

# Builder's Risk Policies Cover COVID-19 Construction Losses

By **Allen Wolff and Ethan Middlebrooks** (April 30, 2020)

Along with the millions of businesses losing income as a result of the COVID-19 pandemic, those with construction projects in progress are suffering a different but equally crushing type of loss. Builders and developers in this situation will look to their builder's risk policies to cover those losses.

Builder's risk insurance policies — a form of inland marine insurance also known as course of construction insurance — are akin to first-party property policies. They cover losses or property damage caused by many of the same types of perils. Their significant point of departure from the typical first-party property policy is the classification of damages they cover. Both types of policies cover loss or damage to property, and both cover financial losses associated with a covered cause of loss, often until things get back to normal.

But the nature of those covered financial losses is different. Commercial property in operation usually generates income. After the property is harmed by a covered peril, coverage is commonly available for the income lost until the property is restored to full operation.

But property that is under construction and covered by a builder's risk policy usually generates no present income to be covered as a business loss. Instead, the business losses covered by builder's risk are the soft costs associated with the project. Those soft costs may include but are not necessarily limited to:

- Additional financing interest expenses;
- Property taxes;
- Advertising expenses;
- Impacted future revenue streams such as rental income from a covered cessation of construction; and
- Commissions, legal and/or accounting fees.

Many of those categories will have increased costs due to COVID-19 and the shutdowns resulting therefrom. And many of those increased costs might be covered by builder's risk



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insurance. What we will set forth below is a concise explanation of why builder's risk insurance is triggered by the COVID-19 crisis and what types of damages should be covered by that insurance.

But first, we must pause for a public service announcement: After reading this article, you should email your insurance broker and tell the broker to put all of your potentially relevant and responsive insurance on notice of your claims for losses associated with COVID-19 and the orders affecting nonessential businesses. Failure to give notice or giving notice late could compromise or harm your insurance recovery.

### **Covered Perils Under a Builder's Risk Policy**

Builder's risk policies are generally not sold as a standard form of insurance. Rather, they tend to vary in form depending on which insurance company is selling and the particulars of a construction policy. Nonetheless, there are commonalities to builder's risk policies.

Builder's risk policies' coverage grants are similar to those of first-party property policies. Coverage is usually all-risk and not for specified perils. This means that the policies cover loss or property damage that is not otherwise specifically excluded by the policy.

Because builder's risk policies are not always a standard form policy, a policyholder should check their policy's form of the insuring agreement. For example, some builder's risk policies will pay for loss or property damage. Sometimes they apply only to property damage or only to loss. And some policies include the word "physical," as in physical loss or damage. The word "direct" also maybe present such that the policy responds to direct physical loss.

It is also important to review the definitions in insurance policies, especially for those words specifically defined in a policy. But sometimes important words are not defined and the meaning is construed under the applicable rules of contract interpretation, often in favor of the policyholder.[1]

In that regard, damage is not the same as destruction or loss. Damage describes a broader array of covered harm than destruction. Loss describes a broader array of covered harm than damage. Under a typical builder's risk policy, there is coverage for property that is harmed even if it is not destroyed.

The requirement for physical loss is not a basis for exclusion due to COVID-19 because the coronavirus that causes COVID-19 is itself physical and causes loss or damage. COVID-19 is not theoretical or abstract. The coronavirus that causes COVID-19 can be seen with scientific instruments. It can physically be deposited onto surfaces and in the internal atmosphere of property. Its presence in or on the subject property, or nearby, is also responsible for government orders relating to nonessential businesses.

### **Exclusions Under a Builder's Risk Policy**

Once the policy's coverage clause is satisfied, all-risk policies such as commercial property and builder's risk policies cover the loss unless specifically excluded. For example, builder's risk policies may have exclusions for consequential losses such as delay, loss of use or loss of market.

Exclusions are narrowly construed and must be fully applicable to the circumstances.[2] Thus a policy exclusion for pollution, or fungus, or mold or bacteria has no applicability to

COVID-19. A policyholder should look for an exclusion that specifically mentions "virus." If it is not in your policy, it may be difficult for an insurance company to deny coverage.

Such exclusions that do include the word "virus" have been available to insurance companies for many years. Whether such exclusions apply to a COVID-19-related loss is unsettled and they may be subject to challenge. If the word "virus" was not used, then the implication is that the insurance company specifically chose not to use that exclusion when it sold you the insurance policy.

## **Covered Losses**

### ***Hard Costs***

Hard costs are considered to be the amounts it would take to physically repair or replace items of construction and constructed property damaged in the event of a loss.[3]

Such items would include costs such as: debris removal; cleaning; the erection and maintenance of fencing, scaffolding and temporary construction structures during the reconstruction period; waiting and certifying permits and plans; and reconstruction work. Costs for materials and supplies are also often included, and might include such items in transit or in temporary storage at an off-site location.

In addition, pertinent to the COVID-19 pandemic, it is unclear how government-mandated shutdowns will be lifted and how businesses will emerge from them. Therefore there might be additional and unknown costs of compliance with the process of restoring operations.

### ***Soft Costs***

Covered soft costs may include additional: (1) interest expenses on money borrowed to finance construction; (2) property taxes; (3) advertising expenses; (4) commissions, legal and accounting costs and fees, including administrative fees incurred to renegotiate leases. All of these types of soft costs might be incurred due to the COVID-19 crisis.

Soft costs also may include coverage for the interruption of the expected revenue stream that would have been earned if the project was completed as expected, such as lost rental income, due to government orders or covered causes of loss at nearby property separate from the property covered by the builder's risk policy.

Although this soft cost coverage might seem unusual because builder's risk policies often have exclusions for "loss of market," certain policies might have express revenue stream coverages for particular instances. These coverages are typically subject to a limited period of indemnity and/or dollar limit. A policyholder should review a business risk policy for such express revenue stream coverages if facing losses incurred due to the COVID-19 crisis.

In addition, builder's risk policies, like first-party property policies, will often have a civil authority coverage grant that extends to losses due to government orders prohibiting access to the project. Such orders are in wide effect right now. Civil authority coverage is often included within a soft costs coverage part, but might also be elsewhere in your policy.

However, the amount of time or money covered for losses due to government orders may be more limited than the time or money available under coverage for business income or soft costs, so you should look at all available options in the entirety of the policy.

## ***Sue and Labor Costs***

Builder's risk policies will probably include sue and labor clauses that mandate a policyholder to take all reasonable steps to protect the construction project from additional damage, such as stabilization work, or, perhaps pertinent to a COVID-19-related shutdown, hiring security, or taking other protective measures for an additional length of time. Such sue and labor costs should be recorded and might be recovered under the policy.

Similarly, some policies might have a provision that covers expenses to reduce the amount of loss. Such coverage has been found to include the increased costs that reduce what would otherwise be a longer number of delays, thereby lessening other soft costs incurred under the policy.[4] If your policy has this type of provision, it might be applicable if trying to accelerate a work restart following a COVID-19-related closure.

## ***Force Majeure***

The COVID-19 crisis may trigger force majeure clauses in construction contracts, potentially excusing construction contractors from those contracts. Contractors might see the triggering of such clauses as an opportunity to look for a more profitable job or increase the pricing on the construction contract. An owner then may be in the position of looking for a new contractor or paying more to the existing contractor.

A builder's risk policy may provide coverage for the owner's increased time and cost of completion, including labor, due to a covered cause of loss, depending on the language of a policy. If that loss involves increased expenses to complete the work after a force majeure event, seek insurance coverage for those costs.

Similarly, depending on the policy language, if a contractor is named as an additional insured to an owner's builder's risk policy, the contractor might be able to seek a loss on earned profits, which might be an incentive to keep the existing contract in place notwithstanding the triggering of the force majeure clause.

## ***Conclusion***

Builder's risk policies cover a wide range of losses for construction projects unless they are specifically excluded. The coverage may be for hard costs, soft costs, and sue and labor, among others. The COVID-19 crisis might implicate one or more categories of loss under a builder's risk policy. Civil authority coverage might be applicable as well and should be reviewed.

COVID-19 is a real thing and may be physically present at or near your construction project. If your policy does not mention the word "virus," an insurance company may be hard-pressed to avoid coverage for COVID-19-related losses.

Accordingly, if your construction project has been shut down due to the COVID-19 crisis, you should review your builder's risk policy for possible coverage. And remember, even if in doubt, it is wise to provide notice of loss under all possibly applicable insurance policies.

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[1] See, e.g., *Fed. Ins. Co. v. Int'l Bus. Machs. Corp.*, 965 N.E. 2d 934 (N.Y. 2012).

[2] See *Barnard Pipeline, Inc. v. Travelers Prop Cas. Co. of Am.*, 3 F. Supp. 3d 865, 872 (D. Mont. 2014); *Dean v. Tower Ins. Co. of N.Y.*, 979 N.E. 2d 1143 (N.Y. 2012).

[3] See *RLI Ins. Co. v. Highlands on Ponce, LLC*, 635 S.E.2d 168, 170 (Ga. 2006).

[4] See *Indianapolis Airport Auth. v. Travelers Prop. Cas. Co. of Am.*, 849 F.3d 355, 368 (7th Cir. 2017).