

## A QUICK GUIDE

# Insurance Contract Terms

## what they mean and how to negotiate them

By Luke J. Farley and Dixie T. Wells

One of the most important functions of a construction contract is to allocate risk between the parties. Among the key risk-shifting terms of any construction contract are the insurance provisions. Most contracts have an entire section devoted to insurance that describes the types and amounts of coverage both the contractor and the owner must maintain during the project. These provisions also require the parties to obtain insurance policies that include particular terms such as who is covered under the policy and which parties can sue each other for losses covered by insurance. Not obtaining the required insurance can be a breach of contract. This article examines the most common insurance terms, what they mean, and how to negotiate them.

**TIP:** When negotiating a construction contract, consider consulting your insurance agent. The agent can tell you whether you already have the required types and levels of coverage, and, if not, what it will cost to obtain what you need.

### TYPES OF INSURANCE

The basic terms of the contract should list the types and levels of insurance

coverage each party must maintain during the project. Three common types of insurance required in construction contracts include Commercial General Liability, Workers' Compensation, and Builder's Risk.

**TIP:** Many contracts refer to insurance "limits." This can lead to confusion. The contracts establish the minimum amount of insurance a party must carry. The "limit" is a limit on the amount the insurance company could be required to pay under the policy, not the contractor's overall liability to the owner. To limit liability, contractors should negotiate other provisions that waive consequential damages or cap overall damages.

Contracts almost always require contractors to maintain Commercial General Liability (CGL) and Worker's Compensation insurance. CGL coverage insures against losses from personal injury or property damage due to the contractor's negligence. In the current market, the typical amount of coverage required for a CGL policy is \$1 million per "occurrence" (i.e., per single accident) and \$2 million in the "aggregate" (i.e., total amount payable during the policy term, usually a year). The amount of

Worker's Compensation coverage is usually dictated by state law. Contractors may also be required to carry automobile, pollution, environmental, property, and umbrella insurance.

**TIP:** When negotiating insurance requirements, contractors should consider whether the required insurance is relevant to their scope of work. For instance, there may be no need to require a contractor building a parking deck to maintain environmental or pollution insurance if the work does not involve hazardous chemicals.

Contracts usually require owners, for their part, to also carry CGL insurance.

The parties will often negotiate whether the owner or the contractor will provide the Builder's Risk policy. Builder's Risk is property insurance that covers the building under construction plus materials and equipment on site. It provides critical protection to the project during construction because ordinary property insurance does not cover construction in progress. Builder's Risk insurance can either limit coverage to certain risks (e.g., vandalism, fire, etc.) or be written on a broad, "all-risks" basis. Both the owner and the contractor will benefit from an

“all-risks” policy. Owners and contractors must take care to ensure that one of them obtains the Builder’s Risk.

**TIP:** Whichever party obtains the Builder’s Risk policy will have more control over making a claim under the policy and receiving payment for a loss.

Before starting work or getting paid, the contractor will often be required to prove it has the required insurance by providing the owner with certificates of insurance showing the proper type and level of coverage.

### ADDITIONAL INSURED

Contracts frequently require the contractor to name the owner as an “additional insured” under the contractor’s insurance policies. Naming the owner as an additional insured entitles the owner to make a claim under a policy of insurance as if the owner was the primary named insured. Owners like being an additional insured

because it allows the owner to make a claim under someone else’s policy and avoid the premium increase that would likely result from the claim. Adding an additional insured to a policy increases the insurance company’s risk—another person can now make a claim—and so there is an added cost to the contractor. Adding the owner as an additional insured does not happen automatically simply because it is required by the contract; instead, the contractor must purchase an “endorsement” (i.e., amendment) to the insurance policy.



Learn about the term “subrogation” in this article on [mcsmag.com](http://mcsmag.com)

### CLOSING THOUGHT

Insurance provisions read like technical legalese and can be an afterthought when negotiating the construction contract. But with a basic understanding

of the contractual insurance provisions, contractors can be empowered to actively negotiate these key risk-shifting terms. ■

### about the authors

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