AmWINS Group, Inc.

BENEFITS AND CHALLENGES OF USING CONTROLLED INSURANCE PROGRAMS IN CONSTRUCTION PROJECTS

Controlled insurance programs ("CIPs") are specialized insurance products purchased by a single entity for construction projects. CIPs typically include general liability coverage, with - at times - optional coverage available for workers' compensation, builder's risk, environmental liability, and excess liability.

Traditionally, construction projects are subject to various insurance policies of the owner, developer, general contractor, and subcontractors. However, CIPs constitute a single insurance policy for all of these entities on a given construction project or series of projects. CIPs purchased or sponsored by property owners are known as Owner- Controlled Insurance Programs (OCIPs), while CIPs sponsored by general contractors are known as Contractor-Controlled Insurance Programs (CCIPs).

CIPs entered the marketplace in the 1940s, during the post-World War II industrial boom. The United Nations building and the Chase Manhattan Bank headquarters, both in New York City, were among the first construction projects to utilize CIPs.[1] Since that time, and especially since the turn of the century, CIPs have become increasingly popular in both private and public sector applications.

ADVANTAGES OF CIPs

CIPs allow for greater bargaining power on the part of the collective insured entities, streamline the claim handling process, and ensure uniformity of coverage (including aggregate and per occurrence limits) among all entities, which leads to more robust coverage terms and lower premiums. Let's look at these advantages closer.

1. CIPs offer coverage where it may otherwise be cost-prohibitive or unavailable, such as in condominium construction projects, where traditional commercial general liability policies routinely contain condominium exclusions. Regarding cost, credits due to contractors who factor in the cost of traditional insurance products may significantly reduce or even offset entirely the cost of a CIP, making careful calculation of these credits critical.
2. CIPs offer meaningful cost savings over traditional schemes in which the entities each obtain their own insurance policies at their own cost. The redundancy of coverage which may impact traditional schemes is eliminated with CIPs.[2] Construction projects remain particularly sensitive to uniformity of coverage requirements, as the renewal of policies during the course of construction creates the risk of weaker coverage terms than were in place at the inception of the project. Further, traditional schemes may result in primary and excess coverage of inconsistent scopes among the entities. CIPs address these concerns by ensuring a single, uniform policy for all enrolled entities. CIPs eliminate the need for an owner or general contractor to follow up with other entities to ensure compliance with contractual insurance requirements.[3]

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3. CIPs tend to generate fewer claims among insureds compared to traditional schemes, since the insured entities all fall under the same insurance policy, creating a disincentive for claims among them. In the context of litigation, CIPs conceptually reduce the likelihood of cross-claims among the enrolled entities, as they are all subject to the same policy. As a result, claims are more likely to be resolved without disputes over liability among the enrolled parties. Further, CIPs often require an enhanced and uniform set of safety procedures, reducing construction site injury claims.[4]

   In addition, CIPs typically feature completed operations coverage extended to the particular jurisdiction's statute of repose, which eliminates the uncertainty of coverage after project completion through the period of potential liability. struction projects, where traditional commercial general liability policies routinely contain condominium exclusions.

4. As CIPs provide complete coverage during a project's duration, the total insurance cost of the project is known at the outset. CIPs reduce the risk of higher renewal premiums during the course of a project, which creates certainty in budgeting and financing of that project.[5]

DISADVANTAGES OF CIPs

Of course, CIPs are not without drawbacks, including the following:

1. The transaction cost of CIPs may be greater than traditional insurance products. CIPs require heavy administrative responsibility that may be borne in large part by the insurance broker and, to some degree, by the program sponsor. Alternatively, third-party wrap administrators are often hired to take on much of this burden, but that does add to the cost.[6] At the outset, the insurance broker must ensure proper and timely enrollment of all intended insured entities. When contractor bids include the cost of traditional insurance products, the insurance broker, with the general contractor, must calculate bid credits or deductions to account for the fact that the contractor will not be purchasing its own insurance. Bid credits often offset the entirety of the costs of the CIP program, so proper calculation of these is critical.[7] Some CIPs have stringent project course of construction reporting requirements, which may be satisfied by the insurance broker as well. Reporting requirements include closeout procedures memorializing the completion of construction. These heightened administrative requirements make the selection of a experienced CIP insurance broker or wrap administrator all the more important.

2. The fact that CIPs have a single sponsor means the responsibility for implementation of the program and the coordination of claim handling falls on that single entity (either an owner or contractor.)

3. As CIPs are often project-specific, owners or contractors who are involved in multiple construction projects will have to continue to maintain their conventional insurance policies for those other projects, despite the use of CIPs on a single project, as well as to cover issues that might be excluded under CIPs and in compliance with an owner's or general contractor's contractual obligations.

4. CIPs are generally suited to larger construction projects, due to relatively high administrative costs and the economic unviability of scaling to smaller projects with limited coverage requirements.[8]

5. While CIPs may include insured entities' owners, contractors, construction managers, and subcontractors, they typically do not provide coverage for design professionals[9], suppliers, and (off-site) manufacturers, as well as second-tier subcontractors.[10]

6. CIPs often carry higher deductibles or SIRs than may be carried by the enrolled contractors on their individual policies. The manner in which deductibles or SIRs are allocated back amongst the insureds requires careful negotiation and should be clearly understood by all parties from the start.

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OWNER-CONTROLLED INSURANCE PROGRAMS (OCIP's)

As with CIPs and traditional insurance policies, OCIPs and Contractor-Controlled Insurance Programs (CCIPs) offer unique advantages and disadvantages for owners and contractors, respectively.

OCIPs provide the owner with the greatest risk management control.

In OCIPs, the owner is the program sponsor, and therefore has the benefit and responsibility of selecting the insurance broker/administrator and the OCIP product, including the carrier, policy limits and terms. The owner, as the program sponsor, also determines the allocation of premiums and deductibles among the general contractor and subcontractors. The program sponsor may also select and have written into the program terms its choice of counsel in the event of a claim.

As the owner is making premium payments, the cost savings of using an OCIP generally inure to the owner's benefit.[11] OCIPs allow an owner to have a direct relationship with the carrier, leading to further long-term cost savings spread over multiple projects. OCIPs also allow the owner to obtain the benefit of lower premiums when multiple projects are involved. For example, a single OCIP may provide "rolling" coverage for one project or phase of a project after another, all in a single program. The aggregate limits of such an OCIP may be shared among all the projects or dedicated to each project, according to the owner's preferences.[12]

An OCIP also allows an owner the ability to confirm compliance with the lender or investor-imposed insurance requirements.

Moreover, it allows the owner to change general contractors. A change of general contractor mid-project in a CCIP would require the owner or new general contractor to procure a new CIP, which is a costly and challenging prospect.

The control and related features of an OCIP also offer disadvantages, which may steer owners to CCIPs. For instance, while OCIPs give owners control, they also burden owners with the requirements of being program sponsors (i.e. selecting broker, carrier, policy limits/terms, etc.).

General contractors with established company-wide CCIPs may be able to offer cost savings on par with or even better than OCIPs. Additionally, some general contractors may have the bargaining power to insist on a CCIP over an OCIP, regardless of cost savings to the owner.

CONTRACTOR-CONTROLLED INSURANCE PROGRAMS (CCIPs)

In a CCIP, the general contractor will have the power to select the insurance broker/administrator, the carrier, policy terms, and counsel in the event of a claim. This decision-making may be most appropriate for a general contractor, as it is the intermediary between the owner and subcontractors, maintaining contractual privity with both. Further, a general contractor's sponsorship of the CIP allows it to tailor those contracts based on the terms of the CIP which it negotiates.

As the general contractor is responsible for project safety programs, construction means and methods, supervision/oversight, and sequencing, it is in the best position to sponsor the CIP. Coordination of course of construction reporting and project close out with the general contractor, as opposed to the owner, makes practical sense, as well.

Just as OCIPs provide the cost savings to the owner, CCIPs provide the cost savings to the general contractor. While the general contractor may charge an up-front fee to the owner for insurance, it may end up paying significantly less in premiums for a CCIP, creating a profit for the general contractor.

CCIPs come with disadvantages similar to those of OCIPs, with the most important being that the ability to control the program requires its own costs in terms of time, resources, and administrative handling. Further, certain owners with well-established insurance programs may force general contractors to choose between working on a project with an OCIP or not at all. For owners, CCIPs create distance between risk management and themselves. Depending on the owner's appetite for this management and cost savings, CCIPs may prove more costly.

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CONCLUSION

The economies of scale often favor the use of CIPs for large construction projects, including mixed-used residential and commercial projects. However, smaller projects (e.g. under $25M in cash value) are also increasingly utilizing CIPs, especially for residential projects in venues where construction defect claims are common and robust coverage options are limited. CIPs streamline risk management by project where it would otherwise yield insufficient, inconsistent, and redundant insurance coverage. However, the advantages of OCIPs and CCIPs must be carefully weighed by owners and general contractors alike, with an eye toward the double-edged sword of control/responsibility and cost effectiveness.

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[2] DeLaRue, David and Lori Ribinett, *Construction Project Controlled Insurance Program,* WILLIS TOWERS WATSON, https://www.willis.com/documents/publications/Industries/construction/Construction_Project_Controlled_Insurance_Program_CIP_flyer.pdf (last visited Sept. 29, 2019).

[3] Grindle, Gary, *5 Risk Transfer Options for Owners and Developers And the Emerging Use of GL Wraps for Smaller Projects*, AMWINS GROUP (2017), https://www.amwins.com/insights/article/5-risk-transfer-options-for-owners-and-developers_3-17 (last visited Sept. 29, 2019).

[4] Gibson, Jack P. *The Wrap-Up Guide*, 4th edition, INTERNATIONAL RISK MANAGEMENT INSTITUTE (2006).

[5] Grindle, *supra* note 3.

[6] Taylor, *supra* note 1.

[7] For example, in the case of an OCIP, the general contractor would receive a bid credit or deduction from the owner. In the case of a CCIP, the subcontractors would receive a bid credit or deduction from the general contractor.

[8] Grindle, *supra* note 2.

[9] Some CIPs offer general liability coverage for designers and engineers, but professional liability insurance must be procured separately.

[10] Aegerter, Colleen, *Taking the Stress Out of Controlled Insurance Programs: Guidance for Contractors and Subcontractors*, LOCKTON BROKERS (2019), https://www.lockton.com/whitepapers/Aegerter-Guidance_for_Subcontractors-lo_res.pdf (last visited Sept. 29, 2019).

[11] Taylor, *supra* note 1.

[12] Gibson, *supra* note 3.