

Be Wise: Uninsurable Risks Utility Contractors Should Consider

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It is the nature of the business for utility contractors to face high risk and the potential for sizeable losses. Learning to assess relative risk is crucial in protecting and growing a business. For a utility contractor, this is especially important.

While most small utility contractors understand many things can go awry and lead to financial loss, they also need to thoroughly understand uninsurable risks and exposures as well as the potential of any incident that could exceed their insurance coverage.

Some situations may be unavoidable and come with a high risk. Utility contractors can be held liable for many things that may occur regardless of a careful and thorough effort, thus some risks are unavoidable. There are also legal requirements in some contracts that require a contractor to cover losses that are not necessarily their fault, but by virtue of the contract they become legally liable for them. When considering potential projects, utility contractors of all sizes should be familiar with the following before entering into a contract.

Certain Jobs Cannot Be Insured

When it comes to prospective risk, jobs with an indemnity obligation are partially uninsurable and yet, this stipulation is included in many contracts. With contractual transfer, or Type 1 Indemnity, anything that goes wrong on the project becomes the responsibility of the utility contractor, even if they were not the origin of the problem or if problems occur after the project has been completed.

For example, consider a project where a company secures a contract to upgrade the sewer system in a city's downtown area. In order to complete the job, it is necessary to close down the street for six months. While this is clearly a necessity and the job's completion will benefit the local area, downtown businesses will likely experience slow sales due to the temporary road closure. As the indemnified party, the businesses are able to pursue the contractor for their loss of revenue.

In this situation, negligence is not the issue. The fact is someone is losing money and unless they have been convinced of the project's overall value to their business, they may understandably seek compensation. Anticipating which storeowners may choose to pursue damages during the course of the six months, or after, is essentially impossible. For a contractor, the only way to manage the risk is to network with the impacted businesses and try to work toward building strong communication that may help ward off damage claims.

Locations

Contractors should carefully consider high liability locations before committing to a job. When reviewing an opportunity, study who will be affected if something goes wrong and how much financial risk is involved. Most high liability location projects require agency indemnity, which similar to indemnity obligation, means losses will be paid by the contractor if something goes wrong, regardless of who the responsible party is.

An example would be a million dollar job that requires de-watering next to a high-rise building. If de-watering causes the settling of the neighboring high-rise, the indemnified party can be held liable even if they did everything properly in the process. In most cases, it is impossible to purchase enough coverage for an incident of this magnitude.

If damage or loss of revenue occurs, a lawsuit can be filed by any business or individual that is adversely impacted by the project. The costs of the lawsuit are regularly passed onto the contractor and the indemnified party, and often the contractor will be held liable to compensate them.

CONTRACT

Agency indemnity also means a contractor may face lawsuits that have nothing to do with their work but occurred on the premises upon which they worked. It is very loosely defined and can open a contractor to lawsuits during the job or years after the work has been completed.

While it is possible to purchase commercial coverage that covers some estimated losses in a high liability location, it is not feasible for most contractors. If a company makes \$35 million annually, it would take a policy of \$100 million in coverage to cover a small contractor in the case of damage to a high-rise building, which is not a practical expenditure. Most companies that can afford this kind of coverage choose to self-insure and deal with losses as they occur as opposed to purchasing this high dollar insurance. The stakes get similarly higher with higher risk projects, so everything is relative.

When considering a contract that includes indemnity obligation, the practical question is, "How large is my balance sheet?" For large contractors, indemnity obligation is a cost of doing business, as it is associated with most sizable contracts. In many cases, the potential loss exceeds the available insurance proceeds. The risks are assumed nonetheless and often times "risk" is a contingency component of a bid.

Unfortunately, many contractors are regularly taking these uninsured or underinsured risks without being aware of the potential ramifications of an incident in a high-risk location. In researching an opportunity with indemnity obligation or agency indemnity attached, a contractor should look beyond the potential profit. The main concern is whether or not a contractor has the resources to pay the necessary costs should any problems arise, or to spend hundreds of thousands of dollars fighting the lawsuit in court.

Large and small contractors alike would be wise to carefully assess these contracts and the potential liabilities associated with them before making a bid or commitment. A contract that appears to be a growth opportunity could potentially be the end of that company if they are not financially prepared to handle an extensive litigation process or substantial, unforeseeable costs.

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