GAPS IN WRAPS!

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Wrap-Up Insurance policies, commonly known as Wrap Insurance, have been available for decades on larger construction projects to cover the liabilities of the owner, the contractors and the subcontractors in a single policy. Because of the reduced premiums associated with a combined policy, Wrap Insurance became even more popular during the downturn in the economy when margins were tighter for all parties involved in a project. Now as the inevitable litigation, resulting from construction disputes during the recession, has wound its way through the courts, owners, general contractors and subcontractors find themselves lacking the coverage they expected their Wrap Insurance to provide.

A "Wrap" is an all-inclusive insurance policy usually consolidating workers' compensation, general liability and excess/umbrella insurance coverage for most of the entities working on a construction project (commonly excluding design professionals). The two standard types of Wrap programs include the Owner-Controlled Insurance Program (OCIP) and the Contractor-Controlled Insurance Program (CCIP).

This article is a brief overview of the advantages and disadvantages of OCIP and CCIP policies, and the issues which you should consider when a Wrap policy is suggested as the insurance on your next project. An owner and a contractor will have different perspectives on the benefits and detriments of an OCIP versus a CCIP, as discussed below.

PROS and CONS OF OCIPS and CCIPS

1. **Insurance Cost Savings**: During the bidding process a contractor might offer to provide certain coverages under a CCIP at a fixed premium amount, which would be adjustable based on various exposures, as well as whether any claims were brought during the project. For example, coverage for general liability might be provided at a fixed premium for say $10,000,000.00 in coverage. However, workers compensation premiums might be adjustable, and allow for refunds or credits, based on whether any claims were made during the project. OCIP policies have very similar fixed and adjustable premium costs. For an owner, the benefit of an OCIP in this situation

is that if there are no claims during a project for variable or adjustable premiums, those premium refunds or credits would go back to the owner and not the general contractor.

2. **Higher Coverage Limits**: Both OCIPs and CCIPs potentially provide for more coverage than a contractor (or an owner) could obtain by itself. This would include amounts that could be obtained by subcontractors. It is important that with either an OCIP or CCIP, that the parties obtain a sufficient amount of insurance to cover all potential losses related to the specific project.

3. **Less Subcontractor Litigation**: There tends to be less subcontractor litigation because all of the companies/contractors are covered by the same policy. This applies to both OCIPs and CCIPs.

4. **Owner as Named Insured (OCIP) vs. Additional Insured (CCIP)**: The owner would have Named Insured status under the OCIP and most likely Additional Insured status under the CCIP. There are potential lawsuits against an owner that would be covered under an OCIP as a named insured. Coverage for an owner under a CCIP would depend on the “Additional Insured” wording in the policies, which is usually restricted to losses resulting from the operations of the Named Insured (the contractor).

5. **Dedicated Limits of Liability**: The OCIP would normally provide liability limits that are dedicated to the specific project only. That means that the full limits are available to respond to a severe accident or loss (or a series of accidents) that arises from the construction project. On the other hand, some CCIP policies are actually “Rolling CCIPs,” which allow a general contractor to share the CCIP coverage limits amongst multiple projects on which it is working. Therefore, the policy limits can be depleted or exhausted by losses on the general contractor’s other projects. This could leave the owner, the general contractor itself and the subcontractors uninsured on the actual project.

6. **Cancellation of the CCIP**: Further complications could arise in number of situations on a multi-year construction project, which could lead to the cancellation of a CCIP:

- The contractor could become insolvent.
- The program could be cancelled due to non-payment of insurance premiums.

- Cancellation could result from safety issues on other projects.
- Performance issues could arise which necessitate the replacement of the contractor during construction.
- If the program is cancelled, the job could be shut down while alternative insurance coverage is arranged.

7. **Administrative Issues**: OCIP or CCIP programs both require a significant amount of administrative activity. Traditionally, the owner is not equipped for such administration and is required to incur additional expense on additional staff to manage important items, such as document control, data management, reporting, inspections and audits. In most cases, general contractors on larger projects already have staff who can manage the specifics of administering the program.

8. **Subcontractor Issues**: Introducing the idea of Wrap insurance to the subcontractors on a project can present unique problems. Initially, subcontractors might be resistant to the idea because they may perceive it as a disruption to their insurance programs already in place, particularly if the project constitutes a major portion of their work (and risk).

Because general contractors and subcontractors work side-by-side on a daily basis, often on multiple projects at a time, they have the ability to work through these issues together. This often gives the contractor a greater ability to manage through the CCIP enrollment process, the appropriate level of insurance "deducts" or "credits" from the subcontractor trades.

Because of the relationship between the general contractor and subcontractors, and the fact that they are on-site, the general contractor under a CCIP will also be able to take the lead on additional program administration items such as:

- Weekly safety meetings with all subcontractors;
- Monthly payroll reporting by all subcontractors;
- Management of all claims;
- Coordination of off-site medical clinics and emergency response;
- Implementation and management of the "Return to Work" program; and
- Quarterly meetings with the owner/broker/underwriter/insurer claim's staff.

9. **Safety**: Both OCIPs and CCIPs are loss sensitive. Depending on the policy, safety fines and penalties can be between $500.00 and $2,500.00 per violation. No matter the program type, the program sponsor is responsible for the deductible and losses, so safety and loss control becomes a priority.

Because they are on-site and responsible for implementing and enforcing their own safety program, general contractors under a CCIP are often in an optimal position to drive that program down through all subcontracted tiers and control claims through a safe-work environment. Of course, general contractors who are able to control these issues are in a great position to reap the financial benefits arising from such cost savings under a CCIP policy.

10. **Completed Operations Coverage**: One of the more critical differences between a CCIP and OCIP deals with completed-operations exposure. Typically, completed-operations coverage should extend to the applicable Statute of Repose, which in California is now ten years. On some projects involving homeowner associations or similar entities, a longer coverage period should be considered.

If the Wrap is underwritten to include coverage for the completed-operations period, coverage will be continuous to protect all “insureds” in the event a loss occurs well beyond the completion date of the project. Although coverage continues, the program deductible also remains in effect.

The program sponsor remains responsible for the deductible for the entire completed-operations period. If an OCIP is in place, it can be difficult for owners to ultimately cap their project costs, or more importantly, close their construction loans. Under a CCIP program, owners are not faced with these issues.

11. **Pricing & Cost**: Perhaps the biggest difference between a CCIP and OCIP is the final program rate or cost. Insurance companies that offer Wrap programs are usually the same insurers that write insurance for large general contractors. These insurers often have a higher degree of comfort under a CCIP because they may already be familiar with a certain general contractor’s safety program and therefore, may have a high level of confidence when writing CCIP’s for them. Furthermore, contractors may get the benefit of better pricing and collateral options due to ongoing or continuing projects underwritten by a specific insurance carrier.

12. **Project Close-Out**: As indicated earlier, a Wrap is typically written for the period of the Statute of Repose, which is 10 years in most states. In every case, the program sponsor bears the risk of deductible loss during this entire period, until all claims are closed, or a “buy-out” is offered by the insurer. Buy-outs typically do not occur until the 24th or 30th month following project completion.

At times, because of the length of time that has passed or the lack of available personnel to monitor the situation, an owner may lose track of remaining open losses. As a result, “buy-out” opportunities may ultimately be more expensive.

Because contractors are often very familiar with Wrap administration, they will continue to manage all outstanding claims and have greater potential to work toward a more favorable buy-out with the insurer.

SPECIFIC ISSUES TO BE AWARE OF WITH OCIPS AND CCIPS

1. **Deductibles/Retentions:** Deductibles and Self-Insured Retentions (SIRs) under most OCIP and CCIP programs are the responsibility of the sponsor (i.e., the owner under an OCIP or the general contractor under a CCIP). It is important that both the prime contract and subcontracts address the payment of program deductibles. Specifically, it is common for the contracts to categorize or “tier” the various subcontractors or other program participants as it relates to the payment of deductibles. For an example, a window subcontractor may be categorized as “Tier 1” and be obligated to pay a $50,000.00 deductible for any claim. On the other hand, a drywall subcontractor may be categorized as “Tier 3” and be responsible for a $10,000.00 deductible. Of course, one of the risks of such arrangements is that over time, a subcontractor, or even a general contractor, can become insolvent, thus leaving the deductible or SIR payment to the program sponsor.

2. **Coverage**: It is important that any Wrap program have sufficient coverage to cover all potential losses. While many general contractors and subcontractors carry their own general liability coverage, most of those policies include exclusions for projects that include a Wrap program. As such, if for some reason the Wrap policy fails to cover a certain loss or is insufficient to cover a loss, there will be an argument on the part of the contractor’s own insurance carrier, that they are not required to cover that loss. This could expose the individual contractor to

liability, leaving the owner to determine whether that contractor is financially capable of absorbing that liability.

This issues needs to be kept in mind even more so when it comes to what an OCIP or CCIP actually covers and when coverage applies. Some questions and issues are as follows:

Start Date: Some OCIP policies, but not all, provide a "basket" aggregate that combines operations losses and completed operations losses under one aggregate limit. However, contractors are usually only covered from the date they actually enroll and the policy begins. If a contractor starts working before being enrolled in the OCIP program for the project, they may need their own policy to cover the time before (or after) the OCIP policy ends.

What Is Covered? What is actually covered under an OCIP or CCIP depends on the specific policy language. Typically, OCIPs and CCIPs cover:

- General liability for bodily injury and property damage claims;
- Products and completed operations liability;
- Workers compensation;
- Employers liability for all enrolled subcontractors and employees working at the project site; and/or,
- Occasionally, excess liability.

However, the following items are +not+ traditionally included in an OCIP/CCIP:

- Builders risk;
- Property of the subcontractors (whether owned, rented, borrowed equipment);
- Materials which are not incorporated into the project,
- Automobile liability; and/or
- Subcontractors off-site workers compensation and liability exposures.

There are many advantages to using Wrap policies on certain projects, but owners,

general contractors and even subcontractors need to be aware of the pitfalls that exist, involving coverage and cost issues which could leave certain parties exposed and subject to uninsured liability. Before entering into any contract for a project which includes a Wrap program, we recommend consulting with your attorney and insurance broker, to ensure you are best positioned for dealing with claims which inevitably arise during and after most construction projects.

If you have questions regarding Wrap insurance, contact Mike Middleton at Trainor Fairbrook for further information.