

Establishing a Corporate Policy for Sub-consultant and Subcontractor Insurance

Architectural, engineering and construction management firms have legal responsibility not only for the services performed by their own employees; but also for any services performed by sub-consultants or subcontractors they retain. That's why it's essential for any architect, engineer, or construction manager (A/E and CM) that retains sub-consultants or subcontractors to have and follow a sound corporate policy with respect to good contract hygiene practices and insurance requirements.

Claims made against A/Es and CMs are often caused by the actions of sub-consultants or subcontractors. If the insurance program of the sub-consultant or subcontractor is inadequate or does not cover the type of loss caused, the primary architectural or engineering firm's insurance – and, ultimately, the firm, itself – must bear the financial burden of satisfying the loss. Most firms and their project managers generally are well-versed in selecting sub-consultants and ensuring proper oversight relative to schedules, payment requests, and other operational and administrative details. They also usually follow good practice with regard to having a written agreement with a clear scope of work and appropriate indemnification clauses. Yet, things can get murky when it comes to establishing insurance requirements for their sub-consultants and subcontractors. Failure to address this significant issue can leave the prime on the hook for this potentially substantial financial burden.

This *InfoAlert* describes key considerations for design firms and construction managers in establishing a corporate policy requiring sub-consultants and subcontractors to carry insurance. We outline types of insurance policies that should be required, typical limits, and significant clauses that can help maximize protection for the prime on any construction project.

Goals in Establishing Corporate Subcontractor Insurance Requirements

The main goal of establishing corporate requirements for sub-consultant and subcontractor insurance is to insulate your firm and its own insurance program from losses caused by the actions of the sub-consultant or subcontractor (the "sub"). The sub's insurance should respond **first** to pay such a loss, with your firm's insurance

responding only if the sub's insurance program limits are insufficient to satisfy the full amount of the loss.

A secondary, but equally important, goal of corporate-mandated insurance requirements for sub-consultants and subcontractors is to ensure that each sub has the financial assets to cover loss caused by the sub's services, as well as to back up any indemnity the sub agrees to provide

your firm or your client in any contract. In these instances, insurance becomes an important financial asset protecting your firm. Given the magnitude of potential exposures, most design firms and construction companies are unlikely to have other financial assets sufficient to pay for such losses without insurance.

Establishing a Corporate Sub-consultant and Subcontractor Insurance Requirement

As with any corporate policy or procedure, senior management of the firm should be involved in the creation and implementation of the firm's standards governing sub-consultant and subcontractor insurance. The standards should outline the minimum requirements for insurance coverage, amount of limits and any special endorsements. As there may be valid reasons from time to time to use a sub that does not meet the minimum insurance requirements, a formal approval process should be in place for any deviations from the minimum standards. Decide who within the firm can approve an exception and under what circumstances. In addition, be sure the firm's policy requires that written documentation be included in the project work file for any approved deviations.

Firms should look to qualified insurance advisors or brokers to assist with determining the types of insurance coverage, amount of limits and special endorsements. In our case, Ames & Gough has assisted many clients in drafting insurance clauses to be inserted into subcontractor and sub-consultant agreements. Here are some key considerations for determining what insurance to require from subs.

Required Types of Insurance

Typical insurance coverages that should be required of every sub-consultant and/or subcontractor include:

- **Workers' Compensation and Employer's Liability** – Required of employers within every state, workers' compensation provides state-mandated

benefits for workers who sustain job-related injuries or illnesses. Assuring benefit availability to injured workers of subs reduces the likelihood of a suit against the primary architectural, engineering or construction management firm. Employer's Liability responds to any possible lawsuits against an employer by an injured worker.

- **General Liability** – Provides coverage for bodily injury and property damage claims arising out of the sub's operations. Typically, completed operations coverage is also included. It is important to note that the general liability policy for most design firm subs contains a professional services exclusion, thereby, creating the need for professional liability insurance.
- **Automobile Liability** – Provides coverage for bodily injury and property damage claims arising out of the use of sub's automobiles, including hired (rented) and non-owned (borrowed) autos.
- **Umbrella Liability** – Applies above the automobile, general liability and employer's liability coverage (under the workers' compensation policy), providing additional limits to pay for claims.
- **Professional Liability** – This insurance, which is necessary if the sub is providing any professional or consulting services, provides coverage to a consultant for liability arising out of professional services performed. Specifically, it protects against liability for bodily injury, property damage, and economic loss (including repairs, increased project costs, overruns and delays) caused by the consultant's negligence. Notably, it protects a prime for their "vicarious liability" arising from a sub-consultant's negligence.
- **Property Insurance** – Subs should be required to obtain property insurance on any tools, equipment or personal property utilized. While not directly affecting the prime, having adequate insurance in case of a loss helps ensure the sub will have sufficient resources to finish their work.
- **Contractors' Pollution Liability Insurance** – If the sub is performing any environmental services, drilling services, excavation services, or if the project involves the risk of environmental contamination, the sub should also be required to have contractors' pollution liability insurance. This coverage can be obtained either as part of a professional liability insurance policy or as a

separate, stand-alone policy. Regardless of how the environmental coverage is structured, the sub should be required to have this insurance in place before commencing work whenever there is any risk of environmental contamination.

While this list includes some of the more widely used insurance coverage in design and construction projects, you should regard it only as a starting point. Design firms and construction managers also should compare this list to any client-required insurance coverage and be sure to “flow down,” as much as possible, the insurance and other risk allocation provisions to your subs.

It is also important to review the services the sub is performing for any unique exposures. In addition, you want to craft your insurance requirements to back-stop any indemnity you are insisting that the sub provide your firm.

Determining Amounts of Limits

There really is no definitive answer regarding what liability insurance limits a firm should require its subs to carry. That’s because it is impossible to predict with any kind of certainty the extent of bodily injury, property damage or other harm another might suffer as the result of any errors, mistakes or other actions that may cause a loss.

Most businesses, even the smallest, tend to purchase at least \$1 million of insurance limits for general liability and automobile liability insurance – and these would be pretty typical minimum limit requirements to include in a contract with a sub. Businesses also tend to purchase at least \$500,000 of employer’s liability limits on their workers’ compensation insurance policies. Employer’s liability is the part of workers’ compensation insurance that can respond to lawsuits brought against the firm by injured workers (in jurisdictions where such actions are permitted).

Many businesses also purchase umbrella liability insurance policies with at least \$1 million of limits. As noted earlier, these policies provide excess

insurance for general liability, automobile liability and employer’s liability. When combined with these underlying coverages, umbrella liability policies increase the amount of coverage. Be aware that umbrella liability insurance policies do **not** provide any coverage for professional services.

Architects, engineers, construction managers and other construction consultants tend to purchase at least \$1 million of professional liability insurance. Most professional liability policy forms also include contractors’ pollution liability as part of the coverage.

Factors to consider when determining the level of insurance limits to require include:

- Whether or not your client has specific requirements in its contract with regard to the limit of insurance subs should carry (your requirements should “flow down” these client requirements);
- The percentage of the overall work being performed by your sub;
- The services your sub is performing and the likelihood these services could cause a sizable loss (e.g., geotechnical or structural work is more risky than wayfinding/signage);
- Controls in place on the project that might protect against a sizable loss; and
- The cost of requiring higher limits weighed against the likelihood of a sizable loss.

Generally, you should establish minimum limit requirements for liability policies of no less than \$1 million. Additionally, consider requiring each sub to maintain at least \$1 million of umbrella liability insurance limits. Whatever limits you decide to require, be sure that all project managers and others who retain subs adhere to the minimums.

Many prime design firms consider projects with a total construction value above \$20 million to be a milestone requiring higher insurance limits. Often, at this size and above we see umbrella liability limits increase to \$5 million and professional

liability limits increase to \$2 million or \$3 million per claim or more.

Required Special Endorsements

Construction projects present unique risk exposures for which the insurance industry has designed special endorsements that can apply to one or more coverage lines. For example, among the endorsements applicable to general liability policies, are: additional insured, general aggregate limits applying per project, waiver of subrogation, primary and non-contributory wording, severability of interests, and coverage for explosion, collapse or underground hazard. The waiver of subrogation endorsement is also widely used with workers' compensation, automobile liability, umbrella liability, and contractors' pollution liability policies. And the additional insured endorsement is often added to automobile liability and contractors' pollution liability policies.

Here are details of some of the more important endorsements that should be required from each sub. A chart at the end of this *Information Alert* provides additional recommendations, depending upon the services the sub may be performing for you.

Waiver of subrogation: In the U.S. legal system, if an insurer pays a loss, the insurer is given the right to pursue recovery of that loss from any party that may have caused or contributed to the loss. This right is known as *subrogation*. After a sub's insurer pays a loss, that insurance company may seek recovery of all or part of the loss from your firm under this right of subrogation, alleging your firm was either partly or fully responsible.

A waiver of subrogation is an agreement by the sub's insurer not to pursue a recovery for a paid loss against your firm. It is generally provided by insurers that cover construction and design risks at no additional cost. You should require that a waiver of subrogation in your firm's favor be provided under the sub's general liability, automobile liability, workers' compensation,

umbrella liability, professional liability and pollution liability insurance policies. **In order for the waiver to be valid it is important that the waiver of subrogation be included in the contract itself.**

Additional Insured Endorsement: Additional insured status is often viewed as "belt and suspender" protection in concert with the indemnification requirements of the underlying contract with a sub. Insurers offering general liability and umbrella liability insurance to construction contractors and design professionals typically provide endorsements that afford "additional insured" status on their policies to any party where a contract requires that party to be an additional insured. In contracts with your subs, be sure to require that the general liability, automobile liability, and umbrella liability insurance of the sub name your firm as an additional insured.

Primary and Non Contributory Requirement:

Another stipulation that should be in your contractual insurance requirements to subs is that **the sub's general liability and umbrella liability insurance, in particular, must act as primary and non-contributory to your firm's insurance.** The sub's insurer must **first** pay any loss caused by your sub and not seek participation from your firm's insurer in satisfying the loss.

This primary and non-contributory language is important; many additional insured endorsements in use today will require your firm as an additional insured to first report any claim to your own general liability insurer for coverage **unless** the written contract between your firm and your sub requires that the sub's insurance be primary and non-contributory.

Absent the primary and non-contributory language, the expectation of your sub's insurer is that your firm's insurer will participate and share in paying the legal fees and damages to resolve a claim. This approach undermines the goal of insulating your firm from loss caused by a sub-consultant or subcontractor. However, if you

specify in your contract that the sub's insurance must act first in a primary and non-contributory role, the sub's insurer will first pay the legal fees and damages to satisfy the loss and your firm's insurance will only become involved if the sub's insurance limits are insufficient to satisfy the claim.

“Per Project” General Aggregate for General Liability: Be sure to specify in every contract, regardless of what work the sub may be performing, that the sub's general liability insurance be endorsed so that **the aggregate limits on the policy apply to each project or job where the sub is working during the policy period.** In this way, the sub-consultant or subcontractor's general liability insurance limits that are covering your project don't get wiped out due to claims from other jobs where the sub is working.

The endorsements described above represent some of the more significant and widely used with respect to design and construction projects. In addition, depending upon the service that the sub may be performing, there are other endorsements (noted in the chart at the end of this publication) that may be beneficial in protecting your firm.

Insurance Requirements as Part of a Written Contract

It is essential that your insurance requirements for subs be spelled out in detail as part of a **written contract** between your firm and the sub. The special endorsements insurers offer that provide added protection to your firm – such as the additional insured endorsement, primary and non-

contributory wording and waiver of subrogation – **require** that there be a written agreement between the sub and your firm stating that the sub's insurance policies must be endorsed to provide these benefits to your firm. **Remember, if it is not stated in a written contract, the benefit will not be provided by the sub's insurer to your firm.**

Certificate of Insurance Procedures

No subcontractor insurance requirement policy is complete without the means of checking compliance. It should be your firm's standard requirement that no sub-consultant or subcontractor can begin work on a project until they have furnished you with a certificate of insurance confirming that they meet your insurance requirements. Require project managers to maintain current certificates in the project work file. And be sure there is an effective diary system in place to obtain renewal certificates at least 15 days before the subs' insurance coverage renews. One certificate issue that also needs consideration is the so-called “notice of cancellation” provision. (See Ames & Gough's Winter 2011 *InfoAlert* for further information.)

Conclusion

Ames & Gough also has developed sample insurance requirements for use in sub-consultant and subcontractor agreements that are available on a complimentary basis on request. If you would like copies of the sample insurance clauses or further information on insurance requirements, please feel free to contact us.

Recommended Subcontractor & Sub-consultant Insurance Requirements

Insurance Type / Endorsement	Benefits to the Prime Architect or Engineer	Additional Cost for the Endorsement Yes or No
Workers' Compensation:	Required of employers in every state to provide state-mandated benefits for injured workers. Assuring benefit availability to injured workers of subs reduces likelihood of suit against A/E or CM firm.	
USL&H Coverage	Require ONLY IF workers are working on, near or over navigable water. Policy extends to cover benefits mandated by U.S. law.	Y
Waiver of Subrogation	The endorsement means that the workers' compensation insurer will not seek recovery from you for any worker injury claim paid.	N
Commercial General Liability:	Provides coverage for bodily injury and property damage claims arising out of the sub's operations (and completed operations, if purchased).	
Additional Insured Status for Prime (including completed operations)	A/E and/or CM become an additional insured on the policy providing a defense and indemnity from third party liability as well as liability for worker injuries.	N
General Aggregate Limits applying "per project"	The aggregate limits on the policy will apply separately to each project or job where the subcontractor or sub-consultant is working. Claims on other jobs won't affect limits available for the Prime's project.	N
Waiver of Subrogation	The general liability insurer agrees not to seek recovery from the Prime for any claims it pays under the general liability insurance if required by contract.	N
Primary & Non Contributory Wording	This confirms that the sub's insurer recognizes that its policy will pay the loss first and that any insurance carried by the A/E/CM will not be expected to contribute as well to pay the loss.	N
Severability of Interests	This confirms that the insurer will treat the A/E/CM's interests separately from the sub's with regard to defense and payment of any claims.	N
Coverage for XCU Hazard	Particularly if hiring drillers, excavators or blasters. Specify that the general liability insurance will cover property damage arising from explosion, collapse or underground hazard (XCU).	Y (Charge only applies to drillers, blasters & excavators)
Automobile Liability Insurance (Any Auto Coverage)	Provides coverage for bodily injury and property damage claims arising out of the use of sub's automobiles, including hired and non-owned autos.	
Additional Insured Status	A/E/CM becomes an additional insured for liability claims related to automobiles that are used in connection with the sub's services.	N
Waiver of Subrogation in favor of Prime	The automobile insurer agrees not to seek recovery from the A/E/CM for any claims it pays under the automobile liability insurance.	N
Transportation of Pollutants Coverage	If you hire contractors hauling contaminants from site. This endorsement extends coverage to pay the costs to clean up pollutants as well as pay any bodily injury or property damage claims resulting from pollution due to an auto accident.	Y
MCS-90 Proof of Financial Responsibility	As required by the US Department of Transportation this endorsement confirms that the motor carrier has a bond or insurance in place to meet its financial responsibility in the event the motor carrier causes BI, PD or environmental damage.	N

Insurance Type / Endorsement	Benefits to the Prime Architect or Engineer	Additional Cost for the Endorsement Yes or No
Umbrella Liability Insurance	Coverage applies above the automobile, general liability and employer's liability coverage (under the workers' compensation policy) providing additional limits to pay for claims.	
Waiver of Subrogation	The umbrella liability insurer agrees not to seek recovery from the Prime for any claims it pays under the umbrella liability policy.	N
Professional Liability Insurance: When professional services are being procured.	Provides coverage to a consultant for liability arising out of professional services performed. Protection against liability for bodily injury, property damage and economic loss (e.g., project damage, increased project costs, overruns and delays) caused by the consultant's negligence is covered. Protection against claims caused by sub-consultants as their insurance responds first.	
Contractors' Pollution Liability Coverage Endorsement (for sub-consultants)	Most professional liability insurers include this as part of the policy for A/E/CMs or add by endorsement.	N
Additional Insured Status under Contractors' Pollution Liability Coverage	Though professional liability insurers will not agree to add Prime as an additional insured under professional liability, they WILL usually agree to provide additional insured status under the contractors' pollution liability coverage part.	N
Waiver of Subrogation in favor of the Prime	The professional liability insurer agrees not to seek recovery from the Prime for any claim it pays under the professional liability and contractors' pollution liability insurance policy. This is included in most insurers' forms without need of an endorsement.	N
Contractors' Pollution Liability Insurance (for subcontractors)	Contractors cannot purchase pollution liability insurance as an endorsement to a general liability insurance policy. They must purchase a separate policy. This provides protection for liability arising from a release due to the contractor's operations. Require especially from remediation contractors, drillers or excavators.	
Additional Insured Status for Prime	Prime can be an additional insured under the contractor's policy and is protected against pollution release claims.	N
Waiver of Subrogation in favor of Prime	The contractors' pollution liability insurer agrees not to seek recovery from the Prime for any claims it pays under the policy.	N

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