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Builders Risk Insurance – Whose line is it anyway?

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Session Title: Builders Risk Insurance – Whose line is it anyway?

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Michelle Luster is the director of risk management for Swinerton Inc., with more than 25 years of experience in construction risk management for general and specialty contracting. Michelle has the CRIS designation, and in 2021, she served on the national AGC Climate Task Force.

Jeremiah Welch serves as Managing Partner of SDV's West Coast office and as a member of the firm's Executive Committee. Jeremiah represents most of the ENR Top 20 construction contractors, advising on and litigating insurance claims relating to heavy civil, industrial and commercial construction projects. These claims typically feature complex coverage problems implicating builder's risk, professional liability and protective indemnity, default insurance, general liability, pollution liability and others. Jeremiah is also a trusted advisor to most of the major national insurance brokerages who serve the construction industry and a frequent speaker at national conferences.

Russ Johnson is a respected expert in construction and risk management. He has nearly 20 years of experience dealing with commercial insurance and claims management. Russ is also a long-standing member of the AGC's National Surety Bonding and Risk Management Committee.

Tammy Pike has been in Risk Management and Insurance for almost 30 years, starting out as a broker and then joining Kiewit's corporate Risk Management and Insurance Department more than 20 years ago. Her responsibilities over the years have included supervision of the Insurance Analyst team, providing Risk Management Services to the company's operating districts, including mega and P3 project programs in North America, and supervision of the Claims team, responsible for management and adjustment of claims, management of TPA and RIMS vendor relationships, and coordination with Corporate Safety, Leave, Human Resources, Accounting, Payroll, and Legal departments. Tammy's expertise includes risk assessment, cost containment, construction contract review and negotiation, claims negotiation and oversight, vendor management, and overall construction risk management consulting.

Builders Risk Insurance – Whose line is it anyway?

Builder's risk insurance is a critical component to a successful construction project, yet it remains both poorly understood and managed. Builder's risk insurance is a form of property insurance designed to cover damage to a project during construction. Most policies are "all risk", covering all causes of loss except those specifically excluded. Most insurers offer a myriad of enhancements for various types of damage such as soft costs, extra expenses, and debris removal. These are first-party policies – their primary benefit is to promptly fund repair costs, allowing projects to continue without getting bogged down in disputes between stakeholders over whose fault the damage is. Yet the success of these policies is often plagued by bad decisions made in how they are purchased and deployed.

First, the question always arises of whether the owner or the general contractor should buy the policy. Before we answer, it is important to recognize that brokers are incentivized by commissions, and rarely argue that their client is not the party who should purchase it. Market access is an important factor - which party is in the best position to buy the best coverage -but the most important points are experience and intent. Builder's risk policies are manuscript – it takes experience to know what coverages, limits and terms fit the project in question. Whoever buys it, the intent should be to buy the best coverage for *all* stakeholders, and the decision should never be made on price alone.

When it comes to price, deductibles are a very important decision. Who pays it can be as important as the amount. In general, the placing party should be responsible for the deductible. Historically, this has been a recurring problem with owner-placed policies – some owners take a high deductible to reduce the premium but then hesitate to submit claims to avoid the financial burden. Others attempt to make the party "at fault" responsible for the deductible through their contracts. Builder's risk insurance is "no fault", first-party insurance, creating disputes based on deductible responsibility undermines the insurance's effectiveness. Related to this point, if an owner buys the policy and intends to make contractors responsible for deductibles, contractors must be allowed to price deductible risk into their contracts, and that may require a change order.

As a preliminary matter, builder's risk insurance should name the owner and all on-site contractors as insureds. This ensures all parties have access to the policy to foster timely submission and processing of claims. Many builder's risk policies purchased by project owners do name the contractors but make the owner the "sole agent and loss payee" for the policy. Often, this decision is motivated by a perceived need to control the policy, guarding against improper claims and payouts. Again, this usually frustrates the intent of the policy. Owners don't always know about potential claims when they happen and often see the project through the lens of contractual obligation rather than potentially covered property damage. Moreover, these "sole agent" clauses can backfire - in a situation where a contractor loses coverage it would have had but for an owner's mishandling of a claim (e.g. failure to provide timely notice as the "sole agent"), the owner may find it has liability to

the contractor as a fiduciary or for tortiously interfering with the contractor's rights as an insured.

A fundamental point often lost is that a successful builder's risk policy must dovetail with the project's construction contracts. While indemnity and liability insurance requirements typically focus on fault, builder's risk policies are "no fault". Ideally, parties should waive liability against each other to the extent of builder's risk coverage. Forcing parties to fully use the builder's risk insurance minimizes disputes between parties and helps the project move forward more quickly.

Subrogation waivers are very important with builder's risk insurance – in many states, builder's risk insurers can subrogate against their own insureds so long as the property interests are different. For example, a subcontractor who starts a fire might face a subrogation claim for damages caused to an owner's property and other work. Again, this creates needless conflict and should be avoided – all contracts should have mutual subrogation waivers.

Parties should bear in mind that like many policies, builder's risk insurance can cover consequential damage. This can include time element costs for repair work as well as increased costs of construction due to delay, and owner's lost profit and extra expenses due to delayed completion. Contracts frequently include broad consequential damage waivers – these should not apply to the extent covered by project-required insurance.

On the subject of time-element coverage and other enhancements beyond cost of repair, it is important to consider the perspective of all stakeholders when deciding what coverages to buy. Particularly with respect to delay costs, each party needs coverage for its own delay-related exposure. Owners want delay in opening and soft cost coverage. Contractors want delay/extra expense coverage. Such coverage should be used in lieu of liquidated damages whenever possible.

Duration of coverage is another important issue. Builder's risk insurance should be maintained until all construction work, including punch list, has been completed. This is especially important since many construction general liability policies now exclude coverage for property damage to the project during construction. This must be considered when purchasing the policy – construction projects frequently run longer than planned – will the insurer extend the policy when needed?

All insureds need to be aware that builder's risk policies often have suit limitation provisions – clauses that say suits must be brought within a specified time frame, some as little as a year or two from the date of loss. Some states allow insurers to enforce these clauses as written. This means claims must be identified early and pursued cooperatively.

Turning to the management of builder's risk claims, all insureds need to be aware that builder's risk policies often have suit limitation provisions – clauses that say suits must be brought within a specified time frame, some as little as a year or two from the date of loss. Some states allow insurers to enforce these clauses as written. This means claims must be identified early and pursued cooperatively.

In terms of coverage, builder's risk policies cover physical damage to covered property, and potentially economic losses (e.g. delay impacts) resulting from the damage. Challenges surround exclusions for specific perils, or limitations on certain types of coverage (e.g. sublimits). How the insureds describe a loss in terms of cause and type of damage can be critical in determining whether and how much an insurer pays. This gets especially challenging when presenting claims for damage resulting from faulty workmanship, design or materials. Virtually all policies exclude these causes of loss subject to exceptions. In general, policies may cover damage resulting from faulty work/design/material but not the cost of correcting the faulty work/design/material itself. Most policies will not cover betterments. Some policies only cover damage resulting from a defect when an independent peril results. These factors make claim presentation challenging – teamwork among all insureds is critical.

Builder's insurance is a necessary and valuable component of a successful construction project, but it is imperative all stakeholders work together to buy the right coverage, adopt supportive contract terms, and pursue claims diligently and carefully.