



**GENERAL CONTRACTORS
(AND THEIR SUBS) BEWARE –
LESSON LEARNED IN PRIVATE ARBITRATION**

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General Contractors (and their Subs) Beware *Lesson Learned in Private Arbitration*

by Justin L. Carley

Typically, under a cost-plus compensation model, an owner pays a general contractor for all of its allowed costs, plus an additional percentage for profit. Within those costs, there are usually insurance costs and subcontractor costs. Subcontractor costs also often include insurance costs, whether the subcontractor provides that level of detail in their billing or not. At the time of the billing, no one disputes that these are valid costs under the cost-plus contract. However, general contractors and subcontractors may be vulnerable to claims from project owners when those contractors utilize some form of self-insurance or large-deductible insurance coverage on a cost-plus contract project.

For example, a subcontractor may implement a large-deductible insurance policy for workers compensation insurance. Large-deductible insurance policies provide significant savings on insurance premiums for financially secure subcontractors with strong safety records. However, the subcontractor must pay a substantially higher deductible for each individual workers compensation claim, when compared to a traditional full-coverage or first dollar insurance model. Under those models, the insurance company usually pays claims right away, or after a small deductible, hence the higher premium. So, if a subcontractor

qualifies and obtains a large-deductible insurance policy, it is typically required to have a certain amount of money allocated to satisfy future claims, and may even be required to enter into letters of credit or other financial arrangements sufficient to satisfy the insurer of the subcontractor's ability to pay claims as they are made. The subcontractor may choose to fund an account with the money collected throughout the billing life of the job. Because workers compensation claims may be subject to lifetime opening and reopening in certain states, the subcontractor's risk for claims may reduce over time, but does not fully expire until every worker employed during a coverage year has died and their estates have been settled.

A subcontractor or contractor should be aware that a project owner may claim that savings realized by a subcontractor who had an exemplary safety record under these insurance models mean that the subcontractors didn't truly incur these insurance costs. The project owner may claim that those savings should be refunded to the project owner. Even where the subcontractor has not directly contracted with the project owner, the subcontractor may be vulnerable to claims of unjust enrichment and conversion. The project owner may also allege contractual claims against the general contractor for failure to audit the subcontractor and return payment for these claimed excess costs. Accordingly, while self-insurance or large-deductible insurance policies have the potential to generate significant savings, there is a risk that an owner will view those savings as an invalid cost of the work that should be refunded.

The take-away is that general contractors and subcontractors should carefully review their contracts to see if any provisions address this issue. If not, it may be prudent to include specific provisions or agreed upon insurance markups in your subcontract and contract to increase the likelihood that these insurance markups cannot be challenged in a cost-plus contract.

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