

THE RISK OBSERVER

MANAGING INSURANCE AND CONTRACTS DURING BUILDING PROJECTS

Managing the risks inherent in a building project presents a challenge and opportunities not often encountered in the ordinary affairs of a school district. A building project brings the district, its staff and students as well as the community in close contact with architects and engineers and a number of contractors for a period of time often measured in years from concept to occupancy.

This discussion will not attempt to provide you with a detailed step-by-step “how to” analysis of the risks and their amelioration, because each project is somewhat different from all others. We will try to hit the high points and suggest the things to look for that might cause trouble, as well as, expose the district to unwarranted loss. You are urged to consult with an insurance and risk management specialist with demonstrated expertise in building project loss exposures to be sure that appropriate measures are taken to provide the district with the optimum level of protection for each project.

To begin with, the selection of an architect who will translate your educational goals and objectives into steel and masonry is usually based on less than objective criteria. Aside from licensure, personality, design vision, and general reputation, you have no direct way to measure the technical competence of the architect and engineers he or she will employ to create the detailed design for your building, addition or reconstruction.

The way you can help protect yourself against design flaws or failures that result in a loss, is to require the architect and the engineers to carry errors and omissions coverage of at least one million dollars. A higher limit would be desirable. This coverage is written on a claims made basis, which means that a claim must be brought within the policy period to be covered. **You should require that the coverage be for your project and that “tail” coverage be provided that will accommodate claims for a reasonable time after the policy period and after the project is completed.**

Tail coverage makes claims made policy coverage available after the expiration date of the basic policy. It can be written for varying periods and is priced higher for longer periods. That is, of course, negotiable but will become a part of your contract with the architect so it is important. **Most architects use the Standard American Institute of Architects (AIA) contract form with slight modifications. You do not have to accept this format, and indeed it should be reviewed by your attorney with an eye toward possible changes to strengthen the position of your district.**



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The next important step is to establish the committee or working group which will determine the risk management steps that need to be taken to protect the district, its staff, students and public from loss during the project. This activity should start before the plans and specifications are drawn so that specific concerns and conditions are appropriately addressed in the plans and specifications. This advisory group should include the district official responsible for risk management, the administrator of the building in question or a surrogate for this purpose, a senior representative of the architect, your insurance agent or broker and risk prevention staff of your property and casualty insurance carrier, the clerk of the works if that person has been selected, the district senior buildings and grounds official and, if necessary, the district's legal representative. After bidding, the group should also include at the very least a senior representative of the general contractor and, as necessary, representatives of the other prime contractors. The architect's representative on the group is important in terms of what may reasonably be expected of contractors as expressed in the specifications for bidders.

Aside from the matter of insurance or financial security to be required of bidders and successful prime contractors, **the group should address such issues as the safety of building occupants if the project involves an addition or reconstruction during the school year, public safety in terms of the attractive nuisance doctrine, contractor access to the site, storage of construction equipment and materials, rearrangement of school schedules or procedures at construction interface, school bus access, loading and unloading zones, site security, parking, emergency procedures and access, community use of the existing facility and other similar kinds of concerns.**

Keep in mind that vandalism, malicious mischief and arson have been a significant cause of loss to both contractors and districts during school construction projects. Emergency exits should also be reviewed and changes made if necessary. Depending on the competitive state of the construction market in your area, the specifications may be so burdensome as to reduce the number of bidders or contractors resulting in exceptions to specifications in their bids. If, for example, you require the general contractor to provide full time site security at times other than working hours this will increase the price.

As the committee or working group begins to establish priorities and identify risk transfer, modification or avoidance strategies, **a written plan should be prepared and various members of the group assigned responsibility for carrying out the plan.** As much of the work of the group as possible should be documented, and a log kept from point to point along the path to conclusion. This record will become an invaluable tool for the successful completion of subsequent projects, as well as, a potentially valuable document in the defense of any claims against the district as a result of the project since it would show concern for safety in almost every area of possible activity.

In most cases, the transfer of risk will be accomplished through the use of insurance, bonds, hold harmless agreements or similar devices. The requirements placed on the parties to the



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contracts will be detailed in the general and special conditions of the bid specifications and made a part of the contracts with the successful bidders.

It is essential in all these matters, as indeed it is in all district insurance matters except for highly unusual exceptions not worth noting here, **that bonds and insurance be written by companies licensed to do business in the state in which the project is located.** This provides two very important safeguards. First, the oversight of the insurance authority in your state will help to determine the financial health of the companies and second, if a company should later prove financially troubled, the state's guarantee fund can be brought into play to help with any unpaid claims.

The size of the bonding company or insurance carrier is important, but not as important as claims paying ability. Do not accept policies or bonds from companies on a "watch and warning" list in any state or, if a publicly traded stock company, one that has been recently downgraded by a rating agency. Companies domiciled in exotic overseas locations such as the Turks or Cacaos Islands may also be suspect. Use your insurance agent or broker to help you validate these coverages.

The second use of a risk transfer will be the requirement that contractors present security with their bids in the form of a bid bond or certified check usually amounting to ten percent of the base bid amount. This is drawn on behalf of the district and forfeited to pay the cost of re-bidding if the first bidder awarded the contract cannot or will not undertake the project. This can happen when a contractor makes a serious error in calculating the bid amount which is greater than the 10% bid security. All bonds should be validated immediately by contacting the bonding company, not the agent, and verifying the coverage. Certified checks speak for themselves. These uncased bonds or checks are returned to the bidders when the contracts are signed and replaced by performance and payment bonds.

Within the specified time of the contract signing with the prime contractors, these contractors will be required to provide evidence of the following coverages before work begins and in a timely fashion for the validity of all coverages to be confirmed:

1. A Performance and Payment Bond:

This bond guarantees completion of all work as specified under the contract if the contractor fails to do so, as well as, guarantee the payment for all materials ordered by the contractor for use on the project. It is essential that the clerk of the works be sensitive to the possibility that materials are being directed to another job or not delivered to your site because of payment problems of the contractor. Any suspicion of this kind should be communicated to the bonding company immediately. It is possible that at an early stage of trouble, a bonding company can "rescue" an ailing contractor.

The last thing you want is to have the bonding company take over the project. They will attempt to complete it at the lowest cost possible regardless of the alienation of the other contractors, the architect and the district.



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2. Workers' Compensation and Employers' Liability

This coverage should be self-evident but there are several matters, which must be addressed to be sure the district is protected.

First, if the contractor is from out of state, be sure the coverage applies to the laws of your state where activity will occur. The employers' liability portion of the coverage should be at least \$1 million. Second, the contractors should contractually hold the district harmless in the event a worker is injured, and the worker or his or her family can go beyond workers' compensation with a claim of negligence. The hold harmless agreement will require the contractor to respond in your place. Since there are a number of different ways workers' compensation laws can be satisfied in the various states, it is essential that the coverage be provided by a carrier licensed to do business in your state, as will another state in which activity under this contract will take place.

3. Liability Coverages:

The prime contractors should provide evidence of both general and auto liability coverage with limits at least equal to that of the district. The commercial general liability coverage should be in the simplified or broad form on an occurrence basis, and be the primary coverage for acts performed by the contractor or on behalf of the contractor by the district and its staff without limitation. The district's general liability coverage should be in excess of the contractor's. Be sure that mobile construction equipment not listed on the auto policy is covered by the general liability policy.

Auto liability should include owned, hired, and non-owned vehicles, and again have limits equal to those of the district but a combined single limit of not less than \$1 million for property damage and bodily injury. Aggregate limits should apply to this project without impairment, which are prior losses or reserves experienced by the contractor which reduces the amount of coverage available for your building program. Any but the very smallest deductibles or self-insured retentions of the contractor should be covered by a bond which will pay losses, defense and expenses. Again, these coverages must be written by a carrier licensed to do business in your state.

The liability coverage should include:

- A. Premises and Operations for the ongoing work.
- B. Products and Completed Operations for the suitability and safety of the components and completed building.
- C. Contractual – for hold harmless agreements between you and the contractor.
- D. Owners and Contractors Protective with separate aggregate and special limits on behalf of the district rather than naming the district as added insured under the contractor's policy. This also can cover subcontractors of the general contractor.
- E. Auto, including hired and non-owned vehicles. If there is to be any blasting, grading or



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pile driving performed, the so called “X” (explosion), “C” (collapse) and “U” (underground) exclusions must be removed from the policy to avoid any gaps in coverage for loss resulting from these activities.

4. Builders Risk Coverage:

This coverage will provide all risk coverage for the project during the construction. This coverage can be purchased by all the prime contractors, the general contractor for himself and the other prime contractors, or by the district as an endorsement to its own fire and extended coverage. This latter arrangement is advantageous in several ways. First, it may be less costly since the contractor’s usual overhead and profit would not be added to the cost when purchased by the contractor. The district can more effectively control the policy inception and ending dates, thus also reducing some cost and finally, if the project is reconstructed or an addition, the same carrier insures both the existing building and the new work, thus avoiding coverage controversy in the event of a loss. In general, the amount of coverage will depend on the contract value. If, however, the project is an addition to or reconstruction of an existing building, and you have to get out of the building in its entirety during construction, the value of the coverage should equal the value of the entire building as it stands at contract inception. **This satisfies the important risk management concept that you do not accept the risk of loss for an activity over which you do not exercise control.**

Finally, the builders risk policy can be written on a completed value form or a reporting form.

The latter form would be used in the event a large part of the value of the project would not be put in place until late in the construction process.

The uses of a completed value form for reconstruction or an addition is highly questionable since these policies typically start at zero and increase in values as the project progresses. In the event of a fire early in the contract, the builders risk policy limits would not cover the existing structure. In addition, if a project involves multiple parts of a building, be sure that occupying one of the parts does not eliminate the coverage for the remaining incomplete portions of the work. This is an area where the special expertise of an agent or broker knowledgeable about this coverage would be helpful. Indeed, such a person should be a part of your risk management team, as indicated earlier. This entire area is one in which it is unwise to accept the guidance of any but the highly qualified insurance or risk management professional.

Other Specifications to Consider:

1. **All insurance certificates and hold harmless agreements shall be delivered to the district not less than ten working days prior to the commencement of work or**



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access to the site by any contractor. Insurance coverage renewal certificates shall be provided not less than ten working days prior to policy inception. Notice of policy cancellation or change shall be provided not less than fifteen working days prior to their effective date.

2. **Coverage shall be in place continuously during the entire project and thereafter, as required in the detailed specifications.** Certified copies of policies with all endorsements shall be supplied, if requested. Coverage shall be provided by carriers licensed to do business in the state of the project and carriers shall not be under any “watch”, “warning” or sanction by the insurance regulator of any state.
3. **Hold harmless agreements should apply to contractors, their employees and their subcontractors and cover all liability arising from the project, except that which is the sole negligence of the district.** This will establish more clearly which carrier is responsible for a given loss and should reduce the cost of coverage.
4. **Hold harmless agreements and specific coverage where applicable should apply to all types of damage or injury, including but not limited to bodily injury, property damage, personal injury, loss of use, failure to comply with laws and ordinances, where legal, and differences in conditions, damages to contractors property, employees and agents or other third parties and provide for the defense of the district.**
5. Hold harmless agreements should ideally not be indemnification agreements: that is, the contractor will pay you after you have paid any loss. This leads to serious disputes and lengthy adjudication of appropriate indemnification amounts. **These agreements should place the contractor in your shoes and require the contractor to act to defend the district.** You should, however, notify your carrier of any such suits.
6. It is appropriate to sign mutual waivers of subrogation in property coverage so that liability for a loss is fixed with the responsible party. It is not necessary to notify your carrier that you have done this unless you have a non-standard policy. Check with your insurance carrier or broker.

Depending on the condition of the construction market in your area at the time of bidding, contractors may take written exception to some of these requirements at the time of the bid. It may be necessary to negotiate some of these conditions and agreements. This is why it is absolutely essential that you have expert legal and risk management assistance at this point in the process, and not rely on those with only a general knowledge of the subject. Even the architect may not be totally reliable in this area in terms of the best interests of the district. Do not be intimidated by the size or complexity of these matters. Get good advice and do your best. Remember, you are the customer and are paying the bill with public funds.



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