Paper Title: Working with OCIPs: Practical and Technical Strategies for Building an Effective Program

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Session Title:
Working with OCIPs: Practical and Technical Strategies for Building an Effective Program

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Gregory D. Podolak has spent his entire career advocating on behalf of policyholders and, over more than a decade, has handled issues involving all lines of coverage. His litigation practice includes successful arguments in courts in multiple jurisdictions, including a $40 million builder's risk claim in New York federal court involving previously unsettled issues of law related to coverage for construction scheduling impact costs; a Florida Supreme Court case ruling that a notice of right to repair is a "suit" and placing the burden on insurers to show why the defense of such a process should not be provided; and a case before the New Jersey Supreme Court holding that damages caused by construction defects trigger CGL insurance.

In addition to an active practice, Greg frequently collaborates with national insurance brokerage firms and regularly speaks and authors articles on a variety of insurance coverage topics.

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Wrap-ups, otherwise known as consolidated insurance programs (“CIPs”), are insurance programs that provide coverage for all or most parties involved in a large-scale construction project. Typically, this includes the owner, general contractor, and subcontractors. Wrap-ups provide various types of coverages for enrolled parties, including general and excess liability, workers compensation, employer’s liability and, occasionally, builders risk. This insurance arrangement functions as a streamlined alternative to traditional risk transfer schemes. Instead of procuring their own individual insurance and executing corresponding trade contracts outlining the insurance requirements, parties enroll in the CIP and benefit from the single program that usually also includes a cost-savings for subcontractors.

The wrap-up concept has applications to various sectors of the construction industry and can be used for a diverse array of projects. The use of wrap-ups can potentially maximize various goals: (1) save money on insurance costs; (2) ensure the participants have adequate or better coverage than available outside a wrap-up; (3) improve jobsite safety; (4) improve claims outcomes; and (5) reduce defense costs.

Wraps come with their own unique nuances, however, and it is crucial for all stakeholders to be familiar with these considerations to best refine and define the goals of the program and ensure the best change for the goals to be met. The following discussion focuses on important coverage considerations in crafting an appropriate wrap-up, as well as issues that can limit or eliminate coverage.

I. Coverage Considerations

a. Coverage Territory: Site-Description

A fundamental consideration in crafting a proper wrap-up is the site description. The CGL policy for a wrap-up only applies to damages related to the project, effectuated by an endorsement limiting coverage to the location of the project. Many wrap-ups use a standard endorsement drafted by the Insurance Services Office (ISO), which limits the coverage geographically; there are innumerable manuscript versions that adopt a similar approach. On a macro level, using physical confines to describe the scope of coverage inherently presents challenges, as the nature of project risk is not always so neatly bound. Moreover, an imprecise description can inadvertently narrow the intended scope.

For example, using only an address to define the premises covered by the CGL policy for the wrap-up can create gaps in coverage when there are injuries or property damage on staging areas, adjacent lots, or other locations where offsite preparation work is being carried out. Additionally, an underdeveloped definition

1 ISO is a private organization that drafts and sells standard insurance policy forms that are utilized by most insurance companies.
of this nature can leave critical property or materials vulnerable, while needlessly providing coverage for buildings or areas at the address where construction is not taking place under the contract. Experienced insurance professionals use a site description that specifically accounts for these types of concerns.

Moreover, negligence or property damage that begins offsite can lead to disputes between carriers over coverage. For example, if an offsite fabricator damages portions of the material during preparation for transit to the project, it can create a dispute between the wrap-up insurer and the corporate insurer for that offsite fabricator.

As a practical consideration, when preparing the contracts for a project it is crucial to identify any offsite or incidental areas related to the project which should be listed on the ISO endorsement in addition to the project address or whether to include coverage for incidental areas generally. Practically speaking, the sponsor should ensure that coverage is as broad as its potential liability. If coverage is limited to the project site, but statute or common law leave the sponsor liable for injury or damage at locations incidental to the project site, coverage should be extended to those locations to close any gaps in coverage.

b. Adequacy of Limits

The parties will also have to make multiple decisions regarding limits of coverage under the wrap-up, including the per occurrence limit, the aggregate limit, and the limit for completed operations. In addition to the number of limits, there are several other issues that can impact coverage limits which parties must be aware of.

Parties should ensure that the limits in the wrap-up are dedicated solely to that project. For example, residential wrap-ups sponsored by developers often can have the limits of insurance shared between multiple projects. Parties should always inquire and ensure that the limits only apply to their project and are not reduced by other projects. This is of concern if a rolling wrap-up (used for multiple projects, with additional projects being added throughout the term of the policy) is being used. Should there be substantial losses at another covered project it could potentially exhaust the policies limits leaving no coverage for claims for the project at issue.

Additionally, it is important to determine how the limits of insurance apply. Limits of insurance should apply on an annual basis, and traditionally, insurance policy limits renew each year. However, under a wrap-up, the limits can apply for the entire duration of the project, which may be more than one year.

Keeping this in mind, parties should choose their necessary limits accordingly. Greater limits may be necessary if they do not renew annually. If the limits of
insurance do not renew each year, losses early in the project could cause the limits of insurance to be inadequate for the remainder of construction.

In determining the appropriate limits for coverage, it is also important to factor in whether defense costs are within the policy limits. Standard CGL policies generally place defense fees and costs outside of the limits of insurance, meaning that those fees and costs do not erode the coverage available. However, defense within limits has become increasingly common in wrap-up policies.

When defense is inside limits, all defense costs, such as attorney’s fees, court costs, investigation and filing legal papers, are deducted first from the policy limit, which cuts into the overall limit of dollars available to pay for claims. In multi-party construction defect litigation, these expenses accumulate exponentially, based on the pervasiveness of the damage and, as a result, the expansion of potentially responsible parties. Each implicated entity comes with its own set of lawyers, consultants, and experts, and it’s not uncommon to have between 10 and 20 parties involved.

When contemplating the necessary limits for coverage, it is important to keep these issues in mind. If the policy limits do not renew annually, or defense is inside the limit, higher limits may be required in order to adequately cover any liability.

c. Completed Operations Coverage

The term “completed operations” is shorthand for the coverage provided by CGL policies for damage or injury that takes place after the project is complete. The coverage under the CGL policy for construction claims can be broken down into: (1) “ongoing operations” or “GL” coverage for damage/injury during construction; and (2) completed operations coverage for damage/injury occurring after project completion. The policy refers to completed operations coverage as the “products completed operations hazard.” This more general term is used in the policy because CGL forms are used to cover business risk for many different types of policyholders, not just construction companies. Thus, the products completed operations hazard coverage includes coverage for any liability an insured may have after its product is issued (in the case of a manufacturer or craftsman) or operations are complete (in the case of a builder).

In crafting an appropriate wrap-up, it is important to consider the length of the completed operations period, and whether it covers the statute of repose in the state in which you are working. Additionally, it is important to remember that any extended completed operations period will only commence when that portion of the project is put to its intended use. This is something to be mindful of when dealing with renewals of policies. If the sponsor does not renew the policy and it expires prior to the completion of the project, or the project being put to its intended use, the extended completed operations period may never be triggered and therefore unavailable should there be a loss later.
i. Repair Work Endorsements

Adding an additional wrinkle to the completed operations assessment are “repair work” endorsements. These endorsements are often misunderstood and generally treated as coverage enhancements, but many provide no additional coverage and if improperly crafted, can risk reduction of coverage otherwise provided as part of the products-completed operations extension inherently provided by the wrap GL.

The common feature of these endorsements is a grant of coverage for bodily injury and property damage resulting from “repair work” for a specified period. Most endorsements define “repair work” to mean the repair of completed work performed pursuant to a contract or warranty.

Generally, completed operations coverage covers bodily injury and property damage “arising out of” your product and your work, and includes work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete. Therefore, when a policy grants an extension of coverage for completed operations, it grants coverage for bodily injury and property damage arising out of the repair of completed work.

In contrast, repair work endorsements provide coverage for the repair, correction or replacement of “your work” which is performed after “your work” was originally completed, and often states that it does not apply to liability included in the “products-completed operations hazard.”

Repair work endorsements typically do not explain how to reconcile the inconsistency between that endorsement and the fact that completed operations coverage extensions include coverage for repair work. Now consider the fact that most completed operations coverage extensions provide coverage to the applicable statute of repose or 10 years, whereas most repair work endorsements provide an extension of only 2 years. The risk is that an insurer having issued a policy including both a repair work endorsement and a completed operations coverage extension would argue that claims for injury or damage arising out of repair work are covered only for the period specified in the repair work endorsement. The argument would be that the repair work endorsement carved out a subset of the products completed operations coverage and limited its coverage period to the time specified in the repair work endorsement. In the typical policy, this means coverage for injuries or damages arising out of repair work is reduced from 10 years to 2 years. The courts have yet to tackle this issue, providing no guidance on how this inconsistency will be interpreted and reconciled.

In assessing the sufficiency of completed operations coverage, it is important to focus on the length of coverage, and how that coverage is triggered. If coverage is triggered based on completion of a portion of the project, and not the project, it
could leave insufficient coverage for the duration of the statute of repose. By knowing when and how the completed operations coverage is triggered, or by ensuring that it is not triggered until the project is complete, parties can assess whether additional completed operations coverage is necessary in order to prevent any gaps in coverage. Additionally, parties should be aware of any endorsements, such as the “repair work” endorsements, that can erode coverage for completed operations.

d. Deductibles and Self-Insured Retentions

Wrap-ups commonly includes some element of self-funding, a deductible or self-insured retention (SIR). Typically, the sponsor will pay the SIR; however, the construction contracts and wrap documents may provide otherwise. The basic rationale for having the sponsor pay the SIR is that the sponsor has the most control over the implementation of the program, as well as the safety and quality control standards on the project.

Principal stakeholders should understand the nature of their obligations at the outset of the project and make sure contract terms are clear. This will reduce the potential for friction when a claim arises.

e. Cross-Suits Exclusions

While more common in traditional insurance programs, an imprecise cross-suits exclusion can inadvertently frustrate the purpose of the wrap-up policy. Cross-suits exclusions preclude coverage for claims brought by one insured against another insured. Often these exclusions specify “Named Insured verse Named Insured,” but in a wrap-up context this is still problematic.²

In a wrap-up, this kind of exclusions can bar coverage for any liability one party to the wrap-up may have to another party of the wrap-up. For example, it could preclude coverage that an owner would want available from the general contractor’s general liability policy for any losses arising from its negligence, or the negligence of one of its subcontractors.

Although a wrap up is designed to help avoid litigation between the parties, the GL policy remains, at its core, a liability policy, usually written on an ISO standard form. Thus, although practical protocol by the certain insurers may require less formality, for a party to make a claim to the wrap-up insurance, they must make a claim against its insured. Therefore, if a cross-suits exclusion remains on the policy and is enforced, there would only be coverage for liabilities to third-parties not

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² As opposed to a traditional insurance program, where an owner or general contractor may be listed as an additional insured on a subcontractor’s policy, therefor still providing them the opportunity to pursue a claim against the Named Insured as they would only qualify as an “insured” or “additional insured.”
involved in the project. There would be no coverage for any loss to anyone insured under the wrap-up.

Practically speaking, the best option is to ensure that there is not a cross-suits exclusion to the wrap-up policy. A less drastic approach is to carefully review any cross-suits exclusions, and ensure they provide appropriate coverage for the project. For example, many cross-suits exclusions that exclude claims between subcontractors but provide coverage for claims involving the owner and/or general contractor, may be an efficient solution to prevent frivolous claims between subcontractors, while still providing necessary coverage for upstream parties.

II. Gaps Between Builder’s Risk Policies and Wrap-ups

The interplay between a wrap GL and builder’s risk insurance is also important to understand in order to prevent any gaps in coverage. By being cognizant of any so-called “builder’s risk” or “course of construction” exclusions contained in the wrap-up, parties can ensure the program functions as intended.

Builder’s risk insurance is first-party property insurance that covers property damage during construction of a project. It is commonly purchased through the owner’s standard property policy via endorsement, through the contractor’s master/rolling program, or by either party as a stand-alone project policy. At times, there can be friction over who should provide builder’s risk coverage. There are many factors that come into play: pricing, coverage specifications, claims experience, and administrative control. Ultimately, the best approach depends on the objectives of the participants, and frank, clear discussion about relevant considerations, followed by properly documented arrangement is key to avoiding unanticipated results and frustration.

In assessing coverage, it is important to be aware of any builder’s risk exclusions in the GL policy and their effects on coverage. There are several variations on these exclusions. One example is:

It is agreed that the following exclusion is added to SECTION I – COVERAGES paragraph 2. Exclusions:

“Property damage” caused by “your work” to any part of the Premises or Project designated in the endorsement entitled LIMITATION OF COVERAGE TO DESIGNATED PREMISES OR PROJECT before “your work” has been completed or abandoned as defined in the “Products-Completed Operations Hazard.”

This exclusion can also be expanded to the point of applying to all ongoing operations property damage, not just the specific project. As builder’s risk coverage is not often co-extensive with a wrap GL, it is important to exercise caution with these exclusions. The above example could potentially exclude coverage for third
party liability claims which would have been covered by the GL but are not covered under the builder’s risk policy.

Other examples of builder’s risk exclusions include endorsements that simply delete or exclude coverage otherwise provided by the GL. Typically this will include coverage for damage to property, damage to “your product,” and damage to “your work.”

An overly broad builder’s risk exclusion can leave parties without necessary coverage. However, these exclusions can also be limited to apply only to the extent of valid and collectible builder’s risk coverage or removed pending insurer review of the builder’s risk policy. This would be ideal as it prevents duplicative coverage, but still leaves the parties protected should a property damage claim arise. It should further be coupled with an appropriately narrow “cost of making good” (a/k/a faulty workmanship exclusion exclusion on the Builders Risk policy, either L.E.G. 2 or 3. These exclusions retain greater coverage under Builders Risk for ongoing operation claims involving defective construction, thereby reducing the risk of a liability claim requiring GL to respond.

Builder’s risk insurance protects parties from damage or destruction to their assets such as buildings, equipment, inventory, etc., while the building or project is under construction. In contrast, wrap-up coverage is essentially CGL coverage while a building or project is under construction. While builder’s risk insurance only covers first-party property damage claims, the wrap-up policy will typically cover potential bodily injury and property damage to third parties that occurs as a result of operations at the project.

Builder’s risk policies are rather specific in the coverage they provide. Coverage under this type of policy is limited only to the insured interest, and if the proper parties are not added as additional insureds (i.e. owner, general contractor, subcontractors) parties can find themselves without any means of coverage for losses.

To prevent any gaps in coverage, parties to a wrap should carefully examine any builder’s risk exclusions to policies in their wrap-up, and ensure that adequate builder’s risk insurance is obtained, and that all the necessary parties are included as insureds. By analyzing these policies together, parties can ensure that the coverage is complimentary and provides coverage for a broader range of liability.

3 There are three standardized exclusions developed by the London Engineering Group (L.E.G.). L.E.G. 1 is a total exclusion, providing no coverage in the event of a loss caused by faulty design, materials or workmanship; while L.E.G. 2 excludes only rectification costs for preventing damage. L.E.G. 3 provides the broadest coverage, excluding only improvements to the original material, design, or specification.
III. Wrap-Up Exclusions

While the existence of wrap-up exclusions on enrolled subcontractor’s policies is usually of no concern to the owner and general contractor, an overly broad wrap-up exclusion can fundamentally frustrate the intended risk transfer.

One potential gap in coverage is the unenrolled subcontractor. When a wrap-up is acquired, not all parties involved in the construction project are enrolled. Accordingly, general contractors typically require subcontractors who are unenrolled in the wrap-up to obtain CGL insurance, which covers the general contractor and owner as Additional Insureds. It is generally understood that if a liability claim against the general contractor involves the work of an unenrolled subcontractor, the unenrolled subcontractor’s CGL policy would respond first (i.e. before the wrap-up coverage is implicated). However, a broadly phrased wrap exclusion can eliminate Additional Insured access to the subcontractor’s policy, merely because the wrap exists, and irrespective of whether the subcontractor has access to it.

Courts typically engage in a straightforward application of the exclusionary language of wrap-up exclusions. Generally, this plain language interpretation produces the intended result: avoidance of duplicative coverage. However, when a court does not consider whether the subcontractor is receiving coverage under the wrap-up, the intent of the exclusion is overlooked, and risk transfer is frustrated.

The New York Appellate Division First Department held that a wrap-up exclusion contained in a subcontractor’s CGL policy barred additional insured coverage for a wrap-up project’s general contractor, even though the subcontractor was not enrolled in the wrap-up. The wrap exclusion contained in the subcontractor’s policy included standard wording, excluding coverage where a "consolidated (wrap-up) insurance program has been provided by the prime contractor/project manager or owner of the construction project in which you are involved." (emphasis added).

4 Consider also the scenario of the enrolled subcontractor with certain offsite responsibilities. In the wrong scenario (see discussion of project description, above) coverage may not be available.
Notwithstanding the fact that the subcontractor was not enrolled in the wrap-up program, the Appellate Division affirmed the lower court's reasoning that "[t]he language of the Exclusion does not require that [the subcontractor] be enrolled in the wrap-up program, but that the wrap-up insurance program exist and cover a bodily injury that arose from [the subcontractor's] operations." This holding is not reflective of the underwriting intent of the exclusion and does not accomplish the avoidance of duplicative coverage.

Overbroad wrap-up exclusions can be even more problematic as they can apply equally to named and additional insureds. A recent Florida Federal District Court decision has reinforced the dangers of these types of exclusions when the language of the exclusion is not carefully crafted. See TNT Equip. Inc. v. Amerisure Mut. Ins. Co., 2016 WL 5146198 (M.D. Fla. Sept. 21, 2016). In TNT Equip., TNT, an equipment lessor not involved in any onsite work, leased a mast climber to Stowell for stucco work on a hotel in Kissimmee (the “Project”). The TNT-Stowell lease required Stowell to include TNT as an Additional Insured under Stowell’s general liability policy. Although Stowell was enrolled in the Project’s CIP issued to the Project owner, Stowell possessed a corporate CGL policy as well. Subsequently the mast climber collapsed while in use, and an employee of Stowell’s subcontractor – harnessed to the equipment – fell forty to fifty feet.

The injured party sued TNT, among others, and TNT sought additional insured coverage from Stowell’s corporate CGL. However, the CGL policy had a standard controlled insurance program exclusion which stated, in pertinent part:

This insurance does not apply to bodily injury or property damage arising out of either your ongoing operations or operations included within products completed operations hazard if such operations were at any time included within a controlled insurance program for a construction project in which you are or were involved.

Although TNT performed no operations at the Project, the CGL insurer maintained that the Wrap-up Exclusion applied because the underlying claims were based on bodily injury arising from Stowell’s operations and that Stowell’s operations were covered by the CIP. The court ultimately found that the plain language of the wrap exclusion precluded coverage, irrespective of whether a controlled insurance program supplied adequate coverage or coverage identical to that of the corporate CGL policy.8

Hence, it is crucial for all parties involved, including all subcontractors, to understand the implications and dangers of these overly broad exclusions. It is not

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8 Id. at 6.
only crucial for proper risk transfer for the project covered by the wrap, but also for their own protection.

Given the influx of these exclusions, the importance for upstream parties in vetting their subcontractors for this coverage is starting to be on par with confirming additional insured coverage. Upstream parties may contractually prohibit wrap-up exclusions; however, this may not be practical and may not always produce the intended result. It may set the party up for a breach of contract claim for failure to procure insurance, but in some jurisdictions, the damages may be limited to out-of-pocket expenses.\(^9\)

Instead, general contractors should start an up-front dialogue to educate their lower tiers and insurance advisors on the effects of wrap-up exclusions. Solutions can include agreeing that the unenrolled party will endorse their policy to state that an existing wrap-up exclusion will not apply to the project, require a wrap-up excess endorsement instead of a wrap-up exclusion, and/or requiring the subcontractor supply a certificate of insurance including the forms list and declarations page from their CGL policy at the outset. Where the subcontractor provides a wrap-up exclusion with a schedule, the language in the schedule should be reviewed with scrutiny as a casual approach to filling it out could lead to an inaccurate application, even where the body of the endorsement otherwise presumably presents no issues.

IV. Workers Compensation Benefits

Workers Compensation (“WC”) insurance can also be added to wrap-up programs. While the related expense for this coverage can be significant, especially in the construction industry, the benefit afforded to the employer by acquiring WC coverage is also substantial.

When employers purchase WC insurance, they receive tort immunity for work-related injuries to their employees. This statutory restriction is known as the “exclusivity rule,” and under this rule, employee recovery is confined to medical expenses and injury (or death) benefits, which are based on the gravity of the injury and the resulting impact on wages.\(^10\)

\(^9\) For example, the rule in New York is that damages are limited to out-of-pocket expenses such as premiums and any additional costs incurred including deductibles, copayments, and increased future premiums. See Amato v. Rock-McGraw, Inc., 297 A.D.2d 217, 746 N.Y.S.2d 150 (2002).

The application of the exclusivity rule is usually limited to the direct employer of the injured worker. However, there is an exception to this general rule in the instance where the company directly employing the injured worker does not procure the required workers compensation insurance. In such cases, an overseeing entity, such as a general contractor, may be held to be a “statutory employer” (also referred to as a “principal employer”) and required by law to pay the injured employee’s workers compensation benefits. States impose this statutory obligation on certain upstream companies in order to provide a safeguard for workers if an actual employer fails to abide by its obligation.

A twist on the statutory employer rule occurs in instances where workers compensation insurance is purchased under a wrap-up program. This is due, in large part, to the fact that the owner (in the case of an OCIP) or general contractor (in the case of a CCIP) has acquired the workers compensation insurance protecting the subcontractors’ employees, thus arguably qualifying as a statutory employer in the literal sense. However, as there are distinctions between a traditional statutory employer situation, and the unique circumstances of an OCIP or CCIP, this has caused debate and friction between wrap-up participants, who on the one hand claim to be statutory employers and project employees and on the other seek to pursue tort claims against contractors other than their direct employers.

The workers compensation quandary involving wrap-up insurance programs has been addressed by a handful of courts across the country. The outcomes are varied, as are the explanations provided by the courts in support of their conclusions.11 Some states apply the exclusive remedy statute to wrap-ups,12 some do not,13 and some states are undetermined as there is no precedent on this issue.14

By taking the time to understand how the state governing the wrap-up treats the application of the exclusive remedy statute to wrap-ups, participants can make an informed cost benefit analysis as to procuring WC coverage. In states where the exclusivity remedy statute is applied to wrap-ups, it is certainly worth considering adding WC coverage to the wrap program.

V. Conclusion/Set Clear Goals and Build A Strong Team

12 Including: California, Connecticut, Kentucky, Louisiana, Maryland, Nevada, Ohio, Texas, Utah, and Virginia. Id.
13 Including: District of Columbia, Florida, Georgia, Indiana, Michigan, Mississippi, Nebraska, New York, Oregon, and Wisconsin. Id.
Putting these granular issues back into the broader perspective of engineering a successful program, it’s critical to remember, and to regularly emphasize, the importance of program goals. Having a better awareness of these issues aids all parties in more meaningfully participate in evaluating, and most clearly defining, the appropriate needs for their CIP. That dialogue should include the input of a myriad of professional perspectives is vital to developing a comprehensive CIP agenda with reasonable goals – including risk management, the executive suite, legal (in-house counsel and coverage counsel), and broker partners.