Traffic Lines Completes Sixty Years In Construction
TACKLING IT HEAD-ON: Changing Insurance Industry Requires New Game Plan

For all the challenges of doing business as a contractor in the current regulatory and economic environment, there has been one area that has been generally favorable to contractors – obtaining competitively priced insurance coverage that offers very broad protection. In the April issue of the magazine, I wrote about the current state of the insurance industry and how this is beginning to change. Now I’ll focus on some of the specific challenges that contractors will face going forward regarding their insurance programs.

Unfavorable Case Law

Courts across the country continue to challenge liability coverage provided for construction risks. Some cases are at odds with the traditional understanding of how policies are interpreted and how coverage is provided. Various jurisdictions seemingly have a different viewpoint on how an occurrence is defined and how the primary versus excess limits apply. By messign with the definition of an occurrence, the courts have turned on its head what we would traditionally expect a General Liability policy to cover in the areas of Faulty Workmanship and Resulting Damage. In addition, state anti-indemnity statutes that limit the amount of contractual risk that can be transferred are being extended to also limit the additional insured coverage required of subcontractors.

The resulting lack of clarity and understanding you might have with respect to the risks you may be assuming or transferring for any given project can impact your business. It is no longer only important to make sure your contracts are well-written and combined with broad liability coverage, but now it is equally important to understand the jurisdictions in which you are working and their interpretations of insurance policies.

Additional Insured Coverage

One of the standard insurance provisions in any contract is the requirement to add other parties as an Additional Insured. Additional Insured endorsements have gone through a transition over the past several years. There are hundreds of different variations of Additional Insured endorsements in use, each with its own pitfalls. Simply requiring that another party name you as an Additional Insured and requiring a certificate of insurance to that effect is not sufficient to protect your interest. To achieve the most certainty on what is being provided by a subcontractor, many construction agreements are now specifying which Additional Insured endorsements are acceptable and/or requiring a copy of the endorsement in addition to a certificate of insurance.

One of the specific growing concerns related to Additional Insured coverage is endorsements that require a direct contract requirement between the contractor and the Additional Insured in order for coverage to apply. Oftentimes a contract between two parties also requires numerous other entities be included as Additional Insureds, such as various governmental entities, engineering firms, funding sources, etc.

Additional Insured endorsements requiring a direct contract agreement between all the various parties named in a contract in order for coverage to apply presents a significant obstacle for these various other entities to obtain the coverage they are expecting from the contractor. In the event these other parties are relying on this Additional Insured coverage and it is not there, the contractor can be faced with uninsured claims, breach of contract suits and a lost customer.

Horizontal Versus Vertical Exhaustion

Many jurisdictions have weighed-in on how the various limits and insurance will apply to a loss given the numerous parties typically involved in a construction project. Whether the limits must be applied vertically (beginning with the primary coverage and moving into excess coverage) or on a horizontal basis (all primary insurance available for all parties involved must be exhausted first before an excess policy will apply) can differ by jurisdiction. As a result, many contracts are including a requirement for the subcontractors to carry a $2,000,000 per-occurrence limit with a $4,000,000 aggregate limit on the general liability policies.

This is especially the case in a jurisdiction like New York, which looks for horizontal exhaustion of limits in excess policies. By requiring subcontractors to carry higher primary limits, this insulates the Owner’s and General Contractor’s primary policy limits in the event of a claim that horizontal exhausts. At a time when insurance companies are looking to restrict or tightly manage their exposures, many are seeking to get significant dollars for these additional primary limits.

This issue of horizontal versus vertical exhaustion is even causing some large General Contractors and Owners to dictate which Umbrella Liability insurance companies their subcontractors can do business with because of the particular position that insurance company has regarding the exhaustion of limits during a claim scenario involving Additional Insureds. This can obviously present an issue if your Umbrella Liability insurance company is on one of the “forbidden lists” because now you will have to get a project-specific Excess policy that could make your bid uncompetitive compared to another contractor who does not have to get that project-specific Umbrella policy because its insurance is with an approved insurance company.

These three issues facing contractors that I have described in this article can all be mitigated with a well-designed and structured insurance program. At a minimum, the contractor and its insurance broker should be aware of these potential issues and be aware of other potential issues in specific jurisdictions in which you may be working. This way you will be able to take a proactive approach to addressing these issues before it costs your job or places your business in an unnecessary financial burden.

About the Author: Carl is a Producer with The Graham Company, one of the largest commercial insurance and employee benefits brokerages in the Mid-Atlantic region. He is responsible for servicing the Property and Casualty Insurance requirements of his clientele, many of which are part of the Company’s construction portfolio. He is also responsible for new business development and technical expertise. Carl is a graduate of the United States Military Academy, where he earned a bachelor of science in civil engineering.