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Stella Szantova Giordano

USA

ssg@sdvlaw.com

+1 203 287 2129

www.sdvlaw.com



Insurance and Risk Management Considerations for Modular and Prefabricated Construction

By Stella Szantova Giordano

As modular and prefabricated construction gains widespread usage, unique issues with insurance coverage for projects involving these technologies emerge. This article surveys the landscape of available insurance types, potential coverage issues, and insurance and risk management strategies to consider for modular/prefabricated construction to avoid costly mistakes and claims.

What is modular and prefabricated construction?

In a nutshell, prefabricated construction refers to building a structure or a unit in a factory before assembling it at a construction site, while modular construction refers to elements which are at least 70% prefabricated.¹ Examples include CitizenM New York, a 21-storey hotel composed of 210 modular units, each housing two hotel rooms;² classrooms for the University of Santiago de Chile,³ and McDonald's restaurants in Great Britain.⁴ According to the 2018 study by the National Institute of Building Sciences Off Site Construction Council, more than 87% of construction project stakeholders used some form of prefabrication in the preceding 12 months.⁵ The main benefits of modular and prefabricated construction are increased efficiency, safety and reduced waste

1. See, e.g., *PREFAB VS. MODULAR: CAN YOU TELL THE DIFFERENCE?* (Jan. 21, 2017), <http://www.prefabmarket.com/prefab-vs-modular-tell-difference/>. In practice, the two terms are often used interchangeably.

2. Jimmy Stamp, *New Report Shows that the Modular Construction Business is Booming*, ARCHPAPER (Aug. 16, 2019), <https://archpaper.com/2019/08/new-report-modular-construction-business-booming>.

3. *BEST MODULAR CONSTRUCTION PROJECTS OF 2018* (Oct. 19, 2018), <https://www.panelbuilt.com/blog/best-modular-construction-projects-of-2018/>.

4. *MODULAR BUILDER TO COMPLETE MC DONALD'S FRANCHISES IN FOUR-WEEK SITE SCHEDULE*, http://www.modular.org/htmlPage.aspx?name=McDonalds_Franchises_4Weeks.

5. *MODULAR AND PREFABRICATED CONSTRUCTION: INSURANCE AND SURETY QUESTIONS AND CONCERNS, AGC: MEETINGS* (Jan. 29, 2019), <https://meetings.agc.org/risk/wp-content/uploads/sites/21/2019/02/BO-3C-and-4C-Presentation-on-Modular-Construction-compressed.pdf>.

gained by portions of a project constructed in a controlled factory environment rather than a jobsite.⁶

Insuring modular and prefabricated construction

Because modular and prefabricated construction differs from traditional construction in important ways, insuring it comes with its own set of challenges. The most common types of insurance for modular and prefabricated construction are commercial general liability policies; builder's risk policies; and professional liability policies. Let us examine each type of insurance in turn.

Commercial general liability policies ("CGL")

CGL policies protect the policyholder from third-party claims for liability associated with "bodily injury" or "property damage" on a construction project. The key issue related to coverage for modular/prefabricated elements is time-related: Before such an element is incorporated into a building, it is considered a "product" and could be excluded under the "your product" exclusion.⁷ Once the element becomes part of the structure, it is considered the installer's "work". Case law is limited, but at least one U.S. court has found that modular units as constructed, assembled and affixed to the foundation for incorporation into an apartment building were "real property," and therefore the "your product" exclusion did not apply.⁸ Consequently, when in the process of installation

6. Sheri Coones, *Modular Construction 101*, FORBES (Jun. 3, 2019), <https://www.forbes.com/sites/sherikoones/2019/06/03/modular-construction-101/#db978b12ceba>.

7. ISO form CG 20 01 04 13, Section I – COVERAGES, subsection 2.

Exclusions, exclusion k. *Damage to Your Product* reads: "This insurance does not apply to 'property damage' to 'your product' arising out of it or any part of it." All CGL policies based on the ISO form contain this exclusion.

8. See *Scottsdale Ins. Co. v. Tri-State Ins. Co.*, 302 F. Supp.2d 1100 (D. N.D.,

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of modular/prefabricated elements the loss occurs is crucial – under one set of facts, there will be coverage; under a different set, there may not.

Another issue arises when the modules or prefabricated elements are manufactured in one country but used on a project in another. Increasingly, US-based projects use Canadian manufacturers for the prefabrication of steel and concrete. In this scenario, it is important for the installer of the prefabricated elements to have proper coverage: the Canadian manufacturer's liability policies may not adequately cover US-based projects because of the difference between the legal systems and strict labour laws with potential high exposures for bodily injury in some states, such as New York.⁹ It is thus preferable for a US-based contractor to install the prefabricated elements as their insurance is likely better suited to cover a project in the United States.

Because claims involving modular construction can be expensive, some carriers are including "modular" exclusions in CGL policies. These are manuscripted and can be very broad. Suppliers and installers of modular/prefabricated products should avoid such exclusions in their liability policies.

Builders risk policies

Builders risk policies protect the project owner, the general contractor and all subcontractors from loss to the project during construction on an "all-risk" basis, unless otherwise excluded. It

Northwestern Div., Feb. 20, 2004) (damage occurred after the modular units have been assembled and set but before the roof was completed).

9. In addition, in the event of a dispute with the supplier's carrier, US-based project stakeholders may have to sue them in Canadian courts which would interpret the policy under Canadian law.

matters whether the modular/prefabricated manufacturer is only a supplier or also the installer, because suppliers are sometimes not covered by builders risk policies. Issues also arise in the area of transport, storage and delay: if the modules are delivered to the project site prematurely, they may get damaged if stored outside while awaiting installation. This may void the product's warranty, and potentially trigger the warranty exclusion.

Also, project delays can be amplified for modular construction. Take this example of a real-life claim: a three-storey building included modules of full apartment units which arrived on site with finishes including electrical wiring, drywall and carpeting. Once the modules were set on the foundation, heavy rains came through the unfinished roof and caused significant interior water damage. Because the staircases were not completed, it took several days to detect the damage which led to mold. The building had to be gutted to the studs and the interior completely rebuilt, resulting in a multi-million dollar claim and extended delay. This claim would have been smaller and the delay shorter on a traditional project because the building's interior would have been unfinished until the roof was completed.

Professional liability policies

Modular and prefabricated construction is prone to unique issues, such as an error in design or manufacturing repeating itself in every module or component used on a single project.¹⁰ This can lead to sizeable claims depending on the number of units

10. Ray Allen, *Constructive Conversations: Professional Liability considerations when insuring modular construction* (Nov. 26, 2018), AXA XL, https://axaxl.com/fast-fast-forward/articles/constructive-conversations_professional-liability-considerations-when-insuring-modular-construction.



manufactured and used in different projects.¹¹ In addition, if there is a design flaw in the modules or prefabricated components, it is difficult to procure a replacement from another source, leading to delays.¹² Exposures related to faulty design claims are covered by professional liability policies. Coverage needs depend on whether a company uses modular/prefabricated elements manufactured by other parties,¹³ or whether they both manufacture and perform the installation.

Like CGL policies, professional liability policies also contain “your product” exclusions, but some carriers allow exceptions for specific modular/prefabricated products.¹⁴ It is also crucial whether the elements are considered a “product” or part of the installer’s “work.” If it is the former, merely supplying the product may not trigger coverage because there is no rendering of “professional services” as defined by the policy.¹⁵ Since little case law exists on these issues, coverage will depend on the facts of each case.

Risk Management Considerations

Projects using modular/prefabricated elements can benefit from shorter construction times, increased quality and cost savings. Before using modular/prefabricated construction on a project,

11. *Id.*

12. *Id.*

13. Manufacturers should carry errors and omissions insurance to cover any issues or defects with the module or prefabricated product.

14. *Supra* at n. 11, *id.*

15. *Id.*

risk managers should consider the following: Is the modular/prefabricated manufacturer supply-only, or are they also the installer? Depending on the answer, determine who should carry liability insurance for these elements, and ensure that the policies do not contain a “modular” exclusion.

For builders risk policies, ensure that the installer is an insured, remove or revise the warranty exclusion, and carefully review policy language concerning building materials, fixtures or products to ensure that modular/prefabricated elements are covered. Consider increasing your delay in completion coverage to account for the increased cost and potentially longer delay associated with modular construction. Confirm that the manufacturer has professional liability coverage, with limits sufficient to handle even a systemic issue with its products that may affect multiple projects.

With benefits outweighing potential drawbacks when handled thoughtfully, modular and prefabricated construction will continue to thrive. For projects utilizing these technologies, careful risk management and insurance planning is crucial to avoid claims or uninsured exposures.

Stella Szantova Giordano is a policyholder coverage attorney at Saxe Doernberger & Vita in Trumbull, CT. She heads the firm's international practice group and frequently writes and speaks on insurance topics, particularly related to construction.

