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## Hidden Risks in Builders Risk and First Party Property Insurance

By Finley T. Harckham | Friday, April 2, 2021

Risk Management , Court Decisions , Insurance



Many builders risk and first party property insurance policies require the policyholder to “maintain” certain types of “protective devices” on construction sites or in completed buildings, typically to address fire and theft hazards. These provisions are often poorly written, confusing and self-contradictory. Insurance

companies are increasingly relying upon these “protective devices” provisions as an excuse to deny coverage even for losses that are completely preventable and not cost prohibitive. It is not possible, various legal arguments can be made to prevent the insurer from prevailing in this game of gotcha in the event the clause is not complied with and an unrelated loss occurs. At the same time, steps should be implemented and adhered to on the jobsite to avoid these issues ever arising.



Even more troubling for policyholders, is the fact that many provisions plainly state that the failure to comply with any condition of the policy is a condition precedent to coverage. This gives the insurer a far more potent argument that a failure to “maintain” a protective device, such as a sprinkler system, would result in the forfeiture of coverage for damage caused by fire.

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Policyholders should keep these confusing and sometimes punitive provisions out of their policies, if possible and not cost prohibitive. If that is not possible, various legal arguments can be made to prevent the insurer from prevailing in this game of gotcha in the event the clause is not complied with and an unrelated loss occurs. At the same time, steps should be implemented and adhered to on the jobsite to avoid these issues ever arising.

### THE VARIOUS PROTECTIVE DEVICES PROVISIONS AND HOW THE COURTS INTERPRET THEM

The provisions relied upon by insurers to deny claims for failure to “maintain” protective devices come in a number of different forms. The specific form used may well determine whether the insurer can make a winning argument that coverage for a loss has been forfeited for failure to comply with the provision.



The simplest and least problematic forms simply require that protective devices, such as sprinkler systems or chain link fences around a construction site, be “maintained,” and exclude coverage if a loss results from the failure to maintain the device in “complete working order.” These provisions often include exceptions if the device is out of order for less than 48 hours or the policyholder gives notice of the problem before a loss. The fact that both the term “maintain” and the phrase “maintain in complete working order” appear in these clauses indicates that these terms should be given different meanings.

This type of clause has been addressed by a number of courts with mixed results. In *Praetorian Ins. Co. v. Axia Contracting, LLC*, 794 F. App'x 791 (10th Cir. 2019), a policyholder engaged in a hotel construction project purchased an insurance policy that included a Protective Devices Endorsement requiring the policyholders to “maintain, at all times during the policy period, the protective devices and services described on the Protective Devices Schedule.”

Coverage for losses caused by fire were excluded for failure to maintain fire protective devices, and separately losses caused by theft were excluded for failure to maintain a theft protective device. The Protective Devices Schedule required, among other things, that the jobsite “will be protected with chain

link fencing” and that “[a]ll entrance and access gates shall remain securely locked during non-working hours.” Id. at 792

There was a fire at the property, which v ultimately denied coverage because “th of the fire and all entrance and access g requirement was a condition precedent



used by arson. The insurance company ot enclosed by chain link fencing at the time locked.” The insurer argued that the fencing thin the fire-protection exclusion.

The Court granted summary judgment in favor of the insurance company on that basis, finding that the Home v. Safety and Risk / Hidden Risks in Builders Risk and First Party Property Insurance failure to maintain the fence in working order was a material breach. But the appeals court reversed, spelling out that failure to enclose the site with chain link fencing was not a condition of coverage for fire. See also Meridia Downtown Urban Renewal Bound Brook, et al, v New York Marine and General Ins. Co, slip op. (N.J. Super., Union County, Jan. 8, 2021, Walsh, J.).\*

While those decisions are logically appealing, it must be assumed that insurers will continue to make the argument that failed in those cases – that maintenance of the security fence was a condition of coverage and the failure to fulfill any condition bars coverage for any claim, whether related to the cause of loss or not.

Insurers have had more success when the policy at issue contains a broad provision barring coverage for failure to maintain all of the conditions of the policy. In Nat. Fire & Marine Ins. Co. v. 3327 W. 47th Place, LLC, 2017 WL 5499154 (N.D. Ill. Nov.16, 2017), the court addressed whether coverage for a fire loss was barred because the policyholder had failed to maintain a burglar alarm. The policy contained a protective devices endorsement which expressly barred coverage for fire if the policyholder “failed to maintain any protective safeguards device.” (emphasis added). Based upon that provision, and Illinois law to the same effect, the court felt compelled to uphold the enforceability of the clause under the facts presented.

However, the court also found an issue of fact as to whether the insurer waived its right to enforce the provision because the insurer had inspected the property and knew the burglar alarm was not operational, and yet said nothing, did not cancel the policy and did not return the premium. The alleged facts supporting this waiver argument may have been fortunate for the policyholder, but are unusual and cannot be counted on to save the day for other policyholders.

When faced with a provision like that in W. 47th Place, policyholders may find other successful arguments. Some courts have found the absence of a material breach where the loss is unrelated to the failure to maintain a protective device. Also, under the laws of many states an insurer cannot escape its coverage obligations unless it has been prejudiced by the failure of a policyholder to comply with a condition. Finally, some courts have found certain protective devices endorsements to be ambiguous, particularly in their use of the term “maintain.”

For example, in Five Star Hotels, LLC v. Ins. Co. of Greater New York, 2011 WL 12126022 (S.D.N.Y.),\* sprinkler pipes burst, causing extensive water damage to a building. The insurer denied coverage, arguing that the policyholder had failed to comply with a clause requiring it to “maintain” the sprinkler system. The court rejected the insurers’ argument, holding that under the circumstances the term “maintain” was “hopelessly ambiguous” and agreeing with the policy holder that “maintain” could mean to simply have the device in place, rather than to keep it in complete working order. But see Breton, LLC v. Graphic Mut. Ins. Co., 446 F. APP’X 598 (4th Cir. 2011).

Given the uncertainty and cost of litigation, policyholders should do everything possible in advance to avoid the protective devices clause trap



1. Before procuring a builders risk or protective devices endorsement, c

2. Take all steps necessary to ensure policy requires a security fence, m is fully assembled and secured, including requiring all subcontractors who may control the site at times to comply with that requirement. It is often necessary to take sections of these fences down

policy attempt to negotiate a policy without a oly limited in scope.

rovisions. For example, if the builders risk checked every night to ensure that the fence is fully assembled and secured, including requiring all subcontractors who may control the site at times to comply with that requirement. It is often necessary to take sections of these fences down

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3. Make sure that project or building managers fully understand the requirements of the protective devices endorsement. Often, those provisions excuse a failure to maintain devices under certain circumstances for short periods of time, but may require notice of the condition to the insurer.

Policyholders must be aware of the protective devices endorsements in their builders risk and other policies, should negotiate the least draconian provisions they can obtain, and then follow best practices to comply with the clause. If not, they may fall prey to an insurance company’s game of “gotcha.”

**\* The author was counsel for the policyholder in Meridia and Five Star.**

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