

# **Builders Risk Coverage: Navigating Hard and Soft Costs, Delay in Opening Expenses and Construction Delay Measurement**

Strategies for Contractors and Insurers to Resolve Recurring and Costly Disputes

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Today's faculty features:

Dan Millea, Partner, **Zelle Hofmann Voelbel & Mason**, Minneapolis

Michael Pepe, Esq., **Saxe Doernberger & Vita**, Hamden, Conn.

William D. Wilson, Partner, **Mound Cotton Wollan & Greengrass**, Florham Park, N.J.

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# Builder's Risk Coverage

Navigating Hard and Soft Costs, Delay in Opening Expenses and Construction Delay Measurement



William D. Wilson

Mound Cotton Wollan &  
Greengrass

[wwilson@moundcotton.com](mailto:wwilson@moundcotton.com)

Dan Millea

Zelle Hofmann

[dmillea@zelle.com](mailto:dmillea@zelle.com)

Michael Pepe

Saxe Doernberger  
& Vita

[mvp@sdvlaw.com](mailto:mvp@sdvlaw.com)

# Presentation Overview

## I. **Scope of Coverage**

- A. Hard costs
- B. Soft costs
- C. Delay in opening/completion

## II. **Measuring Construction Delay**

- A. Delay in construction schedule
- B. Period of business interruption and restoration
- C. Delay due to contractor/subcontractor default

## III. **Coverage for “Ensuing Loss” Resulting From Defective Design or Workmanship**



# Section I

## I. **Scope of Coverage**

A. Hard costs

B. Soft costs

C. Delay in opening/completion





# What is the Purpose of Builder's Risk Insurance?

- Provides coverage for physical loss or damage that occurs in connection with a construction project (new project or the renovation or repair of an existing building or structure).
- In addition to covering damage to the project itself, builder's risk insurance also provides coverage for damage to the materials, supplies, fixtures, machinery and equipment being used in connection with the project.
- Typically provides coverage for all physical loss or damage resulting from a fortuitous event (fire, vandalism, hurricanes and other perils).





# Unique Nature of Builder's Risk Coverage

- Builder's Risk is a species of **Inland Marine** Coverage.
  - Inland Marine grew out of **Marine** Insurance.
  - Inland Marine insures property during inland **transit**.
  - Inland Marine also insures property in custody of others, in storage, or after arrival on premises of insured.
  - Builder's Risk essentially covers construction projects while "**in transit**" – as the components are being delivered and assembled into a completed structure.

# Policy Attachment and Termination

Builder's Risk policies typically provide that:

- Coverage attaches when construction commences
- Coverage terminates upon:
  1. Expiration or cancellation of the policy;
  2. Formal acceptance of the project by owner;
  3. Upon substantial completion;
  4. Upon occupancy/substantial occupancy/certificate;
  5. The placing of the project or any portion thereof into commercial service for its intended purpose.

# Who Is Insured?

- Policy **Definition** of Insured is Key – may include “other contractors and/or subcontractors and/or suppliers and any other company . . . with whom the [principal insureds] have [contracted] . . .” *Texaco Exploration v. AmClyde*, 448 F.3d 760, 777 (5<sup>th</sup> Cir. 2006) (quoting policy language).
- However, an **unnamed subcontractor** will not be assumed to be an additional insured under **North Dakota** law. *Tri-State Ins. Co. v. CGW*, 698 N.W.2d 483 (N.D. 2005).
  - Court focused on “**Property Covered**” clauses, to see whether property of party seeking additional insured status was included.

# What Is Insured?

- *Ajax Building Corp. v. Hartford*, 358 F.3d 795 (11<sup>th</sup> Circuit 2004) –
  - “**Covered Property**” included “Property of others used or to be **used in**, or incidental to the **construction** operations . . .”
  - “**Property Not Covered**” included “equipment, or other property which **will not become a permanent part** of the structure(s) . . .”
  - The question was whether a crane was **covered property or excluded** property under the builder’s risk policy. **What is the answer?**

# Covered Property and Hard Costs

## Property Typically Covered Under Builder's Risk Policies

- 1) buildings
- 2) structures
- 3) materials that will form a permanent part of structure
- 4) materials in transit
- 5) materials in storage
- 6) foundations
- 7) excavations, grading and backfill
- 8) attachments to structure
- 9) permanent fencing
- 10) permanent fixtures



# Other Hard Costs

Additional Hard Costs Potentially Covered:

- 1) labor
- 2) materials
- 3) building permits
- 4) site security
- 5) material storage costs
- 6) utility costs
- 7) overhead and profit
- 8) insurance costs



# Hard Cost Coverage Issues

- ***Zurich v. Keating Building Corp.***, 2007 WL 913874 (D.N.J., March 22, 2007) (collapse of portion of multi-story Tropicana Casino project).
  - Due to partial collapse, insured experienced **delays in completion of undamaged portions of project**, leading to additional costs for (1) Extended General Conditions, (2) idle labor and equipment, and (3) increased wages, prices and storage costs.
  - Zurich argued such costs were not within the scope of coverage for repairs, which was limited to the “cost to repair or replace the property lost or damaged.”
  - Court found that “**the term ‘property lost or damaged’** as a result of the collapse **refers to the entire structure**, not simply to the location of the collapse.” Cost increases were covered as part of the property damage repair.



# Costs For Undamaged Portions of Project – An Alternate View

- ***Oceanside Pier View v. Travelers***, 2008 U.S. Dist. LEXIS 37755 (S.D. Cal. May 6, 2008) – Shoring wall collapsed in early stages of construction, which impacted critical path and led to delays in construction of other portions of project not yet started at time of collapse.
- Court **granted summary judgment to Travelers** -- Coverage for **increased costs of construction** materials and labor to complete portions of project **that had not yet been built** at time of collapse, only existed under extension for Expediting Costs and Additional Cost of Construction Materials and Labor (which was **sublimited**).
  - Broader builder’s risk coverage was limited to “Buildings or structures . . . while being constructed . . .” Costs related to portions of project not under construction.

# Soft Cost Items

## Soft Costs Potentially Covered Under Builder's Risk Policies

- 1) Architect and engineering fees
- 2) Building inspection fees
- 3) Construction loan fees
- 4) Insurance premiums
- 5) Interest expense
- 6) Legal fees
- 7) Lost tax credits
- 8) Advertising costs
- 9) Leasing expenses (renegotiation costs)



The “soft costs” category is extensive: “The term ‘soft costs’ has been a moving target for the insurance industry. . . . The scope of possible soft costs is limited only by the types of expenses actually incurred.”

- *The Builder's Risk Book*, Coombs & Malecki, International Risk Management Institute, Inc., Chapter 16.

## Exhibit 16.5

### POTENTIAL SOFT COSTS

- Abatement cost
- Accounting fees
- Additional cost of construction materials and labor
  - Advertising, promotional, sales, and marketing expenses
  - Appraisals
  - Architect, engineering, and consultants fees
    - Assessments
  - Building inspection fees
- Commissions/fees for renegotiation of leases
  - Construction loan fees
  - Construction management fees
  - Debt service payments
- Development fees and other costs
  - Equipment rental
  - Expediting expenses
- Expenses to prepare a proof of loss
  - Extended general conditions
- Extra printing, copying, and mailing costs
- Extra travel and lodging costs for employees
  - Feasibility/plan studies
- Fees for letters of credit and remarketing of bonds
  - Financing fees (including refinancing)
  - Founders fee refunds
- Furniture, fixtures, and equipment storage fee
- General overhead expenses—developer
  - Historic tax credits
  - Insurance costs
- Interest expense for loans/bonds
  - Interest points
- Leasing expenses (including renegotiation)
  - Legal fees
  - License fees
- Loan origination commitment and closing costs
  - Loss of tax credits
  - Office expenses
  - Permit fees
- Preopening expenses—new hire, costs, training expenses, etc.
  - Real estate and property taxes
  - Site inspection services
- Site safety and protection expenses
  - Slotting charges
- Surety bond premiums
  - Surveys
- Tenant bonuses or extra allowances
  - Testing and inspection fees
- Utility hook up expenses (sewer, water, electric, gas)
  - Utility survey fees
- Wheeling charges to an electric utility

# Scope of Soft Costs Coverage

- “The scope of soft-cost coverage can vary, so **it is critical to carefully review the terms of the endorsement.** . . . Keep in mind, however, that **delayed completion insurance only pays if the loss is due to the occurrence of a peril covered under the builder’s risk policy, which usually means physical loss or damage.** Delayed completion insurance usually will not respond when the job is late simply because the contractor is having difficulty making the completed project perform as guaranteed.”  
– *Design-Build Contracting Handbook*, Section 14.04[B].
- Separate Cost Overrun/Delayed Opening coverage is required for delay losses that are not the result of physical damage. – *Practicing Law Institute Real Estate Law and Practice Guide*, 284 PLI/Real 929 (1986).
- **In sum:** (1) there must be **physical loss or damage** caused by an **insured peril**; and (2) **scope** of soft costs coverage will be **determined by the specific policy terms or**, if ambiguous, by **extrinsic evidence**, including expectations of insured.

# Delay in Completion Coverage

- Usually added by way of endorsement.
- Provides coverage for:
  - “soft costs”
  - Loss of income resulting from a covered loss



# Delay in Completion Coverage

Typical insuring agreement:

“In the event of direct physical loss of or damage to insured property from a **covered cause of loss**, the Company shall indemnify the Insured for Soft Costs/Additional Expenses, Loss of Rental Income, and Loss of Gross Earnings arising out of the resulting **Delay in completion** of the project described in the declarations.”

- There is generally a waiting period deductible before coverage will kick in.
- There is no coverage unless the delay exceeds the deductible period (typically 30 to 45 days).

# Definition of Delay

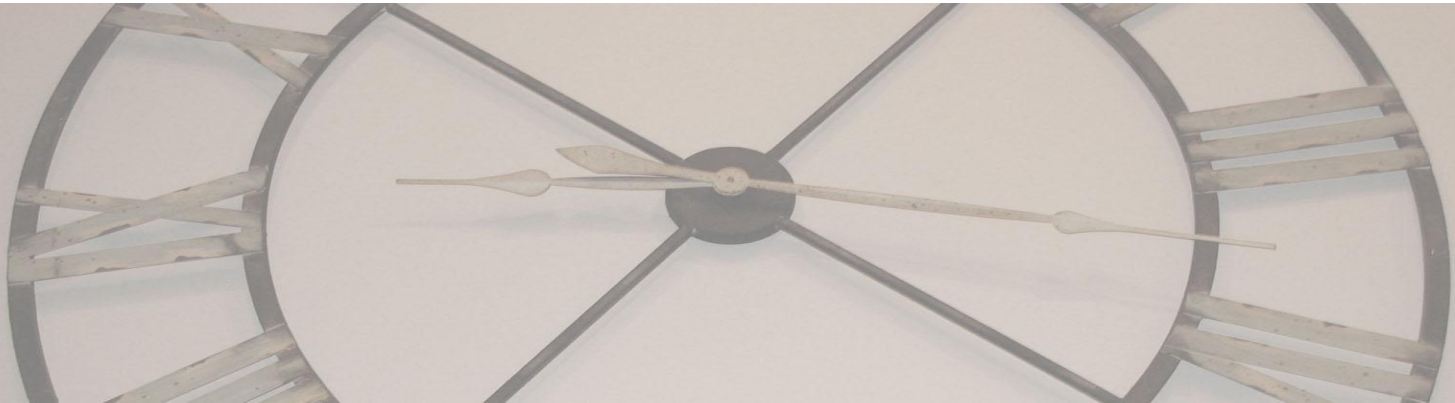
- Typical definition of delay:

The period of time between the Scheduled Date of Completion and the actual date on which commercial operations or use and occupancy can commence with the exercise of due diligence and dispatch.
- The Scheduled Date of Completion is generally set forth in the policy declarations.
- The Scheduled Date of Completion may change several times during the course of construction.
- The Scheduled Date of Completion is generally the later of the date set forth in the declarations or “the date on which but for the insured loss or damage, commercial operations or use and occupancy would have commenced.”
- The deductible period begins to run from the Scheduled Date of Completion.



# Delay Period End Date

- The Delay period for which coverage is provided ends on the date on which commercial operations or use and occupancy can commence **with the exercise of due diligence and dispatch.**
- This is a **theoretical** period.
- If the insured fails to act with due diligence and dispatch coverage may end before commercial operations or use and occupancy actually commences



# Permission to Occupy

- If occupancy or operation of a project is to take place on a rolling basis, it generally is necessary to add a Permission to Occupy/Operate Endorsement to the policy.

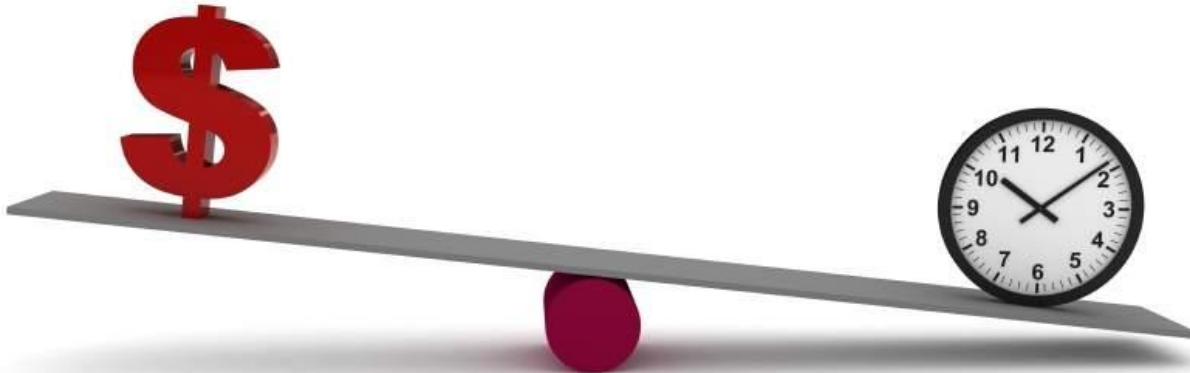


- A typical endorsement provides:

This policy is extended to permit partial occupancy/operation of any machinery, facility or other property insured hereunder being a part of the INSURED PROJECT but prior to final acceptance by the Owner and **coverage shall not be reduced due to such partial occupancy/operation** except as provided in this endorsement . . . . If the Delay in Completion Endorsement applies to the policy, coverage thereunder shall be null and void as respects any machinery, facility or other property which is occupied or put into operation.

## Section II

# Measuring Construction Delay



# Period of Indemnity

- Challenge of defining the Period of Indemnity is to determine the actual impact of the delay
- Analysis of the pre-loss and post-loss construction schedules and the duration to repair/restore the damaged project may alter the perceived Period of Indemnity
- Schedule projections may not equate to the actual days of delay that occurred: e.g. compression of schedule
- Company will not be liable for any loss or increase in delay caused by or resulting from failure to use due diligence and dispatch (reasonable duration) in restoring the damaged property to the condition existing prior to the loss or damage.

# Period of Indemnity

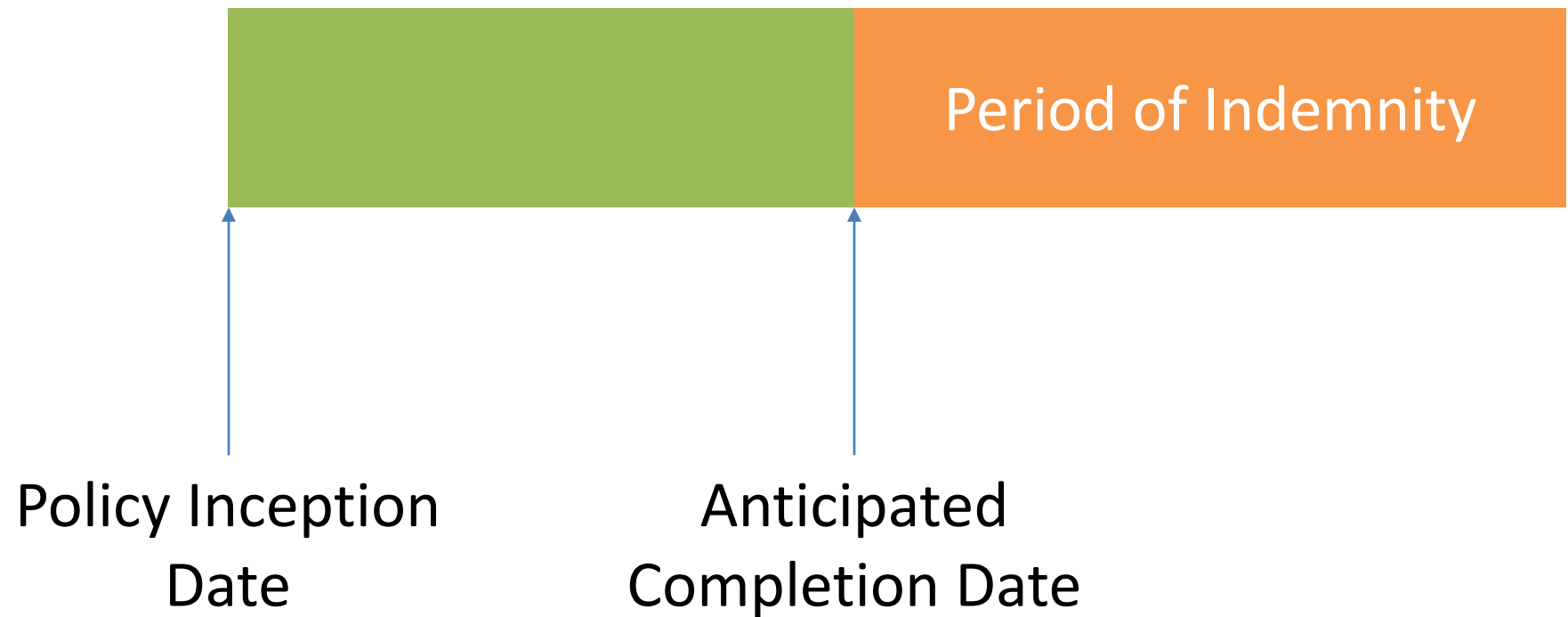
## Areas of Conflict

1. When does it begin?
2. When does it end?
3. Due diligence and dispatch

# Anticipated Date of Completion

- **Completion Date** means the later of the original scheduled completion date in the construction contract or the date the structure would have been completed if a loss had not occurred. *In no circumstances will the completion date predate the original scheduled completion date in the construction project.*
- **Scheduled Date of Completion** – The later of the completion date scheduled in the construction contract and shown on Page 1 of this endorsement, or the date the Insured Project would have been completed for commencement of commercial operations or use and occupancy if a loss hadn't occurred.
- **Anticipated Date of Completion** – The date stated in the schedule on which the work is scheduled to be completed for commencement of commercial operations or use and occupancy.
- **Planned Completion Date** – The date the project would be put into operation or use in the normal course of construction if loss of or damage to covered property from any of the Covered Causes of Loss had not occurred.

# Period of Indemnity





# Start of the Period of Indemnity

The date a project would have been completed absent a loss.

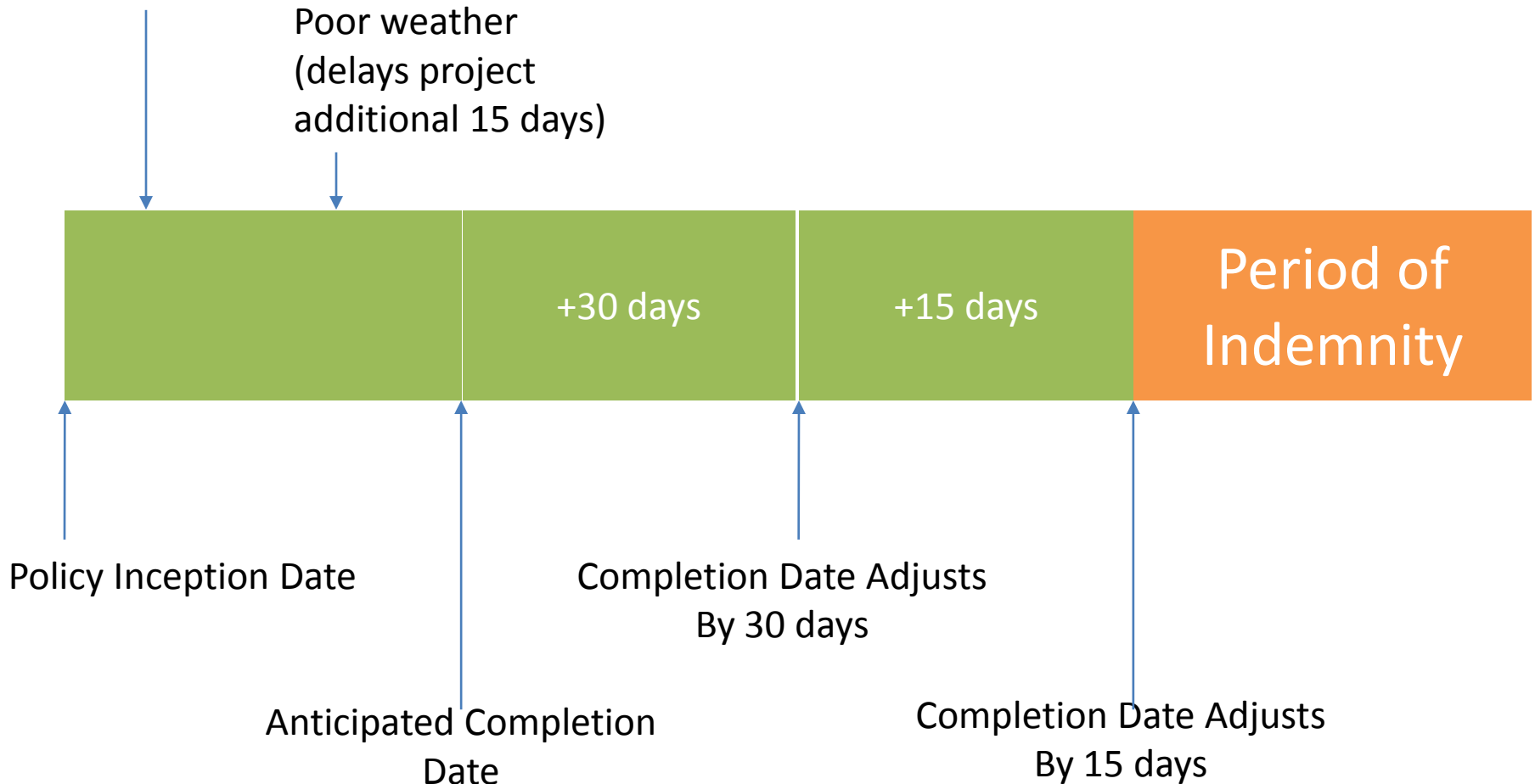
Was the project “on schedule” immediately prior to the loss?

# POI – Project Behind Schedule

Labor strike

(delays project by  
30 days)

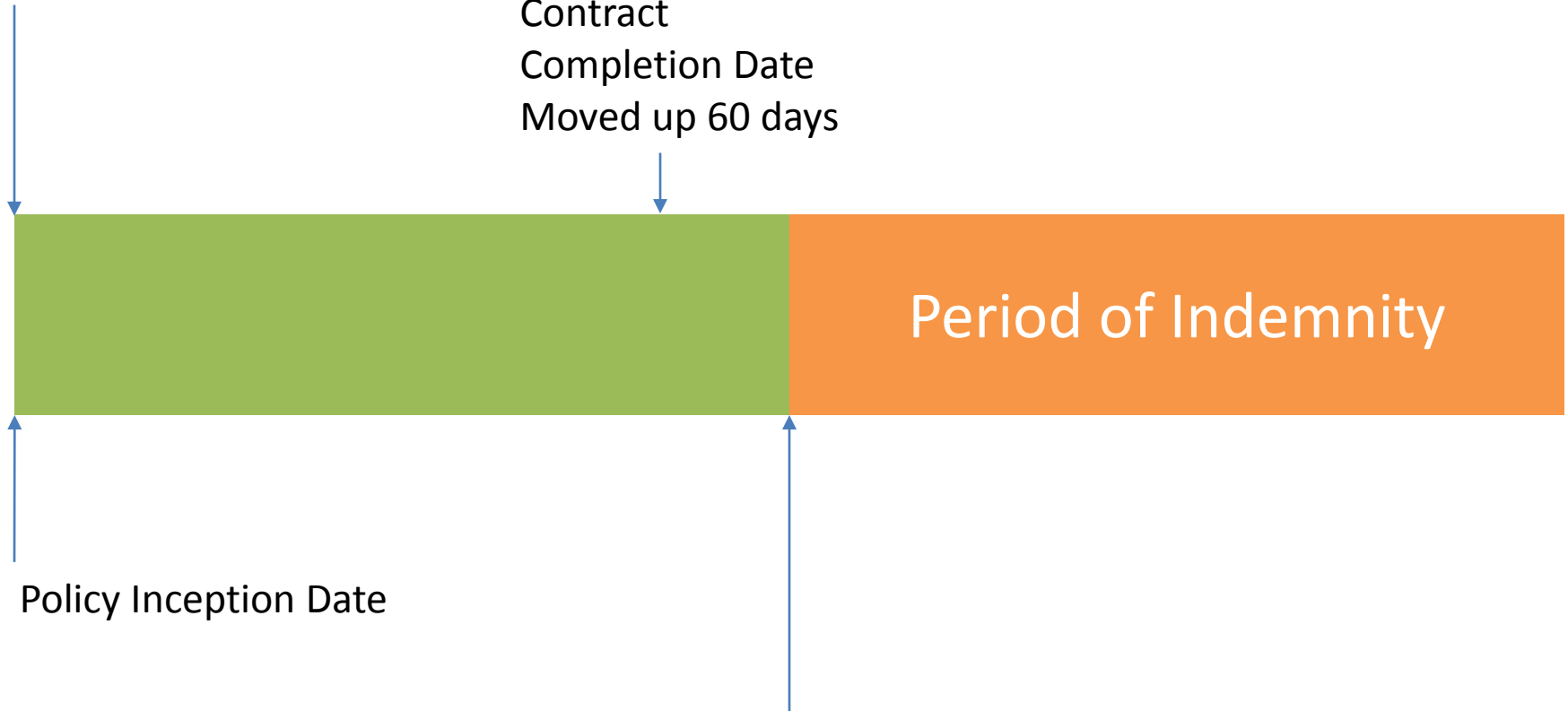
Poor weather  
(delays project  
additional 15 days)



# POI - Project Ahead of Schedule

Project ahead of  
schedule by 60  
days

Contract  
Completion Date  
Moved up 60 days

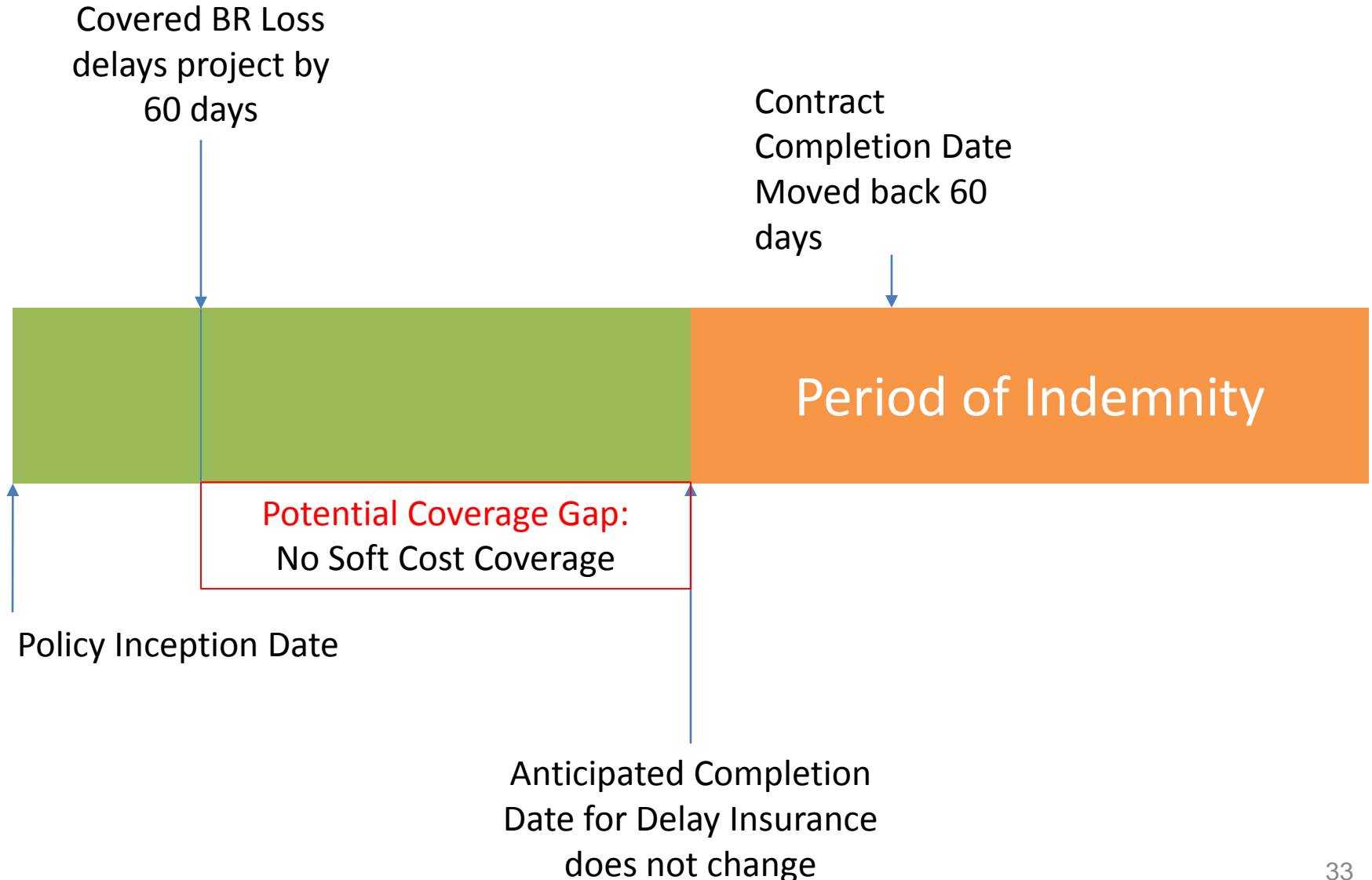


Policy Inception Date

Period of Indemnity

Completion Date for Delay  
Insurance does not change

# Period of Indemnity



# End of Period of Indemnity

When project is completed with due diligence and dispatch

May be limited by Policy language to a specific timeframe (i.e. 12 months)

# End of Period of Indemnity

On the date when the project should be completed using reasonable speed and similar materials and workmanship.

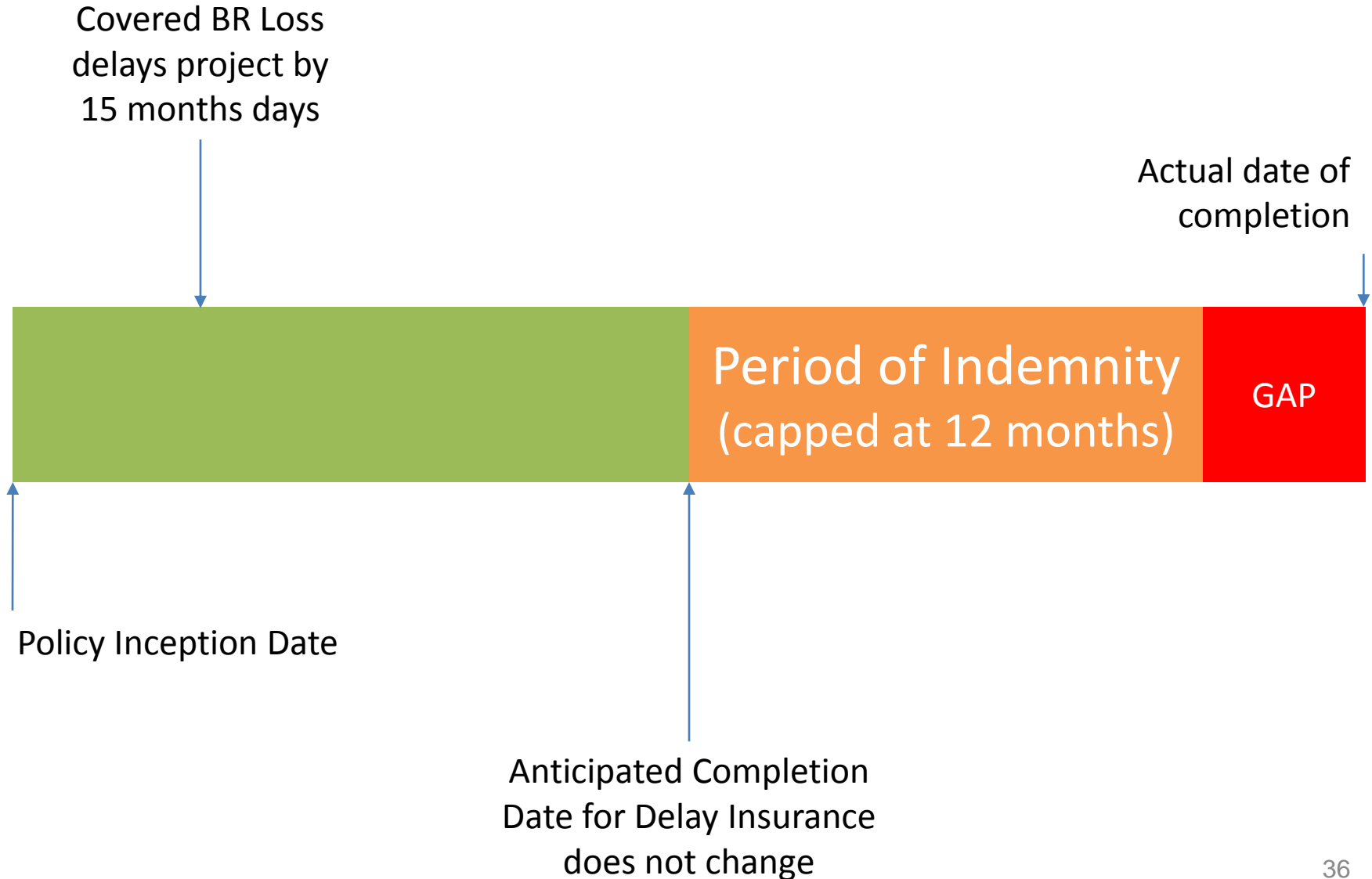
The number of calendar days stated in the schedule, which are in excess of the deductible period.

The actual date the project is completed with reasonable speed and similar quality.

The date the construction is actually completed or 12 months, whichever occurs first.

The time required with the exercise of due diligence and dispatch to rebuild, repair, or replace that part of the property sustaining the loss.

# Delay exceeds the POI





# Due diligence and dispatch

Insured is required to complete the project with “due diligence and dispatch” or “reasonable speed”

If moving too slowly, insurers may attempt to reduce the period of indemnity

# Factors affecting Delay Period

- Post loss delays unrelated to the loss
- Delays which are affected by non-covered issues, including:
  - Consequential impacts on the project schedule;
  - The need to repair or replace non-insured property;
  - The need to correct an uninsured condition such as a product or failure or design flaw.

# Illustrations

W2001Z/15 CPW Realty, LLC v. Lexington Ins. Co., 2014 NY Slip Op 30215(U) (Sup. Ct.) aff'd, 2015 N.Y. App. Div. LEXIS 3438 (N.Y. App. Div. 1st Dep't, Apr. 28, 2015)

A water leak delayed portions of a residential condo project. The leak directly affected 4 units and several common areas, but the owner sought to recover \$5.7 million in lost income allegedly incurred by delays in closing to 82 units.

“[T]he terms of the delay-in-completion endorsement require plaintiff to establish that the delay in completion of the insured project was caused by direct physical loss or direct physical damage to the insured project. Similar provisions have been enforced in accordance with the plain meaning of these words.”

“Here, inasmuch as the only direct physical loss or damage caused by the August 2007 leak was to units 4E, 5E, 3B, and 3C, the lobby and concierge space, the alleged "domino effect" of these losses or damage to the other 80 units is not covered under the policies.”

“Contrary to plaintiff's contention, once the first covered delay occurred, not all subsequent delays were covered, unless that delay was caused by a direct physical loss or direct physical damage.”

Court found in favor of the insurer, holding the loss of income related to the units that were not delayed because of the physical damage was not covered under delay-in-completions endorsement to BR policy.

# Illustrations

Granite Penn Sq., LLC v. U.S. Fire Ins. Co., 960 A.2d 394 (N.J. App. Div. 2008)

Original Completion Date = Sept. 1, 2001

Switchgear damage = Dec. 25, 2000

Repair completed = Mar. 23, 2001

Completion = Oct. 10, 2002 (13 months late)

Owner claimed project delay was 321 days (88 days because of covered loss.)

Insurer claimed delays existed before loss, and “the project was mismanaged, poorly planned, and improperly executed.”

Court held no coverage under delay endorsement because none of the delays were “directly caused” by the covered loss.

# Illustrations

Shadow Creek Apts., LLC v. Hartford Fire Ins. CO.,  
No. 01-2212, No. 01-2251 (4<sup>th</sup> Cir. Aug. 22, 2002)

Fire loss in multi-building apartment complex.

Buildings were scheduled for staggered turnover.

Lost rents calculated at “ramp up period” rates, not “stabilized” rates.

But, POI extended beyond completion, until each building reached “stabilized” level.

# Delay due to Contractor or Subcontractor Fault

Which Insurer Should Pay First?

Contractors look to builders risk insurance as primary means to pay for project losses

Owners prefer project losses involving contractor liability to be paid for by contractor's CGL insurance.

- What does trade contract say about insurance priority?
- What do respective policies say about insurance priority?

# Section III

## Coverage for “Ensuing Loss” Resulting From Defective Design or Workmanship



# Faulty Workmanship

One important limitation in a builder's risk policy is that there generally is no coverage for loss or damage resulting from faulty or defective design or workmanship.

The purpose of that exclusion is to place the responsibility for damages resulting from faulty design or workmanship on the party that performed the faulty work rather than on the property insurer.





# Faulty Workmanship

“Builder's risk insurance is a type of property insurance coverage, not liability insurance or warranty coverage. The purpose of this type of insurance is to provide protection for fortuitous loss sustained during the construction of the building.”

A builder's risk policy “does not operate as a warranty for faulty workmanship and should not be transformed into a guarantee against design and construction defects.”

*Swire Pacific Holdings, Inc. v. Zurich Ins. Co.*, 845 S0.2d 161, 165-68 (Fla. 2003).

# Faulty Workmanship

The failure of workmen to exercise proper judgment in executing their skill or craft, or the negligent execution by workmen of their skill, constitutes faulty or defective workmanship within the meaning of a policy exclusion.

*See, e.g., Kroll Construction Co. v. Great American Ins. Co., 594 F. Supp. 304, 307-08 (N.D. Ga. 1984).*

A “faulty workmanship” exclusion has been held to apply to “both a flawed product and a flawed process.”

*See, e.g., BSI Const., Inc. v. Hartford Fire Ins. Co., 705 F.3d 330, 332 (8th Cir. 2013).*

# Faulty Workmanship: Ensuing Loss

- Faulty design and workmanship exclusions typically contain an "exception" for damage that ensues or results from the faulty workmanship.
- Thus, while first-party policies generally provide no coverage for the cost of correcting or "making good" the faulty workmanship, there may be coverage for damage that results from the faulty workmanship.



# Faulty Workmanship

- A typical exclusion with an ensuing loss provision provides:

This policy shall not pay for loss, damage or expense caused directly or indirectly and/or contributed to, in whole or in part, by any of the following excluded perils:

\* \* \*

B. Cost of making good faulty or defective workmanship or material, unless direct physical loss or damage by an insured peril ensues and then this policy will cover for such ensuing loss or damage only.

C. Cost of making good fault, defect, error, deficiency or omission in design, plan or specification, unless direct physical loss or damage by an insured peril ensues and then this policy will cover for such ensuing loss or damage only.

# Faulty Workmanship – Two Examples

*W2001Z/15 CPW Realty, LLC v. Lexington Ins. Co.*, 2014 WL 264468 (N.Y. Sup. Ct. Jan. 22, 2014), *aff'd*, 127 A.D.3d 643, 9 N.Y.S.3d 18 (2015).

- 15 Central Park West is a two building, ultra-luxurious condominium complex located at the corner of West 61st Street and Central Park West.
- The insured claimed that closings on two condominium units were delayed as a result of a July 12, 2007 water leak.
- The insured also claimed that closings on an additional eighty-two condominium units were delayed by as much as 459 days as a result of a water leak that occurred on August 14, 2007, even though only two of those units sustained physical loss or damage.
- The insured was seeking to recover in excess of \$6 million.

# Faulty Workmanship – Two Examples

- The two water leaks at 15 Central Park West were caused by faulty workmanship.
- There was ensuing water damage to other portions of the project as a result of the faulty workmanship, which was covered.
- The insured also incurred costs to prevent future losses and repair faulty fittings that had not yet failed, which were not covered.

# Faulty Workmanship – Two Examples

*E3 Biofuels-Mead, LLC v. Zurich American Ins. Co.*, 2012 WL 6554437 (D. Kan. Dec. 14, 2012).

- The second example involves an ethanol production facility located near Mead, Nebraska.
- The claim arose from an internal explosion in one of the steam boilers at that facility.
- The insured claimed that the initial explosion ultimately resulted in \$130 in damages.
- The insured claimed that due to the initial explosion, the plant never became fully operational, ultimately causing the bankruptcy of the business.

# Faulty Workmanship – Two Examples

- The boiler explosion at the E3 Biofuels facility was caused by faulty workmanship.
- The faulty workmanship provided that there was no coverage for:
  - B. COST OF MAKING GOOD
    - (1) Faulty or defective workmanship, supplies or materials;
    - (2) Fault, defect, error, deficiency or omission in design, plan or specification;

Unless direct physical loss or damage by an insured peril ensues and then this Policy will cover for such ensuing loss or damage only.
- There was no coverage for the “cost of making good” the defective design or workmanship.
- There was coverage for ensuing damage to other portions of the project as a result of the explosion.



# Faulty Workmanship - Summary

There is no coverage for costs incurred to repair the faulty workmanship.

Under an ensuing loss provision, however, damage that occurs subsequent to, and as a result of the faulty workmanship, may be covered.

You need collateral or subsequent damage in order for coverage to be triggered. Some policies and/or courts also require that the damage be caused by a separate peril.

As a general rule, an ensuing loss provision will not be construed, interpreted, or applied so broadly that it essentially swallows the faulty workmanship exclusion.

*Laquila Const., Inc. v. Travelers Indem. Co.*, 66 F. Supp. 2d 543 (S.D.N.Y. 1999); *Swire Pacific Holdings, Inc. v. Zurich Ins. Co.*, 845 S0.2d 161, 165 (Fla. 2003); *Narob Dev. Corp. v. Ins. Co. of N. Am.*, 219 A.D.2d 454, 631 N.Y.S.2d 155 (1<sup>st</sup> Dep't 1995).

# Questions?



William D. Wilson

[wwilson@moundcotton.com](mailto:wwilson@moundcotton.com)

Dan Millea

[dmillea@zelle.com](mailto:dmillea@zelle.com)

Michael Pepe

[mvp@sdvlaw.com](mailto:mvp@sdvlaw.com)