



## Builder's Risk Insurance—Don't get burned.

Builder's risk insurance is essential coverage for new and remodel construction projects. The construction contract often requires that it be purchased by the project owner or general contractor. Unfortunately this does not always happen, and when a property damage claim is incurred, you don't want to get burned.

Here is an actual claim regarding a fire loss with a result that was less than satisfactory for the general contractor and subcontractor.

**Actual Claim:** The project was a large remodel of the State Capitol Building in Salem, Oregon. The general contractor was obligated to procure builder's risk coverage for itself and its subcontractor(s). Unfortunately, nothing was done to acquire it.

During the construction, a suspicious fire erupted at the project and it destroyed part of the existing building, including the work of the subcontractors. The ATF and Oregon State Fire Marshall joined together to conduct the fire investigation. Suddenly, without solid evidence, one of the subcontractors was singled out for the blaze. The evidence against that subcontractor was shaky at best, yet the State of Oregon's property insurer sued the general contractor and the subcontractor for the damages; over \$2,000,000 was at stake.

There were other possible causes that the ATF and Oregon State Fire Marshall could have pursued, but they were abandoned because the general contractor and subcontractor had adequate assets.

The subcontractor was frustrated by the pending litigation and lack of evidence, however it agreed to pay \$600,000 to set itself free from the litigation. Reason: An estimated \$300,000 would have been spent in defense fees and costs. Moreover, the litigation was impacting other parts of its business with the general contractor. Paying the \$600,000, although painful, put an end to the subcontractor's participation in the ongoing litigation and saved its relationship with the general contractor. Another unintended insult, the subcontractor lost most of its material costs and the labor put into the project. Questions: Whatever happened with builder's risk coverage? How could the \$600,000 payment have been avoided by the subcontractor? How could the costly litigation expense and damaged relationship with the owner been avoided for the general contractor?

Builder's risk insurance coverage is the best solution to avoid the above loss scenario. Yet, it is many times forgotten or coverage is not negotiated correctly to include protection for the subcontractors. General contractors need to be diligent to protect their financial and contractual requirements and the interests of their subs.

## **Builder's risk coverage is the best solution to finance your construction and contract risk including:**

- Project delay and expediting expenses to get project back on schedule
- Lost profits
- Liquidated damages (not covered by standard property insurance)
- Your material damaged or destroyed by the loss
- Your labor cost to rebuild damaged work

## **What is the difference between property insurance and builder's risk Insurance?**

Builder's risk insurance usually covers the insurable interests of all parties including the owner, general contractor, and subcontractors, for construction work while in progress. It is a no fault (first party) property coverage and it covers labor, materials and loss of use.

As a first party coverage it will indemnify the insured parties for a covered loss such as fire, theft, earthquake or flood. Subrogation (the recovery rights of the insurer) is waived to prevent litigation or a demand from the insurer to collect back from the responsible insured.

Owner's property insurance is not the same. The owner's insurable interest is protected, but generally not that of the general contractor or its subcontractors. Once the owner's property insurance has paid the claim, it will subrogate against the general contractor and subcontractors by assigning blame for negligence. Liquidated damages also become an issue.

## **Detrimental reliance leads to litigation:**

A minority of private owners do not readily purchase builder's risk coverage, even when required by contract. One of the primary reasons is that they feel that the general contractor and subcontractors already have commercial general liability coverage, so why be concerned? If anything happens on the project that causes damages, it must be through the negligent acts of the general contractor or the subcontractors. Regrettably, it does not always work out that way, because of policy exclusions for your work or your product. What compounds these issues is a large loss. A \$15,000,000 to \$25,000,000 loss usually means that the subcontractors will have inadequate policy limits. Unfortunately, the owners want to hope for the best. They believe there is no detrimental reliance if they don't procure builder's risk coverage because they think that the commercial general liability coverage of the general contractor and the subcontractors will carry the day.

At this point, things can get really messy. Litigation ensues between the potential tortfeasors (the general contractor and the subcontractors) and rebuilding is stalled pending adjudication. Coverage disputes arise when the general contractor's commercial general liability insurer attempts to push the legal liability down onto the subcontractors. The litigation is drawn out and the policy limits are inadequate for the loss. At the end, all of the parties feel resentful and exhausted by the experience. All of these potential problems could have been resolved quickly if the owner had just purchased builder's risk insurance.

## Why purchase builder's risk insurance?

General contractors should purchase builder's risk insurance to ensure that the proper protection is in place. It is considered to be a pass-through cost, so there is very little investment on the general contractor's part aside from the 10-15 minutes completing and sending an application to its insurance broker. Reasons to procure:

- Required by written contract with owner or by lender. Typically on all new construction builder's risk insurance is required to protect the value of work until accepted by the owner.
- Builder's risk insurance is a first party coverage. There is no need to prove that a third party was negligent or responsible for causing damage to work; you only need to prove the damage was caused by a peril that is insured under the policy.
- You want to keep claims off of your commercial general liability (CGL) policy to keep your premiums down. Typically builder's risk premiums don't go up if you have a claim. CGL policies are experience rated and claims will cause your rates to go up.
- The claims process is much faster for a builder's risk claim, as you don't have to prove who was responsible for causing the loss. This allows you to finish the project quickly, and hopefully avoid liquidated damages.
- Builder's risk insurance is very broad. It protects the interests of the owner and the subcontractors. The coverage can be customized for the projects to include loss of income, delayed opening expenses, coverage for changes in building ordinances, etc.

If the owner insists on purchasing the builder's risk coverage on their own, there are a number of items that the general contractor should contractually require:

- The general contractor should request a copy of the owner's insurance coverage prior to the start of any work. The named insureds should include the project owner, general contractor, and subcontractors of every tier.
- The contractor should ensure that the owner is responsible for the deductible for claims not caused by the contractor or subcontractors.
- In the contract with the owner, the owner should be responsible for uninsured losses (e.g. acts of God such as flood and earthquake) not purchased by the owner.
- Any loss adjustment should involve both the owner and the general contractor.

**Consult with a PentaRisk account executive to develop a solid builder's risk strategy to avoid getting burned! Visit our website at <http://pentarisk.com/>.**

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