



Structuring Your Contract for Optimal Risk Transfer: Understanding Indemnity and Insurance Requirements

Contractual risk transfer is a fundamental component of protecting upstream parties' financial interests from the inception of a construction project through completion and, ultimately, through the statute of repose period. It is critical that parties take proactive steps to contemplate the risks associated with a specific project and implement effective strategies for allocating risk between the Owner, General Contractor, and subcontractors of all tiers from the outset of a project and throughout the contract formation process. There are two key components to consider when structuring your contracts for optimal risk transfer – indemnity and insurance.

With respect to the insurance component of contractual risk transfer, there are two broad overarching categories of contractual requirements that are crucial to effecting optimal risk transfer – (1) those pertaining to the coverages themselves (e.g. what requirements should be imposed on the scope of workers' compensation coverage) and (2) those governing how risk is transferred between the parties (e.g. additional insured endorsements). The first category governs the actual coverage protections required of downstream parties. A failure to draft these components of the contract correctly can leave you facing gaps of totally uninsured exposure. We frequently see this occur when a party to the contract has an overly broad understanding of what risks are covered by builders' risk and general liability insurance. There are many specific exposures on a construction project that stretch beyond the parameters of a modern builders' risk or general liability policy.

In this guide, we focus on the General Contractor's perspective. As the party involved in the project that usually carries the most experience with managing risk transfer, the onus often starts with the General Contractor to implement and facilitate the structure for the risk transfer arrangement between the parties. We encourage this structure, as the General Contractor's experience puts it in the best position to manage and facilitate optimal and effective risk transfer between all of the parties involved on the project. We also assume that the project will involve pass through of risk from the Owner to the General Contractor and, ultimately, to the subcontractors. This is the most frequent arrangement utilized in the industry and, although we recognize there are exceptions to this model, they are the exception.

Ultimately, the biggest challenge to achieving effective risk transfer between all of the parties on a project is the frequency with which subcontractors do not (or are not able to) comply with the requirements of the contract. Unfortunately, the number of subcontractors on some projects, coupled with the complexities of reviewing and understanding each of their insurance policies, make oversight of this process practically untenable for nearly all General Contractors. While the best of the best review at least some of their subcontractors' policy provisions, such as additional insured endorsements and primary/non-contributory endorsements, we are aware of no General Contractors who

fully review all of their subcontractors' policies. This leaves the General Contractor, to at least some extent, at the mercy of what coverage their subcontractors' actually obtain. Having an effective insurance exhibit provides additional protection in two key ways. First, it gives the subcontractor something more specific to potentially give to its broker to guide the procurement process. Second, it bolsters the General Contractor's case that the subcontractor failed to procure proper insurance in the event that a significant loss leaves the General Contractor short of coverage that should have been obtained by the subcontractor.

This guide will focus solely on the first broad category of contractual risk transfer provisions – those governing the required coverages themselves. A future update will include additional insight regarding the provisions governing the mechanisms through which risk is transferred between the parties. We defer to Cottingham & Butler's market expertise to provide guidance on discretionary limits requirements depending on the needs of the market(s) in which the contractor operates.

INDEMNITY

Issue	Explanation
Defense & Indemnity	The contract should require the subcontractor to defend and indemnify upstream parties. Specifically, subcontractors should at least assume all liability, including defense costs, associated with a claim or lawsuit brought by a third-party claimant against an upstream party and arising from the subcontractor's work. This requirement may be more broad, depending on the particular state's anti-indemnity statute.
State Specific Anti-Indemnity Statutes	Anti-indemnity statutes vary from state-to-state. The underlying objective of these statutes is to place limitations on the scope of liability that can be passed on to downstream parties through contractual indemnity agreements. Anti-indemnity statutes take three general forms, whereby the owner and/or general contractor is permitted to pass the risk of loss down to subcontractors for: (1) all liability, (2) all liability except the owner/general contractor's sole negligence, or (3) only the liability that is the subcontractor's fault. Upstream parties should carefully review and consider the anti-indemnity statutes applicable in the state where the contract work will be performed to avoid (1) inadvertently drafting an indemnity provision that is unenforceable or (2) utilizing an indemnity provision that requires less protection from downstream parties than it otherwise could.
Fullest Extent Permitted by Law	As a safeguard to unforeseen implications of an anti-indemnity statute, the contract should include language that preserves indemnity. For example:

	<i>"In the event that the law of the State in which the project is located limits the indemnity obligations of the subcontractor, then the indemnity obligations of the subcontractor shall be enforced to the fullest extent permitted by applicable law, and this article shall be construed to conform to such law."</i>
Attorney's Fees	The indemnity provision should require the subcontractor to pay any legal fees and costs incurred by the upstream party for enforcing the indemnity provision.

INSURANCE

Issue	Explanation
Workers Compensation and Employers Liability	
State Requirements	The contract should require Workers' Compensation coverage consistent with the statute in the State(s) in which the work is to be performed, including an all states endorsement where applicable. In states with monopolistic workers' compensation state insurance funds (e.g., North Dakota, Ohio, Washington, Wyoming), the contract must require coverage to be secured through the applicable state fund.
Navigable Waters	If work is to be performed, in whole or in part, on the navigable waters of the United States or on a flagged vessel, the contract should require subcontractors to obtain coverage pursuant to the Jones Act and/or the Longshoremen's and Harbor Workers' Compensation Act.
Independent Contractors	If the contract work involves equipment operators furnished pursuant to equipment lease agreements, employees of independent contractors, sole proprietors or partners, the contract should require the subcontractor to ensure any labor provided by such entities is covered by that entity's workers' compensation insurance.
Leased Workers	If the subcontractor intends to lease any employees through the use of a leasing company, payroll company, employee management company, or other company, the contract should require that the subcontractor procure workers' compensation insurance written on an "if any" policy form, including an endorsement providing coverage for alternate employer/leased employee liability. Exceptions should be made only where the subcontractor furnishes a copy of its contract with the alternate employer and a certified copy of the alternate employer's workers' compensation insurance policy, evidencing that the alternate employer's insurance will provide coverage for the leased employees for injuries

	sustained at the project site. This review is essential when considering an exception because alternate employer's policies may limit coverage to injuries sustained at its own premises/headquartered location.
Professional Employer Organizations	Similar to the issues that arise with leased employees, a subcontractor that uses employees from a professional employer organization ("PEO") runs the risk that the PEO's insurance policy is insufficient to provide coverage for injuries sustained at the project site. Accordingly, subcontractors intending to use employees from a PEO should be contractually required to furnish a copy of its agreement with the PEO and a certified copy of the PEO's workers compensation insurance policy. The only time an exception should be given to these requirements is when the subcontractor reports such PEO employees as part of its own workers' compensation payroll such that its own workers' compensation policy will cover the employee(s) during their time on the project site.
Employer's Liability	
Limits	The contract should require employer's liability coverage with limits of at least \$1,000,000 for each bodily injury by accident, each bodily injury by disease, and annual aggregate.
Monopolistic States	In states with monopolistic workers' compensation state insurance funds (e.g., North Dakota, Ohio, Washington, Wyoming), the contract should require that such coverage includes employer's liability coverage and, if it does not, shall require the subcontractor to obtain such "stop gap" employer's liability coverage separately.
Automobile Liability	
Coverage Form	The contract should require automobile liability coverage on an ISO CA 00 01 03 06 or later form.
Limits	The automobile liability coverage limits should be at least \$1,000,000 per accident for bodily injury and property damage and applying on an "any auto" basis.
Hazardous Waste Hauling	If hauling of hazardous waste is within the scope of work, the contract should require automobile liability coverage with a \$1,000,000 combined single limit per occurrence for bodily injury and property damage applicable to all hazardous waste hauling vehicles, and include MCS 90 endorsement and the ISO form CA 99 48 03 06.
Commercial General Liability ("CGL")	
Coverage Form	Downstream parties should be required to provide commercial general liability coverage for damages because of property damage, bodily injury, and personal and

	advertising injuries, including products-completed operations coverage written on ISO Form CG 00 01 (edition 12 07 or 04 13) with no modifications to coverage terms except as explicitly permitted in the contract. It is crucial that the General Contractor require these specific forms, as other manuscript forms written by some insurers to replace these forms impose various impermissible restrictions on coverage that are not present in the modern CG 00 01 forms.
Scope Limitations	CGL coverage should not contain any limitations on the scope of coverage afforded by the base CG 00 01 form, unless specifically approved by the General Contractor Examples of limitations that may be permitted, but should not be given without careful consideration of the scope of work contemplated by the contract, include: (1) professional liability exclusions broader than ISO form 22 79 04 13, (2) progressive or continuing injury exclusions, (3) residential construction exclusions, (4) Endorsements removing the “insured contract” exception to the contractual liability and/or employer’s liability exclusion, and (5) scope of work exclusions, such as Exterior Insulation and Finishing System (“EIFS”) exclusions.
Limits	Subcontractors should be required to obtain an endorsement stating that separate and distinct general aggregate and products-completed operations limits of liability apply to the subcontractor’s work on the project.
Commercial Umbrella Liability	
Scope of Coverage	Subcontractors should be required to carry commercial umbrella or commercial excess liability insurance providing coverage excess to and at least as broad as the primary CGL policy, employer’s liability, and automobile liability insurance described above.
Drop-Down Coverage	Coverage provided by the umbrella and excess policies should be provided on a “drop-down” basis for defense and indemnity in the event of exhaustion or insolvency of the underlying insurance.
Limits	Umbrella and excess policies should provide that separate aggregate and per occurrence limits of the required amounts are available for the Project. However, the upstream party should consider the scope of work and nature of risk involved with each subcontractor’s work when determining what excess limits are appropriate. For example, a subcontractor conducting tower crane operations should be required to carry much higher limits than a flooring subcontractor.

Property/Contractor's Tools and Equipment	
"All Risk" Coverage	Subcontractors should be required to carry "all risk" property insurance for its tools, personal property, mobile equipment, scaffolding and forms to the extent it is not covered by builders' risk insurance procured for the project.
Cranes	If the subcontractor or its sub-tier subcontracts will be utilizing a tower or heavy crane at the project, the contract should further require "all risk" property insurance for the crane(s), including coverage for: (1) full replacement cost, (2) take-down and re-erecting, (3) damage to the project caused by the crane, including collapse, and (4) time element loss, including delay and soft costs resulting from damage to the crane or caused by the crane. The upstream parties should be named insureds on such insurance.
Waiver to the Extent of Property Coverage	The contract should require parties to waive all rights against each other, against other subcontractors, and against the project owner, including their respective agents and employee, to the extent coverage is provided by the project's builders' risk policy or any other property or equipment insurance. This reduces instances of disputes during ongoing operations that can create delays and tarnished working relationships. It also incentivizes effective use of the builder's risk policy while deterring strategic claims reporting that would otherwise benefit the party that purchased the policy to the detriment of the other parties involved with the project.
Additional/Optional Coverages	
Contractor's Pollution Liability	If the subcontractor's work involves the handling of hazardous materials or contaminants, Contractor's Pollution Liability coverage for bodily injury and property damage should be required, should remain in force for both on-site and off-site exposures, and should remain in place for not less than 5 years after substantial completion or acceptance of the project.
Crane Liability and Riggers Legal Liability	If the subcontractor's work involves the rigging, hoisting, lowering, raising, or moving of property or equipment and Riggers Liability, this coverage should be required.
Watercraft and Aircraft Liability	If the subcontract work involves the use of any owned, leased, chartered, or hired aircraft or watercraft of any type, the subcontractor should require Watercraft and Aircraft Liability coverage, including Passenger Liability for bodily injury and property damage. The Watercraft Liability coverage should include pollution coverage, including coverage for clean-up costs, third-party property damage, assessment of and damage to natural resources, loss of

	revenues and profits by third parties, defense, investigation, civil penalties, criminal fines, and interest.
Railroad Protective	If the subcontractor's work will be conducted on or near railroad tracks or a railroad property, the contract should require the subcontractor to obtain Railroad Protective Insurance with adequate limits based on the scope of work.
Marine Cargo and Goods-In-Transit	If the subcontractor's work involves the shipment of products from overseas, the contract should require Marine Cargo and Goods-in-Transit Insurance with limits sufficient to cover the full replacement value of any delivery of cargo or materials lost or damaged plus the shipping and other transit and insurance costs of re-shipping or re-transporting the delivery to the extent that the subcontractor is responsible for the transit of the same.