obligations with respect to the subcontractors because the named insured had not made actual payments that satisfied the retention.

Another issue that arises is how the deductibles and retentions are exhausted among the various participants. This is a matter of contract. For example, the contract might specify that each "at-fault" participant will pay a portion of the deductible or retention. Or, the contract might provide that the contractor or owner will satisfy the deductible or retention and charge it back against the participant. Note that the participant's agreements among each other about how the deductible or retention will be exhausted should take into consideration the policy language regarding who must pay the retention and how payment is made.

8. Obligations and Notice Requirements.

Yet another issue that arises is regarding who is required to provide notice of a claim or suit. Common questions are: Who must give notice? Is notice from one insured deemed notice by all insureds? If one insured has notice of a defect, are all the insured's deemed to have notice? Etc. Like the issue just discussed, this boils down to: (i) the policy language, and (ii) the contract language between the Wrap participants allocating any responsibility. Typical language in a Wrap might provide something like: "A named insured must provide notice of any occurrence or offense that may result in a claim, as soon as practicable." Moreover, the policy might provide that notice to one insured is not deemed notice as to all of the insureds. For example, the policy might provide: "Knowledge of an 'occurrence,' claim or 'suit' by one or more Named Insured or Insured shall not constitute knowledge of such 'occurrence,' claim or 'suit,' by any other Named Insured, and notice of any 'occurrence,' claim or 'suit' given to the Company or any of its authorized agents by one Named Insured or Insured shall constitute such notice by all Named Insured and Insured."

9. Exclusions / limitations.

Some of the exclusions and limitations that are implicated in Wrap programs are discussed below.

a. Design build elements of the project.

Typically Wrap-up policies contain a standard professional liability exclusion baring coverage for damage arising out of the rendering or failing to render a professional service. Professional service typically include: "engineering, architectural, or surveying services." But does not include: "services within construction means, methods, techniques, sequences and procedures employed by the insured in connection with its operations as a construction contractor."

b. Damage to the work.

Wrap policies will typically exclude damage to "Your Work." The general "Your Work" exclusion states: "This insurance does not apply to 'property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" The exclusion does not apply to work that is subcontracted. The majority of courts hold that the exclusion bars coverage for the insured's defective work, but not to resulting damage to other contractor's work. *See e.g. United States Fire Ins. Co. v. J.S.U.B., Inc.,* 979 So.2d 871, 891 (Fla.2007). Moreover, policies typically exclude damage to "that particular part" of property being worked on by the Named Insured during operations. There is also a "separation of insureds" provision, which states: "This insurance applies (i) as if each named insured were the only named insured, and (ii) separately to each insured against whom claim is made or suit is brought." The impact of this is that the work exclusion should be considered with respect to each Wrap participants' work. Damage beyond that work (even if to other participant's work) is generally covered. The end result is that the work exclusions may have limited effect in a Wrap dispute depending on the nature of the defects and damages.

c. Contractor's consequential damages.

Typically the Wrap participants waive subrogation rights against one another with respect to covered consequential damage at the project. This means that Wrap participants can only sue one another for consequential damages that are not covered by the Wrap program.

d. Loss of use damages.

Another common exclusion in construction claims is the exclusion for loss of use damages – also known as the "impaired property" exclusion. Generally speaking, impaired property is someone else's property that cannot be used because your work or produce, which has been incorporated into that property, is inadequate or defective. Like the damage to work exclusions discussed above, the separation of insured provision plays an important role here. The impaired property exclusion should be considered with respect to each contractor's work.

e. Wrap / OCIP / CCIP exclusions in general liability policies.

Many Wrap participants own general liability policies include a "wrap-up exclusion." The exclusion generally reads as follows: "This insurance does not apply to 'bodily injury' or 'property damage' arising out of either your ongoing operations or operations included within the 'products completed operations hazard' at the location described in the Schedule of this endorsement, as a consolidated (wrap-up) insurance program has been provided by the prime contractor / project manager or owner of the construction project in which you are involved." These exclusions are generally enforced by the courts. *See McRae Fire Protection v. McRae*, 493 So.2d 1105 (Fla.App. 1 Dist.,1986) (Noting that Florida State "guidelines for wrap-up insurance programs require that the writing company notify the contractors' present carriers to exclude from existing policies the coverage to be provided by the wrap-up policy.") These exclusions can potentially result in coverage gaps to the extent that the Wrap program provides narrower coverage than the contractor's own general liability policy.

10. Administering the Wrap / OCIP / CCIP.

An entire presentation could be devoted to Wrap administration alone. Wrap administration specialists and companies devoted to Wrap administration have popped up in recent years. Here, we focus on whether the Wrap administration documents should be made part of the construction projects. Those documents include insurance, safety, and claims procedure manuals.