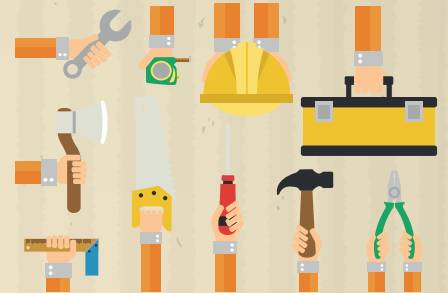


**JULY  
2018**

## Contractor's Protective Indemnity Coverage?

*5 Pieces of Valuable Information to Share with You*



**1**

### What is Contractor's Protective Indemnity Coverage?

### How Does Protective Coverage Work?



### Keep in Mind

**3**



### Target Classes



**4**



GOOD TO KNOW



### Wrapping It Up

#### OTHER ENVIRONMENTAL PROSPECTS WE CAN HELP WITH!

- General Construction Firms
- Fire & Water Restoration Contractors
- Mold/Asbestos/Lead Contractors
- Asphalt and Paving Contractors
- Environmental Contractors
- Waste Water Treatment Plants
- Landfills
- Farms
- Municipalities
- School Districts
- Plumbers, Roofers, & Artisan Contractors
- Hotels, Condo & Apartment Building Owners or Managers
- Property Transfers Including Purchase & Sales, Mergers & Acquisitions
- Roustabouts, Freshwater Haulers, & Fracking Support Contractors



## What is Contractor's Protective Indemnity Coverage?

Contractor's Protective Indemnity (Protective) coverage is a first-party insurance coverage that is designed to indemnify the Named Insured for a loss exceeding a subcontractor's insurance OR for the amount not covered by a subcontractor's insurance because the claim is limited or denied. In order to trigger, the loss must result from work performed by a subcontractor with which the Named Insured holds a contract and the Named Insured must first have taken necessary steps to recover the loss amount from the subcontractor and/or their insurance. Essentially, Protective coverage is designed to protect the Named Insured from under-insured subcontractors or from subcontractors with deficient insurance coverage. It provides a difference-in-coverage (DIC) above the underlying subcontractor's policy and extends coverage to the Named Insured in the event the subcontractor's policy is inadequate.

Commonly, Protective coverage is specific to a line of coverage; for example, two common lines of coverage that Protective is offered for are Professional Liability coverage and Contractor's Pollution Liability coverage. Both of these variations follow the general framework of Protective Indemnity coverage, but they apply to specific loss scenarios and requirements. In the case of Professional Protective coverage, coverage applies when recovery is being sought for a loss resulting from a negligent act, error, or omission on the part of a (sub)contracted design professional. Pollution Protective coverage, on the other hand, kicks in when a Named Insured is attempting to recover on loss that was caused by a pollution incident resulting from a subcontractor's work or services.

Contractor's Protective Indemnity coverage can be a bit confusing, because it works differently than standard liability coverages such as General Liability. The next section provides an example of the coverage in practice and how it would apply in a claim scenario to help clear up some of the confusion.



## How Does Protective Coverage Work?

Let's look at an example of how this coverage would be applied. Imagine a construction manager who oversaw the construction of a new commercial building. As with many aspects of construction, they subcontracted out the installation of the HVAC system to a qualified mechanical contractor. Unfortunately, this mechanical contractor who designed and installed the ventilation system for the new commercial building miscalculated the cooling needs of the structure, which resulted in excess moisture and condensation within the building. This damp, humid environment led to mold growth in parts of the new building.

After the discovery of the mold growth, further inspection concluded that the inadequate HVAC system was to blame. Therefore, in addition to the property damage from mold growth and the costs for remediating the mold, additional economic losses were incurred given the HVAC system needed to be removed and replaced. Total costs to remove and replace the HVAC system for the whole structure came in at \$2,000,000. The mold remediation expenses were \$250,000, which is about average for a commercial mold remediation job.

The construction manager was operating under a guaranteed maximum price contract with the owner of the project and, ultimately, they were responsible for the design aspects of the building project. Therefore, they had little recourse with the owner and had to absorb these additional costs. One of the few remaining options is to seek recovery from the HVAC subcontractor and/or their insurance. The construction manager, in addition to a Commercial General Liability (CGL) policy, carried a combined-form Contractor's Pollution and Professional Liability policy with \$5,000,000 occurrence and aggregate limits that included both Professional Protective and Pollution Protective coverage. The HVAC subcontractor, in addition to their CGL policy, had a Professional Liability policy with a \$1,000,000 occurrence limit and \$2,000,000 aggregate limit.



Given the HVAC subcontractors design miscalculation, the construction manager files a claim for the removal and replacement of the HVAC system on the HVAC subcontractor's Professional Liability policy. They also file a claim on the subcontractor's CGL policy for the mold remediation costs incurred due to the under-performing HVAC system. Recall that the total costs to replace the HVAC system were \$2,000,000. The \$1,000,000 occurrence limit on the HVAC contractor's Professional Liability policy only covers half of these costs; the remaining \$1,000,000 is picked up by the construction manager's Professional Protective coverage.

Coverage for the mold remediation costs gets a bit more complicated. The claim made by the construction manager is denied by the HVAC contractor's CGL insurance carrier stating that coverage is precluded by the Fungi or Bacteria exclusion. This exclusion states that coverage does not apply to property damage which would not have occurred but for the presence of, any "fungi" or bacteria on or within a building or structure regardless of whether any other cause or event contributed concurrently or in any sequence to such damage. Fortunately, the construction manager has Pollution Protective coverage which steps in to cover the costs of the mold remediation, because it triggers for pollution conditions, which includes mold.

This is a simplified claims example and demonstrates a relatively easy claims experience. Being in insurance, we know that oftentimes things do not go this smoothly. The next section goes over some major coverage aspects to be aware of so that in the case of a claim, there are no big surprises in respect to what the policy is designed to cover and that expectations are set on how the claims process will proceed.



### Keep in Mind

As stated in the first section and exemplified in the claims example segment, Protective coverage is often limited to a specific line of coverage and is not an end-all-be-all DIC coverage that sits over any subcontractor's insufficient policy. A lot of times, insurance carriers will call what is really only Professional Protective coverage "Protective Loss" coverage, which can imply more coverage being offered than is actually being provided. In the claims example above, the construction manager had two types of Protective coverage, Professional Protective and Pollution Protective coverage. There are significant differences between these two Protective coverage offerings. For this reason, it's important to review the policy forms to clarify what kind of Protective coverage is truly being given by the carrier. Coverage can be further refined through definitions, conditions, and other aspects, reinforcing the importance of reviewing

forms and endorsements.

In a real-life example, a well-known P&C carrier that offers a combined form Contractor's Pollution Liability and Professional Liability policies, provides an endorsement entitled "Contractor's Protective Indemnity Coverage". Further examination of the eight-page endorsement shows that is amending the Professional Liability insuring agreement to provide coverage for a protective loss in excess of a design professional's insurance. The loss must result from a negligent act, error or omission in design professional services performed by a design professional. So, essentially, this Contractor's Protective Indemnity coverage is limited to professional design work performed by a design professional despite its broad name.

Another important thing to note when it comes to Protective coverage is it is common for the legal costs or expenses incurred in bringing a protective claim against a design professional are excluded. This is significant, because many times one of the conditions for collecting on a Protective claim is that the insured must have taken all necessary steps to pursue and recover from the design professional or their insurance company. Legal expenses that the insured will incur to meet this condition will not be covered by the Protective coverage; this coverage is only designed to collect damages. Additional conditions apply for reporting, settlement, and cooperation much like other standard coverages.

Finally, one aspect of Protective coverage is often overlooked. It is important to note that is an excess coverage. Therefore, it will not respond until the underlying policy's coverage is determined, settled, or applied. In other words, the subcontractor's insurance limits must be exhausted, the claim denied, or some other situation making the insurance insufficient. In some cases, this can take years to settle the claim under the subcontractor's policy and until then the Protective coverage will not respond. That is not meant to take away from the coverage's inherent value, but simply to point out this aspect of the coverage that may go unnoticed or unrealized.



## Target Classes

- Foundation Contractors
- Glass and Glazing Contractors
- HVAC or Mechanical Contractors
- Industrial Maintenance

## Target Classes

By now, the advantages of this coverage should be clear. Protective coverage would benefit any entity that hires contractors, subcontractors, architects, or engineers to design, install, or perform various construction, environmental, or engineering services. Examples of target classes include but are not limited to:

- Construction Managers
- General Contractors
- Carpenters
- Drywall Contractors
- Electrical Contractors
- Insulation Contractors
- Masonry
- Plumbers
- Street and Road Contractors
- Geophysical Contractors
- Painting Contractors
- Roofing Contractors
- Utility Contractors
- Excavation & Grading Contractors
- Structural Steel Constructors
- Sewer and Water Contractors



## Wrapping It Up

## Wrapping It Up

At its core, Protective coverage offers a lesson on ensuring that companies are insured for the loss exposures they face, including the ones from hiring subcontractors. First, it is important to be covered for the actual services that a contractor performs and the associated loss exposures. In the case of the HVAC contractor in the claims example above, they did not carry Contractors Pollution Liability (CPL) coverage. This created issue when they had no coverage for the mold growth and damage resulting from their inadequate design of the HVAC system that required remediation. They clearly had a mold loss exposure, yet they were not adequately insured for that loss exposure. Unfortunately, this is a common occurrence for many businesses. Misinformation and unawareness around Pollution Exclusions

such as the Fungi or Bacteria Exclusion are widespread, leaving many companies underinsured or completely uninsured for their environmental and pollution loss exposures.

The construction manager on the other hand is an example of a contractor that is properly insured for their environmental loss exposures as well as the loss exposures from hiring subcontractors. They carried a combined form CPL and Professional policy with Professional Protective and Pollution Protective coverage. Without the Pollution Protective coverage, they would not have been able to fill the significant coverage gap created by the HVAC subcontractor not having a CPL policy.

Understanding the loss exposures clients possess and having knowledge of the insurance products designed to cover those loss exposures makes a huge difference in properly insuring a risk. Partnering with a specialty broker like American Risk Management Resources who works with risks like this day-in and day-out not only ensures that the client is adequately covered, but also offers peace of mind for your E&O risk.





# GOOD TO KNOW



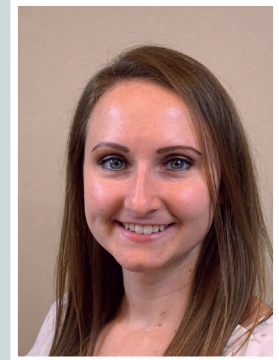
**AMERICAN RISK MANAGEMENT  
RESOURCES NETWORK, LLC.**  
**ENVIRONMENTAL**  
**INSURANCE TOOLBOX**

## *Your ARMR Production Team:*



**LORI WATERS**

waters@armr.net  
608 836.9589



**JULIA WIENER**

wiener@armr.net  
608 836.9833

### **OTHER ENVIRONMENTAL PROSPECTS WE CAN HELP WITH!**

- General Construction Firms
- Fire & Water Restoration Contractors
- Mold/Asbestos/Lead Contractors
- Asphalt and Paving Contractors
- Environmental Contractors
- Waste Water Treatment Plants
- Landfills
- Farms
- Municipalities
- School Districts
- Plumbers, Roofers, & Artisan Contractors
- Hotels, Condo & Apartment Building Owners or Managers
- Property Transfers Including Purchase & Sales, Mergers & Acquisitions
- Roustabouts, Freshwater Haulers, & Fracking Support Contractors

**Honesty | Integrity | Knowledge | Excellence | Accountability**