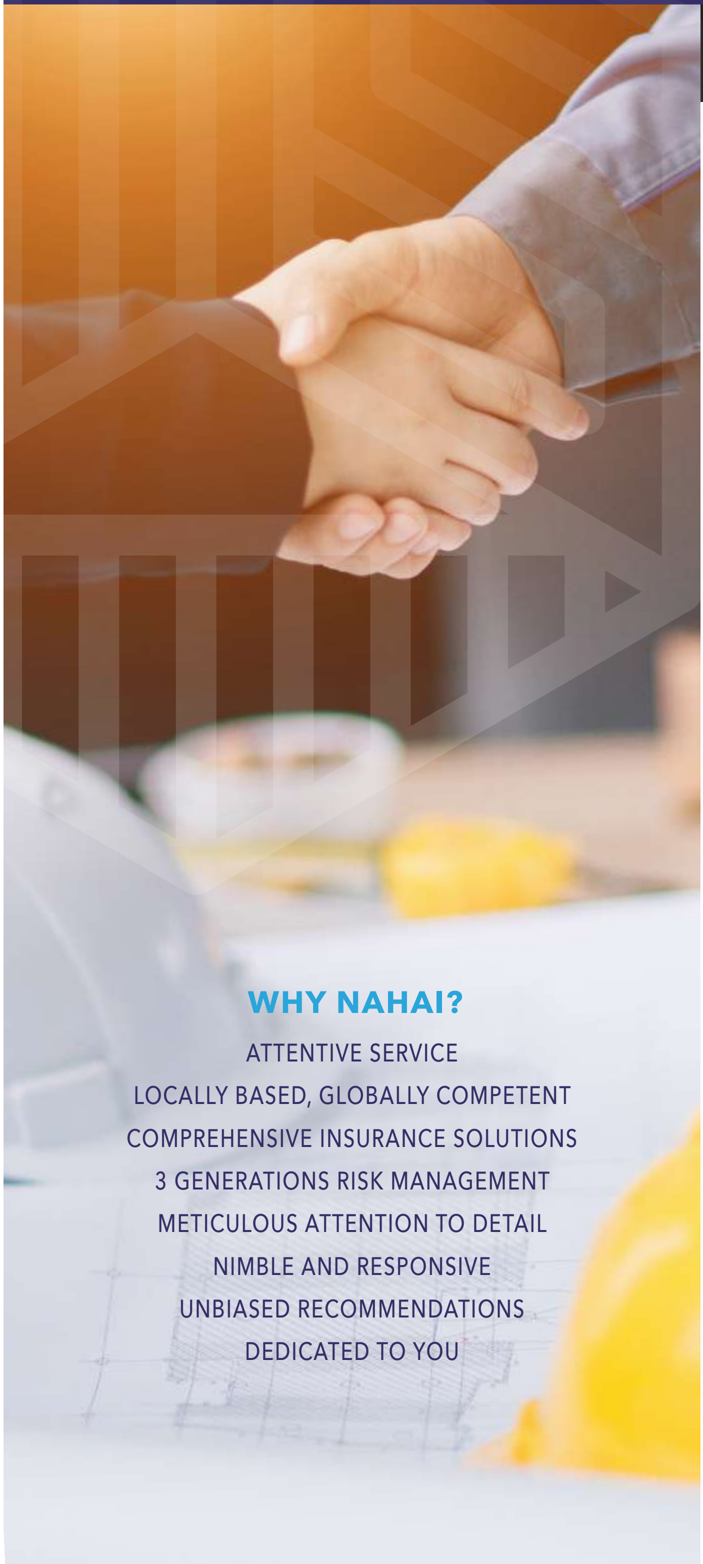
APRIL 2020

Nahai's OCIP – Wrap Up Owner Controlled Insurance Programs



WHY NAHAI?

ATTENTIVE SERVICE
LOCALLY BASED, GLOBALLY COMPETENT
COMPREHENSIVE INSURANCE SOLUTIONS
3 GENERATIONS RISK MANAGEMENT
METICULOUS ATTENTION TO DETAIL
NIMBLE AND RESPONSIVE
UNBIASED RECOMMENDATIONS
DEDICATED TO YOU

WHAT ARE OCIPs?

Until recently, protecting your construction project has resembled a blindfolded sprint through a minefield of potential losses. For example, for even a small, single residential construction project, the resulting pyramid of policies could easily number 20 or more policies, as every participant requires his own general liability (GL) policy. Of even greater concern are the legal costs incurred as attorneys for the competing insurers square dance around every claim filed. While no government agency collects data on the costs of legal settlements and associated legal fees across the construction industry, an informal survey by the Building Industry Association estimated legal fees at 4-5 times the actual loss settlement costs. For this reason, a more centralized approach to covering certain construction projects is preferred.

OCIPs ATTACK EXCESS COSTS

Recognizing the opportunity for cost efficiencies, select insurers now offer Controlled Insurance Programs (CIPs). Also referred to as "wraps" within the industry, CIPs come in two flavors depending on which party, the developer-owner (OCIP) or the general contractor (CCIP), sponsors the policy.

At its core, Owner Controlled Insurance Programs (OCIPs) are project-specific, GL policies that address risks during construction and thereafter. The project sponsor is the entity that purchases and controls the insurance. The OCIP "wraps up" all of the individual GL policies of the various parties – subcontractors, general contractors, and owners – into a single, comprehensive program providing similar general/excess liability. Thus, project owners gain coverage and cost advantages by limiting the scope of coverage to the risks associated with their project specifically. More importantly, as the single point of reference for any claim filed, attorneys for the OCIP insurer(s) are able to streamline the legal process to eliminate the finger-pointing, cross complaints, and procedural delays that drive up costs when multiple attorneys representing each project participant are involved.

OCIPs were originally used for very large municipal work projects as a method to control insurance costs and utilize proper loss control. At its genesis, the job sizes eligible for Wraps exceeded $150 million. Throughout the last two decades, the job size for eligibility has reduced dramatically. For instance, OCIPs are now used on nearly every condominium project of any size for two reasons: a) difficulties in placing traditional insurance, particularly General Liability coverages for Completed Operations/Construction Defect issues, b) these types of projects have been rife with litigation. As a result, most, if not all, subcontractors in California have a "Condominium Exclusion" in their annual general liability policy. Effectively, the only way these projects can be insured is with an OCIP.

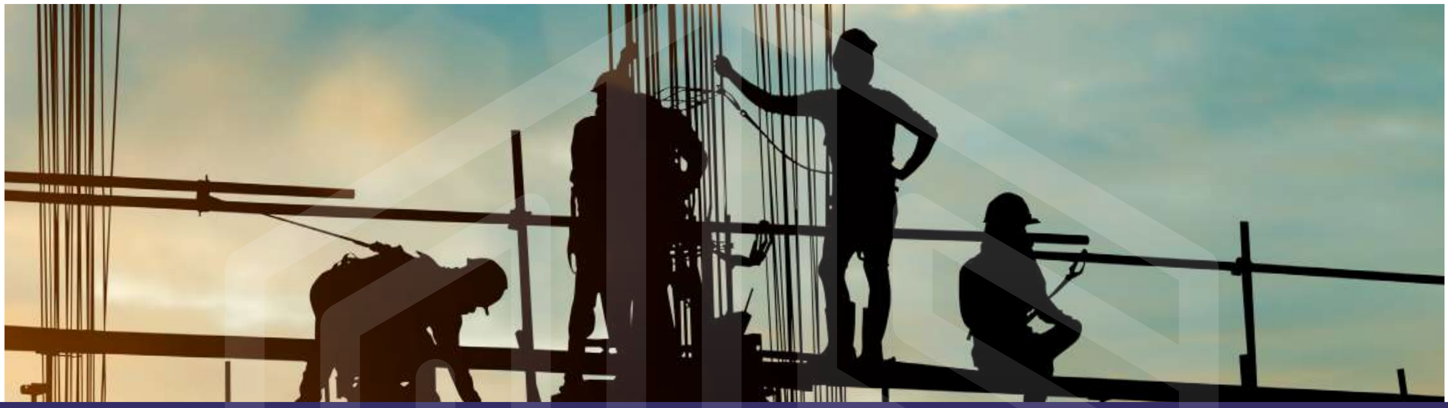
Commercial projects like multi- family, office, retail and industrial also employ OCIPs. However, coverage is generally available on a subcontractor's practice GL policy so OCIPs are not the sole option. Apartment projects that could be converted to condos within the statutory timeline for reporting latent defects would want to consider using an OCIP that does not contain a "Condominium Conversion Exclusion." Alternatively, developers today "Deed Restrict" the project so it cannot be converted to condominium ownership within the statutory timeline.

AN OCIP IN ACTION

An OCIP policy must be secured prior to project commencement. It typically continues through substantial completion of the project plus a number of years thereafter. This period is known as the Completed Operations Tail. Ideally, the tail extends through the applicable statute of repose, which, in California, is 10 years upon substantial completion. Named insureds of the policy will include the owner, general contractor and all enrolled subcontractors. Some underwriters are willing to include design professionals under a wrap- up, but note that this is not a substitute for the design team's professional liability policy (E&O). To be clear, an OCIP is a general liability policy that principally covers damages that result in bodily injury (BI) or tangible property damage (PD). Professional liability, on the other hand, extends to legal liability arising from professional services that result in economic damages as well as BI and PD.

Defense costs (attorney fees) are commonly included inside the liability limit for condominium projects, but can be provided in addition to the limit on other projects — mainly non-residential. There is also a "Joint Defense" requirement. In the event of a claim, insureds under the policy will be jointly defended by the attorney selected by the insurance company.

As an industry standard, it is recommended that the liability limit be equal to 50%-75% of the hard construction costs. Some projects may warrant higher coverage. The policy will have a



deductible (or what is commonly referred to as a Self Insured Retention.) Minimum deductibles start as low as $25,000, but, depending on the size of the project, can be much higher. Payment of the deductible is usually apportioned to whatever is stated in the wrap addendum to the prime and sub contract agreements. It is critical that the deductible allocation be addressed in the contract documents. Minimum premiums for residential projects begin at about $50,000. The ultimate premium depends on the hard costs, project type, quality of soils and experience of sponsor and builder. It is common for a fully layered (primary and excess coverages) OCIP policy to cost 1-2% of hard construction costs.

It should be noted that a wrap is project specific, offering dedicated limits with the inclusion of a 10 year tail. Comparatively, under the traditional insuring method, contractors' insurance costs typically range from 1% to 3% of the hard construction costs of a project, and yet, their policy limits are often shared amongst their other projects/customers, and do not contain a dedicated tail to coincide with the statute of repose. For this reason, it is extremely advantageous both from a financial and a coverage standpoint, for the project owner to secure an OCIP on their own.

ADMINSTERING A WRAP PROGRAM

Without an OCIP, each contractor working on a project provides his own insurance and builds the cost for insurance into his bid. With an OCIP, the sponsor negotiates and purchases the coverage for all eligible contractors working on the project. In exchange, the sponsor requests an off-set, or insurance credit, from all parties included in the OCIP coverage. The credit is equal to the conventional cost of the coverages that the separate parties would have been required to buy in the traditional marketplace. An OCIP is administered to dovetail with construction management activities such as contract bidding, contract award, ongoing construction operations, and closeout of each contract and project. Some parties are specifically excluded from an OCIP by the OCIP insurer.

At its discretion, the sponsor or 3rd party wrap up administrator can also choose to exclude certain parties based on risk or preference (as one misstep of a contractor can comprise the limits for the entire program). While eligibility for participation varies among OCIPs, the following categories are considered ineligible: delivery services, suppliers and vendors, truckers and haulers, equipment installers, structural demolition, waste removal or remediation contractors, contractors that do not perform any actual work on-site, and any contractor excluded by the sponsor in its discretion.

The following trades may be considered ineligible at the option of the OCIP sponsor or program administrator: surveyors, soil testers, crane operators, construction elevator firms, elevator contractors, contractors providing professional services, contractors with a contract value below a stated threshold, contractors that perform work of a short duration, or under a specified duration, demolition contractors and site preparation contractors.

Underwriters of OCIPs will also require that the services of a quality assurance (QA) company be employed. The QA company will review plans, and inspect and document the project during construction. In the event of litigation, this can be a crucial element to a defense.

POLICY EXCLUSIONS

Wrap-Ups, like any standard general liability policy, have many exclusions that limit or remove coverage. Some typical exclusions to be mindful of are:

- Subsidence exclusions. This should be of particular concern for any trades involved in excavation and foundation work.
- Total pollution liability exclusions with no exceptions for building mechanical systems or hostile fire.
- Exclusions for installation of material that is manufactured or fabricated off-site. This should be particularly concerning for those trades that will fabricate the product off-site and then transport the material to the job site for installation.
- Failure to remove or modify exclusions pertaining to damage caused to the property being worked on at the time of the accident or for claims of faulty workmanship after the work is completed. These are commonly referred to as exclusions J, K, and L, and can be very problematic.

IN CLOSING

Owner Controlled Insurance Programs are convoluted. They are not standardized policies so each one must be carefully reviewed for coverage. We advocate involvement of the entire risk management team (broker/risk manager, lawyer, owner) as careful examination and review of these policies is warranted.

This coverage summary is not an affirmation of coverage, and any proposed program or policy should be read for actual terms and conditions. These recommendations are made only from an Insurance and Risk Management perspective.