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**Nuts & Bolts of Modern Wrap-Up Liability Insurance**  
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After years of hard learned lessons, your company has finally mastered the purchasing of insurance for your construction projects. Your staff is familiar with insurance certificates, endorsements, renewals and premium audits. You understand the need for insurance to secure indemnity obligations. Then one day, your risk manager or insurance broker recommends “wrap-up” insurance for your next project. Rest assured there is no need to panic. The purpose of this article is to explain the basics of wrap-up insurance, which is also known as a consolidated or controlled insurance program (“CIP”).

#### **A. Expansion of Wrap-Up Insurance**

Wrap-up insurance or CIPs are commonly understood to be an insurance policy or series of insurance policies which cover all or most of the participants on a single construction project, including the general contractor, its subcontractors and enrolled suppliers.<sup>1</sup> Under a CIP, one party usually procures insurance on behalf of other parties performing work on a project. A wrap-up policy purchased by an owner is commonly referred to as an owner controlled insurance program or OCIP, as opposed to a contractor controlled insurance program or CCIP. Historically, wrap-up insurance was used on large public works or commercial projects with costs that typically exceeded \$100,000,000. These programs typically included multiple types of coverage, such as liability, builder’s risk and workers’ compensation. The use of project specific wrap-up insurance to cover all participants on a project often afforded an owner cost savings, especially in workers’ compensation premiums. In some states, the use of wrap-up insurance on public works was limited by statute to larger projects.

With the explosion of construction defect litigation during the 1990s, insurance carriers began to sustain unacceptable losses under commercial general liability (“CGL”) insurance policies. Losses from construction defect litigation caused many liability insurance carriers to withdraw from the market of insuring residential construction projects. Liability insurance carriers refused to insure subcontractors for condominium projects, and ceased issuing additional insured endorsements to owners and general contractors for subcontractors’ completed operations coverage (coverage for losses occurring after completion of the project). In response

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<sup>1</sup> See e.g. California Insurance Code § 11751.82

to the lack of available insurance, many states have enacted statutory limitations on enforceability of indemnity agreements against contractors and subcontractors.<sup>2</sup>

As a result, owners and developers turned to project specific wrap-up CGL insurance policies to insure high liability construction projects. These modern wrap-up policies often do not include other coverages such as workers' compensation or builder's risk. During the residential boom following 2003, condominium developers paid the high premiums for project specific wrap-up CGL policies. As insurers became more competitive, the premiums charged for wrap-up CGL policies decreased significantly. Additionally, insurance carriers offered broader liability coverage on wrap-up policies with coverage limits as low as \$2,000,000.

As insurance carriers, owners and contractors have become familiar with the new wrap-up policy forms, the use of CGL wrap-ups has continued to expand to include both residential and commercial projects. Wrap-up insurance is now the predominant form of liability insurance used on many residential and mixed use projects.

## **B. Benefits and Risks of Wrap-Up Insurance to Owners**

### **1. Consolidated Coverage**

As wrap-up coverage became more available, owners and general contractors discovered that they could purchase project specific wrap-up CGL policies which provided better coverage than could be obtained by paying contractors and subcontractors to provide coverage under their separate conventional CGL policies. Under wrap-up programs, owners no longer needed to rely upon contractors and subcontractors to procure the correct limits and types of coverage to protect an owner from losses. Wrap-up insurance generally eliminates the need for an owner to collect additional insured endorsements under the contractor's policy and each of the subcontractors' policies to protect an owner from liability claims.

### **2. Dedicated Limits and Control**

Under a wrap-up program, owners can buy a single policy with dedicated limits that cannot be depleted by claims against contractors and subcontractors on other projects. Furthermore, owners can obtain extended completed operations coverage which provides protection from liability claims for as long as ten years after completion, or in some cases, until the expiration of the applicable statute of limitations. This is a huge advantage over traditional liability insurance which depends upon the contractor and subcontractors remaining in business and continuing to buy adequate insurance coverage after a project is completed. The owner is no longer exposed to the risk that one or more of the insurance carriers for its contractor and subcontractors become insolvent, leaving gaps in the project's risk management program. Although the solvency of the wrap-up carrier is also critical, the owner can investigate the strength of the wrap-up carrier before binding coverage.

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<sup>2</sup> Anti-indemnity statutes have been adopted in many states. For example, *see*: California (Cal. Civ. Code § 2782(c) & (e)(1)), Florida (Fla. Stat. §§ 725.06 & 725.08), Nevada (Nev. Rev. Stat. Ann. 616B.609), New Jersey (N.J. Stat Ann. § 2A:40A-2), New York (N.Y. Gen Oblig. Law § 5-322.1), Pennsylvania (Pa. Stat. Ann. Tit. 68 § 491), Texas (Tex. Civ. Prac. & Rem. Code §§ 130.002(1) & (2)), and Washington (Wash Rev. Code Ann. 4.24.115(1) & (2)).

### 3. Broad Coverage

Owners can also obtain broader coverage under an OCIP or CCIP than is generally available under the additional insured coverages provided by contractors or subcontractors. Wrap-up CGL policies often provide coverage without exclusions for work product and subsidence. Additionally, some insurance carriers offer limited pollution and design liability coverage under wrap-up policies. Assuming an owner manages the costs of insurance in the bidding and the buy-out process, the broader coverage offered by a wrap-up policy can be a better bargain than relying upon the traditional structure of aggregating coverage under multiple policies of contractors and subcontractors through additional insured endorsements.

The primary risk to owners is dealing with new policy forms that are not well understood by many insurance brokers. Owners should use an experienced broker who has previously placed wrap-up insurance coverage on a significant number of construction projects. Unfortunately, many brokers lack sufficient knowledge of the critical details of wrap-up coverage to maximize these advantages. A few brokers will even pass up good wrap-up programs, and direct clients to inferior policies because of higher fees paid to the broker.

### 4. Obtaining Cost Reduction

If the project is not bid-out properly, or the subcontracts are not bought-out properly, then the owner may end up paying for both the wrap-up insurance policy and for subcontractors' separate insurance policies. If a subcontractor is asked to give back a credit after they have bid on a project, they will often not credit back the full cost of insurance from their bids, especially if they are unsure about the coverage promised under the wrap-up policy. Furthermore, there may be legal limitations on the amount of credit an owner can require from subcontractors for providing wrap-up coverage after a subcontractor has submitted its bid.<sup>3</sup> The better practice is to obtain competitive bids, both with and without insurance, from multiple subcontractors.

### 5. Allocation of Deductibles

Many wrap-up CGL insurance policies require the owner to assume a relatively large deductible or self insured retention ("SIR"). Owners and general contractors will often allocate some or all of the exposure for the deductible or SIR to the subcontractors in the subcontracts. Owners argue that those in the best position to prevent a loss should be responsible if a preventable loss occurs. Arguably, parties who have no financial risk for claims and losses may be less diligent in preventing losses. To prevent disputes, the contract documents need to be properly drafted to implement a fair and reasonable risk allocation.

### 6. Coordination and Consistency with Contract Documents

There is a risk that if the OCIP is not described properly in the contract documents, the contractors and subcontractors may make claims against the owner for non-covered losses or for misrepresentation. The owner should retain experienced professionals to properly structure the program, and to coordinate the preparation of contract documents. An attorney preparing the construction contracts should understand the insurance requirements, and review the insurance

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<sup>3</sup> For example, *see* California Civil Code § 2782.95 (AB 2738)

specifications, wrap-up program manual, administration procedures, insurance binder and proposed policy forms and endorsements (“proforma policy”). It is essential that all contract documents, as well as the key subcontracts and purchase orders forms, are prepared so as to avoid inconsistencies with insurance requirements and to implement any wrap-up policy requirements for third party administrators, peer review or quality assurance programs.

#### 7. Claims Handling under Wrap-Up Insurance

In theory, claims can be handled more efficiently under wrap-up insurance because one insurance carrier covers the loss and the cost of resolving cross-claims among separately insured parties can be avoided. In response to claims and lawsuits, wrap-up carriers can theoretically hire one law firm to jointly represent all insureds. However, this joint defense can create conflicts if the wrap-up carrier reserves its rights to deny liability for the outcome of the lawsuit, or if the lawsuit involves both covered and non-covered claims. Because of the potential for conflicts, owners should be wary of joint defense requirements in the policy. Parties should also consider the effect of cross-liability exclusions in drafting contractual indemnity and warranty provisions. Furthermore, parties should maintain their separate policies or annual “practice policies” to cover operations not covered by wrap-up insurance.

### **C. Benefits and Risks of Wrap-Up Insurance to Contractors and Subcontractors**

#### 1. Hard to Insure Projects, Potential Cost Savings and Better Coverage

The primary benefit of wrap-up insurance to contractors and subcontractors is that it allows them to work on projects which they might otherwise not be able to properly insure. Furthermore, general contractors can sometimes obtain a CCIP at lower total project cost than conventional insurance programs in which insurance costs are included in every subcontractor’s bid. This can provide a competitive advantage to a general contractor bidding on new projects. In recent years, a greater proportion of projects are going into CCIPs.<sup>4</sup> A wrap-up CGL insurance policy can also provide broader coverage for the construction team in terms of eliminating certain exclusions and in affording limited coverage for design build liability and environmental risks. The additional cost of a program administrator is often less than the cost of having to monitor the myriad of insurance certificates, additional insured endorsements, renewals and premium audits that accompany traditional multiple liability insurance policies for each of the project participants.

#### 2. Bidding Projects

The primary risks for contractors and subcontractors are that the coverage afforded under the wrap-up CGL insurance policy will have gaps and will not cover them sufficiently for future losses. Contractors need to exercise diligence in screening coverages afforded under a proposed OCIP. Similarly, subcontractors need to carefully review the provisions of any proposed OCIP or CCIP before bidding. If insufficient information is provided in the invitation to bid, subcontractors should qualify their bid. Subcontractors need to be particularly aware of “rolling wraps” or CCIPs that cover more than one project. Under a rolling wrap, there is a risk that the rolling wrap-up insurance policy could be depleted by losses on other projects.

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<sup>4</sup> See The State of Wrap-ups April 2008, by R. Resnick, <http://www.irmi.com/expert/Articles/2008/Resnick04.aspx>

### 3. Allocated Contributions to Deductibles

Contractors and subcontractors also need to carefully review the contract documents for indemnity provisions which are inconsistent with the wrap-up program and contribution requirements to an SIR or deductible. Recently, legislation in California was enacted to protect contractors and subcontractors from broad indemnities and unreasonable contribution allocations under wrap-up programs.<sup>5</sup> Commencing with contracts entered into after January 1, 2009, California law will attempt to restrict the allocated contribution for which a contractor or subcontractor can be reasonably held liable on residential construction projects. A number of states, including California, require disclosure of the terms of wrap-up programs to contractors and subcontractors on certain public works, commercial and residential projects.

### 4. Maintaining Separate Policies

In addition to carefully reviewing the coverages provided under an OCIP or CCIP, contractors and subcontractors can mitigate the risks of insufficient coverage by maintaining their separate insurance coverage. Although most conventional CGL insurance policies exclude losses on “*projects*” covered by a wrap-up insurance policy, the contractor or subcontractor should attempt to negotiate a modification to narrow the exclusion, so as to preclude “*losses*” covered under a wrap-up insurance policy. Additionally, contractors should verify that a project has “builder’s risk” insurance which covers property damage during the course of construction.

## **D. Additional Tips in Purchasing Wrap-up CGL Insurance Coverage**

1. Use the services of an experienced insurance broker, risk manager or attorney.
2. Provide adequate policy limits for the project, and investigate the financial strength and size of the wrap-up insurance carrier.
3. The policy period should be extended to provide coverage for completed operations claims based upon the applicable state statutes of limitation.
4. If the insurance carrier proposes a “cross liability” exclusion (which attempts to exclude claims brought by one insured party against another), the terms of exclusionary provision or endorsement should be carefully considered.
5. If using a CCIP which names the owner as an additional insured, use the appropriate form of endorsement.<sup>6</sup>
6. Generally, a wrap-up policy should provide that it is primary and non-contributing to any other coverage of an insured or additional insured.
7. Beware of unreasonable venue or choice of law provisions in insurance policies.<sup>7</sup>

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<sup>5</sup> See California Civil Code §§ 2782, 2782.9, 2782.95 and 2782.96 (AB 2738).

<sup>6</sup> The type of additional insured endorsement used can be critical. To obtain completed operations coverage, use a form which does not limit coverage to the on-going operations of the named insureds.

8. The contract documents, CIP manual, insurance binder and proposed policy forms should be carefully reviewed for inconsistencies.
9. Administration of the wrap-up programs should be monitored for compliance with the requirements of the wrap-up policy and program manual.
10. Parties should confirm that affiliates and agents are properly named or enrolled, and that proper proof of coverage is maintained as a permanent record.
11. An experienced attorney, risk manager or insurance broker should review the wrap-up policy after it is issued to be sure that its terms are consistent with the quote, binder, proforma policy forms and contract requirements. Umbrella and excess policies should also be reviewed for consistency with the underlying coverages.
12. In the event a wrap-up insurance carrier agrees to provide a defense to a lawsuit, but asserts the right to deny liability for the outcome, an insured should retain independent counsel to advise them of their rights and liabilities.

This is not intended to be a complete list of the issues. However, this article identifies the basics in dealing with wrap-up insurance.<sup>8</sup> As the use of wrap-up coverage expands, issues will continue to evolve. Understanding the basics of wrap-up insurance coverage will assist in assessing insurance proposals and building the foundation of your company's risk management program.



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<sup>7</sup> For an example of the differences in how different states apply insurance law, compare the decisions in *KW Mechanical Services, Inc. v. American Protection Insurance Company* (2007) 835 N.Y.S.2d 703, 40 A.D. 709, with the case of *Southeast Wisconsin Professional Baseball Park District v. Mitsubishi Heavy Industries America, Inc.* (2007) 304 Wis.2d 637, 738 N.W.2d 87.

<sup>8</sup> Additional information on wrap-up insurance can be found on the website of the International Risk Management Institute at: [www.irmi.com](http://www.irmi.com).