

RISK MANAGEMENT IN CONSTRUCTION

Does your Contractor Have the Coverage You Need?

Commercial construction projects involve a complex set of risks for businessowners, developers, design firms, contractors, and banks and financial institutions that provide funding.

From concept to the final build-out and beyond, each participant must navigate issues that range from pollution at the project site to design errors that manifest during construction or years after a project is completed. And because of the dangers inherent in construction, job-site safety and accident prevention are critical concerns.

Business owners may protect themselves from some aspects of construction risk by assigning that risk contractually to architects, engineers and construction contractors, described in indemnification agreements and funded by minimum insurance requirements.

Owners may also take a proactive role in construction risk management and safety. These efforts generally may not increase an owner's risk unless the owner inadvertently directs means and methods on the site, a mistake that can be avoided.

The most common construction risks include design error, faulty workmanship, natural hazards, release or spread of pollutants, unsafe acts or conditions, unavailability of qualified labor, loss of capital or funding, contractor or subcontractor default, unavailability of materials or equipment and inaccessibility to the site.

These exposures can result in third-party injury and property damage, worker injuries, damage to surrounding buildings, physical damage to the work, project shutdown, failure to perform to specifications, government fines and mandated actions, remedial design or construction, cost overruns, delays and mold-related problems.

Architects, engineers and construction contractors typically buy the insurance coverage and limits they feel address their exposures and meet insurance requirements and indemnification provisions of their construction contracts.

While having carefully worded contract language and reviewing insurance certificates may give project owners some sense of security, the fact that the commercial insurance market is cyclical may lead to wide variances in the quality and limits of coverage available at any given point in time.

Even when insurance is readily available, most company-specific policies are subject to renewal, cancellation, or aggregate limits of liability that may be exhausted by claims from other projects.

In this case, when the insurance buyer is a design firm or contractor working on a job site, the resulting inadequate coverage ultimately could lead to serious exposures for the insured firms as well as for the business owner undertaking the construction.

To address this potential risk many owners purchase project-specific insurance, which provides dedicated limits and coverage for the scope and term of the project and often survives the dissolution of any participating firm.

Policies may be purchased individually for one project, or to provide coverage for a schedule of projects designed by various architects and constructed by various construction managers.

Here are some of the most popular project-specific coverages:

- Professional liability--protects against claims arising out of the services of design firms, environmental, construction management, and other technical professionals. Specific insurance policies may be purchased for all design firms on an individual project or just to protect site owners from potential exposures if coverage carried by design or construction management firms proves to be inadequate.
- Environmental liability--a variety of insurance policies are available to protect site owners against known and unknown contaminants at the site, as well as the accidental release of pollutants brought onto the site by contractors or removed by waste haulers. The use of these coverages is widespread, and businesses building on or near former industrial sites, or "brownfields," have found these coverages particularly useful to protect themselves from potential exposures as well as to help secure financing for their projects.
- Builders' risk--protects owners and contractors in the event of direct physical loss of, or damage to, the project, including building materials while in transit, awaiting installation, or being installed. These policies can be extended to cover consequential financial losses arising from a delay in completion of the project and expediting expenses to avoid that delay--provided, of course, the delay results from physical damage to the structure caused by an insured peril. This coverage is critical to organizations that face expenses such as debt service or the cost of leasing alternate facilities because of a delay in project completion.
- Controlled insurance programs, or "wrap-ups"--a single insurance program that covers the job-site risks of the owner, construction manager, general contractor and subcontractors. This popular approach can be used for handling exposures related to single- and multiple-site construction activities. The program sponsor procures certain insurance coverage--typically workers' compensation, general liability, and excess liability insurance--on behalf of some or all parties working at the job site, rather than having each firm provide its own insurance.

Wrap-ups do not shift the chain of liability. Negligent parties are still responsible for their own actions. The only difference between a wrap-up and other insurance arrangements is that a single entity--usually the owner or general contractor--buys insurance policies that will respond to most claims.

The advantages of a wrap-up include potential coverage enhancements, control over the program structure and handling of claims, potential public relations benefits as smaller and minority contractors may be able to bid on contracts where insurance procurement may represent an obstacle, and potential cost savings gained by assuming and managing risk through a consolidated, high-deductible insurance program.

The overall design of an insurance program for a construction project and the limits purchased depend on several factors, including the type and scope of the project, its location, the owner's desire and ability to oversee the insurance program, its appetite for risk, among several other factors.

A firm's financial executives should involve risk management and insurance professionals early in the planning stage of their project so that an optimal risk management and insurance program can be designed and implemented on a cost-effective basis.

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