WORKSHOP T5

Tuesday, November 8
10:30 a.m.–12:10 p.m.

FUNDAMENTALS OF RISK MANAGEMENT FOR SUBCONTRACTORS

Presented by

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While subcontractors face many risks that are common to the construction industry as a whole, they also have some unique risks and challenges. This session will explore the basic elements of subcontractor risks and provide some practical suggestions and solutions for use in everyday situations. Subcontractors and their insurance partners will gain a better understanding of their unique risks and have a greater ability to develop and implement solutions. General contractors and project owners will also benefit from this session by gaining a better understanding of the impact their decisions and policies can have on subcontractor costs.

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Mr. Dolnick is risk manager for The Brady Companies, a construction and development firm headquartered in La Mesa, California. He has direct responsibility for insurance, claims, litigation, and enterprise risk management activities, and he has general oversight responsibility for occupational safety and health, human resources management, business continuity planning, and crisis management.

Mr. Dolnick has been involved in risk management for nearly 30 years, and prior to that, he held positions in underwriting, loss control, and marketing capacities for several insurance companies. He is active in a variety of professional and industry groups, including the Associated General Contractors of America (AGC) and the Risk and Insurance Management Society (RIMS). He was honored with the Heart of RIMS Award in 1998 and was the 2011 recipient of IRMI’s Words of Wisdom Award. He is also a member of the Society for Human Resources Management (SHRM) and is a professional member of the American Society of Safety Engineers (ASSE).
Notes
The Disclaimers

- The content of this presentation is based on basic risk management practices and principles
- Your Mileage May Vary – each State is different
- You should consult competent legal counsel before implementing any programs discussed here
- I am not a lawyer. Nothing in this presentation is legal advice.
Overview - what this session will cover

- A BASIC overview of Subcontractor Risks and Risk Management in 100 minutes
  - Start with definitions of “Risk” and “Risk Management”
  - Discuss types of risks faced by subcontractors
    - Some solutions and approaches to managing risk
    - A broad, fundamental overview of subcontractor risk management - not a detailed discussion
  - Q&A at the end

Overview - what this session will cover

- Subcontractor Risks and Risk Management
  - Operational Risks
  - Contract and Legal Risks
  - Financial Risks
  - Political/Regulatory Risks
  - Environmental Risks
Overview - what this session will cover

- What you should get from this session:
  - Subcontractors – Review of fundamental risk management practices
  - General Contractors/Construction Managers – Appreciation of the risks your subcontractors face
  - Owners – Overview of what can you reasonably expect Subcontractors to provide
  - Others – Information to help you understand the risks Subcontractors face on their projects

What is “Risk Management”?

- Definitions
  - Risk: the effect of uncertainty on objectives *(ISO 321000)*
  - Risk Management: An organized approach to identifying and impacting risks that affect organizational goals
What is “Risk Management”? 

• Definitions
  ➢ The Risk Management Process
    o Identify and describe the risks, and then:
    o Avoid the risky activities altogether
    o Mitigate or reduce likelihood or the severity of the risk
    o Transfer the risk to others
    o Finance the costs of the risk

What is “Risk Management”? 

• The Risk Management Process
  ➢ Identify your Risks
    o Risk Mapping
    o Surveys and Questionnaires
    o Consultants, Insurance Brokers & Agents, Experts
    o Industry and Trade Associations
      ▪ AGC, BIA, ASA, BOMA, etc.
    o Professional Associations
      ▪ ASSE, RIMS, etc.
What is “Risk Management”?  

The Risk Management Process

- Avoid
  - Know your organization’s appetite for risk
  - What keeps you up at night
  - Balance risk versus reward
    - Never Risk a lot for small gains
  - Keep economies of scale in mind
    - Billion dollar companies have more risks, but also more resources

- Transfer
  - Contractual transfer is most common
    - Indemnity is frequent and visible
    - Many other parts of the contract transfer risk
  - Consider other forms of Risk Transfer
    - Corporate structure & separations
    - Risk silos & Single Purpose Vehicles/Single Purpose Entities
What is “Risk Management”? 

• The Risk Management Process
  ➢ Retain and Manage/Mitigate
    o Safety and Loss prevention programs
      ▪ Public and Employee safety
    o HR and personnel, hiring decisions, etc.
    o Supply Chain management
    o Resiliency, Business Continuity & Crisis/Disaster Preparation
    o Ethics and compliance programs
    o Reputational Risk Management/Public Relations

What is “Risk Management”? 

• The Risk Management Process
  ➢ Finance the Costs of Risk
    o Retain and self-fund the risks
      ▪ Taxation questions
    o Insurance
      ▪ Market questions
      ▪ Retained risk levels (SIR or deductibles)
    o Alternative Risk Financing programs
      ▪ Captives, captive-like programs
What is “Risk Management”? 

The Subcontractor’s unique role 

- **Project Labor** 
  - Self performing GCs have less subcontracting exposures 
  - Subcontractors typically have a better handle on workforce issues in any given craft 
  - Can provides from 5% to 100% of workforce/labor 

- **Project Coordination** 
  - Required to but cannot enforce cooperation from other subs 
  - Cannot enforce other subs to comply with contract
The Subcontractor’s unique role

- Project Financing
  - Payroll costs may precede payment by 60+ days
  - Materials costs may precede payment by 90+ days
  - Lower tier (Sub-subcontracted) costs can precede payment by 90+ days
  - Recourse to Owner or Lender can be limited in some States
  - Recourse to liens or property limited in any public works contracts (Federal, State, Municipality, etc.)

Subcontractor Risks

- Major Areas of Subcontractor Risk
  - Operational Risks
  - Contract and Legal Risks
  - Financial Risks
  - Political/Regulatory Risks
  - Environmental Risks
Subcontractor Operational Risks

- Subcontractor Operational Risks
  - Safety & Accident Prevention
  - Quality Assurance vs. Quality Control
  - Productivity and Schedule Risks
  - Staffing and Labor Risks
  - Supply Chain Risks

Safety

The single most important risk management area

Safety drives contractual risk issues (indemnity, tort law issues etc.)

Safety drives insurance and financial risk issues (cost, availability, retentions, etc.)

Safety drives regulatory and political risk issues (OSHA, MSHA, State plans, etc.)
Subcontractor Operational Risks

• Quality
  ➢ Quality concerns are reaching critical importance
    o Construction defect litigation is growing
    o Customers expect a functional building
    o Reputational risks related to quality are prevalent
  ➢ Quality issues now drive significant insurance costs
  ➢ Quality related claims have long lag times
    o Lag times vary from 2 to 10 years, averaging 4.5 to 7 years

Subcontractor Operational Risks

• Quality
  ➢ Construction Defect litigation is spreading
    o More courts are adopting some coverage for CD
  ➢ The California Model
    o Condos and Common Area developments
  ➢ The Commercial Model
    o Impaired Functional and loss of use/rents
  ➢ Know your ‘Right to Cure’ laws
  ➢ Not every State has one
Subcontractor Operational Risks

• Productivity
  ➢ Overestimated/Under-Yield = ‘bid-bust’
    o Not insurable
    o Typically not a “Risk Management” item
  ➢ Underestimated/Over-Yield = ‘lost opportunity’
    o Not insurable & not usually a Risk Management item
    o Idle workforce can also lead to key employee loss
  ➢ External impacts - delay and disruption
    o Litigation can be costly
    o Schedule driven claims can be complex and difficult

Subcontractor Operational Risks

• Staffing and Labor
  ➢ General skilled/craft labor shortages
    o Many contractors have difficulty finding skilled workers
    o Many also report difficulty finding PM/PE
    o Pew Research reports 10,000 Baby Boomers retire daily
  ➢ General labor shortages
    o Construction not seen as desirable
  ➢ Turnover and training issues
    o Turnover reduces efficiency
    o Turnover impacts safety
Subcontractor Operational Risks

• Staffing and Labor
  - Project Labor Agreements
    - Read the fine print
    - May extend obligations beyond the project
    - Non-participating unions can complicate matters
  - Local hiring requirements
    - Can keep skilled workers OFF jobs
    - Imposed turnover reduces efficiency and safety

• Supply Chain
  - Weather uncertainty can impact long-haul items
  - Owner specified items can be problematic
    - Document all owner-imposed requirements & impacts
  - Complex & long-lead-time items are problematic
  - Single source items leave no flexibility
    - Substitutions can be difficult - read the contract
    - Get ahead of the curve with both supplier and owner
  - Some insurance products may be available
**Subcontractor Contractual Risk**

- **Overview of Contractual Issues**
  - Subcontractors need to look past the "Big Four"
    - Amount, Scope, Start Date & Signature Block
  - Contracts serve multiple purposes
    - Allocate 3 R’s - risk, reward & responsibility
    - Assign authority
    - A combo of premarital, marriage, and divorce agreement

- **Indemnity**
  - Most commonly recognized ‘risk’ in a subcontract
  - Most States have some limits, even if minimal
    - Several States limit or eliminate “Type I” indemnity
  - Provisions are often contested and rarely altered
  - Problematic language includes:
    - “… all risks of loss …” or “… all work covered by …”
    - Indemnification by “…parents, subsidiaries, affiliates…”
    - Losses or claims “…regardless of fault …”
    - “…regardless concurrent or comparative causation …”
Subcontractor Contractual Risk

• Indemnity
  - Some States have little to no limitation
  - Many States have some limits, even if minimal
    - Many States require indemnity to be clear and express
    - The majority of States limit or eliminate some or all parts of “Type I” indemnity in either public contracts or both public and private work
      - Most bar indemnity for sole negligence of indemnified party
      - Some bar indemnity for both sole and concurrent negligence
      - Many States have other unique requirements

Subcontractor Contractual Risk

• Additional Insured (AI)
  - Can be more valuable than indemnity
  - Everyone wants the CG 20 10 11 85 language
    - Almost nobody can get that version any more
  - Over 200 forms used to provide AI
    - Differences in: “... arising out of:
      - “…the insured’s work…” versus
      - “… the insured’s ongoing operations…” versus
      - “… the insured’s negligence …”
Subcontractor Contractual Risk

- Additional Insured (AI) Endorsements Available
  - The Old Gold Standard: CG 20 10 11 85 - covers both ongoing and completed operations
  - Newer CG 20 10 – Ongoing Operations only
  - Newer CG 20 37 - Completed Ops - supplements CG 20 10

Subcontractor Contractual Risk

- Additional Insured (AI) often required to be
  - Primary and noncontributory
    - “… any insurance available to …” is not the same as “… insurance carried by …”
  - Evidenced by a Certificate of Insurance
    - Certificates are only a snapshot in time
    - Certificate is not binding
    - Certificates provide the “… illusion of protection …”
Subcontractor Contractual Risk

• Acceleration for Convenience
  - Can impact other jobs without compensation
    o Certainly impacts manpower
  - Impacts scheduling, affects quality and safety as well
  - Overtime may dramatically impact financial results

Subcontractor Contractual Risk

• No Damages for Delay
  - Often provides that extension of time is only remedy
  - Negates possible impacts from delays, disruptions, poor plans, permit problems, etc.
  - Schedules are rarely mutual
Subcontractor Contractual Risk

- Conditional Payment – Pay *If* Paid
  - State-by-State – not valid in some, perfectly OK in others
    - Shifts much of the burden of financing project to the Sub
    - Owner payment history and credit worthiness are critical but rarely examined
    - Liens *might* be an effective counter – Check your local laws and beware of backlash

Subcontractor Contractual Risk

- Conditional Payment – Pay *When* Paid
  - Can be allowed even where Pay-If-Paid is not
    - Still shifts much of the burden of financing project to the Sub
    - Owner payment history and credit worthiness are just as important as with Pay *if* Paid
    - Liens or Stop Notices *might* be an effective counter
    - Check your local laws and beware of client backlash
Subcontractor Contractual Risk

• Covering the Work of Others
  ➢ Aka “You bury it, you bought it!”
    o Double check “Notice” provisions to make sure any problems are properly and timely noticed to upstream parties

• Coordination with Prior Work/Work of Others
  ➢ Obligations are typically independent
    o Commonly, each sub is 100% responsible for coordinating their work
    o Can be highly problematic on multi-prime & CM Agent type jobs
    o Good schedule management and documentation is critical

Subcontractor Contractual Risk

• Force Majeure
  ➢ Not a ‘Get Out Of Jail Free’ Card
  ➢ Generally does not apply to labor disputes
  ➢ Probably won’t apply to supply chain disruptions absent a widespread acute problem
  ➢ Can be highly limited in scope and applicability
  ➢ Generally will not apply to consequential or incidental damages
Subcontractor Contractual Risk

• Differing Site Conditions
  ➢ Can shift SOME risk to Owner for SOME risks
    o Generally requires Owner to have sole responsibility
  ➢ Be familiar with the Spearin Doctrine and its limitations
  ➢ Can be problematic in a design-build contract
  ➢ Can be problematic in IFOA, IPD or IPD-esque
  ➢ Can be problematic with Lean Project Delivery principles

Subcontractor Contractual Risk

• Incorporation by Reference
  ➢ Expands the ‘four corners’ of your contract
  ➢ Read and understand upstream contracts

• Flow Down
  ➢ Can your lower (downstream) subs really comply?
  ➢ Their failure to comply expands your risk
    o How small is small enough not to matter?
    o Is there really such a thing as a minor disaster?
Subcontractor Contractual Risk

• Substitution of Materials
  ➢ Often restricted in the Contract once submittals have been approved
  ➢ Can limit ability to complete work if supply issues arise
  ➢ Some pre-selects alternatives can be proposed in advance
  ➢ Document ‘imposed materials choices’ carefully!

Subcontractor Contractual Risk

• Dispute Resolution
  ➢ Mediation can be valuable
    o Value depends on the parties willingness to settle or compromise
  ➢ Arbitration is sometimes cheaper than litigation
    o Value depends on the skill of the arbitrator
  ➢ Litigation
    o Bench (non-jury) trial are more efficient
    o Juries can be helpful or painful
Subcontractor Contractual Risk

• Choice of Laws/Choice of Venue/Forum
  - Generally upheld
    - If you and the project are in Oregon, do you really want to go to trial in Georgia?
  - Some jurisdictions may not allow choice of venue for various reasons (Statute or Case Law exceptions are rare)
    - No substantial relationship to the chosen venue
    - Applying the choice would violate some public policy of the State.

Subcontractor Contractual Risk

• Notice Provisions
  - One of the most critical areas to understand
  - Almost all jurisdictions uphold contractual notice requirements
  - Breach of notice is generally a waiver of your rights
    - Can bar claims for damage
    - Can bar extensions of time
    - Can preclude payment for extra work
Sub-Subcontracting

• Direct Control versus Risk Transfer
  ➢ Advantages
    o Spreads risk
    o Greater specialization = better skill/performance
    o Can reduce costs
  ➢ Cautions
    o Smaller divisions of labor ≠ greater efficiency
    o Less capacity for Risk
    o Outsized impact of flow down provisions
    o Impact on insurance requirements

Subcontractor Financial Risks

• A Sub’s Credit Risks – Owner
  ➢ Lender restrictions/3rd party fund control
  ➢ Project funding adequacy
  ➢ Multi Prime delivery model – benefits and problems

• A Sub’s Credit Risks – GC
  ➢ Payment history with subcontractors
  ➢ Cooperative versus adversarial approaches
  ➢ Historic responses to liens or stop-notices
Subcontractor Financial Risks

- Payment and cash flow
  - Project funding adequacy
  - Lender restrictions/3rd party fund control
  - Multi Prime delivery model – benefits and problems
    - Greater collaboration with other subs
    - Less control over coordination
    - Potential clash of installations, schedules, etc.

Subcontractor Financial Risks

- Insurance Risks
  - Market Pricing fluctuations
    - Carriers abhor uncertainty
    - For an underwriter, the safe answer is always “No”
    - Some predictable losses can be better than zero losses
  - Participate in the process
    - Meet your underwriter
    - Know your story and tell it well
Subcontractor Insurance

• Insurance Risks
  ➢ Policy Structure - Retentions
    o Skin in the game can be good for both you and the insurer
    o Two primary mechanisms in GL - Deductible or SIR
      ▪ Self Insured Retentions are an uninsured layer
      ▪ Deductibles are billed by the carrier after loss payments are made
    o In Workers’ Comp use retrospectively rated policies
    o Some States allow Work Comp deductible programs

Subcontractor Insurance

• Policy Structure - Retentions
  ➢ Deductible
    o Carrier manages the process
    o Carrier calculates the amount due
      ▪ Can be tied to incurred or to paid losses
    o Collateral required
      ▪ Ties up bonding/credit capacity or cash
    o Deductibles are easier to manage for smaller contractors
    o Some carriers prefer deductibles
Subcontractor Insurance

• Policy Structure - Retentions
  ➢ Self Insured Retention (SIR)
    o Insured manages the process
    o No coverage until satisfied
    o No collateral required
    o How much depends on liquid assets and cash flows
    o Avoids trading $ with the carrier on small claims
    o Allows early and knowledgeable intervention in claims
    o Notice and reporting are key
    o Carriers greater risk for the subcontractor

Subcontractor Insurance

• Insurance Risks
  ➢ Broker/Agent skills
    o Exposure, coverage & risk management
    o Premiums, credits and payment
    o Claim and loss handling
    o Insist on competent adjusters/examiners
      ▪ Bring in the experts if unsure or confused
    o Policy verification and retention
    o Broker ‘shopping’ indicates price driven buying
    o Relationships do matter
Subcontractor Financial Risks

• Insurance Risks
  ➢ OCIP/CCIPs (Wrap-Up programs)
    o Know what is covered and what isn't and at what price
    o Policy documentation may be scanty
    o Credits calculations can be obscure
      ▪ Forced credits for fixed price policies can be difficult
      ▪ Some credits calculations are adverse to subs?
      ▪ May need to adjust bid to reflect true costs of CIP
    o Removes premiums from your market - reduces clout
    o Claims handling is at risk of & controlled by others

Subcontractor Financial Risks

• Insurance Risks
  ➢ OCIP/CCIPs
    o Know your ‘cost of risk’ or your ‘cost if insurance’
    o The CIP broker does NOT work for YOU
      ▪ They may not owe you any duty of care
    o Wrap-Ups are now an industry of their own
    o You can often negotiate on CIP costs and terms
    o Contractor Controlled Programs tend to be more flexible
    o One-off Owner Controlled Programs can be challenging
      ▪ Often sold on the basis of recouping construction costs
Subcontractor Financial Risks

• Insurance Risks
  ➢ Builders Risk assessment - who carries & ?
    o Watch out for subcontractor obligations to carry Builder’s Risk/Installation Floater (common on multi-prime projects)
    o Get a copy of the policy. Read it!
    o Make sure YOU (Subs) are named as insured
    o Understand back charges & deductibles for claims
    o Understand the exclusions
    o Know if your blanket Installation Floater will be excess

• Insurance Risks
  ➢ Certificates & Additional Insured Endorsements
  ➢ Remember - Certificates are not binding documents
  ➢ Certificates provide a (required) illusion of protection
    o Incoming –
      ▪ Are they adequate and how do you know?
      ▪ Should mirror upstream obligations to maximum possible extent
    o Outgoing
      ▪ Are they timely and complete?
Political and Regulatory Risks

• Statutory & Case Law
  ➢ Employment law
    o Protected class expansions
    o Wage and Hour litigation
      ▪ Classification (Independent Contractor versus Employee)
      ▪ Overtime & Exempt versus non-exempt
      ▪ Meal & rest breaks
    o Anti-harassment and anti-bullying statues
    o Gender and related accommodation statutes

Political and Regulatory Risks

• Statutory & Case Law
  ➢ Lien Laws
    o Documentation and filing requirements
    o Notice and service requirements
    o Parallel mechanisms for public works
    o Timing and precision are essential
  ➢ Indemnity and Contract Law
    o Anti Indemnity Statutes
    o Owner and GC reactions
Political and Regulatory Risks

- Regulatory/Administrative Law Risks
  - Public Works Projects
    - Certified Payroll – complexity is a problem
    - Non-Discrimination & Affirmative Action
      - HUB Zone
      - MBE/DBE/WBE
      - VEVRAA
    - Local Resident Hiring Requirements
    - OFCCP & similar State agencies
    - False Claims Act & Parallel State regulations
  - OSHA and Safety
    - Silica
    - Electronic Reporting
      - Impact on Drug Testing
      - Impact on Incentive Programs
    - Repeat Violation window (2012)
    - Whistleblower laws are enforced by OSHA
  - Fair Pay and Safe Workplaces - Executive Order 13673
    - “Blacklisting” Rule
Environmental Risks

- Types of Environmental Risks
  - Endemic environmental risks
    o NOA, Valley Fever, etc
  - Spill, Leak or Discharge to ground or water
    o Storm water, wash-down/wash-off
    o Fuels, chemicals, etc.
  - Airborne discharge
    o VOCs, Coatings, Silica, mold, etc.
  - Demolition and remodel work are highly problematic

Questions?