OWNER CONTROLLED INSURANCE PROGRAMS (OCIPs)
<u>AND WRAP INSURANCE POLICIES: UPDATE</u>

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Controlled Insurance Programs ("CIPs") are a family of project-specific insurance, also known as "wrap-ups," that are increasingly common, especially in large projects. Such programs may be sponsored by the project owner, as an Owner Controlled Insurance Program ("OCIP"), or by the contractor, as a Contractor Controlled Insurance Program ("CCIP"). In a project without an OCIP or CCIP, all participants have their own insurance normally with the Owner being made an "additional insured" on the general contractor's policies and the Owner, the general contractor, and all "upstream" subcontractors being made "additional insureds" on their lower-tier subcontractors' policies. By contrast, a CIP is a single project-specific insurance program for on-site risks, losses and casualties that protects most project participants.

These materials will describe CIPs, their advantages, disadvantages and potential pitfalls. It will give practical advice on avoiding the pitfalls.

General CIP Description

Traditionally sponsored and controlled by the Owner (an "OCIP") or by the general contractor (a "CCIP"), a CIP typically includes workers' compensation coverage (including employer's Part B coverage) and general liability insurance, both primary and excess. Traditionally, builders' risk policies were not included in a CIP. The theory was that the builders' risk policy already covered the participants' on-site property losses "as their interests may appear."[1] Today, however, builders' risk policies are included in CIPs more and more often. The recent trend is also to include construction management and other professional liability policies as well as environmental liability policies. Commercial Auto liability is customarily excluded from a CIP. However, there is no universal rule for what a particular CIP will or will not include.

The vast majority of CIPs are established for a single project. However, sometimes an Owner or large contractor will set up a "rolling" OCIP or CCIP to be available for use on similar projects, particularly for a series of similar projects which are not individually large enough to warrant a stand-alone CIP. A maintenance OCIP, also known as a "Gate OCIP," can be set up to cover ongoing plant maintenance and renovations. These are called "Gate OCIPs" because they

[1] ATIMA clauses can be problematic. *See, e.g., St. Paul Fire & Marine Ins. Co. v. FD Sprinkler Inc.*, 76 A.D.3d 931 (N.Y. App. Div. 1st Dep't 2010) (Builders' risk insurer subrogation against subcontractor not barred by ATIMA.)

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attach to persons and entities who come through the facility's gate. Environmental CIPs ("ECIPs") are used for major environmental remediation projects. International CIPs are known as ICIPs. These materials discuss the prototypical domestic, single project CIP.

Administration

A CIP typically gives the Sponsor integrated, centralized cost control, safety and loss control programs, claims submissions, and CIP administration, all of which is beneficial from the Sponsor's point of view. However, other principal participants – especially a large general contractor covered by an OCIP – may dislike losing at least partial control over these activities. For example, claims experience with the CIP insurers may not be as good as claims-handling under your usual program. There is the additional hassle of having to go through the CIP administrator rather than dealing directly with the insurer. Moreover, a different jurisdiction's law may govern the CIP program (and claims thereunder) than the law governing a participating contractor's own insurance program.

Good administration of a CIP is crucial. In all jurisdictions, one must be a licensed insurance agent or broker to buy or sell insurance for others, but this is not enough. For effective administration of a CIP, one needs a well-regarded, experienced administrator. This is not a job for neophytes. The sponsor's broker/CIP administrator must negotiate appropriate terms and conditions with the carriers, draft the CIP manual, establish and operate the enrollment process, run the CIP (monthly payroll/values reporting, audits, certificates of insurance, reports, etc.), supervise safety and loss control programs, handle claims administration, and generally act as an advocate *vis-à-vis* the various insurers.

Advice: Be wary if the general contractor or Owner is interested in a standalone CIP for a small project or is using an inexperienced administrator. You need experienced professionals setting up the CIP, obtaining and negotiating the appropriate policies, and administering the CIP.

Litigation Risk

In theory, with a CIP, there should be less litigation among contract participants. If the same policy insuring all of them responds to the loss, there should be no need to allocate fault. This has been touted as one of the distinct advantages of a CIP. Unfortunately, particularly for completed operations and "construction defect" claims, this laudable goal appears not to have been realized in practice. Especially when uncertainty regarding coverage exists, an OCIP will not eliminate disputes regarding project-related damages issues. Major construction litigation or arbitration proceedings often involve CIPs. It is hard to know, however, if this happens disproportionately to their use on large projects. Reliable statistics, corrected for project size, are hard to find. Anecdotally, use of a CIP does not make such major litigation significantly less likely. It is possible that a CIP expedites more routine claims payments during construction.

Advice: Understand how defense under the policy will be handled in the event of litigation.

Who is Covered?

Typically, in an OCIP, the Owner is the first named insured, but the general contractor, subcontractors, consultants and subconsultants of every tier are also named insureds. In a CCIP, the general contractor is usually the first named insured and named insured status is extended to subcontractors, consultants, and subconsultants of every tier. Some experts advise that the Owner should be merely an "additional insured," not added as a "named insured," in a CCIP, in part so that the Owner cannot extend "additional insured" status to others.[2] However, this can introduce a whole host of "additional insured" issues that are best avoided. Many CCIPs therefore include the Owner as a "named insured."

A typical OCIP named insured endorsement may provide:

NAMED INSURED ENDORSEMENT (OCIP)

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY INSURANCE FORM

Policy Declarations, "Named Insured" is amended to include as Named Insureds:

All contractors and/or subcontractors/consultants and/or subconsultants for whom the Owner or Owner's agent are responsible to arrange insurance to the extent of their respective rights and interests.

Coverage afforded by this policy is automatically extended to contractors who are issued a Workers' Compensation policy under this Owner Controlled Insurance Program (OCIP). All other contractors not issued a Workers' Compensation policy must be endorsed onto the policy to be afforded coverage under this policy.

"Named Insured" does not include vendors, installers, truck persons, delivery persons, concrete/asphalt haulers, and/or contractors who do not have on-site dedicated payroll.

All other terms, conditions and exclusions remain the same.

Please note that the endorsement extends "named insured" status only to those subcontractors/consultants or subcontractors for whom the Owner or the Owner's agent are responsible to arrange insurance *and* to whom a workers' compensation policy has been issued. This does not mean everyone who may be on-site.

Excluded contracts and activities often include some or all of the following: security guards, suppliers, vendors, material dealers, truckers, haulers, sometimes design consultants and subconsultants, subcontractors with scopes of work less than $10,000, $15,000, or some other amount, and others with little or no on-site payrolls. The rationale for excluding these entities is

[2] Tracey Alan Saxe, *Construction Wrap-Ups: Owner and Contractor Controlled Insurance Programs*, *in* CONSTRUCTION LAW HANDBOOK § 19.03[B] (Richard K. Allen & Stanley A. Martin eds., 2009).

that CIP coverage should not be provided to parties whose work and safety is not controlled by the CIP. However, such limitations can present problems for subcontractors who in turn subcontract the fabrication and installation of substantially all of their scope of work. Such subs may have little or no on-site payroll (although their representatives may be on-site periodically for inspection and supervisory purposes), yet they need the protection of the CIP. Some CIPs exclude janitorial services, demolition or blasting activities.

Unfortunately, there is no uniform standard for who is in and who is not; different CIPs take different approaches. You need to consider if any CIP protection will be extended to normally excluded entities, such as suppliers, who may nonetheless sometimes be on-site. If not, what insurance will respond? It is very important that all CIP policies' and manuals' named insured endorsements track precisely the contractual documents in identifying named insureds, and that all contracting parties clearly understand precisely who and what is – and is not – included.

As could be expected, there has been litigation over whether a particular entity, particularly erection companies or haulers, were included in the CIP. Thus, *Higgins Erectors & Haulers, Inc. v. Niagara Frontier Transportation Authority*, 529 N.Y.S.2d 654, 655 (App. Div. 1988), held that the term "subcontractor" does not apply to those entities who do not actually perform work on the project but merely provide materials to those who do perform the construction work. Similarly, in *Waco Scaffolding Co. v. National Union Fire Insurance Co. of Pittsburgh, PA.*, No. 74656, 1999 WL 980629 (Ohio Ct. App. Oct. 28, 1999), Waco Scaffolding provided an unassembled scaffolding unit for use by a subcontractor on the project, but did not provide any labor on the project or any materials that were to be incorporated into the project. It was held not covered by the CIP.

The Maine Supreme Court came to the opposite conclusion about "furnish and install" suppliers. *Am. Prot. Ins. Co. v. Acadia Ins. Co.*, 814 A.2d 989, 993-94 (Me. 2003) (finding company which had agreed to supply structural steel and to furnish *and install* metal fabrications covered by the OCIP) (emphasis added). In *Acadia*, Kemper argued that "[w]hether or not an accident is covered under the OCIP is determined by the activity being performed at the exact time of the accident, and since [the employee] was *delivering* at the time of his accident and not *installing*, his injuries are not covered by the OCIP." The Maine Supreme Court rejected the argument:

> This interpretation is contrary to the very title of subsection 2.3, which is "excluded *entities*."
>
> * * *
>
> The plain meaning of the document, when read as a whole, is that subcontractors *covered* under the OCIP are covered for work done at the Project site, but they must have their own insurance to cover accidents that occur away from the Project site. In contrast, those entities that are *excluded* from the OCIP must procure their own insurance to cover all accidents, even those occurring at the Project site.

* * *

> Acadia was entitled to summary judgment because under the unambiguous provisions of the contract Kemper was responsible for payments under the OCIP.

Id. at 994.

The dangers posed by arguably ambiguous OCIP (and other insurance) provisions in construction contracts is illustrated by the troublesome decision of the Georgia Court of Appeals in the *Pitts* litigation, which fortunately for the contractors and the City of Atlanta, was reversed by the Georgia Supreme Court in November 2012. *See Archer W. Contractors, Ltd. v. Estate of Pitts*, 735 S.E.2d 772 (Ga. 2012). In *Pitts*, the estate and minor children of a worker killed when struck by a truck during construction of the new international terminal at the Atlanta airport, sued the City, his employer (Archer Western) and several contractors, arguing that the decedent was the "intended beneficiary" of a contract containing an "OCIP addendum" that allegedly required the trucking company, as a subcontractor, to carry $10 million in automobile liability insurance. The Court of Appeals, in reversing the trial court's entry of summary judgment for the defendants, relied on a statement in the OCIP addendum providing that its purpose "'is to provide one master insurance program… with high limits that will benefit all participants involved in the project.'" *Id.* at 776. Relying on the dictionary definition of "participant," the court ruled that because he "had a part in the construction project," Pitts was an intended beneficiary of contractual requirements requiring each subcontractor to carry the required automobile insurance. *Id.* The Supreme Court disagreed, concluding first that the Court of Appeals had inappropriately (but without considering potentially admissible parol evidence) concluded that the word "participant" referred to every person, such as Pitts, involved in the construction, as opposed to "contractors and subcontractors, other than mere suppliers, that fulfill the requirements to enroll in [the] OCIP." *Id.* at 778.[3]

Second, the Supreme Court decided that even if Pitts could be classified as a "participant," he was not an "intended beneficiary" of "every provision of the OCIP addendum," noting that the Court of Appeals "failed to identify the specific contractual provisions of which Pitts was an intended beneficiary," and whether or not Pitts could be entitled, as a third-party beneficiary of the insurance provisions, "not only to benefit from insurance to defend *against* a claim of bodily injury from an automobile accident but to *make* such a claim." *Id.* at 779, 780 n.14. Finally, the Supreme Court also ruled that the Court of Appeals "appears to have erred" in deciding that the City had breached its contract with the general contractor by failing to make sure that every contractor of every tier, including the trucking company at fault in the accident, carried the required $10 million in automobile insurance. The Supreme Court concluded that its review of the OCIP addendum failed to identify a "promise by the City to ensure that subcontractors carried adequate insurance." *Id.* at 780.

While the Supreme Court concluded that the decision of the Court of Appeals "cannot be affirmed," it did not reverse the decision outright, but instead remanded the case for

[3] The Court of Appeals had noted, but was not persuaded, by language of the OCIP addendum that excluded "suppliers" and defined the term to include "a person or organization contractor 'to supply materials or equipment needed for the completion of the [construction].'" *Estate of Pitts*, 719 S.E.2d at 15 (alteration in original).

consideration of "certain parol evidence" that could be considered in construing the relevant contracts, including certain "admissions" by one or more defendants that might "supply an answer to all the unanswered questions that remain." *Id.* at 781. Interestingly, the Supreme Court did not address the ruling of the Court of Appeals finding that while A&G Trucking had never been treated as a subcontractor and had never enrolled in the OCIP, that it was a "subcontractor" required to have $10 million OCIP liability insurance for an injury for one of the subcontractors' employees. *Estate of Pitts*, 719 S.E.2d at 14-15.

Following remand, the Georgia Court of Appeals vacated its earlier decision and affirmed the trial court's entry of summary judgment to the City.

> As to the construction companies, however, after having applied the rules and canons of contract construction and considered parol evidence, we remain convinced that the parties to the contract intended a worker such as Pitts to be a third party beneficiary of the promises made by the construction companies to obtain the required minimum automobile liability insurance coverage and to ensure that their subcontractors of all tiers did so as well. We again find that the undisputed evidence shows that these promises were breached, that the Estate was harmed thereby, and that the exclusive remedy provisions of the Workers' Compensation Act do not apply. Accordingly, we again reverse both the trial court's grant of summary judgment to the construction companies and its denial of summary judgment to the Estate.

As of the writing of these materials, a petition for certiorari to the Georgia Supreme Court remains pending.

Making entities "Named Insureds" by reference to a blanket endorsement such as that quoted above has its advantages if there is a "glitch" in the enrollment process. Similarly, some policies broadly define insureds or "additional insureds"[4] to include contractors of every tier, if required by written contract. Otherwise, courts may require adherence to the enrollment process. *E.g.*, *Hartford Underwriters Ins. Co. v. Am. Int'l Grp., Inc.*, 751 N.Y.S.2d 175 (App. Div. 2002). *Accord, Workers' Comp. Fund v. Wadman Corp.*, 210 P.3d 277 (Utah 2009) (insurer not liable where general contractor negligently failed to enroll subcontractor). To protect the workers' compensation system, a few states require the insurer to pay regardless of a mistake in the enrollment process. *E.g.*, Kan. Stat. Ann. § 40-5403 (2000).

Responsible parties can be held liable for a failure to procure the promised CIP insurance. *SMI-Owen Steel Co. v. Marsh USA, Inc.*, 520 F.3d 432 (5th Cir. 2008) (the sponsor's broker misrepresented that professional liability insurance extended to all OCIP participants when in fact it was limited to the general contractor); *Estate of Pitts*, 719 S.E.2d at 15 (owner and contractors held liable for excess judgment shortfall because subcontractor/hauling company not enrolled in OCIP and therefore did not have required $10 million CIP limits).

[4] Depending on the form of policy's "additional insureds" endorsement, even if you qualify as a blanket "additional insured," your rights may be, and often are, substantially less than your rights as a "named insured" in a CIP.

Unfortunately, as a practical matter, it may be difficult, if not impossible, to prevent these disputes. Even if the policies' and the contractual language is co-extensive, multiple subcontractors', suppliers' or haulers' contracts, purchase orders, scopes of work, standard terms and conditions, etc. may not be. To make matters worse, many liability policies expressly exclude insurance-related negligence, errors or omissions.

Advice: Be certain that "named insureds" in the CIP policies track precisely contractually-defined parties. Understand precisely which persons, entities and which activities are or are not included. As a participant, be sure you are enrolled and retain your paperwork in case you need to prove this fact in the future. Do not rely on the program sponsor or the CIP administrator to do this for you.

Scope of Coverage

CIP coverage is typically limited to on-site risks, losses and casualties. Particularly given modern construction practices, determining whether an accident is an on-site or off-site loss may not be straightforward. For example, steel assemblies or subassemblies may be specially manufactured and then brought on-site for final assembly and installation. *See, e.g., Zurich Am. Ins. Co. v. Pa. Mfrs. Ass'n Ins. Co.*, No. A-4260-01T1, 2003 WL 23095605 (N.J. Sup. Ct. App. Div. May 7, 2003) (unpublished) (Zurich argued leaking windows were not an on-site exposure since the shop drawings were not prepared on-site and the windows had been manufactured and tested off-site. The court concluded that the occurrence was when the windows were installed at the site.)

Difficulties can also arise from a terse description of the covered project site. The contract documents, the CIP manual, and the policies must define the "Project Site" in the same way. If the CIP endorsement refers only to a street address, it can be difficult to determine if coverage includes access roads, adjacent lots, staging areas, storage areas, project offices, trailers, parking areas, etc.

Even if coverage is extended to "incidental areas," those may need to be specifically defined. Simple mistakes can also occur. For example, in *Chase v. Terra Nova Industries*, 728 N.W.2d 895, 900 (Mich. Ct. App. 2006), a contractor on an unrelated project claimed coverage under a OCIP because the unrelated project fell within the literal description set forth in the order establishing the OCIP.

Even if the initial CIP policies provide comprehensive coverage for the "project site," appropriately defined, because many projects continue for several years, the CIP participants run the risk that sometime during this period, one or more CIP insurers may cancel, refuse to renew, or materially change their policies. If this happens, the other participants need to be sure that they will be promptly notified of the change and that notice will not be limited to the Sponsor, as the first named insured. Otherwise, they can have a nasty surprise when the claim arises. Insurers are not likely to agree to provide such notice to all participants, but they sometimes will agree to provide notice to both the Owner and the general contractor. In any event, the Sponsor and the CIP Administrator can be required to provide such notice.

Advice: Be sure the description of the "project site" is consistent with contractual documents and with the risks of loss. Be sure you are entitled to notice of any material change in the CIP program.

Limits

Higher coverage limits, particularly as compared to the limits of lower-tier subcontractors' policies, are typically available in a CIP. Under the traditional approach, each contractor must procure its own insurance as required by the contract documents. CIPs can provide higher limits and broader coverage than smaller, disadvantaged, and/or minority contractors may be able to buy. CIPs can, therefore, give increased opportunities to such contractors to participate in large, complex projects. *See*, *e.g.*, Brief of *Estate of Pitts v. City of Atlanta*, 719 S.E.2d 7 (Ga. Ct. App. 2011), *vacated and remanded sub nom.*, *Archer W. Contractors, Ltd. v. Estate of Pitts*, 735 S.E.2d 772 (Ga. 2012), *appeal after remand*, 746 S.E.2d 698 (Ga. Ct. App. 2013) (Pet. for cert. pending).

At the same time, the limits are shared among all program participants and liability aggregate limits might be eroded by a single large claim. Whether the limits are adequate will depend on a number of things: whether they reinstate annually or at the insured's option following a catastrophic claim, whether they span the entire project, whether they apply per project. A rolling CIP's limits, of course, need to be compared to the risks and values in all of the projects subject to the limits. Given a CIP's shared limits, it is often difficult to predict how an excess, uninsured judgment would be allocated among the various insureds.

For all of these reasons, it is prudent to have the Owner's or contractor's own liability programs respond on an excess, "difference in conditions" basis (although this may reduce the cost savings usually anticipated with a CIP). Furthermore, you should consider requiring the Sponsor to purchase an automatic limits reinstatement in the event of a catastrophic claim.

Advice: Carefully assess the scope of coverage and limits available under the CIP. Insist on reinstatement rights to protect against premature impairment or exhaustion of limits. Owners and large contractors should consider having their own insurance programs apply on an excess, "difference in conditions" basis.

Duration of the CIP

Usually a CIP continues until project acceptance by the Owner or the project is "complete." Setting aside "completed operations" coverage which is discussed below, such termination provisions can be problematic. It is not always clear when a project, or a portion of it, will be deemed "complete." Standard general liability policies often provide that "Your Work" will be deemed completed at the earliest of the following times:

- **(a)** When all of the work called for in your contract has been completed.
- **(b)** When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.

(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as complete.

Other policies may have similar provisions or may also deem the project "complete" whenever a temporary or permanent certificate of occupancy is issued. Please note that under the standard GL provision, a participant's work may be deemed "complete" months or even years before the overall project is "complete."

Furthermore, one needs to insure that the CIP coverage continues for hot testing and commissioning (if applicable), "punch list" work, warranty work, "rework," and other continuing activities. If the CIP is prematurely terminated, the CIP insurers may say that a loss arises out of ongoing operations – which are no longer covered – and yet does not trigger "completed operations" coverage either.

ISO form CG 21 31 can be used to provide coverage under the contractors' regular programs where a wrap-up has been terminated (except where the CIP aggregate limits have been exhausted) if (but only if) the insured timely notifies its carrier of the CIP termination. This is often not a workable, much less a complete, solution. For one thing, having a gap in time between the CIP carriers' being on the risk and the remaining participants' carriers assuming that risk leads to coverage disputes where neither group is willing to step up to the claim. For another, many contractors' policies may have "wrap-up exclusions" which must be deleted. Third, amalgamating many individual coverages is unlikely to be the equivalent of the CIP program. For all of these reasons, it is preferable to negotiate up-front with the CIP insurers coverage for these "tail-end" activities.

Advice: Ensure that appropriate extension endorsements are negotiated as long as any construction-related activities are occurring.

Completed Operations Coverage

Perhaps no area is litigated more often or more intensively than are completed operations claims. In a typical CIP liability policy, policy limits may reinstate on an annual basis during construction. In contrast, a single "completed operations/products liability" limit applies to the entire CIP completed operations period. It is critically important that the CIP policies provide PCOH coverage for the full statute of repose period on a primary, non-contributing basis. Otherwise, if participants' policies have "wrap-up" exclusions, they will have no protection against this major risk.

Different insurers have different form "completed operations extension" endorsements. One often-used endorsement provides:

Endorsement Completed Operations Extension.

> This endorsement modifies insurance provided under the following: Commercial General Liability Coverage Part.
>
> Schedule: ABC LLC's commercial office building expansion contract.
>
> Completed operations coverage is extended for the project described in the above schedule for a period of six years (extended completed operations). <u>The extended completed operations period will commence when that portion of the project is put to its intended use, or a temporary or permanent certificate of occupancy is issued</u>. Failure to protect or maintain completed portions of the project by the owner or the contractor will invalidate coverage.
>
> The extended completed operations limit of insurance is $5 million per project and in the aggregate for the term of the project including the extended completed operations period.
>
> All other terms and conditions remain unchanged. (emphasis added.)

Given the partial completion wording highlighted above, this may not extend coverage for as long as necessary, including where the running of the statute of repose may be tolled for some reason. Indeed, all extended coverage might be forfeited if the Owner does not (or cannot) insure the property before "final" completion. The endorsement also provides that "failure to protect or maintain completed portions of the project by the owner or the contractor will invalidate coverage."

As discussed earlier in the section dealing with CIP termination, care must be taken with the language triggering the completed operations coverage. For example, what happens when:

- Different portions of a project are "complete" at different times?
- Construction resumes after a temporary certificate of occupancy expires?
- Work on the penthouses continues after the lower floors are occupied?

Furthermore, if the completed operations extension endorsement goes into effect before the entire project is "complete," the extension may not provide protection for the entire statute of repose period.

What does it mean that "failure to protect or maintain completed portions of the project by the Owner or the contractor will invalidate coverage"? How long must the Owner or contractor "maintain" the project? Does negligent maintenance invalidate coverage? If the burden to protect or maintain shifts to the Owner at some point, why should the general contractors' and other CIP participants' completed operations insurance be invalidated? They have no control over the Owners' actions. This can be especially problematic in condominium

developments where typically ownership is shifted to the homeowners' association or regime. Water intrusion or construction defect cases are often defended by claiming that the problems are due to the owners' ignoring maintenance requirements.

An IRMI article advises that "the [standard] ISO form [defining when "Your Work" will be deemed "complete"] considers repair and warranty work on previously wrap-up construction at the site as a part of the completed operations definition. Contractors need not worry about that coverage because they are still protected by the wrap-up for the completed operations extended term. The only concern remains the premises/operations exposure."[5] This *should be* true; however, I strongly advise that this be confirmed in writing with the CIP insurers up-front or a special manuscripted endorsement be negotiated.

It should go without saying that all other PCOH issues need also to be considered and appropriate manuscripted provisions negotiated for the program. In particular, under no circumstances should a CIP policy eliminate the "subcontractor exception" to the "Your Work" exclusion, as some carriers have started to do. Astoundingly, some CIP policies for residential construction have had a residential construction exclusion.

Advice: Be sure you have negotiated PCOH CIP coverage through the entire statute of repose period. Ensure/confirm that you also have ongoing premises/operations coverage for any tail-end or post-construction activities.

Cost Savings

Most authorities suggest one can expect significant savings in overall insurance costs with the use of CIP as compared to a traditional insurance program. Realization of these savings, however, requires that you accurately capture the avoided insurance costs of all project participants' carrying their own coverages. This is not always easy to do. You must determine what amount would have been charged to the project if there were no CIP, and whether it will be truly avoided by using a CIP. Furthermore, the general contractor or the prime subcontractors may continue to have their own insurance programs apply on a "difference-in-conditions" and excess basis (see below), which may depress the savings. (The contractor should insist that these costs reduce the insurance credits granted the Owner because of the OCIP.) *See* discussion of "wrap-up" exclusions below. Moreover, many large contractors already have a robust safety and loss-prevention program with a loss-sensitive insurance premium arrangement in place, which may make further significant improvement in insurance costs difficult to obtain. At the same time, monthly CIP reporting, payroll audits, and the initial cost and expense associated with the bidding process and establishing the CIP can increase CIP costs.

Traditionally, most experts advised that a project needed to be in excess of $100 million before a CIP makes economic sense. More recently, amendments to states' anti-indemnity statutes have pushed construction participants toward CIPs, which in some states provide insurance "safe havens." The 2013 amended ISO "additional insured" endorsements may also drive toward increased use of CIPs. At the same time, some states by regulation bar a CIP unless

[5] Richard Besnick, *Wrap-Ups and Their Inevitable Termination* (April 2011), *available at* http:/www.irmi.com/expert/articles/2011/resnick04-wrap-up-insurance.aspx.

there is a minimum amount of project value.[6] *See State, Dep't of Commerce, Cmty. & Econ. Dev., Div. of Ins. v. Alyeska Pipeline Serv. Co.*, 262 P.3d 593 (Alaska 2011).

Advice: Carefully document cost savings. Be sure to check any regulatory CIP requirements in the relevant jurisdiction. Carefully consider the interplay among the CIP, contractual indemnity and/or insurance requirements, and relevant anti-indemnity statutes.

Financial Considerations

Some of the principal coverages often provided by CIPs, especially for liability, including professional liability, usually carry substantial deductibles or self-insured retentions – $250,000, $500,000, or even $1 million per claim or occurrence. Although the deductibles may be capped at an aggregate amount (often a percentage of payroll), the potential exposure of the CIP Sponsor for such amounts can be several millions of dollars. Moreover, this exposure continues until the last claim is finally resolved – which is often several years after the project is complete – and in the case of significant "completed operations" claims can be many, many years later.

The insurer(s) will require an evergreen letter of credit or other collateral to secure payment of such deductibles. The Sponsor needs to be able and willing to assume this responsibility. At the same time, the other participants need to think about what happens if the CIP Sponsor goes bankrupt, becomes insolvent, or is otherwise unable or unwilling to continue to discharge its responsibilities. Although insurance companies insist that the CIP Sponsor, as the first named insured, have certain plenary responsibilities – such as paying premiums and deductibles – the parties can, and do, reallocate those responsibilities among themselves in the contract documents so that they share the CIP's risks and rewards. It goes without saying that such "partnered" CIPs need to carefully negotiated and documented.

Please be aware the some policies have been held to require that only the Named Insured, sometimes only the first Named Insured, can satisfy the deductible or self-insured retention ("SIR"), leaving an "additional insured" with no ability to recover under the policy. *E.g.*, *Forecast Homes, Inc. v. Steadfast Ins. Co.*, 181 Ca.App.4th 1466 (2010). Others have held that a SIR or deductible must be paid in cash and remain uninsured, negating the ability to satisfy a deductible or SIR by other insurance payments. One must carefully examine the CIP policies to ensure that one is not caught in a deductible or SIR "trap."

One should also consider the "number of occurrences or claims" issue under the particular jurisdiction's law – a topic which is beyond the scope of this paper – but which can result in the imposition of multiple deductibles or SIRs for a single integrated loss. One approach to this latter problem is to negotiate an aggregate limit on all deductibles or SIRs or to add a "batch" or "integrated occurrences" clause, permitting the insured the option of aggregating all related claims or losses for purposes of deductibles, SIRs, and limits.

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[6] *E.g.*, Mich. Comp. Laws Ann. § 418.621(3) (1999) (no workers' compensation CIP unless construction costs exceed $65 million and must be authorized by Michigan insurance director). Some jurisdictions do not allow "rolling CIPs." *E.g.*, N.M. Stat. Ann. § 52-1-4.2 (2003) (no rolling workers' compensation CIP; minimum of $150 million within five years construction value at a single site required).

Advice: If the financial CIP risks and rewards are going to be shared among the Sponsor and other parties, which can inure to everyone's benefit, be very careful. Be sure you have "back-up" protection – or the ability to get it – in case the Sponsor becomes unable or unwilling to continue to discharge its CIP duties and responsibilities. Consider the total potential exposure for deductibles and self-insured retentions and be sure you have the ability to satisfy them.

Coverage Terms and Conditions/Selection of Carriers

In the traditional insurance delivery context, the Owner, general contractor or upper-tier subcontractors often find themselves dealing with insurers or coverages as "additional insureds" under lower-tiered subcontractors' policies that are significantly less satisfactory than their own. A CIP permits the Sponsor to avoid this situation. Moreover, because CIPs are usually used with large projects, there may be more and better capacity and competition in the insurance market for these programs.

However, many large developers or contractors have negotiated impressive insurance programs tailored to their particular risk profiles, which the CIP may or may not emulate. Even with a CIP, there remains a need for other insurance (off-site risks, product liability, auto, sometimes professional or environmental liability). Many contractors may continue to have their own programs apply on an excess, difference-in-conditions basis. The potential for coverage gaps and other unintended consequences by using a CIP with these other programs exists.

Advice: Again, carefully assess the scope of coverage and limits available under the CIP. Insist on reinstatement rights to protect against premature impairment or exhaustion of limits. Owners and large contractors should consider having their own insurance programs apply on an excess, "difference in conditions" basis.

Wrap-up Exclusions

It is customary for the CIP participants' own policies to include a "wrap-up exclusion." Indeed, having such exclusions is at the core of the cost savings' advantage claimed for CIPs. However, this can lead to a large coverage gap: particularly for large experienced contractors, the CIP coverage may not be as broad as its negotiated program. Although it does not happen often, CIP limits have been exhausted by large claims. As alluded to earlier, the CIP can have "glitches." Finally, inexplicably, some CIP policies themselves have "wrap-up exclusions." Presumably, it would violate Georgia's public policy to enforce such an exclusion. *Barrett v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 696 S.E.2d 326, 330 (Ga. Ct. App. 2010) ("It would violate the public policy of Georgia to allow National Union to sell a liability policy to cover AGL whose main product is natural gas, which policy contains an exclusion for damages resulting from such natural gas.")

To avoid these coverage gaps, it is far better for a party's own program to apply on a true excess, "difference-in-conditions" basis. This way, a contractor has its own insurance to fall back on if the CIP program does not respond. However, this risks diluting the cost savings for a CIP and can lead to coverage disputes, particularly over priority of payments and contributions. *See* next section. In that instance, the financial impact can be severe because such large, ongoing

programs often incorporate substantial self-insured retentions, deductibles, or other loss-sensitive premium arrangements. Without careful consideration, a contractor could unexpectedly find itself paying for a loss that it thought had been transferred to the CIP. These risks must be balanced against the risk that the CIP may not provide all the necessary protection.

Advice: On balance, having the Owners', general contractors', large subcontractors' and professionals' programs apply on a true excess, "difference-in-conditions" basis rather than having a "wrap-up" exclusion provides a needed degree of protection.

"Other Insurance," Priority of Payments, and Contribution

The contracting parties' expectation is that CIP insurance will be primary – that is, it will respond first – and non-contributory – that is, the CIP insurers will not seek contribution from the CIP participants' other, potentially applicable insurance. Indeed, one can argue that this is the crux of a CIP program. It is also a reflection of the insurance industry's "closer-to-the-risk" doctrine: the insurer who is "closest to the risk" should pay first and exclusively until the policy's limits are exhausted.

Unfortunately, without careful attention to the "other insurance" clauses in the primary CIP policies and the parties' own policies and to the definition of "underlying insurance," "other insurance," "exhaustion," and related clauses in the excess policies, this intent may be frustrated. For example, CIP excess/umbrella carriers have argued that they apply only on an "excess basis." In other words, some excess/umbrella CIP insurers contend that *all* underlying, potentially available insurance must first be exhausted before they must pay. They argue for so-called horizontal, not vertical, exhaustion. Thus, in *Zurich Am. Ins. Co. v. Pa. Mfrs. Ass'n Ins. Co.*, No. A-4260-01T1, 2003 WL 23095605, at *5 (N.J. Sup. Ct. App. Div. May 7, 2003) (unpublished), Zurich, the excess OCIP carrier, argued that it was excess to an enrolled contractor's own program policy. The court looked beyond the policies to the contract documents and rejected the argument. *Cf. Va. Sur. Co. v. Adjustable Forms, Inc.*, 888 N.E.2d 733 (Ill. App. Ct. 2008) (guaranty fund that assumed Reliance's OCIP policies argued that employer's workers' compensation carrier should pay). Other jurisdictions may not permit reference to extrinsic evidence beyond the policy's terms and conditions. Thus, in *National Union Fire Insurance Co. of Pittsburgh, PA v. American & Foreign Insurance Co.*, No. CV-04-7257 PA (PLAx), 2006 WL 4757339 (C.D. Cal. Feb. 9, 2006), the court held the contractor's practice policy to be primary. In that case, the OCIP manual, like many others, declared that the terms and conditions of the policies controlled.

A decision from the Georgia Court of Appeals, *Northland Ins. Co. v. American Home Assur. Co.*, 689 S.E.2d 87 (Ga. Ct. App. 2009), suggests that this could be an issue under Georgia law. WalMart had hired Pro-Carriers, Inc., a trucking company, to transport a loaded trailer from Alabama to Florida, and Pro-Carriers had hired Mr. Williams as the driver and leased his tractor. Unfortunately, Mr. Williams was involved a serious motor vehicle accident on his way to Florida. The trucking company, Pro-Carriers, had a $1 million primary policy, as did Mr. Williams. Pro-Carriers also had a $1 million excess policy issued by Lexington. WalMart had an American Home $10 million policy with a $5 million deductible. Tort claims arising out of the accident were settled for $4,534,000.00 – $1 million paid by the driver's policy and $1

million paid by Pro-Carriers' primary policy. WalMart paid $2,534,000.00 under its $5 million deductible. Lexington, Pro-Carriers' excess policy, paid nothing. All parties reserved rights, and litigation ensued over which policy should pay. Because both WalMart's and the driver's policies had mutually-repugnant excess "other insurance" clauses, the court held that they paid on a basis proportional to limits. Thus, WalMart's American Home policy was obligated to contribute 10/11 ($3,212,727.00) of the settlement after payment of the first $1 million by Pro-Carriers' primary policy. Lexington, Pro-Carriers' excess policy, still paid nothing. As a result, contribution by the at-fault driver's policy was reduced from $1 million to $321,273.00.

The court rejected the argument that because WalMart's policy had a $5 million deductible, it was not "any other collectible insurance" so as to trigger the proportional sharing of responsibility. *Id.* at 90-91. To the contrary, the court held that the policy clearly provided for WalMart's insurer to pay claims from the first dollar and then seek reimbursement from WalMart up to its deductible limit. In short, WalMart, not the at-fault driver's nor the trucking company's policies, ended up paying the bulk of the loss out-of-pocket even though the accident was not WalMart's fault. *Cf.*, *Air Liquide Am. Corp. v. Cont'l Cas. Co.*, 217 F.3d 1272, 1279 (10th Cir. 2000) (holding that a policy constituted "other collectible insurance" notwithstanding insured's obligation to fully reimburse insurer for any losses).

Advice: Carefully draft endorsements in all CIP policies, primary and excess, all layers, to ensure that they will pay on a primary, non-contributing basis, as intended.

Excess CIP Tower

In several instances, a lot of attention was given to the primary CIP policies, but much less attention to the excess tower. This can be a devastating mistake. Even if excess policies are called "following-form," that is, they apply on the same basis as the underlying "followed" policies, they can, and often do, contain endorsements significantly changing the coverage. Some excess CIP policies exclude claims by one participant against another (a cross-suits endorsement). Others exclude completed operations claims even though the primary CIP policies provide completed operations/product liability ("PCOH") coverage. As noted earlier, some excess policies may have exhaustion/"other insurance" clauses that mean that they do not respond at all to a contractor whose insurance program does not have a "wrap-up" exclusion. Indeed, some CIP policies exclude:

> Property Damage to Owner's Property Exclusion
>
> It is agreed this policy does not cover loss or damages to the project, to the Owner's facility that incorporates this project, nor to loss of use of either the project or the facility.

One must ensure that this exclusion is not in any CIP policy. Defense costs may deplete limits even though they do not do so in the primary layer. In short, in many instances, the excess policies do not track the primary CIP policy at all, much less precisely.

Moreover, although less common, this can be true as well for upper-layer excess policies – different layers may include unexpected limitations of coverage. To make matters worse, depending on exhaustion and other provisions, if an intermediate-layer excess policy does not respond, one may also lose the ability to get any money from any of the higher layer carriers. Because CIPs are normally used only on sizable projects, the maximum potential loss exposure can be millions of dollars. An inability to access the entire excess tower can be financially devastating – especially when one considers that the limits apply to all CIP participants, many of whom may have "wrap-up exclusions" and thus no other available insurance.

Advice: Pay close attention to all excess policies.

Settlements

Related to the excess exhaustion issue is the need to ensure that one can resolve coverage disputes with primary or lower-tiered insurers without jeopardizing all upper-level excess coverage. Some excess policies require exhaustion by payment by the lower-level insurers of covered losses – or words to that effect. They argue that if one settled a coverage dispute for less than payment of the full primary or underlying limits – the very definition of a settlement – one can never access the excess policy. One solution, again depending on policy language, is to permit payment of the underlying limits by the insurer or the insured.

Related to this is the requirement in some policies that the insurance pays only judgments after an actual trial and settlements to which the insurer consented. Although earlier jurisprudence tended to find such limitations unenforceable, following *Zieg v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir, 1928), the more recent trend is to enforce them as written. *See, e.g., JP Morgan Chase & Co. v. Indian Harbor Ins. Co.*, 947 N.Y.S.2d 17 (App. Div. 2012)*; Citigroup Inc. v. Federal Ins. Co.*, 649 F.3d 367 (2011). This, too, can result in the CIP excess insurer escaping liability.

Also, be very careful if any CIP policy will be placed in the London market or governed by U.K. law. The Court of Appeals has recently affirmed a decision that one must show that on the probabilities, one would have been liable for at least the amount of the settlement – it is not sufficient to prove a reasonable settlement of a potential liability. *Astrazeneca Ins. Co. Ltd. v. XL Ins. (Bermuda) Ltd.*, 2013 WL 617292 (Queens Bench Division (Commercial Court) Feb. 28, 2013)), *aff'd,* 2013 WL 6537246, [2013] EWCA Civ 1660 (Dec. 20, 2013). Moreover, even the entry of a judgment in the underlying matter does not necessarily satisfy this burden. Even more surprising to American policyholders is that under English law, policies that reimburse defense costs do not do so where the defense is successful. Furthermore, with respect to product liability claims and perhaps some builders' risk claims, English authorities support an argument that, again depending on policy language, the insurance may not respond to a loss caused by a product that never existed in a non-defective state. *See, e.g., Promet Engineering (Singapore) Pte. Ltd. v. Sturge and Others, (The "Nukila")*, [1997] 2 Lloyd's Rep. 146 ("A policy of insurance does not cover matters which already exist at the date when the policy attaches. The assured if he is to recover an indemnity has to show that some loss or damage has occurred during the period covered by the policy."). Discussion of the significant differences between English and the law prevailing in most U.S. states is beyond the scope of this paper. Suffice it to say, if any of the

CIP will be placed in London or governed by English law, careful analysis needs to be undertaken to ensure that the insurance provides the protection normally expected by Americans.[7]

Workers' Compensation Statutory Bar

States are split whether the sponsor of a CIP is entitled to the protection of the workers' compensation statutory bar. In *Pogue v. Oglethorpe Power Corp.*, 477 S.E.2d 107 (Ga. 1996), the Georgia Supreme Court, answering a certified question from the United States Court of Appeals for the Eleventh Circuit, held that a premises owner was not entitled to statutory tort immunity, despite the fact that it had purchased a wrap-up insurance policy to provide workers' compensation insurance coverage for all on-site contractors. *Accord, Pride v. Liberty Mut. Ins. Co.*, No. 04-C-703, 2007 U.S. Dist. LEXIS 40833, at *12 (E.D. Wis. June 5, 2007) ("[I]t does not matter, in other words, how various contractors on the same project decide to divy up costs for insurance coverage: whether each subcontractor buys his own insurance or whether they all fall under the policy purchased by the developer, their own contractual arrangement for insurance purposes does not transform nonemployers into employers."). In *Estate of Pitts*, *supra,* the Court of Appeals ruled that A&G Trucking was not Pitts' statutory employer, and O.C.G.A. § 34-9-11(a) did not bar the employee's contract claim for failing to insure; however, like the other OCIP issues discussed above, the Georgia Supreme Court ruled that if, on remand, the lower court concluded that Pitts was in fact an intended beneficiary of the insurance clauses of the construction contracts, the court also should consider whether §34-9-11(a) should apply to claims for breach of those provisions. 735 S.E.2d at 781 n.18.

Other courts have gone the other way. *HCBeck, Ltd. v. Rice*, 284 S.W.3d 349 (Tex. 2009) (general contractor "provided" workers' compensation insurance coverage to subcontractor and its employees and was therefore immune). *Accord, Stephenson v. HH & N/Turner*, No. 01-DV-71705-DT, 2002 U.S. Dist. LEXIS 26831, at *39 (E.D. Mich. Apr. 22, 2002) ("Allowing Plaintiff to recover in a common-law tort action in the case at bar would contravene the entire policy behind the OCIP in this case: to reduce the cost of insurance and to allow for a coordinated risk management and safety program at the Project for all program participants and insureds ….") *Accord, Etie v. Walsh & Albert Co.*, 135 S.W.3d 764 (Tex. App. 2004) (extending statutory employer status to lower-tier subcontractors) and *Wenzel v. Boyles Galvanizing Co.*, 920 F.2d 778 (11th Cir. 1991).

Advice: Be sure you are knowledgeable about the particular jurisdiction's stance on this issue – and that you have coverage if you are not entitled to the statutory bar.

Joint Defense

Another issue to be considered up-front is how the CIP participants will be defended. Many CIP policies essentially provide for a joint defense, absent an actual conflict of interest.[8]

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[7] Even where the policy is governed by New York law, if coverage is litigated or arbitrated in London, the decision-makers may be influenced by these English precepts.

[8] Ethical rules, statutes or regulations may limit enforceability of this provision in some jurisdictions.

Because different states may not consider a mere reservation of rights to give rise to an actual conflict, this, too, should be negotiated up-front. Separate defense counsel should be provided for participants whose interests may diverge, and the use of joint counsel limited to where the CIP carrier has without reservation confirmed coverage and the CIP limits are sufficient to cover the entire joint maximum loss exposure (including defense costs where appropriate).

Advice: Be sure to address at the outset whether and under what circumstances you will be defended by a lawyer who owes duties only to you.

Conclusion

Obviously, it is impossible to address in writing all issues that can (and do) arise with an OCIP, CCIP or other wrap-up. This article has highlighted a few of them and has tried to give some practical tools to use in dealing with them. Some (like "additional insureds," notice of coverage termination or modification, and "other insurance"/priority of payments) are fairly intractable and may require a major, on-going joint development effort by the insurance and construction industries to solve. In the meantime, we hope that this article provides some useful ideas about how to approach them.