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Complex Builder's Risk Claims

Introduction

Builder's risk claims are often complex, involving a variety of issues and requiring multiple areas of expertise. Managing a builder's risk claim requires an understanding of the policy, an investigation into the cause of the loss and extent of the damage, the retention of the proper experts, and an analysis of the policy coverage, exclusions and valuation provisions in light of the results of the investigation. This paper will provide an overview of the builder's risk policy, including a discussion of some of the legal issues which arise and cases which have dealt with those issues.

Policy Overview

A builder's risk policy is a property policy that provides coverage for a project during the course of construction. If part of the project is physically damaged during construction, if the loss is not excluded, the policy will pay to repair or replace the damaged property. As one court explained:

“Builders risk” insurance is a unique form of property insurance that typically covers only projects under construction, renovation, or repair and insures against accidental losses, damages, or destruction of property for which the insured has an insurable interest. . . . The purpose of builder's risk insurance is to compensate

for loss due to physical damage or destruction caused to the construction project itself.¹

These types of policies can cover all types of projects, including commercial buildings, warehouses, schools, hotels, condominiums, stadiums, public works, airports and so on. Builder's risk policies are issued to owners, developers and general contractors. The policies will always have an overall limit of insurance coverage, stated as a dollar amount, which is typically equal to the value of the project. The policies will also have a variety of sub-limits for certain types of costs which are covered under the policy.

Insureds and Additional Insureds

Builder's risk policies usually name the project owner and developer as insureds. Further, the policies typically provide that the general contractor and any sub-contractors are also additional insureds under the policy.

Duration of Coverage

The policy will typically set forth the duration of coverage. The policy may include a specific policy period, with coverage starting on a specific date and ending on a specific date. If the project continues beyond the expiration date of the policy, the parties may agree by endorsement to extend the policy period.

The policy may also have specific language that states when the policy begins and when it expires. For example, the policy may provide that the policy begins with the commencement of the project at the location and ends upon acceptance by the owner or placing the project into commercial service for its intended use.

¹ *Fireman's Fund v. Structural Systems Technology*, 426 F. Supp. 2d 1009, 1025 (D. Neb. 2006).

Type of Property Covered and Excluded

Builder's risk policies typically will have a description of the covered project set forth in the declarations. The policies will then have specific provisions listing the property that is covered, as well as the property that is excluded. In general, the property covered usually includes buildings in the course of construction or renovation², structures, including temporary structures, property that will become a permanent part of the buildings or structures at the project site, plans, blueprints, drawings and specifications. Property typically excluded includes preexisting buildings or structures, land and contractor's equipment, machinery, tools, trailers, materials, and supplies.

The Insuring Clause (The General Grant of Coverage)

The policy will have what is referred to as an insuring clause, or general grant of coverage. Typically, the policy will state that it insures against all risks of physical loss or damage to insured or covered property, except for those causes of loss which are excluded. The insured has the burden to prove that this insuring clause is triggered. The insurer has the burden to prove any exclusions.

First, there has to be loss or damage to insured or covered property to trigger coverage. There has to be an event which causes damage to property which is insured under the policy. The event may be a fire, a structural collapse, high winds, storm waters or a number of risks or perils.³

² *38 Sequoia Associates, LLC v. Lumberman's Mutual Cas. Co.*, 114 Fed. Appx. 28, 30 (2d Cir. 2004) ("Buildings in the course of construction or renovation means structures that are undergoing, currently, construction or renovation.")

³ *See* 10A Couch on Ins., § 148.46 ("As with any insurance, property insurance coverage is 'triggered' by some threshold concept of injury to the insured property. Under narrow coverages like theft, the theft is itself the trigger. Under most coverages, however, the policy specifically ties the insurer's liability to the covered peril having some specific effect on the property. In modern policies, especially of the all-risk type, this trigger is frequently 'physical loss or damage,' but may be any of several variants focusing on 'injury,' 'damage,' and the like."); *MRI*

Second, the loss or damage to the property has to be physical. If there has been no physical loss or damage to property, the policy is not triggered. Courts often deal with disputes between insurers and insureds about whether there has been physical loss or damage.⁴

Insureds have often argued that because an insuring clause may state that the insurer will pay for “loss”, then (if there is coverage) the insurer is obligated to pay for all of the insured’s costs, including economic losses, which flow or result from the property damage. Insureds often rely on the case of *Zurich American Ins. Co. v. Keating Bldg. Corp.*⁵

However, this is not true. The purpose of the insuring clause is to determine whether coverage is triggered in the first place. If it is, then one looks to the rest of the policy to determine what costs may and may not be recoverable.

In 2015, Judge Sheila Finnegan, in the case of *One Place Condominium, LLC et al. v. Travelers Property Casualty Company of America*,⁶ rejected *Keating*. In particular, the Court rejected One Place’s argument that because the insuring agreement states Travelers will pay for “loss”, that means the policy will pay for all costs, expenses and economic losses that flow from the damage and resulting delay in completing the project. The Court devoted 6 ½ pages analyzing and critiquing the *Keating* opinion. The Court held that *Keating* “is both

Healthcare Center of Glendale v. State Farm General Ins. Co., 187 Cal. App. 4th 766, 780, 115 Cal. Rptr. 3d 27 (2010) (“For there to be a ‘loss’ within the meaning of the policy, some *external force* must have acted upon the insured property to cause a *physical change* in the condition of the property, i.e., it must have been ‘damaged’ within the common understanding of that term.”).

⁴ See 10A Couch on Ins. § 148.46 (“The requirement that the loss be ‘physical,’ given the ordinary definition of that term is widely held to exclude alleged losses that are intangible or incorporeal, and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property.”); *Simon Marketing v. Gulf Ins. Co.*, 149 Cal.App.4th 616, 623, 57 Cal.Rptr.3d 49 (2007); (“the threshold requirement for recovery under a contract of property insurance is that the insured property has sustained physical loss or damage”).

⁵ 513 F. Supp. 2d 55 (D.N.J. 2007).

⁶ 2015 WL 2226202 (N.D. Ill. April 22, 2015). The author represented Travelers in this case.

distinguishable and unpersuasive.”⁷ Judge Finnegan’s opinion is one of the most comprehensive opinions ever issued on a builder’s risk policy. The Judge explains, in detail, how a builder’s risk policy is structured, what costs are covered and what costs are not covered under a builder’s risk policy.

Valuation, Measure of Damages and Additional Coverages

Assuming there is coverage under the policy, one looks to the rest of the policy to determine what costs are covered and how they are measured. Similar to a first party property policy, a builder’s risk policy will cover the cost to repair, replace or restore the damaged property. The policy may also contain other additional coverages, such as: (a) demolition and debris removal; (b) extra expense; (c) cost to expedite the repair of the damaged property; (d) increased costs of construction materials and labor to finish the project; (e) expense to reduce certain losses; and (f) civil authority and/or ingress/egress. Often these additional coverages will have sublimits. The insured has the burden to prove that its claimed costs fall within the coverage under the policy.⁸

In builder’s risk claims (as well as other first party claims), there are often disputes about whether the insured can recover certain costs under these categories. In fact, quite often, insureds, their counsel and their public adjusters will submit all of their claimed costs and refuse to allocate them to the categories listed in the policy. This creates a major issue between the insurer and insured. Often, the insurance company will hire its own consultants to review and

⁷ See also *Vision One, LLC v. Philadelphia Indemnity Ins. Co.*, 174 Wash. 2d 501, 276 P.3d 300 (Wash. 2012) (rejecting an insured’s argument that millions of dollars of delay losses were covered under the general grant of coverage).

⁸ *Axiom Insurance Managers, LLC v. Capitol Specialty Ins. Corp.*, 2012 WL 2424606 *1 (N.D. Ill. June 21, 2012).

analyze the claimed costs and allocate them according to the categories of costs that may be recoverable under the policy.

Typical Exclusions

A builder's risk policy will usually contain exclusions which are also often found in first-party policies. Typical exclusions will include loss caused by or resulting from: (a) faulty or defective construction, workmanship or materials; (b) defective design, plans or specifications, (c) earth movement; (d) water; (e) enforcement of ordinance or law; (f) wear and tear or deterioration; (g) subsidence, settlement, cracking; and (h) consequential loss, damage, expense or delay. Some builder's risk policies may, in fact, provide earth movement or water coverage, but typically there is a dollar limit for those types of coverages.

The policy may also contain anti-concurrent cause language as a preamble to some of the exclusions. The language typically states:

We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regarding of any other cause or event that contributes concurrently or in any sequence to the loss.

Faulty Design or Workmanship

The exclusion for faulty or defective construction, workmanship, materials, design, planning or specifications is often litigated in builder's risk cases.⁹ The exclusion, however, will often have a resulting or ensuing loss provision. Typically, the provision will state that if a loss by a covered or insured cause of loss results or ensues from the first loss, then the policy will pay for that resulting or ensuing loss. The concept arose from the San Francisco earthquake in 1906.

⁹ Examples of representative cases include: (a) *Swire Pacific Holdings, Inc. v. Zurich Insurance Co.*, 845 So. 2d 161 (Fla. 2003); *Laquila Construction, Inc. v. Travelers Indemnity Co. of Illinois*, 66 F. Supp. 2d 543 (S.D.N.Y. 1999) *aff'd*, 216 F.3d 1072 (2nd Cir. 2000); *Allianz Ins. Co. v. Impero*, 654 F. Supp. 16 (E.D. Wash. 1986); *Vision One, LLC v. Philadelphia Indemnity Ins. Co.*, 174 Wash. 2d 501, 276 P.3d 300 (Wash. 2012); *RK Mechanical, Inc. v. Travelers Property Casualty Company of America*, 944 F. Supp. 2d 1013 (D. Colo. 2011).

Property policies excluded earthquakes, but did cover fires. Accordingly, the policy would not pay for earthquake damage to a house, but if the earthquake causes a gas line to break, which then led to a fire that damaged the house, the policy would pay for the fire damage. There is extensive case law around the country regarding what constitutes an ensuing or resulting loss. Generally, the rule is that there has to be a separate and independent loss that causes damage to property separate and apart from the property that was defectively constructed or designed.

Delay in Completion and Soft Costs Coverage

Builder's risk policies typically contain an exclusion which states that the policy will not pay for loss caused by or resulting from delay in completing the project. Courts usually enforce this delay exclusion.¹⁰ The policy, however, may provide for coverage for certain, limited types of costs, due to the delay in completing the project caused by covered property damage. This is referred to as delay in completion coverage, which can be part of the policy or added by endorsement.

Generally, the policy may provide that it will pay for certain types of soft costs and, perhaps, loss of income, during the period of delay in completion. The period of delay in completion is defined in the policy. Typically, the period is the delay in completing the overall project that is caused by the covered property damaged.

Accordingly, the delay in completion must be caused by the physical loss or damage to insured or covered property from a covered peril or cause of loss. The insured, then, has the burden to prove the length of the delay in the completion of the overall construction project caused by the physical loss or damage to the covered property. Practically, one has to determine the planned or anticipated completion date of the project immediately before the date of loss, that

¹⁰ *James F. Campenella Const. Co. v. Great American Ins. Co.*, 2010 WL 4812990 (E.D. Pa. 2010).

is, the date the project would have been completed had there been no loss. Then, you have to determine the number of days the project was delayed beyond the planned completion date due to the loss. The delay in completion of the project due to the covered physical damage can be quite complicated. Both the insurer and insured typically retain construction scheduling experts to perform the analysis. Delay in completion coverage is often litigated in builder's risk cases.¹¹

Under the delay in completion coverage, the builder's risk policy will specifically list the types of soft costs that may be recoverable. They will typically be limited to a small list, and may include things like interest on money financed, advertising and promotional expenses, real estate taxes, cost to renegotiate leases or loans, and insurance premiums. If there is also coverage for loss of income or rents, the policy will also set forth how that amount is to be calculated.

¹¹ Representative cases include: *W2001Z/15 CPW Realty, LLC v. Lexington Insurance Company*, 2014 WL 264468 (N.Y. Sup. January 22, 2014); *Vision One, LLC v. Philadelphia Indemnity Ins. Co.*, 174 Wash. 2d 501, 276 P.3d 300 (Wash. 2012); *James F. Campenella Construction Co. v. Great American Ins. Co. of New York*, 2010 WL 48129900 (E.D. Pa. 2010); *Diamond Beach, VP, L.P. v. Lexington Insurance Company*, 748 F. Supp. 2d 648 (S.D. Tex. 2010).