UTCLE The University of Texas School of Law

Presented:
University of Texas School of Law
2011 Construction Law Conference

September 22-23, 2011
Belo Mansion, Dallas Texas

A Practical Guide to Construction Insurance

C.A. (Joe) Davis
Lorinda Holloway

C. A. (Joe) Davis
Brown McCarroll, L.L.P.
111 Congress Avenue, Ste. 1400
Austin, Texas 78701

cadavis@brownmccarroll.com
512-703-5780

A Practical Guide to Construction Insurance

I. INTRODUCTION

Whether a lawyer is drafting a construction contract or litigating a construction dispute, a basic practical familiarity with the insurance policies and coverages commonly utilized for construction projects is essential to competent representation of one's client. This paper will provide definitions of certain terms and concepts which are prerequisite to a clear understanding of construction insurance, discuss some of the most common types of construction insurance coverage, identify some areas that deserve special attention and attempt to give an overview of how the various policies and coverages fit together.[1] This paper is an effort to lay a practical and useful foundation upon which the reader may begin to build a sound and thorough understanding of construction insurance, but it is not intended to be an advanced or complete disquisition on this complex topic. As demonstrated by the large and growing body of case law on coverage issues, there remains a substantial degree of uncertainty in coverage analysis, a full parsing of which would go far beyond the scope of this presentation of basic principles.

II. KEY TERMS AND CONCEPTS

Policy Forms: Modern insurance policies in general, and construction insurance policies in particular, are the descendants of contracts written in ages past for the ocean shipping trade, to transfer the risk of the loss of a shipment to the insurer. Historically, or traditionally at least, the business of insurance began in 1688 in Edward Lloyd's Coffee House in London, where customers laid wagers on whether particular cargo ships would return safely to port (as well as on such risks as the fate of criminals and highwaymen, and the possible death of peers of the realm.[2]. Today, much of the world's commercial risks are still insured or reinsured by the members of the organization known as Lloyds, through syndicates which write policies on a wide range of forms, some relatively standard, and some entirely customized to address unique risks. Archaic language derived from old marine insurance forms, as well as the often cryptic verbiage common in policy terms can be serious obstacles to understanding modern insurance policies. An insurance trade association, the Insurance Services Office (ISO) was formed in 1971 to provide, among other things, standard form policy language. The standard ISO forms for general liability and commercial property insurance policies are frequently encountered in all types of businesses, including the construction industry. When an insurer does not use an ISO or other standard form, the carrier creates its own policy form known as a "manuscript" form. Endorsements modifying the terms of the policy are often manuscripted, even though they may

[1] The author acknowledges that much of the form and substance of this paper is drawn (with an eye on Texas law) directly from the excellent treatise, Construction Insurance, A Guide for Attorneys and Other Professionals, (Stephen D. Palley, Timothy E. Delahunt, John S. Sandberg, and Patrick J. Wielinski, eds., Am. Bar Ass'n 2011). This book treats the subject matter exhaustively and authoritatively, and can be relied on to correct and complete this article's shortcomings.

[2] Hugh Cockerell, Lloyd's of London, A Portrait 13 (1984). Cockerell further noted, "[O]ne could insure to receive a payment of money if Parliament should be dissolved or war declared, and the lives of persons accused of a crime could be insured." *See also,* http://www.lloyds.com (last visited September 12, 2011).

be attached to a standard form policy.[3] It is dangerous to generalize about the coverage implications of a particular form, and in analyzing coverage for a particular loss, there is no substitute for a careful reading of the entire policy and all endorsements.

First Party v. Third-Party Coverage: First-party coverage applies to and protects an organization's own physical assets, such as buildings, equipment, and vehicles. If a covered event or "occurrence" damages these items, the insurance company pays the insured the promised compensation, usually the value of the property or the cost to repair or replace it. The hallmark of first-party coverage is that the insured party suffering an injury can submit the loss directly to the carrier for reimbursement. First-party policies generally do not protect the insured from claims by third parties. Notably, some policies do include both first-party and third-party protections.

Third-party coverage, on the other hand, is typically known as liability insurance and covers the insured's liability for damages to a third party. The two most common third-party coverages on a construction project are commercial general liability and professional liability policies. Many, but not all third-party policies provide two distinct types of protection: a duty to defend, and a duty to indemnify. The duty to defend, which is typically broader than the duty to indemnify, covers the cost of defending against potentially covered third-party claims, while the duty to indemnify encompasses the cost of paying covered third-party claims.[4] Potential extra-contractual claims against an insurer generally arise out of a breach of either the duty to defend or the duty to indemnify.

The duty to defend exists when simply the *potential* for coverage exists. Texas limit the duty-to-defend analysis to a comparison of the four corners of the pleading with the four corners of the insurance policy. This is known as the "eight corners" rule, or the "complaint-allegation" rule.[5] In other words, if the complaint alleges facts which, if true, would constitute a covered occurrence under the policy terms, the insurer has a duty to defend.

Because of the complexity of modern commercial litigation such as construction defect litigation, it is commonplace for a defense to be provided under a reservation of rights or nonwaiver agreement. A reservation of rights is a unilateral reservation by the insurer of its rights to contest coverage (and may assert a right to seek reimbursement of defense costs if coverage is ultimately negated). A nonwaiver agreement is a bilateral agreement between the insurer and insured regarding the potential application of coverage defenses. Reservation-of-rights letters are far more common than nonwaiver agreements, but the purpose of both is to alert the insured to potential coverage defenses.

The duty to defend generally begins upon the tender of a suit (or under certain pollution liability policies, upon tender of an administrative action) and ends when the insurer has paid a

---

[3] David T. Dekker, et al., *Insurance and Risk Transfer Basics for Construction Projects in* Construction Insurance: A Guide for Attorneys and Other Professionals 17 (Stephen D. Palley *et al*. eds., 2011).
[4] *Id*. at 11-12.
[5] Lee H. Shidlofsky and Patrick J. Wielinski, *Commercial General Liability Coverage in* Construction Insurance: A Guide for Attorneys and Other Professionals 102-103 (Stephen D. Palley *et al*. eds., 2011).

Title search: A Practical Guide to Construction Insurance

First appeared as part of the conference materials for the
2011 Construction Law session
"A Practical Guide to Coverage and Policy Provisions for Construction Liability"