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The Future of Insurance and Bonding

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The Future of Insurance and Bonding

Albert Einstein is quoted saying “I never think of the future, it comes soon enough.” Whether intentional or otherwise, most of us experience the future as it happens. This paper, and the related presentation at the ABA Forum on the Construction Industry’s 2013 Annual Meeting, attempts to consider the future of the construction industry as it relates to general liability insurance coverage for contractors and subcontractors, professional liability insurance coverage for architects and engineers and new “hybrid” players in the market, and novel bonding considerations the industry will face. The Forum has gathered three (3) industry experts to guide our journey into the future:

Leonard J. Geraci, Claims Construction Industry Vice President, AIG, New York, NY, who will help us explore the changing world of Construction Risk Insurance for contractors and lower tier subcontractors;

Richard E. Towle, Vice President, Manager of Surety and Political Risk Claims, Chubb Surety, Warren, NJ, as expert in bonding markets and experienced with the underwriting challenges the industry faces in an ever-changing world; and

Joseph H. Jones, Jr., Vice President, Victor O. Schinnerer & Company, Inc., Chevy Chase, MD, with an expertise in the professional liability insurance market.

The term “future” is undefined, but our panelists have considered trends in their respective industries to speculate what insurance and bonding may look like 10 or 20 years from today. Because CGL coverage, professional liability coverage and bonding are independent topics that implicate a myriad of issues—issues that often do not overlap—this paper explores the future of insurance and bonding based on the following trends in the construction industry:

1) The Mega Project. The large, or mega, project is much more common today than 10 or 20 years ago. Having experience with mega projects in the past, our panelists explore future considerations and solutions for insuring and bonding the mega projects of the future.
2) **Public Private Partnerships (PPPs).** Current trends have forced the public sector to explore partnerships with the private sector to finance, construct and operate infrastructure improvements, which raise interesting insurance and bonding considerations.

3) **Insurance Costs.** Unfortunately, the cost of insurance will continue to rise in the future, which will force all players in the industry to reevaluate the role of insurance and the ability of the parties to shift or share risks inherent in the industry, including coverage for defective work.

4) **New Technology.** New Technologies are constantly changing the way projects are managed and constructed, which will require new approaches to underwriting and insuring both traditional players in the industry and “new” players.

5) **New Insurance Products.** New insurance products are coming on line. How will these new insurance products impact the industry? What new products are on the horizon?

6) **International Markets.** Globalization of the construction industry is a reality. Whether insuring or underwriting a domestic company working abroad or an international company working domestically, success for many in the industry will involve international markets and corresponding insurance and bonding cost and risk considerations.

8. **INSURING, BONDING AND UNDERWRITING THE “MEGA” PROJECT**

Now, and as we look to the future, mega projects may have total costs which may exceed a billion dollars. Mega projects likely include infrastructure, commercial and industrial projects. Mega projects usually involve sophisticated parties and often joint ventures; require four to five years or longer to complete; and involve substantial risks to contractors and sureties.
With increased cost and complexity come increased risks—risks that may be difficult to insure, especially through traditional pass-down risk allocation in which the prime contractor requires its subcontractors to insure their work and the work of others. With larger, more sophisticated subcontractors, risk shifting is more difficult and costly. Insuring such risk typically requires multiple insurers and/or tiers of insurance and bonding capacity, including excess insurance and reinsurance. Current attempts to address some of these concerns have included controlled insurance programs - either an owner-controlled program (OCIP) or a contractor-controlled program (CCIP), multiple joint venture partners and co-surety relationships.

The mega project delivery method is another consideration. Determining the appropriate delivery method requires a careful assessment of the size of the project, owner capabilities and funding, time considerations, scope of work, potential changes in the scope of work and risk allocation. Delivery methods for mega projects have been trending away from traditional design-bid-build in favor of design-build or construction-manager-at-risk project delivery methods. All of these factors influence insurance and bonding considerations.

C. Insuring the Mega Project

Insuring the mega project has been in the past, and will be a significant challenge in the future.

i. Multiple Insurers and Tiers of Insurance

Currently, the Construction Risk Insurance at various levels is not based upon a Quota share among carriers. Usually one carrier will retain the risk in a single level on the tower of insurance that is placed. Sometimes carriers will take several positions on the insurance towers, which commonly reach as high as $200 Million.
In the future with high limits being requested you may see quota share arrangements, where a number of carriers will take a percentage of the risk, on a single level. In that case, one of the carriers will likely be named as the “lead” to handle claims issues as they arise in that particular layer.

Also, because of the larger insurance towers required, carriers may be faced with issues of limited capacity. Therefore, in addition to the quota share requirement you will also likely see an individual carrier playing a role in fewer layers.

Further, as layers become more intricate, and coverages complex, it will be imperative that the forms match from layer to layer. Consequently, along with the complexity of the coverages, the brokers will also have to gain additional market savvy and expertise.

ii. Controlled Insurance Programs

The future success or relevance of OCIP (Owner Controlled Insurance Programs) and CCIP (Contractor Controlled Insurance Programs) will likely be determined by loss experience. The losses that the Carriers are experiencing today will determine the pricing, cost and appetite for these coverages tomorrow. Already, certain carriers have discontinued writing OCIP in certain areas of the country. Projects that are getting larger may be looking at the contractors not only to build the project but to run the insurance program (CCIP).

Further, rates could be locked in on the OCIP or CCIP for project duration as opposed to an increase every year based on loss experience. Triggers will be placed in multiple year OCIP’s and CCIP’s based on loss history and regulatory change.

Ultimately, the expense to manage OCIP’s may get too high and it could be turned over to the contractor. Contractors could roll multiple projects in one CCIP for cost savings. (“Rolling
CCIP”). Benefits of these programs will include being aware of the coverages for every party, preventing the proverbial gap in coverage.

iii. **Subcontractor Default Insurance (SDI)**

General contractors who subcontract a significant amount of the work are the prime buyers of subcontractor default insurance (SDI). Most contractors use SDI in lieu of bonding subcontractors. Subguard©, which was developed by Zurich North American Insurance Company in 1995, is a specific SDI product that shifts the burden of defaulting subcontractors to the insurance company. However, rather than issuing individual policies for each subcontractor, Zurich’s Subguard© policy covers all subcontractors on a given project or on an annualized basis for all projects combined. SDI is not accepted as an alternative to statutory bonds required for public or quasi public projects.

In the future, SDI insurers may have to reexamine the policy limits that they provide. One possible reason for that is the potentially large liability to which SDI insurers may be exposed for latent defects and warranty claims. Additionally, how will those insurers respond to warranty claims and latent defects after the policy has expired? These considerations will likely shape the future of SDI, and the price it demands, as we move into the future.

**D. Bonding the Mega Project**

In layman terms, sureties exist to assure owners that projects will be completed according to the contract. But at its core, surety products are credit products—they extend credit to the contractor guaranteeing performance of the work. As such, the applicant must be creditworthy in order to develop, increase, or maintain its bonding capacity.

Bonding capacity is the lifeblood of many contractors without which they could not operate. To obtain bonding capacity, contractors must submit to stringent underwriting
standards. For a small or new contractor the process is uncertain and, if unsuccessful, could impair their ability to secure large or public projects. The surety industry, particularly through the Surety and Fidelity Association of America, recognizes the issue for small and new contractors and is responding with education and collaboration to help to make these contractors bondable.

Most large contractors enjoy a close, longstanding relationship with their surety. Strong relationships often equate to more bonding capacity because the parties have built up a level of understanding and trust. In the future, even these long standing relationships could change, as the structure of the contractor-surety relationship becomes more formalized through committed facilities and more formal underwriting procedures.

As these projects get larger there could be a trend towards more formalized agreements which define relationships between sureties and surety and principal.

i. Committed Facilities

One such formal arrangement between a surety and its principal may take the form of a committed facility. Such an arrangement may commit the surety to a prescribed capacity of bonding coverage provided that certain covenants are met. This formalized arrangement will likely provide an advantage to a larger contractor, which will be able to forecast and plan for the future. However, it will likely come at a higher price, as the surety is committing a portion of its balance sheet in the future.

ii. Formalized Underwriting Process

Surety bonds are three party arrangements providing a guaranty to an obligee that the contractor/principal will complete the project pursuant to the terms of the contract and pay their bills. Ultimately the beneficiary of the surety bond is the obligee. Obligees typically rely on the
surety to “prequalify” the contractor for the work, which is part of the underwriting process. Underwriting is essentially an audit of the contractor’s credit worthiness among other attributes.

More credit or bonding, capacity often requires more qualified contractors. Many contractors on mega projects are joint ventures, so each partner in the joint venture may need to be highly qualified. Further, in some instances, the joint venture agreement and bonding of the joint venture will require the venturers to share their financial exposure (and their balance sheets). If not, one or more of the well-qualified partners must assume the risk.

Underwriting typically involves an application and assessment of the contractor’s credit worthiness, including a review of its financials, work history, loss history, and, particularly in the case of the mega project, a good understanding of the project.

Underwriting standards in the future will likely be more stringent, which will further narrow the pool of qualified contractors. Effective management of the project on all levels—scheduling, coordination, and safety—are crucial for success. In the future, sureties will likely evaluate to a greater degree the contractor’s management protocols and track record during the underwriting process.

However, a current trend, which will likely continue in the future, is how the surety underwrites a bond. A surety often will not price risk upon the nature of the project. Sureties, as issuers of credit, are more likely to make a pure financial decision. The nature of the project is not the determinative factor, but instead how the exposure is recognized and managed. In making that decision, sureties will start to pay much more attention to the types of insurance procured for the project and type and caliber of consultants and lawyers, etc. As a financial decision, sureties in the future are less likely to base their decisions regarding bond premiums on
whether the project is a rail station on the moon; instead, they will review whether their principal has procured the right space suit.

iii. **Evolution in language of bond instruments**

Sureties are also likely to adjust the ways in which bonds and the documents underlying the bonds are written. For instance, in order to protect themselves in the future, there will likely be an evolution in the language of the general agreement of indemnity between surety and principal. This evolution will be necessary based upon the way in which construction players on an entity and individual basis are manipulating the control and possession of their assets for greater protection.

Additionally, recent litigation has highlighted the “gaps” in current bond products, and litigants have been quick to argue that a gap in the bond should be read to favor the claimant. As such, sureties, to the extent that they are able, will likely draft the bonds of the future with more formalities regarding claim requirements as well as potentially delineating the requirements of tender or takeover agreement, and specifying the time in which the surety is allowed to investigate the claim. The “to the extent that they are able” is included because in the vast majority of projects, it is not the surety that drafts the bond but rather the bond obligee—be it the project owner or the general contractor.

Once the surety concludes that its bond obligations have been properly triggered, the surety has several options, all of which involve risk—significant risk if the project is large. Although a surety’s options are controlled by the language of the bond, and sometimes differ; the surety generally may (1) finance the bonded contractor’s completion of the contract; (2) takeover the performance of the contract by hiring a new completion contractor; (3) tender a new
contractor to the owner for the owner to contract with for completion, often subject to the approval of the obligee; (4) attempt a straight cash settlement to the owner in exchange for a release; (5) reserve its rights to contest the default at a later date and enter into a takeover agreement with the owner while agreeing to fund the completion in the first instance, once the available contract balance is exhausted by the owner; or (6) deny the claim. Generally, the bond also contains language which requires an accounting of the contract balance, which is used to cure the principal’s default. In the event of a shortcoming, the surety must make up any difference.

As most bonds currently read (the AIA A312 Performance Bond being an exception), the surety may not require the obligee to enter a takeover or tender agreement as a condition of the surety’s performance. However, in the future, bonds may be re-written to include that requirement. Depending on who you ask, a tender or takeover agreement is something which delineates a surety and obligee’s rights and responsibility (from the surety’s perspective) to a gratuitous attempt to re-write the rules to its advantage after the contest has begun (from an obligee’s perspective).

Regardless of which perspective you subscribe, tender and takeover agreements are likely to be used more frequently, and perhaps incorporated into the bonds, in the future.

iv. **Co-Surety Agreements**

While the underwriting process provides accountability and security for the surety, risks associated with mega projects are significant—often too significant. Most bonding companies may not have an appetite or capacity for multi-million or billion dollar risk associated with mega projects and, thus, turn to other sureties to manage and share the risk through co-surety arrangements.
The ways in which sureties handle claims on co-surety bonds often are governed by co-surety side agreements which designate a “lead” surety which is charged with investigating and resolving the claims in accordance with the terms of the co-surety agreement. Although the lead surety is often charged with resolving the claim, the “following” surety is not necessarily powerless to accept the decision of the lead. However, that acceptance may not be unreasonably withheld.

Co-surety relationships usually arise in one of two ways: Where the principal is a joint venture and the joint venture is made up of distinct companies with separate ownership, represented by different agents and brokers, each of the venture partners may be bonded with respect to their overall construction program by a different surety. In those instances, the surety for each of the venture partners may enter into an agreement whereby they apportion the risk between themselves on the joint venture account. As between the two sureties, there may be an allocation of liability under the bond, usually in proportion to the percentage or amount of participation of each partner within the joint venture. However, when performance and payment bonds are written on behalf of the joint venture, the sureties executing those bonds are jointly and severally liable to the obligee and claimants, without regard for the apportionment between them. As a result, the participating sureties typically establish and document each venture partner’s joint and several indemnity responsibilities to each of the sureties through separate indemnity agreements.

The other situation giving rise to co-surety arrangements with increasing frequency is the case of a contractor with a large work program which, through its broker/agent, approaches multiple sureties to “share” its account from an underwriting perspective. Through the execution of a co-surety agreement, the sureties will agree on their respective co-surety participation and
designate a “lead” surety for purposes of underwriting and claims management. As with the joint venture scenario, the sureties in this arrangement are typically jointly and severally liable to an obligee on bonds executed for the shared account. For federal projects, however, sureties can limit their liability by filling out the bond form and listing a percentage or a dollar amount of commitment on the bond. In those situations, however, where each surety is jointly and severally liable to the obligee, if one surety is unable or unwilling to pay claims, the other surety or sureties must step up and satisfy those claims and seek reimbursement from the non-contributing co-surety pursuant to their agreement. If that surety is insolvent then the remaining sureties must fulfill its obligations.

It is important for the surety receiving the initial notice of claim against a co-surety bond to ascertain the nature and terms of any co-surety agreement governing that bond. As a threshold matter, it must be determined which of the sureties is the “lead” surety with respect to the investigation and resolution of claims. Then, the lead surety must be aware of the extent of its duties and obligations to its co-sureties, including any limitations on its authority, any notice requirements, and any consent required from the co-sureties. The lead surety must be careful to fulfill its obligations, but not overstep its bounds. Traditionally, co-surety agreements have been less formal than most of the documents involved in the performance of the construction contract and issuance of the bond. However, as co-surety arrangements are becoming more prevalent, sureties are recognizing the need to formalize, and more specifically delineate, the relationship among, and the respective responsibilities of the co-sureties.

9. **PUBLIC-PRIVATE PARTNERSHIP PROJECTS (PPP)**

Governments worldwide have increasingly turned to the private sector to provide infrastructure services in energy and power, communication, transportation and water sectors
that were once delivered by the public sector. As available funding from traditional sources in the public sector remains limited, governments have found that partnership with the private sector is an attractive alternative to increase and improve the supply of infrastructure services. These partnerships are commonly referred to as public-private partnerships, PPP’s or P3s.

The partners in a PPP, usually through a legally binding contract or some other mechanism, agree to share responsibilities related to implementation and/or operation and management of an infrastructure project. Insuring PPP presents some novel considerations that need to be evaluated and understood to ensure all partners and risks are covered.

An important aspect of a PPP project is an explicit arrangement for allocation of risks between the parties involved. A good feasibility study provides the background that is needed for an allocation exercise. The following general principles may be considered to manage and allocate risks:

D. Minimize Risk

Eliminate or reduce to the extent possible the chances of a risk occurring. For example, when possible, borrow in local currency to avoid exchange rate risk.

E. Allocate Risk

Allocate risks to the party that is best equipped to manage them most cost effectively. For example, political and regulatory risks are more appropriate for the public sector, while construction and operating risks are more suited to the private sector. The project company, in turn, may transfer some of these risks to third parties; for example by passing them on to sub-contractors which maintain insurance to protect against the risk or have the risk guaranteed by the project sponsors.
Although the commercial risks are generally allocated to the private sector, deviations can be considered. For example, sharing commercial risks with the public player may be utilized in order to attract private investors in an untested PPP market. However, in such a situation there is a danger that needs to be carefully examined before agreeing to any such risk sharing arrangement.

The project debt is often allocated to the public player, essentially rendering the project risks, government risks.

Although the general principle of allocating risk that the party who is in the best position to manage should assume the risk applies to all situations, the party in the best position to manage a particular risk may vary from one situation to another. Many risks are project and situation specific.

One unique concern for PPP when dealing with projects that were traditionally built and operated by governmental agencies that will now be run by private entities is that the PPP does not have the protection of sovereign immunity. In that, as well as other situations, a viable option may be to consider insurance (if available) to deal with risks, which neither party is able to manage.

F. Share Risk

When neither party is in a position to effectively manage a risk, it may be kept unallocated with an indication in the contract how the risk may be shared between the parties or assumed by a party in the event of its occurrence. In case of a concession contract, it may also be transferred to the end-users by way of charging higher tariffs.
It is not advisable to transfer all risks to the private party. There should be a good balance in risk allocation between parties. If a good balance is not achieved, it will result in increased costs and one or both parties may not be able to fully realize their potential.

The magnitude of project risks is also assessed as a part of the due diligence process undertaken by the lenders. The greater the assessed/perceived risk of a project, the higher is the risk premium charged by lenders. Consequently, the financing cost of the project becomes higher.

Usually, a performance and payment bond is used to manage the performance risk on the PPP project. Therefore, sureties, in the same way as lenders, conduct a due diligence process in underwriting the risk. However, if the principal is providing the financing for the project, the surety’s analysis becomes much less predictable. For instance, if the principal on the PPP is financing the project, perhaps by way of revenue it expects to generate upon the completion of the project, and it becomes insolvent, how is the surety to collect its premiums? Normally, the surety would be able to recover the contract balance. In this case, however, there is no contract balance and the surety’s potential liability is much greater. Sureties of the future will certainly have to determine how to underwrite a principal when the financing for the project is secured by revenues generated from a concession agreement for the project. Is the surety to “perform” by operating the toll bridge in order to exercise its indemnity rights?

Similarly, PPPs involved in the construction and operation of a project for many years, often 30 or more years pose significant risk. That “project duration” entails its own issues as carriers are often reluctant to commit to insure for that length of time.
10. INCREASING COST OF INSURANCE

Insiders in the construction insurance and risk industry anticipate 2013 to bring a rise in insurance rates and premiums, a trend that began to emerge in 2011. In late 2011, unprecedented property losses stemming from natural catastrophes, anemic interest rates and worsening workers compensation results were forecasted to drive up construction contractors’ premiums on commercial general liability, builders’ risk, and workers’ compensation policies. Indeed, 2012 saw a steady firming of the market, though experts hesitate to predict a “hard” market. Id. According to Marsh’s August 2012 Construction Market Update, most underwriters are seeking rate increases of up to fifteen percent.

Another significant driver of increased premiums is defect claims.

Unfortunately, these trends will continue into the future. What happens when premiums increase by 100% or even 200%?

C. Mitigate Risk: Better & Safer Business Practices

“With insurance rates and premiums trending higher, contractors are focusing more intensely on ways to control their costs through careful insurance purchasing, safety programs and good claims management.” Experts in the industry have offered the following ways for construction companies to budget and plan for the challenge of the future insurance market:

vi. Quality Partners

Is the construction company working with a broker with a deep understanding of construction risk? The broker depth and breadth of experience is the most important factor. These are unique products for a unique industry. Also, they want a specialist in their line of business, (i.e. Construction Risk, Excess insurance, Professional liability, surety and so on). An insurance broker should have solid relationships in the construction insurance community.
vii. Start Early and Have a Strategy

Develop clear, concise objectives, and a strategic plan to achieve them. Carefully evaluate the proposal from your insurance representative against your pre-determined objectives. As insurance costs rise, expect your insurance professional to provide additional value to meet your needs. Some potential insureds will retain an insurance professional to work with broker placement and carrier decision. This will get more popular in the future as insurance costs increase.

viii. Invest in Loss Control and Safety

“As leading contractors understand, safety must not be simply a compliance exercise. The best in class do not have safety programs – they have safety cultures, and it’s a commitment at the CEO level.”

Safety best practices are a major consideration for a carrier if they even want to write a risk. Carriers and brokers offer loss control services as well as specialized training for insureds and employees and safety training programs. Preventing loss from happening should be the first priority. In the future, carriers will expect (and require) better than zero loss targets for a project.

ix. Contractual Risk Transfer

The transfer of risk to downstream parties through construction contracts remains a “viable strategy to pass risk along to the party which is best suited to manage it.” Insurance carriers look favorably upon construction companies who employ this risk transfer process.

However, even if the risk is transferred downstream, the lower tier party must still obtain insurance to protect itself and others involved in the project. In some instances, these lower tier players assume more risk than they can effectively manage or control. In that case, the “shove down” may not be in the best interest of the project.
In some places, risk transfer, in the traditional sense, is limited or otherwise not possible. For instance, in Louisiana a newly enacted anti-indemnity law prevents a contractor from purchasing a policy for the owner. In Florida, a statute requires certain types of indemnity provisions to include limits of liability. In California, a statute precludes a subcontractor from indemnifying a contractor or owner for anything not caused by the subcontractor and precludes the subcontractor from buying insurance for those risks as well.

x. **Alternative Risk Financing Options**

Captives and large deductible programs are two examples of such options. Collateral is required under both options.

Large deductibles for Construction Risk Insurance are becoming and will continue to be more common in New York. This phenomenon has been caused by the very high settlements and verdicts for New York Labor Law Cases.

D. **The Uncertain Future of Construction Defect Insurance**

Insurance is a business. Profits earned in the industry are calculated from premiums earned and invested (investment income), less incurred losses and expenses, including legal defense costs. Many in the industry believe the current process of litigating and managing construction defect claims is inefficient, time consuming, and expensive. Construction defect claims have an average emergence time of seven years and take, on average, two to three years to settle. The insurance industry estimates that most insurers are paying out $2.50 for every $1.00 collected in premiums for construction dispute insurance. The cost to litigate often exceeds the claim indemnity valuation, meaning legal expenses exceed costs associated with loss, repairs costs or replacement value. These legal costs drive up insurance premiums.
Based on the premise that early resolution of construction defect claims benefits all players—the parties, the insurers, and judicial system—many state legislators have mandated pre-litigation resolution mechanisms to facilitate and encourage early resolution of construction defect claims.\(^\text{10}\)

Now, and in the future, in an effort to minimize risk, insurers will either raise premiums or limit or eliminate risk. The following are some of the limitations commonly found in today’s CGL policies designed to limit construction defect exposures:

- **Elimination of the subcontractor exception by endorsement.** Under the exception, the named insured is provided coverage for property damage arising out of the defective work of its subcontractors, often referred to as the “subcontractor exception.”

- **Habitational Exclusionary Endorsements.** These endorsements effectively exclude “residential” risks and were designed to address the massive influx of residential construction defect claims, including homeowner and condominium claims.

- **Restrictive Additional Insured Endorsements.** In an effort to restrict expansive coverage under the 1985 edition of CG 20 10, new endorsements restrict coverage, for example, to only those liabilities caused by the fault of the named insured and endorsements will exclude completed operations for additional insureds.

- **Other Restrictive Endorsements.** As unforeseen risks arise, insurers have been quick to respond with corresponding exclusions such as Exterior Insulation and Finish System (EIFS) and mold exclusions.
Whether through increased premiums or endorsements limiting certain risks, or both, the insurance industry will protect its profits. The best predictor of future behavior is past behavior. Insurers of the future will more closely scrutinize the contractors long-term experience, contracts that they are signing, and states they are doing work in. They may even offer a small coverage for non conforming work. However like anything else cost for these coverage will depend on the situation.

11. **NEW DELIVERY METHODS**

New technology may enable the services that design and construction professionals can provide to go beyond the “traditional.” As a result, the obligations of a surety and the exposure of an insurer are likely to change. As such, the policies and bonds will also need to change.

As an example, the definition of “professional services” may expand. As technology and new forms of project delivery foster greater collaboration among the design and construction teams, construction entities may have new or increased exposure for design decisions. Disputes between exposure for construction or design liability may result in new products being introduced to the market.

Professio
nal liability insurers generally write policies which are more specially tailored to the professional negligence of the insured. Since professional liability policies focus their coverage, almost singularly, on professional negligence, seldom do professional liability carriers issue Insurance Services Office (ISO) standardized forms; opting instead to draft their own policy forms defining the scope of professional services covered and exclusions that reflect their risk appetite. That has allowed the Professional Liability insurance industry to be more “nimble” to changes in the industry.
As a contractor’s design liability exposure varies from project to project, professional liability insurers have in the past, and may likely continue to move more towards project specific policies. The need for project specific policies is often even greater on projects where the potential exists for parties to have claims against each other when both have some degree of design responsibility. However, the challenge has been, and likely will continue to be, how to assess and underwrite the risk properly on large projects with many parties that could potentially have any number of claims against other parties. Insurance carriers have struggled with this and have experienced situations where the risk was not properly assessed and the claims were larger than the premium collected.

D. BIM and Professional Liability Insurance

Most agree that Building Information Modeling (BIM) is here to stay. From a macro perspective, the insurance industry welcomes BIM as a mechanism to lower inherent risk by facilitating close collaboration and clash detection during the design and construction phase. The growing popularity of BIM has made it almost commonplace on most mega projects, a trend that will likely continue into the future. However, BIM presents new challenges for insurers. Insurers have two main concerns with BIM. First, BIM creates liability not necessarily considered or known at the time the project is started, or in the case of project insurance, when the project was underwritten and insured. Second, insurers are concerned about possible blurring of traditional responsibilities between various BIM participants and collaborators. The key is to make sure measures are taken to ensure the risks associated with BIM are fully disclosed and covered at the onset.

Another concern insurers have is the “over-reliance” on BIM technology, which may present a heightened risk exposure for design professionals if the information used to build the
model is incorrect. There is a concern in the design professions that a new generation of architects and engineers will allow the BIM technology to “take over” professional judgment. In much the same way many will allow spell check to make corrections without verifying if “from” or “form” should be used, the concern is that because BIM is such a powerful tool enabling design professionals to do more and to do it quicker than they have in the past, and a generation of design professionals that is very “comfortable” in an electronic environment, the experience and “street-sense” that comes with years of practice, could lead to design and specifications that require using materials and systems that experienced personnel would intuitively understand to be “unwise.”

Finally, BIM also represents a technology exposure unlike the industry has experienced before. The concern is that the model and software be adequately protected against viruses, hacking, and other cyber-threats that can compromise the ability of the software to process and develop the information correctly. A virus, or unauthorized access and changes, can have a cumulative effect on a design that may not be detected until the project is well under construction. Legal issues will also arise in determining responsibility for design errors and omissions where greater collaboration among the design and construction team spreads decision-making for design decisions beyond the traditional set of design professionals. Liability may depend on what information is included in the model; who has the ability to add or change the model; and how much reliance contractors place on the model itself for pricing, fabrication and construction. With the lines of responsibility blurred, professional liability risks may spread from the traditional design professionals to include contractors, subcontractors and other construction entities.
E. Integrated Project Delivery

Integrated Project Delivery (“IPD”) contemplates a situation where the owner, architect, and contract “employ[] a collective approach in which they agree, within certain limitations, to share the risks, agreeing to forego individual liability policies in favor of deductibles or self-insured retentions to cover negligent errors and omissions (but not willful acts) by themselves or one of the other parties.” IPD fosters a collective, team approach intended to minimize the situations that often lead to liability claims. Usually, the parties agree not to make claims against each other. However, this also means that all parties will be responsible for a valid claim brought by a third party against any one of them. This collaborative approach can also “blur the lines of design responsibility, and the insured-versus-insured exclusion limits traditional recovery in a multiparty contract.”

Because this is a new, non-traditional approach, many traditional insurance products will not be sufficient. Insurance companies have introduced certain IPD solutions, which have included “professional liability coverage tailored to the contract terms and coordinated with a Controlled Insurance Program; Incorporation of both first party and third party coverage for technology risks associated with the use of BIM; project dispute resolution processes incorporated into the terms of the professional and pollution liability coverages; waivers of subrogation against all IPD team members; single points of contact for all lines, establishing internal coordination features and fostering collaboration with the insureds; and having the insurer assist with the evaluation and enhancement of the IPD project’s QA/QC program.”

F. Design-Build/Professional Liability Coverage

For years, the industry has struggled with risk allocation in the design/build arena. Assuming CGL coverage is in place, professional liability coverage often remains an issue, often
because contractors do not want to bear the expense of obtaining additional professional liability coverage.

Most often, a contractor involved in a design-build project does not want to rely solely on the designer’s professional liability policy. The design-builder “will want its own professional policy to protect against its vicarious liability arising from the acts of design professionals acting on its behalf as well as the direct claims that may be asserted against the design-builder for the negligent performance of its own professional responsibilities.”

Design-builders can purchase Contractors Professional Liability coverage either on an annual or project-specific basis. CPL covers defense and indemnity related to actual or alleged negligent acts, errors, or omissions in rendering professional services, and protection against damages beyond the policy limits of the design professional’s own coverage. In addition, some insurance companies offer coverage beyond the aforementioned, to include: “expanded professional liability coverage for contractor’s means and methods – closing the gaps created by exclusionary language applied in many industries – for commercial general liability; expanded definition of professional services that now includes technology services, specifically addressing LEED and BIM; blanket joint venture coverage to help protect the design-builder’s interest in a joint venture; modification of the warranty/guarantee exclusion to make an exception for liability that would have attached in the absence of the warranty or guarantee; and choice of self-insured retention coverage.”

Various insurance products have been utilized to address professional liability concerns, including project specific excess insurance, project professional liability insurance, contractor’s professional liability insurance, and Owner’s protective professional indemnity. However, these practice specific policies often possess insufficient limits or provide inadequate coverage. They
are often cost prohibitive or simply unavailable, especially on large, complex projects. In response, owners have stepped in with various policies like owner controlled insurance programs (OCIP) to address general liability coverage, and owners protective professional indemnity policy (OPPI), which the owner purchases to supplement, not replace, the design professional’s liability insurance.

12. NEW TECHNOLOGY

The last decade has seen a massive increase in all business’s reliance on technology. The construction industry is no exception. Most communication is accomplished via e-mail, and data can be easily sent, received and viewed on smart phones or tablets in the field. “As these changes have happened, more and more responsibility for the protection of privacy and personal data has fallen on business.”

Moreover, “most of the valuable assets of a company now involve some form of network and data connection or storage: customer lists, books, records, receipts, tax documents, intellectual property and trade secrets.” Further, the advent of the 24 hour news cycle is requiring construction players to re-examine their risk and risk management.

D. Cyber Liability Coverage

Cyber liability coverage is “insurance coverage for liability that arises out of unauthorized use of, or unauthorized access to, electronic data or software within your network or business. Cyber liability policies also provide coverage for liability claims for spreading a virus or malicious code, computer theft, extortion, or any unintentional act, mistake, error, or omission made by your employees while performing their job.” Typical commercial general liability policies only cover tangible assets, and courts have uniformly held that electronic data is not considered tangible under the typical policy definition. Most cyber liability policies can be tailored to the needs of a particular business depending on the technology and security needs.
E. Crisis Response Coverage

Crisis Response coverage may be useful to large, high-profile construction clients who would receive massive media attention and possible damage to their reputations if faced with a large-scale liability claim. Crisis Response coverage “puts expert crisis management support at the ready” when policyholders need it to help avoid a severe liability claim and protect their assets and reputations. In some instances, this coverage is offered for free, but often contains a sublimit. Included in the coverage is:

• Direct, 24-hour access to claims specialists who provide advice on how to respond quickly and effective to manage the incident and keep it from escalating into a large-scale claim
• Funds to hire an approved crisis management firm to assist in managing communications surrounding the crisis

F. Political Risk Coverage

Political Risk Insurance helps clients protect their investments in overseas markets against unpredictable losses due to specified political risk perils. Insurance companies often target contractors and engineering companies for this type of coverage because contractors working overseas have large financial exposures due to the specialized mobile assets and equipment required on site locations. AIG, for instance, offers two different types of political risk insurance: wrongful calling of guarantees insurance, which protects contractors against unexpected losses which may result from the calling of a bond or guarantee due to no fault of the insured, and loss of plant and equipment.
13. **OTHER NEW OR FUTURE PRODUCTS AND SERVICES**

**F. OSHA**

Insurers have responded to the ever evolving regulation of labor and laborer safety by offering endorsements to assist contractors in responding to violations issued by the Department of Labor and the Occupational Safety and Health Administration (“OSHA”).

**G. Non-conforming work**

Non-conforming work endorsements provide contractors with coverage for the cost of repairing non-conforming work, rather than just the damage to other property or bodily injury. Notably, this endorsement will generally contain a sub-limit detailing the maximum which a carrier will pay to repair the non-conforming work.

**H. Storm tracking**

Along with new coverages, CGL insurers are providing new services in order to better, more cost effectively serve their contractors. Insurers are attempting to assist contractors in avoiding an occurrence by providing storm tracking services and notification. Insurers also provide quality control certifications so a contractor can be aware of those with whom it deals, and advise its customers.

**I. Emergency response vendor panels**

However, when the inevitable accident does occur, insurers have established emergency response vendor panels in order to more promptly respond and limit a contractor’s exposure.

**J. Expedited claims resolution**

Further, in order to better handle disputes arising from claims, insurers are offering online mediation and other forms of expedited mediation and claim resolution processes. Those processes are often handled by panel counsel who are experts in construction. Further, in some
situations, carriers are offering contractors alternative legal fee arrangements in order minimize the cost of premiums to contractors.

14. INTERNATIONAL MARKETS – THE GREAT UNKNOWN

Liability on international projects stems primarily from contractual obligations, and sometimes statutes. Some legal systems provide for “decennial liability,” originally a French concept which obligates contractors and design professionals for damage or destruction, in whole or part, to a building, caused by faulty construction. The decennial liability idea is really an outgrowth of an 1804 Napoleonic “Principle of Building,” which basically states that “He who makes a building for pay is responsible for 10 years.” As it stands today, in those countries which follow the concept of decennial liability, contractors and design professionals are potentially liable for ten years. Within those ten years, the owner is not required to prove negligence once the damage occurs. Liability is imposed automatically.

Under decennial liability, neither the contractor, nor the design professional can defend based upon their compliance with building codes or other acceptable standards. Moreover, attempts to contractually shift or protect oneself from liability are not honored.

Decennial liability is just one example of a foreign legal system that differs markedly from most common and statutory law in the United States. It provides an excellent illustration of a significant risk for construction professionals who elect to conduct business in international markets – the uncertainty of working within a country, the laws of which are unknown to the construction professional. Further unsettling is that in some instances there may be no law on a crucial topic, or if a law exists, it may change without notice.

As technological advances create an ever expanding global economy, like the legal systems in many foreign countries, the future of insurance products for international construction
is a great unknown. Construction related insurance is not utilized in most foreign countries as there is little or no legal and economic framework in place necessitating them.

Professional liability insurance is generally based upon the Anglo-Saxon concept of “negligence.” That is a standard unrecognized in many foreign countries. Therefore, as design professionals expand and provide services in countries with different (or no) legal concepts governing their performance, professional liability policies will need to be written in a way to provide coverages based upon different concepts governing a design professional’s standard of performance; likely resulting in an expansion of products and endorsements to address a myriad of unique situations.

Bonds are generally not a part of international construction industries. Most of the time, that is a result of local markets being unable to economically support the expense. As globalization of construction continues to increase, injecting new dollars into these markets, the use of bonds could also increase.

However, currently in most countries there are no laws providing for payment on construction projects. As such, there is little perceived need for payment bonds.

Further, sureties are often asked to issue bonds for 10% or less of the contract price. And in the event that there is a default, sureties seldom get chased.

Also general liability coverage is offered as part of the Builder Risk coverage in areas around the globe outside the US. Stand alone GL policies are not very common in foreign counties. However, in the future as the economies expand, there will be greater demand for stand-alone contractual risk insurance.
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