Ten Tips for Mitigating Risk in Construction Projects

by Robert M. Horkovich and Kevin J. Connolly

Among the economic risks associated with any construction project, payment risk looms large. Money is the lifeblood of construction, and the withholding of payment can doom a project to failure. Industry participants employ a battery of tools to manage payment risk, first among them the construction contract itself. The oft-heard slogan, "allocate now or litigate later," recognizes that disputes can sink a project.

Construction contracts tend to be large, complicated documents, with a multitude of moving parts that are the work of many hands. Herein lies one of the greatest, but incompletely recognized, risks of construction: coordination. And among the challenges of coordination, insurance arrangements are a foremost concern.

Below are ten factors to consider to ensure that insurance contracts and construction contracts are properly aligned.

1. Recognize the construction contract as the bedrock of risk management.
The contract documents are the place for agreements to provide insurance, as well as additional insured provisions, indemnity and exculpation clauses. They are also the place to make clear which parties are responsible for the many surprises that arise during the course of construction, from latent subsurface conditions to accidents and failures to construct the project in the manner that the owners and designers intended.

2. Pay attention to the definition of "covered property."
Insurance sometimes does not attach until the materials and equipment arrive at the site. The policy usually distinguishes between "your" building materials and those of "others," with different sublimits. Always compare these sublimits, especially the transit sublimit, to the value of the property covered.

3. The insurance and the contracts need to be coordinated.
If the contract requires coverage on parts of the work wherever located, but the insurance does not attach until the materials are delivered, there is an avoidable exposure to loss.

4. You might think that you don't need builders risk insurance, and you might be right, but…
"Permanent" insurance, such as ISO's Building & Personal Property Coverage Form (CP 00 01), often includes insurance for additions, renovations and even additional buildings on the site. However, this insurance has many shortcomings and typically has many more exclusions than a dedicated builders risk policy.

5. Don't pay for coverage you don't need.
For instance, if the project is an interior fit-out, you do not need (and usually cannot use) collapse coverage.

6. Beware potential traps in waivers of subrogation.
A waiver of subrogation takes the form of a waiver of the right to recover for losses that are covered by insurance. Saying that the parties waive subrogation does not always work. Some insurance policies will penalize the policyholder for waiving subrogation against certain design professionals.

7. Insurance wraps are a way of life, but still poorly understood.
Constructors need to be aware that owner controlled insurance programs (OCIPs) and contractor consolidated insurance programs (CCIPS) typically have large self-insured retentions (SIR) instead of deductibles. Until the SIR is satisfied, the insurance company does not pay the costs of defense unless the policy has been specially endorsed. This can leave trade contractors without protection, since few of them can shoulder a million-dollar SIR. Owners need to have a tool to allocate payments made for SIR to the contractors who are responsible for the loss, and this needs to be coordinated with any waiver of subrogation.

8. Insurance is a critical ingredient, but not the whole of risk management.
An ounce of loss prevention is worth a pound of insurance. Indemnification may be limited, but it is always useful. Many losses cannot be covered by insurance, but they can be covered by indemnification agreements so long as they are coordinated with the anti-indemnity laws that are frequently seen in construction. Remember that there are risks entailed in compliance with the bewildering thickets of regulations that surround construction. Construction risk management must include advice from a range of consultants.

9. Challenge all assumptions.
If you are building on top of an existing structure, make sure that the ability of the structure to bear increased loads is attested by engineers who have enough insurance to pay for the potential losses. The establishment of field conditions and the allocation of the expense of responding to surprises is critically important. Remember that

the "guaranteed maximum price" is no more guaranteed than an "all-in lump sum." The price to be paid is subject to expansion for a wide variety of reasons -- though there are tools that can reduce exposure to these expenses, such as a "no damage for delay" clause. Even these are not bulletproof, so owners and constructors alike should vet the contingency allowances with a jaundiced eye.

10. Read the friendly policy.

There is no substitute for reading the policy. Insurance certificates are generally unsatisfactory for any purpose, and often the actual policy will not be available until after it is bound. Careful policyholders (and additional insured parties) always review the policy promptly upon receipt and reject the policy if the terms do not align with the specifications and indications that were in hand when the insurance was purchased.

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