Coverage Issues Concerning Catastrophes in Construction

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An Introduction to Property Insurance Issues Following a Natural Disaster

Builder’s risk insurance is a variation of first-party property insurance, providing coverage for damage to property in the course of construction or renovation. One of the distinct features of this type of insurance is that the value of the insured property increases as construction progresses. There also often are multiple parties involved in a construction project, including the owner, investors, the contractor, and the various subcontractors, each of whom has a different insurable interest. The differences in the risk and interests insured under a builder’s risk policy raise unique coverage questions, including what property is insured, whether the claimed costs are to repair or replace physical loss or damage to property insured or are delay-related expenses, and whether (or to what extent) there is coverage for delay-related costs resulting from physical loss or damage to insured property. As with other types of first-party property insurance, it also is necessary to consider which perils are covered and which are excluded, including catastrophe risks such as earthquake, windstorm, and flood.

I. Period of Insurance

As with most first-party property insurance policies, builder’s risk policies typically (although not always) provide coverage for all risks of direct physical loss or damage to insured property occurring during the period of insurance. Unlike most first-party property insurance policies, which generally have a fixed time period, builder’s risk insurance runs concurrently with construction, the timeline for which is often subject to change. Generally, coverage under a builder’s risk policy attaches when construction commences. While most builder’s risk policies
state a date when the policy terminates, which is typically based on an anticipated substantial
completion date, builder’s risk policies often specify that coverage may end earlier if, for example:
the policy is canceled, the project is accepted by the owner, the project is occupied, the insurable
interest of the named insured ceases, or construction is abandoned with no intent to complete.

That said, it is not uncommon for builder’s risk policies to be extended because of delays
in construction. For example, even where a major catastrophe does not result in any covered direct
physical loss or damage to an insured project, the catastrophe still may impact the construction
schedule due to downtime resulting from the event itself, shortages in manpower or supplies
following an event, or the need to re-sequence work. In such circumstances, the insured may seek
an extension of the policy. Any extension is subject to additional premiums, with rates,
deductibles, limits, terms, and conditions to be agreed at the time of the extension.

It is also important to note that while builder’s risk insurance generally only provides
coverage during construction, extensions are sometimes granted, e.g., for hot testing (the startup,
commissioning or other form of testing of equipment or machinery at the project, particularly in
the power and energy industry) or occupancy (when the project or a portion thereof has been put
to its intended use, but prior to acceptance by the owner). Some policies may include
“maintenance” period coverage that insures against damage caused by post-completion
maintenance work or against property damage that occurs during the specified maintenance period
as a result of a pre-existing construction defect. During such periods, the project is typically near
or at its highest value, and there may be a greater risk of loss or damage occurring. Coverage
during such periods is often subject to lower limits or higher deductibles. It is therefore necessary
to determine what stage of construction the project was at when a covered loss occurred in order
to determine if coverage was still in effect and, if so, the extent of coverage available. This may
be complicated by the fact that the date the loss is discovered or reported may not be the date on which the damage actually occurred.

II. Property Insured

Typically, “property insured” under a builder’s risk policy is defined to include permanent works at the project, including materials, supplies, equipment, machinery and other similar property intended to become a permanent part of, or consumed in the construction of, the project, as well as temporary works, e.g., scaffolding, form work, shoring, boarding, false work and temporary buildings or structures such as trailers. Most builder’s risk policies require that, in order for there to be coverage, the value of the property must be included in the estimated contract value for the project.

There are, of course, exceptions to what is included in “property insured.” Unless otherwise scheduled, builder’s risk insurance will not provide coverage for a number of features of a project. For example, policies will often exclude land or land values; this may include things like trenches or other excavations for earthwork or utility projects. In Glacier Constr. Co. v. Travelers Prop. & Cas. Co. of Am., 2014 U.S. App. LEXIS 11630 (10th Cir. June 20, 2014), a contractor was engaged for the dewatering of a construction site for a wastewater pumping facility. The contractor installed four wells/pumps at the site, which failed after extraordinary rainfall. The contractor had to develop a second dewatering plan, which involved replacement of the wells and pumps and substantial additional site work, and made a claim for the additional costs associated with the second dewatering plan under its builders risk policy. This policy actually included additional “Builders' Risk Site Preparation” coverage, which was intended to cover costs to re-excavate and re-prepare the site, regrade the land, or perform similar work because of a covered loss. The carrier, however, denied the claim. The Tenth Circuit agreed and held that “ordinary
and accepted sense of the policy terms limited coverage to correction of work previously done”, not to cover the expense of a new dewatering design and the costs to implement that design. On the other hand, courts have held that cut, fill, and backfill materials may be covered under the builders risk policy to the extent included in the project values.

Policies will also generally exclude damage to existing buildings and structures, which is typically relevant to renovation or expansion projects. Many builder’s risk policies also exclude contractor’s tools, machinery, plant and equipment not destined to become a permanent part of the project. During a major catastrophe, the risk of loss includes not just the work completed at the project itself, but the supplies, tools, and equipment left on site during the event. Where a builder’s risk policy excludes contractor’s tools and equipment, there is a potential for a large, uninsured loss if there is damage to equipment necessary to complete the project.

For example, in Lend Lease (U.S.) Const. LMB Inc. v Zurich Am. Ins. Co., 136 A.D.3d 52 (1st Dep’t 2015), aff’d sub nom. Lend Lease (US) Const. LMB Inc. v Zurich Am. Ins. Co., 28 N.Y.3d 675 (2017), a developer and construction manager for a high-rise construction project in Manhattan sought coverage for damage to a tower crane damaged during Superstorm Sandy. The policy defined “Covered Property” to include both property under construction and temporary works. “Property under construction” included “materials, supplies, equipment, machinery, and other property of a similar nature, being property of the insured or of others for which the insured may have assumed responsibility, that will become a permanent part of the Insured Project,” the value of which was included in the total project value. “Temporary works” included “[a]ll scaffolding (including erection costs), formwork, falsework, shoring, fences, and temporary buildings or structures, including office and job site trailers, all incidental to the project,” the value of which was included in the total project value. The policy excluded “[c]ontractor’s tools,
machinery, plant and equipment including spare parts and accessories, whether owned, loaned, borrowed, hired or leased, and property of a similar nature not destined to become a permanent part of the Insured Project, unless specifically endorsed to the Policy.”

The insurers declined coverage, in part, on the ground that the tower crane was excluded from coverage by the contractor’s equipment exclusion. The insured argued that the crane was a “temporary work” and therefore was covered under the policy. In Lend Lease I, the Appellate Division held that “[t]he tower crane was integral, not ‘incidental to the project,’ and therefore does not fall within the definition of Temporary Works. Even if the tower crane fell within the definition of Temporary Works, the contractor’s tools, machinery, plant and equipment exclusion would be applicable . . ..” In reaching its decision, the Appellate Division considered the underlying contract documents, which provided that the contractor would supply, *inter alia*, tower cranes and other “heavy equipment” required for the erection of the building. The contractor was required to secure, pay for, and maintain property insurance necessary for the protection against loss of the crane. The Appellate Division further recognized that the tower crane was assembled when the project started, and then disassembled and completely removed when the project was completed. The court concluded that “by reading th[e] exclusion in its entirety and ascribing to it its plain and ordinary meaning, the tower crane is, without question, contractor’s machinery or equipment that is excluded from coverage.”

While the Court of Appeals disagreed with the Appellate Division as to whether the tower crane constituted a temporary work, it nonetheless held that “[a]ssuming that the policy contains coverage for the crane in the first instance, we conclude that the contractor’s tools exclusion would defeat that coverage.” The Court of Appeals found it was not necessary to determine whether the tower crane constituted contractor’s tools or equipment because the tower crane fell squarely
within the definition of “machinery,” which was defined as “a mechanically, electrically, or electronically operated devise for performing a task.” The Court of Appeals further recognized that “the principal parts of the crane were ‘not destined to become a permanent part of the [building]’ upon completion of construction.” Accordingly, the Court of Appeals concluded that the “contractor’s tools exclusion applies to the crane.”

It is worth noting that, in order to minimize risk, an insured can obtain coverage for contractor’s equipment. In many cases, general contractors maintain separate policies insuring their own equipment. Additional coverage, however, can often be purchased under the builder’s risk policy (subject to additional premium, deductibles, etc.) for contractor’s equipment.

III. Physical Loss or Damage

It is a prerequisite under any first-party property insurance policy that, in order for there to be coverage, there first must be direct physical loss or damage. There is often a question as to what constitutes “direct physical loss or damage.”

Generally, “[t]he requirement that the loss be ‘physical’ given the ordinary definition of the term is widely held to require some distinct, demonstrable, physical alteration of the property.”

Even where property was exposed as a result of a covered peril, the insured must still demonstrate some alteration.

While courts recognize that “physical loss or damage” requires that there be “actual, demonstrable harm of some form” to the property, it does not necessarily require that “the physical loss or damage be tangible, structural or even visible.” Some courts have stretched “direct physical loss or damage” to include an impairment of function or value by, for example, contamination. In such cases, there was a discernible condition affecting the property, i.e.,
asbestos contamination, carbon monoxide contamination, methamphetamine odor, or gasoline odor, which caused an impairment of function or loss of use.

In most instances, however, physical loss or damage from a catastrophe is evident. In other cases, there may be a question of whether the property did, in fact, sustain damage. For example, a manufacturer of building components may void its warranty because the building components were potentially exposed to some detrimental conditions, such as water or salt from wind-driven spray. The building components, however, do not exhibit any signs of impairment. Or an earthquake may cause subsurface alteration adjacent to a building's foundation, which does not cause to instant damage to the foundation or structural components but which may lead to future settlement and ensuing loss. The concern is not immediate damage, but rather that the building components may exhibit damage at some future unknown time.

The risk that the insured property might sustain damage at some unknown future time arguably does not constitute physical loss or damage. In Port Auth. of N.Y. & N.J. v. Affiliated FM Ins. Co., 311 F.3d 226 (3d Cir. 2002), the insured alleged asbestos contamination resulting from the use of asbestos-incorporating products in the construction of a number of its properties. The court noted that the insureds' losses arose from the presence of asbestos, unaccompanied by even the suggestion of actual release or imminent threat of release of asbestos fibers. The court held that the “continued and uninterrupted use of the buildings without any indication of elevated airborne asbestos levels, coupled with the plaintiffs’ own assurances of public safety, ‘belie the existence of contamination to the extent required to constitute physical loss or damage.’” The court declined to find coverage for the threat of future loss, and concluded that the mere presence of asbestos or the general threat of its future release was not enough to survive summary judgment.
Moreover, at least one court has held that loss of warranty alone does not constitute “physical loss or damage.” In Glens Falls Ins. Co. v. Covert, 526 S.W.2d 222 (Tex. Civ. App. 1975), the insured sought coverage for several vehicle safety stabilizers that had fallen from a storage area to the floor. The safety stabilizers were in sealed containers and could not be inspected for internal damage. As a result of the fall, the manufacturer withdrew its warranty that the products were free from defects. The insured decided not to sell the products without the warranties and made a claim under its commercial property insurance policy. The policy in question insured against all risks of “physical loss or damage” to property described in the policy and specifically excluded loss caused by loss of market. The insurer claimed that because there was no evidence of physical loss or damage, there was no coverage under the policy. The court agreed and held that the insured had failed to prove that it had suffered physical loss or damage where the insured did not know whether the devices in question were physically damaged and had made no tests to see whether the devices would still work. In contrast, the insurer provided expert testimony that the devices in question were not physically damaged.

Based on the foregoing, the loss of warranty (or the threat of potential future loss or damage) is not sufficient to constitute a risk of “direct physical loss or damage.” In order for there to be coverage, there must be some demonstrable physical alteration to the building components.

IV. Application of Exclusions

In addition to excluding certain types of property, builder’s risk policies (as with most first-party property policies) exclude certain risks, including, inter alia, faulty workmanship and design defect, wear and tear, inherent vice, latent defect, corrosion, rust, gradual deterioration, etc. Catastrophe perils such as earthquakes, windstorms, and floods also are often excluded or limited. For example, while a builder’s risk policy may provide coverage for named windstorm (usually
subject to a sublimit and/or a higher deductible), the same policy may exclude coverage for flood, including storm surge. Conversely, while a builder’s risk policy may exclude coverage for earth movement, the same policy may provide coverage for an ensuing insured peril, such as fire. Wildfires will typically be treated no differently than an accidental fire, but it is conceivable that, because of the rise in wildfire incidents, this may change under future policies issued by carriers. This, of course, raises the questions of whether the covered or non-covered peril was the cause of the loss for insurance purposes and, if excluded, whether there is any covered ensuing loss.

A. Causation

In determining whether an exclusion applies, it is first necessary to consider whether the excluded risk was the legal cause of the loss. This analysis will vary depending on how the loss came about. A proximate cause analysis comes into play when a sequence or chain of events – some covered and some excluded – produce a loss. Whether there will be coverage depends on which of the perils in the chain is considered to be the “proximate” cause of the loss. Concurrent causation, on the other hand, exists when independent perils come together to produce a loss that would not have happened in the absence of any one of the perils.

The concurrent causation doctrine typically mandates that coverage will be provided when a loss would not have occurred but for the concurrent occurrence of multiple independent causes as long as at least one of those concurrent causes is a covered peril. Thus, when multiple independent perils – some of which are covered and some of which are excluded – jointly contribute to cause a loss, the concurrent cause doctrine provides that a first-party policy must respond even if one or more of the concurrent causes is an excluded peril.

The determination of the proximate cause of the loss will vary depending on which state’s law applies. For example, in determining the proximate cause of a loss, New York courts will seek
to identify the “dominant and efficient cause.” This is not necessarily the cause nearest in time to the loss, but rather refers to that cause which is “most nearly and essentially connected with the loss as its efficient cause.” Similarly, in California, courts will look beyond the moving cause and will look instead for the “predominant” cause, *i.e.*, the most important.\(^{vi}\)

On the other hand, in determining the “cause” of a loss, New Jersey courts apply the “Appleman’s rule,” under which a “loss is covered if a covered cause starts or ends the sequence of events leading to the loss.”\(^{vii}\) Thus, New Jersey courts will likely find that a loss is covered if the first or last step in the chain of causation was a covered cause.

Texas is unique in that its courts will segregate damage caused by separate perils. Applying a variation of the doctrine of “concurrent causation” that it materially different from the causation analysis undertaken by other states, Texas courts hold that an insured is entitled to recover only that portion of the damage caused by the covered peril.\(^{viii}\)

That said, most courts will allow the parties to an insurance contract to “contract around” these doctrines and generally uphold anti-concurrent causation provisions, *i.e.*, where the policy expressly provides that “such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.” Such wording will preclude coverage for losses caused by concurrent or proximate causes so long as one of the concurrent or proximate causes was an excluded peril. This wording, however, is often initiated by the carrier or a holdover from language previously used by an agent. So it is paramount for the insured owner or contractor to fully understand the language and/or endorsements governing exclusions.

**B. Ensuing Loss**

Many exclusions contain exceptions for ensuing or resulting loss, *i.e.*, the exclusions preclude coverage “unless direct physical loss or damage by an insured peril ensues and then only
for such ensuing loss or damage.” Consider, for example, an exclusion for loss or damage directly or indirectly caused by earthquake, which is defined as a shaking or trembling of the earth that is tectonic in origin. However, ensuing physical loss, damage or destruction arising from a peril not otherwise excluded shall not be considered earthquake.”

Generally, in order to recover under an ensuing loss exception to an exclusion, an insured must show that there was a subsequent, fortuitous event that caused collateral damage. Courts will seek to assure that the exception does not supersede the exclusion by disallowing coverage for ensuing loss directly related to the excluded risk.

For example, in Narob Dev. Corp. v. Ins. Co. of N. Am., 219 A.D.2d 454 (N.Y. 1st Dep’t 1995), the insured sought recovery under a property policy for the collapse of an improperly constructed retaining wall. The evidence presented at trial showed that the wall collapsed because of faulty workmanship. The insured, however, argued that the collapse of the retaining wall fell within the ensuing loss exception to the exclusion. The court held that in order for the “ensuing loss” clause to operate, there had to be “collateral or subsequent damage or loss as a result of the collapse of the free-standing wall.” In other words, the collapse of the wall by itself was not enough since that was itself the result of the faulty workmanship and not the cause of the damage.

As with causation analysis, the determination of whether there is a covered ensuing loss will depend on which state’s law applies. Texas courts have found coverage under an ensuing loss exception for damage that follows as a consequence of the excluded peril where the damage for which the courts found coverage was “collateral or subsequent” to the damage directly related to the excluded peril.x

New Jersey courts construe ensuing loss exceptions more broadly, applying the reasonable expectations doctrine. For example, in Spiniello Cos. v. Hartford Fire Ins. Co., No. 07-CV-2689,
the insured suffered damage to a polyester lining being installed in a pipeline when a defective catalyst used to speed up the hardening of the liner caused the liner to collapse. The insurer denied the claim based on the faulty materials exclusion. The exclusion contained an ensuing loss provision that stated “we will pay for resulting direct physical ‘loss’ to other Covered Property, except as otherwise excluded or limited.” The Spinello court, in holding that the damage to the lining was an ensuing loss, rejected the insurer’s argument that the ensuing loss provision applies only where a separate, independent covered peril or event causes the damage. The court noted that “nothing in the language suggests that an intervening event is required before coverage is triggered.” The court held that based on the insured’s reasonable expectations, the ensuing loss language indicates simply that damage inflicted on property “other” than the defective property itself will be covered, whether or not some intervening event intercedes.

C. Faulty Workmanship

In the wake of a catastrophe, it may become evident that some of the costs for which the insured is seeking to recover are not directly related to the damage caused by the event, but rather were due to a design defect or faulty workmanship in the construction of the project itself. For example, during a hurricane, wind uplifts portions of the project’s roof. In investigating this damage, it was discovered that the roof was not installed properly and the whole roof will need to be replaced. Such a scenario raises the question of whether the recoverable loss includes costs to repair or replace such defects.

Courts generally recognize that:

Builder's risk insurance is a type of property insurance coverage, not liability insurance or warranty coverage. The purpose of this type of insurance is to provide protection for fortuitous loss sustained during the construction of the building. [Builder’s risk insurance] does not operate as a warranty for faulty workmanship and should not be transformed into a guarantee against design and construction defects.”
Such exclusions bar coverage for a defect in the way that some part of the property is constructed.\textsuperscript{xii}

Some courts construing faulty workmanship exclusions have held that the exclusion bars coverage for “defects in the construction process . . . It is the \textit{quality} of the product which is excluded from coverage.”\textsuperscript{xiii} Under this approach, where faulty workmanship contributes to the cause of the damage, but the loss essentially occurs from an extraneous and fortuitous event, the exclusion will not apply.\textsuperscript{xiv} For example, a faulty workmanship exclusion would not preclude coverage for damage where a worker negligently drives a truck into a construction project and knocks it over, since the cause of such damage is extraneous to the construction project. The exclusion, however, will apply to exclude damage from negligence that is an “integral part” of the workmanship in the construction of the project.\textsuperscript{xv}

Other courts have narrowed the application of the exclusion further, distinguishing between the faulty \textit{process} of workmanship (treating “workmanship” as the act of performing work) and the faulty \textit{product} of workmanship (treating “workmanship” as the end result of the work). These cases tend to involve situations where a contractor’s negligence (\textit{i.e.}, faulty process) causes damage to some part of the construction project that was not improperly constructed.\textsuperscript{xvi} These courts recognize that the process/product distinction applies only to discrete, individual acts of poor performance, and that the faulty workmanship exclusion unambiguously applies to poor performance over the course of a longer construction project.\textsuperscript{xvii}

Still other jurisdictions have rejected the distinction between a faulty process and a faulty product, holding that a faulty workmanship exclusion also bars coverage for work that was performed in a faulty manner.\textsuperscript{xviii}

While many courts have addressed what constitutes faulty workmanship for purposes of the exclusion, few courts have addressed what is encompassed by an exclusion that bars recovery
for “all costs rendered necessary by defects in material, workmanship, design, plan or specification . . .”

In Kroll Constr. Co. v. Great Am. Ins. Co., 594 F. Supp. 304 (N.D. Ga. 1984), the insured was the general contractor for the construction of an office condominium project insured under a builder’s risk policy. After the project was essentially completed, the insured discovered that the waterproofing materials and/or work furnished by the subcontractor were deficient in several respects and had to replace or repair the waterproofing as well as much of the landscaping, concrete work, irrigation system, and electrical system that were damaged in the process. The insurer denied coverage based on the exclusion for the cost of making good faulty or defective workmanship.

After holding that “faulty or defective workmanship” included the “execution of making or doing something,” the court looked to the meaning of “cost of making good,” holding that the “costs incurred following the correction of the waterproofing work do not fall within the narrow meaning of the phrase.” In reaching this conclusion, the court observed that the exclusion in question “did not provide an exception for losses or damages stemming from faulty workmanship.” Rather “it simply [excluded] the cost of making good faulty workmanship or materials, leaving covered the cost incurred after the faulty work was ‘made good.’” Thus, while the cost of replacing or repairing the waterproofing was excluded, the court held that the insured was entitled to recover the costs incurred following the “making good” of the defective work, e.g., the damage to the landscaping, concrete work, irrigation system, and electrical system.

D. Another Approach – LEG Exclusions

The London Engineering Group, also known as LEG, crafted three defect exclusions for
use in various applications, including the insurance of large infrastructure projects. Initially adopted by European underwriters, the exclusions more recently have found their way into property and construction policies written in the U.S. or covering U.S. risks.

The LEG exclusions vary in the nature of the costs they exclude. LEG 1/96 – A Model “Outright” Defects Exclusion, provides that “[t]he Insurer(s) shall not be liable for Loss or damage due to defects of material workmanship design plan or specification.”xix This is the broadest of the LEG exclusions, containing no exception for ensuing losses.

LEG 2/96 - A Model “Consequences” Defects Wording, provides:

The Insurer(s) shall not be liable for

All costs rendered necessary by defects of material workmanship design plan specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage

For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.x

This exclusion is akin to the traditional “cost of making good” exclusion. While it excludes costs rendered necessary by defects in, e.g., workmanship, it contains an exception for ensuing loss or damage. In the event that damage occurs to any portion of the property containing a defect, the cost excluded is the “cost which would have been incurred if replacement or rectification . . . had been put in hand immediately prior to the said damage.” This requires a hypothetical measurement of what it would have cost to rectify the defect if covered damage had not occurred.

LEG 3/06 – A Model “Improvement” Defects Wording, is the narrowest of the LEG exclusions. This exclusion provides that:
The Insurer(s) shall not be liable for

All costs rendered necessary by defects of material workmanship design plan or specification and should damage (which for the purposes of this exclusion shall include any patent detrimental change in the physical condition of the Insured Property) occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.

For the purpose of the policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.

Thus, LEG 3/06 excludes costs made necessary by defects in workmanship, for example, but should damage occur to any portion of the property, the only costs excluded are those to improve the original workmanship.

Notably, under both LEG 2/96 and 3/06 there is a caveat that the existence of the defect itself is not damage. Therefore, absent some other physical loss or damage, there is no coverage for cost to rectify the defect. Once damage occurs, then there is coverage, and the only losses excluded would be either the hypothetical cost that would have been incurred to rectify the defect if it had been done before the damage occurred (LEG 2/96) or the cost to improve the original workmanship (LEG 3/06).

There is limited case law to date addressing LEG-type wording. A British Columbia court did address LEG 2/96 wording in Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Ins. Co., No. S111660, 2014 BCSC 1586 (B.C. Sup. Ct. August 19, 2014). In Acciona, a hospital was built with large but thin concrete slabs that needed to be level. Because the slabs gradually deflected downward with time as they cured, the proper process required shoring and re-shoring to be loosened and retightened as additional stories were added to the structure so that the load could be evenly distributed. The contractor failed to do this, resulting in the lowest slab being
overloaded, which caused the rebar to yield and a permanent depression in the middle of the slabs. While the slabs were safe, remedial work was necessary to create a level surface. The court held that the thin slab design was acceptable, so long as adequate shoring and re-shoring was used to support each slab. The court further held that the fault occurred as a result of a workmanship issue in the shoring/re-shoring procedures.

In addressing the LEG 2/96 exclusion, the court observed that the provision must be read as a whole and, therefore, the first phrase ("This Policy does not insure . . . all costs rendered necessary by defects in material, workmanship, design, plan or specification") could not be read as a distinct exclusion. Consideration must also be given to the second phrase ("the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage") so as not to render this second phrase meaningless. This second part makes the exclusion much narrower.

The court explained:

In other words, the excluded costs are only those costs that would have remedied or rectified the defect immediately before any consequential or resulting damage occurred, but the exclusion does not extend to exclude the cost of rectifying or replacing the damaged property itself; the excluded costs crystalize immediately prior to the damage occurring and are thus limited to those costs that would have prevented the damage from happening.

Accordingly, the court concluded that while the damage was the cracking and over-deflection of the concrete slabs, the defect was the improper framework and shoring/re-shoring procedures used. Accordingly, the excluded costs were those that would have been required to implement proper formwork and shoring/re-shoring procedures. The court found that these costs would have been minimal, and the insurers were required to indemnify the insured for a considerable portion of the claim.
V. Distinction Between Hard (Property Damage) and Delay-Driven Costs

In insuring against “direct physical loss or damage,” builder’s risk insurance provides coverage for costs to repair or replace damaged property. Disputes often arise as to whether, and to what extent, builder’s risk policies insure expenses incurred as a result, or consequence of, such property damage. Unless specifically provided, builder’s risk policies generally exclude loss, damage or expense caused by or resulting from “consequential loss,” including loss of market or delay, delay in completion, liquidated damages or performance penalties, penalties for non-completion, or non-compliance with contract conditions.

Courts that have considered this type of exclusion in builder’s risk policies have drawn a line between the direct effects of physical damage on a construction project and the indirect effects of that damage, such as delay-driven increased construction costs. There is no coverage for costs associated with the construction of the project as a whole that would have been incurred even in the absence of the loss event. Further, any costs resulting from delay in construction to perform repairs, including increased general conditions costs, would be excluded consequential loss.

At least one court has held that consequential loss exclusions are limited to economic losses separate and apart from regular construction defects. In *Zurich Am. Ins. Co. v. Keating Bldg. Corp.*, 513 F. Supp. 2d 55 (D.N.J. 2007), the insured was in the process of constructing a hotel facility when a portion of the parking garage that was under construction collapsed. Following the collapse, the insured submitted claims under the policy for the costs to repair the collapse as well as increased construction costs resulting from the delay to the project. The insurer denied that coverage was available for these increased costs under the property damage coverage afforded by the policy, because “the scope of indemnity only covers repair costs to the damaged portion of the Project, not increased costs to complete construction of undamaged property.”
The court held in favor of the insured, holding that the additional construction costs were covered as “property damage.” The court also ruled that the “consequential loss” exclusion did not apply. The policy excluded “loss, damage or expense caused directly or indirectly by and/or contributed to, in whole or in part . . . [c]onsequential loss, damage or expense of any kind or description including but not limited to loss of market or delay, liquidated damages, performance penalties, penalties for non-completion, delay in completion, or non-compliance with contract conditions . . .” In holding that this exclusion did not apply, the court reasoned that “[t]he types of losses listed in the exclusion – ‘loss or market or delay,’ . . . – are purely economic losses that are separate and apart from regular construction costs. Extending the exclusion of ‘consequential losses’ beyond purely economic losses to include regular construction costs . . . is unwarranted[.]”

Most courts, however, have declined to follow the economic loss limitation applied to the consequential loss exclusion by the court in Keating. For example, in Diamond Beach, V.P., L.P. v. Lexington Ins. Co., 748 F. Supp. 2d 648, 649 (S.D. Tex. 2010), which involved the destruction and flooding of a condominium project in Galveston during Hurricane Ike in 2008, the builder’s risk policy excluded “[c]onsequential loss, damage or expense of any kind or description including but not limited to loss of market or delay, liquidated damages, performance penalties, penalties for non-completion, delay in completion, or non-compliance with contract conditions, whether caused by a peril insured or otherwise . . .” The Southern District of Texas held that the exclusion barred coverage for costs arising out of delays in the construction of the project, where the delays were not directly caused by any physical loss or damage to the project. The court held that such supplemental soft costs were “by definition consequential damages or losses and are specifically excluded by the language of the policy.” Similarly, in James F. Campenella Const. Co., Inc. v Great Am. Ins. Co. of New York, CIV. A. 10-681, 2010 WL 4812990, at *1 (E.D. Pa. Nov. 24,
2010), the court held that general conditions costs incurred by a general contractor were excluded consequential loss. In Campenella, a water-supply line failed, causing damage to a condominium renovation project. The builder’s risk insurer paid for the cost to repair the water damage but declined the general contractor’s general conditions claim on the grounds that the policy excluded loss caused by delay. The general contractor calculated its claim based on its daily general conditions costs for the entire project, multiplied by the length of time necessary to make repairs. The court found that the claimed “costs were associated with the construction of the project as a whole and, therefore, would have been incurred even in the absence of the loss event. Thus, any additional general conditions costs necessarily resulted from delay in the construction to perform repairs.” The court concluded that because the policy excluded costs incurred due to delay, the general contractor could not recover for general conditions.

VI. Delay in Start Up / Completion Coverage

While builder’s risk insurance generally excludes consequential loss, such policies will often provide limited coverage for certain delay-related losses. In this regard, in the event of direct physical loss or damage to insured property covered under the policy, Delay in Start Up / Completion endorsements provide coverage for scheduled gross earnings, rental income, or soft costs (e.g., general overhead, operational and maintenance expense, interest expense, construction loan fees, permit fees, consultant and professional fees, marketing and advertising expense, insurance premiums, legal and accounting fees, and realty taxes) caused by or arising out of the resulting “delay” in the completion of the project.
“Delay” usually is defined by the policy. Typically it is the period of time between the “anticipated date of completion” and the actual date on which commercial operations or use can commence. Thus, before it can be determined whether there was a covered “delay” it is first necessary to determine the “anticipated date of completion.” In general, the “anticipated date of completion” is the date a project would have been completed absent a loss. This invariably requires an investigation into whether the project was in fact on schedule immediately prior to the loss. As always, it is important to consider the specific policy wording, inasmuch as there are variations in how the “anticipated date of completion” is defined. Common variations include:

- The date stated in the schedule on which the work is scheduled to be completed for commencement of commercial operations or use and occupancy;
- The later of the original scheduled completion date in the construction contract or the date the structure would have been completed if a loss had not occurred. In no circumstances will the completion date predate the original scheduled completion date in the construction project;
- The later of the completion date scheduled in the construction contract and shown in this endorsement, or the date the Insured Project would have been completed for commencement of commercial operations or use and occupancy if a loss hadn’t occurred.
- The date the project would be put into operation or use in the normal course of construction if loss of or damage to covered property from any of the Covered Causes of Loss had not occurred.

Next, it is necessary to determine whether the claimed “delay” was caused by or arose from covered physical loss or damage. A covered “delay” does not include the impact on the construction schedule by non-covered issues, including: change orders that result in a deviation
from the original construction schedule; other changes in the construction schedule independent of the time necessary to repair or replace the damaged property; design errors or ambiguities that impact the progress and/or sequence of the work; the need to repair or replace non-insured property; the need to correct an uninsured condition such as faulty workmanship or a design flaw; other alterations, additions, improvements, betterments or other changes in the design of the work; the enforcement of any ordinance or law regulating the construction, rebuilding, repair, replacement, removal or reconstruction of the work; or any stop work order that interferes with the progress of construction.

In the wake of a catastrophe, it is not uncommon for there to be multiple factors that delay construction of the project that are not directly related to physical loss or damage to insured property, ranging from damage to non-covered property (such as contractor’s equipment), to damage from non-covered perils (such as flood in a high hazard flood zone), to non-damage related impediments such as labor shortages. In determining the covered “delay” for purposes of Delay in Start Up / Completion coverage, it is necessary to carefully review pre- and post-loss construction schedules to isolate what, if any, “delay” was caused by or arose from covered physical loss or damage to insured property, versus other holdups. Needless to say, this may involve a time-consuming and potentially costly schedule analysis by a qualified consultant, so prompt action is critical.

Once it has been determined that there was a covered “delay,” it will then be necessary to determine the “period of indemnity,” which is the maximum period of time for which Delay in Start Up / Completion losses are recoverable. It includes consideration of the deductible or waiting period (e.g., 30 days), and any time limits applicable to Delay in Start Up / Completion coverage.

VII. Other Delay-Related Coverages
Even where a builder’s risk policy does not provide “Delay in Startup” coverage, certain coverage extensions may serve to cover some delay-related costs, including coverage for Expediting Expense and Contractor’s Extra Expense.

Expediting Expense provisions typically provide coverage for the reasonable and necessary extra costs incurred for such things as overtime and express freight incurred to facilitate the immediate repair or replacement of the property that sustained direct physical loss or damage. Sometimes, Expediting Expense provisions also provide limited coverage for costs that are necessary to return the work on the damaged portion of the project to the same schedule as immediately prior to it sustaining direct physical loss or damage. This coverage extension is tied to costs incurred in connection with the covered physical loss or damage but extends beyond the repair of the damage to include some delay-related costs incurred to return the work on the damaged property to the same schedule. It does not provide coverage for increased costs on the project as a whole.

Contractor’s Extra Expense provisions provide coverage for the reasonable and necessary costs incurred during the period of restoration or repair of the damaged property that are over and above the total costs that normally would have been incurred during the same period for the purpose of continuing as nearly as practicable the scheduled progress of the undamaged work. This coverage is available only for such length of time as it takes to restore or repair the damaged property. Once repairs are completed, Contractor’s Extra Expenses coverage generally comes to an end and there is no coverage for additional costs incurred to return the project as a whole to its pre-loss schedule, or for any costs incurred as a result of the delay in the construction of the project.

As with any coverage analysis, it is always essential to check policy wording for the specific requirements for coverage.
VIII. Additional Considerations for End-of-Project Coverage and Preventing Coverage Gaps

As alluded to previously, ensuring property insurance coverage at the end of a given construction project can pose some challenges based on the applicable builder's risk policy in place. This can be critical because final completion may not always be determined by a fully objective measure, and facility operations or partial occupancy/operations may commence before the owner signs off on a certificate of final completion. During that time, the owner and the contractor will continue to need property damage coverage. In the meantime, the costs of maintaining such coverage may increase significantly, especially if the project involves high risk activities, such as a power plant, high-tech manufacturing, oil and gas, or a chemical operations facility.

Again, some builder's risk policies can include “maintenance” period coverage that insures against damage caused by post-substantial completion maintenance work or against property damage that occurs during the specified maintenance period as a result of a previous installation. In addition, contractors will sometimes obtain builder's risk “floater” policies that are not project specific, but will cover property damage at any project undertaken by the insured contractor, subject perhaps to lower limits than a project-specific builder's risk policy. Floaters are often utilized when expensive equipment or materials (e.g., generators, compressors, turbines, etc.) are involved in the project and the project team wants coverage while the property to be installed is in transit, in a temporary location or being staged. But floaters may also be a good alternative at the testing stage when equipment or machinery is installed at the end of the project (similar to hot testing extensions).

This can be particularly important when the testing and start-up protocols require several stages, including “preliminary acceptance,” followed by partial operations and “final completion”
that may not be accomplished for some weeks (or even months) later. The timing of damages, whether caused by flood, fire or explosion, especially during or shortly after final testing, can lead to disputes regarding coverage, not to mention disputes between the parties. In these and other circumstances, the builders risk carrier may contend that its coverage ended (at substantial completion, perhaps), while the owner’s property damage carrier may contend that its policy had not yet commenced. In that regard, “floater” programs may fill coverage gaps not otherwise insured by the project specific builders risk program, and may be worth considering based on when the project schedule is forecasting the relevant completion date, testing schedule, or maintenance period (i.e., during hurricane or tornado season, or dry seasons susceptible to wild fires, end of winter thawing and rains vulnerable to flood, etc.).

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In short, natural disasters, particularly those affecting a large geographic area, can create complex claims intertwining a mix of coverage issues, including whether the event in fact caused damage to covered property; whether the damage was from a covered or an excluded cause of loss (or a combination of the two acting either concurrently or in sequence); or whether the claimed costs are hard costs incurred to repair damage to covered property or are delay-driven costs and, if so, whether such costs are excluded consequential loss or covered as, e.g., Expediting Expense, Contractor’s Extra Expense, or Delay in Start Up / Completion loss. If the builder’s risk policy provides Delay in Start Up / Completion coverage, whether there is coverage will hinge on whether there was a delay in the completion of the project arising from or caused by covered property damage (rather than non-insured property damage or some other factor such as a labor shortage). Resolution of each of these issues will depend on the specific policy wording, as well as the
applicable law. Notably, resolution of key questions such as the “cause” of the loss will vary from state to state.

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xxi London Engineering Group LEG 3/06 at 


xxiv Id. at *5.