



# Reserving for Construction Risks

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September 15, 2011

# Agenda

- My Bio & Company Info
- Risks on Construction Projects...
  - Consistency? Predictability?
- Industry Trends
- Risk Perspectives...
  - Owner & Contractor
  - Loss Control & Underwriter

# My Bio & Company Info

- **Joseph Charczenko:**

- Civil Engineering Degree from Worcester Polytechnic Institute (WPI)
- Engineer / Superintendent for Kiewit Construction Co. on Boston's Big Dig
- Construction Risk Engineer for Zurich in NYC Office
- Construction Customer Service Manager for Zurich in NYC Office
- Regional Underwriting Manager for Zurich in Northeast Region
- Partner at Construction Risk Partners – NYC Office

- **Construction Risk Partners:**

- [www.constructionriskpartners.com](http://www.constructionriskpartners.com)
- Privately held, boutique surety and insurance broker dedicated to the construction industry
- Construction Industry Experts in:
  - Casualty
  - Property
  - Umbrella
  - Surety
  - Subcontractor Default
  - Builders Risk
  - Property
  - Pollution
  - Professional
  - Financial Lines

# What Makes Construction Unique?

- Construction is Risky Business:
  - Complex Project Finance
  - Challenging Labor Markets
  - Contractual Litigiousness
  - Evolving Supply Chain
  - Exposure to Unsafe Conditions
  - Constantly Changing Case Law



# Risks on Construction Projects

- Lending & Banking
  - Project & Contractor
- Labor Shortage or Strike
  - Union & Open Shop
- Permitting & Political Issues
  - Vary by Project
- Numerous Complex Contracts
  - Jurisdictional Variances



# Risks on Construction Projects

- Design Errors
  - Evolving Technology
- Constructability Issues
  - New Materials & Processes
- Unknown Site Conditions
  - Environmental Remediation
- Contractor / Supplier Default
  - Banking Impact



# Risks on Construction Projects

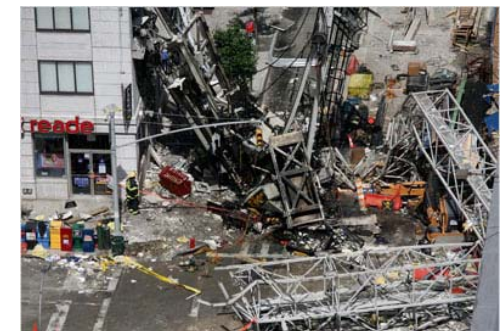
- Quality Control:
  - Construction Defect
- Material Availability
  - Supply Chain
- Schedule
  - Project Completion
- Natural Disaster





# Risks on Construction Projects

- Life, Safety & Health:
  - Construction Trades
  - Public Exposure
  - Cranes / Hoists





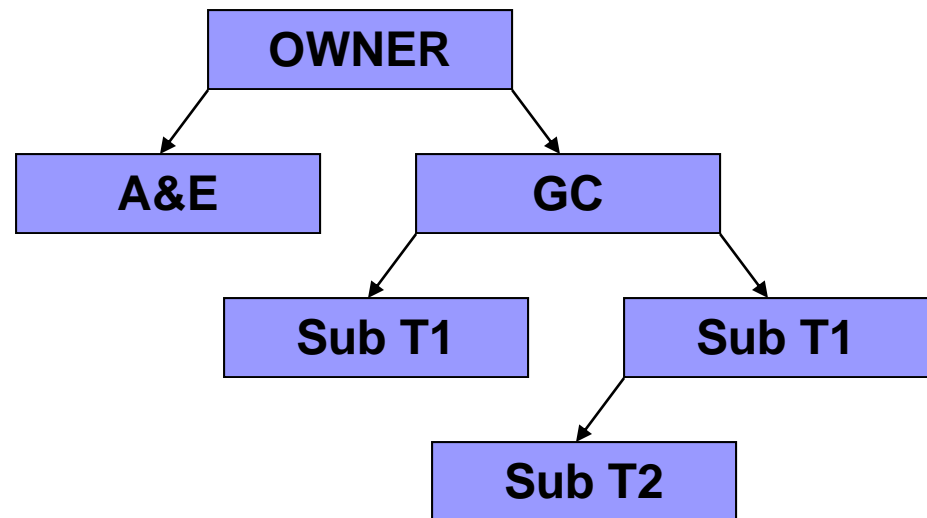
# Construction Risk Trends

- Contractual Liability
- Insurance Products
- Project Delivery Methods
- Construction Means & Methods
  - Technology
  - Construction Products:
    - Green Technology
    - Chinese Drywall
- Case Law:
  - CD as Occurrence
  - Horizontal Exhaustion

# Contractual Liability

- Large Construction Projects Typically Have a Large Number of Contracted Parties
- This Normality Creates Emphasis on Contractual Risk Transfer:
  - Additional Insured
  - Indemnification

## Typical Contractual Structure:



# Standard Contractual Language

*(AIA Document A201TM – 2007)*

## **INDEMNIFICATION:**

**§ 3.18.1** To the fullest extent permitted by law the Contractor shall indemnify and hold harmless the Owner, Architect, Architect’s consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys’ fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge, or reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Section 3.18.

## **ADDITIONAL INSURED:**

**§ 11.1.4** The Contractor shall cause the commercial liability coverage required by the Contract Documents to include (1) the Owner, the Architect and the Architect’s Consultants as additional insureds for claims caused in whole or in part by the Contractor’s negligent acts or omissions during the Contractor’s operations; and (2) the Owner as an additional insured for claims caused in whole or in part by the Contractor’s negligent acts or omissions during the Contractor’s completed operations.

# Insurance Products

- Workers' Compensation
- General Liability
- Umbrella
- Wrap Ups (OCIP/CCIP)
- Commercial Automobile
- Builders' Risk / Inland Marine
- Property / Equipment
- Surety Bonds
- Subcontractor Default Insurance (Subguard<sup>®</sup>)
- Professional Liability
- Pollution Liability:
- Railroad Protective (RRP)
- Owner and Contractor Protective (OCP)

# Project Delivery Methods

- **CM-at-Risk** – Traditional Method #1
- **Design Bid Build** – Traditional Method #2
- **Design Build** – Design and Construction are Contracted Together to One Entity.
- **Integrated Project Delivery (IPD)** – Design and Construction Teams are Contracted to Work Together to Deliver Project.
- **Public Private Partnership (PPP)** – Project is Financed, Designed, Constructed, and Operated by Private Contracting Group.



# Means & Methods

- Technology:
  - Building Information Modeling (BIM)
  - Equipment Advances
- Construction Products:
  - Green Materials (LEED®)
  - Supply Chain:
    - Pricing & Product Quality Volatility
    - Chinese Drywall

# Chinese Drywall

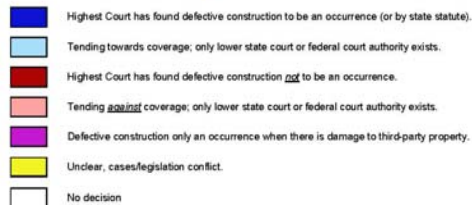
- Between 2004 and 2005, an estimated 100,000 homes were built with toxic Chinese drywall
  - Toxic Chinese drywall was delivered to the U.S. after Hurricanes Katrina and Rita
- Considered toxic because it contains high levels of chemical pollutants such as sulfur:
  - Linked to health problems such as breathing trouble, nosebleeds, coughing, headaches, and eye irritation among others.
  - Toxins can also corrode pipes/wiring and emit a foul odor
- Florida, Alabama, Louisiana, Mississippi, Southeast Texas and Virginia are the hardest hit areas thus far due to the heat and humidity levels of the climate. All 50 states have at least some exposure to the drywall.
- Many homeowners have opted to have all of the drywall removed (a complete renovation) in order to deal with the problem, resulting in a significant volume of lawsuits.
- Economic Losses from Chinese Drywall have been estimated at between \$15B and \$25B.



# Case Law Trends

- Construction Defect – Is it an Occurrence?
- Horizontal Exhaustion – What comes first?

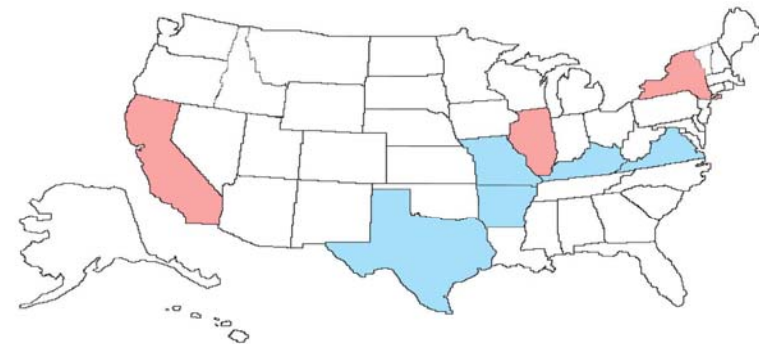
DEFECTIVE CONSTRUCTION AS AN “OCCURRENCE”



<sup>1</sup>Policy exclusions may apply to preclude coverage despite a finding of an occurrence.  
<sup>2</sup>This survey is as of January 7, 2011, except for cases/statutes cited after that date. Courts may change their views at any time.



HORIZONTAL EXHAUSTION IN THE AI CONTEXT



<sup>1</sup>This survey is as of November 1, 2010. Courts may change their views at any time.

# Summary: Risk Perspectives

- **Owner & Contractor:**
  - Project Finance & Delivery Methods
  - Emerging Technology & Methods
  - Loss Control Programs (Safety, QA/QC)
  - Contractual Liability & Risk Transfer
- **Underwriting & Loss Control:**
  - Impact of Loss Control Programs?
    - Zero Losses Does Not Mean Zero Credibility
  - Impact of Changing Risk Profile within the Construction Industry?
  - Unique Coverages
    - SDI, GL, BR, Wrap-ups, WC, PL
  - Shifting Exposures
    - Differences by State
    - Differences by Type of Work
- **Consistency? Predictability?**