

## **Workshop M2**

**Monday, October 27, 9:00 a.m.-noon and 1:30-4:30 p.m.**

### **MANAGING THE RISKS OF HIRING INDEPENDENT CONTRACTORS**

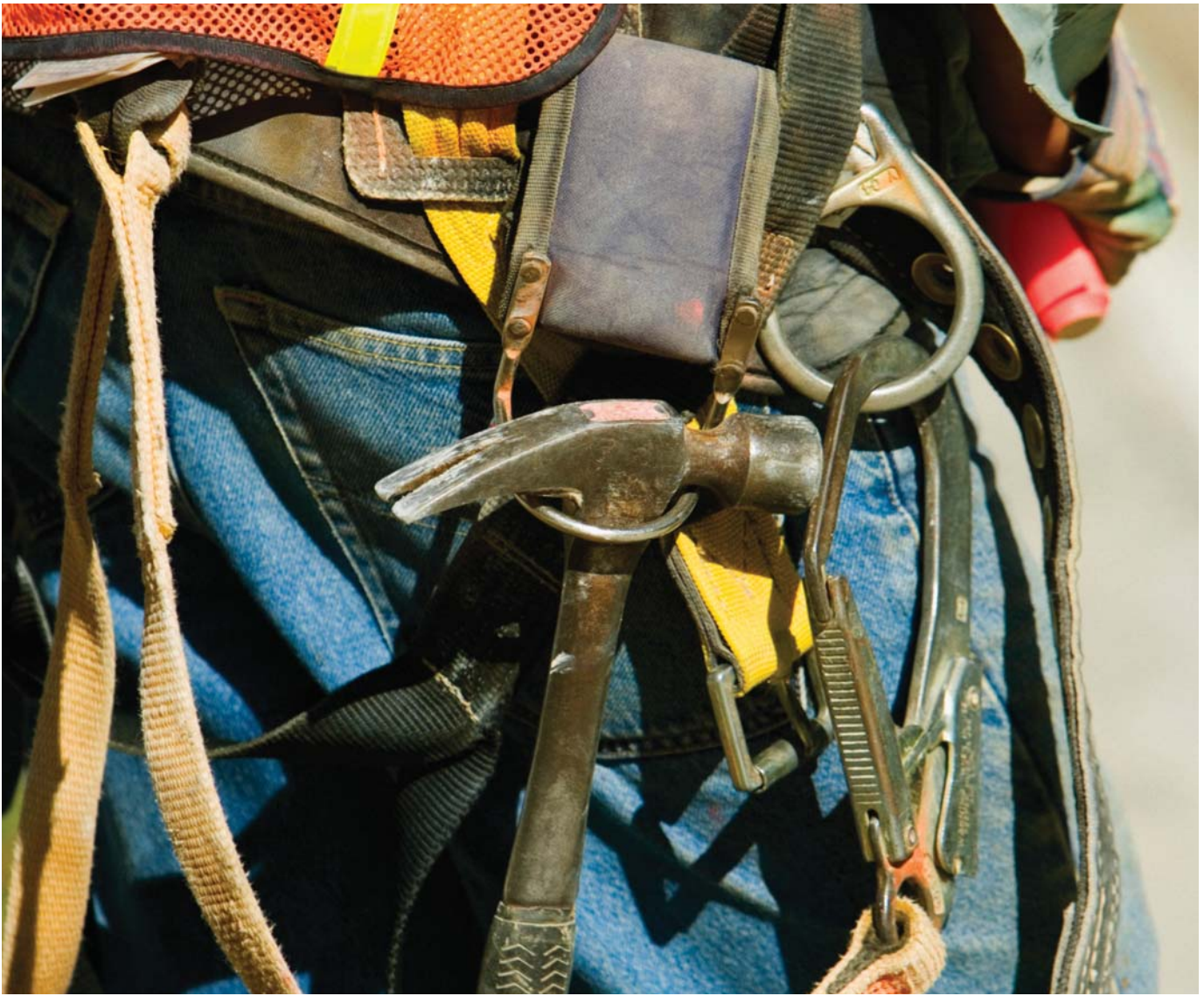
**Presented by**

**Jeffrey A Segall, CPCU, CRIS**  
**Vice President**  
**CNA**

**Lane Tanabe**  
**Chief Financial Officer**  
**Absher Construction**

Despite the many benefits of utilizing independent contractors on a construction project, parties who do so undertake a variety of risks. From vicarious liability for a contractor's negligence to statutory liability for workers compensation benefits to contractor default, these arrangements present risks for the hiring party. This workshop outlines the various liabilities associated with hiring independent contractors and how to protect yourself against these risks.

- Outlines key risks associated with the use of independent contractors for owners and contractors.
- Provides strategies for minimizing or avoiding independent contractor risks.
- Shows how to design an insurance program that adequately protects against the risks that cannot be avoided.



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**Jeffrey A Segall**  
**Vice President**  
**CNA**

Mr. Segall is copresenting Workshop M2, "Managing the Risks of Hiring Independent Contractors," on Monday. He is vice president, E&S, of CNA Global Specialty Lines. In this capacity he is responsible for the underwriting of programs, nonadmitted liability lines, and for-hire trucking accounts. Previously, as CNA's vice president of Construction, Mr. Segall was responsible for developing strategy and best practices for the construction segment.

Over the years he has presented at the Construction Risk Conference on a variety of insurance topics, including general liability, builders risk, workers compensation, and others. His commitment to education is demonstrated both by the numerous certifications and credentials he has earned and in Conference attendees' consistent praise for the way he freely shares his knowledge and experience. Mr. Segall is an important construction industry resource, sharing his expertise not only as an IRMI speaker but also as a presenter at other industry conferences and by contributing to numerous trade publications.

Prior to joining CNA, Mr. Segall was a senior vice president in the Construction Risk Management Group of Willis. In that role, he provided marketing and account servicing assistance to Willis offices and key clients. His prior experience includes various positions at AIG, St. Paul, and a number of agencies now affiliated with Aon and Acordia. He began his insurance career in 1972.

Mr. Segall holds a bachelor's degree in business administration from the University of Texas in El Paso. His professional insurance designations include Associates in both Underwriting and Risk Management, Construction Risk and Insurance Specialist (CRIS), Certified Insurance Counselor, Chartered Property Casualty Underwriter, and Certified Risk Manager. He is recipient of the Continuing Professional Development program award and the IRMI WOW (Words of Wisdom) award for his previous contributions to IRMI.

**Lane S. Tanabe**  
**Chief Financial Officer**  
**Absher Construction Company**

Mr. Tanabe is copresenting Workshop M2, "Managing the Risks of Hiring Independent Contractors," on Monday. He is currently the chief financial officer at Absher Construction Company. His previous work experience, in addition to construction, includes time spent in industries from maritime transportation to health care. He holds a master's degree in Taxation from Golden Gate University and an MBA from Seattle University. Mr. Tanabe's professional designations include CPA-Inactive, Construction Risk and Insurance Specialist (CRIS), and Certified Construction Financial Professional (CCIFP). He is the current president of the South Sound Chapter of CFMA (Construction Financial Management Association).

## **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.



## Managing the Risks of Hiring Independent Contractors

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IRMI 2008  
Construction  
Risk Conference



Workshop M2

### Managing the Risks of Hiring Independent Contractors

IRMI 2008 Construction  
Risk Conference

#### Overview

- Despite the many benefits of utilizing independent contractors on a construction project, parties who do so undertake a variety of risks. From vicarious liability for a contractor's negligence to statutory liability for workers' compensation benefits to contractor default—these arrangements present risks for the hiring party. This workshop outlines the various liabilities associated with hiring independent contractors and how to deal with these risks.

## Treatment of Risk

- **Balancing the risk-reward equation**
  - Avoid—don't do the job
  - Retain—keep the risk
  - Transfer the risk
    - Contractually—only as good as the financial ability of the party accepting the risk
    - Through the purchase of insurance—actually a risk financing technique

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## Basic Insurance Premises

- Purchasing insurance indemnifies the contractor for loss.
- Insurance policies are contracts—similar in many ways to construction contracts.
- Contractors in one sense are purchasing/negotiating one set of contracts (insurance) to support another contract (construction).
- There is no direct relationship between the drafter of the construction contract (owner, A/E) and the drafter of the insurance policies (insurers); except as amended by the common party (the contractor).

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## Risk vs. Peril

- Risk—uncertainty arising from the possible occurrence of adverse events
- Peril is a cause of loss (i.e., fire, fall, car crash)
- Insurance covers perils, not risks
- Insurance won't cover all your perils or risks!!!

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## Risk Provisions Not Handled by Insurance

- Claims submission—compliance with the claims procedure is a condition precedent to proving entitlement to additional time or damages
- No damages for delay—denies the contractor additional money for costs incurred due to a delay outside their control
- Dispute resolution procedures—right to mediate or arbitrate an architect's decision may be lost if that party fails to timely file a demand for mediation or arbitration
- Waivers and releases—the provisions can be very broad, extending to lien claims, claims for extensions of time, claims for additional compensation, bond claims, causes of action, etc.

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## Treatment of Risk, Non-Insurance Approach

- To a contractor, insurance is just one factor of the risk management equation.
- The majority of a general contractor's job costs relates to subcontractors,
  - Subcontractor selection
  - Subcontract
  - Subcontractor management

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## Subcontractor Selection

- Database
- Interviews
- Reference checks
- Credit reports
- Subcontractor prequalification program (all of the above and then some)

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## Subcontractor Prequalification Program (Overview)

- The program is an effort to properly manage and mitigate the risk associated with subcontracting the vast majority of the work on any project.
- Goal is to be proactive in assuring that our information and evaluation of every subcontractor/ supplier is current and useful for determining their current status (in our judgment).

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## Subcontractor Prequalification Program (Overview)

- Assure subcontractors/suppliers that the information provided will be kept confidential.
- Ultimate goal is to establish a method of rating subcontractors and suppliers so that decisions regarding subcontractor selection are systematic rather than by “gut feel” or instinct.

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## Subcontractor Prequalification Program

- Elements:
  - Questionnaire
    - Ownership & Corporate Structure
    - Backlog
    - Insurance & Surety Information
    - References
    - Safety
    - Business Classification (WBE, MBE, HUB Zone, etc.)

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## Subcontractor Prequalification Program (continued)

- Financial statements
  - External (compilation, review, or audit)
  - Internal (current reporting period)
  - Balance sheet & income statement at a minimum
  - Updated financials on an annual basis at a minimum

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## Subcontractor Prequalification Program (continued)

- All subcontracts/supplier contracts that exceed a certain dollar amount will require the subcontractor/supplier to furnish a performance and payment bond.
- With new subcontractors/suppliers, consider requesting that they provide a performance and payment bond even if the dollar amount of the subcontract is below the dollar threshold established above.

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## Key Risks

- Key risks associated with the use of independent contractors for both project owners and upper-tier contractors—note: whether a job is self-performed or subcontracted, the risks are the same. The treatment of the risks vary based on:
  - Damage to the property in the course of construction
  - Damage to owned property
  - Damage to non-owned property
  - Additional costs as a result of any of the above

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## Key Risks (cont.)

- Injury to workers on the site
- Injury to non-workers at the site
- Failure of completion
- Failure of the structure to perform or function as intended
- Damage to reputation

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## Some Risks Exist Outside the Construction Site

- Damage to the property in the course of construction
  - At the site
  - Off-site
  - In transit
- Damage to owned property
  - During construction
- Damage to non-owned property
  - During construction
  - After construction is completed

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## Common types of insurance

- Builder's Risk
- Installation Floaters
- General Liability
- Workers' Compensation
- Automobile Liability
- Umbrella Liability
- Professional Liability
- Environmental Impairment Liability

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## Insurance Requirements

- Common insurance issues
  - Who is responsible for materials to be installed before, during, and after construction?
  - Who is responsible for oversight?
  - Is a worker an employee, a subcontractor, or both?
  - Is a building your work or your product?
  - When is work completed?
  - Certificates of insurance—proof of insurance
  - Additional insured issues
  - Waivers of subrogation
  - Need for surety or other financial guarantees?

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## Builder's Risk

### *What Is Covered and Where*

- What
  - Existing structures
  - Temporary structures
  - Forms & false work
  - Scaffolding
  - Land

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## Builder's Risk (cont.)

### *What Is Covered and Where*

- Where
  - The location is covered
  - W/I 100'
  - Adjacent areas
  - Over water
  - In transit

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## Builder's Risk

### *Who Is Covered*

- Insured named on policy
  - Everyone on the project, not ATIMA
    - Installation floater
- Waivers of subrogation

### *When Covered*

- Term of policy is not the term of coverage
  - Term of construction
  - Punch list returns
  - Testing period
  - Consent to occupy

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## Builder's Risk

### *Perils Covered*

- Are all risk perils always the same?
  - Collapse—All risk/Named perils
  - Wind & flood—deductibles, sub limits, definitions
  - Earth movement—earthquake, subsidence, sinkhole
  - Mold & leakage
  - Boiler & machinery—applied technologies
  - Testing—hot & cold

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## Builder's Risk

### *Valuation*

- Typically actual cash value is the same as replacement cost
  - Renovation projects
  - Historic buildings/Tax credits
  - Enforcement of codes and ordinances
  - Debris removal

### *Optional Coverages*

- These are not always provided
  - Delay of use and occupancy
  - Soft costs
  - Off-site storage or property in transit—type of transit

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## General Liability

### *Types of Triggers*

- The most common trigger is occurrence
  - Claims-made
    - Retro date
    - Extension for reporting claims
    - Definition of claim
  - Close of escrow
    - Term of coverage
    - Statutes of limitations and repose

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## General Liability

### *Who Is Covered*

- Built-in gaps for contractors
  - Any organization you newly acquire or form—other than a partnership, joint venture, or limited liability company—and over which you maintain ownership or majority interest will qualify as a named insured if there is no other similar insurance available to that organization. However:
    - No person or organization is an insured with respect to the conduct of any current or past partnership, joint venture, or limited liability company that is not shown as a named insured in the declarations.
- Joint ventures must be added by manuscript endorsements as insureds and, if required, as additional insureds.

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## Workers' Compensation

### *Two Coverages in One Policy: Statutory & Employers' Liability*

- Statutory benefits
- Adding a new statute
  - Defense Base Act (WC 00 01 01 A)
  - Longshore and Harbor Workers' Compensation Act (WC 00 01 06A)
  - Outer Continental Shelf Lands Act (WC 00 01 09A)
  - Nonappropriated Fund Instrumentalities Act (WC 00 01 08A) entertainment and retail goods and services to armed forces personnel on a military base

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## Workers' Compensation

### *Including Others on One Policy*

- Who is insured
  - Alternate employer endorsement (WC 00 03 01A)—oil companies & property managers like adding an additional insured
  - Employee leasing client endorsement (WC 00 03 19)—you lease, they cover
  - Labor contractor endorsement exclusion (WC 00 03 20A)—you lease, you cover
  - Multiple coordinated policy endorsement (WC 21 06 04)

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## Workers' Compensation

### *Including Others on One Policy*

- Joint venture as insured—includes members (WC 00 03 05), partners, officers & others exclusion (WC 00 03 08)
- Sole proprietors, partners, officers and others coverage (WC 00 03 10)
- Voluntary compensation & employers' liability (WC 00 03 11A)

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## Workers' Compensation

### *Modifying Employers' Liability*

- Employers' liability
  - Maritime coverage (WC 00 02 01A) & limited marine coverage (WC 00 02 04)
  - Stop Gap—employers' liability endorsement (WC 00 03 03C) (not Ohio; Ohio is separate—excludes intentional injuries)

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## Workers' Compensation

### *Modifications Determined by Location or Program Design*

- Unusual
  - Medical benefits reimbursement coverage (WC 00 03 07)—insureds that do not qualify to self-insure
  - Waiver of rights (WC 00 03 13)—not legal in all states
  - Extended statutory benefits in monopolistic states—monopolistic state “drive-throughs”

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## Umbrella

### *Insuring Agreement*

- Coverage triggers
  - Occurrence—claims made—close of escrow
  - Accident or offense
  - Indemnify vs. Pay on behalf of

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## Umbrella

### *Things To Consider*

- Since this policy is excess of the general, auto, and employers' liability coverages, issues mentioned there apply here as well:
  - Not standard coverage
  - Contractors LIMITATION endorsement
  - Approach on defense
  - Drop down provisions
  - Conditions surrounding maintenance of underlying policies
  - Punitive damages
  - Uninsured motorists
  - Territory

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## Umbrella

### *More Things To Consider*

- Limits
  - Apply excess of retention
  - Apply excess of underlying policies
  - Retained amounts met only by actual damages (e.g., not defense costs)
  - Retained amounts met only by claims covered by this policy

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## Key Risks (Non-Insurance)

### Subcontract

- Every general contractor should have a standard subcontract that it uses for all of its jobs and subcontractors.
- The standard subcontract should be drafted and/or reviewed by legal counsel.
- Do not allow subcontractors/suppliers to make significant changes to the standard subcontract. If you elect to allow changes, make sure that both parties initial these changes or disputes could arise at a later date.
- Standard subcontract should not be static. Must be updated to reflect new legislation, court cases, or lessons learned.

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## Subcontract (continued)

- Elements of subcontract:
  - Scope of work
    - Be sure that you understand and agree with the terms, conditions, & exclusions contained in a subcontractor's bid.
  - Payment
    - Pay when paid/pay if paid.
  - Use of project management systems
    - Require that the subcontractor utilize the general contractor's system for daily reports, RFIs, and all correspondence. Important for documentation of claims and change orders.

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## Subcontract (continued)

- Incorporation of other documents
  - Binds the subcontractor to the terms of the prime contract.
- Schedule
  - Any float time belongs to the general contractor.
  - Coordination of work is the responsibility of the subcontractor.

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## Elements of Subcontract (continued)

- Claims
  - GC agrees to present to the owner any subcontractor claims for equitable adjustment or time extension.
  - Subcontractor understands that payment for extra work required by the owner will be paid out of the owner's payment to the GC.
  - Subcontractor shall proceed with the work pending final resolution of any dispute arising out of this subcontract.

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## Elements of Subcontract (cont.)

- Termination provisions
  - GC may terminate the subcontract at any time in whole or in part by written notice. Subcontractor is not entitled to anticipated profits or consequential damages.
- Indemnification
  - Subcontractor shall defend, indemnify, and hold harmless from any and all suits, claims, or losses arising out of the subcontractor's performance of this subcontract or the performance of its sub-tier subcontractor.

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## Elements of Subcontract (continued)

- Changes/Extra work
  - Any change in work must be authorized in writing by the GC.
- Notice
  - Subcontractor must provide written notice to the GC within x days after the occurrence of any event giving rise to a claim. Failure of subcontractor to provide written notice shall result in an absolute waiver of that claim.
- Safety
  - Maintain a written accident prevention plan and a jobsite specific safety plan.

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## Elements of Subcontract (cont.)

- Miscellaneous
  - Prohibit assignment of contract or any proceeds without written consent.
  - Agreement to incorporate this subcontract and the prime contract into any contract the subcontractor may enter with any sub-tiers or suppliers.

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## Subcontract Management

- Review each subcontractor's monthly pay application for accuracy and reasonableness before inclusion in the pay application to the owner. Make sure that the subcontractor has enough money left in its contract to complete the work.
- Personal guaranty from owner (if not bondable).
- Sub tier/Supplier releases before releasing payment.

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## Subcontract Management (continued)

- Certificates of insurance.
- Require certificates of insurance from subcontractors, tenants, service providers, and other parties.
- Determine appropriate insurance coverages and limits.
- Review certificates of insurance.
- Enforce certificate of insurance requirements.
- Monitor certificates of insurance.
- Create a filing system.

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## Subcontract Management (continued)

- Joint Check Agreements
  - Don't use the form that the supplier sends you. Spend the money and have your attorney draft a joint check agreement that protects your interests.
  - Make sure that both the subcontractor and the sub-tier/supplier sign the agreement before you sign.
  - Don't sign a joint check agreement if the third party to the agreement is a lender, factor, or finance company because they are not furnishing any goods and services to the project in question.

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## Subcontract Management (continued)

- Bond Claims/Liens
  - Hold subcontractor payments until they have resolved any downstream bond claims/liens.
- Other required paperwork (i.e., certified payrolls)
- Job closeout documentation (i.e., O&M manuals)
  - Do not release retainage to a subcontractor until you have all of the required documentation because an owner may withhold your final payment and the subcontractor has little incentive to assist you if it has all of its money.

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## Subcontract Management (continued)

- Pay attention to the grapevine. The first hint of trouble will often be a rumor relayed to you from the superintendent or project manager who heard something from a disgruntled employee, union rep, or supplier of a subcontractor.

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## Special Projects Require Special Insurance

- Location
  - Statutory issues
  - Territorial modifications
  - Rail exposures
- Underground vs. Above ground
- Separating yours, theirs, and ours
  - Whose work, property, employee, deductible is it?

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## Wrap-Ups

- The sponsor purchases the coverage for some or all of the contractors at a project
- The sponsor can be the owner or contractor
- May be general liability, workers' compensation, excess, or all three
- Contractor suspends own coverage for the job and relies on the wrap-up
- Sponsor expects a credit for providing the insurance
- Watch for:
  - Off job exposures
  - Restrictive or limited coverage

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## Why Do a Wrap-Up?

- Control Issues
  - Everyone on site has appropriate coverage
  - Consistent limits
  - Consistent program throughout the life of the project
  - Uniform safety
  - Claims handling and management issues
- Cost Issues
  - Lower costs through streamlined claims handling, eliminates contractor vs. contractor issues
  - Economies of scale
  - Better loss experience on wrap-up programs

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## Why To Not Do a Wrap-Up?

- Is there really a savings?
  - Handling change orders
  - Participant deductions
- Can contractors afford to give a credit?
  - Flat rate programs
  - Minimum premiums
  - Reducing premiums on non-wrap-up projects can influence available markets and rating programs

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## Why To Not Do a Wrap Up? (cont.)

- Availability of contractors
  - Some contractors avoid wrap-ups
    - Extra admin. reports
    - Subcontractor hassles
    - Coverage issues
    - Impact on insurance program
- Sponsor administration effort

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## Project Protective Policies—OCP, PMPL, & RRP

- Avoids the risk of not being added to the contractor's CGL as an additional insured
- More coordinated defense to a claim against all insured parties
- Provides separate limits for the project
- Does not include completed operations coverage

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## Owner's & Contractor's Protective Liability Policy (OCP)

- Covers the owner's liability arising out of its general supervision of the contractor's operations
- Covers the general's liability arising out of its general supervision of subcontractor's operations
- Automatically a part of the CGL policy

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## Liability Policies—Contractual Obligations

### Railroad Protective Liability

- A railroad's version of contractual liability
- Bodily injury and property damage liability insurance, covering the railroad's liability to others
- Physical damage to property owned by or leased to the railroad
- Still no contractual coverage
- Should have waiver of subrogation in the contract

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## Project Management Protective Liability Insurance (PMPL)

- A provision in the 1997 edition of the American Institute of Architects (AIA) General Conditions of the Contract for Construction (A201)
- No standard form agreed to by the insurance community
- Gives the owner the option of requiring the contractor to purchase coverage for the owner's, the architect/engineer's, and the general contractor's vicarious liability from the project
  - Protects limits of contractor's insurance
  - Removes losses from the contractor's general liability

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## Additional Insured on CGL vs. Project Protective Policies

- CGL = BI + PD + PI
- CGL shares limits with A/I
- A/I has access to umbrella
- A/I does not have a contractual right to notice of cancellation
- Little, if any, additional cost
- PPP = BI + PD
- PPP new limits
- No excess limits
- Named insured status of PPP policy obligates insurer to provide notice
- Cost paid by owner

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## Design Exposures

- Professional liability
  - Passive loss—the work does not perform as intended or does not meet the expectations of the owner; but, no actual physical injury to the work occurs
  - Active loss—involves actual physical property damage to the work or bodily injury
  - Contingent loss—one party is responsible for the actions of another
- Occurrence vs. Acts, errors, & omissions

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## Professional Liability

- Types of claims
  - Bodily injury
  - Property damage
  - Economic loss
- Exposures to loss
  - Design driven
    - Vicarious or contingent liability from a design subcontractor
    - Liability from a JV partner who is a designer
    - Design performed by the contractor's in-house design professional

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## Professional Liability

- Non-design-driven
  - Construction means and methods
  - Construction management
  - Cost overruns
  - Delays
- Cost overruns and delay hazards result in economic damages. If the alleged cause is negligence in covered professional services, economic damages are typically covered by professional liability policies.

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## Professional Liability

- Coverage options
  - Annual program
  - Project specific
- Coverage triggers
  - Occurrence
  - Claims made

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## Protecting Your Assets—Layers of Protection

- Certificates of insurance
- Additional insured status
- Indemnification provisions in contracts
- Waivers of subrogation

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## Strategy for Protection

- Carefully review contracts before signing.
- Review contract language with legal counsel to determine the extent of hold harmless protection requested.
- Develop a contract review checklist.
- Recognize that different states interpret contracts differently.
- Additional insured wording varies; all versions may not be acceptable.
- Check the insurance section of job contracts for hold harmless provisions and mandated coverages that aren't provided by your policies.

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## Disclaimer

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