Beware: An Insurance Trap For The Unwary Contractor

Contractors routinely bid for various construction projects. In most projects of any size, there are contract specifications that have been prepared either by an architect or an engineer. The specifications are comprehensive and generally include a significant section dealing with insurance and bonding requirements. In most instances, the insurance and bonding requirements are prepared by architects or engineers acting on behalf of the owner. Architects and engineers are generally not licensed intermediaries (i.e. insurance companies and insurance agents). Many times, the architects and engineers prepare insurance requirements without the benefit of input by a licensed intermediary. In many instances, the insurance specifications can be one sided. This can present a problem for the unwary contractor.

Issues

There are generally two issues that arise as a result of the insurance specifications. First, there is a concern over the scope of liability coverage that the contractor must provide pursuant to the contractor's Comprehensive General Liability Policy ("CGL"). It is routine for the contract specifications to provide that the contractor's CGL name the owner and engineer/architect as an "additional insured;" and that the coverage under the Contractor's CGL be "primary." The question becomes the scope of coverage afforded to the additional insureds. At one extreme, specifications could require that the contractor's CGL cover the architect/engineer for all damages incurred by the architect/engineer, even those damages caused solely by the architect/engineer's own negligence. At the other end of the spectrum, the specifications could provide that the contractor's CGL provide coverage for the architect/engineer's damages that were caused by the contractor. In between the foregoing extremes, the specifications could require that the contractor's CGL provide coverage to the architect/engineer if damages were caused, at least in part, by the contractor's negligence. It is very important that the contractor be aware of the specific insurance requirements, because that establishes the scope of coverage provided by the contractor's CGL.

The second problem relates to indemnity agreements. It is routine that construction contracts contain an indemnity whereby the contractor will indemnify the owner and architect/engineer for certain matters. The broad form indemnity is where Party A (the indemnitor) agrees to be liable for all damages incurred by Party B (the indemnitee), even if those damages were caused solely by Party B's own negligence. At the other end of the spectrum, Party A would be liable only for Party B's damages actually caused by Party A. Again, there are variations in between. The contract specifications many times provide that the contractor is to procure and maintain a "contractual liability endorsement" to the CGL, providing some "teeth" to the indemnity clause. In other words, the promise of indemnity becomes subject of an insurance obligation.

Marketplace

There are various types of insurance policies available in the marketplace, offering different and varied kinds of coverages. However, in most instances there are "standard" policies. The standard contractor CGL does not cover the architect/engineer/owner for their own ordinary negligence. Generally, they cover only where the negligence of the contractor is somehow or other transferred to the owner/architect/engineer or, alternatively, where there may be some joint negligence on the part of the contractor and the other parties. In order to get coverage for the sole negligence of the architect/engineer/owner, it will be necessary for a contractor to access special markets. Accessing special markets means that the insurance may not be available or, if available, it is costly.

Unfortunately, many contractors who bid on jobs do not advise their insurance agents of the insurance requirements. In fact, the norm seems to be that contractors do not share insurance specifications with their agents. This can work to the detriment of the contractor. Invariably, the contract specifications require the contractor to procure certificates of insurance evidencing that the required coverages have been obtained. Assume that an incident occurs where someone is injured, and the owner, contractor, and architect/engineer are all named as responsible parties. If an insurer under the contractor's CGL makes a determination that neither the owner nor the architect/engineer are covered under the CGL by virtue of policy terms, then it is clear that the carrier will have no obligation to defend these "additional insureds." However, that does not mean that the contractor is relieved of liability. These parties may assert a contractual breach by the contractor in failing to obtain the requisite insurance coverage mandated by the specifications. In such event, the contractor may have a liability to the owner and architect/engineer arising by virtue of contract (i.e. a failure to procure the required policies). This may be an uninsured liability of the contractor.

Advice

Contractors are well advised to review, as far as possible in advance of the award date of the contract, the insurance specifications. Those specifications should be given to the contractor's insurance agent who can then work with the contractor's carrier/underwriters for purposes of determining appropriate coverages. An early determination can then be made as to whether or not the existing policies can satisfy the contract specifications. This means that the contractor must work with his or her agent in a timely manner. A contractor who does not involve the agent and insurance company runs significant risks of becoming trapped in a situation where there is no insurance coverage for a liability of the contractor.

Written By: Independent Insurance Agents of Wisconsin
Legal Counsel Tim Fenner

December, 2007