



## 2025 Surety Bonding and Construction Risk Management Conference

### **Case Study: Vertical Construction Project's Complex Risk Management and Insurance Journey**

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Presented by Steve Cvitanovic, Build Group, Inc. and Miles C. Holden, Hanson Bridgett LLP

### **Authors/Presenters Biographical Information:**

#### Steve Cvitanovic

Steve is a recognized leader in construction law with more than 25 years of experience. Prior to joining Build Group, Inc. as General Counsel, Steve was a partner at Haight, Brown & Bonesteel where he handled hundreds of construction law and real estate matters, and spent years cultivating relationships. Clients retained Steve because of his expertise, legal abilities, and his total devotion to client satisfaction. Steve shared his expertise and insights with others by routinely speaking at conferences, seminars or webinars. Steve also served as leader of Haight's Construction Law Practice Group.

Steve brought these skills to work as General Counsel for Build Group, Inc. On a daily basis, Steve works on contracts, real estate issues, employment issues, claims handling, insurance, licensing, corporate compliance and/or formation, project financial matters, and works with project teams to ensure projects are delivered as promised. Steve works closely and manages outside law firms on all matters pertaining to Build Group. Steve was an integral part of Build Group's response to

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Miles is a partner at Hanson Bridgett LLP's San Francisco office and serves as the firm's Insurance Recovery Practice Group Leader. He advises on a wide variety of insurance matters, and litigates and arbitrates insurance-coverage actions throughout the US. Miles has represented both insurers and insureds, but focuses on advising and advocating for insureds. He obtained his undergraduate degree from Stanford University and his J.D. from Benjamin N. Cardozo School of Law, Yeshiva University. Miles is admitted to practice law in Arizona, California, Florida, New Jersey, New York, and various federal courts.

# **Case Study: Vertical Construction Project's Complex Risk Management and Insurance Journey**

## **I. Introduction**

Individual construction projects can encapsulate the types of complex challenges that risk-management professionals face on a daily basis and throughout their careers. This case study involves examples of such issues, with a focus on insurance matters under builder's risk, OCIP, and subcontractor default insurance (SDI) policies. It demonstrates how different risks and coverages intermingle on a single construction project and is designed as a rough framework and springboard for the accompanying conference session discussion.

## **II. Case Study Summary**

Imagine the construction site of a new high-rise residential project at a busy intersection in a dense urban location. The apartment complex will be dozens of stories tall when completed, and the hundreds of units will rent for thousands of dollars per month to affluent professionals in the heart of the city. It will include high-end finishes and amenities throughout. We will call it the 22000 Tinseltown Boulevard project in Tinseltown, California ("22000 Tinseltown").

Aside from the expected logistical challenges of staging the site preparation, construction, and storage of materials and equipment in such an environment, along with bureaucratic issues like permitting and inspections, this kind of project involves many risks. For example, physical risks of damage, financial risks of delayed construction, staffing and labor risks of subcontractors not timely completing their scopes of work, and risk-transfer risks whereby the project participants' insurance strategies encounter obstacles.

The issues with this hypothetical project started relatively small, but accumulated over time to result in tens of millions of dollars in losses. First, window-installation problems caused the project to be plagued with water intrusion into completed apartment units and common areas, causing damage to finishes and other property such as carpeting, wood flooring, baseboards, drywall, cabinetry, and electrical work. Those materials had to be removed and replaced, resulting in extra costs and disrupted sequencing of completing the units (and the project).

The water intrusion and damage became widespread over time. Some replacement finishes were not readily available and their delivery delay impacted the repair work. The work resequencing caused inefficiencies. And labor strains on the windows and flooring subcontractors (Windows, Inc. ("GlassSub") and Johnny Flooring d.b.a. The Flooring Company ("FloorSub"), respectively), resulted in them defaulting and having to be replaced. In the end, 22000 Tinseltown was delivered eight months late and substantially overbudget due to the damage.

As a result, the owner, Big Developer, LLC ("BigDev"), lost out on millions of dollars' worth of rent and incurred additional costs during the course of construction, including extra construction-loan financing expenses in the form of additional interest and refinancing costs. Seeking to make itself whole, BigDev sued the general contractor, General Contractor, Inc. ("GenCon"). In turn, GenCon filed its own claims against the defaulting subcontractors, GlassSub and FloorSub.

### **III. The Insurance Claims**

The project's losses resulted in BigDev and GenCon making claims under multiple policies.

#### **A. The Builder's Risk Policy**

The owner-procured builder's risk policy for the project contained two coverage parts: (1) the builder's risk coverage part; and (2) the time element coverage part. The former, which insured both the contractor and the owner, provided coverage for physical damage to the project—i.e., the costs related to repairing/replacing damage. The latter, which solely insured the owner, covered loss related to delay in completion of the project, including lost business income and soft costs.

GenCon submitted claims under the policy's builder's risk coverage part. Its claim components included costs for: (1) demolition; (2) debris removal; (3) replacement materials; (4) installing replacement finishes; (5) additional supervision; and (6) markups (overhead and profit). Unfortunately, the builder's risk insurer, Builder's Risk Insurance Company ("BRIC"), took the position that GenCon was due nothing. It asserted that 758 deductibles applied—one for each separate water intrusion, under the theory that each constituted a separate occurrence. Multiplying 758 occurrences by the policy's \$250,000 per-occurrence deductible wiped out GenCon's entire claim.

In the meantime, BigDev submitted its claims under the policy's time element coverage part. Its claim included items for eight months' worth of: (1) lost rental income; (2) extra construction loan costs; (3) additional real estate taxes; and (4) claim preparation costs. But BRIC refused to cover that claim either, contending that the project's delayed completion was not caused by the water damage at all, but rather defective finishes in the apartment units.

The BRIC policy contained a mandatory arbitration provision that called for all disputes under the policy to be arbitrated before a three-member panel in either Alaska or Hawaii. It also included a one-year contractual limitation period.

## **B. The OCIP Policy**

As a seasoned developer, BigDev insisted on using an owner controlled insurance program to provide commercial general liability coverage to the project's participants. Although it contained a cross-suits exclusion, the OCIP provided an exception for suits by BigDev against other enrollees.

BigDev did not waste much time before suing GenCon in California state court related to the 22000 Tinseltown's delays stemming from the water damage to the apartment interiors. Upon receiving service of process, GenCon tendered its defense to the OCIP's primary insurer, Owners National Indemnity Company of Ohio ("ONICO"). It then filed cross-claims against GlassSub and FloorSub for contractual indemnity, to recoup its own losses related to their defaults, and other relief. The subcontractors also tendered their defense to ONICO.

ONICO agreed to defend GenCon against BigDev's claims under a full reservation of rights, but denied coverage to GlassSub and FloorSub based on the cross-suits exclusion.

The ONICO policy's dispute-resolution clause required mediation and non-binding arbitration as pre-conditions to filing suit against ONICO regarding disputes about coverage under its policy.

## **C. The SDI Policy**

As an experienced contractor, GenCon sought to manage its exposure related to subcontractor defaults through SDI. It ensured that 22000 Tinseltown was added to its SDI program as an insured project. Its program carried large deductible and co-payment obligations, and only provided coverage to GenCon after it had incurred/paid costs related to a subcontractor default in excess of those deductible and co-payment amounts.

Because it suffered not one but two subcontractor defaults, GenCon made claims related to both GlassSub and FloorSub to its SDI insurer, Subcontractor Default Assurance Company ("SDAC"). SDAC requested that it be kept apprised of any developments related to GenCon's efforts to recoup funds from GlassSub and FloorSub in the California state court action, which GenCon did.

But after monitoring GenCon's litigation against the defaulted subcontractors for six months, SDAC took the position that the SDI policy's purchased-materials exclusion applied. It contended that because BigDev—which was not a named insured under the SDI policy—had directly purchased window caulking and baseboards from suppliers for the Project, all coverage for the defaults of GlassSub and FloorSub was precluded under its policy. That exclusion provided:

**XI. EXCLUSIONS**

The insurance provided by this Policy does not apply to any loss:

\* \* \* \* \*

Q. Arising from or related to materials that any person or entity other than the Named Insured purchased directly from a supplier.

The SDAC policy had Florida choice-of-law and forum-selection provisions.

**IV. Next Steps**

Tinseltown 22000's issues, while not particularly extraordinary and possibly even banal, raise a number of issues for the project participants.

For example, where should BigDev and GenCon look for relief? To the builder's risk policy, despite BRIC denying coverage? To the OCIP, even though ONICO denied coverage for GenCon's claims against the subcontractors? To the California state court litigation? And in GenCon's case, to its SDI policy, notwithstanding SDAC's reliance on the purchased-materials exclusion? Do the policies' various dispute-resolution clauses influence their strategies?