

COVERAGE FOR THE COST OF MITIGATING DAMAGE

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"I think you misunderstood. The million dollar umbrella policy only covers you for claims involving an umbrella."

Products Which May Provide Coverage for the Cost of Mitigating/Stopping Ongoing Damage

- Builder's Risk Coverage
- CGL Insurance
- Professional Liability Coverage for "Rectification"
- Subcontractor Default Insurance
- Pollution Insurance Mitigation Coverage

Note: The rules governing coverage for damage mitigation coverage vary, depending on the type of insurance involved.

Mitigation Coverage Under Builder's Risk Policies:

Sue and Labor: Coverage highly dependent on policy language

- The Maritime Version
- Current Builder's Risk Form

Sue & Labor: Things to Remember

- Unless the form broadens the clause to “actual or imminent loss,” no coverage absent some damage to covered property.
- Case law mixed on whether sue and labor clause will pay for **cost of making good** the defect which caused the damage, even where further damage is thereby mitigated. In most jurisdictions, the answer is no.
- Case law also mixed on whether damage mitigation effort must be successful to qualify for reimbursement.
- Most current sue and labor clauses **do not** explicitly require insurer consent prior to expenditure.
- Sue and labor clauses **do not** cover the cost of mitigating damage to property owned by third parties.

Builder's Risk: Time Related Losses

“Extra Expense Coverage: . . . in the event of direct physical loss or, this Policy shall pay for:

1. Expediting expenses...;
2. Extra expenses...***Extra expenses shall include equipment rental, emergency expenses, additional security, temporary use of property, demobilization and remobilization of equipment and facilities, and other expenses necessarily incurred to reduce loss.***”

Time-Related Expenses: Things to Remember

- Typically not covered under sue and labor; mitigation of such expenses is regarded as the responsibility of the contractor.
- Default sublimits typically very low, but limits are negotiable—try to match sublimits with perceived exposure on the job.
- The extra coverages are limited to certain time-related exposures. **They do not cover schedule impact claims which cause time-related losses once repairs are complete.**

General Liability Policies: Damage Mitigation

The *Leebov* Doctrine:

“It is folly to argue that if a policy owner does nothing and thereby permits the piling up of mountainous claims at the eventual expense of the insurance carrier, he will be held harmless of all liability, but if he makes a reasonable expenditure and prevents a catastrophe he must do so at his own cost and expense.”

---*Leebov v. USF&G*, 165 A.2d 82 (Pa. Sup. Ct. 1960)

The Property Damage Requirement

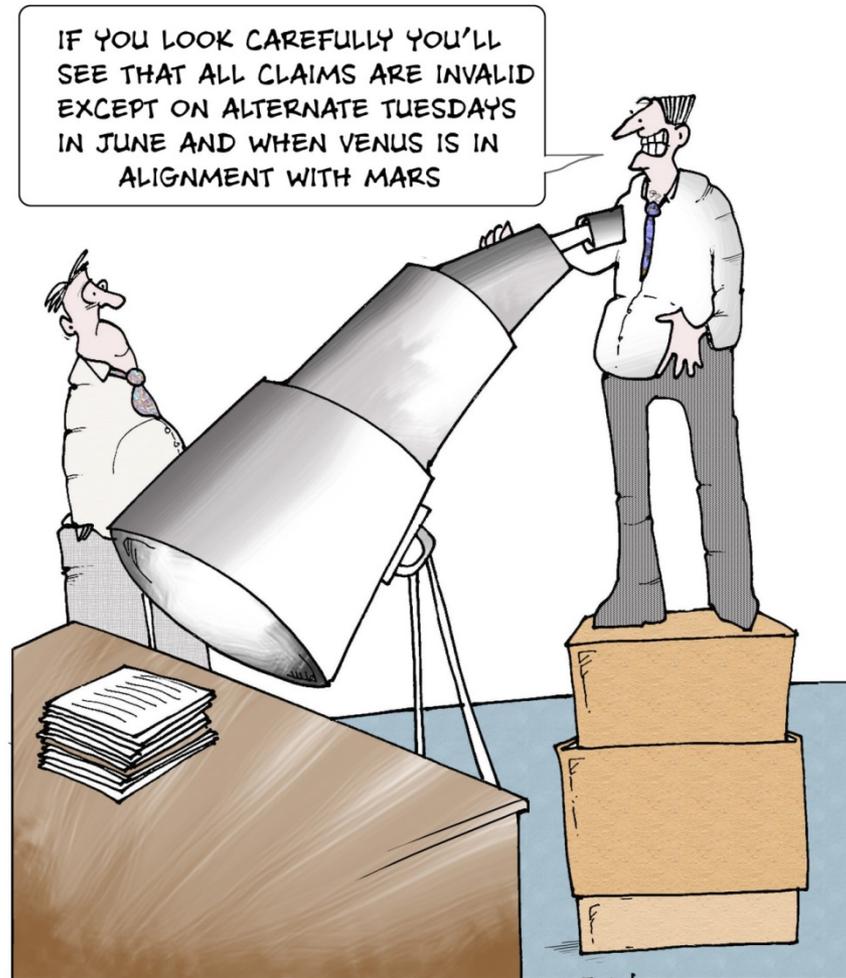
Standard ISO language requires existence of *some* property damage.

- Note: Even jurisdictions allowing recovery for mitigation of ongoing damage don't allow recovery where property damage is imminent but no damage has yet occurred.
- “Because the cost to repair defective work, which is expressly not covered, will almost always also mitigate potential damage to other property, which is covered, an uncovered claim for costs to repair defective work would instantly be transformed into a covered claim for mitigation costs.”
 - *J.B.D. Const., Inc. v. Mid-Continent Cas. Co.*, 571 Fed. Appx. 918 (11th Cir. 2014)

Rectification Coverage: Damage Mitigation

London “ALS 67” Form:

“This policy does not cover... *the cost of making good defective* workmanship, material, construction or *design*, but this exclusion shall not apply to damage resulting from such defective workmanship, material, construction or design...”



London Engineering Group “LEG 2 & 3” Exclusions:

“All costs rendered necessary by defects of material, workmanship, design, plan or specification, and should damage occur to any portion of the Insured Property containing any of the said defects **the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.**”

IRMI Definition:

“Rectification coverage provides first-party insurance for the costs a contractor incurs in correcting a design defect that is discovered after the construction is put in place but before it actually results in a professional liability claim.”

Rectification Coverage

- Typical Insuring Clause:
 - “We shall indemnify the ‘Named Insured’ for the ‘Named Insured’s’ ‘Actual and Necessary Costs and Expenses’ incurred in **rectifying a ‘Design Defect’** in any part of the construction works or engineering works for any project upon which the ‘Named Insured’ is responsible for both design and construction . . .”

Rectification Coverage: Notes

- Does Rectification Coverage apply to only the correction of the design error or also to resulting damage?
 - Industry Innovator's View: “Covers the cost of correcting a design defect . . . [and] . . . ensures that the contractor has the funding to correct the error and keep the project moving.”
 - Policy Language: “Does not apply to damage to property ***other than property which forms the subject of the contract . . .***”
- Rectification Coverage is almost always framed as Excess Insurance

Subcontractor Default Insurance:

- Principal Selling Point:

- It's a first-party product that is designed to respond in a non-adversarial manner to protect the general contractor upon subcontractor default.

- But Note:

- This insurance is written to respond where a subcontractor commits a construction defect that causes ongoing damage to the work, either before or after substantial completion.

**This coverage is written with subrogation rights and is typically excess to their applicable insurance.

Pollution Mitigation:

- This insurance arose out of case law holding that CGL policies covered the cost to mitigate the spread of pollution.
 - “ [A]n insured could reasonably expect a CGL policy to provide coverage for any economic outlay compelled by law to rectify damage”
- When first introduced, it appeared to require the policyholder to obtain sign-off from insurer prior to incurring expenses.

Pollution Mitigation: Timing Requirements

- Pollution mitigation coverage typically has very strict reporting requirements that must be complied with as a condition precedent to coverage:
 - “[T]he pollution condition must be discovered by the insured ***no later than 15 calendar days*** after the date of commencement and ***reported to the insurer no later than 45 business days*** after the date of commencement.”

Case Study One: The Case of Dewatering the Swamp



Case Study One:

The Case of Dewatering the Swamp

- Many losses implicate multiple policies, and the General Contractor must come up with a recovery plan that “stitches” together benefits from more than one policy.
- What does a General Contractor do when its contract requires immediate development and implementation of a damage mitigation plan, but one or more policies require insurer approval, or worse, deny recovery for expenses incurred voluntarily?
- The fact pattern implicates damage to both covered property and non-covered property under the builder’s risk policy.

Case Study One:

The Case of Dewatering the Swamp

- Sue and labor expenses will most likely be allocated between covered and non-covered interests (covered property and non-covered property, and resulting damage vs. cost of making good.)
- Time-related benefits under the builder's risk policy will likely be the subject of low basic sublimits.
- Additional insured coverage under the foundation sub's GL coverage is implicated, but unless the foundation contractor was responsible for design of its own dewatering, its GL insurer will resist payment under its professional services exclusion.

Case Study One:

The Case of Dewatering the Swamp

- Whether or not the General Contractor's own GL policy will pay indemnity will depend on time-consuming forensics--was the loss design-caused or means-and-methods-caused?
- As between the General Contractor's GL and professional liability/rectification insurer, who will pay for mitigation to the adjacent office park structures?
- Generally, the solution to multi-policy losses in situations where the General Contractor is obligated to furnish a damage mitigation plan *lies in getting all insurers together in a mediation-protected setting*, and negotiating a Loan Receipt agreement, with or without recourse, to allow each insurer's forensic investigation to "catch up" with the operational need to conduct and pay for immediate damage mitigation.

Case Study Two: The Case of the Missing Structural Steel



Picture of 900 Biscayne Bay Condominium

Case Study Two:

The Case of the Missing Structural Steel

- Like in the first Case Study, the Contractor in Case Study Two will benefit by “stitching together” its Subcontractor Default insurance with its Wrap GL insurance.
- Step one is to rule out the possibility of Course of Construction coverage. Some COC policies provide coverage until the General Contractor is no longer “responsible” for the work. In condo construction, the General Contractor may well be responsible after occupation begins, at least through the date of turnover. If COC coverage applies, it will typically be primary to all other coverages.
- SDI insurance typically has a large SIR. Most jurisdictions allow the contractor-policyholder to be “made whole” for the SIR before the insurer obtains subrogation.

Case Study Two:

The Case of the Missing Structural Steel

- To the extent there is contractual language in the SDI that allows the SDI insurer to be made whole first, it is important for the General Contractor to assert the right to be made whole out of its own claims against the Wrap insurer.
- Some excess policies in Wrap GL coverages *reduce the insureds to Developer and GC, excluding trade contractors as insureds*. This obviously complicates claim resolution in large losses.
- Some Wrap GL policies still contain cross-suits exclusions which bar claims by General Contractors against Subcontractors. The time to deal with such exclusions is obviously before, not after a loss. The ISO Wrap exclusion endorsed onto most trade contractor policies *excludes coverage even if the Wrap does not cover the trade contractor for the loss*.

Case Study Two:

The Case of the Missing Structural Steel

- Case law is mixed throughout the jurisdictions as to whether the cost of making good a workmanship defect is covered where mitigation of ongoing property damage requires it.
- The contractual requirement of an immediate damage mitigation plan always complicates resolution of the claim. As with Case Study One, it is usually helpful to negotiate a Loan Receipt (with or without recourse) which will allow cash flow and approval of an early damage mitigation plan.

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