A Pilot's Checklist for Construction Risk Management

By George F. Burns

January 23, 2015

Airplane pilots need to assess and manage risks before takeoff, during the flight and upon landing. Construction companies need to do the same. The following checklist will help achieve this goal.

BEFORE TAKEOFF

Don't Fly Blind: Assess Risk Before TakeOff

Legal risks and liabilities fall into two categories: liabilities arising out of promises made by contract, and liabilities arising out of promises imposed by society, referred to in the legal world as "tort" liabilities. Although it is helpful to think of contract and tort-based liabilities as distinct categories, they often overlap. With the help of seasoned construction lawyers and insurance and surety experts, companies should get a grasp of both kinds of risk, and then figure out

- how to contract only for those obligations the contract price will justify, and no more; and
- how to shift responsibilities to subcontractors, suppliers, insurers and sureties, as appropriate.

Know Customers and Vendors—and Their Creditworthiness

Who is the customer? Who is the subcontractor or supplier? Who is their insurer or surety? Are they competent and creditworthy? No promise is any better than the net worth of the person making the promise. This applies not only to buyers and sellers of goods and services, but also organizations such as insurance companies, banks and bonding companies. It is important to insist on players with solid credit ratings and keep checking those ratings.

Sign Contracts Thoughtfully—Set Up a System to Distinguish Between Routine and Unusual Risk

Implement a screening procedure to distinguish routine low-risk jobs from unusual high-risk jobs. Construction participants do not always know in advance what is usual and what is unusual. They all may believe that everything about the project is standard and customary—only to find out from outsiders to the project (governmental agencies, subcontractors and suppliers) that something very different from their expectations is at work.

How do companies know this project is standard? On whom are they relying in that belief? How are they made whole if that belief is wrong? Develop forms of purchase order both as buyer and as seller. Develop a policy on indemnification, both as giver and taker of such commitments.

Obtain, Maintain and Manage Suitable Insurance and Surety Arrangements

It is fundamental for the owner of a construction project to require the general contractor to procure builders' risk and comprehensive general liability coverage, in addition to the boilerplate requirements for workers' compensation coverage. The degree of elegance and thoroughness in these clauses varies from job to job, often dramatically. In its classic form, an owner will insist that the general contractor provide contractual liability coverage to cover the indemnification agreement by the general in favor of the owner. The owner, of course, also has its own comprehensive general liability policy in force. Similar arrangements are mirrored downstream in the contract arrangements between general contractor and subcontractors and, sometimes, suppliers.

To protect against gaps in coverage, it is important to carefully review the company's own documents, and the documents received from others, to make sure that the necessary protection is in place. It is best to have these documents, along with draft insurance policies and communications with brokers, reviewed by someone who is knowledgeable on the subject, and to negotiate any necessary changes to make coverage meaningful and complete. Do not rely on the broker exclusively.

Companies should take great care to fill out application forms completely, make full disclosure to their brokers in writing and send their brokers copies of key contracts. After a claim arises, the insurance company may claim there is no coverage because there was a failure to disclose something significant about the risk (e.g., the facility or the condition of the builder).

In the event something bad happens, make sure to have someone knowledgeable review the insurance policies. Once again: Do not rely only on a broker. Make certain that responsibility for contract claims and insurance claims is coordinated by someone who can see the big picture. Keep copies of all policies. Never throw a policy out.

Give prompt notice of any claims to the broker and follow up. Do not assume the broker has given notice to all insurance carriers. Insist on follow-up and acknowledgement of notice back from the insurance company. Document all losses.

As for sureties, resist the temptation to skip the creditworthiness analysis. Surety companies are credit-rated for a reason.

Continually Assess 'Gross Risk' and 'Net Risk'

What is the total risk assuming there is no ability whatsoever to transfer the risk to other parties or to insurance? This is "gross risk."

What is the risk after reliably transferring the risks to other creditworthy parties or insurers? This is "net risk."

If the company makes a mistake, does it have insurance to make it whole? If not, does the contract price and schedule take that uninsured exposure into account?

THE FLIGHT

Rights – Use Them or Lose Them: Stay With the Flight Plan

The construction phase is like the flight. What happens during the flight can weaken a strong flight plan and strengthen a weak flight plan. For example, an owner that constantly fails to enforce performance milestones called for by the contract documents can end up losing the right to enforce the contract documents literally. The owner's hand is weakened and the general's strengthened. So the question is always: are events in the field – the way life is actually led out there – strengthening or weakening protection from risk?

From the general contractor's, subcontractor's and supplier's standpoint, the question is the same. Are there readings during the flight that show surprising conditions? Are there encounters with challenges and risks that were reasonably unforeseen (and therefore should be compensated for) when the price and schedule were quoted? If so, the company must notify the owner promptly, or else risk waiving the claim for more compensation or time of performance.

Throughout the construction phase, the participants will be generating written documents, change orders, field directives, shop drawing submittals and approvals, lien waivers, requisitions, emails, etc. All of this documentation is loaded with the potential to strengthen or weaken the company's hand. Most will be about the basic, good business of getting the job done well and on time to everyone's benefit. While the company is busy getting the job done, there may be a document signed (e.g., an overly broad lien waiver) that unfairly curtails its rights, and that will be an unpleasant surprise down the road.

THE LANDING

Keep Asking – How to Be Sure Risks Are Minimized

The close-out of the project is the plane landing. The owner has to make sure it has gotten everything the contract calls for, including as-built drawings, warranties from the general, lower-tier subs and critical suppliers, and of course final lien waivers and indemnifications against lower-tier liens. The general and the lower-tier participants must ask the same question from their vantage points. And they, as well as the designer, must calculate after completion and final payment, how long they and their insurance companies and bonding companies will remain exposed to warranty and other post-completion responsibilities. A builder wants the peace of mind of knowing that the landing will be the genuine end of the flight—and that they have landed safely.

The overall goal of this checklist is easy to state, but requires resolve and discipline to achieve. Is whatever is knowable known? Has the controllable been controlled? To the extent to either question the answer is no, do the price and schedule adequately compensate for the remaining uncertainty? Some flights and some contracts are not worth the risk. Good pilots know the difference.

George Burns is a member of Bernstein Shur's Construction, Litigation, and Dispute Resolution Groups and serves on the firm's Board of Directors. Burns's trial and appellate experience is extensive, including numerous construction cases involving schools, water and sewage treatment plants, power plants, recreational facilities, bridges and boats. He is listed in Best Lawyers in America, recognized as a New England Super Lawyer for construction law and is AV-rated by Martindale-Hubbell. Burns is admitted to practice in Maine, Massachusetts, New Hampshire and New York. He is a resident of Falmouth, Maine. More at http://www.bernsteinshur.com/attorney/george-f-burns/. Contact him at gburns@bernsteinshur.com; 207.228.7127.