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Risky Business:
Beware of Construction Contract Pitfalls

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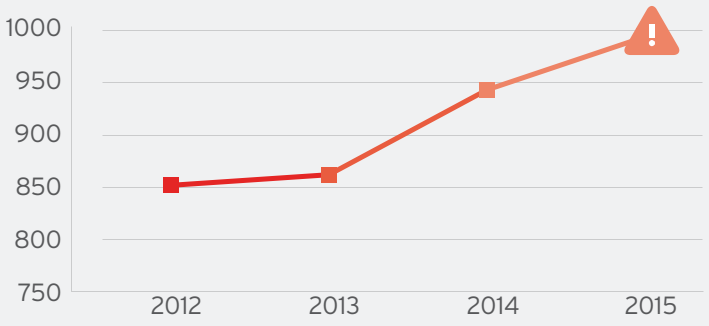
The competitive business environment for construction projects is making contractual risk transfer more commonplace and, as a result, is complicating insurance solutions. Around the nation, large general contractors are asking subcontractors to include them as additional insureds and, in some cases, are seeking to modify the coverage language itself. Adding to the confusion is the fact that multiple versions of additional insured endorsements are in use nationwide. Wording changes and nuances in contract language can introduce inconsistencies that may cause coverage issues. In their eagerness to ink a business deal, the parties may not fully appreciate the risks they are transferring and assuming. For retail agents and brokers serving the construction industry, this presents an opportunity to help clients ensure that their insurance coverage supports the financial commitments that insureds agree to make.

Every State Differs

State laws regarding indemnity provisions and extending liability protection to additional insureds differ, and certain states have specific indemnification laws. Master Service Agreements govern the agreements between the parties. It is therefore critical for agents and brokers to know what applies to their insured's situation.

Construction is a field with a high incidence of injury and death. In 2015, the sector generated the most fatal incidents and the fourth-highest fatality rate, 10.1 per 100,000 full-time equivalent workers, according to the Bureau of Labor Statistics. The risks of not fully understanding the liability implications of a contract are significant. For example, an oil and gas contractor accepted a sole negligence transfer in its maintenance contract with a refinery owner in Texas. The purpose of this broad transfer, which is not permitted in every state, is to shift liability to another party to the contract. Diligently following a lockout/tagout procedure to maintain safety, the contractor checked with the refinery owner three times to make sure the line the contractor was scheduled to work on had been shut down. The owner insisted that it had, but the line was still operating. The resulting accident severely injured an employee of the contractor and generated a $12 million claim, which was subsequently covered by insurance. The contractor's acceptance of the sole negligence transfer effectively shielded the refinery owner from liability for the accident.

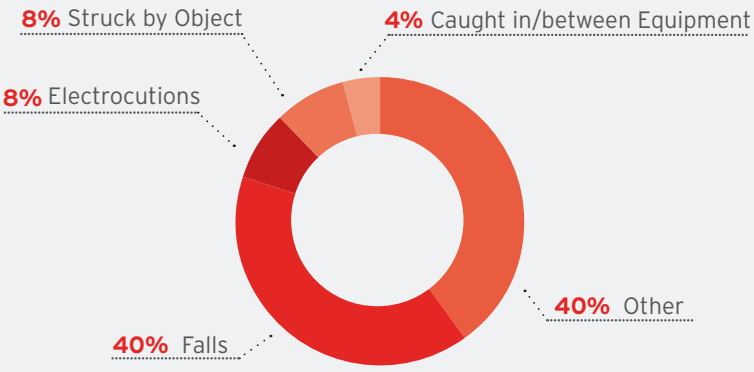
Construction Fatalities Rising



Source: Bureau of Labor Statistics, U.S. Department of Labor

Fatal Four in Construction

Four types of accidents accounted for more than 60% of all fatal construction incidents in 2014



Source: Bureau of Labor Statistics, U.S. Department of Labor

Critical Terms

Three common and often misunderstood terms seen in construction contracts:

- **Additional insured.** This endorsement extends underlying coverage to a named entity. Many different versions of the additional insured endorsement exist. For example, the Insurance Services Office's CG 20 10 endorsement comes in four different edition dates (1985, 2001, 2004 and 2013), all of which vary significantly. The extent of contractual risk transfer is often governed by state law regarding indemnity clauses. Contractual indemnification may be: limited, in which the subcontractor assumes liability for its own negligence only; intermediate, in which the subcontractor provides partial or full indemnity, even if partly at fault; or broad, shifting full responsibility to the subcontractor regardless of which party is at fault. Complicating such risk transfers are anti-indemnity laws, which differ from state to state.

  The intent of these additional insured endorsements can often vary significantly as well, even if the language seems similar. These endorsements may cover additional insureds on a blanket basis, or may require that each is named in the contract. Recent court decisions have addressed the idea of privity within that blanket language, yet different states have reached varied conclusions on privity in construction cases. The most common of additional insured endorsements may also differ in the scope of the services covered under the contract, where courts tend to interpret nuances in language as intentional and significant.

  Insurance markets have recognized the importance of these extensions of coverage, however, and now each has its own library of endorsements to offer in policy negotiations. Each of these endorsements may address not only the scope, locations or additional insureds covered but, among other things, may also alter the limit of liability available or may allow other signed contracts to govern certain aspects of coverage.

- **Waiver of subrogation.** This waiver, commonly found in contracts between general contractors and subcontractors (and upper-tier subcontractors and their own lower-tier subcontractors), prevents insurers from recovering losses. The often cited example of the building that burns down while under construction serves as a good illustration. The contractors' insurer that assumed this risk pays the insurance claim, but should not be able to sue the welder who was found to be responsible for the fire during the investigation.

  When drafted correctly, the waiver of subrogation clause recognizes the agreement between the insurer and the entity that may cause the loss, as well the agreement between the insurer and the insured. However, when this clause is not considered in tandem with the additional insured coverage granted in the policy, gaps may exist that can leave the subcontractors exposed to claims by the insurers. This can occur when the scope of the services is not defined properly or losses exceed the policy limits. It is critical that the waiver of subrogation clause is drafted in conjunction with the additional insured endorsements and the primary and non-contributory language to ensure that coverage gaps do not exist.

CRITICAL TERMS CONTINUED...

- **Primary and non-contributory.** This language is intended to assert which party's insurance is deemed primary and therefore contributes in the event of a covered loss. Any insurance purchased by the additional insured may be considered non-contributory -- that is, it will not contribute to the coverage of a loss under terms of the contract. This requires that a contractor remains vigilant that its insurance limits are sufficient not only for its own balance sheet protection, but also in the event that the limits may be eroded by additional insureds operating on various projects in different states, where different laws may apply.

  Both the waiver of subrogation and the primary and non-contributory language should work in concert with additional insured blanket wordings. Inconsistencies could negate the parties' intent regarding subrogation and coverage.

Don't Forget to Ask

Retail agents and brokers that serve contractors and subcontractors should consider:

- ✓ What is your client's intent as a party in the construction contract as to risk transfer?
- ✓ What are the applicable laws regarding indemnification and additional insured eligibility?
- ✓ Have we vetted the applicable additional insured endorsements to ensure they accomplish what is required?
- ✓ Has the waiver of subrogation clause been amended to ensure that the insurer's coverage will respond to loss as designed?
- ✓ Whose insurance is deemed primary and non-contributory? Are limits adequate when stress tested by additional insured extensions?
- ✓ Is your client's insurance coverage adequate and in place to support the terms of the construction contract?

Analyzing the coverage issues and obtaining appropriate insurance requires expertise and market knowledge. For more information, please contact your CRC or CRC Swett representative.

Contact your CRC, CRC Swett or SCU broker.
To find a conveniently located broker visit us on the web at:
crcins.com, crcswett.com or scui.com.