

**Coverage for Delay and “Soft Costs” Under
Builder’s Risk Policies:
Avoiding the Pitfalls**

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I. INTRODUCTION

Builder's Risk policies differ from other property insurance policies in that they attempt to provide coverage for a "moving target." Since Builder's Risk policies are underwritten on the basis of an ongoing construction project whose scope and progress will likely change over time, they pose special challenges for identifying and measuring covered damages in the event of a loss. Nowhere is that more true than in the area of "soft costs," where definitional and loss measurement challenges abound. In contrast to the use of the term "soft costs" in the construction industry to encompass costs "incurred to perfect a construction project other than labor and material (which are commonly referred to as hard costs),"² "soft costs" in the insurance context may refer to any number of fixed and/or time-sensitive expenses resulting from delay caused by physical loss or damage to a building during construction.³ Those costs may, but need not, be incurred in connection with the actual process of repairing, rebuilding or replacing the damaged property and may include business interruption and other time element losses.⁴

Despite, or perhaps as a result of, the relatively loose use of the term "soft costs" in the past, those costs have become an often overlooked but increasingly important component of many commercial Builder's Risk claims. In some cases, especially long-term projects involving complex financing arrangements, difficult project logistics and/or aggressive leasing targets, the insured's cumulative claim for additional costs resulting from project delays, extra expenses, and lost rental income may equal or even exceed the "hard costs" of construction labor, materials and equipment incurred in rebuilding the damaged property. Although Builder's Risk policy forms and endorsements have evolved substantially over the years in response to a changing marketplace,⁵ a recent federal court decision has prompted several insurers and industry advisory groups to revisit their traditional "soft cost" endorsements and to devise new policy forms and endorsements aimed at keeping pace with the evolving financial and logistical realities of

commercial construction. Whether claims are brought under new or older policy forms, both insureds and insurers have a keen interest in taking steps to clearly define which “soft costs” are and are not covered under the policy and to implement practical measures to ensure that all costs are properly accounted for. Without those measures, insureds may find themselves lacking the funds they need to complete the project and/or compensate themselves for lost income, while insurers may unwittingly pay twice or more for the same project costs.

The objective of our presentation is three-fold: (1) to review and place in context the 2007 federal court decision that upended the traditional assumptions of insurers about the availability, scope and limitations of delay and soft cost coverage under Builder’s Risk policies; (2) to explain how the insurance industry has responded to that decision by re-evaluating, and in some cases rewriting, “soft cost” endorsements to define time-sensitive “soft costs” and distinguish them from other extra expenses and costs that may result from property damaged during construction; and (3) to suggest a few practical steps that both insureds and insurers can take to avoid common pitfalls and exercise greater control over their potential exposure following a substantial loss.

II. RECENT DEVELOPMENTS IN SOFT COST COVERAGE

A. The Traditional Framework for Builder’s Risk Soft Cost Coverage

Before the New Jersey District Court issued its decision in *Zurich American Insurance Co. v. Keating Building Corp.*, 513 F. Supp. 2d 55 (D. N.J. 2007), “soft cost” and delay coverage was all too often offered in the form of relatively simple endorsements that did little to define coverage or differentiate between disparate categories of expenses. Coverage for soft costs sometimes appeared to be almost an afterthought, indicated by the checking of an appropriate box in a list of available additional coverages. Policy forms often failed to describe the scope of coverage for delay and soft costs or to differentiate time-element expenses from fixed costs.

This framework had the benefit of simplicity, but it proved to be increasingly unworkable as the potential magnitude and complexity of those costs grew.

Insurers who follow the traditional approach in drafting coverage for soft costs may find themselves vulnerable to a court finding ambiguity in their policies when disputes arise over the extent of coverage for soft costs following a loss. For example, in one “checklist” policy where the “soft cost” section of the policy was left blank, a dispute arose between the insurer and the insured over whether the parties nevertheless intended to include soft cost coverage in the policy. The court in that case denied the insurer’s motion for summary judgment, reasoning that the policy was ambiguous.⁶

Likewise, by failing to state the nature and scope of soft cost coverage in a policy with specificity, insurers can unwittingly expose themselves to far greater liability than they intend. In one case, an apartment complex was damaged by fire and a dispute arose over whether \$100,000 in expenses for such items as interest payments, property taxes and advertising were part of the policy’s \$29.5 million per occurrence limit or fell under a separate sublimit.⁷ Again, the court denied summary judgment due to the ambiguity in the policy.⁸ The court reasoned that the policy could be interpreted to mean that soft costs were limited to \$100,000 per occurrence irrespective of the \$29.5 million limit or it could mean that once the \$29.5 million was exhausted, there still remained \$100,000 liabilities for soft costs and business income.⁹

Beyond the potential exposure to both insurers and insureds arising from uncertainty over coverage in a checklist-style “soft cost” endorsement, policies utilizing the traditional approach may simply be unable to meet the needs of many of today’s increasingly complex construction projects. Costs that are grouped under the rubric of “soft costs” may vary tremendously in both amount and character. The better approach is to draft such coverage with specificity so that the

scope of coverage – and any limitations – can be tailored to the individual needs of each project. That way, the policy form provides more certainty for both the insurer and the insured and can minimize the significant risk of unintended results if and when a conflict arises. Indeed, the continued treatment of soft cost coverage as an afterthought led to exactly that result – one with ramifications for the entire industry – when a New Jersey federal court reviewed a dispute over coverage for expenses that arose due to a building collapse during a hotel expansion project.

B. The Impact of *Keating*

Before 2007, courts had little occasion to provide guidance on which delay and soft costs are covered under standard Builder’s Risk policy forms and endorsements or, where the court found coverage, on how those specific costs should be measured. As a result, the New Jersey District Court sent ripples throughout the insurance industry in 2007 when its analysis of “soft cost” coverages in *Zurich American Insurance Co. v. Keating Building Corp.*, 513 F. Supp. 2d 55 (D. N.J. 2007), turned insurers’ coverage expectations on their head. Applying basic principles of general contract and policy interpretation, *Keating* held that a standard Builder’s Risk policy provided coverage for three standard categories of soft costs – extended general conditions, delay costs and price increases – despite limiting language in the grant of coverage and a broad exclusion of consequential losses.¹⁰ Whether or not this decision becomes the majority view, it merits a closer look, as it underscored the need to consider at the outset of a project how soft costs are defined and measured under the policy and triggered significant changes in the way soft cost coverage is now being written.

1. A Collapse at a Large Construction Site Causes Millions in Delays

Like most Builder’s Risk policies, the policy at issue in *Keating* was written on an “all-risk” basis, insuring against loss from all perils except those that have been specifically excluded.¹¹ Accordingly, the scope and enforceability of limiting language and exclusions that

would remove claimed losses from the coverage grant become paramount considerations in determining the availability and scope of coverage. In *Keating*, Aztar Corporation (“Aztar”), the owners of the “Tropicana” in Atlantic City, New Jersey, undertook an extensive expansion and renovation of the resort, which included a three-floor dining, retail and entertainment space topped by a seven-level parking garage and seventeen additional floors of hotel rooms.¹² Aztar hired Keating Building Corporation (“Keating”) to serve as the general contractor on the project.¹³ The project schedule called for Keating to complete the project some time in the first quarter of 2004.¹⁴

Prior to commencement of construction, Zurich issued a builder’s risk policy covering both the project owner, Aztar, and the general contractor, Keating, for losses arising out of an accident.¹⁵ The policy included a Policy Valuation Clause under which the insurer would only cover costs to “repair or replace *property lost or damaged* at the time and place of loss with materials of like kind and quality.”¹⁶ In addition, the policy expressly excluded damages or expenses “caused directly or indirectly and/or contributed to, in whole or in part” by “consequential loss, damage or expense of any kind or description including but not limited to...*penalties* for non-completion, delay in completion, or non compliance with contract conditions....”¹⁷ Finally, the policy included a “Delay in Completion” endorsement insuring Aztar, but not Keating or any of the subcontractors, against the loss of gross earnings, rental income and “soft costs/additional expenses” associated with a delay in the project construction schedule.¹⁸

After the project was well underway in October 2003, a portion of six floors of the garage collapsed on top of the three-level retail, dining and entertainment complex.¹⁹ The collapse caused significant damage and numerous injuries, including four deaths, to construction workers

on the project.²⁰ The day after the accident, Zurich dispatched representatives and consultants to the site to work with Keating in reviewing and classifying the work performed to date.²¹ Keating shortly submitted a claim for costs that were outside the scope of work under its contract but resulted directly from the accident, such as debris removal, repair of the garage, and increased construction costs due to delay.²² Aztar in turn submitted a claim under the Delay in Completion endorsement for losses it allegedly sustained as a result of delay in finishing the project, chiefly lost rental income, other lost hotel revenues, and additional project financing costs.²³

Although the decision touches on several issues relating to coverage for additional costs and expenses,²⁴ the final section directly addresses coverage for soft costs and “delay-driven increases in construction costs in completing the expansion project.”²⁵ According to Aztar, the accident caused a delay of more than eight months, leading Keating to substantially revise the project schedule to reflect a new completion date of November 2004.²⁶ Keating incurred additional expenses as a result of having either to retain some subcontractors on the job site longer than anticipated or to suspend the work of others and ask them to return to the site months later than originally planned.²⁷ Aztar and Keating claimed that the eight month delay resulted in a cost increase from \$225 to \$300 million and jointly submitted an \$80 million claim to Zurich.²⁸ Zurich paid \$40 million of the claim but refused to pay certain increased expenses.²⁹ Zurich’s denial of coverage focused on the claim for delay and soft costs for Extended General Conditions, Contractor’s Delay charges resulting from idle labor and equipment, and material, labor and storage price increases.³⁰ Aztar claimed the costs fell within the policy’s broad, “all-risk” grant of coverage because they were needed to complete the project.³¹ Zurich countered that Aztar’s and Keating’s delay claims were not covered because the insuring provision

language was limited to the costs to repair or replace the damaged portion of the project and did not extend to increased costs needed to complete construction of the undamaged property.³²

2. The Court Rules that there is General Coverage Under the Policy

The court rejected Zurich's argument and held that the policy covered all three disputed cost categories.³³ The court started from the premise that the policy was written on an "all risk" basis, since it insured both the owner and contractor against "all risks of direct physical loss or damage."³⁴ As a result, absent a specific exclusion, the policy covered all fortuitous losses proximately caused by the covered peril.³⁵

The court then determined that neither the coverage grant nor the valuation provision distinguished between losses resulting from damaged and undamaged portions of the property.³⁶ The policy did not restrict coverage only to the area of the project where the accident occurred, but instead insured physical damage at the "Insured Project."³⁷ Similarly, the court held, the policy's Valuation Clause did not limit coverage only to the costs of repair to the damaged property, since from the perspective of an ordinary insured, the term "property lost or damaged" as a result of an accident would refer to the entire structure, not just to the location of the collapse.³⁸ Finally, the court stated that Zurich could have limited the coverage under its policy by including language restricting coverage to only obligations of repair costs of the damaged property but failed to do so.³⁹ The court went so far as to note that Zurich had an insurance form stating that Zurich would pay for "losses required to rebuild, repair or replace such part of the property herein described as has been damaged or destroyed."⁴⁰ Because this form proved that Zurich knew how to issue a policy with such limiting language, the court refused to limit the language in the Aztar policy in this same way.⁴¹ Accordingly, the court declined to place limits on the scope of the "all risk" coverage that would exclude project costs incurred in connection with the undamaged property.

3. The Court Holds the Policy Exclusions Inapplicable

Zurich argued in the alternative that, even if the extra costs fell within the general grant of coverage, coverage should be denied because they fell within the policy's "consequential loss" exclusion.⁴² The court rejected this last obstacle to recovery by invoking the "efficient proximate cause" doctrine, stating that even when excluded and covered perils combine to cause a loss, coverage is available if the covered peril was the efficient proximate cause of the loss and an excluded peril merely occurred in the chain of events that followed.⁴³ The court held that even if the consequential loss was involved in the chain of events leading to the loss, coverage was still available because the collapse was the efficient proximate cause and the policy exclusion did not bar coverage so long as the efficient proximate cause was covered.⁴⁴

Furthermore, the court stated that the types of losses listed in the exclusion – "liquidated damages," "performance penalties," "loss of market or delay," and "penalties of non-completion, delay in completion, or non-compliance with contract conditions" – were purely economic losses separate from regular construction costs.⁴⁵ The court stated that to extend the exclusion of consequential losses to include regular construction costs incurred to complete the project was impermissible and unwarranted under the New Jersey rule requiring narrow interpretation of exclusionary language.⁴⁶

Finally, Zurich argued that the claimed additional costs were barred from coverage because the policy's consequential loss exclusion expressly encompassed delays in completion.⁴⁷ The court held, however, that the exclusion did not state that a delay in completion would be a consequential loss but rather that the "penalties" associated with a delay in completion would be a consequential loss.⁴⁸ Reasoning that Aztar was seeking coverage for additional costs of delay and not for any penalties associated with the delay, the court stated that the exclusion did not apply.⁴⁹ The court subsequently held that Zurich must pay the extra costs that Aztar paid to

complete the project, *without regard to whether the costs involve work at the project away from the immediate area of the collapse.*⁵⁰

4. The Impact of Keating on Builder's Risk Policies and Soft Costs Coverage

It is premature to predict whether the *Keating* decision will be followed in other jurisdictions, or even be the final word under New Jersey law on this issue, especially if it is superseded by new policy forms. Regardless of whether *Keating* was properly decided, it upended insurers' expectations that coverage for soft costs is generally excluded as a consequential loss absent a specific endorsement. First, instead of placing the burden on the insured to establish the existence of such coverage, the court treated extended general conditions, contractor delay damages, and even materials, labor and storage price increases as "regular construction costs" that were incurred "to simply finish the project." Traditional policy exclusions did not operate to limit or control the insurer's exposure. *Keating* raises the specter that other soft costs, whether incurred on- or off-site, will be treated as recoverable even though they would appear to fall squarely into the category of consequential losses.

Second, the court held those costs recoverable under the general grant of *property coverage* even though they are more in the nature of time element costs that grow with time. Traditionally, time element coverages are subject to a very different set of limits and deductibles to control costs and forestall any incentive for insurers to claim coverage for project delays resulting from other causes or non-covered perils. In the next section, we discuss how *Keating* has led to a substantial revision in the treatment of soft costs under Builder's Risk policies.

C. The New Paradigm for "Delay In Completion" Coverage

In the wake of *Keating*, policies are shifting from the old paradigm where coverage for soft costs was often treated as an afterthought and insureds were often simply presented with an

undifferentiated mass of soft costs in a buffet-style checklist. As noted above, this method has proven inadequate – particularly as soft costs have become an increasingly large percentage of insurance claims arising out of losses during construction. To deal with the complexities of modern construction projects and the shortcomings of the old paradigm, insurers have taken a more sophisticated approach under which the various types of soft costs are compartmentalized into groups that can be treated differently for purposes of defining the nature and scope of coverage.

For example, recent policies have moved to distinguish between “construction expenses,” which are fixed or lump-sum costs incurred during a delay in construction, and “additional soft costs” that fall within more traditionally recognized time element losses.⁵¹ These policies provide coverage for all soft costs under a general “Delay in Completion Coverage Part.”⁵² However, by breaking out the types of soft costs into groups sharing similar characteristics, insurers can better control their exposure and define exactly what soft costs are covered and to what extent. The following discussion outlines the different categories of expenses that may arise from a loss in addition to hard costs. The lines between these categories are not hard and fast, but they do illustrate the different considerations that may impact the scope of and limitations on recovery:

Construction Expenses: Soft costs falling into the “construction expenses” category include, among others:

- Additional advertising, public relations and promotional expenses;
- Design, architecture and engineering fees and other service-related professional fees;
- Inspection fees;
- Commission and loan fees and other non-interest financing costs;

- Costs to renegotiate leases; and
- Costs to renew construction permits and licenses.⁵³

Extended general conditions – costs needed to perform and manage the project outside of the materials, labor and equipment that are incorporated into the property – may be considered to be either construction expenses or additional soft costs, since they may involve both fixed and variable costs.

These costs are generally incurred in lump sums when construction delay occurs, and are less likely to be impacted by the length of the delay than soft costs falling under the more traditional time element-type losses.⁵⁴ As a result, to the extent that the parties elect coverage for these costs, the insurer's exposure can be limited by subjecting them to a single per occurrence limit and the general policy deductible (i.e., they are less likely to be subject to sub-limits).

Additional Soft Costs: Additional soft costs – more dependent on the length of construction delay – are treated separately from other types of soft costs under the new paradigm, and include:

- Additional interest on financing necessitated by the delay;
- Additional real estate taxes;
- Additional costs to extend leases of construction equipment, temporary office space, etc.;
- Extended general conditions and administrative overhead;
- Operational-type expenses such as salaries and wages, overtime, utilities, maintenance, and other costs an owner begins to incur as he or she is gearing up to commence operations in the building under construction; and
- Additional costs for insurance premiums.⁵⁵

Unlike the fixed costs of construction, these costs grow over time and are directly dependent upon the delay attributable to the physical loss or damage resulting from the coverage peril. As with other time element coverages, they may be subject to a waiting period and a separate cap on liability in order to limit unnecessary delays in repairing or rebuilding the damaged property.

Traditional Time Element Soft Costs: Some policies consider traditional business interruption and time element losses caused by delay in construction to be soft costs. Such costs can be generally defined as economic damages resulting from lost use of the facility, and include:

- Lost income from products that cannot be manufactured by the date anticipated; and
- Lost rental income from commercial space.⁵⁶

Like the “additional soft costs,” these time element losses are treated differently from other “construction expenses,” and will be subject to a waiting period rather than a general deductible as well as a separate limit of liability.

Breaking out coverage for soft costs into these categories allows insurers to manage their exposure by tailoring coverage for different groups of risks – all of which fall under the general umbrella of “soft costs” – to their specific characteristics. Thus, for example, more time-sensitive risks can be subject to a waiting period while more fixed or “lump sum” risks are subject to a general policy deductible. This approach is a significant departure from the old paradigm, where little thought was given to the fact that soft costs encompass a number of very different types of risks with different characteristics. The new paradigm recognizes the complexities inherent in trying to define “delay in completion” coverage, and affords the insured more certainty in the scope of its coverage while allowing the insurer to manage its exposure by

treating different risks differently, rather than trying to lump all soft costs together into a single grant of coverage.

III. PRACTICE POINTERS FOR AVOIDING THE PITFALLS IN DEFINING AND LIMITING LIABILITY FOR SOFT COSTS

Even under the emerging framework for defining and categorizing coverage for soft costs under Builder's Risk policies, some pitfalls remain. Many of the additional "construction expenses" that may be the subject of a soft cost claim correspond to costs that were already part of the original project budget. The measurement of time element losses may be complicated by project delays that preceded, and are unrelated to, the covered cause of loss. Although it is not possible to address all of the steps that must be taken into consideration in underwriting or adjusting Builder's Risk soft costs claims, we offer a few practical suggestions that should benefit both insurers and insureds by establishing the basis for, and limitations placed on, those claims.

A. Definition and Segregation of Project Costs

The emerging framework for evaluating soft costs under Builder's Risk policies begins with the proper definition and segregation of potential additional expenses during the underwriting and policy formation process. The new framework attempts to avoid unpredictable results like the outcome in *Keating* by carefully delineating three very distinct types of extra expenses and then subjecting each category to its own limits and deductibles. Even so, some hazards remain for the unwary.

The extent of coverage for soft costs is determined by the language of the policy. With soft costs, "what you see is what you get."⁵⁷ Insurers must be careful to set forth the costs they intend to cover – or exclude – with specificity. This is the lesson of *Keating*. Furthermore, it is important not to overlook the distinction between costs to perfect the project and costs incurred

as a result of the delay. Only the latter are true “soft costs,” while the former are likely covered – if at all – under the policy’s general property coverage.⁵⁸

- Soft costs should be itemized as either covered or excluded under the policy or soft cost endorsement.
- The parties should be aware of the distinction between costs necessary to complete the project and costs arising from the delay caused by an event of physical loss or damage – only the latter should be covered as “soft costs” under the policy.
- Even if the policy does not distinguish between time-element and non-time element soft costs, doing so after a loss will help in the adjustment process because it will allow the insurer to better monitor those soft costs that will increase over the duration of the delay.
- The parties should recognize that many claimed additional construction expenses may already be included in the project budget. Therefore, not only is it important to monitor the claim after the loss, but both insureds and insurers should track those costs both before and during the project in order to establish which expenses may already have been incurred. For instance, the project budget will already include a fixed amount or percentage of hard costs for general conditions costs needed to perform and manage the project. Although a covered loss may necessitate an extension of these costs, many items may be one-time costs and/or involve a significant initial outlay that has already been paid under the original contract. Careful monitoring of those costs both *before and after* the loss will greatly assist insureds in establishing and quantifying legitimate claims for extra expenses while allowing insurers to avoid duplicative coverage.

B. Early Deployment and Claims Assessment Following a Loss

As important as proper policy drafting and underwriting are to defining and controlling soft cost exposure, project monitoring and early intervention following the loss to evaluate the progress of construction are just as critical. If counsel is familiar with the project as a result of prior cost overruns, delays or other pre-loss issues, or is fortunate enough to be retained immediately after the loss, he should advise the client to assemble a team and implement a plan “on the ground” to measure the loss.

The more an insurer knows about the status of a project before the loss even occurred, the better equipped it will be to quickly and correctly determine the extent of coverage following a loss:

- Be familiar with the contract documents: Contractor proposals showing milestone completion dates for various phases of the project, as well as baseline and periodic amended “critical path” schedules setting forth the sequence and progress of construction, are both good sources of information for tracking the actual progress of a project before and after the loss.
- Track invoices, change orders and similar documents showing what materials have actually been purchased for the project. These documents will help to reveal where the project stood before the loss.
- When tracking the progress of a project, be sure to amend the policy any time there is a change in the anticipated completion date. This will ensure that if a loss occurs, the policy will accurately reflect the date from which the period of delay will begin to run, and will protect both the insurer and the insured.
- Where the project encounters substantial delays prior to the loss, gather and review progress meeting minutes, field notes, correspondence and similar documents to memorialize the pre-loss status of the project and to scrutinize the insured’s likely claim that it had a plan in place to make up for any pre-loss delays.

Once a loss occurs, the insurer must move quickly to confirm the pre-loss anticipated completion date and to determine the length of the anticipated delay:

- Review the contract documents to determine what was left to complete at the time the loss occurred.
- Immediately dispatch a representative to clarify whether the damaged portion of the project is covered or non-covered property. This factor may be especially important on projects involving renovations or additions to existing structures.
- Determine what repairs need to be made and how they will affect completion of the project as a whole.
- Review the policy to determine what types of delay are covered and what types of delay are excluded.

- Closely monitor the repair process to ensure delay is not extended by lack of due diligence by the insured and that costs not truly caused by the delay (i.e. debris removal or general repair costs) are not included in the insured's soft cost claim.

Although these “nuts and bolts” measures may seem intuitive, it will be important to have the framework and resources already in place at the time of loss in order to facilitate the prompt collection and evaluation of project information impacting the potential recovery of project soft costs.

C. Calculating the Period of Indemnity and Measuring the Amount of Loss

Builder's Risk coverage for soft costs applies only to those costs incurred during the delay resulting from an event of physical loss or damage to the property – otherwise known as the “period of indemnity.”⁵⁹ The period of indemnity is typically defined as the period of time between the pre-loss anticipated completion date and the date the project is actually completed.⁶⁰ As such, a builder's risk policy typically sets the anticipated completion date as the “date against which any subsequent delay will be measured.”⁶¹ Because the period of indemnity commences on the date the project would have been completed as opposed to the date the underlying physical loss or damage occurs, the period of restoration for property damage and the period of delay for soft cost coverage rarely run concurrently.

A properly drafted builder's risk policy will identify the pre-loss anticipated completion date and will allow for that date to be modified by the parties as necessary to account for scope or deadline “creep” usually encountered on major construction projects or accelerations in construction that push up the anticipated completion date. Failing to monitor and amend the anticipated completion date throughout the construction process can significantly impact the coverage available under the policy in the event of a loss. As noted above, coverage for soft costs following an event of physical loss or damage generally begins on the anticipated completion date. Thus, if a project is behind schedule at the time the physical loss or damage

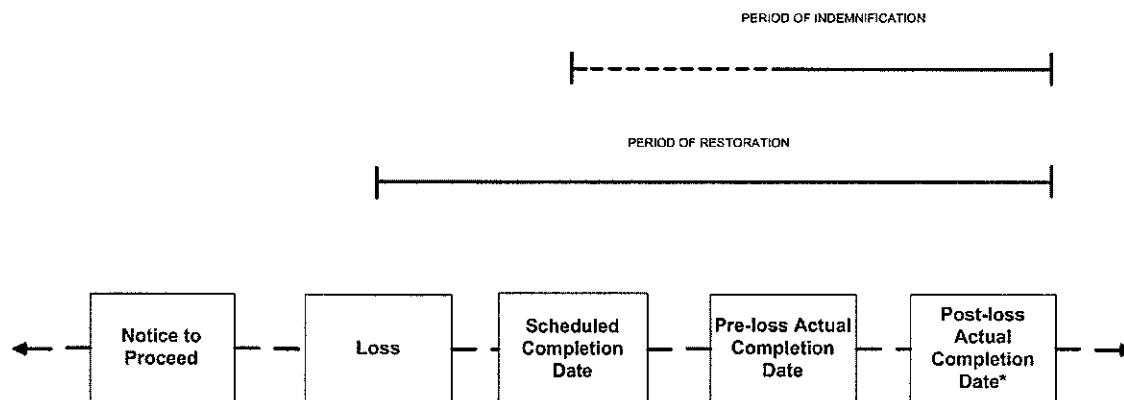
occurs, the insurer may be liable for a much longer period of indemnity than it intended. For example, if a project is six months behind schedule at the time an event of physical loss or damage occurs for reasons unrelated to the loss, but the anticipated completion date has not been modified, the period of indemnity will commence six months before it would have had the anticipated completion date been modified to reflect the fact that the project was behind schedule.

Conversely, if a project is ahead of schedule at the time of the loss, the insured could lose coverage it would otherwise have been entitled to if the anticipated completion date is not modified. Assume, for example, that a project is six months ahead of schedule and a loss occurs one month before the project would have been completed. If the insured is able to fix the damage and complete the project three months later, it might expect coverage for the two-month delay caused by the physical loss or damage. However, the project was six months ahead of the original schedule at the time of the loss and the total delay was only two months. As a result, if the policy was not modified to reflect the fact that the project was ahead of schedule, the insured may not be able to recover for its extra soft costs because the project was still completed four months ahead of the date listed on the policy as the anticipated completion date.⁶²

1. Calculating the Period of Indemnity

Because differences between the original and actual anticipated date of completion at the time of an event of physical loss or damage occurs, as well as the date the project should be completed once a loss occurs (the period of delay) are critical to determining coverage for soft

costs under a builder’s risk policy, both insurers and insureds should be particularly attuned to the following dates:



In addition, the policy may limit the potential period of indemnity to a set number of days. As a result, in the event of an extended delay, it is possible that the actual period of the delay may exceed the allowable covered period of indemnity, which could leave an insured without soft cost coverage for some portion of its loss. Regardless, however, determining these dates is a critical first step in adjusting a claim for soft costs.

2. Exclusions Can Alter the Period of Delay

When calculating the period of indemnity, careful attention must also be paid to the relevant policy exclusions, many of which can alter the applicable delay period. As noted above, soft cost coverage only applies to delay caused by events of physical loss or damage covered by the policy.⁶³ As such, “soft cost” endorsements generally will not cover delay caused by loss or damage to property not insured by the builder’s risk policy. Depending on other coverages afforded by the policy, other costs may be excluded or subject to separate sublimits that have both cost and scheduling impacts. Special attention should be paid to the following items:

- Delay caused by the insured’s failure to maintain proper permits;

- The need to obtain licenses;
- The insured's lack of funds to complete the project.

Other exclusions can affect the length of covered delay after an otherwise covered loss occurs. For example, to the extent a delay is extended by enforcement of an ordinance or law, that portion of the delay will likely not be covered by a "soft cost" endorsement. Stop work orders are one way in which these delays excluded or sub-limited by ordinance and law exclusions may manifest themselves. Likewise, extended delay caused by the insured's failure to use due diligence and dispatch in restoring the damaged property and delay caused by striking workers will generally not be covered. Finally, delay caused by changes to the project's design unrelated to the repair of covered damage is generally not covered.

A critical step in calculating the period of delay caused by an event of physical loss or damage, therefore, is to review the relevant policy exclusions to determine whether, and how, they may reduce the duration of covered delay under the policy.

IV. CONCLUSION

Determining the pre-loss anticipated completion date and the post-loss date of actual completion are critical to determining the amount of soft cost coverage available under a builder's risk policy. Analysis of the policy terms and conditions and the underlying contract documents, as well as an evaluation of the necessary repairs following covered property damage and the reasonable period of time needed to complete repairs and complete the project, are also crucial elements of the multi-faceted approach required to determine coverage for soft costs following a builder's risk loss. If the parties bear in mind the risk of policy interpretations like the one in *Keating* and take steps both before and after the loss to evaluate the type and magnitude of various potential additional expenses, both insureds and insurers can ensure that

their legitimate expectations as to the availability and amount of coverage for soft costs and other expenses incurred following a covered loss are met.

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² Tony D'Amico, *Adjusting Today, Soft Cost or Delay in Opening: Insure for the Potential Exposure*, at 2; http://www.adjustersinternational.com/AdjustingToday/ATfullinfo.cfm?start=1&page_no=1&pdfID=48 (last visited March 20, 2009).

³ See Philip R. Bruner and Patrick J. O'Connor, 4 Bruner & O'Connor Construction Law at § 11:116 (2008).

⁴ *Id.*

⁵ Builder's Risk policies are a species of Inland Marine insurance intended to provide coverage for commercial goods or materials "in transit" on inland roads, land, or waterways, in that they provide coverage for various materials, equipment and labor input that need to be fabricated, transported and stored before they are incorporated into a project under construction.

⁶ *Seabury Hous. Assoc. v. Home Ins. Co.*, 596 F. Supp. 1244, 1247 (D. Me. 1988).

⁷ *RLI Ins. v. Highlands of Ponce LLC*, 801, 635 S.E.2d 168, 171 (Ga. Ct. App. 2006).

⁸ *Id.*

⁹ *Id.*

¹⁰ See *Zurich Am. Ins. Co. v. Keating Build. Corp.*, 513 F. Supp. 2d 55 (D. N.J. 2007).

¹¹ Builder's Risk policies may also be written on a "Named Peril" basis, insuring only against perils that are specifically identified in the policy.

¹² *Zurich*, 513 F. Supp. 2d at 58.

¹³ *Id.*

¹⁴ *Id.* at 58-59.

¹⁵ *Id.* at 59.

¹⁶ *Id.* (emphasis added).

¹⁷ *Id.* (emphasis added).

¹⁸ *Id.* at 60.

¹⁹ *Id.*

²⁰ *Id.* at 59.

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ For instance, the court had to decide whether the costs of dismantling the collapsed garage were properly categorized as sub-limited "debris removal" charges or as demolition costs that were not subject to a sub-limit. The court determined that indirect costs associated with removing the debris, including temporary utilities, engineering reviews, scaffolding, and project supervision were costs associated with demolition and not debris removal as they were necessary to prepare the site for the resumption of construction, as opposed to the costs of removing the damaged materials.

²⁵ *Keating*, 513 F. Supp. 2d at 58.

²⁶ *Id.*

²⁷ *Id.* at 67.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 68.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* at 69.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 70-71.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* (emphasis added).

⁵¹ American Association of Insurance Services, *Builder's Risk*, 2008, *Latest AAIS revision clarifies 'soft costs' and implements full equipment breakdown coverage*, <http://www.aaisonline.com/Viewpoint/2008/08fall14.html> (last visited 2/10/2009).

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* See also D'Amico, *supra* note 2, at 8.

⁵⁶ See Barry B. Bramble et al., *Design-Build Contracting Claims*, DCTCL § 11.12 (Aspen Publishers 2003).

⁵⁷ D'Amico, *supra* note 2, at 3.

⁵⁸ *Id.* at 4.

⁵⁹ *Id.* at 5.

⁶⁰ *Id.*

⁶¹ *Id.* at 6.

⁶² *Id.*

⁶³ New York Construction Law Manual, NYCLM § 10.14 (2008).