Building a Better Box by Thinking Outside of It

Insurance Issues Facing the Construction Industry During the COVID-19 Pandemic and Beyond

Gould & Ratner presents the third installment of our Construction Interview Series on adapting to the COVID-19 pandemic and beyond. We will continue to periodically sit down with representatives of some of the most influential companies in the construction industry to discuss their insights on relevant and pressing topics of interest in the industry.

Rich Reizen, chair of the firm's Construction Practice, recently discussed a variety of issues with Joel Gregoire, Senior Vice President of Lockton Companies. Joel has 25 years of real estate and construction insurance brokerage experience, and heads Lockton's Midwest Real Estate and Construction Group. Lockton is the world's largest independent insurance broker, with over 100 offices globally.

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Rich: First, let me thank you for sitting down with me, virtually of course, to discuss the state of insurance during this pandemic and after. I feel like this is a time when a lot of people are finding out for the first time what their insurance policies cover and don't cover in real time and that some are quite surprised. I have stressed to our clients that it is a good time to understand their coverages, and ask questions of their brokers regarding future coverage and how best to manage risk. What are your thoughts on that issue before we launch into specifics?

Joel: Thanks Rich. The COVID pandemic has certainly raised a lot of questions about business' insurance policies and how they react to certain situations. The COVID situation is something that nobody could have predicted, and insurance companies certainly didn't intend to cover nor are they financially in a position to cover. Working with your insurance broker and your underwriter to have a good working knowledge of your insurance policies are important in order for you to have a good grasp of your overall insurable and uninsurable exposures. We have always taken the position that it is first important to understand our client's business, identify their corporate and risk objectives, and discuss what they feel their exposures are prior to putting together a risk management program. This allows us to tailor a risk management and insurance program that really meets our client's needs.

Rich: You and I have been in this industry for a number of years, many more years in my case, and I have never seen anything like this even during recessions or after 9/11. What is your assessment of where the COVID-19 pandemic ranks in terms of disruption to the construction insurance industry when compared to these other events and how is it different? Can you also speak to the state of the industry just before the pandemic as a result of climate caused losses the past several years?

Joel: The COVID -19 pandemic certainly ranks high and is different in a lot of ways compared to past events. I think everybody was caught off guard, we are learning all sorts of new medical terms, and our country will probably be a lot different going forward. With regard to the construction industry, every state and jurisdiction seemed to have their own different nuances as it related to construction projects and protecting the community which certainly caused a lot of confusion. We spent a lot of time with our clients talking about the different state and health agency protocols, protecting jobsites that were shut down, cleaning jobsites that were infected, and dealing with ongoing construction projects while social distancing and following CDC guidelines.
It is unclear how this will affect construction going forward. Our clients are concerned about how the new remote workplace will affect future office buildouts, how fast will the economy rebound, the upcoming presidential election, and global issues with China.

The overall insurance market has been hardening for a couple years now, starting with auto insurance about 3 years ago, property insurance 2 years ago, and now excess liability insurance. All of these have been affected by different factors:

- Auto – distracted drivers, cars part costs increasing, large jury verdicts
- Property – natural disasters like hurricanes and earthquakes, wildfires, climate change causing water damage from frozen pipes and flooding in areas that never flooded before
- Excess liability – increasing medical costs, larger nuclear verdicts, litigation funding, opiod crisis, etc.

The one consistent theme is the insurance marketplace was soft for too long.

Rich: I would like to start our discussion with some questions regarding the current state of construction. From the legal side, we are currently assisting our clients in navigating a myriad of ever-changing and often inconsistent state, county, and city construction orders, as well as CDC, OSHA and other health guidance. We have spent a lot of time reviewing site safety and security plans. First, given the pandemic and the resulting new governmental and health guidelines, how can risk be managed with respect to project site safety?

Joel: As an employer responding to the everchanging guidelines and different states opening at different time, it is difficult for employers to be consistent with each state's guidelines for face coverings. In these times an employer needs consistency. As a result of this we are seeing questions regarding how to offer a place of employment that is free of recognized hazards. OSHA has deemed the COVID 19 illness a recognized hazard so employers must act to protect their employees with the tools they have. Guidelines and regulations are two different things in the world of employee protection.

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Shall and Should hold different meanings in the OSHA regulatory text. When reviewing employer's safety plans, we look for all the potential risks associated with a job. And with the COVID 19 hazard, employers in all states must decide on how to navigate the potential health risk associated. In consistency with OSHA and its health hazard assessments to protect employees the employer can offer Personal Protective Equipment as a voluntary use at the locations. When an employer offers voluntary use for respirators, the employer must provide Appendix D of OSHA's Respiratory Protection Standard or the equivalent section of a state OSHA plan. The employer does not need to develop an entire Respirator Health Safety Program. As states begin to open it is possible for employees to wear a surgical facemask, or a CDC recommended face covering to work and have other employees don a voluntary n95 respirator on the site as well.

Rich: Because projects have been shut down temporarily for a variety of reasons, ranging from governmental orders, to site illness, to funding disruptions and the like, sites have had to be secured, often quickly, and left that way for a while. Can you briefly identify some of the risk issues facing that situation and the impact on builder's risk and other coverage?

Joel: As a result of the site shut downs, we are seeing project sites exposed to various exposures.Theft, vandalism, water intrusion, subcontractor default and fire are some of ones we see often, and with COVID-19, the environmental cleanup associated with an infected project site. It is important for contractors to protect their site from these exposures. I have included a sample Construction Site Shutdown Checklist that can be

In addition to protecting your site, it is important to inform your builders risk underwriter of the measures you are taking to secure your site, and how much time you may need to extend your builders risk policy.

Rich: Let me now ask you the broad question our clients are asking: Will any typical coverages cover losses related to COVID-19? Can you discuss business interruption claims in that context?

Joel: Every situation is different, but in broad terms, property insurance policies are triggered by damage to your property caused by a covered peril, ie. fire, wind, water, ect. A property owner's claim to the presence of a virus in its property may not establish a direct physical loss trigger under the policy. In addition, many policies have specific exclusions for contamination, biological agents, or viruses. The ability to reach into a property policy to obtain business interruption coverage requires the physical loss or damage trigger to be satisfied. Even if it's determined, the actual presence of a virus is physical damage, the indemnity period would only be the period needed to disinfect and clean up the contaminant.
In addition to property insurance, we are seeing other policies being analyzed for coverage:

- Workers Compensation for employees who allege they contracted COVID while working
- Pollution Liability policies for potential clean up and third party bodily injury
- General Liability for third parties alleging they were infected from your operation

Rich: Despite what you just said, is there any reason for insureds not to give notice of potential claims?

Joel: Since it is unknown how the overall insurance industry will end up responding or if a government back stop will be put in place, we have been advising our clients to put the insurance carriers on notice for any loss resulting from COVID. If at some point insurance carriers determine these are covered losses, the client has already put the carrier on notice and would not be subject to any late reporting provisions. With that said, there are certain policies that require a certain level of specificity for them to be accepted as claims or even circumstances which could give rise to a claim. An issue that is reported which does not rise to trigger the claim or circumstance requirements could run the risk of being excluded in future policies by virtue of common prior notice exclusion language. These policies are typically in the management liability space including Directors & Officers Liability, Professional Liability, EPLI, and Cyber Liability.

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Rich: Are there any government back-stops for pandemic insurance coverage?

Joel: There certainly has been a lot of talk about a government back stops similar to what was put in place for terrorism after 9-11. It is unknown if a government back stop would help businesses who suffered losses from COIVD-19, or would be for future pandemics. House Representative Carolyn Maloney proposed a bill that would mirror TRIA (terrorism act) in that if overall losses from a pandemic hit a certain dollar threshold, the government would provide a back stop to the insurance companies. We will see if this bill or any others are passed.

Rich: What is the industry's view on the likelihood of legislation requiring insurers to cover COVID-19 claims? What about liability limitations?

Joel: The insurance companies are all required to fund for future losses called surplus. Currently the collective insurance company's surplus would not be adequate to pay for the business interruption losses that businesses have suffered from being shut down due to COIVD-19. As a result, in the event insurance companies were directed to pay these losses, they would need some kind of government back stop to fund the losses.

Rich: Are there policies in existence which can be purchased to prevent some of these losses in future pandemics, even a second COVID-19 wave?

Joel: Prior to COVID, there were a few specialty insurance carriers that did provide coverage for pandemics. The coverage had stringent underwriting guidelines, large deductibles, and was quite expensive. To my knowledge at this point there is only one carrier willing to write this coverage today, and it is only for certain industries (hospitality, retail, manufacturing, and mining), it is a manuscript policy built around specific exposures, and remains expensive.

Rich: Anecdotal evidence in my world suggests that excess liability coverage is becoming far more expensive and hard to get. It also appears that more layers are required to reach excess goals. Is my anecdotal evidence accurate and can you talk about this issue?

Joel: Yes, you are correct. For the reasons I mentioned previously, insurance carriers are reducing the limit capacity they are willing to offer any one insured, they are requiring higher attachment points from underlying layers, and charging more premium. For example, if we had an expiring program with general liability limits of $1million per occurrence and $2 million aggregate, and then three insurance companies each participating with $25 million layers for a total of $75 million limit, the renewal program might need to have general liability limits of $2 million per occurrence and $4 million aggregate, and then instead of three insurance carriers participating in the $75 million limit, you might have five or six, with the lead carrier reducing their limit from $25 million to $10 million at the same or higher premium.

Rich: Can you talk a little about the cyber liability exposures with more people working remotely?

Joel: COVID and a remote workforce have an impact on an organization's cyber exposure in a number of ways.

- Virtual Private Network (VPN) – Weak and misconfigured VPN infrastructures have led to a significant increase in ransomware events since more employees are working remotely. Hacker are exploiting these vulnerabilities and deploying ransomware at higher extortion demand amounts.
- Targeted Phishing Campaigns – Hackers are taking advantage of remote workforces by deploying targeted phishing email campaigns. These emails include coronavirus information and appear credible to the employee that is receiving the malicious message. More clicks take place which leads to impactful cyber events.
- Biometric Employee Information – As workers return to work, some organizations are taking employee temperatures and giving coronavirus tests. There are privacy laws and implications surrounding collecting and storing biometric data. This could lead to privacy lawsuits and regulatory investigations for the alleged misuse and wrongful collection of biometric data.

Rich: Clearly there are going to be sites that will now remain vacant for a while. What unique insurance issues does that create?

Joel: Many property insurance policies have vacancy provisions that state if a property is left vacant for over a certain period of time (60 or 90 days), the insurance company will either exclude certain perils (vandalism, theft, water damage) or have a higher deductible for these perils. It is important to keep your insurance broker and underwriter aware of any vacancies and inform them of what you are doing to prevent these losses. Often times insurance carriers will waive the vacancy provision if they feel the property is protected. In addition, certain insurance carriers have waived the vacancy period of time as a result of COVID. While not an insurance issue, the need to communicate all of this with your project owner is just an important. If the builders risk coverage is canceled or requires additional hard costs (lights, night watchman, video surveillance, physical site barriers, etc.), then those requirements need to be communicated to the owner as they should be the ones to absorb the cost.

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Rich: What else do you see in the insurance future for construction and real estate?

Joel: I think we have all learned how to work remotely, even old people like you and me! It will be interesting how that will affect businesses and how they view working in an office versus having all or some of their employees work remotely. This of course will have ripple effects throughout the real estate, construction, and insurance industries.

As far as insurance, there will eventually need to be some sort of government back stop for future pandemics. Insurance companies have already started shoring up their policy wording to be clear that they will not cover viruses / pandemics. I think there will be more specialty insurance companies that will try to take advantage of the lack of coverage options and develop policies that would respond to a similar pandemic. These policies will be manuscripted to the individual insured's exposures and will likely be very expensive.

Rich: Can you identify some best practices for managing insurance risk during and after this pandemic?

Justin: Some basic things to start with include:

- Talk to your insurance broker and understand what your insurance policies cover.
- With unsure economic times, if you are a GC, make sure you have a good subcontractor prequalification program that includes a financial review and certificate of insurance tracking.
- Review contract requirements very closely.
- Review your safety program, I am sure all contractors will be adding a new section on how to handle a pandemic or site contamination.
- Start your insurance program renewal process early, meet your underwriters, and get realistic expectations for renewal premiums.

Rich: How important is record-keeping to support insurance claims at this point? What types of records are most persuasive to insurance carriers?

Justin: Record keeping is very important especially for a business interruption claims. You must be able to show the claims adjuster the accounting of your loss.

THINGS TO TRACK

- Maintain a log of business impacts on a daily basis, reflecting how operations are modified as a result of the event. Include any government mandates, restrictions, curfews, evacuations, etc.
- Begin tracking the status of all open projects and planned projects, as of the latest date prior to the initial business impact from Covid-19. Obviously, this time frame and date(s) of loss will vary depending on where a contractor has projects.
- Retain all forecasts, outlooks, pace reports, demand or backlog forecasts prior to the loss.
- Maintain a general ledger account tracking all direct expenses incurred to maintain operations exceeding normal costs.
- It is important to track the labor expenses associated with loss for exceptional activities created by the event. This should be identified by name, dates, hours, rates, description of activities and whether the person is hourly/salaried. Employees who are simply idle should not be included in this listing.
- Do not segregate any labor expenses from the income statement and place into the loss receivable account. It is acceptable to establish separate sub-accounts so that they can be segregated (not removed) from normal operating wage expenses. It is also acceptable to simply maintain a separate manual tracking of loss related labor expenses. However, these costs should remain as part of the ongoing payroll expense category in any operating income statement.

WHAT DOCUMENTS TO PRODUCE

Should a significant interruption and claim ensue, the preliminary information needed for the claim will include (for each loss location/project):

- Historical and post-loss construction costs and other operating data (monthly and daily) for 2018, 2019 and 2020 to date.
- Detailed profit and loss statements or cost statements for 2018, 2019 and 2020 to date.
- Detailed budgets for 2018, 2019 and 2020.
- Any industry or market performance statistics available for 2018, 2019 and 2020 to date.
- Monthly back log levels for 2019 and 2020.
- Payroll summaries for each pay period in 2020.
- Planned/forecast sales for 2018, 2019 and 2020.
- Lease agreements for relevant facilities.

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Rich: I recognize that construction is a lagging industry and that many commercial contractors are still busy. How is the pandemic impacting the ability to get bonding and what are your thoughts about the future of obtaining bonds?

Justin: Thankfully, many contractors are still enjoying record backlogs and limited interferences amongst the pandemic. The surety industry continues to monitor a number of factors, with more magnified focus on liquidity, line of credit availability, accounts receivable and capital base/availability. One major item that sureties are focusing their underwriting is the ability of their contractors to obtain future backlog. With many private owners (specifically in the hospitality, office, retail and entertainment industries) pausing or cancelling many projects, it will be key for contractors to focus heavily on bidding profitable work. With this, though, GC's need to keep a close eye on subcontractors that may be getting overly aggressive in their bids to obtain said work. Moving forward, sureties will likely begin to tighten their underwriting standards and potentially lead to a bit of hardening in this industry.

Rich: As you know, I have always been and remain a vocal advocate for a thorough pre-construction phase before final project decisions are made and construction begins. I believe it saves money, anticipates and deals with potential problems and results in a better designed and better built project. In the COVID-19 and post-pandemic area, I believe that is even more important. What types of risk management and insurance issues should be addressed during pre-construction?

Joel: Rich, I agree. Communication is key. All parties need to review and understand contractual requirements prior to starting work. A healthy dialogue to understand who is required to do what is essential. Since the COVID-19 pandemic started, we've seen owners attempting to make GC's responsible for any delay, including delays caused by a pandemic. Contractual requirements need to be fair for both parties to avoid future project delays. Making a decision upfront on how insurance will be placed in the pre-construction phase is important as well. Will the project have any project insurance policies like an OCIP or CCIP, should environmental liability insurance be required or obtained, how is the design exposure addressed for the architect as well as the owner are some of the decisions that need to be made. Also, there are some new wearable technologies and site security platforms available to assist in creating a more secure jobsite, limiting access to approved personnel, and providing accurate data on worker locations. Costs for these should be reviewed with the owner.

> **"TAKING INSURANCE OUT OF THE EQUATION, THIS HAS OPENED THE CONSTRUCTION INDUSTRY'S EYES ON HOW DEVASTATING A PANDEMIC CAN BE TO THE CONSTRUCTION INDUSTRY. RISK MANAGEMENT AND SAFETY CAN PLAY AN IMPORTANT ROLE IN HOW WE VIEW CONSTRUCTION METHODS AND SAFETY ON A CONSTRUCTION SITE FOR COMMUNICABLE DISEASE AND PANDEMIC EXPOSURES."**

Rich: With respect to design changes for future projects, we are seeing such issues as better ventilation systems, touchless systems, less porous fabrics, configurations that allow for social distancing and the like. Do you believe that the inclusion of these types of design features will impact insurance pricing if installed in a project?

Joel: It is too early to tell. These design changes focus on preventing virus transmission which prior to COVID never really was a concern. We are seeing insurance companies adding communicable disease exclusions to their policies to deal with this exposure in the future.

Rich: Continuing my hockey quote theme, Herb Brooks famously said: "Great moments are born from great opportunities." I think that this great moment, tragic and frightening as it is, and not one I would have wished on us. I firmly believe it does create a great opportunity to allow for the construction of safer, more climate resilient and climate friendly, and just better projects and that it gives us a great opportunity to re-think how we work. What are your thoughts on this issue Joel?

Joel: I agree. Taking insurance out of the equation, this has opened the construction industry's eyes on how devastating a pandemic can be to the construction industry. Risk management and safety can play an important role in how we view construction methods and safety on a construction site for communicable disease and pandemic exposures. Perhaps this experience will help all stakeholders better understand the risks involved in construction and will provide a greater level of cooperation towards contract indemnity, the importance of a robust subcontractor pre-qualification program, utilization of physical technology for tradesmen, and an overall improved level of awareness in regards to appropriate risk management and risk transfer approaches.

Rich: Thank you again for sharing your knowledge and experience and I know we only scratched the surface of this topic. Perhaps we can talk again as we see how things progress.