

Understanding Liability Insurance for Today's Construction Projects

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Effective management of risk and insurance is critical when undertaking a construction project, as construction insurance has evolved into a highly specialized and complex field over the past few decades. Unfortunately, there is still no single-solution policy for an owner to adopt for its construction project. Instead, the owner must carefully choose from a basket of policies that are then fine-tuned to cover the particularities and needs of the owner's insurable risks.

Whether an individual owner has chosen to renovate their coop or condo unit or a coop board is undertaking lobby renovations or facade restoration, owners of all stripes need to understand the basics of construction insurance in order to formulate a strategy to deal with the multitude of risks facing their construction projects today. Uninformed, poor planning can commonly result in delayed project completion, budget overruns, and often, litigation.

The Contractor's Policy

Contractors maintain several types of insurance coverage that are primarily dependent on the delivery method determined for the project and the corresponding services provided. For example, a contractor or construction manager of a design-build project may require professional liability coverage in addition to its general liability policy, which is common in the more traditional design-bid-build project. The contractor's commercial general liability policy, or CGL insurance, is the most common and protects the contractor from claims by other parties for damages resulting from bodily injury or property damage. In addition, it may also cover personal injury and advertising injury where possible claims may include invasion of privacy, infringement of copyright, and false arrest. The CGL policy also provides limited no-fault bodily injury coverage which pays medical expenses incurred by a person injured on the insured's property. CGL insurance covers the cost of defending claims even if they are false or without legal merit. The legal expense to defend is normally paid in addition to the policy limit, and the insurer's duty to defend ends only when the policy limits are exhausted by settlements.

In addition to policy limits, the owner should be concerned with several aspects of the CGL policy. First, the CGL policy excludes coverage for the contractor's negligent or defective work. Since such damage amounts to a breach of its agreement with the owner, the owner will be left to make a claim directly against the contractor for such negligent or defective work. As such, the owner should ensure other means of redress are available through its owner-contractor agreement to address defective work, cost overruns, and delays due to the contractor's negligent work. However, the CGL policy typically covers damage to the contractor's work

caused by another contractor (e.g., the owner's) or one of its subcontractors.

The Umbrella or Excess Liability policy allows higher coverage limits above the CGL policy and business automobile limits to protect the owner and contractor against catastrophic loss. Umbrella policies often have as many exclusions as standard CGL policies but have higher limits; most individual unit owners should require umbrella limits ranging from \$2 million to \$10 million. Although there is no simple formula, it is typically determined by a combination of construction cost, project location, environmental exposure, and project complexity.

Design Professional Liability Policies

Condo and coop owners and their counsel routinely assume that design professionals provide insurance that automatically affords coverage for their professional negligence that may occur on their construction projects. In fact, blind acceptance of this assumption can lead to unintended consequences when projects go awry.

A design professional's professional liability policy, generally referred to as errors and omissions (E&O) or malpractice insurance, affords coverage for claims made arising out of negligent acts, errors, or omissions in the performance of professional services.

Most states, including New York, do not require design professionals to maintain professional liability insurance. As a consequence, it is the responsibility of each owner to ensure that its design professionals have current insurance in place to balance the risk associated with the potential for professional liability problems.

When retaining design professionals on a construction project, owners and their counsel must ask to review professional liability policies as to (1) the aggregate limits of liability afforded by the insurer, (2) the available limits of liability for the annual policy in the event a pending claim on another project has reduced the original limits of liability, and (3) the amount of the deductible maintained by the insured.

Owner reliance on professional liability insurance for design professionals may, in many instances, be illusory. Policy wording often contains numerous exclusions which preclude coverage for many types of claims that ordinarily will be asserted by an owner against a design professional. For example, these might include claims involving the design professional's warranties, cost estimates for the project budget, representations as to design features, and claims for the recovery of fees. Additionally, there is usually no

coverage for failure of the design professional to meet a particular contractual requirement unless the claim arises from a negligent act, error, or omission. A common example would be if the design professional misses an established design submission deadline. Unless it can be shown that the missed deadline directly contributed to increased construction costs or other damages, the E&O policy will not cover the claim.

Increasingly, owners and their counsel have begun to recognize the need and the value of securing specialized expertise to review project risks and tailor an insurance program to meet the owner’s goals. The role of owner’s counsel is critical and enormously important in this area of the law as the placement of a successful insurance program can give the owner more control over the quality of coverage, limits of insurance, and management of claims.

Risk Allocation

It is common in owner-contractor agreements for the owner’s attorney to include risk transfer provisions -- indemnity or hold-harmless clauses -- along with insurance requirements in order to adequately protect its clients from exposure to financial loss due to bodily injury or property damage. At the outset of each project – even relatively small residential build-outs – the owner, with the assistance of counsel, should define its legal and business goals for project success. A complete investigation behooves the owner to review its business and legal objectives attendant to all construction related matters. By identifying all risks and other issues relating to the project, the owner will be properly and fully protected should design errors and omissions or other losses arise on the project.

The table **below** lists common construction risks on the left and allocates the relative exposure risk to each major party of the construction project.

<i>Risk</i>	Owner	Architect/Engineer	Contractor	Subcontractor
<i>Injury to contractor’s employee</i>	General liability or homeowner’s protective	Professional liability or general liability	Worker’s compensation	Commercial general liability
<i>Injury to subcontractor’s employee</i>	General liability or homeowner’s protective	Professional liability or general liability	Commercial general liability	Worker’s compensation
<i>Injury to general public</i>	General liability or homeowner’s protective	Professional liability or general liability	Commercial general liability	Commercial general liability
<i>Physical damage to project during construction</i>	Builder’s Risk	Professional liability or general liability	Builder’s Risk	Builder’s Risk
<i>Physical damage to adjacent property</i>	General liability	Professional liability	Commercial general liability	Commercial general liability
<i>Physical damage to project after construction (loss of use)</i>	Builder’s Risk soft cost or system performance	Professional liability	Builder’s Risk soft cost or system performance	Builder’s Risk soft cost or system performance
<i>Physical damage to contractor’s equipment</i>	Not typically insured	Not typically insured	Equipment floater	Equipment floater
<i>Damages caused by hazardous materials including asbestos</i>	Pollution legal liability	Professional liability including pollution coverage	Contractor’s pollution policy	Contractor’s pollution policy
	Primary exposure to loss	Secondary exposure to loss		Negligible exposure to loss

Owners should recognize that building technology, as well as the law surrounding ways in which construction projects are designed and built today, have become ever more complicated, substantially increasing the need of owners to manage the risks in committing costs to their projects. Even seemingly modest losses on small projects can result in substantial damages caused by project delays and budget overruns. Condo and coop owners should give careful consideration to implementing a specially considered and tailored insurance program for their project which reflects the exigencies of an increasingly complex construction world.

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