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SCRATCHING THE SURFACE OF CONTROLLED INSURANCE PROGRAMS

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Risk is an inherent part of any construction project. At the legal heart of any project is how risk is transferred among the participants and controlled through insurance. Traditionally, contractors bring their own separate coverages to each project and pass the premium cost as well as a markup to the project owner.

An insurance program commonly used on larger projects of $100M or more is a Controlled Insurance Program (CIP), also known as a "wrap up." In this arrangement, a single party, either the owner (OCIP) or the general contractor (CCIP), acquires consolidated insurance for all participants working on-site during the construction period. The purpose is to make the insurance more equitable, uniform, coherent, and efficient by eliminating the cost of overlapping coverages and delays caused by disputes between the participants and, at the same time, protect all contracting parties by bringing the risk of loss from the project within the insurance coverage. Economies of scale attained by merging insurance reduces the overhead cost generated by multiple and separate policies.

In a CIP, whether the owner or general contractor sponsors the program, the owner ultimately absorbs the cost of insurance and hopes to realize contract cost savings by the downstream contractors excluding the cost of insurance in their bids. Since a CIP often consolidates workers' compensation, general liability, builder's risk, completed operations, and/or excess/umbrella coverages, cost savings on a large project with a considerable labor element is primarily driven by consolidating workers' compensation insurance since that cost is a significant part of overhead paid by the owner in a traditionally insured project. Other benefits of a CIP include the potential for improved loss control and safety, higher limits usually unavailable to smaller contractors, dedicated "completed operations" coverage, and reduced risk of nonrenewal or cancellation.

CIPs are not structured to cover all risks. Necessary coverages which are typically not part of a CIP are auto, contractor's equipment, and contract surety. Other risks typically excluded through standard CGL exclusions are professional, pollution, contractor's "own work," aircraft and watercraft, and contractual liability. Participating contractors are typically contractually bound under a CIP to assure that its carriers exclude coverage for the project insured by a CIP. At the same time, it is imperative that a contractor review coverages available through the CIP to assure that gaps in coverage are understood and are addressed through other separately purchased coverage and accounted for in the contractor's bid.

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suppliers and servicers, janitorial and security, contractors providing hauling or transportation services, and high-risk operations such as blasting, abatement, and demolition are commonly excluded. Additionally, activities conducted "off-site" are excluded under a CIP. The subcontractor that fabricates or stages material off-site but installs on-site might be covered under a CIP during installation but not during fabrication or staging. The subcontractor that provides design-build services might be insured while providing construction on-site but may not be covered for design risks.

Although one of the objectives of a CIP is to eliminate disputes among program participants, cross-liability exclusions preventing one participant from suing another can be problematic. For instance, the developer/owner who retains ownership of a property after construction and discovers construction defects might find there is no coverage for the responsible contractors under the CIP due to cross-liability exclusions. Likewise, claims for indemnity between contractors are excluded under a CIP. Cross-liability exclusions can cause other unintended financial harm to contractors. For example, a contractor whose employee is injured due to the negligence of another party might experience an enhanced Experience Modification Rate (EMR) and higher premiums due to inaccurate allocation of fault or reporting by the CIP claims administrator.

A well-run CIP features, among other things, incorporation of the CIP Manual in the Contract Documents and an experienced administrator to enroll, educate, and communicate with all participants. Unintentionally unenrolled subcontractors may have no coverage under the CIP. Continued CIP administration is vitally important as a project is deemed "substantially complete" or nears completion. Wrap-ups customarily provide no coverage for warranty or "call-back" work and may or may not provide coverage for "completed operation" losses. As with other coverages, an evaluation of the scope of "completed operations" coverage must be understood at inception and, among other things, a determination made whether that coverage terminates before the applicable state's Statute of Repose applies. A CIP that lapses or is terminated during or near the end of the project can leave participants with no coverage and/or no ability to recover the cost of replacement insurance coverage that was eliminated from their contract bids.

One potential advantage of a CIP is high liability limits. However, limits are shared by all participants. If a limit is eroded by a catastrophic loss or series of losses, other contractors without culpability may find themselves uninsured for a subsequent claim during the same coverage period. It is common for limits to be restored on an annual basis, but once the project is determined to be "substantially complete," limits for "completed operations" coverage do not normally replenish. A high loss in year one of a "completed operations" cover might completely eliminate coverage for losses in subsequent years. The risk of an uninsured loss in latter years is high. Twenty-eight (28) states have Statutes of Repose of 10 years or more. By contrast, 19 states have Statutes of Repose ranging from 4-9 years. With such statutes having no uniformity across the country, it is important to assure that "completed operations" coverages are consistent with the applicable statute for the state law governing the project.

Insolvency of one or more of the insuring CIP carriers can have devastating consequences to the participants. For instance, if the primary carrier becomes insolvent and the excess or umbrella carrier refuses to "drop down" and cover the insolvent carrier's limits, uninsured losses are possible. This issue has been litigated frequently with differing results. While a state insurance guaranty association might undertake the insolvent primary carrier's obligations, whether or not this occurs may depend on whether the insolvent carrier was registered in the state. If the CIP program features London-based or surplus lines carriers, coverage by the insurance guaranty association is hardly a certainty.

The subcontractor community has been distrustful of CIPs primarily because of a lack of communication and involvement in CIP programs. As a result of concern among downstream contractors, trade associations' arguments that CIPS require more regulation and oversight have begun to gain traction with legislators and insurance departments. In 2009, Kansas became the first state to mandate specific guidelines for coverage and participant rights under CIPs when the legislature passed the Controlled Insurance Programs Act. That statute requires CIPs to make quarterly reporting on all claims and losses, replace or pay to replace coverage should the program be cancelled, set a maximum deductible of $2,500 per claim, disclose requirements for safety or equipment prior to accepting bids, allow fines for alleged safety violations to be assessed solely by governmental agencies, and require use of only approved CGL and workers' compensation forms. Nevada now provides requirements for safety programs, and Michigan requires full-time safety managers where a CIP includes workers' compensation insurance. Other states are following suit. States are getting more involved in defining the projects on which CIPs can be used.

CIP brokers and administrators can play a vital role in managing wrap up programs by educating parties about the program and ensuring that they are subscribed to the appropriate coverages. This can be especially important because there are no pre-arranged "off-the-shelf" wrap up programs, and each program must address the unique characteristics of the construction project as well as the overall risk capacity of insurers and insureds. As a practical matter, subcontractors find it difficult to engage their own brokers to make comprehensive reviews of CIP programs and comparisons with their existing programs. Brokers used to getting paid on a commission basis are unlikely to commit hours of work to determine potential gaps in coverage or applicable premium credits to which the subcontractor may be entitled without requesting some consideration. Additionally, subcontractors may find that their own insurers might charge more, i.e., penalize them or reverse volume discounts, if a substantial amount of premium is lost due to involvement in CIP-insured projects.

One of the most salient incentives of a wrap-up is the potential for greater overall project safety as a result of the ability of the sponsor to create and implement an integrated safety and risk management plan for the construction project. Educating all participants about the CIP program by sharing policy forms, claims information, and deduct/credit provisions is important to the success of any CIP. Likewise, including participants in the claims handling process is essential since claims reported under a CIP directly impact participants. CIPs can provide significant advantages over traditional means of insuring construction projects but only if they are carefully considered, thoughtfully planned, and appropriately administered.

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