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Respond to Wrap-Up Risks With New and Updated ASA Resources

Assess and Address the Risks and Hidden Costs Associated with Consolidated Insurance Programs

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The debate over the perceived benefits of consolidated insurance programs (CIPs) — popularly referred to as "wrap-ups" — has evolved over the past several decades into one of the hottest, most contentious issues within today's construction industry. Originally designed to reduce overall insurance costs on large, single-site projects involving significant labor and considerable workers' compensation premium costs, wrap-ups have changed with the industry to apply to massive projects with a high number of contractors and subcontractors. As a result, wrap-ups have become widely regarded as perilous for subcontractors and particularly so when used on smaller and/or multi-site projects.

In its simplest form, a wrap-up is a centralized insurance and loss control program intended to protect the project owner, prime contractor, and subcontractors under a single set of insurance policies. While the wrap-up concept has been around for a while, there has recently been a proliferation of variations in the original plan's design, making many contemporary programs seem like comparatively new insurance models. It should also be noted that the concept of a wrap-up program is a radical departure from the traditional insurance format, where each contractor and subcontractor individually purchases and negotiates its own programs to address liability and the risk of accidents and claims. Wrap-ups are often inappropriately marketed as providing the same or better insurance coverage, at the same or less financial risk and cost to the subcontractor.

Ideally, a wrap-up would provide fully paid comprehensive general liability, workers' compensation, excess liability and builder's risk coverage for all enrolled parties for the entire construction process and completed operations hazard period. All contractors are generally held liable for defects in construction and any resulting damage to property or persons arising from their defects. It is important to note that many states have enacted statutes of repose that establish a time limit after which claims against contractors for defective construction resulting in property damage are barred. Many statutes allow claims to be attached for eight to 10 years after construction is completed.

Today, most subcontractors that have experienced owner-controlled insurance programs (OCIPs) or contractor-controlled insurance programs (CCIPs) have come to realize that all wrap-ups are indeed not the same, and that they are rarely as comprehensive as the sponsor implies. In fact, many wrap-ups employ inadequate coverage and often burdensome procedures for subcontractors that can significantly amplify exposure to risk, increase administrative costs and paperwork, and generate problematic outcomes. To sum up, as last year's edition of the *ASAToday Special Report* highlighted, "as the use of wrap-ups has spread, so has the controversy surrounding them."

Evaluating the risk, predicting the total cost impact, and properly bidding an OCIP, CCIP or similar project-specific insurance program (PSIP) project requires having a firm understanding of the wrap-up coverage's extent and quality. To better assist subcontractors facing the rising tide of projects employing wrap-ups, ASA overhauled its range of contract resources, updating the *ASA Subcontractor Bid Proposal*, as well as publishing two new documents, the *ASA Addendum to Subcontract – Project-Specific Insurance* (2008), and the *ASA Contract Offers Terms for Projects Using Wrap-up Insurance* (2008) — all of which are geared toward helping specialty trade contractors with obtaining favorable terms and an appropriate understanding of coverage under wrap-up insurance programs. See pages 9-11 for copies of the two new wrap-up documents.

What To Watch Out For

The most important issues for any subcontractor considering an OCIP or CCIP are (1) how the subcontractor will be protected by the program and (2) what impact the program will have on its costs and administrative burden. Many perceived "benefits" of consolidated insurance programs are propagated

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throughout today's industry, but these so-called benefits usually favor the owner, or whoever is sponsoring the wrap-up program.

For starters, broader coverage is always one of the first selling-points touted to subcontractors. For some subcontractors, a wrap-up may provide broader coverage than they would ordinarily procure. As a rule, though, subcontractors should not assume wrap-ups provide such "broader coverage." While "broader coverage" may be used as a reward or an incentive for uninsured or under-insured subcontractors to join a wrap-up, subcontractors need to actually find out what additional or broader coverages will be incorporated. Examples of additional coverage include: asbestos and mold abatement, exterior insulation finish systems (EIFS), higher liability limits, pollution liability, professional liability, subsidence, or the removal of certain standard exclusions.

Another popular benefit that proponents of wrap-ups like to cite is cost savings. This can be tricky for subcontractors because wrap-ups, by nature, inherently save the owner/general contractor/policy sponsor money through one centralized insurance coverage that implements large deductibles, economies of scale, and minimized or "efficient" project administration. Subcontractors, on the other hand, must be aware that just because a sponsor's broker claims the policy will save them money doesn't mean it's necessarily true. Some of the numerous ways in which a wrap-up can reduce subcontractors' profit include:

- Increased administrative costs and paperwork preparation due to monthly payroll and loss reports to the wrap-up administrator.
- Open-ended mandates that a wrap-up's auditors/inspectors have to require subcontractors to conduct additional payroll reporting, implement early-return-to-work and other safety programs at the administrator's sole discretion, and other activities that create substantial costs for the subcontractors.
- The failure of the bid documents to explain administrative costs so subcontractors can recoup those costs.
- Worksheets that calculate too large a deduction from the subcontractor's bid for the subcontractor's actual net "cost of insurance" given the insurance package being provided on the project.
- Extra compensation the subcontractor must provide to its normal broker/agent for working with the wrap-up administrator.
- Lack of reimbursement to the subcontractor for the cost impact on its non-CIP insurance program.
- The impact of large deductibles and uncovered losses.
- Lack of *pro rata* (in proportion) sharing in retrospective premium adjustments on the wrap-up.

Reduction of the subcontractor's mark-up on its original insurance costs may be marketed as an area of cost savings under a wrap-up. However, many subcontractors find that the administrative burdens experienced under wrap-ups can become extremely costly.

ASA Resources Help Subs

One of the easiest ways subcontractors can avoid some of these problems is to condition their bids using the newly revised *ASA Subcontractor Bid Proposal* (2008) and the new *ASA Contract Offers Terms for Projects Using Wrap-up Insurance* (2008). By conditioning their bids with these documents, subcontractors can gain the leverage they need to secure less onerous terms and conditions. For example, to limit the rate of the deduction in relation to the "cost of insurance," use language such as that contained in paragraph 10 of the "Conditions of Bid Proposal" of the bid proposal document. This paragraph also stipulates that "[u]ndisclosed coverage terms and exclusions are subject to Subcontractor pricing and approval," and that "[n]o calculation of credits by the wrap-up administrator shall be binding on the subcontractor." Your bid proposal can help "level the playing field," making explicit the level of risk upon which your prices is conditioned. The *ASA Addendum to Subcontract — Project-Specific Insurance* (2008) can also be used to condition a bid. If a subcontractor decides to use an addendum for conditioning its bid, it can clarify in a scope letter that the bid is conditioned on the areas of utmost concern addressed in the addendum. Alternatively, this subcontract addendum can be attached to a client's proposed subcontract to modify it. ASA members can adapt and incorporate specific provisions or language from each of these model documents within their own documents.

The Wrap-Up Manual

To find out exactly how financial burdens are added in wrap-ups, subcontractors must perform a close reading of the wrap-up plan's manual. The wrap-up manual is where subcontractors will discover blatant financial pitfalls, such as the delay of final payment, requirements adding administrative costs, or an excessive deduction for a subcontractor's "cost of insurance." Unfortunately, many wrap-up manuals focus on marketing the plan and often fail to adequately disclose important details of coverage risk. For example, riggers liability may not be a covered exposure and any mention of the missing coverage may be completely omitted from the plan's manual. The policies themselves, including all endorsements and all of the incorporating contract provisions, must be considered as a whole to understand the coverage protections afforded by the wrap-up program. Missing coverage elements or program and contract pitfalls may be identified only after a careful review by experienced risk and insurance specialists.

Another so-called benefit, often hidden within the wrap-up manual, is the implementation of comprehensive safety programs. Proponents of OCIPs and CCIPs like to argue that such safety programs are one of the core fundamentals of any consolidated insurance program, because they regulate all participating parties under one set of rules, *and* because they help reduce insurance costs via the implementation of larger deductibles. However, the manual probably will not disclose that heavy-handed wrap-up safety officers with contract authority can mandate means and methods, including directives that deviate from the subcontractors' best interests in safety and productivity. The program's administrator also probably won't explain that some safety regulations could have nothing to do with your specific trade and will end up creating extra costs you did not factor into your initial bid.

Other factors which wrap-up sponsors market as benefits include low loss ratios and reduced cross-litigation. Loss ratios, which are the dollar amounts paid out for claims as a percentage of premiums paid, generally tend to occur on large wrap-up programs where claims are below 35-40 percent, and realistically only benefit the owner or sponsor, and not subcontractors, because return premiums are often not shared with all participants. Big return premiums indicated from loss-sensitive programs can cause a significant incentive for the sponsor to exercise early termination to capture the credits and close out the program from further losses. Such termination can, in turn, create a significant problem for specialty trade contractors that planned on having the wrap-up insurance remain available until the completion of the project, as well as for its coverage for completed operations hazard risk.

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Cross-litigation is by and large not good for anyone — particularly owners and general contractors that are trying to manage a project. While the reduction is obviously a good thing (as that can limit the amount of finger-pointing that occurs on a job), having to employ the plan sponsor's lawyer should not make or break a subcontractor's decision to join a wrap-up insurance program.

Preparing for Success Within the Wrap-Up Arena

It goes without saying that before someone enters into any agreement with another party, he or she needs to: first, understand that contract; and second, ask any questions about topics he or she does not understand. When the impact from a contract term is not fully understood, it pays to seek independent advice from experienced specialists before accepting the opinion of the other party to the agreement. OCIPs and CCIPs are no different. Wrap-up administrators should encourage full transparency of their program details before subcontractors bid. If a subcontractor can't have an open dialogue with the plan's administrator, including participation of its insurance, risk and legal advisors, during the pre-bid transparency period, it might not want to waste its time, money, and energy participating in the project. For help with this dialogue, see ASA's *Risk Transfer: 30 Questions for Consolidated Insurance Programs ("CIPs" or "Wrap-ups")* on the ASA Member Resources page of the ASA Web site. This resource provides subcontractors with a comprehensive list of CIP qualification questions that need to be answered to help them evaluate their risks and properly price their work.

Once a subcontractor finds out that it is going to bid a job with a wrap-up, it is essential that whoever is handling that bidding process request all available information about the sponsor's plan. Some of the most important documents include: the wrap-up manual (or overview of coverage), all related policy forms, the named insured endorsement, and any language regarding deductibles/self-insured retentions (SIRs). Also, the contract provisions for incorporating and regulating the wrap-up terms should be identified and carefully reviewed. Often, one will find information about deductibles and termination in the incorporating language.

It's also not a bad idea for a subcontractor to involve its insurance agents or brokers as early (and as often) in the process as possible, in order to assist in the analysis of any wrap-up that it hasn't seen before — regardless of whether the subcontractor is familiar with the respective builder. In order to receive the proper help and advice, subcontractors should arrange to pay their agents/brokers, especially since the wrap-up will not provide any compensation. Such costs can be factored in when completing a wrap-up's enrollment form. Simply add a line on the actual form itself adjusting the deduction to reflect your specified professional representation. A reasonable fee would generally be 15 percent of the subcontractor's premium credit.

Last, but not least, it is essential for subcontractors themselves — in addition to their agents or brokers — to exercise the appropriate due diligence when it comes to the details of any wrap-up program. Ultimately, the subcontractor is responsible for evaluating and pricing risk and for putting together an informed bid proposal after identifying limits or conflicts within the plan.

Walk This Way, or Just Walk Away?

Evaluating risk is an essential part of the pre-bid process for any subcontractor, and as with other bid factors, wrap-up requirements sometimes can be too risky for a subcontractor to take the work. Before any subcontractor can conclude whether it should enroll in a program or walk away, it should first be able to answer the following important questions:

- **Does the CIP have sufficient limits to protect all insureds?**

Consider the fact that wrap-ups are often intended to provide protection for the owner, contractors and all subcontractors (some wrap-ups might also apply on a rolling basis to many projects, which might be located at various sites). How does a subcontractor determine whether there will be enough insurance limits to take care of its liability? Many risk managers will expect limits of 70 percent or more of the total project costs to be available during construction and for many years after completion. A subcontractor may need assistance from its broker or agent to evaluate such program limits.

- **Does the plan include a termination for convenience clause?**

With respect to wrap-ups, subcontractors need to know if there are any such clauses in place within the plan — and, if so, does the subcontractor have the ability to replace its coverage in the event that a termination occurs? Otherwise, if the plan sponsor terminates for convenience, does the subcontractor have the right to terminate the contract when its own coverage is not available? In order to prevent any gap that may arise resulting from termination, subcontractors may wish to incorporate the provisions laid out in paragraph 5 of the *ASA Addendum to Subcontract — Project-Specific Insurance (2008)* or the *ASA Contract Offers Terms for Projects Using Wrap-up Insurance (2008)*.

- **Is the subcontractor's commercial general liability coverage eliminated if it participates or enrolls in a wrap-up?**

Unbeknownst to a number of subcontractors, many providers of commercial general liability (CGL) coverage suspend or eliminate a client's right to coverage when it chooses to enroll in an OCIP/CCIP. This can be a major factor with respect to the subcontractor's available insurance protection. The standard wrap-up endorsement, CG 21 54 01 96 (Exclusion – Designated Operations Covered by a CIP), stipulates that coverage does not extend to bodily injury or property damage arising out of any project subject to a wrap-up, thus excluding all coverage for ongoing and completed operations and excess coverage. This exclusion applies whether or not the wrap-up: provides coverage identical to that provided by the subcontractor's existing coverage; has adequate limits to cover all claims; or, remains in effect. The effect of the CG 21 54 01 96 wrap-up endorsement could leave the subcontractor exposed and without any coverage if the wrap-up fails to provide coverage or is terminated. Therefore, a subcontractor that chooses to participate in a wrap-up needs to know if its own policy will provide ongoing and completed operations coverage in the event the wrap-up fails to provide adequate coverage, exhausts its limits or terminates. If not, the subcontractor should attempt to obtain a coverage endorsement providing that its policies will provide excess, difference in conditions, and full coverage in the event of termination with regard to wrap-up projects. Subcontractors may want to obtain terms such as those included in paragraphs 1 and 2 of the *ASA Addendum to Subcontract — Project-Specific Insurance (2008)* or paragraphs 1 and 2 of the *ASA Contract Offers Terms for Projects Using Wrap-up Insurance (2008)*.

- **What are the effective dates of coverage and claims reporting available from the wrap-up?**

Subcontractors need to be aware of whether the completed operations coverage provided by a wrap-up matches or extends through the dura-

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tion of the respective state's statute of repose. A statute of repose is a law that bars claims against contractors for defective construction after a specified period of time has elapsed, post-final completion. Subcontractors should know what the applicable statute of repose is in the project's state. If the wrap-up manual does not provide adequate information about the coverage term, subcontractors should then address this issue with the plan's administrator during the pre-bid period. Subcontractors should also consider incorporating provisions similar to those outlined in paragraph 1 of the *ASA Addendum to Subcontract — Project-Specific Insurance (2008)*, or paragraph 1 of the *ASA Contract Offers Terms for Projects Using Wrap-up Insurance (2008)*, that allow a subcontractor to procure additional insurance and protect the sub's insurance from use by others.

- **Is the subcontractor properly protected by a waiver of subrogation?**

Paying attention to waivers of subrogation is very important because the wrap-up may not be properly designed for the protection of subcontractors. A waiver of subrogation can protect a subcontractor from liability when an insurable loss occurs. This can be particularly significant in relation to the builder's risk insurance when damage occurs during a project. When builder's risk insurance is provided by the owner (with or without a wrap-up), it should then be the sole source of recovery for damage to the work sustained during the course of the project until it is completed. Waivers of subrogation need to be properly coordinated so that subcontractors, which intend to derive benefits from the builder's risk policy when work is damaged, are not later subject to lawsuits for damage they cause. However, subcontractors need to know whether injuries to their employees (paid by workers' compensation insurance) caused or contributed to by other wrap-up insureds will be subrogated to the wrap-up's CGL policy to protect their experience. Will damage to a subcontractor's work caused by other wrap-up insureds and not paid by builder's risk be covered as liability claims under the wrap-up? Will a subcontractor be properly treated as a third-party claimant with regard to damage to its work? To address potential conflicts regarding this issue, a subcontractor should consider insisting that the owner/plan sponsor waive rights of recovery by subrogation by incorporating paragraph 7 of the *ASA Addendum to Subcontract — Project-Specific Insurance (2008)* into its subcontract. Another option is to insure one's property using language such as that contained in paragraph 6 of the *ASA Addendum to Subcontract — Project-Specific Insurance (2008)*, which addresses the scope of the builder's risk coverage included within the wrap-up. These issues also present another compelling argument for the subcontractor to have professional help in place before deciding whether or not to enroll in the wrap-up.

- **Will the wrap-up issue additional insured status for subcontractor's rental equipment?**

When it comes to rental equipment, subcontractors generally must arrange coverage for the rental provider through the wrap-up. They also must find out whether the wrap-up administrator is prepared to provide specific evidence of insurance that will satisfy the rental company. If additional insured status is not granted to the rental equipment provider by the wrap-up, there could be a big problem because of the likely CG 21 54 01 96 endorsement mentioned above. The *ASA Addendum to Subcontract — Project-Specific Insurance (2008)* includes language in paragraph 1 that, if incorporated into one's subcontract, allows a subcontractor to procure additional insurance limits to cover liabilities not covered by the wrap-up. This will be effective only if the subcontractor is actually able to convince its underwriter to agree to provide the coverage on a wrap-up project. Another risk a subcontractor may inadvertently be exposed to will arise from the use of its on-site equipment and scaffolding by other subs that may not be properly enrolled in the wrap-up and not insured by their own insurance programs.

- **Are the plan's self-insured retentions (SIRs) fully funded or collateralized by the sponsor? For how much? For how long?**

A self-insured retention (SIR) is a set amount of money that an insured must expend in its own defense prior to a carrier assuming financial responsibility and/or administrative control over the claim. Subcontractors need to understand the terms and amounts of SIRs since coverage may not be available to them until the SIR is fully funded. Many SIRs are very large ($250,000, $1 million, $3 million or higher) and well beyond the anticipated level which subcontractors are generally prepared to fund. Often SIRs are not disclosed in wrap-up manuals and can only be discovered by reviewing the actual wrap-up policies. When large SIRs are applicable to wrap-ups, a subcontractor will be subject to the financial capacity of the plan sponsor to fund the SIR and when there are multiple claims there may be multiple SIRs. Some plan sponsors are shell LLC developers that may not retain the financial capability to fund the SIR years after completion, which can put the subcontractor at considerable risk. Solving this problem requires the subcontractor to arrange for its own coverage to be available for difference in conditions and excess over the wrap-up, as previously discussed. Another option is for subcontractors to protect themselves against these unplanned liabilities through the incorporation of paragraph 4 of the *ASA Addendum to Subcontract — Project-Specific Insurance (2008)* or paragraph 4 of *ASA's Contract Offers Terms for Projects Using Wrap-up Insurance (2008)*.

The challenges a subcontractor faces in determining its risk and burden relating to wrap-ups cannot entirely be identified or described in this article partly because they are so numerous and also because there are so many differences from one wrap-up to another. The prudent subcontractor will exercise care and employ assistance in evaluating the risk of enrollment, as well as appropriately manage its own program to back itself up where any wrap-up leaves off.

To learn more about using ASA's bid proposals or subcontract addenda, subcontractors can read the bid proposal instructions, the *ASA Short List of Subcontract Negotiation Points (2005)*, and *The Contractor's Compass* article "How to Incorporate a Subcontract Addendum in Your Bid," all of which can be found in the members-only section of the ASA Web site at www.asaonline.com under the "ASA Member Resources" page.

At the end of the day, any subcontractor should possess a firm understanding of the quality and scope of the wrap-up insurance program it is considering. Sweating the details and exercising the appropriate due diligence during the pre-bid transparency period will enable one to obtain the necessary information — the extent and quality of the coverage, the length and details of the program's coverage, the experience and background of the policy's administrator, etc. — and position itself to make a well-informed decision on whether to enroll in an OCIP/CCIP/PSIP. Once a subcontractor makes the decision to bid a project with wrap-up insurance, bid conditioning is a good idea to avoid potential pitfalls or hidden costs associated with these types of insurance policies. Above all, a subcontractor must never forget that it can always walk away from a deal that is too risky.