



Construction Industry Update

MSP PL -11/2009 "Contractual Risk Transfer"

November, 2009

Construction Industry Update Newsletter © 2009 Cavignac & Associates — All Rights Reserved

Contractual Risk Transfer

By Jeffrey W. Cavignac, CPCU, ARM, RPLU, CRIS
President, Cavignac & Associates

© 2009 Cavignac & Associates—All Rights Reserved

The purpose of a contract is to establish who is supposed to do what, and what happens if they don't.

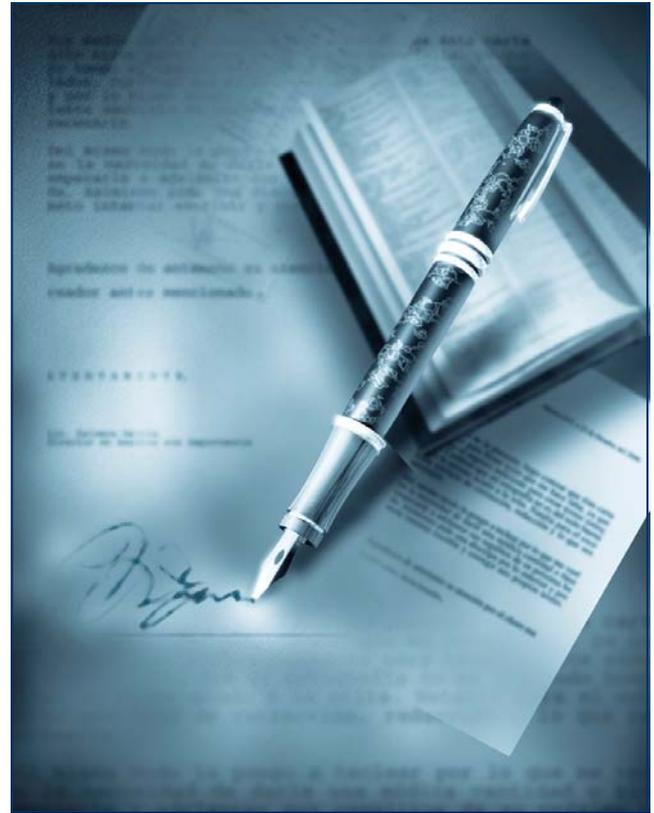
A significant portion of every contract is devoted to what is called "Contractual Risk Transfer", "Contractual Risk Transfer" refers to risk that is allocated among the parties to the contract. In a perfect world, risk is shifted to the party who is best able to control it. In the real world, however, risk is usually transferred from the party with the most leverage to the party with the least.

As risk managers and insurance brokers, we review contracts for our clients from a risk management and insurance perspective. Our reviews are not a substitute for a legal review, and the importance of a decent contract attorney cannot be underestimated. Our comments also reflect our opinion that contracts should be equitable for all parties. In simple terms, all parties should be responsible for their own negligence.

Construction companies enter into contracts on a regular basis. It is critical to understand what risk you are attempting to transfer and what risk you are being asked to assume. While it would be impossible to address every contractual risk transfer provision that you might see, what follows is a discussion of the major issues you are likely to deal with.

Indemnification

Indemnification is defined as "compensation for actual loss or damage." Under common law, one is responsible for indemnifying another party for the consequences of one's negligent acts. Contractually, however, indemnification can be broadened.



There are three basic types of indemnities. From an insurance perspective, we typically break indemnities down into limited form, intermediate form, and broad form.

Contractual Risk Transfer (continued on page 2)

In this issue...

Contractual Risk Transfer	1-5
2009 Risk Management Seminar Series	2
ALERT! Employers with 15 or More Employees	6
Live Well, Work Well	6
Community Bulletin Board	7

1. Limited Form Indemnity

A limited form indemnity merely states that the indemnitor will hold harmless and indemnify the indemnitee for the consequences of the indemnitor's negligence. This is insurable under most professional liability and general liability policies and is legal in California.

2. Intermediate Form Indemnity –

An intermediate form indemnity requires the indemnitor to hold harmless and indemnify the indemnitee for anything and everything except the indemnitee's sole negligence. This is legal in California, and is insurable under most commercial general liability policies. Responsibility for the indemnitee's negligence is uninsurable under most professional liability policies.

3. Broad Form Indemnity

A broad form indemnity requires the indemnitor to hold harmless and indemnify the indemnitee for anything and everything, including the indemnitee's sole negligence. This may be covered under a commercial general liability policy, but this type of indemnity is illegal in California.

The legal profession breaks down indemnities in a different fashion: Type 1, Type 2, and Type 3.

Type 1 Indemnity

The classic Type 1 indemnity clause involves the indemnitee receiving defense, indemnity and a hold harmless agreement from the indemnitor for any claim, loss or other liability that arises from the work or services of the indemnitor, except that the indemnification does not apply with respect to the sole negligence or willful misconduct of the indemnitee. This is analogous to an Intermediate Form indemnity.

Type 2 Indemnity

A Type 2 indemnity is similar to a Type 1 indemnity except that it does not pertain to the active negligence of the indemnitee. In other words, a Type 2 indemnity would require the indemnitor to be responsible for the passive negligence of the indemnitee.



2009 Risk Management Series

- Sexual Harassment Prevention Training

- * Satisfies AB1825 requirements

- Friday, December 4, 2009

- Registration: 8:00 am

- Program: 8:30 am - 10:30 am

- * **NOTE:** This will be our **final Sexual Harassment Prevention Training seminar in 2009**. If you have staff members that must complete this course in 2009, be sure to reserve seats early!

- All training sessions available to our clients

- * Reserve early / seating is limited!

Register for upcoming seminars

Contact **Darcee Nichols** at dnichols@cavignac.com or call **619-744-0596**

- * **NOTE:** Due to the popularity of our seminars and limited space available, we regret we cannot provide refunds or credits with less than **72 hours advance notice of cancellation**.

Although this is insurable under a commercial general liability insurance policy, it is uninsurable under a professional liability policy. If the indemnitees are negligent (whether active or passive), they should be responsible. The contractual coverage under a professional liability policy will not extend to the indemnitee's negligence.

Type 3 Indemnity

A Type 3 indemnity is similar to the limited form indemnity, and is really no more than the basic statement of comparative fault in contractual form. The indemnitor agrees to indemnify the indemnitee for all losses caused by the indemnitor's negligent acts, errors or omissions. This is insurable under a commercial general liability policy as well as a professional liability policy.

Before agreeing to an indemnification agreement, you need to understand exactly what risk is being transferred and whether or not you are in a position to assume the risk. You also need to take into consideration any state laws that might affect the risk transfer.

For example, in California it is illegal to transfer the consequences of your sole negligence. It is, however,

Published by

Cavignac & Associates

INSURANCE BROKERS

License No. OA99520

450 B Street, Suite 1800
San Diego, CA 92101-8005

✦ Phone 619-234-6848

✦ Fax 619-234-8601

✦ Web Site www.cavignac.com

Definition of "Contract"

A piece of paper that marries two business parties together by explicitly anticipating every eventuality of their divorce.

Contractual Risk Transfer (continued from page 2)

legal to transfer the consequences of your concurrent or contributory negligence.

Assuming you are the party being asked to indemnify another, you need to determine if you can insure it. Under most commercial general liability policies, broad-form contractual liability is included. This allows you to assume the "tort liability" of a third party.

In other words, if you agree to be responsible for the concurrent negligence of another, your commercial general liability policy would respond – assuming, of course, that the loss in question is covered by the policy.

On the other hand, most professional liability policies only include limited-form contractual liability. They allow the insured to hold harmless and indemnify a third party from the consequences of their own negligence.

However, if the insured agrees to be responsible for a third party's negligence, it would not be insurable. In other words, if the *insureds* make a mistake they have coverage, but if they agree to be responsible for *another's* mistake, that would not be covered.

Indemnities are one of the most crucial elements in any contract. Whether you are the indemnitee or the indemnitor, you need solid advice from a knowledgeable attorney and insurance broker to understand the legal and risk management implications.

Insurance Provisions

Almost all contracts contain some sort of insurance requirements. It is important that these be reviewed to make certain you are not in breach of contract before the project even starts. In some cases, insurance requirements might necessitate purchasing additional coverage that could have a significant cost. In other situations, coverage may not be available at all. These issues should be clarified *before* the contract is signed.

Some of the more common insurance requirements you will see include the following:

1. Commercial General Liability (CGL)

Commercial general liability covers you for legal liability arising from your business operations that results in either bodily injury or property damage. It also covers the liability of others assumed under a contract. The minimum CGL limit required in many contracts is \$1 million, although higher limits are becoming more common.

Since CGL policies are written with aggregate limits of liability, it is not unusual to see a requirement that the general aggregate limit be

endorsed to apply to each project. This endorsement is not difficult to get, and is fairly inexpensive, but it does need to be added to your policy.

You will often be asked to make your policy primary to the other party's insurance. You should verify that this is automatically included in your policy. If it isn't, the policy will require a separate endorsement.

Finally, naming the other party as an additional insured under your policy is a common requirement. Quite often a specific additional insured endorsement form will be specified, so you need to make certain your insurance company can provide that endorsement.

2. Business Automobile Liability



Business automobile liability protects against liability arising from owned, non-owned, and hired cars used in your business. If a company owns vehicles, this coverage

is mandatory. Even if a company does not have any owned vehicles, it should carry non-owned automobile and hired car liability coverage.

You will often be asked to provide additional insured status on your business automobile liability policy as well. Since a business automobile liability policy automatically extends coverage to "*anyone liable for the conduct of a covered auto*," an additional insured endorsement technically may not be required. Nevertheless, some of your clients may still insist on an actual endorsement, and most insurance companies can provide them.

3. Workers Compensation



Workers compensation covers your employees for work-related injuries. This coverage is required by law and is written on a standard policy form. In addition to evidence of workers compensation insurance,

many of your clients will require that you agree to waive your rights of subrogation against them. Although some companies can provide this on a blanket basis, most require a specific endorsement, and there is typically a modest additional premium.

4. Property Insurance

A coordinated property policy covering real property under construction is a critical insurance coverage. Commonly known as "Builders Risk" or "Course of Construction" insurance, your contract should spell out who is responsible for purchasing the policy (usually the project owner).

Contractual Risk Transfer (continued on page 4)

The policy should be written on an “all risk” basis, and should cover the owner, the general contractor, and all subcontractors. It should extend to materials in transit as well as materials at the jobsite prior to installation.

You should understand what your obligation is in the event of a claim that requires the deductible to be funded. Note that a builders risk policy will NOT cover your tools and equipment at a job site.

5. Professional Liability

Depending on your scope of services, you may be required to carry professional liability insurance. You will want to make certain your limits are appropriate, that they are not required to be dedicated to the project in question (you can endorse a professional liability policy to accomplish this) and that your deductible is acceptable.

Duty to Defend

The California Supreme court dealt a devastating blow to indemnitors when they ruled in the Crawford case that even if indemnitors did nothing wrong, they still could be held responsible for paying the indemnitee’s legal fees. For more information on this topic, see:

<http://www.cavignac.com/pdfs/0209CML.pdf>

Many contracts also specify the number of years you are required to keep your professional liability policy in force. Note that professional liability is recommended for just about any construction company, but in our opinion is considered mandatory for any construction company that either self-performs design work or subcontracts it out.

General Requirements

1. Notice of Cancellation, Non-Renewal, or Material Change

It is not uncommon to see a request for 30, 60 or even 90 days advance notice of cancellation for non-renewal or material change. You should be aware that your insurance company will not send notice of material change. In most cases, the insurance company is only obligated to provide 30 days notice of non-renewal or cancellation, unless it has endorsed the policy otherwise.

Finally, in almost every case, the carrier will only provide ten (10) days notice of cancellation in the event of non-payment of premium.

2. Minimum Financial Size

Many organizations require a minimum A.M. Best rating, or some other type of financial rating. Some requirements also stipulate that coverage must be written on an “admitted” basis. However, many insurance companies choose to operate on a “non-admitted” basis.

Non-admitted is not necessarily a negative. It simply means that an insurance company does not want to be subject to some of the rules and regulations of the applicable Department of Insurance. Insurance companies operating on a non-admitted basis still need to go through a licensing process and pay a fee to operate. If admitted status is required and your carrier is not admitted, you will need to negotiate this in your contract.

3. Evidence of Insurance

In almost every case, you will be required to provide evidence of insurance. This is usually provided in the form of a certificate of insurance. You will also often be required to submit a copy of the Additional Insured Endorsement discussed previously.

Standard industry ACORD certificates are most commonly used. Be wary of manuscripted forms prepared by others – your insurance company may not agree to use them.

Limitation of Liability (LOL)

A limitation of liability provision is designed to limit one party’s liability in the event of a claim. By limiting the liability of the party in whose favor it operates, the risk of loss above that limitation is transferred to the other party.

The rationale for LOL provisions is to limit liability in those situations where risk far outweighs rewards. This can be a provision you use to your advantage on some projects, and it should also be a provision you understand and evaluate when other parties are asking that you limit their liability.

Waiver of Recovery Rights

Oftentimes a contract will require each party to waive their rights against the other party. In other words, each party voluntarily gives up its right to pursue recovery from the other party for amounts each is legally entitled to collect. Typically, these are tied to insurance coverage and are also known as a **Waiver of Subrogation**.

The objective of these provisions is to limit specific types of loss to one insurance policy, and minimize any litigation among the parties. For example, assume that the owner of a project has purchased builders risk insurance on a new office building. Due to the general contractor’s negligence, the building burns down. The builders risk insurer will pay the claim. It will then



Full Service
Surety Department

450 B Tower, 450 B Street, Suite 1800, San Diego, CA 92101-8005

We provide:

- Bid Bonds
- Contract Bonds
- Fidelity Bonds
- Subdivision Bonds
- DRE Bonds
- Court Bonds
- and more!

We have access to all major surety markets, including:

- Chubb
- Great American
- Liberty Mutual
- Zurich
- CNA
- ICW
- Safeco
- and many others
- Hartford
- IFIC
- Travelers

Are you, your clients or subcontractors having trouble obtaining bonds?

We can help! Collectively, our Surety Department has nearly 50 years of surety knowledge and experience — we know how to get companies qualified for surety credit.



Contact Jim Schabarum
 phone 619-744-0565
 e-mail jschabarum@cavignac.com

Contractual Risk Transfer *(continued from page 4)*

“subrogate” against the general contractor, and seek to get the general contractor to pay back what was paid since it was the general contractor’s fault. The waiver of subrogation would preclude the insurance company from subrogating against the general contractor.

Most property, auto and general liability policies allow the insured to waive rights of subrogation if done in writing before a loss. An unendorsed workers compensation policy, however, does not allow this. You can usually endorse this to a workers compensation policy on a specific or blanket basis. If you carry professional liability insurance, you should verify whether or not you

may waive the insurance company’s rights. Some policies allow this and others do not.

Contract Review – Best Practices

Every business enters into contracts that have both risk management and insurance implications. It is important that policies and procedures be put in place so that every contract can be reviewed, the risk quantified and transferred if appropriate.

- Make certain that **every contract entered into by your company is reviewed** by appropriate personnel and, when appropriate, by your legal counsel and insurance broker.
- Remember that **every contract is negotiable** – it doesn’t matter if it is a “boilerplate” or “company policy.”
- **Understand the risks you can assume** and the risks you should not assume.
- **Establish preferred insurance and indemnification standards**, but know and understand what your fall-back position will be.
- **Exceptions** to your insurance and indemnifications standards should only be allowed if **approved by a principal**.
- **Negotiate on the merits** – There’s a right way and a wrong way to negotiate. A number of quality books on negotiation can help you improve your negotiation skills. Two of the best I have read are **Getting to Yes** and **Bargaining for Advantage**.

Risk Transfer is an effective risk management technique, but whether you are transferring the risk or assuming it, you need to understand the exposure. Time taken on the front end of the contract review process to negotiate equitable terms can yield substantial returns on the back side in the event of a problem. ✂

Disclaimer: This article is written from an insurance and surety perspective, and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.





Articles courtesy of Cavignac & Associates Employee Benefits Department

LIVE WELL, WORK WELL

Be Thankful for Family

Thanksgiving Day is National Family History Day! What does this mean?

It's a reminder to ensure that you have a complete family medical history to provide in the unfortunate case of a family emergency. For example, if your child shows signs of a disorder, family medical history can help the doctor confirm a diagnosis.



Your Child's Family History

- Record the names of your child's close relatives from both sides of the family; include conditions each relative has/had and at what age the conditions were first diagnosed.
- If the relative is deceased, include cause of death and age of death.
- Use the U.S. Surgeon General's online tool for collecting family histories, called "My Family Health Portrait."
- Discuss family history concerns with your child's doctor.
- Update your child's family history information regularly and share new information with your child's doctor. ✨

Traveling with Fido

It's the start of the holiday season, which often means traveling to places far away to see loved ones. If you plan on bringing your pet(s) along, ensure you have all your bases covered to make the trip as pleasant as possible:



- Before the trip, make a checklist of all the things your pet typically needs (such as a water bowl, medication or a favorite toy). Then use the checklist as you are packing for the getaway.
- Also before you leave, look up the nearest emergency centers along the route you are traveling, as well as at your final destination.
- Purchase a pet carrier that is large enough for your pet to stretch out and sleep. Label it with your name and contact information in several areas using permanent marker and waterproof labels.
- If traveling a long distance via car, bring cleaning materials and plastic bags in case he/she gets sick. It might be wise to avoid feeding your pet a full meal until you arrive at your destination (if it is a one-day trip.)
- Make sure your pet gets plenty of exercise before boarding a plane or getting in the car for a long trip. Also make sure to stop the car frequently to allow for bathroom breaks. ✨

ALERT! Employers with 15 or More Employees

By November 21st you must supplement your current **EEOC** poster by *also* posting a supplemental poster that provides information about the **Genetic Information Nondiscrimination Act of 2008 (GINA)**.

Title II of GINA prohibits use of genetic information in making decisions related to any terms, conditions, or privileges of employment, prohibits covered entities from intentionally acquiring genetic information, requires confidentiality with respect to genetic information (with limited exceptions), and prohibits retaliation.

- Upload the supplemental poster: http://www.eeoc.gov/employers/upload/eeoc_gina_supplement.pdf
- To learn more about GINA, go to: http://www.eeoc.gov/policy/docs/qanda_geneticinfo.html ✨

Community Bulletin Board

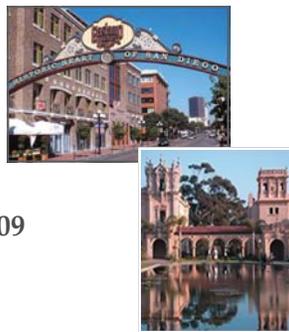
"Neighbors helping neighbors in San Diego"



- ✦ Web Site
- ✦ Resolution Run
- ✦ Questions? Contact **Alicia Gettys** by phone at **619-232-7451** or e-mail **agettys@ymca.org**



- ✦ Events Calendar
- ✦ Web Site



- ✦ Orchids & Onions 2009
- ✦ Web Site
- ✦ Questions? E-mail **info@SDArchitecture.org**



The San Diego Police Foundation supports the men and women who "protect and serve" by raising community awareness of important

unbudgeted or "discretionary" needs that will improve crime-prevention and law enforcement efficiency. The Foundation puts your tax-deductible contributions to measureable work in local communities.



- ✦ Web Site
- ✦ SafetyNet (smartCYBERchoices)
- ✦ For more information, contact **info@sdpolicefoundation.org**



Mission:

To provide quality and compassionate services for the survival, health and independence of seniors living in poverty

- ✦ Web Site



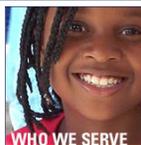
Mission:

The Society for Design Administration advances management and administrative professionals in the A/E/C industry through education, networking and resources.

- ✦ Become an SDA Member
- ✦ Web Site
- ✦ For more information, e-mail **vicepresident@sdasandiego.org**



Monarch Schools



- ✦ Mission Federal School Benefit Campaign
- ✦ Monarch Shop
- ✦ Web Site

