

Members' Bulletin: 2008-03

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To All OIRCA Active Members:

## **Protecting Your Rights To Builders' Risk Insurance As A Subcontractor**

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*Builders' Risk Insurance is a very complicated subject and as such necessitated the preparation of this very detailed bulletin. We encourage all members to read this document as many times as it takes to become familiar with this very important subject.*

*We also suggest that the Member consult with their insurance broker for additional information and to determine that they are sufficiently informed on the subject. Mr. Fenn is also available should you wish to contact him directly.*

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This bulletin serves to advise the trade contractor (acting as a Subcontractor) that in many cases in the event of insurable loss or damage to project work whether caused by the Subcontractor or not, Subcontractors may have certain rights as Insureds within insurance arranged by the General Contractor as required by the Prime Contract that they are mostly unaware of. Our focus herein is on Builders' Risk Insurance. Similar circumstances apply to Wrap Up General Liability Insurance, which are not discussed here to keep focus on the Builder's Risk issue.

We have issued this bulletin due to the following:

- 1) Many Subcontractors are unaware they may have rights to insurance coverage arranged by General Contractors under standard CCDC and oftentimes custom contract forms. (Sometimes Owners arrange the insurance and the same applies, but we will concentrate herein on the Contractor: Subcontractor relationship to avoid confusion.)

- 2) Many subcontractors are not informed about the scope of coverage provided to them by most Broad Form Builders' Risk Insurance policies arranged by General Contractors.
- 3) General Contractors are not always pre-disposed to sharing information on the prime contract insurance requirements. This is the case even when the subcontractor may have an insurable interest in the insurance policies the General Contractor assumes responsibility in contract to arrange.
- 4) General Contractors will not commonly share the actual Builder's Risk Policy information unless they are well informed about insurance coverage themselves and understand the Subcontractors' rights to such insurance.
- 5) Insurers that supply Builder's Risk Insurance are on several occasions settling insurance claims for General Contractors, but they are known to be denying insurance claims from Subcontractors that have a right to coverage as an Insured Party. These claims are being re-directed to the subcontractors' own "Installation Insurance" or sometimes general liability insurance, irrespective of any "primary insurance" clauses that may exist in the Builders' Risk policy. This practice potentially increases rates for Subcontractors, when coverage could have possibly been applied under the General Contractor arranged Builders' Risk insurance; thereby avoiding rate increases brought about by incorrectly paid losses under Subcontractors' insurance.
- 6) If a Subcontractor has caused an insurable accident on a jobsite some General Contractors withhold payment for Subcontractor's completed work and then deduct charges for the rectification costs from such payments. Combined with Insurer coverage denial under 4 above, this practice adds unwarranted and unnecessary financial burden to the Subcontractor when it will in most cases be covered for this re-work under the Builders' Risk Insurance, if not otherwise excluded.
- 7) Insurers that supply Builders' Risk Insurance will sometimes also attempt to recover their losses (subrogate) against the Subcontractor and its insurance if they feel the Subcontractor was at fault/negligent, irrespective of any pre-existing subrogation waiver in the Builders' Risk policy. Many Subcontractors are unaware that this practice is inappropriate and co-operate with these insurers..... **to their own detriment.**
- 8) Save for a few, many very experienced claims adjusters seem to be misinformed about how Builders' Risk Insurance (and other construction coverage) should respond to coverage and who is an insured there under. This is no less than baffling considering how long these products have circulated the insurance marketplace as well as how "mature" some of these adjusters actually are.

Several situations exist where experienced brokers argue successfully on behalf of their Subcontractor clients against Builders' Risk insurers attempting to (1) transfer claims to and also (2) subrogate (recover) paid losses against the Subcontractors' own insurance.

This very inappropriate practice by Insurers seems to be common, increasing and potentially translates into a win/lose against the Subcontractor. Win – for the Builders’ Risk Insurer which increases builders risk profits by avoiding claims and recovering paid losses; lose – for the Subcontractor due to the unnecessary extra financial burden and possibly increased insurance costs this represents. There is also a possible “double dip” scenario that may occur if the General Contractor collects from the Insurer and withholds payment to the Subcontractor.

As a Subcontractor, protect your rights by asking the General Contractor if:

- 1) the prime contract is a standard CCDC 2 Contract and if there are any Supplementary Conditions changing insurance? If so, to what extent that might adversely or positively affect you as a Subcontractor?
- 2) the contract is not a CCDC form, if the General Contractor is responsible for arranging Builders’ Risk Insurance? If so, if it includes Subcontractors as Insureds.
- 3) 1) above applies, has the General Contractor arranged the required IBC Broad Form builders’ Risk Insurance?
- 4) you have tested the ability of your broker on construction insurance and construction contracts: you will absolutely need the right expertise to help you when you have a claim and meet resistance.

## **IDENTIFYING COVERAGE FOR THE SUBCONTRACTOR**

Using the Standard CCDC 2 – 2008 form of contract, the rest of this bulletin assists the Subcontractor in identifying where it is covered within insurance that is the responsibility of the General Contractor to arrange.

We encourage all Subcontractors to carefully examine their insurance rights when considering work as a Subcontractor.

## **CCDC 2 STIPULATED PRICE CONTRACT 2008**

The Current CCDC 2 Stipulated Price Contract 2008 (hereafter CCDC 2) contains “PART 11 INSURANCE AND CONTRACT SECURITY”. Without copying the entire contract form we offer up comments to paragraphs we have extracted from the relevant forms. CCDC 2 - PART 11 contains the following:

### ***“GC 11.1 INSURANCE***

*11.1.1 Without restricting the generality of GC 12.1 - INDEMNIFICATION, the Contractor shall provide, maintain and pay for the following insurance coverages, the minimum requirements of which are specified in CCDC 41 – CCDC Insurance Requirements (hereafter CCDC 41) in effect at the time of bid closing except as hereinafter provided:”*

- This clause states it is the Contractor's responsibility to provide, maintain and pay for insurance as summarized in the CCDC 2 and as more specifically described under the Accompanying CCDC 41 – CCDC Insurance Requirements. Unless amended otherwise through Supplementary Conditions, the party in contract with the project Owner is responsible for arranging the required insurance, be it a General Contractor assuming responsibility for a project or, a Trade Contractor working directly for the owner on a specific trade assignment such as a roofing system installation. Our focus is where a General Contractor has subcontracted work.

The insurance conditions in the CCDC 2 2008 contain the following clause under 11.1.1.4:

*“Broad form” property insurance in the joint names of the Contractor, the Owner and the Consultant. The policy shall include as insureds all Subcontractors.....”*

- The term “Broad Form” in the insurance industry is usually reference to a form of policy that insures against “all perils” or “all risks” of loss, except as limited or excluded within the policy wording. Note that the clause above requires the policy to be issued so that it includes all Subcontractors as insureds. This is the first signal that the Subcontractor has rights to protection under the “Broad Form” property insurance arranged by the General Contractor.

## **CCDC 41 - CCDC INSURANCE REQUIREMENTS**

The current published version of CCDC 41 - CCDC INSURANCE REQUIREMENTS was published JANUARY 21, 2008. This form now accompanies the CCDC 2 and provides the most current version of the insurance requirements. The form publication date can be changed regularly to allow for new issues concerning insurance to be addressed, thereby keeping the Construction industry up to date with relevant insurance industry coverage changes.

The January 21, 2008 version of CCDC 41 contains the following clause concerning the required “Broad From” Property Insurance:

*“4. “Broad form” property insurance shall have limits of not less than the sum of 1.1 times Contract Price and the full value, as stated in the Contract, of Products and design services that are specified to be provided by the Owner for incorporation into the Work, with a deductible not exceeding \$5,000. The insurance coverage shall not be less than the insurance provided by IBC Forms 4042 and 4047 (excluding flood and earthquake) or their equivalent replacement. Subject to satisfactory proof of financial capability by the Contractor, the Owner may agree to increase the deductible amounts.”*

- The above references IBC 4042 and 4047. To explain, IBC 4042 is the CCDC accepted BUILDERS’ RISK property insurance policy form. IBC 4047 BUILDERS RISK POLICY CCDC ENDORSEMENT is intended to accompany the IBC 4042 as it modifies the IBC 4042 form of coverage in very much the same way as Supplementary Conditions modify a construction contract. Incidentally, the reason why Flood and Earthquake are excluded is that these are *non-mandatory* coverage options.

The CCDC 41 also contains the following, which are considered now as standard (insurance industry) coverage exclusions:

*“7. Standard Exclusions*

*7.1 In addition to the broad form property exclusions identified in IBC forms 4042(1995), and 4047(2000), the Contractor is not required to provide the following insurance coverage:*

- *Asbestos*
- *Cyber Risk*
- *Mould*
- *Terrorism”*

At this juncture we have established that the Standard CCDC 2 Construction contract requires the General Contractor to provide Broad Form Property Insurance. It also appears on a CCDC 2 Contract (where the Insurance Conditions have not been amended by Supplementary Conditions), that the Subcontractor has certain coverage rights as an Insured under the insurance afforded by Paragraph 11.1.1.4 (Broad Form Property Insurance) above.

**BUILDERS’ RISK BROAD FORM - IBC 4042/4047**

Let us now review the required insurance policy itself, the Builders’ Risk Broad Form IBC 4042 and its accompanying IBC 4047 Builders’ Risk Policy CCDC Endorsement, with an aim towards closing in on the Subcontractor’s rights to coverage. Without copying the entire wording, we discuss the following clauses, which focus on our issue:

**BUILDERS’ RISK BROAD FORM**

**Under the “INDEMNITY AGREEMENT”** which opens the Policy contract it states:

*“1. In the event that any of the property insured be lost or damaged by the perils insured against, the Insurer will indemnify the Insured against the direct loss so caused to an amount not exceeding whichever is the least of:*

- (a) the "replacement cost" value of the property at the time of loss or damage but in no event to exceed the amount necessarily expended for "replacement";.....”*

- Whilst there are other clauses in this section the Subcontractor’s right to coverage under a General Contractor arranged Broad Form Builders’ Risk policy is our focus. As an Insured the Subcontractor has a right to “replacement cost” as a basis of loss evaluation, that is to say, in simple terms, no deduction for depreciation. Provided the accompanying IBC 4047 has been issued, the definition of Replacement Cost in IBC 4042 has been replaced entirely by the one in IBC 4047 as follows:

***“(d) REPLACEMENT COST***

*Clause 1. Indemnity Agreement in this Policy is amended as follows:*

*Paragraph (a) is deleted and replaced by the following:*

- (a) if the property is repaired or replaced, the "replacement cost" value of the property at the time of loss or damage but in no event to exceed the amount necessarily expended for "replacement"; otherwise the actual cash value of the property at the time of loss;

The definition of "Replacement Cost" in this Policy is deleted and replaced by the following:

"Replacement Cost" means whichever is the least of the cost of replacing, repairing, constructing or reconstructing the property on the same "project site" with new property of like kind and quality and for like occupancy without deduction for depreciation or for necessary and reasonable professional fees and contractors' and sub-contractors' overhead and profit."

The new definition put into effect by IBC 4047, clarifies the meaning of Replacement Cost and that it includes some professional fees and **“Subcontractor’s overhead and profit”**. So, when filing your insurance claim under the General Contractor arranged Builders’ Risk Policy make sure you allow for your overhead and profit in your insurance claim.

The Builders’ Risk Form is intended to cover property (the interest insured) as follows:

**“PROPERTY INSURED**

2. This Form, except as provided in this Form (a signal to you to read the whole policy), insures the following property at the "project site" for the amount of insurance specified on the "Declarations Page" for the "Project Site":

- (a) property in course of construction, installation, reconstruction or repair other than property described in 2(b):
- (i) owned by the Insured;
- (ii) Owned by others, provided the value of such property is included in the amount of insurance;

all to enter into and form part of the completed project including expendable materials and supplies, not otherwise excluded, necessary to complete the project.

- (b) landscaping, growing trees, plants, shrubs or flowers all to enter into and form part of the project provided that the value of such property is included in the amount of insurance;
- (c) temporary buildings, scaffolding, falsework, forms, boardings, excavation, site preparation and similar work, provided that the value thereof is included in the amount of insurance and then only to the extent that "replacement" or restoration is necessary to complete the project.

We have established that under the non-amended CCDC 2 and the IBC 4042 Form the Subcontractor is an Insured. From the foregoing as an Insured, the Subcontractor presumably owns some of the property as described and presumably “*the value of such property is included in the amount of insurance*” as the General Contractor would usually include the cost of the Subcontractors’ work under the estimated total contract price.

Note under “2(a)” this is only property as described that will “*enter into and form part of the completed project*”. Under “2(b)” allowance is made for “*landscaping*” etc., this may be an important feature for Green Roofing in particular, but be careful to ensure the value has been “*included in the amount of insurance*”.

Under “2(c)” allowance can be made for the equipment described but ordinarily this is insured under a separate Contractor’s Equipment floater and is rarely part of Builders’ Risk Insurance.

The policy contains many other clauses including a list of exclusions of types of property and types of perils. The onus of learning this is on the Subcontractor. If you wish to review these wordings, contact your broker.

## **THE CLAIM**

In the real world if the Subcontractor causes the insured damage, let’s say the Subcontractor is a roofer applying torch applied modified bitumen and a fire arises causing damage to the project. (Keep in mind that Property Insured in this case is very specific, as per PROPERTY INSURED discussed above, it is insuring the project work only, not buildings attaching to or neighbouring structures etc., which fall in the realm of third party liability). The Subcontractor expedites the repairs at additional cost to the Subcontractor. The General Contractor may expedite other repairs to other parts of the project damaged by the fire. The Subcontractor applies for payment for the repairs to the General Contractor. The General Contractor suggests that the repairs should be at the cost of the Subcontractor, having caused the fire thus delaying any outstanding payments to the Subcontractor for work completed prior, advising it was using such money to pay additional costs sustained due to the fire. The General Contractor releases a listing of such costs to substantiate its withholding of the moneys owed. The General Contractor meanwhile has advised the Builders’ Risk Insurer, which adjusts the damage and subsequent to investigation, provides the necessary financial indemnification to the General Contractor as settlement for correcting the damages including possibly the Subcontractor’s costs. The General Contractor’s account is put right by the Insurer but the Subcontractor has received no indemnification from the Insurer (irrespective if entitled) and in actual fact is now severely *out of pocket* and likely feeling financial strain. The General Contractor on the other hand, as mentioned earlier, appears to be in a surplus position.

Several months pass and to make things worse, the Subcontractor receives a letter from the General Contractor’s Builders’ Risk Insurer expressing its intention to Subrogate (recover) its loss from the Subcontractor as the Subcontractor caused the fire. This can potentially be up to two years less a day from the date of the loss being first discovered to roughly calculate a limitation period. Sometimes Insurers try to subrogate (recover) the entire loss, sometimes the Subcontractor’s loss and sometimes the loss to the project – except the Subcontractor’s work.

Not only has the Subcontractor not received payment for its work for which it is owed, it has not received any payment for its repairs, now the *General Contractor's* Builders' Risk Insurer is looking to recover its loss. Imagine the burden and stress this represents on the Subcontractor. The General Contractor should have paid the Subcontractor for the work completed prior to the fire. Also, the Subcontractor as an Insured under the Builders' Risk, should have received its portion of the loss settlement issued presumably to the General Contractor by the Insurer, including allowance for overhead and profit.

After all, we have determined that the Subcontractor is an Insured under the Builders' Risk Policy in many cases.

## **SUBROGATION**

We have mentioned above the attempts made by Insurers to recover losses using "subrogation". A Subrogation clause is included in the referenced IBC 4042 policy as follows:

### ***"SUBROGATION***

*12. the Insurer, upon making any payment or assuming liability therefor under this Form, shall be subrogated to all rights of recovery of the Insured against others and may bring action to enforce such rights. Notwithstanding the foregoing, all rights of subrogation are hereby waived against any corporation, firm, individual or other interest with respect to which insurance is provided by this Form.*

*Where the net amount recovered, after deducting the costs of recovery, is not sufficient to provide a complete indemnity for the loss or damage suffered, that amount shall be divided between the Insurer and the Insured in the proportion in which the loss or damage has been borne by them respectively.*

*Any release from liability entered into by the Insured prior to loss shall not affect the right of the Insured to recover."*

Note the underlined section above. Under the Standard non-amended Builders' Risk Policy a Subcontractor is an Insured so effectively the subrogation waiver mentioned applies to the Subcontractor. To examine this further the Guide to Construction Insurance CCDC 21, 2000 (hereafter CCDC 21 – 2000) which is presently being re-written, discusses Subrogation as follows:

*"When it pays for loss or damage to insured property caused by someone other than the policyholder, the insurance company acquires the right to claim recovery of its loss from the party responsible. This is known as the "right of subrogation." Where a policy insures more than one party, each party can be protected against recoveries by a "**Waiver of Subrogation**" clause. In the same way, people entering into leases and other agreements might ask each individual to endorse their insurance policies to provide subrogation waivers.*



*An important case heard by the Supreme Court of Canada involved a fire on a large project caused by a Subcontractor and resulting in damage to both the Subcontractor's work and other areas of the project on which the Subcontractor had not been directly working. The Builders' Risk Policy, under which subrogation was being exercised against the Subcontractor for negligent damage to the other areas, provided insurance to all Contractors and **Subcontractors** on the project, and included a Waiver of Subrogation clause. The Court held that the policy should be interpreted to intend that there would be no claims by the Insureds, and ruled that the Subcontractor's insurable interest extended to the entire project. The action by the Insurer was dismissed. As IBC 4047, Builders' Risk Policy CCDC Endorsement, extends the Builders' Risk Policy to insure all Subcontractors, the Subcontractor would be protected against recoveries by a "Waiver of Subrogation" clause incorporated in the Builders' Risk Policy. Legal precedence has also established that an insurance company cannot subrogate against its own insured."*

Note – the above ruling prevented the Insurer from recovering its loss as the Contractor was protected by the waiver of subrogation on the entire project, not just its own work. Furthermore, it was an Insured of the Insurer.

IBC 4047 also includes the following clarification of intent under IBC 4042 to substantiate that Subcontractors are indeed insured:

*"This policy is hereby amended to incorporate the following changes.*

**1. ADDITIONAL INSURED**

*All contractors and/or all subcontractors but not including suppliers who perform no work at the construction site, consulting engineers or consulting architects."*

- This clarifies that Subcontractors are indeed Additional Insureds under the Broad Form Builder's Risk Policy. Additional Insured in this case means in simple terms that whether named or not in the policy, Subcontractors will benefit from coverage under the Policy provided they have an (insurable) interest (in property insured) under same. The exclusion of "suppliers who perform no work" was based on a Supreme Court of Canada decision clarifying "Subcontractor".

- The Other Insurance clause clearly states the intention of the Builder's Risk Policy to be primary insurance:

***(f) OTHER INSURANCE***

*If, on the happening of any loss or damage to property insured by this Policy there is in force any other insurance covering the same interest, this Policy shall be Primary Insurance."*

- This is a very important clause that stipulates that the Builders' Risk insurance is Primary Insurance, as such it is the first policy to respond to Builders' Risk claims. This means that no other policy should be brought into a claim situation otherwise covered by the Builders' Risk Policy.

This combined with the Subrogation waiver discussed above really helps to clarify that only the Builders' Risk Policy is intended to respond to claims for property insured there under. Conclusively, attempts by Insurers to avoid claims and transfer their paid losses to the Subcontractors' insurance are no less than ....**bogus**.

The Agency clause reads as follows and should always be in a Builders' Risk Policy:

**(k) AGENCY**

*It is understood and agreed that the Named Insured who obtained this Policy and paid the premium therefor did so on his own behalf and as Agent and/or Trustee for the others insured hereby, including those referred to by general description for the exclusive purpose of permitting suit or action under this policy. It is further acknowledged and agreed by the Insurer(s) as evidenced by their acceptance of the premium paid that any person, firm or corporation coming within the description of an Additional Insured may ratify such Agency and/or Trusteeship at any time subsequent to the issuance of the Policy for the purpose of entitlement to coverage granted by its terms for good consideration.*

- This provides added protection to Subcontractors as Insured by “general description” that the first Named Insured, (general contractor) will act as their representative which overcomes contractual privity issues, facilitating Subcontractors' rights under the policy.

This bulletin has discussed the ongoing issue of Insurers' attempts to recover their losses against Subcontractors that we have concluded in most cases by Contract and Policy definition, are also their own Insureds. We have explained what is happening, why it shouldn't happen, why the Subcontractor may be covered by the same Insurer and what to do to find out your rights from the beginning of a project and avoid problems later. This practice needs to stop as it causes unwarranted additional stress and cost on the Subcontractor. Subcontractors can help reduce this practice by asking questions about the General Contractor's responsibility for arranging insurance before bidding for the work.

Needless to say not all contracts and policies are written identically so there will be deviations from observations set forth above, where contractually and through insurance, an insurer may truly have rights of recovery/subrogation. We can say that in most cases and certainly under CCDC 2, Builders' Risk Insurance is intended to cover Subcontractors as **Insureds**, to respond on a **primary basis** to Subcontractors; to include a **waiver of subrogation** rights preventing recovery; to provide a **Replacement Cost** basis of loss evaluation and to include an allowance for **overhead and profit**. Please protect your rights by asking precise questions before you bid.

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