



Insurance Coverage Litigation Committee CLE Seminar

March 5–8, 2014

Loews Ventana Canyon / Tucson, AZ

ABA
Section of
Litigation

Wrap-Up Insurance Challenges for Coverage Attorneys from Implementation Through Completed Operations

The Interplay Between Wrap-Up Coverage and Standard Corporate Insurance

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Project owners and contractors have had increased opportunities to employ “wrap-up” insurance programs in recent years as the effects of the economic recovery have re-energized the construction industry. Moreover, as project stakeholders gain familiarity with how wrap-ups work, thus leading to more successful wrap-up projects, it is likely that the use of wrap-ups will continue to grow. In short, wrap-ups appear poised to play an important part in construction risk management for the foreseeable future.

This article first provides a high-level overview of wrap-ups, highlighting how they operate, some of the potential advantages and disadvantages of using wrap-ups, and then discussing common risks that often are not covered under wrap-up programs. The article then discusses two critical questions concerning when coverage under a wrap-up is in force for a particular party and, in addition, what impact wrap-up coverage may have on a party’s own separate insurance program.

I. BACKGROUND

A construction wrap-up is a single insurance risk management program for all or most all of the parties involved in a construction project. Wrap-up insurance programs typically are used for large construction projects. The wrap-up program will afford specified coverage for many different exposures on the project and will usually insure the owner, contractor, and subcontractors at all tiers for work performed at the project site. The wrap-up replaces the

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traditional arrangements by which the parties involved in the construction project separately procure various insurance coverages.

A wrap-up program typically includes workers' compensation, employers' liability, general and excess or umbrella liability, and all risk builder's risk/installation floater (excess liability). Automobile liability and contractor's equipment are not typically included.² In addition, wrap-ups rarely will provide coverage for professional services, and certain project participants may not be enrolled in a wrap-up for any number of reasons.

A wrap-up may be an "Owner Controlled Insurance Program" (OCIP) or a "Contractor Controlled Insurance Program" (CCIP). An OCIP, as the name implies, is an insurance program purchased by the project owner for the project's participants. In a CCIP, the general contractor, design-builder, or construction manager (called the "controlling contractor") typically purchases the wrap-up insurance program. A CCIP may have an advantage over an OCIP to the extent that the controlling contractor is in a better position than the owner to control the contracting process and potentially obtain greater savings. Conversely, when the owner plays an active role in project management, the owner may find it preferable to use an OCIP.

On a traditional project, contractors and subcontractors at all levels each purchase their own insurance and include the cost of that insurance in the price of their bids. In contrast, on a wrap-up project, contractors and subcontractors enroll in the consolidated insurance program but do not pay premiums directly to the insurer. Instead, the controlling contractor or owner will pay the premiums for the wrap-up and then look to offset the costs through lower contract prices with

² This article does not discuss the unique issues associated with subcontractor default insurance, which is a first-party insurance that owners or prime contractors can purchase to protect against subcontractor default, and which may also look very similar to a wrap-up in that it is purchased for an entire project or on a "rolling" basis for a specific contractor or set of projects.

wrap-up participants. (In addition, at the close of the project, the controlling contractor or owner usually will perform a reconciliation to account for the final insurance costs, based on the total contract value and/or payroll of each enrolled participant.) To accomplish this, subcontractors often are instructed to provide their bid without the cost of insurance or, alternatively, to provide a base bid that includes insurance but also to propose an alternate deduction for insurance if the subcontractor becomes enrolled in the wrap-up. Bidders also may be required to provide estimates for payroll and/or work hours on the project to help the owner or controlling contractor evaluate their bids.³ Often, and particularly on negotiated projects, bidders are also required to provide company financials, loss histories, or other information.

The coverage afforded by a wrap-up program typically is described in a project manual. This manual should explain, at a minimum, the bid process, claims management, and safety requirements for all wrap-up participants. The administrator for the wrap-up is often, but not always, the insurance broker.

States regulate wrap-ups based on the type of programs, project size, and other regulatory issues. In addition, unique challenges arise when forming wrap-ups in states where workers' compensation is run by state funds rather than private insurers.

A. Advantages of Wrap-Ups

Wrap-ups have the potential to provide project participants significant advantages that are not offered by traditional insurance, including:

³ Among other things, this can help identify when a bidder's proposed credit for insurance appears to be too low, which may occur when the bidder bases its credit on its own high-deductible insurance plan (which would be inconsistent with the actuarial risks to the bidder in a lower-deductible wrap-up program). Likewise, if the proposed credit appears to be too high, then the reasons for the high insurance credit—such as, for example, poor loss histories—can be examined by the owner or controlling contractor to determine the best course of action. Given that many wrap-ups are loss sensitive, it may be decided that it is best to not enroll a particular contractor in a project's wrap-up program.

- ***Potential of Greater Project Participation***
 - A wrap-up may expand the pool of contractors available to bid on a project. For example, where a project requires specialized insurance, a wrap-up may provide an opportunity for contractors to obtain those coverages that they might otherwise not be able to find at competitive rates.
 - Wrap-ups may be particularly helpful in enabling certain small or disadvantaged businesses to participate on certain projects.
- ***Cost Savings***
 - A wrap-up may lower the total cost of insurance because insurance is purchased in “bulk,” thereby generating volume discounts for the purchaser.
 - In addition, there may be greater efficiency in both insurance administration and claims handling, and the presence of a single insurer may reduce the existence of inter-insurer disputes, and it should eliminate the purchase of overlapping coverages. Indeed, this may be reflected by the fact that case law involving inter-insurer litigation in this area is sparse.
 - Finally, an owner or contractor may avoid paying mark-ups on insurance at each level of contracting by purchasing it directly.
- ***Comprehensive Coverages***
 - A wrap-up may provide comprehensive coverage for an entire project and minimize the potential for gaps in coverage caused by a patchwork of coverage under traditional contracting arrangements.
 - By using a wrap-up, the parties are aware of what coverages exist, what the limits are, and what the parties must do in order to protect their rights under the wrap-up policy.
 - In addition, a wrap-up may enable certain coverages to be provided that otherwise might be unavailable or prohibitively expensive when purchased separately on the open insurance market.
 - Wrap-ups also often contain dedicated limits that are not eroded by losses on other projects, ensuring a certain minimum level of coverage for a specific project.

- ***Improved Safety and Loss Control***

- A wrap-up may promote site safety and loss control, since one insurer is ordinarily providing coverage for all or most all workers on the site.
- Likewise, contractors at all levels often are provided with financial incentives tied directly to safety and loss performance on a wrap-up project.

B. Disadvantages of Wrap-Ups

On the other hand, wrap-ups can present disadvantages—or the use may be restricted— such as those listed below:

- ***Laws Restricting Wrap-Ups***

- Some states restrict the use of wrap-ups, particularly for projects for public entities.

- ***Limitations Based on Size***

- Wrap-ups may not be cost-effective if they are too small or if they will not generate enough workers' compensation premium to justify the costs of set-up and administration.

- ***Unfamiliarity with Wrap-Ups***

- Many parties, particularly certain subcontractors, may be wary of the bidding process and may elect not to participate on a wrap-up project. Likewise, bidders may try to “game” the bid system.

- ***Management Challenges***

- Owners or controlling contractors might find it more difficult to manage subcontractors that are contractually required to repair damaged work where the subcontractor asserts that the wrap-up administrator is delaying adjustment of the claim.
- Likewise, parties may disagree about the responsibility for paying premiums resulting from the actual experience on the project, and courts may find ways to preclude controlling contractors or owners from recouping additional costs of insurance premiums. *See, e.g., East Hills Metro, Inc. v. Jeffrey M. Brown Assocs., Inc.*, 907 N.Y.S. 2d 16, 18-19 (N.Y. App. Div. 2010) (holding that a general

contractor could not withhold amounts attributable to a subcontractor's increased insurance costs based on increased scope).

- ***Coverage Gaps/ Overlapping Coverage***

- Wrap-ups cover work only on the project site, which may lead to gaps in coverage or overlapping coverage. For example, if a subcontractor performed fabrication at an off-site location, or if the subcontractor had a staging or laydown area that was not part of the "project site," then the subcontractor would need to obtain other insurance to cover that work.
- Similarly, wrap-ups do not provide coverage for most products liability exposures if the relevant "products" were not manufactured on site. For example, a wrap-up would not afford coverage for liability arising out of defective products that are simply installed at the project, such as a leaking window or defective fixture. Consequently, a claim arising out of a products liability exposure on a wrap-up may present disputes that would look different than had there been a traditional insurance arrangement in place.

While wrap-ups have been used in a wide range of circumstances, they do not always make sense. Instead, the potential for using a wrap-up should be carefully analyzed at the outset of a project and, if a wrap-up will be used, it should be coordinated with other coverages to ensure that appropriate coverage is in place.

II. ENROLLMENT IN WRAP-UPS

Most often, a party will agree to participate in a wrap-up as part of its contract associated with work on the particular construction project. For example, the section dedicated to "Insurance" in a typical contract between a prime contractor and its subcontractor may specify that the subcontractor will be enrolled in the wrap-up program, and it may incorporate the project manual into the contract by reference. Nonetheless, most wrap-ups require participants to actually enroll in the wrap-up program (at a minimum) before coverage is in place. Therefore,

care should be taken by all project stakeholders to make sure that effective wrap-up coverage is in place for each project participant prior to that participant beginning work on site.

A number of decisions issued in the last few years highlight the point that coverage under a wrap-up is not in force merely because a contractor contractually agreed to participate in the program. For example, in one recent case, a federal district court ruled that a subcontractor was not covered under a wrap-up because it failed to take the steps necessary to enroll in the program. *See Williams v. Traylor-Massman-Weeks, LLC*, No. 10-2309, 2012 WL 1106652, *3 (E.D. La. Apr. 2, 2012). In so ruling, the court rejected the subcontractor's argument that it was insured because its contract with the prime contractor required it to participate in the wrap-up, observing that the insurer was not a party to the contract and that the plain terms of the wrap-up policy required subcontractors to enroll in the program to be covered. *Id.* at *4. *See also Zurich Am. Ins. Co. v. Ill. Nat'l Ins. Co.*, 940 N.Y.S. 2d 271, 271-72 (N.Y. App. Div. 2012) (subcontractor did not qualify as "contractor" insured under OCIP where the term "contractor" required the execution of a written work agreement and the enrollment in the OCIP, and the subcontractor did neither until nearly four weeks after alleged occurrence took place); *Alpha Constr. & Eng'g Corp. v. Ins. Co. of the State of Pa.*, 402 Fed. App'x 818, 825 (4th Cir. 2010) (applying Maryland law) (concluding that a consultant not enrolled in a wrap-up was not covered).

The absence of coverage under a wrap-up could have disastrous consequences for unwary parties. For example, if a party did not secure other coverage for the risk at issue through its own separate insurance program, then it might be left without coverage for the particular loss. In addition, even if the risk were covered by the party's own separate insurer, coverage could be lost to the extent that the party relied on its supposed coverage under the wrap-up and, as a result,

failed to provide notice or comply with the other provisions of its own separate policy. The failure of one party to obtain could have ripple effects on the other project stakeholders, as well. Therefore, it is critical for wrap-up participants to be sure to enroll in the program and/or complete other necessary steps for coverage to be in effect. Likewise, owners or controlling contractors should monitor enrollment status along with project schedules to ensure that coverage is in place for contractors who should be enrolled before work commences on site; not only is this critical to risk management, but it also can help avoid costly schedule delays caused when a contractor cannot begin work on site until its enrollment in the wrap-up is complete.

III. SCOPE OF COVERED RISKS

Another common trap for an unwary wrap-up participant is to view wrap-up coverage as a total risk management solution for its risks associated with a particular project. Indeed, while wrap-ups are designed to cover many of the risks associated with a construction project,⁴ there are certain risks that are almost always not covered.

First, as mentioned above, wrap-ups do not provide coverage for claims arising from losses occurring outside the confines of the project site. For example, losses occurring during off-site fabrication or delivery of materials to a construction site will not be covered.

Accordingly, wrap-up participants should examine their own separate policies and identify how such policies interact with coverage under the wrap-up. In addition, owners and prime

⁴ When a wrap-up is established to provide coverage for a project, it will not afford coverage for claims that do not arise out of the project even if the same injury would have been covered had it arisen from construction activities. *See, e.g., Zeitoun v. Orleans Parish Sch. Bd.*, 33 So.3d 361, 367-68 (La. Ct. App. 2010) (holding that school district's OCIP providing general liability coverage for numerous projects at schools under a capital improvements program did not provide coverage for injury unrelated to construction and suffered at location where no improvements were being made).

contractors may wish to seek additional insured status on subcontractors' policies to the extent that they could be the subject of claims brought under those policies.

Second, most wrap-ups contain very limited coverage, if they provide coverage at all, for liability associated with professional services. For this and a number of other reasons, architects, engineers, and other design professionals rarely will be covered by a wrap-up. In addition, many project consultants (*e.g.*, surveyors, parties doing testing or inspections, etc.) will not participate. Finally, even if certain trades are covered, professional liabilities associated with those trades (*e.g.*, design, preparation of shop drawings, and calculations, etc.) will not be insured under the wrap-up. Consequently, wrap-up participants should carefully examine what potential risks with respect to professional liability are presented and obtain insurance to cover those risks as appropriate.

Third, wrap-ups often exclude certain contractors, either because of the contractor's trade specialty (*e.g.*, demolition, hazardous material abatement, etc.) or because the contractor has a poor loss history. In such a situation, the owner or controlling contractor will likely obtain appropriate proof of adequate insurance coverage from these contractors largely in the same way that it would on a non-wrap-up project. Careful attention should be paid so that these insurance requirements are not overlooked, particularly given that the project personnel may be using different processes for monitoring appropriate subcontractor insurance coverage on the wrap-up than they would if it were a traditional non-wrap-up project.

Fourth, wrap-ups often contain exclusions that may bar or limit coverage for certain types of claims. For example, wrap-ups commonly exclude risks associated with pollution, mold, lead, silica, Exterior Insulation and Finish Systems (EIFS), or earth subsidence. Consequently, owners or controlling contractors may seek to obtain proof of corporate coverages for certain risks

excluded from the wrap-up, and other project participants may wish to secure specific coverages that are not provided by the wrap-up.

Fifth, in many instances, wrap-ups are not purchased with completed operations coverage to cover the entire period of the statute of repose. As a result, participants should examine whether it is desirable to obtain tail coverage from their own separate insurers to cover risks that may arise after the completed operations coverage under the wrap-up has terminated.

Sixth, as a matter of wrap-up administration, owners or controlling contractors may stop ongoing operations coverage once a project is completed or nearing completion. This may be particularly likely if a project completion date has been extended for any significant period of time. As a result, wrap-up participants should ensure that they have appropriate coverage in place to account for ongoing operations to the extent that they will be performing work on-site.

In light of the fact that wrap-ups do not provide truly comprehensive coverage for all aspects of a construction project, it is important for project participants to carefully examine what coverage is contemplated for a given wrap-up and to coordinate those coverages with either their own standard corporate policies or those of other project participants.

IV. WRAP-UP EXCLUSIONS

Many of the benefits of wrap-ups would be eliminated if wrap-up coverage was just “other insurance” for project participants. Stated differently, wrap-ups work properly when participants are not charged premiums under their own separate policies for the risks associated with work covered by a wrap-up.⁵ Of course, to account for the fact that they do not collect the

⁵ Premiums for standard corporate insurance may be set and later adjusted based on a company’s overall payroll (*e.g.*, for workers’ compensation) or revenue (*e.g.*, for general liability). Therefore, to avoid paying for the same coverage twice—once in the form of corporate insurance and again by way of contract adjustments in a wrap-up—companies will not pay premiums under their corporate policies for risks covered by project-specific wrap-ups. By

same premiums for risks covered under a wrap-up project, insurers cannot provide the same coverage, and they often place wrap-up exclusions in their policies to accomplish that intent.

Despite numerous attempts at circumvention, courts have consistently applied wrap-up exclusions as written. *See, e.g., Certain Underwriters at Lloyds of London v. Ill. Nat'l Ins. Co.*, No. 09-CV-4418, 2011 WL 723544, *7 (S.D.N.Y. Feb. 25, 2011) (applying two differently worded wrap-up exclusions to hold that an insurer owed no coverage under its primary and umbrella policies given that its insured was enrolled in a wrap-up program); *Welcome v. Just Apartments, LLC*, 2008 WL 2696252, *3 (N.J. Super. A.D. July 11, 2008) (holding that a wrap-up exclusion applied and rejecting the supposed wrap-up insurer's argument that its policy was not a wrap-up for purposes of the exclusion because it did not provide workers' compensation coverage, coverage for subcontractors, or builder's risk coverage); *cf. also Assurance Co. of Am. v. Nat'l Fire & Marine Ins. Co.*, No. 2:09-CV-1182, 2011 WL 3273892, *2 (D. Nev. July 28, 2011) (concluding that a wrap-up exclusion was not an "escape clause," but instead was a "bargained-for exclusion where secondary insurance [was] already in place"). While the litigation thus far concerning the application of wrap-up exclusions has largely been in the context of inter-insurer disputes, the application of wrap-up exclusions may become more important to policyholders in the event that wrap-up programs are written with insufficient limits or with narrower coverage, as may occur when less risk-averse owners or contractors seek to cut corners on insurance coverage.

In addition, even absent a specific wrap-up exclusion, a court may look to the scope of coverage afforded by the wrap-up and conclude the standard corporate policy did not afford

way of example, if a contractor obtained \$1 million in revenue and spent \$500,000 in payroll in a project in which it was enrolled in a wrap-up with workers' compensation and general liability coverage, those amounts should be excluded from the calculation of its workers' compensation and general liability coverage premiums under its corporate policy.

coverage in the first instance. *See, e.g., Va. Sur. Co. v. Adjustable Forms, Inc.*, 888 N.E.2d 733, 738 (Ill. App. Ct. 2008) (holding that a corporate workers' compensation policy provided no coverage, notwithstanding the policy's absence of a wrap-up exclusion, because it provided coverage for all listed workplaces "unless [the insured] ha[d] other insurance or [was] self-insured for such workplace" and because an OCIP policy qualified as "other insurance").

As with all policy provisions, the specific language of a given wrap-up exclusion must be examined to determine the effect that the exclusion will have in a given situation. For example, many wrap-up exclusions are written to bar coverage altogether for losses occurring on a wrap-up project, and therefore coverage will not be available under the participant's own separate policy even if the wrap-up did not afford coverage for the loss as a result of its narrower scope. This result makes sense, particularly when the policyholder paid no premiums to its corporate insurer based on the risks involved with the wrap-up project. To mitigate these risks, policyholders may purchase difference in conditions (DIC) coverage from their standard corporate insurers, under which the DIC coverage would provide insurance for certain risks that were outside the scope of the wrap-up policy. DIC coverage may be particularly important for certain contractors with specialized risks, since the wrap-up's one-size-fits-all approach likely does not actually fit every contractor.

In addition, policyholders should be careful to coordinate their corporate coverages with the coverage provided by wrap-up programs in which they are involved, particularly with respect to professional services, any excluded perils, and completed operations coverage. This is important because there may be gaps between the insurer's own separate insurance coverage and the coverage provided under a wrap-up. In addition, the proper coordination of insurance can help participants from paying for duplicative or unnecessary coverages.

Policyholders also must pay particular attention to policy wording in order to ensure that they comply with their obligations with respect to notifying their corporate insurers of changes in wrap-up programs. For example, some corporate policies may afford coverage to a policyholder in the event that a wrap-up has been cancelled, non-renewed, or terminated, but those policies often require the policyholder to provide timely notice to its corporate insurer of same. A policyholder's failure to do so could bar or limit coverage under its corporate policy.

Finally, while wrap-up exclusions have been given effect as written, a number of courts have expressed reluctance to permit insurers to rely on those exclusions when the insurers were alleged to have waived their rights by failing to assert them in a timely manner. *See, e.g., GHP Partners, LLC v. Am. Home Assur. Co.*, 929 N.Y.S.2d 131, 131 (N.Y. App. Div. 2011) (insurer's denial of coverage based on a wrap-up exclusion was untimely as a matter of law and thus could not be grounds for disclaimer); *Travelers Prop. Cas. Co. of Am. v. Taylor Morrison of Cal., LLC*, No. 5:12-CV-04204, 2013 WL 2384254, *3 (N.D. Cal. May 30, 2013) (concluding that the "fact-intensive" issue of whether the insurer waived its right to rely on a wrap-up exclusion could not be determined as a matter of law at the stage of the proceedings). Therefore, insurers should include a timely analysis of the potential for wrap-up coverage when assessing claims under policies issued in connection with construction risks.

V. CONCLUSION

Wrap-up programs are often used for a variety of reasons, and they provide flexibility in risk management for owners and contractors on large construction projects. However, it is critical that project stakeholders understand the implications that participation in a wrap-up may have. In addition, participants must be sure to comply with the provisions of the wrap-up as well

as the provisions of their own standard corporate policies in order to preserve whatever rights they might have under either policy.