Contractual Risk Transfer in Construction Contracts

Presented by: The Reschini Group
Contractual Risk Transfer

Definition: Contractual Risk Transfer is the shifting of responsibility from one party to another in a construction contract.

- Part of the Risk Management Process
- Used as a Risk Management Technique
Contractual Risk Transfer

Purpose:

- Part of the Risk Management Process
- Identify Exposures to Loss
  - Property
  - Personnel
  - Net Income
  - Third-party Liability
- Examine Alternate Techniques
- Select the Best Techniques
- Implement the Chosen Technique
- Monitor and Change as Necessary
# Contractual Risk Transfer

## Risk Control Techniques vs. Risk Funding Techniques

<table>
<thead>
<tr>
<th>Risk Control Techniques</th>
<th>Risk Funding Techniques</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss Prevention</td>
<td>Current Expensing</td>
</tr>
<tr>
<td>Exposure Avoidance</td>
<td>Unfunded Reserves</td>
</tr>
<tr>
<td>Loss Reduction</td>
<td>Funded Reserves</td>
</tr>
<tr>
<td>Segregation of Exposure Units - Separation or Duplication</td>
<td>Borrowing</td>
</tr>
<tr>
<td>Contractual Transfer for Risk Control</td>
<td>Captive Insurers</td>
</tr>
<tr>
<td></td>
<td>Commercial Insurance</td>
</tr>
<tr>
<td></td>
<td>Contractual Transfer of Risk Financing</td>
</tr>
</tbody>
</table>

*“the GC is responsible for site safety”*

*“...the GC shall indemnify Owner for any and all damages, losses, claims...”*
Risk Transfer Perspectives

- Owners
- Architects & Construction Managers
- Sub Contractors
- General Contractors
Risk Transfer Perspectives

Owners

• Paying Customer – All Powerful
• Want a No-Risk Proposition
• Need Own Liability & Builder’s Risk Coverage
• Rarely Draft the Contract
Risk Transfer Perspectives

Owners

Architects & Construction Managers

- Draft & Manage Contracts
- “Professional” Standard of Care
- Little Control, Great Risk
- Often-Shallow Pockets
- Architect Errors & Omissions
Risk Transfer Perspectives

Owners
Architects & Construction Managers
General Contractors

- Responsible for Everything
- Deep Pockets, Prime Target
- Power Over Subs
- Transfer Responsibility to Subs
- Vicariously Liable
Risk Transfer Perspectives

Owners
Architects & Construction Managers
General Contractors
Sub Contractors

- Did the Deed – Primary Responsibility
- Indemnify Everybody
- In Control of Own Actions
- Little Power to Alter Contract Terms
- Inadequate Insurance
Indemnification Agreements

- Broad Form
- Contractual Liability Insurance Coverage
- Limited Form
Indemnification Agreements

Broad Form

- “Pay any and all damages, costs, expenses...”
- No or Few Limitations
- Even for the Sole Negligence of the Owner
- Owners Favor Over GCs
- GCs Favor Over Subs
- Inequitable, Possibly Unenforceable
Indemnification Agreements

Broad Form

Limited Form

• “Pay to the Extent of Own Negligence...”
• Limited Scope “…for bodily injury and property damages...”
• Everyone Responsible for Own Actions
• Equitable, Likely to be Enforced
• Acceptable to Contractors
Indemnification Agreements

Broad Form

Limited Form

Contractual Liability Insurance Coverage

- Included in Post-1985 General Liability Policies
- Covers “Insured Contracts”
- Subject to Insurance Policy Terms, Conditions, Exclusions, Limits, etc.

Easements, Elevator Maintenance, Lease of Premises, Sidetrack Agreements... and the tort liability of others assumed in an Indemnification Agreement
Insurance Specifications

Types of Insurance Coverages → Limits & Per Project Limits → Certificates of Insurance → Owner Controlled Insurance Program – Wrap-ups
Insurance Specifications

Types of Insurance Coverages

- Workers’ Compensation & Employer’s Liability
- Commercial General Liability
- Business Automobile Liability
- Umbrella or XS Liability
- Contractor’s Equipment
- Builders Risk or Installation Floater
- Professional Errors & Omissions
- Limited Job-site Pollution Liability
- Contractors Pollution Liability
Insurance Specifications

Types of Insurance Coverages

Limits & Per Project Limits

- WC- Statutory
- $100/500/100 EIL
- $1M/ $2M CGL
- $1M CSL Auto Liability
- $5M- $50M Umb./XS
- $1M- $5M Prof. E & O
- $1M-$5M CPL
- Per Project Limits
- 5-7 Yr. Comp. Ops. Tails
Insurance Specifications

Types of Insurance Coverages
Limits & Per Project Limits

Certificates of Insurance

• Owner > GC
• GC > Owner
• Prof. > Owner & GC
• Subs > GC
• Confirm Compliance
• Avoid Uninsured Subs
• Avoid Audit Charges
Insurance Specifications

Types of Insurance Coverages
Limits & Per Project Limits
Certificates of Insurance

Owner Controlled Insurance Program (OCIP) – Wrap-ups

- Master Policy  All Parties
- Contractors Bid X-Ins.
- Reduce Insurance Cost
- Avoid Litigation
- Best Projects $500M+
Additional Insureds

Coverage Granted

Primary & Non-Contributory

Blanket vs. Specific
Additional Insureds

Coverage Granted

- 100% Defense Expenses to Party A
- If Party B Insured – Settlement Apportioned Between Parties A & B
- If Party B Uninsured – 100% Settlement to Party A
Additional Insureds

Coverage Granted

Blanket vs. Specific

- Blanket- Based on relationship (vendor, lessor, mortgagee, etc.)
- Blanket- Automatic If Required by Contract
- Blanket- No Additional Premium
- Specific- Endorsement specially lists company
- Specific- Requires Underwriter Approval
- Specific- Often Additional Premium Charge
Additional Insureds

Coverage Granted

Blanket vs. Specific

Primary & Non-Contributory

- Defense & Settlements by Party A, Until A’s Policy is Exhausted
- Blanket- Automatic if Required by Contract – No Additional Premium
- Specific- Requires Underwriter Approval – Often Additional Premium
- Owners / Large GCs Favor
- Often Unavailable for Subs
Waivers of Subrogation

Restricts Insurer Rights

Property vs. Casualty

Blanket vs. Specific
Waivers of Subrogation

Restricts Insurer Rights

- Voids Insurer’s Right to Mitigate Losses by Collecting from Responsible Parties
Waivers of Subrogation

Blanket vs. Specific
Restricts Insurer Rights

- Blanket - Automatic if Required by Contract
- Blanket - No Additional Premium
- Specific - Endorsement Specially Lists Company
- Specific - Requires Underwriter Approval
- Specific - Often Additional Premium Charge
Waivers of Subrogation

Restricts Insurer Rights
Blanket vs. Specific
Property vs. Casualty

- Significant Casualty Change
- Eliminates Disputes in Property Claims
- Not Advisable for Workers’ Compensation
Builder’s Risk & Installation Floaters

Ownership Interests
Blanket vs. Specific
Sub-limits
Deductibles & Premiums
Ownership Interests

- Named Insured Includes: Owner, GC & Subs of All Tiers
- Owners or GC Can Obtain Policy
- Owner’s Property Policy is a Poor Substitute for Builder’s Risk
Ownership Interests

Blanket vs. Specific

- GCs Often Have Blanket Builder’s Risk - Limits May be Too Low
- Subs Often Have Installation Floaters - Limits May Be Acceptable
- Other Insurance Clauses May Cause Conflicts
Ownership Interests
Blanket vs. Specific
Sub-limits

- Materials Off-site
- Materials In-transit
- Soft Costs
- Loss of Use
- Mechanical Start-up & Testing
Builder’s Risk & Installation Floaters

Ownership Interests
Blanket vs. Specific
Sub-limits
Deductibles & Premiums

• Contract Often Vague Who Bears Deductible
• Contract May Elect Owner Claim Fiduciary
• Contract Typically Allows Premium to Be Charged to Owner
Contractual Risk Transfer Checklist for Contractors

Indemnification Agreement
- Avoid “Sole Negligence of Others”
- Accept “Extent of Own Negligence”

Insurance Specifications
- Workers’ Compensation
- $1M General Liability/ Policy or Per Project
- $1M Auto Liability
- Umbrella or XS Liability Limits
- Contractor’s Equipment

Additional Insureds
- Blanket- No Premium Charge
- Primary & Non-Contributory- Underwriter Approval & Premium Charge
Contractual Risk Transfer Checklist for Contractors

Waivers of Subrogation
- GL, Auto, Umbrella - Underwriter Approval
- Workers Compensation - Underwriter Approval & Premium Charges
- Contractor’s Equipment - Underwriter Approval

Builder’s Risk/ Installation Floater
- Who Obtains Coverage?
- All Parties are Named Insureds
- Project Cost = Policy Limits
- Adequate Off-site & In-transit Sub-limits
- Optional Soft Cost Coverage
- Who Bears Deductible Obligations?
- Who Pays Premium?
Contractual Risk Transfer Checklist for Contractors

Professional Liability
- Architects & Engineers
- Construction Managers
- Design Builders

Pollution Liability
- Limited On-site, Sudden, & Accidental
- Full Contractors Pollution Liability
- Auto Pollution Liability

Certificates of Insurance
- Obtained From Agent
- Sent to Owner
- Obtained From Subcontractors
- Contractor Coverage Adequate?
Contracts can be confusing. We have the construction expertise and resources to help you manage your contract risks and support a total risk management approach.

The Reschini Group: How can we assist you?