

Perspectives

Disjointed contractual terms and insurance provisions in construction contracts can be confusing. What can building owners and contractors do to mitigate the potential for gaps in a project's insurance coverage when problems occur? Cynthia Pertile Tarle of Tarle Law P.C. and Lori Robinett of Willis North America Inc. outline how to build a partnership, connect the dots and pay attention to all the details.

Drawing up an insurance plan helps prevent coverage gaps

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What can happen when your construction contract has seemingly gone wild, and how do you guard against the potential for resulting gaps in your insurance coverage when disjointed contractual terms and insurance provisions are looming?

Poor planning of the insurance program can be financially devastating to a project. What may seem unimportant to the construction team today can destroy profit margins tomorrow. Whether your perspective is as the owner or as a contractor (regardless of tier), several significant steps can be followed to protect your company:

1. Build a partnership between the construction team and the insurance team. This team approach can accomplish the goal of ensuring the proper scope of coverages under the contract.
2. Connect the dots throughout your contractual terms and provisions. This will make the difference between a successful insurance program and one that may ultimately be disjointed and ineffective.
3. Pay attention to details. The modification of individual words in your contract language and insurance requirements can make a major difference in whether your project has coverage when a claim arises.

The partnership

Development of the insurance program is frequently left as an afterthought to the construction aspects of a project. Insurance teams are often not even consulted until the end of contract negotiations. As a result, contractual insurance requirements may fail to appropriately address the full range of risks associated with the project, and gaps in insurance coverage are created — or worse, a denial of insurance benefits occurs — when coverage requirements, risk of loss, and indemnity provisions are not properly integrated.

Proactive communication is key to avoiding this pitfall, and the sooner the construction team and the insurance team start communicating what type of insurance program the project will be operating under, the more benefits the project will reap.

It's critical for the risk manager and the construction manager to take a team approach and bring the right team to the table for the negotiations. In assembling the team, you may consider retaining outside counsel in order to provide specialized legal advice and negotiation skills, which your in-house counsel may not be equipped to offer.

Moreover, be sure to communicate with your broker early and often in assessing whether the insurance coverage being requested, including any specific endorsement language, is available in the marketplace and economically realistic.

Correctly identifying the team players and evaluating the insurance program options before contract negotiations commence will result in smoother, faster, and more productive negotiations between the parties; will increase leverage when negotiating with underwriters regarding specific language in the policy and endorsements; will likely result in reduced premiums; and will substantially increase the ability to have and maintain seamless and contractually compliant coverage, translating into higher overall profit margins for the project.

Connecting the dots

Once the appropriate parties are involved in the negotiation process, focus collective efforts on understanding your options associated with structuring the insurance program. This includes an analysis of procurement options under a conventional insurance approach or a project specific program. When evaluating your options, consider the perspective of each of the stakeholders. For example, a controlled insurance program, or CIP, can have a financial effect that will differ depending upon who sponsors the program (i.e., owner



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versus general contractor). If contemplating a CIP, it is ideal to address this before negotiations of the contract even begin; however, should circumstances delay a final decision, be sure to specifically set forth in the contract terms a provision which will allow such an option to remain on the table. Credit validation under a CIP will vary between net bid and gross bid, so understand the difference and how this can affect the bid and management of a CIP. Consider the experience level of the parties involved, including the type of safety program which may be employed by the contractor and make sure this is in alignment with what the insurer will require and will sometimes make a condition of coverage. Safety programs can significantly affect how smoothly the project runs and how the claims process is handled.

Additional factors to consider when contemplating a CIP approach include coverage certainty and the size of the budget, as large budget projects are more likely to benefit financially. The number of direct contracts to the owner; disadvantaged business participation; complexity and flow of the indemnity and risk of loss provisions all may lend the project to benefit more from one insurance program over the other.

Pay attention to details

Consider the potential effect of the selected insurance program on issues such as aggregate limits and catastrophic loss; deductibles and self-insured retentions; and scope of coverage. Regardless of the program implemented, policy exclusions are always of utmost concern.

For project-specific insurance programs, or CIPs, carefully craft the scope of eligible and excluded contractor definitions and pay special attention to how named insured and project site are identified. Failure to properly define project site, for example, can result under certain endorsements in the exclusion of coverage for loss of use related to existing structures under renovation that are not in the care, custody, and control of the insured. Be on the lookout for insurers who may opt to tie the administration of the CIP as a condition of coverage, in which the policy is at risk of cancellation if requirements, such as timing of enrollment, are not adhered to.

With regard to conventional policies, wording associated with “your work” and wrap-up exclusions should be reviewed closely in order to prevent unintended denials of coverage. Removal of the

subcontractor exception to the “your work” exclusion can result in lack of coverage for a general contractor who might otherwise have such coverage if the policy wording had been modified up front.

Establishing the insurance requirements alone is not enough. Marrying how and when risk is transferred with contractual insurance coverage requirements is essential. Ask questions such as: Is risk of loss transferred upon a certain trigger — for example, delivery to site, in relation to the cost to repair and replace damage? Consider whether risk of loss/indemnity limits are tied to insurance proceeds under the contract. Does the contract address different risk of loss limits for nonconforming or defective work vs. damage to “your work” in an attempt to address certain policy exclusions? If so, evaluate the aggregate and occurrence limits being contractually required in order to assess whether they will be sufficient, as well as the application of deductibles or self-insured retentions.

Of course, with regard to indemnity provisions, be sure that scope of defense, indemnity and hold-harmless language intersects with the scope of insurance coverage required. Be aware of how the contract defines significant terms and consider the differences in contract interpretation and the potential effect of case law regarding language such as “due to,” “arising out of” or “resulting from” vs. “to the extent of” your negligence when defining “losses arising from.”

Be aware of how the contract defines significant terms, and consider the differences regarding language in contract interpretation and potential effects of case law.

If the indemnity language of the contract contemplates defense and indemnity under a completed operations scenario, be sure to implement the correct additional insured endorsement requirements. And be very cautious regarding the use of “or equivalent to” language, especially in light of the vast number of manuscripted endorsements. Consider, instead, identifying not only the exact ISO endorsement form required, but also the coverage expected, with an eye toward an understanding of what is available in the marketplace.

Don't overlook issues such as jurisdiction during negotiations, as trigger of coverage and policy interpretation can vary widely. Establishing jurisdiction where corporate headquarters reside and for the location of the project may make the difference in litigation between a favorable coverage ruling for the insurer versus the insured.

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