

HOW TO PROTECT CONTRACTORS FROM ECONOMIC LOSS IN CONSTRUCTION PROJECTS

CONTACT

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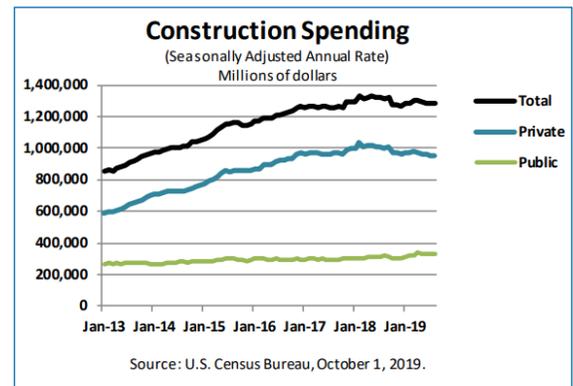
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Courtesy of AmWINS Group, Inc.

Construction spending continues to reach historic heights. According to the U.S. Census Bureau, approximately \$1.3 trillion is spent each year on domestic construction projects.

The increased spending correlates with an increase in the number of construction projects being executed. This ultimately translates to greater exposure and bottom-line risk for all companies involved in the supply chain within the construction sector. These companies include but are not limited to consultants, construction and project managers, design professionals, and builders.



EXPANDED ROLES OF CONTRACTORS LEADS TO INCREASED EXPOSURE

While it's clear that the inherent risk of bodily injury and property damage exists each time a contractor begins a project, the economic loss exposures are not always as apparent. However, their inconspicuous nature does not align with the frequency with which they occur or the extraordinary impact they can have on a company's profit and reputation.

The role of contractors in this space continues to evolve. While contractors and design and engineering firms have traditionally held apparent and bifurcated roles within construction projects, developers and other project owners are now placing more responsibility on their contractors regarding construction management, design supervision and delegation, and hiring of subcontractors, as well as other more ambiguous obligations. These expectations affect the burden of responsibility (and ultimately liability) when something goes wrong.

While traditional Contractors General Liability (CGL) products have addressed the brick and mortar exposures of the construction industry for decades, there is now significant demand for coverage for the less tangible exposures, especially economic (monetary) loss suffered as a result of construction services. Additionally, there is a need for policies with language robust enough to address the evolving exposures faced by construction and contracting firms.

RISKS IN ACTION – CLAIMS SCENARIOS

In the insurance world, these new roles have implications for a variety of firms, including General Contractors, Design-Build Contractors, Construction Managers (At-Risk & Agency), and Special Trade Contractors.

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Each of these firms may choose to insure using a CGL, Architects & Engineers (A&E), Miscellaneous E&O (MPL), and/or Contractors Professional Liability (CPL) policy, all of which have advantages and disadvantages.

A standard CGL policy stipulates that bodily injury and/or property damage must be present for the policy to respond; as a result, pure economic loss (financial loss) is not covered. Conversely, CPL policies are built specifically to respond to such claims and can extend beyond the scope of a traditional A&E or MPL policy.

To illustrate, below are some examples of Professional Liability claims and how each policy might respond.

Negligent Construction Management: The contractor is sued by the project owner on a large school project for negligent construction management. Allegations include failure to schedule and coordinate work properly, which results in significant costs being added to the project that subcontractors did not expect to incur. As a result, they bring suit to recover those costs.

- **CGL: Not covered.** There is no bodily injury or property damage.
- **A&E: Not covered.** Claim is not a result of negligent design/engineering activities for third parties.
- **MPL: Potentially covered.** Generally, the base language is not broad enough to encompass construction management activities. If specifically endorsed for such activities, there is a chance the policy could apply.
- **Contractors Professional: Covered.** Construction management activities are generally covered.

Project Delays: The subcontractor sues the primary general contractor for increased costs as a result of project delays allegedly caused by the general contractor's failure to respond timely to requests for approval across various stages of the project.

- **CGL: Not covered.** There is no bodily injury or property damage
- **A&E: Not covered.** Claim is not a result of negligent design/engineering activities for third parties.
- **MPL: Potentially covered.** Generally, the base language is not broad enough to encompass contracting activities. Can be subject to exclusions on occasion.
- **Contractors Professional: Covered.** Construction management activities are generally covered.

Re-work/Installation: An HVAC contractor incorrectly installs ductwork for a heating system which prevents the building owner from installing the appropriate ceiling for the project. The incorrect installation results in inadequate headroom and loss of otherwise habitable space within the building. As a result, the system must be removed and reinstalled in the correct manner. The building owner sues for costs incurred as a result of the error.

- **CGL: Potentially covered.** May respond in limited capacity depending on endorsements.
- **A&E: Not covered.** The claim is arising as a result of incorrect installation rather than negligent design/engineering activities for third parties.
- **MPL: Not covered.** Broad Bodily Injury and Property Damage exclusions are often present within base MPL forms and costs for correcting or re-performing work are often excluded, as well – issues which would prove problematic in this scenario.
- **Contractors Professional: Covered,** assuming the definition of covered services includes contracting services and/or mitigation coverage.

Protective Claim: A major structural design flaw is discovered at a multi-story apartment project. The engineer has only \$2M in Professional Liability coverage available, yet over \$5M in costs were incurred.

- **CGL: Not covered.** The loss is a result of professional services, so the CGL would not respond appropriately.
- **A&E: Not covered.** The A&E policy for the engineer would respond to policy limits of \$2M – which are inadequate to cover the costs incurred.
- **MPL: Not covered.** MPL policies are not designed to provide coverage for licensed professional activities such as engineering and would not provide first-party costs.
- **Contractors Professional: Covered.** A Contractors Professional policy including Protective cover would provide coverage for the \$3M deficit left uncovered by the engineer's policy.

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THE NUTS & BOLTS OF COVERAGE

To specifically address unique risks, the policy forms for contractors vary from what you might find for an architectural firm, and both differ greatly compared to General Liability and MPL. Though Professional Liability forms are not standardized like CGL, there are some basic tenets present within many of these forms which would affect firms within the construction industry.

The chart below provides some basic points to note.

	COMMERCIAL GENERAL LIABILITY (CGL)	ARCHITECTS & ENGINEERS (A&E)	MISCELLANEOUS PROFESSIONAL (MPL)	CONTRACTORS PROFESSIONAL LIABILITY (CPL)
Common purchasers (including but not limited to)	Any commercial entity with exposure to bodily injury, property damage, or personal/advertising injury to others as a result of business activities	<ul style="list-style-type: none"> Architects Civil engineers Electrical engineers Interior designers Land surveyors Mechanical engineers Structural engineers Technical consultants Other construction design professionals 	Professional Service firms with no licensed design/engineering professionals, such as: <ul style="list-style-type: none"> Misc. Consultants Safety Consultants Appraisers Landmen 	<ul style="list-style-type: none"> Construction managers Design build contractors General contractors Artisan Contractors
Policy Trigger	Occurrence	Claims Made	Claims Made	Claims Made
Wrongful/Liable Act	Bodily Injury or Property Damage to others	Negligence in the provision of (or failure to provide) design/engineering services. Can be broadened via endorsement to include consulting and construction management, but not standard.	Negligence in the provision of professional services. Usually manuscript definition or "services for others for a fee".	Negligence in the provision of (or failure to provide) professional services. Varies by carrier, but often includes (but not limited to): design, Construction Management, Constructability review, and other related terms.
Includes Insured's contracting services?	Yes	Not standard	No	Possible, depending on the carrier. Generally includes professional services performed by the Insured, but some policies also include actual construction/contracting activities.
Indemnity for Economic Loss	No (may be endorsed to include on a contingent basis)	Yes	Yes	Yes
Contractors Pollution coverage available within the form	No	No	No	Often available, usually by request
Mold coverage available	Generally excluded	No	Not standard	Can be included
First or Third-Party Liability?	Third	Third	Third	Possibly both, if Contractors Protective or Rectification cover is included.

The above chart represents standard and widely used/accepted policy wordings. It is provided for illustrative purposes only. Please remember that A&E and Contractors policies are non-standard and vary by carrier. Availability of coverage is dictated by the merits of each individual risk.

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CONCLUSION

The increase in the number of construction projects in the U.S., coupled with the expanding roles and responsibilities of contractors, has created a perfect storm of exposure to economic losses for contractors in a variety of firms within the construction sector. It is important for agents to understand the types of policies and coverage available and to determine the appropriate option for the type of work their contractor clients are engaged in.

AmWINS' Construction Practice has more than 400 professionals that specialize in residential and commercial exposure across the country. We also offer a numerous in-house products and programs tailored to the specific needs of contractors, including Contractors Blueprint which fills the gap in protection left by traditional commercial combined packages and includes coverage for Professional Liability (Contractors E&O), Pollution Liability, Cyber & Media Liability, and Employment Practice Liability.

ABOUT THE AUTHOR

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