BUILDER AND DEVELOPER

UNDERSTANDING THE EVER-CHANGING CONDITIONS IN LIABABILITY POLICIES

During the planning process, it's important to recognize that conditions require careful review before policy purchase.

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Not long ago, there was a time when builders and developers could select a liability insurance program for their projects, write the check, file away the policy and, at least until a claim surfaced, forget about insurance. Moreover, most liability policies featured small deductibles that were paid as a matter of course once a claim, usually a construction defect suit, surfaced.

However, insurers' reactions to heavy policy losses and a harder insurance market have led to the substantial policy changes over the last decade. Key differences have included the use of manuscript policy forms with numerous policy conditions and large self-insured retentions ("SIRs").

The policy conditions imposed on insureds can be numerous and must be factored into a builder's risk management program from the start. In addition, the policy's SIR – generally the amount of money an insured must incur before the insurer will participate in a loss – can have substantial effects both on the insureds' planning for future losses and in determining how much of the loss will ultimately be covered by the insurer. Builders are well served to understand the fine print of these portions of the policy and plan ahead to successfully integrate them into their risk management program.

Insurance policies typically include conditions or "subjectivities" that insureds are required to follow under the insurance program. Traditionally, these have been common with respect to post-loss duties. But over the last decade, carriers increasingly have included conditions aimed at the builder's operational practices.

Certain conditions may impact risk management strategies and related project documents already in place. Seeking to divert potential future exposure, carriers may require builders to provide each homebuyer with home warranties or to contractually require buyers to participate in arbitration in the event of a dispute. Such policy conditions, or provisions found in endorsements like the Contractors Warranty Endorsements, may necessitate the builder to revise its project documents where is necessary to accommodate these requirements.

Carriers' Quality Assurance and Quality Control requirements may be in the form of a simple condition that third-party quality assurance be used, with a list of the carrier's pre-approved firms. Others may state more specific types and levels of quality-assurance program requirements or require that the builder's internal QA/QC program follow certain practices. Builders should carefully examine the requirements and how they will be carried out, and include a direct vetting of the QA firms that they may use.

It is also crucial to understand all that comes with the fine print of liability policies' SIR endorsements. In recent years, it is not uncommon for liability policies to include substantial SIRs, in the range of $100,000 to $250,000 per occurrence. Planning for this exposure involves understanding the effect of the endorsement language, which can vary greatly policy to policy, and year to year.

The fine print of the endorsement will reveal much about what a builder will have to incorporate into its risk management strategies. Policies may have any number or combination of provisions related to how the SIR will apply. Understanding the likely retention amount on future claims is a builder's first step in setting reserves.

The endorsement also may address how the SIR may be eroded and include administrative conditions (e.g. how the insured must track and report expenses and when the expenses must be reported). These conditions will require the builder to have a system in place ahead of time to properly track and account for its costs, so that it can prove to the insurance company that it has exhausted the SIR.

Aside from the differences between the SIR forms used by the various carriers, the legal interpretation of these forms is actively contested between insureds and insurers. Cases continue to address what types of costs borne by an insured will erode the SIR (e.g. indemnity vs. defense costs), whose payments may erode the SIR (e.g. only the named insured or other parties), what type of other payments may erode the SIR, and how the per-claim or per-occurrence language may affect the triggering of the policy.

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