

Workshop M4

Monday, October 29, 9:00 a.m.–noon and 1:30–4:30 p.m.

CONTRACT RISK ALLOCATION

Presented by



Michael J. O'Neill
Executive Vice President
American Contractors
Insurance Group

One of our most popular topics, this workshop provides a practical approach to managing risk through the review and negotiation of construction contracts. Find out how to protect your organization, or your client, from problematic language in key provisions such as changes, unforeseen conditions, delays and schedule, payment, termination, dispute resolution, indemnity, limitations of liability, and insurance. Aimed at those new to construction risk allocation, but with an eye on current developments, this session is also a good refresher for veterans.

- Explores key risk allocation mechanisms and draws on real-life examples to demonstrate negotiation strategies.
- Describes typical approaches for insuring construction risks, as well as market and statutory limitations on insuring contractually assumed risks.
- Identifies common problems that can be avoided by involving knowledgeable insurance professionals in the drafting of insurance requirements.



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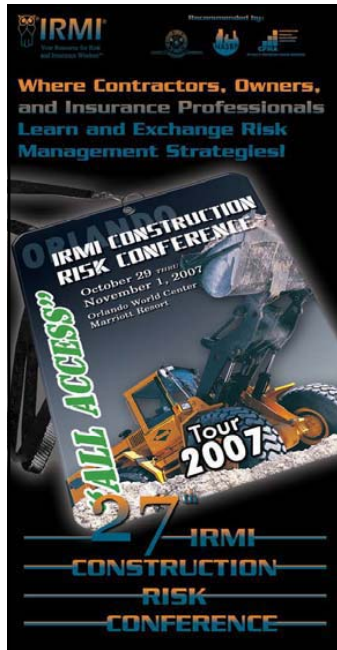


Michael J. O’Neill, CPCU, ARM
Executive Vice President
American Contractors Insurance Group

Mr. O’Neill is copresenting Workshop M4, “Contract Risk Allocation,” on Monday. He has been involved in the construction insurance industry for more than 30 years. He is executive vice president of American Contractors Insurance Group, a construction industry-owned insurance organization in Dallas. Mr. O’Neill is a frequent speaker for construction industry trade associations; he has spoken 18 times at the IRMI Construction Risk Conference, and is a recipient of the IRMI Words of Wisdom speakers’ award. His expertise lies in the areas of captive management, risk management, retention analysis, contractual risk transfer, development of specialized coverage, and risk funding programs. Mr. O’Neill has written many articles for construction industry publications, including AGC, CFMA, and *Engineering News Record*.

Notes

This file is set up for duplexed printing. Therefore, there are pages that are intentionally left blank. If you print this file, we suggest that you set your printer to duplex.



Risk Transfer Programs

Presented By:
Michael J. O'Neill, CPCU, ARM
Executive Vice President
American Contractors
Insurance Group
Dallas, TX

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Risk Transfer Programs - Outline



- I. Risk Transfer**
 - A. Definition**
 - B. Types**
- II. Review Risk Transfer Illustrations**
- III. Indemnity Agreements**
 - A. Types**
 - B. Examples**
 - C. Enforceability**
 - D. Insurance and Anti-Indemnity Statutes**

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Risk Transfer Programs - Outline



IV. Insurance Requirements

- A. Clear and Concise**
- B. Commercially Available**
- C. By Line of Coverage**
- D. Waivers of Subrogation**
- E. Additional Insured Status**
- F. Cancellation and Non Renewal**
- G. Other Key Clauses**

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Risk Transfer Programs - Outline



V. Waivers of Subrogation

- A. Definition**
- B. Policy Treatment**
- C. Standard Endorsements**

VI. Additional Insured Status

- A. How Affected**
- B. C.G.L. Policies**
 - 1. ISO Forms**
 - 2. Manuscript Forms**
- C. Completed Operations**
- D. OCP Policy vs. Additional Insured Status**

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Risk Transfer Programs - Outline



VII. Verification and Administration

- A. Prior to Beginning Work
- B. Best Rating Criteria
- C. Policy Limits
- D. Coverages
- E. Waivers of Subrogation
- F. Additional Insured Status
- G. Cancellation and Non-Renewal

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Risk Transfer Programs - Outline



VIII. Subcontract Audit

- A. Timing
- B. Audit Items
- C. Report to Management
- D. Follow up to Close the Loop

IX. Question/Answer Period

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Risk Transfer



I. Definition

“A contract or agreement whereby one party transfers the risk of loss to another party.”

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Risk Transfer



II. Types of Risk Transfer

- A. Insurance – An agreement between an Insurer and Insured that transfers certain defined risks to the insured for consideration (premium) paid by the Insured.**

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Risk Transfer



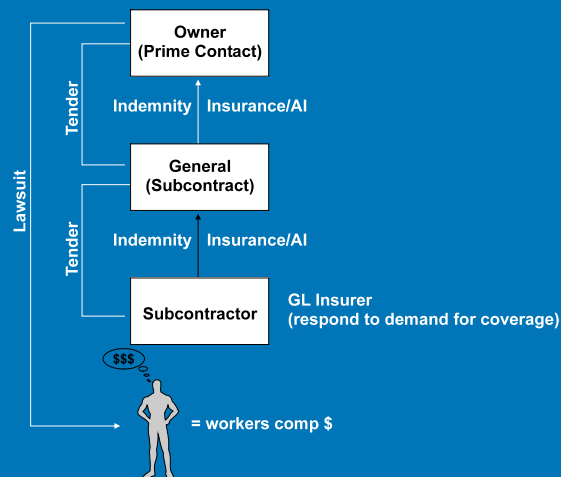
II. Types of Risk Transfer

B. Non-Insurance – An agreement between two parties where the risk of loss is transferred. Examples include:

- Indemnity Agreements
- Lease Agreements
- Rental Agreements

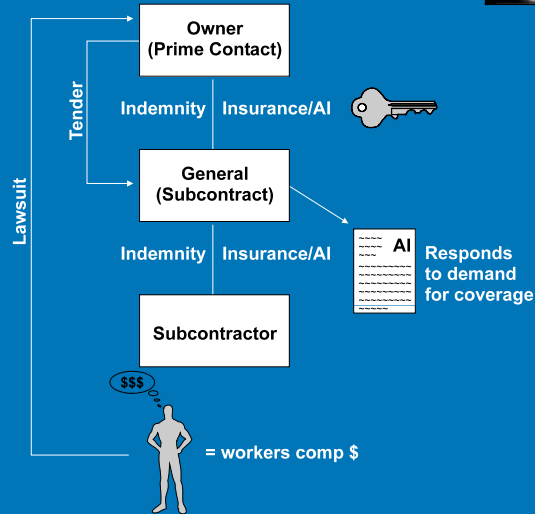
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Risk Transfer Illustration



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Risk Financing Illustration



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Indemnity Agreements



Broad Form Indemnification Agreements

- Under a broad form hold harmless agreement, the indemnitor assumes an unqualified obligation to hold the indemnitee harmless for all liability associated with the subject matter of the agreement, *regardless of which party was actually at fault.*
- Even if the damage, injury, or claim is due to the sole negligence of the indemnitee, the indemnitor must respond to the loss.
- A broad form hold harmless provision transfers *the entire risk of loss* from the indemnitee to the indemnitor.

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Broad Form Indemnity



TO THE FULLEST EXTENT PERMITTED BY LAW, SUBCONTRACTOR SHALL INDEMNIFY, HOLD HARMLESS AND DEFEND CONTRACTOR, AND ALL OF ITS OFFICERS, DIRECTORS, AGENTS AND EMPLOYEES (THE "INDEMNITEES") FROM AND AGAINST ALL CLAIMS, DAMAGES, LOSSES AND EXPENSES, INCLUDING BUT NOT LIMITED TO ATTORNEYS FEES, ARISING OUT OF OR RESULTING FROM BODILY INJURY OR DEATH OF ANY PERSON, OR PROPERTY DAMAGE, INCLUDING LOSS OF USE OF PROPERTY, ARISING OR ALLEGED TO ARISE OUT OF OR IN ANY WAY RELATED TO THIS SUBCONTRACT OR SUBCONTRACTOR'S PERFORMANCE OF THE WORK

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Broad Form Indemnity



OR OTHER ACTIVITIES OF SUBCONTRACTOR, REGARDLESS OF WHETHER SUCH CLAIM, DAMAGE, LOSS OR EXPENSE IS CAUSED, OR IS ALLEGED TO BE CAUSED, IN WHOLE OR IN PART, BY THE NEGLIGENCE OF ANY OF THE INDEMNITEES. THE INDEMNIFICATION OBLIGATIONS UNDER THIS PARAGRAPH SHALL NOT BE LIMITED BY ANY LIMITATION ON THE AMOUNT OR TYPE OF DAMAGES, COMPENSATION OR BENEFITS PAYABLE BY OR FOR SUBCONTRACTOR UNDER WORKERS COMPENSATION ACTS, DISABILITY BENEFIT ACTS OR OTHER EMPLOYEE BENEFIT ACTS.

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Broad Form Indemnity – Texas Express Negligence



TO THE FULLEST EXTENT PERMITTED BY LAW, SUBCONTRACTOR SHALL INDEMNIFY, HOLD HARMLESS AND DEFEND CONTRACTOR, AND ALL OF ITS OFFICERS, DIRECTORS, AGENTS AND EMPLOYEES (THE "INDEMNITEES") FROM AND AGAINST ALL CLAIMS, DAMAGES, LOSSES AND EXPENSES, INCLUDING BUT NOT LIMITED TO ATTORNEYS FEES, ARISING OUT OF OR RESULTING FROM BODILY INJURY OR DEATH OF ANY PERSON, OR PROPERTY DAMAGE, INCLUDING LOSS OF USE OF PROPERTY, ARISING OR ALLEGED TO ARISE OUT OF OR IN ANY WAY RELATED TO THIS SUBCONTRACT OR SUBCONTRACTOR'S PERFORMANCE OF THE WORK OR OTHER ACTIVITIES OF SUBCONTRACTOR, REGARDLESS OF WHETHER SUCH CLAIM, DAMAGE, LOSS OR EXPENSE IS CAUSED, OR IS ALLEGED TO BE CAUSED, IN WHOLE OR IN PART BY THE NEGLIGENCE OF ANY OF THE INDEMNITEES, IT BEING THE EXPRESSED INTENT OF CONTRACTOR

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Broad Form Indemnity – Texas Express Negligence



AND SUBCONTRACTOR IN AGREEING TO THIS PARAGRAPH THAT SUBCONTRACTOR IS TO INDEMNIFY, HOLD HARMLESS AND DEFEND THE INDEMNITEES FROM THE CONSEQUENCES OF THEIR OWN NEGLIGENCE, WHETHER IT IS THE SOLE, CONTRIBUTING, OR CONCURRING CAUSE OF THE CLAIM, DAMAGE, LOSS OR EXPENSE. THE INDEMNIFICATION OBLIGATIONS UNDER THIS PARAGRAPH SHALL NOT BE LIMITED BY ANY LIMITATION ON THE AMOUNT OR TYPE OF DAMAGES, COMPENSATION OR BENEFITS PAYABLE BY OR FOR SUBCONTRACTOR UNDER WORKERS COMPENSATION ACTS, DISABILITY BENEFIT ACTS OR OTHER EMPLOYEE BENEFIT ACTS.

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Intermediate Form Indemnification Agreements



- The second type of indemnification agreement is the *intermediate form*.
- The indemnitor assumes all liabilities of the indemnitee relating to the subject matter of the agreement, except where the injury or damage is caused by the indemnitee's sole negligence.
- *Any* amount of fault on the part of the indemnitor under an intermediate hold harmless agreement obligates the indemnitor to indemnify the indemnitee for the *total* amount of damages.

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Intermediate Form Indemnification Agreements



- For example, whether the indemnitor is 10 percent or 90 percent at fault, it nevertheless must indemnify the indemnitee for 100 percent of the damages.
- The only instance in which the indemnitor is relieved of the contractual obligation to indemnify is when the loss is due solely to the fault of the indemnitee.

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Intermediate Form Indemnity



TO THE FULLEST EXTENT PERMITTED BY LAW, SUBCONTRACTOR SHALL INDEMNIFY, HOLD HARMLESS AND DEFEND CONTRACTOR, AND ALL OF ITS OFFICERS, DIRECTORS, AGENTS AND EMPLOYEES (THE "INDEMNITEES") FROM AND AGAINST ALL CLAIMS, DAMAGES, LOSSES AND EXPENSES, INCLUDING BUT NOT LIMITED TO ATTORNEYS FEES, ARISING OUT OF OR RESULTING FROM BODILY INJURY OR DEATH OF ANY PERSON, OR PROPERTY DAMAGE, INCLUDING LOSS OF USE OF PROPERTY, ARISING OR ALLEGED TO ARISE OUT OF OR IN ANY WAY RELATED TO THIS SUBCONTRACT

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Intermediate Form Indemnity



OR SUBCONTRACTOR'S PERFORMANCE OF THE WORK OR OTHER ACTIVITIES OF SUBCONTRACTOR, REGARDLESS OF WHETHER SUCH CLAIM, DAMAGE, LOSS OR EXPENSE IS CAUSED, OR IS ALLEGED TO BE CAUSED, IN PART BY THE NEGLIGENCE OF ANY OF THE INDEMNITEES. THE INDEMNIFICATION OBLIGATIONS UNDER THIS PARAGRAPH SHALL NOT BE LIMITED BY ANY LIMITATION ON THE AMOUNT OR TYPE OF DAMAGES, COMPENSATION OR BENEFITS PAYABLE BY OR FOR SUBCONTRACTOR UNDER WORKERS COMPENSATION ACTS, DISABILITY BENEFIT ACTS OR OTHER EMPLOYEE BENEFIT ACTS.

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Limited Form Indemnification Agreements



- This third type of hold harmless agreement is sometimes referred to as a *comparative fault* indemnification agreement.
- As its name implies, this agreement obligates the indemnitor only to the extent of its own fault.

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Limited Form Indemnity



TO THE FULLEST EXTENT PERMITTED BY LAW, SUBCONTRACTOR SHALL INDEMNIFY, HOLD HARMLESS AND DEFEND CONTRACTOR, AND ALL OF ITS OFFICERS, DIRECTORS, AGENTS AND EMPLOYEES (THE "INDEMNITEES") FROM AND AGAINST ALL CLAIMS, DAMAGES, LOSSES AND EXPENSES, INCLUDING BUT NOT LIMITED TO ATTORNEYS FEES, ARISING OUT OF OR RESULTING FROM BODILY INJURY OR DEATH OF ANY PERSON, OR PROPERTY DAMAGE, INCLUDING LOSS OF USE OF PROPERTY, ARISING OR ALLEGED TO ARISE OUT OF OR IN ANY WAY RELATED TO THIS SUBCONTRACT

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Limited Form Indemnity



OR SUBCONTRACTOR'S PERFORMANCE OF THE WORK OR OTHER ACTIVITIES OF SUBCONTRACTOR, TO THE EXTENT SUCH CLAIM, LOSS OR EXPENSE IS CAUSED, OR IS ALLEGED TO BE CAUSED, BY THE NEGLIGENCE OF SUBCONTRACTOR. THE INDEMNIFICATION OBLIGATIONS UNDER THIS PARAGRAPH SHALL NOT BE LIMITED BY ANY LIMITATION ON THE AMOUNT OR TYPE OF DAMAGES, COMPENSATION OR BENEFITS PAYABLE BY OR FOR SUBCONTRACTOR UNDER WORKERS COMPENSATION ACTS, DISABILITY BENEFIT ACTS OR OTHER EMPLOYEE BENEFIT ACTS.

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State Construction Anti-Indemnity Statutes

Source: IRMI Online, Contractual Risk Transfer
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State	Statute	Types of Persons Contracts Affected	Type of Indemnity Allowed		
			Sole Negligence of Indemnitee	Concurrent Negligence of Indemnitee	Negligence of Indemnitor
AL	No Statute				
CA	Cal. Civ. Code § 2782 et seq.	All construction and design contracts.	No	Yes	Yes
		All residential construction contracts.	No	No	Yes
IL	Ill. Comp. Stat. 740 ILCS 35/1	All construction contracts. No specific mention of design contracts or design professionals.	No	No	Yes
MT	Mont. Rev. Code Ann. § 28-2-2111	All "construction contracts," which includes architectural and design services.	No	No	Yes

Insurance and Anti-Indemnity Statutes



- Many anti-indemnity statutes specifically provide that the statutes do not apply to insurance requirements.
- Some states have specific statutes that restrict the scope of additional insured status that can be legally required in the contract.
- Those states are:
 - Montana
 - New Mexico
 - Oregon
 - Oklahoma (passed in 2007)

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Insurance Requirements



1. Clear and concise
2. Integrated into the contract or an exhibit that is incorporated by reference.

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Insurance Requirements



1. Insurance carriers
2. Admitted or non admitted
3. Licensed or authorized
4. A.M. Best rating A-, VII
5. Guaranty funds

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Line of Business



1. Workers Compensation
2. Coverage A – Statutory
3. Coverage B - \$1,000,000 Limit
4. Waiver of Subrogation
5. Special Exposures
 1. U.S.L.&H. (wet)
 2. F.E.L.A. (Railroad)
 3. Foreign

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Line of Business



1. **Commercial General Liability**
2. **Limits \$1,000,000/\$2,000,000/\$2,000,000**
3. **Project Specific Limits**
4. **Waiver of Subrogation**
5. **Additional Insured Endorsement (spell out)**

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Line of Business



1. **Business auto policy**
2. **Limits are combined single limit**
3. **Minimum limit \$1,000,000**
4. **No aggregate limits**
5. **Hired and non-owned auto coverage**
6. **No need for additional insured**
7. **Omnibus insured provision**

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Line of Business



- 1. Umbrella liability**
- 2. Limits apply on a per occurrence and aggregate basis, if applicable**
- 3. \$1,000,000 occurrence/\$1,000,000 aggregate**
- 4. Applies over primary E/L, CGL, and BAP limits**

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Line of Business



- 1. If there is a pollution exposure**
- 2. Contractors pollution liability**
- 3. Limits \$1,000,000 occurrence/\$2,000,000 aggregate**
- 4. Occurrence vs. "claims made"**
- 5. Additional insured provision**
 - A. Blanket grant**
 - B. Specific endorsement**

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Line of Business



1. If there is a professional scope of work
2. “Claims-made” policy forms
3. Limits are exhausting including ALAE
4. Limits apply per claim/aggregate
5. Limits example
 - \$2,000,000 per claim
 - \$2,000,000 aggregate
6. Covers all projects after the retroactive date
7. No additional insured status

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Insurance Requirements



1. Certificate of insurance acceptable to contractor must be received prior to commencing work.
2. Prime contract flow down insurance provisions
3. 30 day written notice due to cancellation, or non-renewal
4. Right to request “certified policies”
5. Contractor has the right to withhold progress payments until a fully compliant certificate of insurance is received.

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Waivers of Subrogation



- The ability of parties to contractually transfer risk is profoundly affected by legal doctrines and principles, whether those principles are embodied in statutes or common law.
- A common law doctrine of particular importance to the implementation of contractual risk transfer is that of subrogation.
- This doctrine allows a party who has paid a loss or debt on the part of another to succeed to the rights of that other party to pursue recovery from a third party who was responsible for causing the loss.

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Waivers of Subrogation



- The common law doctrine of subrogation attempts to allocate liability to the party responsible for the injury or damage.
- When two or more parties contract with each other, however, they often desire to allocate risks in a different manner.
- In such cases, the doctrine may operate in a manner that controverts their intent.

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Waivers of Subrogation – Policy Treatment



Workers Compensation Policy Subrogation Provision

PART FOUR YOUR DUTIES IF INJURY OCCURS

Tell us at once if injury occurs that may be covered by this policy. Your other duties are listed here.

* * *

5. Do nothing after an injury occurs that would interfere with our right to recover from others.

Source: Workers Compensation and Employers Liability Insurance Policy, Form WC 00 00 00 A, National Council on Compensation Insurance, 1992

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W/C Waiver Language



We will not enforce our right against the person or organization named in the Schedule. (This agreement applies only to the extent that you perform work under a written contract that requires you to obtain this agreement from us.)

This agreement shall not operate directly or indirectly to benefit anyone not named in the Schedule.

Source: Waiver of Our Right To Recover from Others Endorsement, WC 00 03 13, National Council on Compensation Insurance, 1984

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Waivers of Subrogation



- Subrogation allows an insurer that has paid a claim to succeed to the rights of the insured against a third party that may have been responsible for the loss.
- While subrogation arises automatically under the law, it is frequently the subject of provisions contained in insurance policies.
- Usually, when an insurer seeks subrogation, the insured is reimbursed out of any recovery for any portion of the loss that was not covered by insurance, with the remainder going to the insurer.
- Since an insurer can succeed only to the rights of the insured, the insured must be careful not to impair the insurer's rights to pursue subrogation from third parties.

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Reasons to Require Additional Insured Status



- **Back up the indemnity.**
- **Direct rights to the policy.**
- **Defense costs.**
- **Broader risk transfer than allowed by anti-indemnity statutes.**

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Additional Insured vs. Named Insured



1. The named insured (NI) has more stringent occurrence reporting requirements.
2. The NI's employees, executive officers, and directors are insureds.
3. Certain exclusions apply only to the NI (e.g., property damage).
4. Policy applies "as if each NI were the only NI." Policy applies "separately" to other insureds.
5. The NI must reimburse the amount of any deductible paid by the insurer.
6. The *first* NI is required to pay premium.
7. The *first* named insured must record and provide to the insurer upon request any information necessary for premium computation.
8. The *first* NI receives any premium return.
9. The *first* NI may cancel the policy.
10. The *first* NI receives cancellation and nonrenewal notice

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Additional Insureds Reporting Requirements



- You must see to it that we are notified as soon as practical of an "occurrence" or an offense which may result in a claim.
- You must immediately record the specifics of the claim or "suit" [brought against any insured] and the date received; and notify us as soon as practicable.
- You and any other involved insured must (1) send the insurer copies of legal documents in connection with the claim; (2) authorize the insurer to obtain necessary information; (3) cooperate in the investigation of the claim; and (4) assist in the exercise of recovery rights against other liable parties.

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Additional Insured



- **Insurance Services Office (ISO) Endorsements.**
- **Manuscript Endorsements. Drafted by each insurer.**

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CG 20 10 11 85 - “Liability Arising out of Your Work”



- **One hurdle - “Your Work”**
- **No trigger of negligence**
- **Includes completed operations**
- **Broadest form around – was widely used and is still quoted as a requirement**

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CG 20 10 10 93 – “Liability Arising out of Your Ongoing Operations”



- **One hurdle - “Your Ongoing Operations”**
- **No trigger of negligence**
- **No completed operations**
- **Widely provided**

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CG 20 10 10 01 / CG 20 37 10 01



- **Forms often used together**
- **Provides ongoing operations on 20 10 (10 01)**
- **Provides completed operations on the 20 37 (10 01)**

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CG 20 10 07 04 / CG 20 37 07 04



- **Similar to 10 01 forms above for grant of coverage**
- **Provides ongoing operations on 20 10**
- **Provides completed operations on the 20 37**
- **Requires showing that liability was “caused” by the subcontractor**

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Additional Insured Endorsements



- **We maintain a binder with manuscript additional insured endorsements.**
- **Form numbers and edition dates.**
- **Analysis of limitations.**

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OCP versus Additional Insured Status



Comparison Point	OCP Policy	Additional Insured Status
Cost	Moderate	Inexpensive
Limits	Apply separately for named insured (NI)	Included with contractor and other additional insureds
Excess or umbrella limits	Not a scheduled underlying policy	Usually provided
Effects of losses	Minimal	Affects current loss-sensitive plans and affects future CGL costs
Other insurance	Specifically applies as primary	Clauses may conflict

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OCP versus Additional Insured Status



Comparison Point	OCP Policy	Additional Insured Status
Notice of cancellation	Contractor and NI receive notice	Only contractor receives notice
Coverage for indemnitee's (owner's) negligence	Limited to general supervision only	Covered only when injury or damage is caused at least partly by named insured
Personal injury perils	Not usually covered	Covered
Effects on contractor's coverage	None	May cause problems with respect to certain exclusions
Evidence that contractor has complied with requirement	Copy of policy received	Certificate of insurance

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Additional Insured Issues



- If you are not reviewing the specific endorsements, you won't know if you have a problem until after the loss occurs.
- Proactive risk management vs. reactive risk management.

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Risk Transfer Programs Administration



- Contract documents executed
 - Prime contract
 - Subcontract agreements
 - Purchase orders
- Insurance documents received and verified
 - Certificates of insurance
 - Additional insured endorsements

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Risk Transfer Programs



- **Contract administration system**
 - **Non-compliance letters**
 - **Renewal certificates and additional insured endorsements**
 - **Stop progress payments**
 - **Management reports**

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Subcontract Document Audit



- **Who to perform**
 - **Internal audit function**
 - **Agent/broker**
 - **Carrier**
- **Timing of the audit**
 - **Baseline audit**
 - **Annual**
 - **Turnover affects the frequency**

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Subcontract Document Audit



- **Flow chart the process**
- **Identify and remove any barriers**
- **Automate the process**
- **Establish accountability/chain of command**

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Subcontract Document Audit



- **Compare insurance requirements to insurance documents received**
- **Verify the following items**
 - **Carrier, A.M. Best rating**
 - **Limits of liability**
 - **Waivers of subrogation**
 - **Additional insured endorsement**
 - **Policy dates**
 - **Cancellation and non-renewal provisions**

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Subcontract Audit



- **Select projects from the active project listing**
- **Various stages of completion**
- **Geographic spread**
- **Audit all subcontractors on the project; e.g., University of Rochester Chiller Plant**

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Subcontract Audit



- **Report to management**
- **Date performed**
- **Number of projects (10)**
- **Number of subcontract document audits (244)**
- **Project compliance ratio**
- **Overall compliance ratio**
- **Recommendations for improvement**

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Risk Transfer Programs – Putting all the Pieces Together



Indemnity Provisions	Subcontract Audit
Waivers of Subrogation	Insurance Requirements
Administration	Additional Insured Status

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Risk Transfer Programs – Putting all the Pieces Together



Indemnity Provisions	Insurance Requirements
Waivers of Subrogation	Additional Insured Status
Administration	Subcontract Audit

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Risk Transfer Program



Summary

- **Requires consistent execution**
- **Modify or change as needed**
- **Set out a chain of command**
- **The “buck stops here”**

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