A Primer For Builders
How To Handle A Construction Insurance Claim

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The general contractor's job is to keep the many moving parts of a project working in synchrony to achieve a finished structure. Then, just when the builder thinks the project is completed and can begin the next one, the owner begins to complain that water is intruding here, the wrong finish was used there, or the windows are falling apart somewhere else. Pretty soon, a claim resolution process is set in motion that can determine whether the general contractor retains or loses its profit on the job.

Negotiating this claim resolution process with its insurance companies, the general contractor will be opposite professional insurance adjusters who work on construction claims every day or most days of their working lives. These people generally know what they are doing. Unless the general contractor has similar talent and knowledge at its disposal — either in the form of claim personnel, coverage counsel or both — it runs the risk of being out-manned and out-gunned.

While nothing can substitute for professional advice, particularly not in the case of complicated construction claims, there are some hard-and-fast rules to handling a construction claim that will get the general contracting firm started.

All Policies

Put all available carriers on notice: builders risk, general liability (GL), additional insured (AI) and errors and omissions (E&O). When the contractor learns of an actual or potential construction loss, it should immediately give notice to all insurance companies potentially on the risk. It should not have to delay giving notice while it gathers the relevant policies from the various custodians. Even if other parties (the owner, subcontractors, etc.) were responsible for obtaining applicable coverage, the contractor should have assembled a file of these policies, or at least certificates of insurance documenting them, well in advance.

Builders Risk: If the loss occurs during ongoing operations, particular attention to builders risk (but not to the exclusion of giving notice to other insurance companies — there is no downside to giving notice and a big potential downside to not doing so) and course of construction GL policies.

GL: If the loss occurs after the project is completed, pay particular attention to the GL polic(ies) with products/completed operations risk (even if you are still working through a punch list — if the work is mere repair and replacement of otherwise complete work, under many policy forms the project is still deemed completed).

AI: If your company is an AI under subcontractors' policies, give notice under those policies (having figured out their particulars by reference to the certificate of insurance provided by the sub, documenting the AI coverage). The same warnings stated above with respect to ongoing operations and completed operations, and indeed all other coverage issues arising under the sub's GL policy, apply to the AI coverage provided to the general contractor.

E&O: If the loss is caused by a core construction dispute (e.g., a delay claim) or a pure construction defect case with no occurrence,

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with no resulting property damage and it's strictly an economic loss (e.g., painting a building the wrong color), pay particular attention to the contractor's E&O policy if there is one. If there is any property damage, or the potential for property damage, E&O coverage will not apply — go back to the GL policy.

General Liability Policies

Do your own investigation. Even if the dispute concerns a core construction dispute, have the contractor's own people look for property damage. If the dispute concerns construction deficiencies, get an engineer or other expert to evaluate the defects, the damage and the cost of repair/replacement. Do not wait for your insurance companies to do this. They are more likely to perceive a nascent or ambiguous loss scenario as non-covered, consistent with their own interests. Getting your own opinion will tell the contractor whether, objectively, the loss can be fairly presented as covered. Then you can calibrate prosecution of the claim to emphasize its strengths and compensate for its weaknesses.

Demand a defense from your company's carriers. Insurance companies like to contend that GL policies do not cover construction defects. In fact, these policies do cover deficient construction, if there is an occurrence and resultant property damage, and if certain other restrictions (such as those noted below) do not apply. Also, the contractor should not be afraid to argue that the occurrence occurs early in the chain of causation, advocating an exposure or injury-in-fact trigger coverage theory. In states where a good faith argument can be made that one of these triggers applies, resulting damage to the element of construction, without more, may suffice.

Your work exclusion: Watch out that the contractor's own work is not implicated, and that the subcontractor exception to your work exclusion applies.

Ongoing vs. completed operations: If you go for an exposure trigger, be careful not to push the exposure date back so far that it lands in ongoing operations (i.e., before project completion) or you'll implicate Exclusion j(6), the faulty workmanship exclusion.

Demand a defense from your company's AI carriers. The general contractor's master subcontract should always provide that AI coverage is primary and the named insured contractor's coverage excess. If the contractor frames its contract this way, it can require the AI carrier to provide a defense, protecting the excess nature of its own coverage. If the contractor does not do this, and demands that its own insurance company bear the obligation to defend as if it were primary, it can expect to pay higher, primary policy premiums — having missed the opportunity to pay lower, excess premiums by contracting with its subs to make its own insurance excess.

Demand independent counsel where the insurance company reserves rights. When an insurance company accepts a contractor's tender of defense, it will assign a lawyer from its panel of qualified counsel to defend the policyholder. Often, the carrier also will reserve the right to deny coverage sometime in the future if the facts of the claim turn out a certain way. If it does, this is your signal to demand that the insurance company hire an independent lawyer, one who (unlike panel counsel chosen by the insurance company) is selected by the contractor and owes its allegiance solely to the policyholder. Some states allow the contractor to demand independent counsel whenever a reservation of rights is made. Others ask whether panel counsel could in theory steer the case toward a noncovered result. Know the law of the state in which the loss occurs, and, if allowed, use your right to independent counsel. It is always better to be defended by independent counsel who will serve the company's interests alone, and who will present the loss at settlement time in a manner consistent with coverage.

At settlement time, get all AI and named insured carriers together. When the contractor is named as an AI under its subcontractors' policies, each insurance company will face the costs of defending the named insured subcontractor, as well as the general contractor under the AI coverage. Demonstrate to each insurance company the cost of continued litigation, and the benefit of settling to meet repair costs.

Elect the defending carrier. In many states, the general contractor covered by a number of AI carriers for different subcontractors may elect to enforce the duty to defend against any single insurance company — it need not pursue all insurers. Use this device to impress upon the

AI carrier with the greatest exposure the high cost of being the sole defender of the general contractor (at least until its cross-complaints against other AI carriers are resolved) and the efficacy of settling.

Never waive a contract balance. If the project is completed and the owner still owes the general contractor money, the builder must resist the insurance companies' pressure to contribute the contract balance — waiving the right to receive these funds from the owner — to get the case settled. Unless the general contractor's insurance includes a self-insured layer equal to this contract balance, there is no reason to spare the insurance companies this expense. If the contractor does, it is self-insuring a covered liability risk without consideration.

Use indemnity agreements as weapons. Subcontractors' indemnity obligations toward a general contractor usually are broader than the AI insurance coverage the subcontractors are bound by contract to obtain for the general contractor's benefit. Subcontractors often forget this, assuming that by obtaining AI and named insured coverage, they are immune from personal loss. This is incorrect.

Check the kind of indemnity agreement you have. In many states, indemnity agreements under which the subcontractor must indemnify the general for the latter's own negligence (Type I indemnity agreements) are barred. In others, they are enforceable if clear and unambiguous. In still others, they are enforceable for commercial jobs but not residential ones.

"Have your team of insurance professionals in place before a claim arises, and when it does, use the team proactively."

Check the scope of AI insurance. If the AI coverage is narrower than the coverage required under your master subcontract, the subcontractor is liable for breach of the contractor's insurance requirements.

Check policy conditions and exclusions. An indemnity agreement is unlikely to be subject to conditions and exclusions. The insurance policy always is. Be mindful of the fact that, if the AI coverage excludes a loss, the indemnity agreement likely will not — leaving the subcontractor personally exposed.

Bypass coverage disputes: If the insurance company raises defenses to coverage that you think are wrong, shift the risk to the subcontractor by pointing out that if the carrier does not pay, the broader indemnity will take over and the subcontractor will pay the loss from its own pocket. This will incentivize the sub to put maximum pressure

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on its insurance company to pay on behalf of the general contractor.

E&O Policies

Determine whether the policy is a duty to defend or reimbursement coverage, and adjust your strategy accordingly. Most E&O policies do not contain a duty to defend; they oblige the insurance company to reimburse reasonable and necessary attorneys' fees and costs excess of a retained limit or self-insured retention. If there is a duty to defend, watch for the right to independent counsel. If not, recognize that the general contractor must control the defense and settlement of all claims, subject to the insurance company's consent.

Understand the boundary between GL and E&O coverage. GL policies cover the builder for claims caused by some unintentional, abrupt event for which the builder is legally responsible. E&O policies are professional services policies, they insure the builder for monetary losses caused by some mistake other than physical harm to people and things. If a loss represents the cost of repairing or replacing property that has been physically and accidentally damaged (including loss of use of the property), it probably is a GL loss. If a loss consists of economic damages caused by a covered hazard not involving physical harm to property, it probably is an E&O loss.

> **Example:** A builder hires a subcontractor to apply stucco to the exterior of a building. The sub applies it incorrectly and it begins to peel off, allowed water to intrude and damage the interior. The interior damage represents physical harm to property caused by an occurrence (which may be the faulty workmanship itself, the point at which the injury to property occurs, or the point at which the damage manifests itself, depending on the state). The builder's liability for the cost of repairing or replacing the interior damage is a GL loss. By contrast, if the subcontractor is hired to finish the stucco with a certain material, and uses something else, the loss consists of the cost to replace the stucco. The builder's liability for these economic damages is an E&O loss.

Watch out for claims based on intentional acts. Virtually all E&O policies exclude intentional, dishonest acts. But what happens if the suit against the builder alleges such conduct? Does the mere accusation of fraud bar coverage for the claim in whole or in part? This depends on the language of the exclusion. Typical language excludes any claim arising out of "any dishonest, fraudulent, criminal, or malicious act, error or omission or those of a knowingly wrongful nature." Other professional liability policies (D&O policies, general corporate E&O policies, bankers professional liability policies, etc.) usually include limiting language making clear that allegations of intentional conduct do not cut off coverage — only actually proven or finally adjudicated allegations of intentional conduct do. Some contractors' E&O policies do not include this limiting language, leaving the insured vulnerable to a reduction in defense or indemnity based on yet-unproven allegations of fraud.

Conclusion

Investigating a construction claim and presenting it to an insurance company is a complicated and sometimes risky business. If you do not understand ahead of time the precise facts of the claim, and the potential coverage issues it raises, you could inadvertently walk into a coverage defense that could have been avoided. Have your team of insurance professionals in place before a claim arises, and when it does, use the team proactively. This will give the general contractor the horsepower to play the insurance company's game on a level playing field. ▲