Innovative Ways to Insure Project Risks

Construction Project Risks

Construction project participants – owners, financiers, architects, engineers, contractors, construction managers, suppliers, etc. - all face numerous risks, including:

- differing site conditions
- loss of funding sources
- environmental issues
- changes in government regulations
- design errors
- construction staging and methods
- defective workmanship
- contractor default
- work stoppages and personnel injuries
- force majeure events (acts of God)
- consequential and liquidated damages
- labor and materials shortages
- inflationary trends, etc.

The participants attempt to identify and allocate such risks through contracts and subcontracts among the parties. Some risks are retained by the owner or contracting parties themselves (e.g. funding, scheduling). Other are transferred and funded by indemnification clauses, surety bonds and insurance policies.

Risk Management Process

A best practice is for project managers and planners to employ a formal risk management process using techniques common to most large organizations. The risk management process involves the following steps:

1. Identify the sources from which losses may arise
2. Analyze and evaluate the potential loss arising from each source
3. Mitigate the risks thus identified by:
    - Elimination or avoidance
    - Reduction or control
    - Transfer to others (e.g. subcontracts, outsourcing)
    - Obtain funding through internal or external sources
4. Monitor results continuously and systematically

Project Insurance Coverage

The project's insurance strategy should be an integral part of the risk management process described above and not an afterthought. Construction projects have a high exposure to losses arising from workplace accidents, design errors, employee injuries, damage to the work, construction defects, delays in opening and (all-too-frequently) lawsuits. Insurance is available for many though not all of these exposures.

Under the traditional strategy, each of the parties involved in a project (i.e. owner, architect/engineer, construction manager, prime contractor, subcontractors) purchase their separate insurance policies to protect themselves from the risks associated with their participation in the project. An exception to this general rule is physical damage to the project itself. The standard practice is for either the owner or the general contractor to purchase a single builder's risk insurance policy to protect the interests of all parties involved with the project.

Owners generally impose only minimum insurance requirements on design firms and contractors. Contractors are free to evaluate their risks and arrange their own insurance programs to comply with regulatory, statutory and owner's contractual requirements.

Contractors in particular purchase a portfolio of policies designed to cover their specific risks and obligations. Contractors will include their insurance costs in their bids or as an overhead load, so that project owners indirectly pay for all contractors' insurance. Contractors' coverages include:

- Workers' compensation and employer's liability
- Commercial general liability
- Excess liability
- Employment practices liability
- Business automobile
- Contractor's tools and equipment
- Professional liability (where applicable, e.g. design-build)
- Environmental impairment liability (where applicable)
- Watercraft, aircraft, USL&H and other special coverages (where applicable).

Alternative Ways to Insure Project Risks

The traditional way, described above, is where project owners specify the minimum coverage and limits required of design professionals' and contractors' insurance. Owners then rely on those policies and the construction contract indemnification clauses to protect the interests of all parties. Owners verify the contractors' compliance by requiring certificates of insurance and "additional insured" endorsements.

Another way, often used for large projects or capital programs, is to arrange an Owner Controlled Insurance Program (OCIP) to cover the on-site job site risks of all parties.

A third way is for the general contractor to arrange a Contractor Controlled Insurance Program (CCIP) covering all participants, either for a single project or multiple projects.

The principal features of each method are summarized below.

Traditional Method	The project owner specifies minimum acceptable coverage terms and limits for contractors, and monitors contractors for compliance. The owner and each contractor covers its own risks. Each contractor negotiates the terms and conditions, pays the premiums, hires a broker, uses its own safety resources, and collects insurance and loss data on itself. The losses are adjusted and paid by the contractors' individual insurers.

Controlled Insurance by Owner	The project owner arranges a single insurance program for all parties involved in the project (or multiple projects) for duration of the project term. The Controlled Insurance Program (CIP), also called a "wrap-up," covers all participants (with some exceptions). The owner negotiates the terms and conditions, pays the premiums, hires a broker and safety consultant, and collects insurance and loss data on all participants. The losses are adjusted and paid by the OCIP insurer.
Controlled Insurance by General Contractor	The general contractor (GC) arranges a single insurance program for all parties involved in the project (or multiple projects) for duration of the project term. The Controlled Insurance Program (CIP), also called a "wrap-up," covers all participants (with some exceptions). The GC negotiates the terms and conditions, pays the premiums, hires a broker and safety consultant, and collects insurance and loss data on all participants. The losses are adjusted and paid by the CCIP insurer.

Insurance Coverage Procured Under the Three Methods

Coverage	Traditional Program	CIP – Owner	CIP – Contractor
Workers' Compensation	Each contractor for its own employees.	Owner purchases for all enrolled parties	GC purchases for all enrolled parties
General and Excess Liability	Each party for its own interest	Owner for all parties	GC for all parties
Builder's Risk	Owner or general contractor	Owner for all parties	GC for all parties
Architects & Engineers Errors & Omissions	Design professionals for their own interest	Owner for all parties (sometimes)	GC for all parties (sometimes)
Pollution Liability	Each party for its own interest	Varies, can be owner or contractors	Varies, can be owner or contractors
Automobile Liability	Each party for its own interest	Each party for its own interest	Each party for its own interest
Contractor's Equipment Floater	Each contractor	Each contractor	Each contractor

Advantages and Issues/Concerns of Each Method

Each strategy or method has its advantages and issues or concerns.

The traditional method is used most often because it matches the responsibility for procuring insurance with the usual allocation of risks in the construction contract. The advantages include:

- The owner, design professionals and contractors evaluate their own risks and obligations. Each party purchases its own insurance or uses other risk management treatments it deems appropriate.
- Each party determines its own approach to risk control and uses its own insurance company to pay claims.
- Contractors can include and mark-up their insurance costs to owners through the bidding process.
- Safe contractors with historically low losses and efficient insurance programs may have a competitive bidding advantage.

The issues or concerns of the traditional method include:

- Cost – Smaller design firms and contractors have less clout in the insurance marketplace and fewer alternative risk financing options, leading to higher insurance costs passed on to owners. Contractors also mark-up their insurance costs in their bids.
- Coverage – Contractors' policies often have gaps, exclusions, restrictions, time windows and depleted limits that prevent claims from being paid. Owners do not receive full protection as an "additional insured" on contractors' policies.
- Safety – Insurers' safety resources and inspections focus on the individual contractors, not the project as a whole.
- Claims – Construction claims often involve multiple insurers who may feud, cross-litigate and subrogate against one another to avoid paying claims.

The Controlled Insurance Program (CIP) method has been used for over 50 years. It is most appropriate for single projects larger than $100 million. It is also used for multiple smaller projects under a Capital Improvement Program of at least $100 million. A rule of thumb is that a Controlled Insurance Program should generate at least $1 million in workers' compensation premiums to be cost effective.

Whether arranged by the owner or the general contractor, a Controlled Insurance Program (CIP) can provide the following advantages:

- Cost Savings – A well-executed CIP can save 30% to 50% of contractors' insurance costs (or 1% to 2% of project hard costs).

- Bulk Purchasing - The CIP sponsor pays the ultimate net cost of the insurance and receives the benefit of volume purchasing and dividends for good loss experience.
- Improved Coverage - The CIP sponsor negotiates coverage for all parties, securing higher insurance limits than most contractors can obtain. CIPs can provide completed operations coverage for the entire statute of repose.
- Improved Claims Handling – A single insurer adjusts and settles claims, with reduced potential for litigation and subrogation.
- Focused and coordinated safety program resulting in a safer job site.
- Enhanced bidding opportunities for minority, small and DBE contractors.

Depending on one's perspective, the issues or concerns of the Controlled method include:

- Funding Requirement – The CIP sponsor must budget and fund the project insurance premiums as a separate item, instead of paying for insurance costs indirectly through the contractors' bids.
- Bidding Modification – Contractors may be required to identify their insurance costs for deduction purposes, with possible bid distortion or confusion.
- Contractor Reluctance – Contractors prefer to keep their own insurance programs intact in order to earn dividends/discounts and protect their insurer relationships.
- Vicarious Liability – Some sponsors may fear safety oversight required under CIP programs may increase their liability. A well-designed CIP will augment, not supplant, the contractors' safety programs, thereby diminishing the possibility of an owner being assessed as a vicarious employer.

Conclusion

There are advantages to each of the three project insurance strategies or methods.

While the traditional method works well for most projects and has wide acceptance among the contracting community, Controlled Insurance Programs have been gaining in popularity, particularly with owners with large capital budgets. Many general contractors use CIPs to provide a single, coordinated loss control and claims handling program, resulting in safer jobs and projects completed on time and within budget.

In general, the larger the project or capital budget, the more reasons an owner or general contractor should consider a Controlled Insurance Program. A well-designed CIP can minimize most of the issues or concerns described above and create a "win-win" program for all participants. The party who sponsors and manages the CIP – the owner, construction manager or general contractor – will likely receive the majority of the benefits, particularly the cost savings.

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