



## **Risk Management Considerations for New Construction**

When a water district considers new construction to help meet the needs of its growing population and demand for water there are some important factors to consider. The planning and design process before construction begins is one. The choice of an architect, engineer, and contractor is another. The contract document and its important insurance requirements is the third consideration. This article will explore risk management issues that should be addressed during the planning process and as work with your architect and contractor begins.

### **Planning**

Before you start working with an architect or engineer you should consider the purpose of the new building and what operations and people will be based there. The idea of having a great amount of new, clean space may tempt you to put several operations together. Consider what makes sense to have housed together. Also consider what space freed up by moving to the new building will allow you to do. As you consider the use of the new space, involve staff members at all levels for their input about facilities, amenities, and layout they want to see in the space. Consider special requirements for some spaces like control rooms, Board and meeting rooms, IT needs, storage facilities, parking requirements, landscaping, and utilities. Will the building be part of a project to expand water or wastewater treatment facilities? The first real concrete step toward construction is the design of the building and engaging an architect or engineer.

### **Design**

The architect you choose should have experience with large multi-use commercial buildings. The architect is also your life safety expert and will guide you through the permitting process. Another important concern in terms of reducing the risk a building poses is the operating efficiency.

Specific design concerns the architect should address with the district include:

- Has the architect spent time listening to the future users and occupants of the proposed building?
- Has the architect considered all state and local and federal building codes including life safety provisions and the Americans with Disabilities Act (ADA).?
- Has the architect submitted design plans to a professional engineer for evaluation of the building structure?
- Are the proposed building materials appropriate for the local climate and proposed use of the building?
- Has the building been designed to meet fire and wind resistive standards?
- Are technologies and materials that will reduce energy and water consumption being used in construction?

- Has the design incorporated effective security measures?
- Will the building protect occupants in the event of natural or man-made disasters such as tornados, hurricanes, or explosions?
- Will the design be flexible enough to meet future growth or changing uses?

The district should have a contract with the architect that holds the district harmless and has insurance provisions, primarily for Professional Liability. The architect will probably propose a contract developed by the American Institute of Architects (AIA) that has several provisions that may not be in the district's favor. Engineers may propose the EJCDC contract which usually favors the engineer over the water district. Negotiate and bring in the Fund's risk management consultant for assistance.

### **Contracting**

Contractors should be vetted for their experience with large commercial, multi-use buildings as well. An RFP process will help you evaluate previous experience and the resumes of key people in the contracting organization.

The district's contract with the building contractor is a very effective way of transferring risk to another party. Contracts with building contractors should contain language that transfers risk from the owner to the contractor. This section will deal with written contracts and considerations when hiring contractors.

Hold harmless language should be included in your contracts with general and sub-contractors. This clause places most liability for damages and injury during construction on the contractor. Only liability attributable to the owner's sole negligence would not be transferred by this provision. Changes in Texas law in 2012 regarding hold harmless or indemnification agreements that are part of a construction contract made significant changes in a district's ability to transfer risk. Provisions in the law make contractual language "void and unenforceable" for a district to require a contractor to hold it harmless from liability arising out of the district's own negligence. The main reason for the change is to prevent an owner from transferring its sole negligence to the contractor and the contractor from transferring his sole negligence to his subs. The contract with the main contractor (General) will require them to make sure their sub-contractors comply with the district's requirements.

An exception in the new law still allows the district to be held harmless in the event of a "claim for the bodily injury or death of an employee of the indemnitor (contractor), its agent or subcontractor of any tier." This helps preserve the sole remedy aspect of Workers' Compensation and controls the practice of "third party action over" lawsuits where an injured employee who has already received workers compensation benefits for their injury can sue the district claiming that their negligence or fault contributed to the injury. Language to this effect is still permitted in the hold harmless agreements Texas districts make with their contractors.

Do not sign a contract that is already prepared by the contractor who may be trying to rush commencement of the project. Allow time for your general counsel, Fund underwriter

or risk management consultant to review the contract. Since the district is paying for the work, the district should prepare the contract. The contract prepared by the contractor or on engineering or architectural form does not protect the district as well as a contract prepared by your counsel.

1. Suggested language from the recommended Fund contract template follows:

•9.1 To the fullest extent permitted by law, Contractor shall defend, indemnify, and hold harmless Texas District and its board, directors, officers, and employees, (collectively, the "Indemnitees"), from and against claims, losses, damages, demands, suits, causes of action, settlements, liabilities, costs, fines, judgments, and expenses (including, without limitation, reasonable and necessary court costs, experts' fees, and attorney's fees) (collectively, "Losses"), arising in favor of or brought by any third party, based upon, in connection with, relating to, or arising out of Contractor's willful or negligent acts, errors or omissions (or those of any of its subcontractors, subconsultants, or suppliers or any of its or their respective employees or any party for whom any may be legally liable), under or in connection with this Agreement or any Work Order.

2. The contract should contain insurance requirements that the contractor and any sub-contractor entering the site must meet. Specific limits of liability and coverage provisions are illustrated in the table below and discussed further in the next section.

Two relatively new forms of general contracting should also be considered to bring more efficiency and accountability to the role of general contractor. One is the now common Contract Manager at Risk (CMAR) form that imposes penalties if construction is delayed for reasons other than weather or force majeure. An Owner's Representative form is also in use by some districts for large projects where the representative acts in place of the owner (district) for most major decision making and project management.

### **Checklist**

During the RFP process and before negotiating a contract with the selected contractor consider these items:

1. The contractor will furnish you with their financials.
2. The contractor is bondable.
3. They can provide a performance bond if required. (If you require bid bonds, the contractors who are able to furnish them are bondable for the construction job they are bidding.)
4. You have seen other work done by the contractor.
5. Does the contractor have a job under construction during the time you are considering them? If so, go visit it and check out:
  3. Housekeeping on the job site
  4. Security of the job site and materials on site
  5. Safety measures related to working at height, excavation, access to the site and personal protective equipment
6. You have checked references.

7. The contractor has the licenses required by state or local law.
8. After selection of the contractor and during contract negotiation make sure:
9. The contract places full responsibility for job site safety solely on the contractor.
10. The contract is a two-party contract between the district and the contractor.
11. The architect or engineer as owner's representative is subject to their own contract with the district even if they are included in the construction contract.
12. Make sure any contract with an architect or engineer does not limit their liability to only the fees paid to them for their work for the district.
13. The contract contains provisions regarding environmental issues and responsibility for pollution incidents.
14. The contract does not contain a provision limiting the owner's right to recover consequential damages.
15. The contract may penalize the contractor for failure to complete the work within a certain timeframe.
16. The contractor is capable of doing the work.
17. The contractor has experience completing buildings of similar size and complexity. (Note: in times of economic downturn, contractors often look for work outside of their normal area of expertise. Residential contractors will often bid on commercial work though they lack the necessary experience.)
18. The contractor uses reputable and reliable sub-contractors.
19. The contractor offers a warranty on his or her work. This is usually part of the contract.
20. The contractor will furnish you with a certificate of insurance before any work begins.

## **Insurance**

Insurance related to the construction process is an important and necessary element of any project whether it is a small remodeling job or a multi-million-dollar building. When you ask the contractor to hold the owner harmless in the contract, the contractor's insurance is what funds this transfer of risk. A contractor's insurance also helps protect the contractor from insolvency in the event of catastrophic losses to equipment or a building under construction. Another form of insurance known as Contract Bonds guarantees that a project will be completed in the event a contractor does become insolvent or unable to complete the job. As owner, your evaluation of the contractor should include his insurance program and financial condition, as well as his ability to do the actual work.

## **Checklist**

1. The contractor's certificate of insurance is complete, conforms to the insurance provisions in the contract and is correct in naming the district.
2. The insurance companies shown on the certificate conform to the A. M. Best's letter and numerical ratings on the financial strength and size of an insurance company. Due diligence on your part should require at least an A-(excellent) rating for financial strength and a financial size rating of at least VII (Policy holder's surplus of between \$50 and \$100 million).
3. The certificate names you as owner and as an additional insured.
4. The certificate provides a waiver of subrogation in your favor in all three main coverages.

5. The certificate shows at least a thirty-day notice to the owner in the event of cancellation or non-renewal of the contractor's coverage.
6. Warning: a certificate of insurance is not binding. It provides information about the coverage, but only the actual policy will prove that the contractor has what the certificate shows. Ask for copies of the endorsements providing cancellation notice, additional insured status, and waiver of subrogation. If necessary, ask to see the policies. The table below shows recommended limits of liability for each coverage. In general, aggregate limits should be at least twice the occurrence limits. Occurrence limits apply to each event while aggregate limits are the most an insurance company will pay during the one-year period of coverage. One large claim may exhaust the limits so there is no money available to pay for a second large claim. Require the contractor to endorse their policy to provide for a "per job aggregate."
7. The Contractor's General Liability coverage includes "Products/Completed Operations" coverage. This provides coverage in the event bodily injury or property damage are caused by a product used in construction or by the completed work itself. If a feature of the completed building causes injury, the completed operations coverage would apply. An example would be where a plumbing fixture was not properly installed causing a leak that damaged District property or caused a visitor to slip and fall. There would be no coverage for the faulty fixture, but damage or injury caused by it would be covered by the contractor's General Liability/Completed Operations.
8. The contractor maintains completed operations coverage for at least two years after the project is completed and accepted by the district.
9. If construction values are high or there are nearby exposures to property or large numbers of people, the contractor also carries an Umbrella policy. The Umbrella policy provides additional limits of liability above the occurrence and aggregate limits in the General Liability and the limits in their Automobile and Employers' liability coverages.
10. If the contractor uses equipment that is crucial to the completion of the job, the contractor has coverage for physical damage to "contractor's equipment."
11. Contractors and subcontractors on projects for public entities are required by Texas state law to carry Workers' Compensation coverage.

### **Additional Insurance Coverages**

Three types of insurance that may be required by the project include the Professional Liability of engineers or architects, Builder's Risk on the project itself, and Contract Bonds.

Architects and engineers carry Professional Liability coverage that is issued on a "claims made" form. This means that a claim must occur and be reported while the coverage is in force. If the architect lets their coverage lapse and a claim occurs after that point, there would be no coverage. A defect in design that causes injury and is discovered years after the project is completed will only be covered if the architect or engineer still has continuous coverage in force.

"Builder's Risk" coverage provides all risk physical damage coverage to a building or project that is under construction. The Builder's Risk policy pays based on the completed value of a building at the time of the claim event and includes coverage for materials that

have not yet been installed or that are in transit to the job site. This policy will respond in the event of fire, tornadoes, wind damage, flood, earthquake, theft, vandalism, and other weather-related damage. If the contractor provides the coverage, it should name the district as an “additional named insured.”

Contract Bonds are guarantees that a building will be completed. The bond issuing company guarantees to the owner (district) that the work will be completed if the contractor defaults and is unable to complete the project. Requiring a bond is an effective way to screen out financially weak contractors. Bond companies stringently underwrite the financial strength of contractors because they do not want to step in to complete the work after it has been abandoned by the original contractor. Bonds do add to the cost of a project and may screen out low bidders who are desperate for work and will underbid to get it.

The table below shows recommended limits of liability for each coverage. In general, aggregate limits should be at least twice the occurrence limits. Occurrence limits apply to each claim event while aggregate limits are the most an insurance company will pay during the one-year period of coverage. One large claim may exhaust the limits so there is no money available to pay for a second large claim. Require the contractor to endorse their general liability policy to provide for a “per job aggregate.” This means that each project that a contractor has going will have its own aggregate limit. This helps prevent large claims on other jobs from exposing the district to a lack of available insurance in the event of serious claims on your project.

### **Recommended Insurance Coverages**

Any company that does business with the district should have General Liability (GL), Automobile Liability (AL), and Workers’ Compensation (WC) coverage at a minimum. Recommended Limits of Liability are:

**General Liability** - \$1,000,000 occurrence, \$2,000,000 aggregate for premises/operations

\$1,000,000 occurrence, \$2,000,000 aggregate for products/completed operations

**Automobile Liability** - \$1,000,000 combined single limit for bodily injury and property damage, Hired and non-owned autos included

**Workers’ Compensation** - \$500,000 per occurrence bodily injury,

\$500,000 per occurrence bodily injury by disease,

\$500,000 policy limit for bodily injury by disease

(These are Employers’ Liability limits and do not affect the payment of medical expenses or lost wages to employees injured on the job)

**Umbrella Liability** - \$5,000,000 per occurrence, \$5,000,000 aggregate

### **Coverage should include the following endorsements:**

An “**additional insured**” endorsement naming the district should be added to the contractor or vendor’s General Liability and Automobile Liability policies.

A “**waiver of subrogation**” endorsement in favor of the district should be added to the contractor’s Workers’ Compensation, General Liability, and Automobile Liability policies.

For long term contracts renewable on an annual basis or large construction projects endorse all policies to give the district **30 days' notice of cancellation or non-renewal** if the contractor's insurance is cancelled or non-renewed.

Require a **per project aggregate limits** or aggregate limits by location or project endorsement on a contractor's General Liability. This will help make sure that the contractor's insurance company does not run out of limits on your project if the contractor has other large claims at other job sites. Both occurrence and aggregate limits are exhaustible during the policy period of the contractor's insurance.