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Risk management and loss control solutions for today's businesses.

Contractual Risk Transfer Techniques for Contractors

INSIDE THIS ISSUE

On today's construction sites, one contractor often asks another on the site for help, people or equipment to complete a job. While it's easy to agree to these requests, such informal agreements can lead to liability issues if something goes wrong. This issue provides useful tips to help you identify risks on the job site and effectively transfer them in order to reduce your contracting company's liability exposure.

It's common for contractors to share a worksite without sharing work. They operate independently, using different resources, personnel and equipment. However, every so often, one contractor will ask another on the site for help, people or equipment to complete a job. While it's easy to agree to these requests, such informal agreements can lead to liability issues if something goes wrong, something gets damaged or someone gets hurt.

THE PROBLEM

As a contractor, you know it is common practice to ask construction companies at all levels of a given project to take on more responsibility and risk from the tiers above them – be it the actual scope of the work, the obligation to defend when claims arise, or the financial responsibility to pay for such claims.

Your risks and responsibilities as a contractor are more challenging today than ever. That's why it's important to anticipate and plan for these possibilities when negotiating and drafting contracts. There are steps you can take to reduce, limit or transfer the responsibility to others.

THE SOLUTION

Contractual Risk Transfer: What You Need To Know

A combination of contractual risk transfer techniques can limit, reduce or eliminate the responsibilities and liabilities that your contracting firm may face in the event of a loss.

The best way to limit or transfer liability – as well as obligations to indemnify and to defend in the event of a claim – is to address them in writing in a contractual risk transfer to someone else. This type of risk transfer needs to be clearly outlined in all contracts and other project documents. No matter where you find yourself in the chain of a project – general contractor or subcontractor – whenever possible, negotiate and draft contracts that best protect your situation.

Considerations to keep in mind during the contractual risk transfer process:

- **Consistency.** Ensure that the language in any hold harmless, indemnification and additional insured agreements that you sign is passed down in contracts you have with lower tier subs and that the same exposures are covered.
- **Purchase orders.** The integrity of the contract documents signed by upper management need to be maintained at the field level. Educate field staff to review purchase orders carefully for language that may alter the existing agreements.
- **Jurisdiction.** Know the laws, statutes and regulations for contractors in the state in which the work will actually be done. Hold harmless and indemnification language should be tailored based on how that state's courts are likely to interpret and enforce it. Review the state statutes and consider whether they're compatible with the language used in your contract. Some states may limit or void your contract language.
- **Statutes of limitations and repose.** Be familiar with these and how they impact your liability exposure. The statute of limitations sets a limit on the time during which a claim can be

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filed after the injury or damage is discovered. The statute of repose sets a date by which a claim can be filed, regardless of when the injury or damage occurred.

- **Responsibility to defend and pay for damages.** Ensure that indemnity provisions limit or eliminate your responsibility to defend and pay for damages that arise out of a third party not conforming to OSHA standards. Language to that effect has been upheld in court when a third party created an exposure that resulted in an OSHA violation.

FYI

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Determining What Responsibilities Need To Be Transferred

Transfer language needs to be addressed during the project's contract development and negotiation phase. The transfer language should address responsibility for:

- **Your liability for damages and/or judgments arising out of claims**
- **Your duty to defend** (cost of litigation must be a separate provision in contract)

*** Your duty to insure** (certificates of insurance, named additional insured endorsements)

Indemnification clauses transfer all or part of the responsibility of paying for claims. Each form has a different meaning. If you are not careful, you may take on more responsibility than intended. Read and interpret the language carefully.

Types of indemnification clauses that you should be familiar with include:

- **Broad form clause.** This transfers all liability to you regardless of negligence, even if the other party is solely negligent. (Try to avoid signing this type of agreement. Likewise, try to avoid asking lower tiers to sign such an agreement.)
- **Intermediate form clause.** This transfers liability, except when the other party is solely negligent. As long as both parties contribute to the negligence, it does not matter what percentage of the negligence is assessed to each party. You would have the duty to indemnify (or pay) the whole amount, even if you were responsible for a minority share of the negligence. This is the most commonly used indemnification clause.
- **Limited form.** This transfers liability to you only for your own negligence and for the circumstances over which you exercise control. This is the clause you want to use whenever possible, but it can be very difficult to obtain.

Indemnification agreements should clearly address:

- **The scope of the agreement's coverage** (Does the agreement cover lunch breaks, change orders, completed operations, construction and/or architectural work or defective work claims?)
- **Parties covered by the agreement**
- **The period of time the agreement remains in effect**
- **The jurisdiction that applies**

It is important to note that indemnification does not include the duty to defend. If you want the other party to defend you from claims, the language must be included as a separate provision.

It is also important to note that indemnification agreements incorporated by reference into subcontractor agreements can lead to problems for the general contractors in the courts. Incorporating documents by reference allows the parties to refer to other documents pertinent to the agreement, such as contract drawings, city codes and other massive documents, without having to put them into the actual agreement. However, the courts are afraid that subcontractors will sign such documents and agreements without realizing their full obligations. The courts want indemnification language clearly written in the documents that subcontractors sign.

Additional Insured Endorsements

Additional insured endorsements add other parties as insureds under your general liability policy. However, coverage is limited to liability arising out of the named insured's work for the additional insured.

Considerations to keep in mind when using additional insured endorsements:

- **Be certain that additional insured endorsements you obtain cover completed operations.** They should be in effect for the duration of your responsibility for those completed operations.
- **A company that wants to amend its insurance policy to provide additional insured status to you must provide you with the actual endorsement.** A certificate of insurance will not amend their policy to include you.
- **Clearly state in contract language that your policy provides "excess" coverage and that the other party's coverage is "primary."** This will eliminate any confusion in the event of a claim.

Completed Operations Risks

Completed operations exposures in construction are hard to define because of the fluidity of a construction project. Some phases of the job are completed before others, and project durations vary from days to years. Before signing any contract with completed operations language in it, be sure you understand your responsibilities with respect to:

- **Warranties.** These are the most obvious completed operations obligations and the biggest source of unfunded costs, since most contractors do not budget for warranty work. It is imperative that, during the negotiation stages, warranty work is planned for and addressed in the contract.
- **Unsatisfactory work.** Be certain that the contract requires the upper tier contractor to provide written notice to you regarding issues of unsatisfactory work. The contract should state that you have a right to fix or repair the work. The contract also should say that if the upper tier contractor fails to notify you and give you the opportunity to fix a problem, they waive the right to require correction as well as the right to claim breach of warranty.
- **Higher level of warranty.** Ensure that the contract language does not make you responsible for a higher level of warranty than what is the standard in the jurisdiction where you will work.
- **Avoid warranting other's work.** Ensure that the contract language does not hold you responsible for warranting the end result. This language would hold you responsible if the construction did not provide the owner with the desired results – even if you followed job specifications exactly. This is a design issue rather than a construction issue.

Builders Risk Strategies

Builders risk insurance can provide coverage for materials, equipment and supplies before and during the work activity – whether on site, in transit or in storage. Owners or general contractors usually buy a policy covering the entire job. However, it is important that each lower-tier contractor evaluate the policy and, if necessary, purchase additional coverage to close the gaps they detect. You are responsible for avoiding or mitigating damages, protecting the property during construction and preventing further damage after a loss.

Considerations to keep in mind while evaluating builders risk policies:

- **Know what type of damage the policy covers** (windstorms, floods, pollution, wear and tear, dishonesty, etc.)

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Inside This Issue

Learn techniques to help your contracting company transfer risk and reduce its liability.
Details inside…

AIG Programs manages products and services offered through member companies of American International Group, Inc. (AIG), the leading U.S.-based international insurance organization. AIG Programs draws on AIG's superior financial strength to provide what we believe is the most dependable commercial and industrial insurance coverages and services available. AIG Programs is committed to providing quality risk management and consulting products. ***AIG Programs Business Solutions*** is a publication provided as a service to AIG Programs insureds and their insurance agents/brokers.

Contractual Risk Transfer Techniques for Contractors, continued

- **Be sure that the limits on full replacement costs increase as the job progresses** (obtaining an "open" policy will automatically achieve this)
- **Be clear on who is covered** (subcontractors, material suppliers, design professionals, etc.)
- **Know what is covered** (installed equipment, landscaping, temporary work such as scaffolding, forms, false work and temporary structures, etc.)
- **Understand where property is covered** (onsite only, in transit, temporary offsite storage locations, at manufacturer's facility, etc.)
- **Know when property is covered** (from date first fabricated through storage, etc.)
- **Know what is excluded** (defective workmanship, failure to perform work on schedule, etc.)

CONCLUSION

At the end of the day, your construction contracts and documents are what attorneys and courts will use to resolve a claim or lawsuit. These documents legally bind the parties involved. It is imperative that you consider all of the items presented in this issue before negotiations begin so that you get the contract that best protects you. Compromise will be necessary. Don't blindly accept language that holds your company responsible for things you never intended. Following the provisions outlined in this publication will be your best defense when a claim arises.