



# How to Avoid Pitfalls That Can Leave Your Business Underinsured

By **Barry L. Hunt** and **Jeffrey A. Segall**

**N**o contractor bids a project without examining the specs, or buys materials before reading the blueprints. When it comes to insurance, though, some contractors neglect to look closely at their policies until there's been an incident.

To complicate matters, the coverage in place is often acquired by someone else – the owner, or general contractor/construction manager (GC/CM). These arrangements can create gaps between the protection you think you have and the insurance coverage actually afforded the contractor.

In addition, it's not uncommon for contractors to make concessions regarding their assumption of liabilities. It's actually possible that one party on a construction project could be held financially responsible for the negligence of another because of a contractual agreement that shifts liability.

Insurance gaps like these can be remedied by acquiring supplemental coverage, and sometimes are. But typically, to

keep costs at a minimum, contractors simply play by the owner's or GC/CM's rules and leave themselves exposed, often unknowingly.

Even the most savvy of contractors has been surprised (and hurt financially) by losses that exceeded coverage limits thought to be sufficient, accidents that happened off the construction site, incidents that didn't even involve their work, and failures that occurred long after the project was completed.

This article will offer helpful suggestions for confronting the potential pitfalls lurking in three areas of insurance that are especially thorny for contractors: wrap-ups, builder's risk, and contractual risk transfer and indemnity agreements.

#### **WRAP-UPS**

More small and mid-sized contractors are finding themselves involved in projects where the owner or GC/CM furnishes a single insurance program for all parties on site. These "wrap-ups," which typically include workers' compensation

and general liability (GL), are common on jobs (or a series of jobs by the same owner or GC/CM) costing \$75 million or more.

When contractors participate in a wrap-up, they suspend their regular insurance coverage for that job and let the owner or GC/CM negotiate on their behalf. In return, contractors are expected to give credits to the wrap-up sponsor. Because contractors may have less insurance protection under a wrap-up than under their own coverage, they have the right to negotiate the amount of credits with the sponsor – especially if they can prove endorsements must be acquired to close any coverage gaps.

If a sponsor asks for credits on a contractor's umbrella policy, contractors should ensure they don't extend credit for umbrella coverage that isn't included in the wrap-up, such as auto liability. Contractors also should not give credits for workers who do fabrication, delivery, equipment maintenance and other off-site tasks that are not covered by wrap-ups.

In addition, in the case of large contrac-

tors who opt for the cost-savings of high-deductible policies, it is possible that the required credits could exceed their normal premiums.

Here are a few other areas involving wrap-ups that demand contractors' attention:

- Some wrap-ups will require contractors to place injured employees, if able, on light duty. That can be difficult, especially for smaller contractors that may not have other jobs in which to place these workers. Contractors should also be aware that claim settlement could become complicated if an injured worker aggravates the injury while on light duty on a project unrelated to the wrap-up. In this case, the wrap-up insurer and the contractor's regular insurer may find themselves in a dispute over who is responsible for the claim.
- Contractors may find themselves having to make good on wrap-up deductibles as high as \$150,000 – much higher than the deductibles on their own policies.
- When contractors purchase general li-

ability (GL) coverage, they buy certain limits based on need. But, in a wrap-up, contractors share policy limits, meaning other contractors' losses could exhaust those limits.

- With most GL policies, contractors are covered on an occurrence basis. As long as a loss occurred during the policy period, coverage is available regardless of when the claim is reported. But, in a wrap-up, coverage is often on a disappearing basis. There's a pre-determined time frame in which to report claims. Claims reported after the deadline may not be honored unless the contractor has separately purchased "Difference in Limits and Difference in Conditions" (DIL/DIC) coverage on their own GL policy.

#### BUILDER'S RISK

Builder's risk coverage provides for damage to materials and work during the building process. This includes coverage for theft of materials from the moment they're delivered to the jobsite, and may

include protection for materials in-transit and at temporary locations.

Many small to mid-sized contractors will be covered by a builder's risk policy that someone else purchased. If contractors find themselves in this situation, they should make it a point to examine the policy to know what's covered and what's not. They also need to know the level of deductible and who will pay it. On some policies, the deductible is shared among all on-site contractors; some make the legally liable party responsible for paying it, and sometimes the owner absorbs the deductible. While most deductibles are manageable, on perils like windstorm or flood, they could be very high.

Here are some other issues regarding builder's risk that contractors should consider:

- A builder's risk policy is designed to pay claims regardless of liability. Once the claim is paid, however, the insurance company may seek recovery from the responsible party. Knowing this, contractors should insist that waivers of subroga-

INSURANCE

BONDING

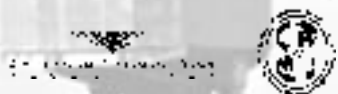
# OAKLAND COMPANIES

INTEGRITY • COMMITMENT • SECURITY

Our Primary Client Goals:

Protect Your Assets • Control Your Costs • Provide Exceptional Service

ISO 9001:2000  
Certified Co.



**NASBP**



888 West Big Beaver Road, Suite 1200, Troy, Michigan 48084  
[www.oaklandcompanies.net](http://www.oaklandcompanies.net)

Ph (248) 647-2500 • Fax (248) 647-4689

tion are in place. If their company causes a loss, and subrogation hasn't been waived, the insurer has the right to require the contractor to reimburse the builder's risk policy. A waiver of subrogation protects them in this scenario.

- If contractors are covered by a builder's risk policy purchased by someone else,

and it doesn't include everything they'd like, they should consider the purchase of a separate policy called an installation floater. If the builder's risk policy does not cover items in transit or storage, for example, an installation floater can ensure they are protected. Also, if the owner buys a policy with a very high

deductible and the contractor is contractually responsible for paying it, an installation floater is a great way to fill in that deductible gap.

- The definitions outlined in any builder's risk policy are something to study, as well. For instance, there are times when part of the property may become occupied while construction is ongoing; perhaps office space is leased on the ground floor while building continues on upper floors. In a circumstance like this, it's important to define exactly when the builder's risk policy ends and permanent insurance takes over because most unendorsed builder's risk policies terminate with any occupancy.

- The definition of the structure being built is crucial, too, especially as it relates to temporary structures, such as scaffolds or forms. Many construction projects require the use of specific forms, which can be costly to replace if damaged. And if they're destroyed, the remanufacturing of new forms can delay a project significantly and push back opening dates, which can increase a contractor's costs in terms of loan interest, equipment rental and lost income. Builder's risk insurance can cover contractors for such "soft-dollar" losses, but it's up to the contractor to ensure the coverage and their limits are adequate.

#### CONTRACTUAL RISK TRANSFER AND INDEMNITY AGREEMENTS

Because so many people are involved in the typical building project, liability needs to be allocated among everyone on-site. To accomplish this, an owner or GC/CM might require contractors to agree to an intermediate form of risk transfer, or indemnity, that says contractors are responsible for their own negligence, as well as anybody else's negligence, rising out of the contractor's work or activity.

They may even request a broad form indemnity that basically says a contractor will accept liability for anything that happens on the jobsite, whether they were at fault or not. Even though most states have laws that prohibit this type of indemnity, there are ways owners or GC/CMs can transfer liability to subcontractors for activities that are beyond their control.



### Next Generation Services Group inc.

#### Next Generation Environmental, Inc.

Asbestos and Lead Abatement, Environmental Remediation

#### 21st Century Salvage, Inc.

Industrial and Commercial Demolition,  
Dismantling, Salvage and Strip Out

#### High Tech Industrial Services

Industrial Cleaning, Water Blasting, Duct Cleaning  
and Plant Decommissioning

**CHARLIE MARTIN**  
President

cmartin@ngsg1.com  
10750 Martz Road  
Ypsilanti, MI 48197  
Ph: 734.485.4855  
Fax: 734.485.6959

For instance, the construction contract may require subcontractors to add the owner and GC/CM as an additional insured on the sub's policy. Doing so would give the other parties protection under the subcontractor's policy and would allow them to use the sub's policy limits and defense before dipping into their own policies. Sharing limits, though, leaves the subs with less coverage – even though they're paying the full premium.

If a GC/CM asks to be included on another contractor's policy as an additional insured, the sub has three options:

- The sub can suggest a predictably priced Owners and Contractors Protective Liability policy as an alternative;
- The sub may request a stipulation that his policy will be excess over the CG/CM's, or contribute on a pro rata basis; or
- The contractor can accept the terms, recognize that some of the risk will not be shared by his insurance policy, purchase higher limits for those risks that can be transferred, and somehow manage the increased policy cost.

In addition to indemnification and hold harmless clauses, it is customary for contracts to stipulate amounts and types of insurance required by contractors. The contractor may well assume that buying the required insurance is full protection for the liability assumed under the hold harmless agreement. Not true.

In practice, the GL policy simply backs the promise of the contractor to indemnify the GC/CM. The policy is subject to coverage limits. By contrast, there are no limits to the amount of liability that may be shifted from the GC/CM to the subcontractor via the hold harmless agreement. Hence, it is important for the subcontractor to minimize assumed liabilities through up-front negotiation, then to mitigate these liabilities via an aggressive safety program and other risk control techniques.

Performance guarantees present another potential financial risk. More and more, contractors are being asked to commit to contract stipulations such as being responsible if heating/air conditioning costs exceed a certain dollar range annually, or agreeing to make repairs to paving work for several years should cracks develop. Performance guarantees present

potential liabilities that exceed the scope of typical insurance policies and need to be considered when bidding and negotiating.

Understanding potential insurance costs and pitfalls is critical, but that's just a first step. Contractors also must be able to put a price tag on the risks, build these elements into their processes and negotiate requirements in ways that won't leave them exposed to unanticipated costs.

Ultimately, once a contractor knows the risks, they have many options. They can attempt to transfer them, they can buy insurance for them and pass the cost on, or pay the premium themselves. They may even decide their firm is financially able to assume the risks – and that's fine, as long as the contractor knows what the risks are going in.

If this assessment seems imposing, remember that your insurance company, agent or broker is available to advise you. This is why it is so important to work with agencies and insurance companies that focus on construction. Their staff experts are available to review the insurance language in your contracts, help you identify exposures, and, develop strategies for dealing with them. Construction-oriented underwriters are able to modify standard insurance policies to respond to your unique needs. Overall, agencies and companies that have been in the business for a long time, and who have relationships with many owners and contractors are in the best position to aid you in your insurance decision-making process. ☞

*Barry L. Hunt is vice president of Oakland Companies in Troy, Michigan. Oakland Companies specializes in servicing the insurance and bonding needs of contractors.*

*Jeffrey A. Segall is vice president of construction at CNA, the Chicago-based insurance firm that provides insurance protection to more than 700,000 contractors.*

*The purpose of this article is to provide information, rather than advice or opinion. It is accurate to the best of the authors' knowledge as of the date of the publication. Accordingly, this article should not be viewed as a substitute for the guidance and recommendations of a retained professional.*

# NEW HUDSON TRADE CENTER



**General Industrial – Flexible Uses**

**Contractors  
Small Business Owners  
Office Users  
Research and Development**

- Industrial Units of 1,710 sq. ft. and up to 19,034 sq. ft. available for Lease or Sale
- Truckwell available in Common Area; One Overhead door per Unit
- 200 Amps Power Service per Unit & 20' Warehouse Ceiling Height
- Only One Mile Off I-96 Exit, Convenient to Major Expressways

**INDUSTRIAL  
CONDOMINIUMS**

**SELLER FINANCING  
AVAILABLE**

**SINGLE OFFICE SUITES  
ALSO AVAILABLE  
FOR LEASE**



**INDUSTRIAL REAL ESTATE BROKER**

**734 432 9020**