

# Business Insurance

\$100

November 12, 2012

www.businessinsurance.com

SPECIAL ISSUE

# CONSTRUCTION RISKS

DATA POSTER INSIDE: Exclusive survey of buyers reveals risk management profile of midsize construction firms



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NEWSPAPER



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# Contractor risks keep rising higher

*Firms expand into new areas in search of business*

By **MATT DUNNING**

With economic recovery in several segments of the construction industry slow to take hold, more small and midsize contractors are pursuing work that may be well beyond their field of expertise, if not their physical or financial capacity, construction risk management experts say.

In order to maintain sufficient levels of operating capital — or worse, simply avoid having to scale back the workforce — small

and midsize contractors are expanding the types of projects for which they're willing to bid, the kinds of contracts they'll sign to secure those projects, and the specific tasks they agree to perform once on site, experts said, and all at profit margins far below normal market levels.

While that broader field of vision regarding viable contracting opportunities may very well mean the difference between solvency

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## Talent shortage raises safety concerns

*Experienced workers may not be available*

By **LOUISE KERTESZ**

Layoffs during the recession have resulted in a shortage of qualified workers in specialized areas of construction in certain geographic areas, and the problem will likely worsen as construction picks up during the recovery.

Analysts expect a boost in demand for construction work in the wake of Superstorm Sandy, which could also exacerbate the shortage of qualified workers.

Smaller contractors may be tempted to stretch their hiring standards to fill out a project roster, increasing the likelihood of on-site injuries and defect claims, among other risks. This scenario worries construction insurers.

"I think there's a limited problem (of worker shortages) right now but one that could grow very rapidly," said Ken Simonson, chief economist at Associated General Contractors of America in Washington. For the past two years, there has been a sharp drop in the unemployment rate for former construction workers, but

not a corresponding increase in construction industry growth. That means those workers who have been unemployed likely will find other types of employment, become full-time students, or have given up looking in the construction industry, Mr. Simonson said.

"We hear scattered reports of shortages of welders and pipefitters and for crews to do aspects of single-family construction on tract homes. In Texas, where the economy has done better than most states, there has been a growing demand for home construction and a lot of competing industries looking for workers," he said.

In Maine, there are not enough workers to do specialized shutdown work at facilities, such as electrical and wiring, said Michael Bosse, chairman of law firm Bernstein Shur's construction industry practice group in Portland.

"We hear from our client base that there is a shortage of good quality (construction workers). They were always in demand and there were probably not enough of them, and since 2007, many have left the industry," said Rick Ciullo, chief operating officer at Chubb Surety in Warren, N.J.

Each construction company works in

### WORKER SHORTAGE?

For the past two years, there has been a sharp drop in the unemployment rate for former construction workers, but not a corresponding increase in construction industry growth. That means those workers who have been unemployed likely will find other types of employment, become full-time students, or have given up looking in the construction industry, according to Ken Simonson, chief economist at Associated General Contractors of America in Washington.

a specific environment and culture, so a worker from one company may not have the required experience going to another company, he said. "As an underwriter, we want to see people proven in their own culture and operating environment," Mr. Ciullo said.

Joe Mair, Philadelphia-based managing director at Smart Devine, a consultant to surety underwriters, said that for smaller and midsize contractors, tight profit margins and financial problems can result in contractors cutting corners

See **TALENT** page 18

## SPECIAL ISSUE

### CONSTRUCTION RISKS

The U.S. construction industry's slow pace of recovery from the 2007-2009 Great Recession is pushing small and midsize contractors out of their comfort zones, exposing them to unfamiliar and potentially devastating legal and financial risks.

Faced with historically high levels of competition for new contracts and a continuing shortage of qualified workers, midsize construction firms are pursuing work in sectors outside their fields of expertise and well beyond their traditional geographic markets.

What's more, many contractors are being asked to bear a greater degree of financial responsibility and liability for the projects they undertake.

However, risk management and insurance solutions are available to address the widening scope of exposure that small and midsize contractors are likely to encounter in the post-recession construction market, as we've highlighted in this special issue of *Business Insurance*. In this issue, we offer expert analysis of the critical risks contractors must consider as they expand their businesses to accommodate new industry realities, as well as the application of insurance products, contractual risk transfer techniques and general best practices designed to minimize those risks.

Also included in this issue is our data poster illustrating key findings from *Business Insurance's* recent survey of more than 250 construction executives and risk managers, as well as commentaries penned by thought leaders in the construction risk management field.

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Business Insurance (ISSN 0007-6864) Vol. 46, No. 44, is published weekly, except for combined issues the first and second week of July, the third and fourth week of August, the second and third week of November, the second and third week of December and the fourth and fifth week of December, by Crain Communications Inc., 150 N. Michigan Ave., Chicago, Ill. 60601-7524. Periodicals postage is paid at Chicago and at additional mailing offices. POSTMASTER: Email address change to customerservice@businessinsurance.com or mail to Business Insurance Circulation Department, 1155 Gratiot Ave. Detroit, Mich. 48207-2912. \$5 a copy and \$149 a year in the U.S. \$169 in Canada and Mexico (includes GST). All other countries, \$249 a year (includes expedited air delivery). Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 40012850, GST No. 136760444, Canadian return address: 4960-2 Walker Road, Windsor, ON N9A6J3. Printed in U.S.A. Copyright © 2012 by Crain Communications Inc.

# Work in new regions brings additional risks

*Differences in laws, rules require careful review*

By **MATT DUNNING**

In order to take advantage of recent spurts of new contract opportunities in certain regions of the United States, many small and midsize construction contractors are finding themselves forced to submit bids for work in states far afield from their usual zones of operation, construction risk management experts said.

While the number of small and midsize contractors moving into unfamiliar geographic regions is vital to the overall health of the construction industry, a small or midsize construction firm choosing to explore contract offers in states hundreds of miles from their own must recognize the litany of legal and financial exposures that await them, experts said.

Regulatory risks, supply chain and staffing issues, cost overruns and other unforeseen complications can seriously jeopardize the safety of a contractor's workers, the viability of the project and, in some cases, the very solvency of the contractor, experts said.

"I see it as knowing the difference between recognizing the situations in which you actually have the expertise needed, as opposed to just needing the job," said Scott Rasor, Chicago-based president of Zurich North America's construction practice.

In the first place, contractors need to appreciate the many legal and regulatory differences between states in terms of insurance laws, workplace safety standards, litigation trends and commerce laws, Mr. Rasor said.

Labor workers compensation laws in New York and California have had drastic firming effects on insurance availability for projects in those states, as have recent natural catastrophes in Texas, Louisiana, Colorado and Florida, to name a few.

Most states also have their own set of occupational health and safety regulations, as well as standards for negotiating with union tradesmen.

"You have to either know that ahead of time or partner with another contractor with experience in the region," Mr. Rasor said.

In New York, he said he and his colleagues at Zurich have observed firms experience significant frustration when it comes to availability of contractor insurance for anyone working from heights that would be subject to state laws that allow workers to file for workers compensation and sue their employers for negligence.

"A lot of insurers have taken some different approaches to that. Ours is to underwrite and price the risk appropriately, but a number of other companies have chosen to exclude the risk altogether or they've decided to stay away from certain classes of business so they don't have the exposure," Mr. Rasor said.

Though a majority of states have made strides in the past several years to improve the portability of construction companies' own contract offers to subcontractors, experts said some states still have not settled within their own judiciary certain insurance terminology and liability assignments, including anti-indemnity applicability and the issue of what exactly constitutes an "occurrence."

"Really, what you have is a handful of



AP PHOTO

**Catastrophes, such as Colorado wildfires earlier this year, open opportunities and risks for construction firms**

states that remain difficult because they've interpreted it differently than the majority of other states," said Paul Becker, Nashville, Tenn.-based chairman of Willis North America Inc.'s construction practice. "There's a lot of uncertainty in states like Pennsylvania and Texas regarding this, and it's a big deal for contractors. It's an area that remains unresolved in my mind, and remains an area that needs to be focused on."

See **TERRITORY** page 22

# Liability exposures keep expanding for contractors

By **MIKE TSIKOUKAKIS**

U.S. construction contractors must clearly understand their general liability exposures as they face firming rates, tightening terms and conditions, and unfamiliar policy requirements.

Changes in the types of work they perform often exposes contractors to policy requirements that are different to the standard wordings they are familiar with, experts say.

Geoffrey Smith, president and CEO of EllisDon Corp. in Toronto, grew the company from a middle-market firm doing less than \$1 billion in revenues in the early 2000s to \$3 billion this year.

While the U.S. and Canadian economic pictures differ, EllisDon significantly broadened its work to include larger building projects and public/private partnerships. It had to adjust its general liability insurance coverage accordingly, Mr. Smith said.

"The scope of our professional activities has broadened dramatically. I foresee that it will continue to broaden, and certainly that's my goal," Mr. Smith said. "Therefore, we've had to review and extend our professional liability and general liability coverages to cover that."

"Clearly, as mid-sized contractors are working in new territories or on different types of projects, it can definitely lead to challenges that aren't covered by project margins," said Edina, Minn.-based John Watras, vice president for middle-market construction for Zurich North America Commercial.

Midsize contractors are evaluating their general liability coverage to make sure they have the correct coverage required by general contractors or project owners and for their own operations, Mr. Watras said.

Terms and conditions for commercial general liability policies are tightening and rates are increasing, said Craig Merten, national construction practice leader of Willis of Colorado Inc. in Denver, a unit of Willis Group Holdings P.L.C.

"We're seeing a 5% to 7% pure rate increase for a good, profitable business," Mr. Merten said, noting that last year "we were out trying to negotiate flat renewals to keep accounts out of the marketplace."

With the downturn of the construction market, three to four years ago insurers provided midsize contractors relief in terms of rates, said Chase Johnson, unit manager for Lockton Construction Services, a unit of Lockton Cos. L.L.C. in Kansas City, Mo.

"But obviously the construction market has not recovered to where it was five or six years ago. Yet carriers are looking for rate stabilization or rate firming now, when many of our clients are still needing relief from a cost standpoint," he said, noting that contractors are not willing to risk branching out to new areas of work, but nevertheless are bidding on more larger projects.

For those contractors with a negative loss history over the last few years, rate increases may be

## ALTERNATIVE APPROACHES

Requirements not in a standard commercial general liability form that can create alternative ways to secure general liability coverage include:

- Requiring a specific additional-insured form with updated policy language
- Specifications of what exclusions are or are not on the policy
- Increasing limits
- Purchasing project-specific wrap-up policies
- Increasing retentions

# Care needed with complex contracts

*Conditions can include tough financial penalties*

By **JOANNE WOJCIK**

Construction contractors that bid on projects outside of their historical areas of expertise, such as residential contractors seeking commercial work, are likely to be presented with contract terms and conditions with which they may not be familiar, construction risk management experts say.

Because they could be subject to financial penalties as a result of delays, transferring and mitigating the risk of inability to perform becomes an important consideration for contractors that may be playing in a whole new space, experts say.

"If you do electrical work and you've done housing your whole life, but now you're doing hospitals, or you're moving from the private to the public sector, contractors with experience in every field of construction are facing new challenges," said David Finkelstein, executive vice president in the surety

division of Philadelphia-based Arch Insurance Group Inc. "Today, more and more is being required of any contractor, because terms and conditions of construction and the processes that go into it are so much more complex."

Tim McGinnis, Dallas-based senior vice president in the national construction practice of Willis North America Inc., said: "Contractually, we are seeing very onerous terms and conditions."

For example, many commercial projects require contractors to pay liquidated damages, a form of financial penalty, if any of their activities result in the delay of a project's promised completion date.

## Deadlines more important

"Contractors basically put their corporate balance sheets at risk every time they sign a contract without the ability to transfer this risk," Mr. McGinnis said.

Such penalties are especially common in the utility sector, where building contractors are required to meet certain performance-based owner specifications, according to Tom Miller, senior vice president at Kansas City, Mo.-based

Lockton Cos. L.L.C.

"Contractors moving into the commercial world are going to find a much stronger focus on project schedule. If the predecessor contractor falls behind schedule, it puts pressure on the successor contractor to complete the job in less time than they negotiated on the front end. So the contract should contain provisions to account for this possibility, either to cover the cost of additional manpower or man hours to complete the job in the compressed time frame," Mr. Miller said.

In such scenarios, "there might be liquidated damages provisions" or a requirement in the contract that the contractor responsible for the delay pay a specified dollar amount to the project owner, he said. Additionally, "the contract might state that you're on the hook to pay the general contractor for whatever period you delay the project," Mr. Miller said.

At least one insurer — Philadelphia-based Ace USA — recently introduced a coverage endorsement to its builder's

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See **LIABILITY** page 22



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# Prequalification important in tough economy

By **DOUGLAS McLEOD**

The weak economy has made it more important than ever for general contractors to vet subcontractors on construction projects, although it has become more difficult in many cases to do so, experts say.

Most project owners and general contractors take steps to prequalify subcontractors, assessing financial condition, safety record,

insurance coverage and other factors. With the slowdown in new construction, though, more subcontractors are bidding on a dwindling number of jobs.

To hold down costs, more non-government projects also are being "hard bid," with work going to the lowest bidder, rather than negotiated with subcontractors who might be more qualified or better known to the general contractor.

**To hold down costs, more non-government projects also are being 'hard bid,' with work going to the lowest bidder.**

"In a bid environment, it's hard to do prequalification," because of time constraints and pressure to go with the lowest bid, said Brian Carpenter, senior vice president with Willis of Minnesota Inc. in Minneapolis.

The need to prequalify is greater than ever, he said, "but the ability to do it has been somewhat impaired."

While general contractors have always tried to choose subcontractors

carefully, they have not always followed a formal prequalification process, relying instead on surety companies to vet subcontractor strength. Since the 1990s, though, formal prequalification has increasingly become the norm.

A key area of prequalification scrutiny is a subcontractor's financial data. General contractors may

See **SUBCONTRACTORS** page 22

## Wrap-ups gaining popularity

By **JOANNE WOJCIK**

With the wrap-up market remaining buyer-friendly, many midsize construction firms are likely to encounter wrap-up participation as a contractual requirement on many projects on which they are bidding, perhaps for the first time.

Anti-indemnity statutes that prohibit subcontractors from naming general contractors and project owners as additional insureds on their liability insurance policies also are driving increased use of wrap-up insurance programs nationwide, industry experts say.

But contractors that participate in wrap-ups should be careful that they provide completed operations coverage through the statute of repose in the state where a project is being built, because most insurers exclude coverage for work completed under a wrap-up, experts say.

In some cases, they also may want to ensure that their own operating and practice policies will sit excess of a wrap-up, experts say, especially if a large number of contractors are participating in the program.

Wrap-ups generally come in two forms: owner-controlled insurance programs, which are sponsored by project owners; or contractor-controlled insurance programs, sponsored by a general contractor. In some cases, there could be a developer-controlled program if developers are awarding all of the contracts involved in a construction project.

"The critical thing about sponsoring one is you have to be in the position to control all of the contracts. Otherwise, you can't force participation and you can't enforce the rules," said Mike Hastings, project risk practice leader in

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BLOOMBERG NEWS

Superstorm Sandy devastated parts of the Northeast last month cause big insurance losses.

## Cat-exposed areas see rate hikes

*In Sandy's wake, builders risk cover likely to cost more*

By **BILL KENEALY**

While rates in the broader market for builders risk insurance have been relatively flat this year, rates in catastrophe-exposed regions have increased between 10% and 20%.

And the widespread destruction wrought by Superstorm Sandy is likely to reinforce that trend, experts say.

"In light of what we have seen on the upper East Coast, we are definitely going to see an increase in rates," said Sheila Hailey, vice president and direc-

tor of underwriting and operations at Farmington Hills, Mich.-based wholesale broker and underwriting manager Burns & Wilcox.

Scott Nissen, senior vice president with the construction services group of Aon Risk Solutions, a unit of London-based Aon P.L.C., said that given the extent of the storm damages, many primary insurers are likely to reassess the rate adequacy for their books of business in catastrophe-exposed areas.

"There will be a lot of insurers taking a second look at their exposures in the Northeast, and a lot of their underwriters will be looking at their shoes," he said.

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## Developers insist on surety bonding

*With defaults rising, contractors required to purchase coverage*

By **MATT DUNNING**

Since the end of the Great Recession, many small and midsize contractors have become much more likely to encounter requirements to provide surety bonding as a condition of approval for a construction contract, according to several surety and construction risk management experts.

Already mandated for most types of public contracts, requests for surety bonds have grown increasingly common among private developers seeking to protect their investments, as contractor and subcontractor defaults continue to rise amid sluggish recovery in the construction industry, experts said.

Still, even with market conditions firming, experts said small and midsize contractors with consistent performance histories, realistic views of their own capabilities and, most importantly, strong financial footing should be able to leverage the surety market in pursuit of public or private work, experts said.

"There are quite a few surety underwriters that are willing to entertain surety bonds for contractors at the \$5 million to \$10 million level," said Erik Johansson, the Irvine, Calif.-based senior vice president of Willis North America's surety practice. "What's probably key at this point in the game is cash on hand and, obviously, that's going to be a challenge to a new entrant into the marketplace."

During the past three years, fewer project opportunities have led contractors to compete for projects at drastically reduced profit mar-

See **SURETY** page 23

### GETTING BETTER RATES

Contractors can take several risk management measures to lower their rates, such as:

- Use proper fencing, locks and lighting at sites
- Remove mobile equipment at night
- Hire security services to guard sites
- Commit to a project timeline that is not so long as to incur weather risks and not so short that the project is rushed

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# Opinions

## EDITORIAL

## Build a bridge to contractors

**I**t's no secret the real estate market in much of the country cratered during the Great Recession. A big part of the implosion was sparked by new residential, commercial and industrial construction projects grinding to a halt.

Now, contractors who survived the malaise are clawing back during the ongoing recovery.

It's important to note that, aside from a handful of big national builders, most of the building in this country is done by regional, or middle-market, contractors and subcontractors. This has created a double-edged sword affecting contractors and commercial insurers who underwrite general and professional liability, property, surety, workers compensation and other insurance coverage for the construction industry.

In order to sustain themselves, many middle-market builders are stretching into uncharted territory by bidding on jobs outside the municipalities and states where they typically work. Also, these contractors are, in some cases, trying to snag bigger jobs outside the scope of their construction expertise. And in order to fulfill larger contract requirements, they need more subcontractors. With a well-documented national shortage of skilled construction workers, it presents quite a staffing challenge.

The hard-hat survival mentality among midsize contractors has made them a far greater risk from an insurance standpoint. In fact, as this issue covers in great detail, the contractors are taking on a slew of new risks as they scramble to make a buck and remain viable.

The commercial insurance industry surely has taken notice. More insurers see the real estate rebound as an opportunity to build and expand their portfolio of construction policies. Underwriters are putting a stake in the ground to get a piece of construction coverage. It's an example of one of the things the insurance industry does best: respond to changing economic trends spawning new business risks.

However, we think a better balance should be struck between insurers and contractors to help the construction industry keep growing. Smaller and midsize contractors must realize they can't resist opening their books to underwriters' scrutiny so insurers can price insurance premiums properly based on risk levels. Insurers must recognize mid-market contractors dominate the construction sector and think innovatively about what risks they'll cover and how to better package policies.

## LETTERS

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## SCHILLERSTROM



## COMMENTARY

## Worker shortage adds to liabilities

**S**uperstorm Sandy could give the construction industry in the Mid-Atlantic a sorely needed boost over the next few years as homes, businesses and infrastructure projects are restored and rebuilt. Even before the storm bombarded the coast, hiring in the long-depressed construction industry was beginning to show signs of recovery, experts say.

But as we report in this week's special issue, mid-market contractors in the Northeast will be hard-pressed to find qualified workers because many have either left the region or the industry to pursue other careers because of the prolonged recession.

Moreover, hiring inexperienced workers could prove costly to middle-market construction contractors. Novice construction workers are more likely to injure themselves driving up workers compensation claims costs for their employers. Contractors also may become subject to fines imposed by the U.S. Occupational Safety and Health Administration, which is cracking down at U.S. job sites to make sure worker safety is being observed.

Workers' inexperience also may contribute to project delays, triggering surety bond coverage. Surety underwriters prefer it when contractors hire employees who are familiar with their workplace cultures and operating environments, experts say. In fact, the rising rate of delays and defaults among subcontractors and smaller general contractors during the recession already has prompted a majority of sureties to impose much stricter underwriting guidelines on midsize construction firms.

Depending on contract terms, project delays attributable to worker inexperience also could force subcontractors to pay costly liquidated damages to

upstream contractors or project owners.

The construction worker shortage also may encourage contractors from other parts of the country, where there are fewer opportunities, to bid on projects in the storm-ravaged Northeast, a geographic region with which they may be unfamiliar.

Because many of the public entities affected by the storm are still in dire financial straits, contractors bidding on infrastructure rebuilding projects may be asked to help finance them by participating in public-private partnerships, or "P3s," which may be a foreign concept to many.

As the rebuilding commences, middle-market construction contractors need to be mindful of these potential legal and financial pitfalls and take the necessary steps to mitigate their exposures, either through contractual risk transfer or by securing adequate insurance and/or surety protection.

For example, mid-market general contractors might decide to prequalify subcontractors to ensure they are adequately insured and that their workers adhere to

established industry safety protocols. In states where it is permitted, middle-market general contractors could require their subcontractors to name them as additional insureds on their liability policies. Alternatively, middle-market construction contractors might want to sponsor wrap-up insurance programs to ensure that all of the contractors on a project have adequate liability protection and emphasize worker safety.

Such due-diligence efforts should make it possible for middle-market construction contractors not only to survive, but perhaps even thrive, in the post-hurricane, post-recession economy.

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**JOANNE  
WOJCIK**  
SENIOR EDITOR

# Professional liability exposures grow as contractors expand their horizons

## Businesses take on unfamiliar projects in tough economy

By MIKE TSIKOUKAKIS

Contractors in the United States that are venturing into new areas of work may face professional liability exposures as they take on unfamiliar projects.

Contractors professional liability insurance and the risks associated with projects in newer fields are often an afterthought for smaller and midsize contractors, who are increasingly pursuing such work due to the sluggish U.S. construction market, industry experts say.

Since the early 2000s, Mississauga, Ontario-based EllisDon Corp., grew from less than \$1 billion in revenues to \$3 billion this year by expanding its capabilities to larger projects and design-build projects.

While the U.S. construction market differs from that of Canada, EllisDon pays careful attention to the contractual requirements of the project owner or general contractor when addressing professional liability exposures, said Brenda M. Giardetti, insurance manager at EllisDon in Mississauga.

"All the insurance that we place on specific projects are dictated by the insurance requirements in the owner contract," she said. "On a design-build project, the owners are always going to want to make sure that there is professional liability in place. They usually would push that down to the design-build contractor, in our case, us."

### Project-specific policies

If the owner requests project-specific professional liability insurance, in which the policy is written for the term of the work, "we would buy a project-specific policy," Ms. Giardetti said, noting that if the owner did not ask for such a requirement, the liability would be pushed down to the firm's architects, who have their own professional liability policies.

Since 2008, U.S. midsize contractors searched for more work in unfamiliar fields because they didn't have the backlog of work that larger firms do, feeling the heat immediately, said Atha Forsberg, senior vice president in Marsh Inc.'s FINPRO architects, engineers, and contractors professional liability practice, based in Chicago.

"We have seen a shift in the type of work that certain contracting firms are working on that's probably been out of a pure desire to stay afloat and to keep the business going in some cases," she said.

Historically, contractors' professional liability insurance was

more project-oriented, Ms. Forsberg said.

Now, "it's not so much project type; it's project delivery type," she said. "When you take that position as a design-builder, it's a huge shift in the allocation of risk on a project."

Mid-market contractors taking

on projects with delivery expectations tend to consider professional liability exposures and the risks associated with those projects, only after being pressured by owners or general contractors' contractual requirements, said

See **LIABILITY** page 10

## \$1 million

The combination of professional liability with pollution liability policies under a single form is becoming a trend in the industry. For such coverage, minimum limits typically are \$1 million, and depending on the market, minimum premiums can be about \$10,000 to \$25,000.



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Ingo Zimmermann, Head of EADS Corporate Insurance Risk Management

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# Liability: Exposures grow as contractors expand their horizons

CONTINUED FROM PAGE 9

Keith Jurss, senior vice president for professional liability within the national construction practice at Willis North America.

"Now when they're taking on that risk more in a contractual format, it creates some exposures for them and they really need to think about buying professional liability," he said.

In the United States, owners and general contractors increasingly are requiring contractors to have either a professional liability

policy in place, or a combination of professional liability with other coverages, such as pollution, said John Watras, vice president of middle-market construction, Zurich North America Commercial based in Medina, Minn.

"It's definitely a trend," Mr. Watras said. "Most of the midsize contractors are considering acquiring combined professional and pollution products. It's a coverage that general contractors and owners are starting to see in the subcontracting community,

in as such, they're regularly asking subcontractors to come to the table with those types of coverages."

Mr. Jurss of Willis said the construction professional liability landscape for midsize contractors is fairly steady, with new entrants coming into the insurance market.

## Combining coverages

Allied World Assurance Co. Ltd., Philadelphia Insurance Cos. and CNA Financial Corp. recently have developed specific forms

targeted at midsize contractors that combine coverages, he said.

"When you have new players entering the market that are chasing that construction professional, everybody's fighting for that business and it really keeps the rates pretty steady," Mr. Jurss said.

"So we haven't seen any real hefty decreases in rates, but what we are seeing is that it's been fairly steady; there are not any real major increases for contractors in the professional liability area," he said.

The combination of professional liability insurance with pollution liability insurance policies under a single form is becoming a trend in the industry, "especially with the middle market," Mr. Jurss said, noting that contractors are trying to save money on insurance wherever they can.

"The view that a lot of the underwriters have, is that it makes it more attractive for a middle-market client when they can buy their professional and their pollution under one form versus two separate policies," Mr. Jurss said.

For such coverage, minimum limits typically are \$1 million,

**'When you have new players entering the market that are chasing that construction professional, everybody's fighting for that business and it really keeps the rates pretty steady. So we haven't seen any real hefty decreases ... but there are not any real major increases.'**

Keith Jurss, Willis North America

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and depending on the market, minimum premiums can be about \$10,000 to \$25,000, Mr. Jurss said.

Providing insurers with all the information on risks that underwriters require can help midsize contractors better secure the professional liability coverages that they need, according to construction insurance experts, because insurers are less willing to make manuscript, or customized, changes to the policy.

Geoffrey Smith, president and CEO of EllisDon in Toronto, said insurers are used to offering conventional coverages.

"So when you start asking them if they want to get creative about how they structure coverages, especially with respect to higher deductibles, they're more resistant to change than sometimes we like them to be," he said.

"Probably, when you say mid-market, the way we are, it's less worth their while than if we were three times the size. We're pushing, but sometimes we have to push people to change," Mr. Smith said.

# Perspectives

Disjointed contractual terms and insurance provisions in construction contracts can be confusing. What can building owners and contractors do to mitigate the potential for gaps in a project's insurance coverage when problems occur? Cynthia Pertile Tarle of Tarle Law P.C. and Lori Robinett of Willis North America Inc. outline how to build a partnership, connect the dots and pay attention to all the details.

## Drawing up an insurance plan helps prevent coverage gaps

By Lori Robinett  
and Cynthia Pertile Tarle

What can happen when your construction contract has seemingly gone wild, and how do you guard against the potential for resulting gaps in your insurance coverage when disjointed contractual terms and insurance provisions are looming?

Poor planning of the insurance program can be financially devastating to a project. What may seem unimportant to the construction team today can destroy profit margins tomorrow. Whether your perspective is as the owner or as a contractor (regardless of tier), several significant steps can be followed to protect your company:

1. Build a partnership

between the construction team and the insurance team. This team approach can accomplish the goal of ensuring the proper scope of coverages under the contract.

2. Connect the dots throughout your contractual terms and provisions. This will make the difference between a successful insurance program and one that may ultimately be disjointed and ineffective.

3. Pay attention to details. The modification of individual words in your contract language and insurance requirements can make a major difference in whether your project has coverage when a claim arises.

### *The partnership*

Development of the insurance program is frequently left as an afterthought to the con-

struction aspects of a project. Insurance teams are often not even consulted until the end of contract negotiations. As a result, contractual insurance requirements may fail to appropriately address the full range of risks associated with the project, and gaps in insurance coverage are created — or worse, a denial of insurance benefits occurs — when coverage requirements, risk of loss, and indemnity provisions are not properly integrated.

Proactive communication is key to avoiding this pitfall, and the sooner the construction team and the insurance team start communicating what type of insurance program the project will be operating under, the more benefits the project will reap.

It's critical for the risk manager and the construction manager to take a team approach and bring the right team to the table for the negotiations. In assembling the team, you may consider retaining outside counsel in order to provide specialized legal advice and negotiation skills, which your in-house counsel may not be equipped to offer.

Moreover, be sure to communicate with your broker early and often in assessing whether the insurance coverage being requested, including any specific endorsement language, is available in the marketplace and economically realistic.

Correctly identifying the team players and evaluating the insurance program options before contract negotiations commence will result in smoother, faster, and more productive negotiations between the parties; will increase leverage when negotiating with underwriters regarding specific language in the policy and endorsements; will likely result in reduced premiums; and will substantially increase the ability to have and maintain seamless and contractually compliant coverage, translating into

higher overall profit margins for the project.

### *Connecting the dots*

Once the appropriate parties are involved in the negotiation process, focus collective efforts on understanding your options associated with structuring the insurance program. This includes an analysis of procurement options under a conventional insurance approach or a project specific program. When evaluating your options, consider the perspective of each of the stakeholders. For example, a controlled insurance program, or CIP, can have a financial effect that will differ depending upon who sponsors the program (i.e., owner versus general contractor). If contemplating a CIP, it is ideal to address this before negotiations of the contract even begin; however, should circumstances delay a final decision, be sure to specifically set forth in the contract terms a provision which will allow such an option to remain on the table. Credit validation under a CIP will vary between net bid and gross bid, so understand the difference and how this can affect the bid and management of a CIP. Consider the experience level of the parties involved, including the type of safety program which may be employed by the contractor and make sure this is in alignment with what the insurer will require and will sometimes make a condition of coverage. Safety programs can significantly affect how smoothly the project runs and how the claims process is handled.

Additional factors to consider when contemplating a CIP approach include coverage certainty and the size of the budget, as large budget projects are more likely to benefit financially. The number of direct contracts to the owner; disadvantaged business participation;

Continued on next page



Lori Robinett



Cynthia Pertile Tarle



**Don't leave development of the insurance program as an afterthought to the construction aspects of a project.**

# Perspective: Drawing up insurance plan helps prevent coverage gaps in policies

CONTINUED FROM PAGE 11

complexity and flow of the indemnity and risk of loss provisions all may lend the project to benefit more from one insurance program over the other.

### Pay attention to details

Consider the potential effect of the selected insurance program on issues such as aggregate limits and catastrophic loss; deductibles and self-insured retentions; and scope of

coverage. Regardless of the program implemented, policy exclusions are always of utmost concern.

For project-specific insurance programs, or CIPs, carefully craft the scope of eligible and excluded contractor definitions and pay special attention to how named insured and project site are identified. Failure to properly define project site, for example, can result under certain endorsements in the exclusion of coverage for loss of use

related to existing structures under renovation that are not in the care, custody, and control of the insured. Be on the lookout for insurers who may opt to tie the administration of the CIP as a condition of coverage, in which the policy is at risk of cancellation if requirements, such as timing of enrollment, are not adhered to.

With regard to conventional policies, wording associated with “your work” and wrap-up exclusions should be reviewed

closely in order to prevent unintended denials of coverage. Removal of the subcontractor exception to the “your work” exclusion can result in lack of coverage for a general contractor who might otherwise have such coverage if the policy wording had been modified up front.

Establishing the insurance requirements alone is not enough. Marrying how and when risk is transferred with contractual insurance coverage requirements is essential. Ask questions such as: Is risk of loss transferred upon a certain trigger — for example, delivery to site, in relation to the cost to repair and replace damage?

Consider whether risk of loss/indemnity limits are tied to insurance proceeds under the contract. Does the contract address different risk of loss limits for nonconforming or defective work vs. damage to “your work” in an attempt to address certain policy exclusions? If so, evaluate the aggregate and occurrence limits being contractually required in order to assess whether they will be sufficient, as well as the application of deductibles or self-insured retentions.

Of course, with regard to indemnity provisions, be sure that scope of defense, indemnity and hold-harmless language intersects with the scope of insurance coverage required. Be aware of how the contract defines significant terms and consider the differences in contract interpretation and the potential effect of case law regarding language such as “due to,” “arising out of” or “resulting from” vs. “to the extent of” your negligence when defining “losses arising from.”

**Be aware of how the contract defines significant terms, and consider the differences regarding language in contract interpretation and potential effects of case law.**

If the indemnity language of the contract contemplates defense and indemnity under a completed operations scenario, be sure to implement the correct additional insured endorsement requirements. And be very cautious regarding the use of “or equivalent to” language, especially in light of the vast number of manuscripted endorsements. Consider, instead, identifying not only the exact ISO endorsement form required, but also the coverage expected, with an eye toward an understanding of what is available in the marketplace.

Don’t overlook issues such as jurisdiction during negotiations, as trigger of coverage and policy interpretation can vary widely. Establishing jurisdiction where corporate headquarters reside and for the location of the project may make the difference in litigation between a favorable coverage ruling for the insurer versus the insured.

*Cynthia Pertile Tarle is founder and managing director of Tarle Law P.C.; she can be reached at (760) 683-8030 or CPTarle@TarleLaw.com. Lori Robinett is vice president of Willis North America Inc.’s national construction practice; she can be reached at (972) 715-6249 or robinett\_lo@willis.com.*



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IN AN INSTANT, JIM WEIDMAN SEES THE VALUE OF DEDICATED EXPERTISE

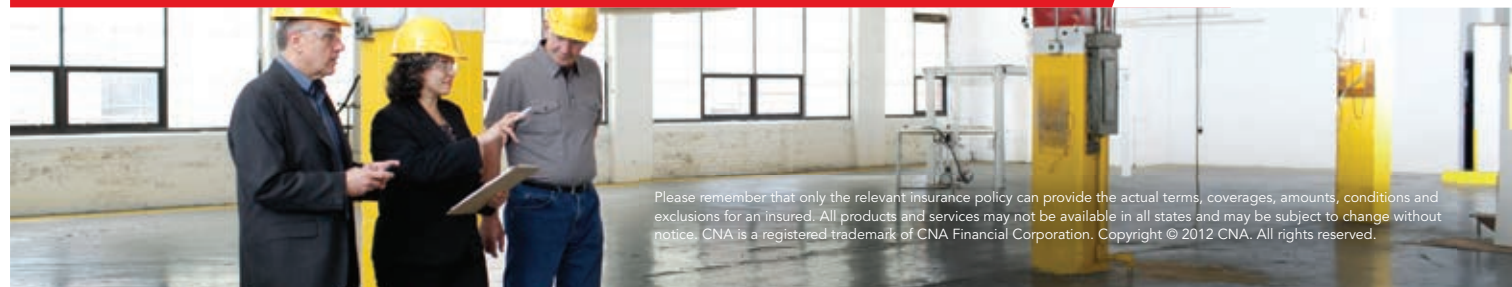
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# **MANAGING RISKS IN CONSTRUCTION COMPANIES**



**RISK MANAGEMENT, RISK CONCERNS AND BUSINESS INSURANCE  
PRACTICES AMONG MIDMARKET CONSTRUCTION COMPANIES**

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# RISK MANAGEMENT PROFILE OF MIDDLE-MARKET CONSTRUCTION FIRMS

*Business Insurance* conducted a survey of 254 U.S. construction companies in October 2012. The participants included 93 small companies (those with \$25 million or less in total 2011 revenue), 126 mid-size companies (those between \$25 million and \$1 billion in 2011 revenue) and 35 large companies\* (those with more than \$1 billion in 2011 revenue).

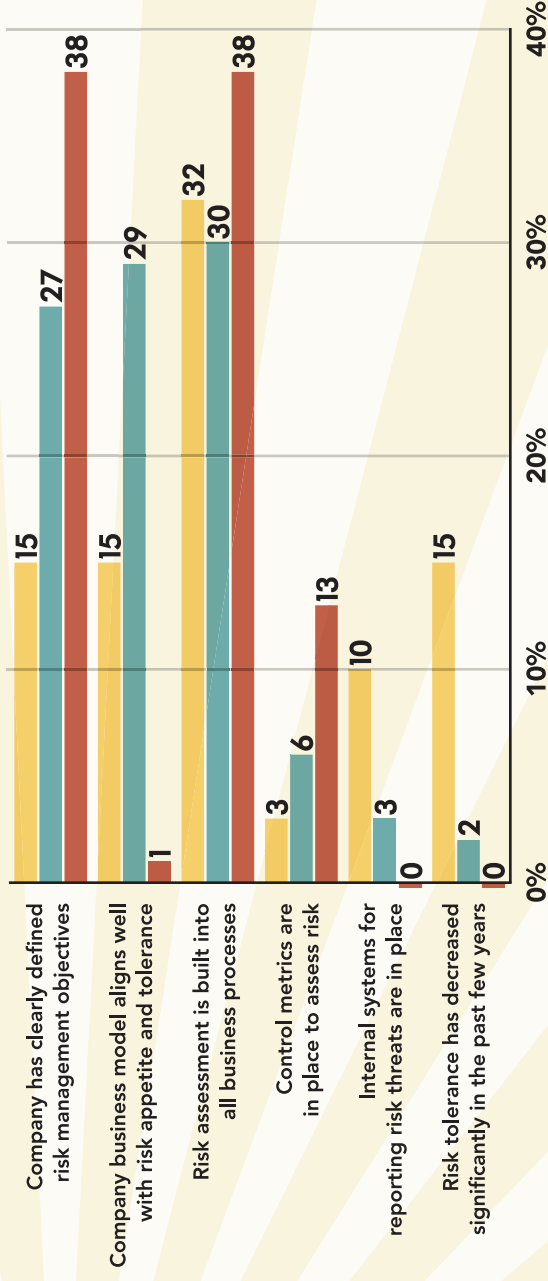
\*Caution, small sample: Results from small samples are considered *directional rather than conclusive*.



## RISK MANAGEMENT PRACTICES

### MIDSIZE CONSTRUCTION COMPANIES ARE WORKING TOWARD ACHIEVING A MORE SOLID APPROACH TO RISK MANAGEMENT.

In fact, 30% have risk assessments built into all business processes, 29% believe the company model aligns well with their risk appetite and tolerance, and 27% have clearly defined risk management objectives. Smaller and larger companies are struggling to align their business model and risk appetite. Control metrics to assess risk are not yet in place at most companies, regardless of size.

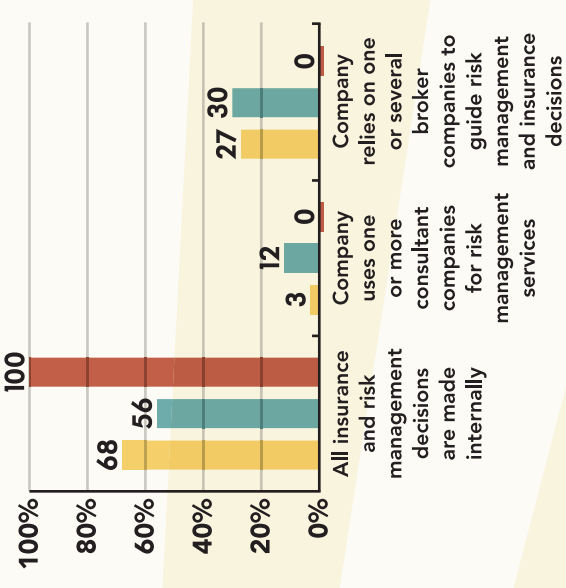


### KEY to all bar charts:

- Small construction companies
- MIDSIZE CONSTRUCTION COMPANIES
- Large construction companies

### USE OF BROKERS AS RISK ADVISERS IS LIMITED.

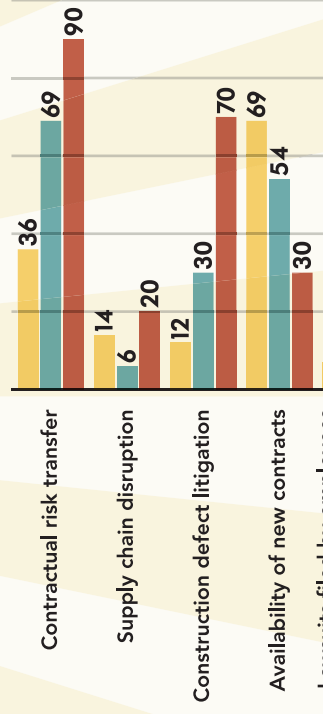
Across companies, most insurance and risk decisions are made internally. However, about one-third of midsize construction companies rely on the broker's advice for insurance and risk management decisions.



## CONSTRUCTION COMPANIES RISK CONCERNS AND BUSINESS INSURANCE

### CONTRACTUAL RISK TRANSFER IS A MAJOR CONCERN AMONG MIDSIZE AND LARGE CONSTRUCTION COMPANIES.

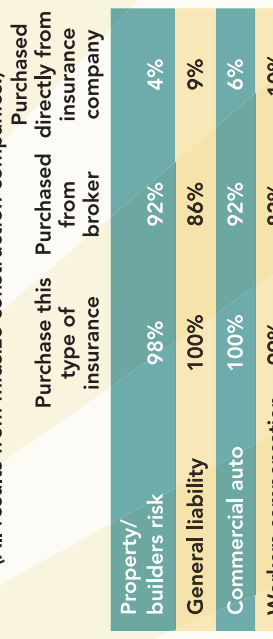
A majority of midsize construction companies also worry about the availability of new contracts and workplace safety. Large companies' biggest concern is construction defect litigation.



### ALL MIDSIZE COMPANIES PURCHASE SOME TYPE OF BUSINESS INSURANCE.

Insurance is purchased mainly via brokers, but there are instances when insurance is purchased directly. The three largest areas of direct insurance purchases are surety bonds, workers compensation and general liability coverage.

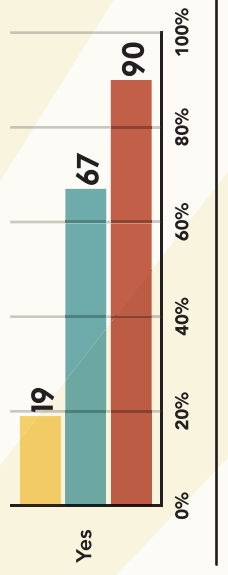
### TYPES OF BUSINESS INSURANCE PURCHASED BY MIDSIZE CONSTRUCTION COMPANIES (All results from midsize construction companies.)



### TODAY, MOST MIDSIZE AND LARGE CONSTRUCTION COMPANIES PARTICIPATE IN WRAP-UP PROGRAMS.

Two-thirds of midsize companies have been asked in the past two years to participate in wrap-up programs, an increasingly popular risk management technique used by construction project owners and/or general contractors to better control construction costs and enhance safety.

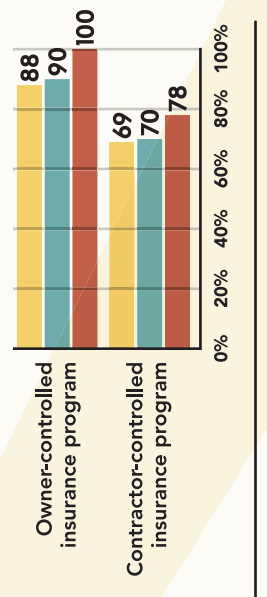
### WAS YOUR COMPANY ASKED TO PARTICIPATE IN A WRAP-UP PROGRAM IN THE PAST TWO YEARS?

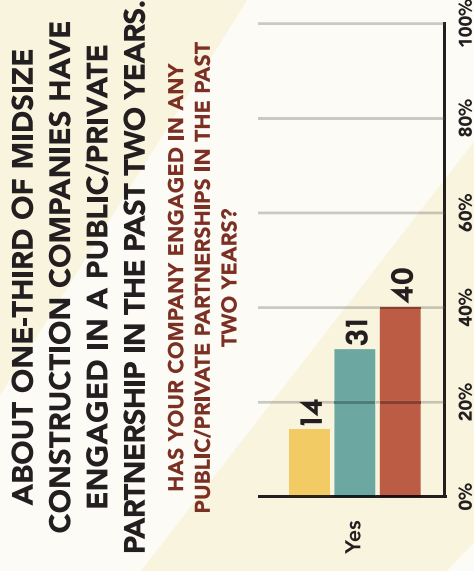
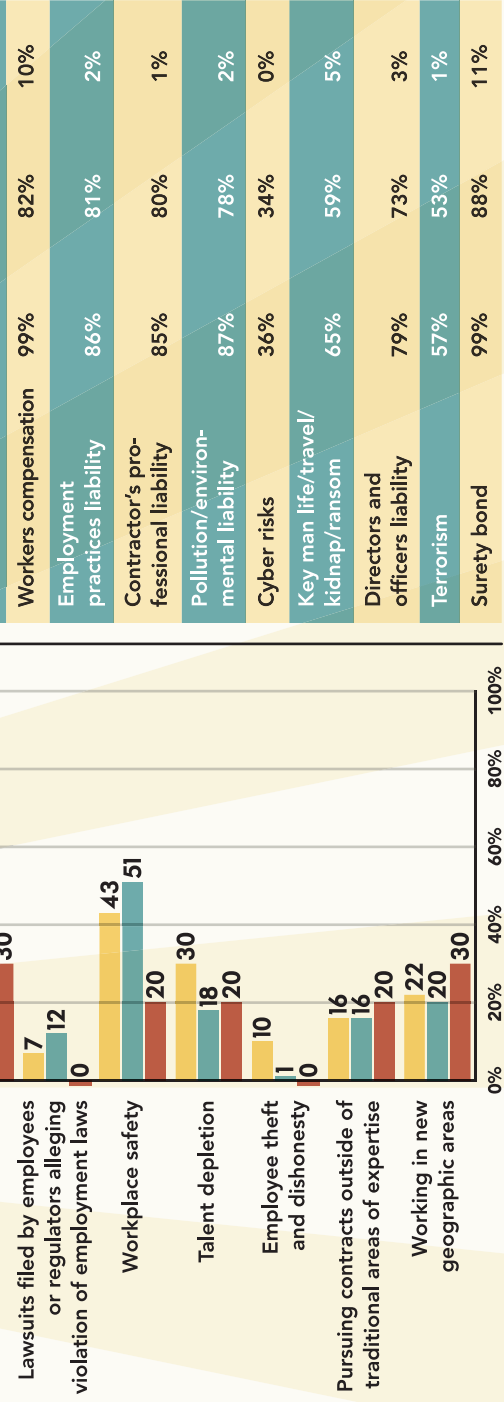


### OWNER-CONTROLLED WRAP-UP PROGRAMS DOMINATE.

The vast majority of construction companies, regardless of size, have been asked to participate in owner-controlled insurance programs in the past two years, while about two-thirds have been asked to participate in contractor-controlled wrap-up programs.

### TYPE OF WRAP-UP INSURANCE PROGRAMS IN WHICH COMPANY PARTICIPATED IN PAST TWO YEARS





## INSURANCE COVERAGE IS AVAILABLE TO MIDSIZE CONSTRUCTION COMPANIES.

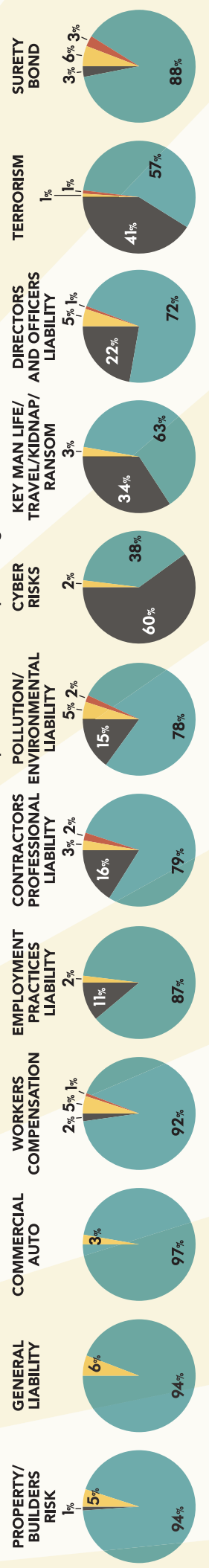
The vast majority of midsize construction companies did not struggle to get coverage in the past year.

### KEY to pie charts:

- Yes, but I got coverage
- Yes, and I did not get coverage
- No, I did not have any problem getting insurance
- I did not need this type of insurance

## IN THE PAST 12 MONTHS, DID YOU STRUGGLE TO GET THIS TYPE OF INSURANCE?

(All results from midsize construction companies. All numbers percentages.)

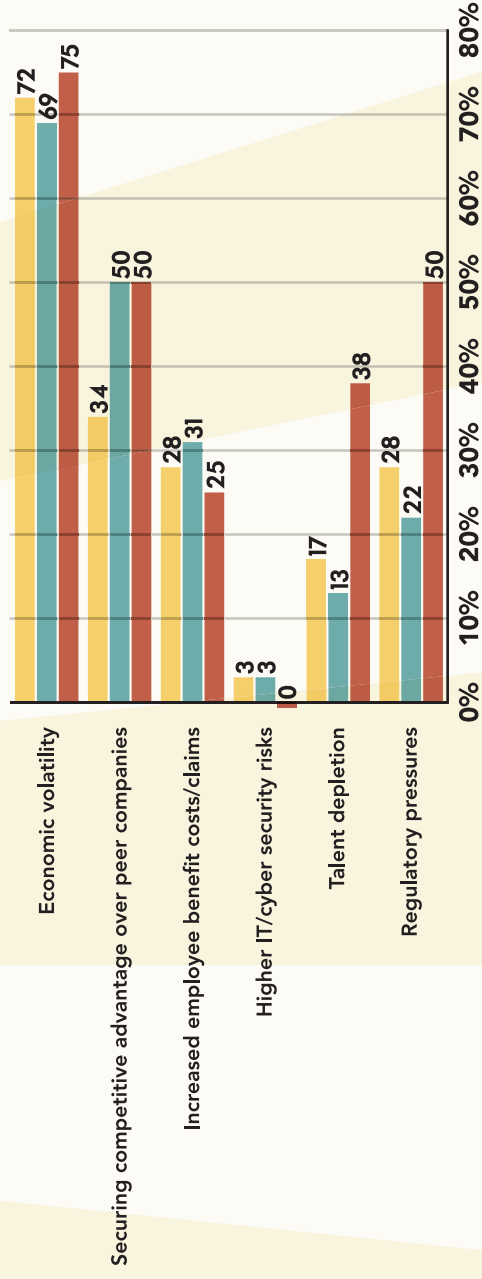


# 2013-2014 CONSTRUCTION COMPANIES PRIORITIES AND EXPECTED GROWTH

## DESPITE COMPANY SIZE, ECONOMIC VOLATILITY IS EXPECTED TO HAVE THE GREATEST EFFECT ON RISK MANAGEMENT PRIORITIES.

For midsize and large companies, securing a competitive advantage over peers also is a major factor in risk management priorities and decisions.

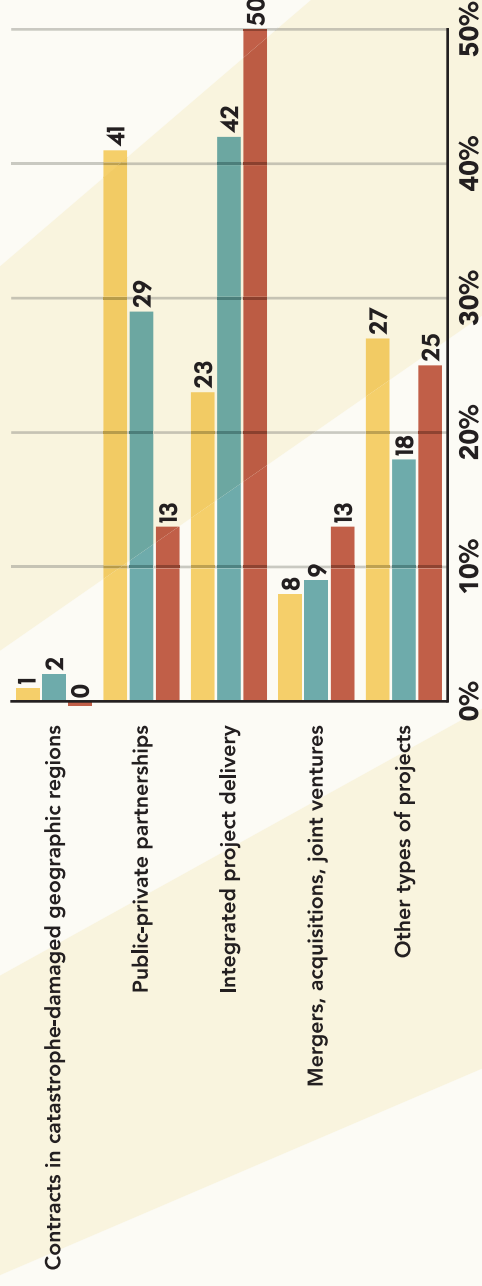
### WHICH OF THE FOLLOWING, IF ANY, WILL IMPACT YOUR RISK MANAGEMENT PRIORITIES IN THE NEXT 12-24 MONTHS?



## MIDSIZE COMPANIES SEE GROWTH FROM INTEGRATED PROJECT DELIVERY.

While midsize and large companies see integrated project delivery as the greatest source of future growth, midsize and small companies also cite public-private partnerships as a source of growth.

### FROM WHERE DO YOU EXPECT YOUR COMPANY'S BIGGEST GROWTH TO COME IN THE NEXT 12-24 MONTHS?



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# Disciplines: Contractor exposures rise as firms expand into new work areas

CONTINUED FROM PAGE 3

and bankruptcy for many mid-market contractors, experts said taking on construction work in unfamiliar disciplines without thoroughly understanding the contract standards, assumed liabilities and logistical constraints of a particular project can have serious legal and financial consequences.

"The most obvious place we've seen this dynamic manifest itself as a problem has been in surety failures and subcontractor default claims," said Scott Rasor, the Chicago-based president of Zurich North America's construction practice. "The margins for a lot of smaller contractors, particularly the smaller trade contractors, have been falling off steadily since 2008 and continue to erode, to the point where there just isn't any room for mistakes in any of these bids, and that's really problematic."

Many general contractors in the middle market, hoping to preserve whatever nominal profit margin they can on new contracts, have begun performing their own site preparation, steel erection, concrete pouring and other tasks typically delegated to subcontractors, said Paul Becker, the Nashville-based chairman of Willis North America's construction practice.

However, he noted, contractors must understand the breadth of worker safety and product defect liability exposures attendant to such operations.

"We do see these kinds of things happening fairly frequently, and we've had to have a number of conversations with clients about how certain risks may or may not line up with their traditional strengths," Mr. Becker said. "If you're doing something like the concrete pour yourself, now you're responsible not only for the subcontractors working around you, you're also responsible for the quality of the concrete you're putting in,"

## Safety protocols

Additionally, Mr. Becker said, most general contractors' safety managers on-site are tasked primarily with coordinating safety protocols and procedures among the separate subcontractors. But if contractors are performing the work themselves, he said, "they're the ones that actually have to drive safety protocols among their own labor force, as well as maintain and watch all of the other subcontractors' protocols."

As certain markets within the construction industry have shown significant signs of life since the end of the recession, mid-market contractors are also expanding the range of projects for which they'll pursue contracts. Civil infrastructure, health care facilities, higher education and rental apartment buildings all have seen moderate recovery in terms of new contract opportunities. And they have begun to attract construction

companies from other fields of construction — such as commercial office space, large-scale retail and smaller, specialty trades — that are nonetheless eager to take on the work.

"Contractors know what parts of the economy are thriving, and will migrate towards those segments if they can," said Steve Healy, senior underwriting manager at Boston-based Liberty International Underwriters, a unit of Liberty Mutual Insurance Co. "Large infrastructure jobs are cer-

tainly in vogue right now. Large, federally funded streets and roads, bridges, toll plazas, those projects are what's picking up speed out there, predominantly."

For example, the migrations are not always as dramatic as a contractor leaving the retail space to erect steel for an interstate bridge, Mr. Healy said. Even contractors working in seemingly similar disciplines often are taken by surprise by the amount of additional risk that must be accounted for when leaving their "comfort

**PROJECTS IN VOGUE**

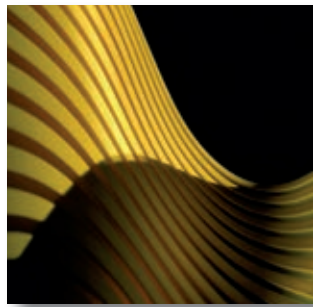
Several sectors have picked up steam since the end of the Great Recession, including:

- Civil infrastructure
- Health care facilities
- Higher education buildings
- Rental apartment buildings
- Large, federally funded streets and roads, bridges, toll plazas

zone," he said.

"A company that normally paves driveways and parking lots suddenly wants to bid for work on a road or a bridge or an interstate is going to encounter a number of risks that they wouldn't ordinarily worry about," Mr. Healy said. "If you're used to

paving driveways and you sign up to pave a four-lane interstate, there are a whole lot more things you have to factor in regarding controlling the flow of traffic, night work, workforce size, even the sheer proximity to moving traffic can be a significant exposure if overlooked."



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## Talent: Worker shortage raises concerns for safety

CONTINUED FROM PAGE 3

in the way they build, he said. "There's a lot more risk for sureties when a contractor has a 4% profit margin than a 10% margin; you have less of a cushion when things go wrong, and things go wrong all the time," he said.

Particularly, "in the smaller and midsize market, when sureties feel uncomfortable with the principals they're bonding, they ask for bigger indemnity agreements. Recently, sureties have been less willing to negotiate away personal indemnity (agreements)," and they have increasingly required collateral from a contractor, Mr. Mair said. "We do a lot of funds control work for sureties. Ten years ago, we might have had five funds-control accounts. Now we have anywhere between 50 and 100."

While U.S. construction companies have made progress in the area of safety, "when you get inexperienced people, safety may be one of the things to go," Mr. Ciullo said.

Moreover, "because we're coming out of a recession, OSHA is taking a larger role than in the past couple of years, being much more aggressive and vigilant at job sites to make sure that worker safety is

being observed," Mr. Bosse said.

Michael Anderson, U.S. construction practice leader at Marsh Inc. in Philadelphia, said he's working with construction company CEOs committed to a cultural change focusing on a mindset of safety. Contractors recognize the greater financial stress among subcontractors in this economy, jeopardizing safety programs, he said. As a result, "we have seen an increased focus on contractors prequalifying their subcontractors for safety," he said.

"Another risk is when you have an inexperienced workforce, you wind up producing a poorer quality product," Mr. Ciullo said.

"I worry about possible injury to the inhabitants long-term" caused by defects in manufactured houses, Mr. Bosse said. "I had a couple of cases in the past couple of years where there were fires involving manufactured homes," where the work consisted of laborers "going to the site and putting boxes together" in a short period of time.

"Construction is an experiential business that requires decades of doing the same thing," Mr. Ciullo said, which means it takes time to train qualified workers.



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# Contracts: Extra care needed with complex provisions

CONTINUED FROM PAGE 4

risk policy to partially mitigate this risk for building contractors.

"When we provide this coverage, the trigger has to be something where there has to be an insured physical loss. For example, if the project is delayed because they can't find materials or there's a labor shortage, that's not covered. But if there's water damage, lightning strikes the building, anything covered by the builder's risk policy, it will respond," said Bruce Jervis, San Francisco-based executive vice president of Ace USA's inland marine division.

The policy, which pays a percentage of the penalty relative to the size of the project, is usually written with a waiting-period deductible, Mr. Jervis said.

Midsized subcontractors also need to be aware of contractual requirements that they name project owners and/or general contractors as additional insureds on their own liability insurance policies because many jurisdictions prohibit such indemnification agreements.

Increasingly, states are enacting anti-indemnity statutes to prevent contractors from indemnifying another party when that party is partly at fault, said Randy Maniloff, a partner in the law firm of White & Williams L.L.P. in Philadelphia.

"Thirty-five states have statutes that limit the extent of indemnity in some shape or form," he said. "It's one thing for me to indemnify you for something that I did wrong. It's quite another to indemnify you for something you did wrong."

Subcontractors should specify in the contract under what terms they will agree to name either the owner or general contractor as an additional insured, then make sure that their insurance policies will permit such indemnification in the state where the project is being built, Mr. Maniloff said.

"When it comes to contractual risk transfer, sometimes it's easier said than done," he said.

"We still have a lot of additional insured requirements in contracts that are at odds with anti-indemnity statutes," said Eric B. Smith, Atlanta-based managing director of Marsh Inc.'s U.S. construction practice. "Some rely on boilerplate templates. They don't update them as often as they should. It's very complicated, and the construction industry has a long way to go."

Mid-market contractors involved in "green" building projects also are being asked to provide guarantees that the end product will meet a specified certification level under the Leadership in Energy and Environmental Design program of the U.S. Green Building Council. But most legal and risk management experts warn contractors against providing any such guarantees, as most professional liability insurers will void coverage if a policyholder offers a warranty of any kind.

"Most of the major projects have strong ambitions to be green, especially flagship properties in the commercial space," said Mr. Smith. "You've got to have careful crafting of the language so you don't run afoul of any warranty exclusions in the policies."

Middle-market contractors increasingly are being asked to participate in public-private partnerships that require contractors to have "skin in the game" by helping to finance a construction project, according to David Bowcott, senior vice

president in Aon P.L.C.'s infrastructure solutions in Toronto.

"The owner is resigning himself to the fact that it's not good at designing and building assets. They're telling the private sector to do it all and won't pay until it's up and running, and the payment will be stretched out over a 30-year period. Governments are finding it's effective in creating greater certainty in budgets and the asset's performance over time. It's like buying a house and withholding payment if any of the systems fail. There

are more and more middle-market contractors playing in this space," usually as part of joint ventures, Mr. Bowcott said.

However, "their inability to perform is a risk to the deal if the contractor enters into a design-build contract vs. a bid-build contract where the owner obtains the design. The interaction between design and build, and build and operations, and operations and design is much greater. That's a new dynamic that middle-market contractors have to get used to and wrap their heads around," he said.

## NEW TERRITORY

Contractors that bid on projects outside of their historical areas of expertise, are likely to face unfamiliar contract terms and conditions, such as:

- Financial penalties if any of their activities result in the delay of a project's promised completion date.
- Requirements that they name project owners and/or general contractors as additional insureds on their own liability insurance policies.
- Requests for guarantees that "green" building projects will meet a specified certification level under the Leadership in Energy and Environmental Design program of the U.S. Green Building Council.



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# Perspectives

Improving profit margins amid increased economic uncertainty, new state laws and subcontractors' inability to afford insurance are prompting more general contractors to move to contractor-controlled insurance programs, says Mike Hastings, national project risk practice leader at Marsh Inc.'s U.S. construction practice. Project size and, above all, extensive loss-control efforts are essential to find the greatest success using this coverage approach.

## Contractors take control of insurance programs

By Mike Hastings

More general contractors today are implementing contractor-controlled insured programs, or CCIPs, amid pressure to improve profit margins and increased uncertainty in the construction and insurance industries.

Several states have passed legislation that limits a general contractor's and subcontractors' ability to indemnify and provide additional insured status for another's contributory negligence on their commercial general liability program.

In addition, contractors remain concerned about the high rate of subcontractor insolvencies and the ability of subcontractors to purchase and maintain adequate insurance coverage.

For a general contractor able to assume and manage the additional risks arising from its subcontracted operations, a CCIP can provide greater coverage certainty, improve relations with owners and subcontractors, and potentially increase the firm's competitiveness and profitability. Such programs, however, do not come without risk.

### Program application

A CCIP may be implemented to cover a single project or on a continuous or "rolling" basis where all eligible projects are enrolled into the program. Under a CCIP, the general contractor purchases general liability, excess liability and workers compensation insurance covering job site risk for itself as well as for enrolled subcontractors of every tier.

The program is designed to respond to claims arising out of operations during the construction period, as well as those arising out of completed operations through a specified period — ideally, the applicable statute of repose.

Subcontractors enrolled in CCIPs remove from their contracts the cost for insurance. The general contractor in turn applies the "avoided costs" to the purchase of the CCIP.

By implementing a CCIP and controlling claims costs through rigorous loss control and claims management procedures, a general contractor may reduce project insurance costs by up to 50% compared with conventional insurance. The cost savings may be applied to improve competitiveness, profitability or both.

### Implementation risk

Implementing a CCIP presents many potential benefits for a general contractor, but there is a significant assumption of risk involved. Programs are often written with a deductible of \$500,000 or even \$1 million per claim. Although total deductible losses are typically capped based on a fixed percentage of payrolls, it is not always feasible for a general

contractor to charge the full maximum loss cost to its jobs and remain competitive. With an unfunded maximum cost, failure to control losses could potentially result in significant financial loss.

Another potential risk for a rolling CCIP is failure to enroll a sufficient volume of projects in the program. To protect the cost of the capital backing their obligation to pay claims, underwriters often charge a fixed minimum premium equal to between 75% and 90% of the total premium estimated at the CCIP's inception. A general contractor that fails to run the minimum volume through the program will nevertheless be required to pay the minimum premium.

To provide flexibility in the face of uncertainty in the U.S. eco-

nomie recovery, many insurers have agreed to implement an adjustable rate. In this structure, a contractor that fails to enroll the expected volume of projects faces a higher rate on its enrolled projects, rather than a high fixed-dollar minimum. With additional enrolled projects, the rate may decrease retroactively until reaching an established minimum. While this structure may facilitate fixed minimum premiums as low as 50% of the estimate at binding, the cap on deductible losses typically remains fixed. Regardless of program structure, realistic expectations and a healthy project pipeline are critical elements to implementing a successful CCIP.

### Successful sponsor

Common traits of contractors with successful CCIPs generally include:

- a highly developed safety culture that permeates the organization, including project managers, superintendents, and tradesmen, and extends to subcontractors of

Continued on next page



Mike Hastings

**'A contractor-controlled insurance program can provide greater coverage certainty ... Such programs, however, do not come without risk.'**



Although contractor-controlled insurance programs covering smaller projects have been successful, expected projects with values between \$30 million to \$40 million or more are widely considered necessary.

# Perspective: Contractors taking greater control of their insurance programs

CONTINUED FROM PAGE 11

every tier;

- experience in managing claims under a high-deductible program;

- a robust subcontractor pre-qualification process;

- well-established subcontractor relationships in the geographies they operate; and

- a significant percentage of revenue derived from repeat business from established customers to meet the CCIP minimum premium requirements.

Although CCIPs covering smaller projects have been successful, expected projects with values between \$30 million to \$40 million or more are widely considered necessary.

**To shift the focus to project costs, CCIP sponsors are instructing subcontractors to bid net of applicable insurance costs, so that bids are evaluated based on cost of materials and labor alone.**

Historically, many owner-controlled and contractor-controlled insurance program sponsors have measured the financial success of their programs by comparing the cost of the program with the avoided cost of subcontractors' insurance.

This approach is falling out of favor because it focuses on a measure of contract savings rather than total project costs, including materials, labor and insurance.

To illustrate this point, consider competing bids from Subcontractor A, whose insurance cost is \$50,000 and whose bid price for material and labor is \$1 million; and Subcontractor B, whose insurance cost is \$30,000, but whose bid price for materials and labor is only \$800,000. Subcontractor A's price may represent greater insurance savings (\$50,000 vs. \$30,000), but Subcontractor B's price represents a lower total cost and greater value to the project.

### *Shifting the focus*

To shift the focus to project costs, CCIP sponsors are instructing subcontractors to bid net of applicable insurance costs, so that bids are evaluated based on cost of materials and labor alone.

To recognize the importance of safety, many implement a robust subcontractor prequalification process including a review of a subcontractor's Occupational Safety and Health Administration total recordable incident rate and

workers compensation experience modification rating.

To achieve the full cooperation of subcontractors, best practices include:

- full disclosure of loss control and administrative requirements at time of bid;

- program coverage, limits and duration providing adequate protection to subcontractors;

- accommodation for subcontractor participation in claims adjustment where the subcontractor's employee or reputation

is involved;

- elimination of the "true-up" for insurance costs, whereby subcontractors that underestimate labor on a project are assessed an amount equal to the insurance cost associated with excess payroll.

Many general contractors with CCIPs establish their contract price net of insurance costs, and charge for the CCIP at a fixed percentage of that cost. This approach provides a simple mechanism to charge the CCIP to a given project. In cases where the

owner wishes to understand how the percentage was derived or compare it with the cost of a potential owner-controlled insurance program, the supporting detail may be provided.

### *Adding value*

While there is often no obligation to advertise the CCIP if it satisfies contractual insurance requirements, many general contractors choose to promote their program and its safety culture as an added value to the project and all of its stakeholders.

In cases where the owner is inexperienced in managing construction risks, a CCIP may be seen as a less risky and simpler alternative to an OCIP.

In some cases, the general contractor may offer a "co-CIP," effectively allowing an owner to assume the risks and rewards of an OCIP, but avoid startup costs and gain economies of scale by using the contractor's established CCIP.

CCIPs are not appropriate for every construction business owner, but a general contractor with a well-developed safety culture, a healthy backlog of business and an appetite for risk may benefit greatly by implementing one.

*Mike Hastings is Marsh Inc.'s national project risk practice leader within Marsh's U.S. construction practice. He can be reached at 404-995-2680 and Michael.d.hastings@marsh.com.*

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## Liability: Exposures keep growing for contractors

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merited, and the market may not be available for them to seek alternatives should their incumbent insurer take a more hard-line approach, Mr. Johnson said.

Eric B. Smith, a managing director within Marsh Inc.'s national construction practice in Atlanta, said some contractors that were successful in segments that are now sluggish have had to explore other segments with more opportunity, such as residential, health care and energy, among others.

"With that comes different types of contract language, different obligations and different expectations on the part of those various project sponsors," he said.

Middle-market contractors must have a clear understanding of the contract requirements and have discussions with their brokers and underwriters "to make sure that the program continues to match up squarely with that different risk profile that they may adopt through contractual angles," Mr. Smith said.

Additionally, as project owners run into more issues involving environmental liability, construction defects and residential construction, they are implementing new strategies to handle those risks through nonstandard forms, nuanced contract language and insurance policy requirements, industry experts say.

"Owners are just as risk-averse and wanting to transfer as much of that (risk) as possible given the economic conditions and their realizations of the increased exposures," Lockton's Mr. Johnson said. "It's important for general contractors and subs, particularly in the middle-market space, to make sure that they are complying with those and transferring as much risk as they can through an insurance contract."

Some of the requirements that are not in a standard commercial general liability form include requiring a specific additional-insured form with updated policy language, specifications of what exclusions are or are not on the policy, and increased limits.

With ample capacity and com-

petition among insurers in the marketplace, contractors also can look for alternative ways to secure general liability coverage, such as purchasing project-specific wrap-up policies or increasing retentions, experts say.

While it can be costly, some project owners may be more comfortable or require wrap-up liability policies to ensure the general contractor and subcontractors are carrying the same adequate limits of insurance, said Brenda M. Giardetti, insurance manager at EllisDon in Mississauga, Ontario.

"Primarily on all of our projects,

**'On all of our projects, we buy project-specific, wrap-up liability policies.'**

Brenda M. Giardetti,  
EllisDon Corp.

we buy project-specific, wrap-up liability policies, so it tends to transfer our risk away from our corporate liability policies and transfers it into a project-specific," which tends to be what larger contractors are doing, she said.

Project owners "may have a better comfort level knowing that all of their subcontractors are carrying \$10 million, \$25 million worth of liability," Ms. Giardetti said.

By reviewing the next fiscal year's potential bids on projects, contractors can determine the value of buying commercial general liability vs. wrap-up policies, she said.

Experts also say midsize contractors need to be careful not to run into cash-flow issues with acceptance of additional retention, though it certainly is an option, and one Mr. Smith of EllisDon prefers.

"When it comes to the mid-level risk of loss on site — and that includes both surety and liability insurance — I actually like to take that on, because I find we manage it best when we have the risk," he said.

## Subcontractors: General contractors turning more to prequalification

CONTINUED FROM PAGE 6

ask for particular details such as annual contract volume, sales and net worth, or may ask for full financial statements.

This can be sensitive, because most construction businesses are privately held, said Brian Harvey, principal with Barnes Dennig & Co. Ltd., a tax and consulting firm in Cincinnati.

A general contractor asking for financials should assure subcontractors that the information will be reviewed confidentially by a limited number of people, then destroyed, he said.

In the past year or so, more subcontractors have been willing to volunteer private financial data, partly as a marketing tool, in competitions with less financially secure subcontractors, said Luke Nolan, director-construction services group with Aon Risk Solutions in Dallas.

A financial review can spot a variety of red flags, Mr. Harvey said, including too much of a subcontractor's equity committed to a single project; excessive dividends taken by its owners; or significant early billings on a project that aren't accounted for as cash or receivables on the subcontractor's balance sheet, indicating that it has to use the money immediately.

The focus of a review can vary depending on the type of work, said Tom Grandmaison, executive vice president and construction casualty leader with Chartis Inc. in Boston.

Worker safety has historically been a key focus because workers comp injuries have been a major source of claims, though work quality has also become important with the rise of construction defect litigation, he said.

General contractors often

### UNDER REVIEW

Besides financial review, other targets of prequalification review include:

- **Safety management history:** Many general contractors require that a subcontractor's workers compensation experience modifier be 1.0 or lower, confirming that its loss experience has been on par with others, said Geoffrey Hall, senior vice president with the construction industry practice group at Ace USA in New York. Prequalification programs also may ask for Occupational Safety & Health Administration data such as illness/injury rates and lost workdays, along with information about a subcontractor's own safety management programs and procedures.
- **Insurance coverage and surety bonding capacity:** General contractors may require minimum general and auto liability limits from insurers with minimum A.M. Best & Co. Inc. ratings, and may want to know a subcontractor's bonding limits even if a surety bond is not required.
- **Work history:** This includes the type of work done, jobs completed and in progress and disputes over previous work. General contractors also should look at a subcontractor's schedule of upcoming jobs to be sure it is not overextended, said Brian Harvey, principal with Barnes Dennig & Co. Ltd. in Cincinnati.

require subcontractors to have a low workers comp experience modifier, said Geoffrey Hall, senior vice president with the construction industry practice group at Ace USA in New York (see box).

Finding subcontractors to bid on projects has not been a problem since the onset of the recession. Many projects are attracting double or triple the number of subcontractor bids they had previously, experts say.

This trend has made prequalification all the more important. "In tough times — and we've been through some tough times — you see a lot of contractors looking for work, often outside their specialties," Mr. Hall said.

"If somebody is a street and road subcontractor, they (shouldn't) go building houses in another part of the country," Mr. Grandmaison said.

Contractors working outside their accustomed territory also can present problems. "Are they

equipped to navigate the rules and regulations of the (geographical) area they're asked to work in?" Mr. Hall asked.

Vetting the growing numbers of subcontractors creates administrative headaches for the general contractor and the sub itself, experts say. In response, one company — Deerfield, Ill.-based Textura Corp. — has created an online database to which subcontractors submit prequalification information. The system is intended to make the information more accessible to general contractors, while saving subcontractors from making separate prequalification submissions with each bid.

General contractors, meanwhile, try to streamline the process by imposing "pass/fail" tests in lieu of a full assessment of each bidder, Mr. Carpenter said. Such tests — a maximum work comp experience modifier, for example — can quickly winnow bidders on a project, he said.

## Territory: Work in other regions of the country brings added risks

CONTINUED FROM PAGE 4

Beyond jurisdictional issues, there exists a wide range of potential exposures brought on by a fundamental unfamiliarity with a state or region's physical and environmental particularities. Variables such as pollutants entrenched in a region's soil or groundwater, geological signatures such as shallow bedrock or landfill erosion, even the mineral composition of the soil itself can wreak havoc on a construction project's pacing and cost-containment strategies, if left unaccounted for.

"If you want to come and build a 20-story building in Boston, you're going to encounter much different site conditions than you would if

you were building the same 20-story tower in Buffalo," said Steve Healy, senior underwriting manager at Boston-based Liberty International Underwriters, a unit of Liberty Mutual Insurance Co. "If you're not aware of all of that going in, it's just one more barrier to success on a project."

As contract opportunities begin to open in major cities such as New York, Chicago and Miami, companies accustomed to working in rural areas can and often do struggle to account for the considerable logistic challenges moving large equipment through narrow congested spaces, surrounded by literally thousands of people, every one of them a potential third-party injury claim.

### BEWARE OF NEW RISKS

Contractors that submit bids for work in states outside their usual zones of operation can face unfamiliar risks, including:

- Regulatory risks
- Supply chain and staffing issues
- Cost overruns and other unforeseen complications
- Different insurance laws
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# Surety: More developers seeking surety bonds

CONTINUED FROM PAGE 6

gins than had been the industry norm just a few years ago, experts said, leaving contractors with less operating capital to cover the cost of even routine project delays. The result has been a creeping, yet predictable upswing in the number of construction companies rendered unable — or in some cases, unwilling — to deliver on contracted work, experts said.

“In some situations, subcontractors are just walking off job sites,” said Drew Brach, Grand Rapids, Mich.-based surety practice leader at Marsh Inc. “We had one instance not long ago where the subcontractor didn’t even go bankrupt, and it cost the contractor more than \$500,000 to replace that company. They just decided that they couldn’t make any money on the job, and walked off.”

Michael Bond, a Washington-based executive vice president and head of surety at Zurich Financial Services Inc., said his practice had recorded about 20 contract default claims in excess of \$1 million midway through 2012, compared with just three at the same point in 2008, and that “all of them are in the small to midsize sector.”

“It’s really because that segment, given the competition and the lagging economic recovery, is still under a lot of stress,” Mr. Bond said. “So now, many of these companies are being asked for the first time maybe to provide a bond, where before they were effectively doing it on the strength of their relationships.”

Unfortunately for contractors, experts said, the rise in claims for defaults and delays also has led to significant firming in the surety market for midsize contractors, as a majority of issuers have begun to impose much stricter prequalification standards.

“It’s certainly becoming a harder market in the midsize contractor range, and in certain lines of construction, sureties are re-evaluating their entire book,” Mr. Johansson said. “Although they might have had some successful contractors without claims in the middle market, they’re still really cranking up their requirements in

terms of financial reporting and financial analysis.”

Beyond cash flow, credit score, access to future capital and other financial health indicators, sureties are likely to evaluate the potential risk of a contractor’s bond application based on the size, scope, location, cost and duration of the proposed project. Also evaluated are previously completed projects, the number of years the company has been in business, pending and previous litigation and insurance claims

and management history.

“From an underwriting perspective, we need to understand that this next deal that they want bonded fits in with their overall business strategy,” Mr. Bond said. “If we see a contractor come in and say they haven’t needed bonds in the past but suddenly need one, and the project they want bonded is twice or three times as big as anything they’ve ever done, and it’s in a state they’ve never worked in before, that raises significant concerns for us. We want to see a proven track record.”

Many sureties have devised other ways of providing small and midsize contractors access to bonding while maintaining a

certain degree of insulation from the risk of default, including requests for guarantees of personal indemnity from contractor owners, as opposed to corporate indemnity alone.

“They’ll say to the owners of a contracting firm that if they want the bond, and they want their subcontractors bonded as well, then you’ll have to give your personal indemnity, or at least some sort of collateral, usually in the form of a letter of credit,” Mr. Brach said. “So there are a number of other underwriting techniques that can be used in order to underwrite the smaller or midsize contractors that aren’t doing as well financially as their larger competitors.”

**‘From an underwriting perspective, we need to understand that this next deal that they want bonded fits in with their overall business strategy. ... We want to see a proven track record.’**

Michael Bond,  
Zurich Financial Services Inc.

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# Wrap-up: Gaining popularity

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Marsh Inc.'s U.S. construction practice in Atlanta.

While wrap-up insurance programs historically combine two lines of coverage — liability and workers compensation — anti-indemnity statutes that limit additional insured provisions in construction contracts, along with recent litigation trends involving action over claims filed by workers compensation claimants in states like New York, is prompting many project owners and general contractors to sponsor liability-only wrap-up programs, construction insurance experts say.

In recent years, there also has been growth in the number of “rolling wrap-ups” where either a project owner or general contractor sponsors a controlled insurance program involving multiple projects being completed over several years.

Contractors that participate in projects covered by wrap-up insurance programs are asked to exclude the costs of either liability and/or workers compensation insurance from project bids. In turn, either the owner or the general contractor provides those lines of insurance in exchange for a premium calculated based on the participating contractor's allocation of risk. In most cases, the cost of coverage is less than the contractors would pay if they had purchased the coverage on their own, experts say.

In fact, wrap-ups are an attractive way for smaller and midsize contractors, including many women-owned and minority-owned construction firms, to obtain more affordable workers compensation coverage so they can compete more effectively for business, according to Jack Probolus, marketing manager for wrap-ups at Liberty Mutual Holding Co. in Boston.

“Now with medical inflation coming up, we're seeing some significant rate increases in workers compensation insurance,” he said. Wrap-ups give project owners and general contractors “the ability to provide a



## WRAP-UPS

Wrap-ups generally come in two forms:

- Owner-controlled insurance programs, which are sponsored by project owners.
- Contractor-controlled insurance programs, which are sponsored by a general contractor.

In some cases, there could be a developer-controlled program if developers are awarding all of the contracts involved in a construction project.

low comp rate for contractors.”

“In a soft market or a hard market, the wrap-up is always going to save money,” said Ken Caldwell, executive vice president of Alliant Construction Services Group in Los Angeles. But now that the insurance market is firming somewhat, “for those entities that can lock in a rate right now, for maybe three years in a market that appears to be

**Be aware of how the contract defines significant terms, and consider the differences regarding language in contract interpretation and potential effects of case law.**

increasing in cost, that would yield even more savings.”

However, on the flip side, a subcontractor could face even higher insurance costs if a significant amount of its work is done under a wrap-up, according to Brian Cooper, San Francisco-based managing director in Arthur J. Gallagher & Co.'s construction services division.

“The insurance market will view you as a smaller contractor. Size matters on the rating plans,” he said.

“When you look at the non-wrap-up work, there's not a lot of

exposure left. That can create challenges to find coverage,” said John Watras, vice president of middle-market construction at Zurich North America Commercial in Edina, Minn.

Similarly, if a lot of contractors enrolled in a wrap-up program file claims, it could erode the overall limits, said Tim Walsh, executive vice president and managing national director in the national wrap-up group of Aon Risk Solutions.

For example, the cost of defending construction defect claims in a residential project general liability wrap-up can easily erode the limits, he said.

Another potential gap in coverage under wrap-up programs that could hurt the midsize contractor is whether completed operations coverage extends through the statutes of repose in the states where projects are being built, according to Lori Robinett, Dallas-based vice president in the national construction practice at Willis North America Inc.

“From a CCIP perspective, they don't always offer up the full completed operations tail,” she said. “That's probably the biggest thing that middle-market contractors need to watch out for.”

Unfortunately, “some operational insurers won't cover anything that was covered by a wrap-up,” which makes it unlikely that the contractor's operations policy will respond should a claim or suit be filed after the wrap-up coverage expires, Ms. Robinett said.

“There are some difference-in-conditions policies that contrac-

tors can get” for an additional premium, she said. Alternatively, middle-market contractors can negotiate with their insurers to have their practice policies sit on top of a wrap-up program as added protection, Ms. Robinett said.

Contractors participating in wrap-ups also may find there is no coverage for work performed off-site.

“Typically, off-site exposures are not covered by a wrap-up. So if you have a fabricator, the workers compensation and general liability at their facility is not necessarily covered under the wrap-up, so they need to make sure it's covered under their own insurance program,” Mr. Cooper said.

To avoid any gaps in coverage, Mike McKinley, Chicago-based vice president of controlled insurance programs at XL Construction Group, a unit of XL Group P.L.C., advises that contractors carefully examine their operating or practice policies — the insurance they buy to cover their day-to-day operations.

In addition, contractors should “request all the details and review everything you can from the OCIP or CCIP sponsor to get comfortable with what is provided in that program.”

Most importantly, contractors should begin this process early, Mr. McKinley said.

“The most frequent situation I run into is a mid-market contractor who doesn't read through the CCIP until after they've been awarded a contract. That sends everyone into panic mode,” he said.

# Property: Catastrophe-exposed areas see rate hikes

CONTINUED FROM PAGE 6

Ms. Hailey said one factor that may exert downward pressure on rates is that new insurers may enter the market to capitalize on the expected surge in demand for builders risk insurance from contractors servicing businesses and homeowners afflicted by the storm.

“There are just so many people that need to rebuild,” she said.

Contractors looking to take advantage of this competitive

landscape still will need to exhibit to underwriters the use of best practices, Ms. Hailey said.

“We do look at each risk to make sure that the contractor is properly licensed and at other factors, such as the number of years they have been in business,” she said. “We will also take a look at the company's financials, if we can get them.”

Underwriters also will credit builders that adhere to best practices in site security as a way to deter theft, such as making sure a

building site is properly fenced, locked and lighted.

“The better contractors know to secure equipment and take anything mobile off-site at night,” she said. “Some projects even hire a security service, which will put them in a better category from a pricing standpoint, as well.”

Mr. Nissen said insurers are paying increased attention to issues concerning the timeline and cost of a project, with longer projects viewed as more likely to incur weather risk.

Ms. Hailey agreed contractors need to ensure that the length of the project is reasonable for the task at hand to receive optimum pricing. Projects perceived as rushed or deemed to stretch on too long both may give an underwriter pause, she said.

“You don't want to see a builders risk policy being written for annual term and it's only a \$50,000 job,” she said. “On the same note, an underwriter doesn't want to see a three-month, \$2 million project.”

# Business Insurance

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# Business Insurance

2012 Election Roundup

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amount of money, likely were intentionally not provided by the federal government before last week's elections. Two examples: It's estimated employers will have to pay \$60 to \$90 per health care plan participant, as an assessment for a federal reinsurance program to reimburse insurers covering people with high medical bills. And

companies will learn the specific criteria the government will use to decide whether to impose a stiff \$2,000 fine per worker on employers for leaving any full-time workers without coverage.

See all stories at [www.BusinessInsurance.com/electionroundup](http://www.BusinessInsurance.com/electionroundup)

election

**HEALTH CARE REFORM:** With President Barack Obama's re-election, employers should soon receive the nitty gritty financial details of how to comply with certain provisions of the Patient Protection and Affordable Care Act rolling out next year. Experts say these rules, which will cost many companies a significant



**STATE TORT REFORM:**

Nine states saw their legislatures clearing the way for significant new tort legislation, legal experts say. No meaningful tort law changes are expected federally given the continued balance of party power in Congress.



**DODD-FRANK:**

The failure of Republicans to win the presidency or take control of the U.S. Senate removes strong opposition to the full implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act.



**TERRORISM INSURANCE:**

Supporters of the federal terrorism risk insurance backstop face an uphill battle.



**POWER GAME:**

Gallery of political players in Washington who affect the insurance and benefits management sectors.



**DEFICIT-CUTTING:**

Congress might help slash the deficit by lowering limits on employee 401(k) contributions.

## inBrief

### Rates up 4% in October for commercial insurance

Commercial insurance rates rose 4% in October over those of October 2011, MarketScout reported. That represented a slip from the 5% rate increase registered year-over-year in September. Property, business owners and general liability rate increases moderated to 5% in October from 6% in September.

### 401(k) plan balances hit record high for 2012

Aided by strong investment results, employees' 401(k) average account balances hit a record \$75,900 at the end of the third quarter of 2012, according to Fidelity Investments. For the three-month period ending

Sept. 30, employees' average account balances jumped 4.2% from the prior quarter, and 18% compared with the end of the third quarter of 2011 when account balances averaged \$64,300. Strong investment results accounted for 78% of the third quarter account balance increase, and 22% was attributable to participant action, such as boosting contributions.

### Institutes introduces fundamentals course

The Institutes has developed a new international insurance fundamentals course intended to provide instruction on creating an international insurance program for U.S.-based organizations. Topics include an overview of international insurance, identifying international loss exposures, regulatory compliance, insurer and broker networks, reverse flow business and selecting international insurance solutions. The Institutes is the operating name for the Insurance Institute of America and the American Institute for Chartered Property Casualty Underwriters.

### Storm hits where Sandy devastated

Last week's East Coast nor'easter dumped rain and snow on many of same areas that Superstorm Sandy devastated last month, delaying recovery efforts and a precise accounting of damage caused by the storms.

Catastrophe modeling firms estimated insured Sandy losses at \$10 billion to \$20 billion, while state estimates put economic losses between \$30 and \$50 billion.

That would make Sandy, which hit the Northeast the hardest, one of the costliest natural disasters in U.S. history.

"The devastating impact of Sandy has been closely observed by the insurance industry," Steve Jakubowski, president of Impact Forecasting L.L.C., a unit of London-based Aon Benfield, said in a statement.

While much of the insured losses are attributable to storm surge and coastal flooding in New Jersey and New York, the post-tropical cyclone also included



Taxis in Hoboken, N.J., are submerged in floodwaters after Superstorm Sandy hit the region.

BLOOMBERG PHOTO

heavy rain, inland flooding, heavy snow and high winds.

In addition to estimates from other catastrophe modelers, Boston-based Karen Clark & Co. last week estimated that Sandy caused insured wind losses of \$12 billion from some 100,000 commercial property claims.

London-based Willis Group Holdings P.L.C said Sandy's impact will be evident to commercial

insurance buyers in catastrophe-exposed regions.

"We expect non-cat rates to be down slightly or flat, while cat rates are likely to start edging upward," Willis said. "Increases of 5% may be common, though that number could be much higher depending on Sandy's impact on the reinsurance protection for primary property carriers."

— By Bill Kenealy



## Minimizing International Business Travel Risks

Employers face health and safety risks when they send their employees overseas to foreign locations, especially to developing countries, either as part of a corporate global expansion or for business travel. **Join us Nov. 13 at 2 p.m. EDT/11 a.m. PDT** for this **FREE** webinar, which will help employers determine the best way to keep track of multinational insurance programs when employees are visiting more than one country, and which nations have the most onerous regulations and taxes.

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Michael Washington claims his likeness was stolen to create a video game character.

## COURT REJECTS RAPPERS CLAIM TO VIDEO GAME CHARACTER FAME

An appeals court has ruled against a backup singer for the rap group Cypress Hill who claimed game makers misappropriated his likeness to create the main character for "Grand Theft Auto: San Andreas."

In his lawsuit against Rockstar Games and Take-Two Interactive Software Inc., Michael "Shagg" Washington also describes himself as a professional model and claims that his likeness was stolen to create the game's hero named CJ. He sought \$250 million in damages and argued that in 2003 he met with game developers and described his former life as a gang member to them. Mr. Washington further claimed that a third party gave the game developers photos of him from a magazine.

Years after the meeting, Mr. Washington learned from a nephew that many people suspected he was CJ, and he filed the lawsuit.

But a judge dismissed the case, ruling that the video was an "expressive work" entitled to First Amendment protection. The judge also ruled that Mr. Washington failed to present adequate evidence that CJ was based on his image.

"Plaintiff is relying entirely on CJ's physical appearance in the game, but that appearance is so generic that it necessarily includes hundreds of other black males," the judge said.

Unfortunately for Mr. Washington, the appeals court agreed, finding that he "introduced no evidence indicating that the fictionalized locations, characters or events in the video game are based on his own life."

CONTRIBUTING: Roberto Cenicerros, Matt Dunning, Bill Kenealy, Joanne Wojcik

# End Page



BLOOMBERG PHOTO

Actor Tom Hanks and numerous others allegedly have found themselves duped by a broker, who is charged with pocketing more than \$800,000 of his clients' money.

## Insurance broker accused of acting out

The sleuth powers depicted by actor Tom Hanks in such films as "The Da Vinci Code" and "Angels & Demons" apparently did little to prevent him from falling victim to an insurance scam allegedly orchestrated over more than a decade.

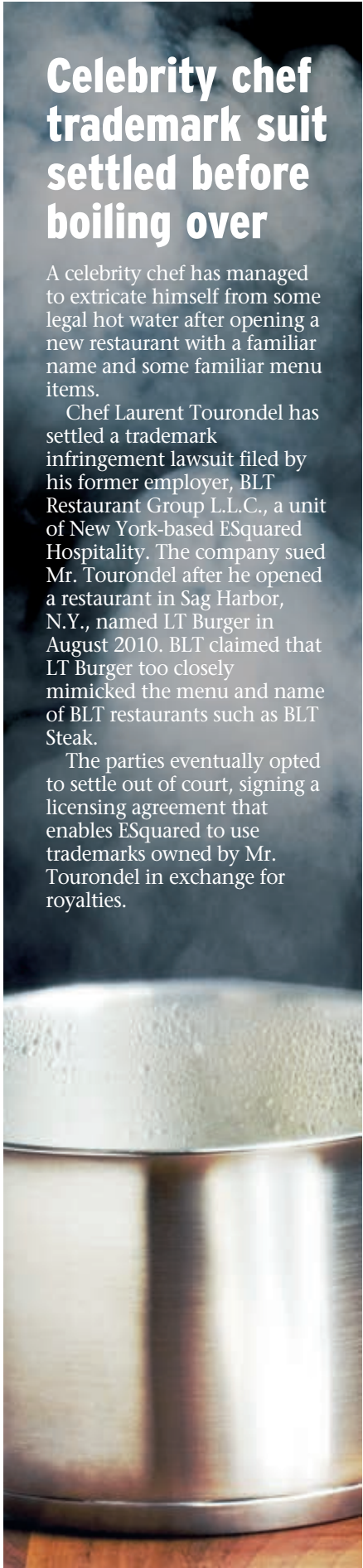
According to an indictment handed down Oct. 30 by a federal grand jury in Los Angeles, Thousand Oaks, Calif.-based insurance broker Jerry B. Goldman overbilled numerous clients – including Mr. Hanks – by as much as 600% since January 1998, pocketing more than \$800,000.

The 10-count indictment says Mr. Goldman negotiated premiums for insurance coverage on behalf of his clients and was paid

commissions by the insurance provider on each policy. Then Mr. Goldman allegedly created fraudulent invoices on his company's letterhead that inflated the premiums due. Later, when clients requested copies of their insurance policies, Mr. Goldman allegedly redacted the true premium from policy documentation to prevent his clients from discovering that they had been overcharged.

However, Mr. Goldman pleaded not guilty to the charges during his arraignment last week.

If convicted, each of the 10 counts of mail fraud alleged in the indictment carry a statutory maximum penalty of 20 years in federal prison.



## Celebrity chef trademark suit settled before boiling over

A celebrity chef has managed to extricate himself from some legal hot water after opening a new restaurant with a familiar name and some familiar menu items.

Chef Laurent Tourondel has settled a trademark infringement lawsuit filed by his former employer, BLT Restaurant Group L.L.C., a unit of New York-based ESquared Hospitality. The company sued Mr. Tourondel after he opened a restaurant in Sag Harbor, N.Y., named LT Burger in August 2010. BLT claimed that LT Burger too closely mimicked the menu and name of BLT restaurants such as BLT Steak.

The parties eventually opted to settle out of court, signing a licensing agreement that enables ESquared to use trademarks owned by Mr. Tourondel in exchange for royalties.



## WOMAN LOSES FIGHT WITH BUS

Picking a fight with a school bus is enough of an exercise in bad judgment by itself, but an Indiana woman took the extra step of filing an insurance claim accusing the bus of starting the fight.

Shelley Lapsley, 42, of Fort Wayne, Ind., was charged with felony insurance fraud this week after claiming she was struck and injured by a Fort Wayne Community Schools bus, according to a report by the Fort Wayne Journal Gazette.

Ms. Lapsley allegedly

submitted a claim to the school district's insurance company, claiming bodily injury. However, surveillance footage tells a different story, according to the report.

Video taken from the bus' onboard computer shows that Ms. Lapsley intentionally punched the bus with her fist, according to the Journal Gazette. She was charged with submitting false injury claims and misleading information to the insurer, but had not been arrested as of last week.

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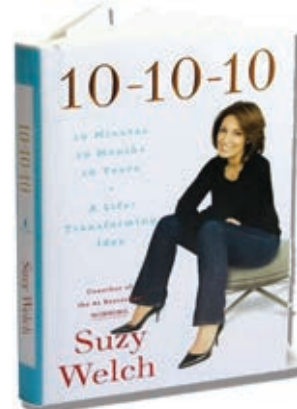
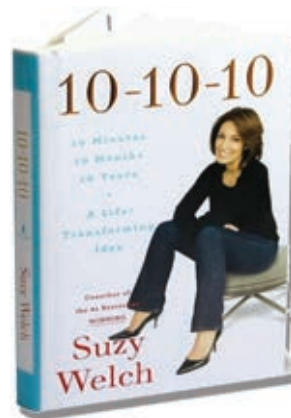
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