

HOW TO MANAGE RISK



A Canadian Home Builders'
Association Guide for
New Home Builders
and Renovators



*Canadian
Home Builders'
Association*

How to Manage Risk
is published by the Canadian Home Builders' Association
with the support of Federated Insurance Company of Canada

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Introduction

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New home builders and renovators face a lot of risks. They are usually first in line when anything goes wrong and clients, workers, injured members of the public, or governments are looking for compensation.

Society needs risk takers

We need people who can see an opportunity and fill it — people who can see a restriction and push past it. These are the entrepreneurs who identify and respond to people's needs. They are the inventors who produce new products and services — or even entire new systems of thinking and building. They take on different kinds of risks.

First are the basic strategic and financial risks of the **market** — can you compete against the other providers; is your service or product going to attract the customers it needs to be successful; can you cope with unexpected shortages, price changes, etc.; are your clients credit-worthy?

Second are the risks of **accidents and hazards** outside of their control — fire and flood, explosions, collision, sickness, etc.

Third is a whole class of risks related to **operations** — including management issues, security, and both contract and legislated requirements to meet specific standards such as provincial building codes, health requirements, workers' safety, environmental legislation, requirements for advertising, non-discrimination, etc. — and their associated fines, penalties and possible civil court actions.

Fourth is a "**duty to take care**" — making sure that the work you do, and the work you hire others to do for you, is done well and not negligently, so that it will not result in physical injury or property damage to others. The standard of care for this class of risks is rising.



INTRODUCTION

Last but certainly not least are risks due to the **loss of personnel**. Death, disability or critical illness of an owner or a key employee can be a serious threat to the business' survival.

Liabilities are increasing

- ❑ Higher expectations
Throughout society, there is an increased emphasis on health and safety, and on individual and corporate responsibilities. Although in some areas government regulations, roles in enforcement and responsibility have been scaled back, standards of care and responsibility expected of industry are higher. In some cases, penalties have skyrocketed.
- ❑ New approaches
There are new products and new systems, which may offer significant advantages but may also have unforeseen impacts on other parts of the building, or on workers.
- ❑ More claims
At the same time, people are more litigious, court interpretations are being widened, and claimants in some provinces have access to powerful new legal tools, such as class actions and directors' liability.
- ❑ Business cycles
Economic slowdowns and booms just add to the problems. When the most pressing goal is cost reduction or meeting delivery dates, then quality control, safety and after-sales services are too often given inadequate attention. This can create increased liability exposure — from poor workmanship, less rigorous procedures, use of non-conforming products and materials, increased customer dissatisfaction, etc.
- ❑ Changing insurance conditions
Insurers and reinsurers also face business cycles, with changing income or loss experience. As a result, some kinds of cov-

erage can become hard to find, or much more expensive. New conditions can be added to insurance contracts requiring new risk management and loss prevention procedures. If you accept these conditions and don't meet their terms, you can find yourself with no coverage.

It has come as a surprise to many new home builders and renovators to discover how much risk they can actually face. Your traditional contracts may not limit your responsibilities as you thought. Manufacturers' warranties often are limited to covering replacement of a defective product only — and no damages to other parts of the home that may have happened as a consequence. Manufacturers' warranties may not pay out at all if the manufacturer goes under. Enrolment in a new home warranty program doesn't relieve you of responsibility if things go wrong. You are the one who will be sued if work and materials by subcontractors and suppliers isn't good enough. The cost of defending a lawsuit can be enormous, even if you are not at fault. And if a court finds your negligence did contribute to a problem, even if you were only 10% to blame, you can end up having to pay for all of the damages, and then trying to recover from the other parties.

Risks can be managed

Many new home builders and renovators have started to investigate how they can address these growing liabilities. They know there is a fundamental difference between taking a calculated risk, and betting into the wind. This booklet is intended to give some guidelines on managing common risks.

How To Deal With Risks

Good management includes managing your risk. Risk management isn't just something the big companies do. And it isn't rocket science. Experts have all kinds of nifty terms and jargon, but basically every risk management program starts with four questions:

What should you really be worried about?

What can you do to help prevent these things from happening?

If you can't entirely prevent them, how can you limit their impact and cost?

If one of them happens anyway, what should you do?

New home builders and renovators face business risk questions every day in the construction and scheduling process — bathroom fixtures go on back order, designers quit, expected permits get delayed. You are probably quite familiar with the damage control options. Dealing with these other risk situations is very similar.

Incorporation and insurance will probably be your immediate response to a risk management program. But this is only one part of the solution. There are other steps you can take, from dealing only with reputable trades and suppliers and improving your site supervision, through changing contract terms and setting up new safety programs, to improving customer service. These steps can help lessen risks and prevent a loss that could change your life.



Case Study 1 Subcontractor's Unsafe Conditions

A new home builder hires a drywall firm, but fails to ensure that this subcontractor has a functioning accident prevention program. The subcontractor fails to properly train his workers or to provide fall prevention instruction or equipment. The builder's supervisor does not notice the unsafe activities or infractions. One of the subcontractor's workers falls through an unprotected opening and is critically injured.

The government agency responsible for safety lays charges and obtains a conviction against the subcontractor's supervisor, the subcontractor, the project supervisor and the builder. The fines range from \$10,000 to \$60,000. Since the builder did not ensure the opening was properly protected, the safety agency transfers the \$100,000 cost of claims from the drywall subcontractor's account to the builder's - resulting in a very significant reduction in the builder's rebate over each of the next two years.

What steps could the builder have taken to avoid this situation?

- Ensure its own required accident prevention program is in place, and functioning properly.
- Deal with experienced, reputable trades (ask unknown firms for references from three other builders).
- Require subcontractors to provide proof of training.
- Ensure the project is supervised by a "competent person".
- Ensure the subcontractor's accident prevention program is in place and functioning properly.
- Have the project supervisor complete a contractor orientation checklist before work begins, and follow up on any outstanding items in writing to ensure compliance.
- Have the health and safety representative complete daily workplace inspections on standard form, and have the supervisor make sure any unsafe acts or conditions are rectified as soon as possible.
- Conduct weekly safety meeting with all tradespersons on project, and follow up on all concerns or recommendations.

What legal terms would have been helpful?

- A clause in the subcontract, requiring the subcontractor to have a proper workplace safety program.
- A standard form, signed by the subcontractor, stating that it had received a copy of the builder's workplace safety program and agreed to abide by its terms.

Who will end up paying?

- The Workers' Compensation insurance will pay costs to the employee related to the accident.
- Significant fines and lost rebates will be borne by the individual firms. Standard insurances will not make good on these costs.

Other considerations:

- You may want to consider employers' liability insurance for claims that would not be covered by Workers' Compensation, such as accidents involving principals, etc.

What Should You Really Be Worried About?

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In order to deal with your risks, you have to know what they are.

The first thing to check is your actual losses. If losses are high from fall injuries to workers, you probably need a new safety program including protective gear, fall arrests, better attention to guards and/or improved training. If you regularly experience thefts from your construction sites, you may need to change the scheduling of deliveries, make subcontractors responsible for goods up to installation, find better lock-up methods, and/or use security guards¹. If you are facing frequent fines or lawsuits, you need to improve your compliance to legal requirements.

First, check out your own loss experience:

- **accident records**
- **company safety representatives**
- **feedback from trades**
- **insurance claims**
- **workers' compensation claims**
- **warranty complaints**
- **other claims and lawsuits**

Then identify other foreseeable risks:

It can be more difficult to foresee and manage risks you haven't experienced. But it is vital.

- ❑ Loss patterns can change for your industry, or your geographic area.
- ❑ Insurance coverages may be restricted or become unavailable.
- ❑ Laws and regulations are brought in and changed quite frequently².
- ❑ Many new home builders and renovators do not realize that they can face liabilities from their work, which extend far beyond their own one or two year callback warranty clauses.
- ❑ New Home Warranty Programs are not a protection for the builder.
- ❑ Manufacturers' warranties are only as good as the company standing behind them, and they often specifically exclude consequential damages³
- ❑ The costs of defending yourself in a lawsuit can be enormous, even if the cases prove to be unfounded.
- ❑ Additional requirements, conditions and "warranties" on Builders' Risk/Course of Construction policies may be onerous. Not meeting them can void coverage.
- ❑ Losing key personnel through death, disability or critical illness would raise serious issues: how to finance buy-out of an owner's interest; effect on sales/productivity/credit; effect on other employees.

1 Where theft and/or fire experience has been high, insurers frequently want builders to "warrant" that they will use security guards, as part of their Builders' Risk/Course of Construction policies.

2 Not knowing about a new law is not accepted as a reason for not meeting its terms. You are expected to keep informed.

3 A roof tile manufacturer may replace defective tiles, for example, but not take responsibility for the resulting damage to the roof structure, walls, interior finishes, etc.

Helpful sources of information:

Your lawyers

Lawyers with specific expertise in construction, real estate development and safety can help alert you to what is changing on the legal front and how it might affect your business. They can recommend changes to contracts or to business practices. Specifically ask them to keep you informed.

Your insurers

Insurance companies have a real interest in reducing claims, and many of them have become experts in risk management. This may include your own corporate insurers, as well as workers' compensation programs and insured warranty providers. Make sure you ask them for risk management advice, as well as specific coverages. Check whether they have newsletters, and ask their representatives to keep you informed of changes.

Your insurance broker

Some brokers have an in-depth expertise in construction and can provide very useful advice, or even design entire risk management programs. Look for a broker who specializes in construction.

Your accountant

Accountants can provide useful advice, particularly on how to structure your affairs to reduce operating and financial risk.

Your Construction Safety Association

Specifically for risks involving safety on site, these provincial organizations can provide a wealth of information, courses, printed materials, etc.

Other government departments

Again, depending on the issue, government departments may be able to give you useful information about various risks, plus statistics which might help you to assess which are the most likely to occur, and sometimes how much they might cost.

Your Home Builders' Association

Local, provincial and national levels of the Canadian Home Builders' Association try to keep members informed about new approaches to safety, changes to legislation, technical problems and solutions, new scientific information, insurance, major tax and legal decisions, etc. They can help you to become aware of new risks, to assess how serious the risks are and to hear about ways of preventing or reducing them. Meeting with other renovators and new home builders can help you figure out the best way of dealing with new risks.

The term "insurance agent" usually refers to a "captive" or "direct" insurance agent, meaning someone who is an employee of an insurance company, dealing with that company's products exclusively. The term "insurance broker" refers to an independent advisor, not tied to any one company, who may compare coverages and negotiate on your behalf with different insurers. In this Guide, the term "insurer" will encompass an insurance company's direct insurance agents.

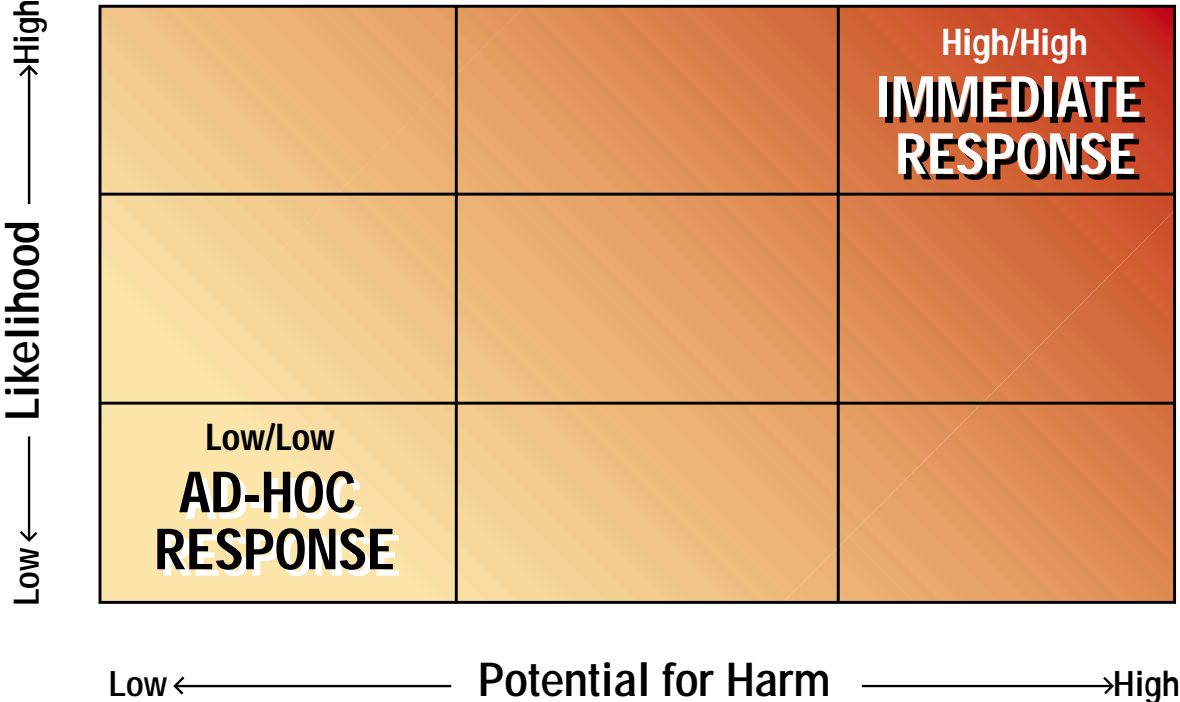
Risk Analysis

Once you have this information, you have to look at your own operations and answer two more questions:

How likely is it that these things will actually happen?

If they did happen, how much physical or financial harm would they cause to:
your customers?
your workers?
your company?

Some will have both a high likelihood and a high potential for serious harm: those must be dealt with — and quickly. Some will have both a low likelihood and a low potential for harm: you can probably deal with those on an ad hoc basis, if they ever occur. For the others, you need to use your judgment.



Types of Risk

The major risks to a new home building or renovation business include:

1) **Damage to the construction site**

Construction sites by their nature are subject to relatively high risks. The building is a work-in-progress and its final safeguards and protection systems are not yet in place. Tools, materials or temporary heating sources can spark a fire; pipes can burst; excavation walls or bracing can give way; temporary overloading can cause structural failure; heavy materials and equipment can fall; equipment operators can misjudge clearances. Wind, lightning and floods can create serious problems. Vandals can destroy or deface the property. Incidents like these can cause significant and costly damage to the construction project itself and to materials and equipment stored on site.

2) **Workers' safety**

Risks to workers are also high. People working on a construction site can fall, be hurt by the tools they're working with, be hit by materials, vehicles or equipment, get burned or exposed to dangerous or toxic materials, be overcome by fumes if there's insufficient ventilation — or suffer any number of other accidents. All employers are responsible for the health and safety of employees while they are on the job. They are required to provide a safe workplace, competent fellow employees, safe tools, training, and warning of any existing dangers. Extensive temporary protection systems, safety laws and standards, protective clothing and equipment, and mandatory insurance programs have been developed in response to construction site risks. In a number of jurisdictions, even if they manage their own forces well, new home builders and renovators may be held responsible, and face large fines

and/or premium increases, if subcontractors' workers or uninsured personnel are injured on their sites.

3) **Damage to clients' property or the property of others**

An accident on site or problem with materials delivery vehicles, can also cause damage to neighbouring buildings or to cars parked outside the site, etc. If the project is a renovation or addition, a problem with it can also damage the rest of the house and its contents. Similarly, a worker doing repairs to completed work may inadvertently start a fire which destroys an entire furnished home — with huge cost implications for the new home builder or renovator. A company may also attract liability for damage to property or equipment belonging to subcontractors or rental firms.

4) **Public safety and personal injury**

Many of the risks identified above have the potential to cause physical injury or even death to clients, neighbours, or other members of the general public who might be passing by. Other risks may be posed by ice on sidewalks, accidents involving company cars, inadequate hoardings, etc. The legal liability of a company can depend on how negligent they were in allowing these incidents to occur. Damage awards and liabilities have both been increasing. Some companies have been held liable when people trespassed on their sites and were hurt as a result — especially if the trespassers were children. Mould is a new source of lawsuits. Incomplete repair of water damage may be held responsible for mould growth and serious adverse health problems for owners and their children. A large lawsuit could put a company out of business.

Liabilities

Liabilities can arise in a number of ways:

- **contract:**
The terms and conditions of a specific contract, and the general law relating to contracts; this will include the scope of the work and the terms set out in the contract and any plans, specifications, etc. specifically included in the contract; it will also include specific exemptions, "hold harmless" clauses and "indemnification" clauses (to the extent those are allowed by law).
- **tort:**
"Tort" means being at fault, other than under a contract. Negligence and nuisance are two prominent kinds of torts. The Common Law used in most of Canada says that people have a duty to take care and not harm others; this duty has been expanded in recent court cases dealing with negligent design, construction and inspection. The Quebec Civil Code says essentially the same thing, though with different words.
- **statute:**
Specific laws and regulations passed by federal, provincial and municipal governments.

The extent and duration of liability can be affected by:

- **corporate form:**
People acting through sole proprietorships and partnerships are personally liable for all the obligations of their business. Incorporation creates a separate "entity", with its own, separate obligations. See page 12.
- **limitation periods:**
Liabilities are subject to specific time limits, set by statute. If a claim has not been started by the time those limits have passed, the liability ends. However, except in Alberta, in cases claiming the tort of negligence for latent defects, the time does not start to run until the person harmed knows or ought to have known that they have suffered damages — which essentially means there is no time when potential liability for a project can be known to have ended. (In 1999, Alberta introduced a 10-year ultimate limitation period on lawsuits, starting from completion of construction. Ontario has proposed a similar change, with a 15-year period.)
- **the "joint and several" liability rule:**
Where more than one person or company is found to have contributed to a problem, they are generally considered to be "jointly and severally" liable. This means that the plaintiff can collect the full amount of damages from any one defendant, who has to try to go after the others for their portions. This applies even if the others are no longer in business or do not have enough money to pay their share. It is intended to resolve the problem for the plaintiff, and not enmesh him/her in disputes among wrongdoers. Some parts of the world assign liability on a proportional basis instead.
- **available defences:**
Interpretation of contracts and assessment of negligence is generally subject to a "reasonableness" test — essentially this means that the defendant can escape liability by showing that he or she met the standards that would have been expected of a reasonable person at the time that the work was done. Some other claims are subject to a "strict liability" regime. In this case, it doesn't matter if the defendant met all the standards of the day: as long as the product is proved to be in violation, the defendant will be found liable.

5) Damage to the company's office or equipment

This can include direct loss or damage to the building, furnishings, inventory, records, tools, computers, software, plans and drawings, etc. — usually from fire or water damage, but possibly from theft or vandalism.

6) Vehicle accidents

The risks from vehicle accidents are well known. They include both the direct loss or damage to your vehicles themselves, and your potential liability for causing physical injury or property damage to others. They may also include accidents involving, and damage to supplies and materials being transported by, your staff in their own cars on company business.

7) Fraud and theft

Probably all construction sites have experienced theft, from a few 2 x 4s to complete kitchen cabinet packages. Businesses also lose money because of employee thefts of cash, supplies, tools, etc. Some schemes are quite elaborate, involving outsiders. And there are a number of phoney operations (bogus charity programs, office-repair, investment, advance fee for supplies, and similar schemes), which prey on small business.

8) Unknown pre-existing conditions

In some cases, excavation uncovers unforeseen site conditions — soils with inadequate support, contamination, water, etc. — which require extra costs.

9) Defective products, equipment or installation

Builder responsibility for defects can include everything in the construction contract, including faulty workmanship, improper installation, non-compliance with codes and standards, defects in materials, products or equipment, and defects in design. During their own materials and workmanship warranty period (stated in

their contracts), most new home builders and renovators absorb their own smaller losses, and require subcontractors to replace defective products and installation, as part of their after-sales-service function. Larger defects, and those caused by negligence which do not become obvious for many years, can pose serious potential costs and difficulties. Particularly if the people at fault do not accept responsibility, or are no longer in business, new home builders and renovators can find themselves having to replace defective work.

10) Negligence

Parallel to other business obligations is a duty to take reasonable care. New home builders and renovators also have to take all reasonable steps to make sure that others who rely on their skills and expertise do not suffer avoidable damages.

11) Other legal liabilities

Contracts set out the specific rules for each specific business dealing. Courts will turn to their wording to resolve disputes. In addition, governments have imposed a number of laws and regulations which must be met, or companies can face significant penalties, fines, correction costs, corporate (or even personal) liability for damages, etc. These include various municipal bylaws, provincial building codes, condominium registration and sales rules, environmental protection, health and safety, construction liens, and requirements for advertising/sales.

12) Faulty title

A builder buying or selling a property without clear title could face a number of expensive problems.

13) Business interruption

When disasters such as fires and floods occur, the damage to your business can be two-fold. Not only can they cause property loss, your business operations could

come to a standstill, resulting in loss of revenue. Strikes can also shut down operations, leaving a new home buyer or renovator with overhead and fixed charges to pay, but no new cash flow.

14) Loss of key executive

Every small company has one or two people who are key to its success. They can be incapacitated through sickness or injury, or lost through death or attraction to another company. If they can't be replaced, the small firm can suffer serious harm. Where one partner dies, the firm may face a double jeopardy: needing to hire someone to provide the missing expertise at the same time as the dead partner's surviving spouse or children may need to be provided for or bought out. Even the best insurance protection and support for physical assets and business liabilities can be undone by a lack of proper estate and business perpetuation planning.

15) Bad debts

Whenever a new home builder or renovator extends credit to customers, they face the possibility of not being able to collect. New home builders who own title to the lots they are building on have the security of the property. Custom new home builders and renovators have access to construction liens, which can also give them some security related to property title for a brief period of time. However, sometimes the costs to the business can be serious.

16) "Illegal" agreements/underground economy

A person or company that enters into an agreement designed to evade taxes or other mandatory costs can find that they cannot enforce any of the other terms of their contract in a court of law, including product warranties. They may also find that insurers will not cover claims arising from unreported/illegal agreements.

17) Litigation

New home builders and renovators can face potentially crippling costs even when they are not at fault, simply by having to defend themselves in a court action.

18) Damage to the company's image/negative publicity

Disputes can generate negative publicity, whether in the form of media coverage or word-of-mouth reports. In a business where reputation is important to sales, bad public image and negative publicity can seriously affect ongoing operations.

The benefits of incorporation

Incorporation is one of the oldest forms of risk management. It was invented to encourage people to set up new business ventures without having to worry that they would lose all their personal assets if the venture didn't succeed.

People who conduct their operations through sole proprietorships or general partnerships are personally liable for all of the obligations of their business. However, once a company is incorporated, it becomes a legal "person" in its own right. It has its own name, address, funds, and life. Any debts or liabilities it incurs are charged against the assets of the limited liability corporation, and not generally against the personal assets of its directors.

While it is a common strategy for risk management, incorporation is not a fail-safe protection against all liability. Some statutes specifically include a personal liability for directors and officers of incorporated companies if they permit offences to happen. There is a growing public and court aversion to separate incorporation of "shell" companies for each project. It appears that courts today are more likely to go behind the "corporate veil" and hold individuals responsible for negligent actions.

What Can You Do To Stop These Things From Happening?

The cheapest accident, theft, construction defect, infraction, or lawsuit is the one that doesn't take place. Although it is impossible to prevent all accidents, relatively small investments of time and money into preventive measures can reduce the risks tremendously - and pay huge dividends for your company.

In many cases, there are established standards of care or "due diligence", which a reasonable, prudent business person would be expected to meet. Again, the questions are fairly simple:

What prevention measures exist?

Are there recommended best practices? product or installation standards? edu-

cation/training? customer service measures? legal requirements?

Are you already doing it?

If not, why not?

People don't know about it? higher costs? no defined procedures? you never demanded it from subs or suppliers?

What do you need to do next?

Training or explanations? write new procedures? change specifications? pay a little more? change contracts?



Here are some recommendations for a loss prevention program⁴:

Management

- Commitment of senior management
- Corporate policy on safety, prominently displayed on job sites
- Corporate policy on loss reduction
- Corporate policy on customer service, including swift response to after-sales service calls
- Diligent supervision on site
- Enforcement of safety, loss reduction and service measures, with appropriate penalties
- Procedures to ensure required registration/premium payments/bookkeeping/reporting/etc., by your own company and by subcontractors
- Due diligence in entering new ventures
- Well-written, signed contracts with clients, developers, subcontractors, suppliers
- Co-operative attitude on site
- Compliance with all human rights laws, and avoidance of discrimination based on race, religion, national origin, sex, marital status, disability, etc.
- Compliance with all codes, standards and applicable law
- Appropriate insurance with adequate litigation coverage

Create a strong risk management culture throughout your operations.

Site selection

- Due diligence about site conditions (soils, water, bearing capacity, encroachments, etc.)
- Information about possible contamination

Sales/Marketing

- Knowledge of legal requirements
- Proper information for sales personnel
- Clear policy to avoid misleading statements or overselling
- Indemnification clause in contracts with sales agents
- Review of all brochures, advertising, plans, models, etc. to remove any unintended promises or warranties

Construction

- Diligent supervision
- Realistic schedules with enough time to do the work well
- All required building and trade permits and inspections
 - Proper training for new systems, installation procedures, etc.
 - New home warranty coverage for owners including major structural defects
 - Insurance which includes appropriate ongoing coverage for completed works
- Participation in industry groups which discuss potential problems and solutions

Subcontractors and suppliers

- Check on all subcontractors for reputation and past safety and after-sales service records
- Requirement in all subcontracts that subcontractors will conform with all laws and statutes, and with the company safety policy
- Requirement in subcontracts to provide certificates of workers' compensation, vehicle and general liability insurance
- Consider asking major subcontractors to provide you with coverage as an additional insured under their commercial general liability policy

4. Many of the required procedures, personnel, structures and management commitment are already established by companies, to respond to provincial requirements for occupational health and safety programs.

- Indemnification clauses, where subcontractors agree to hold you harmless if their work creates problems
- Litigation coverage in your own insurance
- Follow-up to enforce contract requirements
- Safety information sessions for subcontractors' staff if required

Building products, materials, design and installation

- Check on all products and suppliers for reputation and past performance records
- Requirement in all contracts that products conform with codes and standards, and with the plans and specifications
- Careful preparation of purchase orders including required standards
- Appropriate manufacturers' and installers' warranties
- Where possible/appropriate, confirm manufacturers' commercial general liability insurance coverage, including products liability insurance
- Clear corporate commitment to quality control
- Reliable plans, appropriately stamped by qualified designer
- All necessary, signed engineering support and approvals for innovative products and systems
- Checking procedures to ensure materials and equipment delivered match specifications

Fire

- Measures to control use and storage of flammables
- Clear requirements for appropriate fire avoidance measures by all levels of personnel and subcontractors
- Appropriate fire extinguishing equipment on site
- Training for staff in proper use of extinguishing equipment
- Property, Builders' Risk/Course of Construction insurance with adequate fire coverage

- All management, staff and subcontractors aware of and meeting insurance agreement requirements for fire prevention, including "hot work warranties"

Security

- Measures to keep non-construction personnel off the site
- Protection for passers-by
- Deliveries scheduled to avoid leaving materials and equipment unprotected
- Regular check of the boundaries between your job sites and neighbouring properties
- Advice from police services and insurers about security measures
- Active contact to encourage staff, neighbours, public, police, etc., to report unsafe or suspicious conditions to management
- Where available, participation in a housing industry/police crime stoppers program with "tips" phone line
- Property, project or general insurance with adequate theft coverage
- All management, staff and subcontractors aware of and meeting insurance agreement requirements for security

Safety

- Written corporate/workers' safety program, with details of safety policy
- Identification of high risk operations, and step-by-step procedures for safety (information is available from safety organizations, government departments, and the Canadian Home Builders' Association)
- Conditions of employment which clearly include compliance with safety rules
- Medical examination of staff on hiring, and matching of job requirements to physical capabilities
- Training for all new staff on risks, company requirements and procedures
- Regular updating on specific safety measures, and accident response
- Prompt correction of unsafe practices and conditions

- ❑ Enforced use of personal protective equipment and clothing, guards, fall protection and fire protection equipment plus budget for acquisition and maintenance of these systems
- ❑ Effective system for workplace, tool, and equipment inspection and maintenance
- ❑ Regular site safety meetings and recognition for jobs well done

Appropriate incident procedures

- ❑ Assigned safety representative(s)
- ❑ Fire extinguishers and first aid kits
- ❑ List of emergency contact numbers on hand in case of incidents:
 - safety representative
 - hospital
 - fire department
 - ambulance
 - head office
 - government agencies to be notified
 - insurance representative
 - other
- ❑ Standard incident report form
- ❑ System to investigate all accidents and near misses, to discover causes and prevent recurrence

After-sales service

- ❑ Strong corporate commitment to after-sales service
- ❑ Training for staff in responding to customer questions and complaints
- ❑ System to identify and quickly complete deficiencies noted on final inspection with client
- ❑ Tracking system for other complaints, to

- identify if items are being allowed to lag
- ❑ Advice or manual for new owners on regular maintenance
- ❑ System to track defects and complaints, identify causes and produce required changes
- ❑ Participation in industry groups which discuss potential problems and solutions

Additional considerations for renovators and their clients

- ❑ Specific discussion with homeowners on risks, including:
 - risks to children and pets
 - measures to avoid risk
 - listing of major homeowner responsibilities
 - notification by homeowners to their own home insurance companies, possible extension to cover renovation work.

Hire good staff, consultants and trades – and listen to their advice. Never ignore warnings about possible future problems. Look at future risks as well as upfront costs.

Long Range Planning

- ❑ Specific day set aside each year to meet with trusted advisors and plan for future
- ❑ Review of risk management plans, loss experience, new issues and management response
- ❑ Business continuation plan with agreement on what will happen if owners or key personnel die suddenly, become disabled or suffer a critical illness
- ❑ Succession plan for smooth management transition on retirement
- ❑ “Tax wise” plan for retirement income for owners and employees

Case Study 2 - Site Theft

A renovator is hired to completely redo the kitchen in an existing house. The owners move out while the work is going on. The kitchen cabinets are delivered on a Monday afternoon, but the renovator is not quite ready for them, so they are stored under tarps behind the garage. The following morning, when the renovator comes to the site, the complete cabinet package is gone. Neighbours report hearing some noises, but didn't pay any attention, thinking it was the renovator working late.

What steps could the renovator have taken to prevent this situation?

- Schedule deliveries better.
- Store all materials indoors, with a secure locking system.
- Refuse or send back major packages which arrive too early (but the renovator should be prepared to pay for additional delivery charges if the delay is his fault).
- Some police departments and home builders' associations work together on crime prevention programs. Check with your local association for more information.
- Consider using one of the relatively inexpensive tracking devices which can be attached to expensive materials and equipment while they are considered to be at risk.

Who is responsible for replacing the cabinets?

This depends on the contracts and delivery arrangements, and is a grey area.

- If the renovator's contract with the owner includes providing and installing the cabinets, it may also include responsibility for secure storage.
- If the owner had a separate supply and installation contract with the kitchen cabinet manufacturer, the owner is likely to have the responsibility - unless the renovator inadvertently assumed it by accepting the delivery.

Could the responsibility for these damages have been shifted?

- If the renovator's contract includes the kitchen cabinets, he could attempt to negotiate a clause in his subcontract with the manufacturer saying that responsibility for the cabinets remain with the manufacturer until they are installed. (It would be extremely difficult to get the manufacturer to agree to that clause, however.)
- The renovator's contract with the owner could state that the owner assumes liability for loss or theft of materials stored on the owner's property.
- If the cabinets are arranged separately between the owner and the manufacturer, a similar clause might be inserted in their contract.

Who will end up paying?

- The homeowner's property insurance may well respond to the loss.
- Alternatively, the renovator's Builders' Risk insurance should cover the theft. It will be important to check exclusions and clauses regarding security.

Other considerations:

- If the thieves happened to fall and get injured while stealing the cabinets, because of improper protection of open areas, for example, the renovator and possibly the owner would be liable for any personal injury they suffered.
- That liability should be covered under either the homeowner's property policy or the renovator's commercial general liability policy.

Which Risks Will You Just Absorb Yourself?

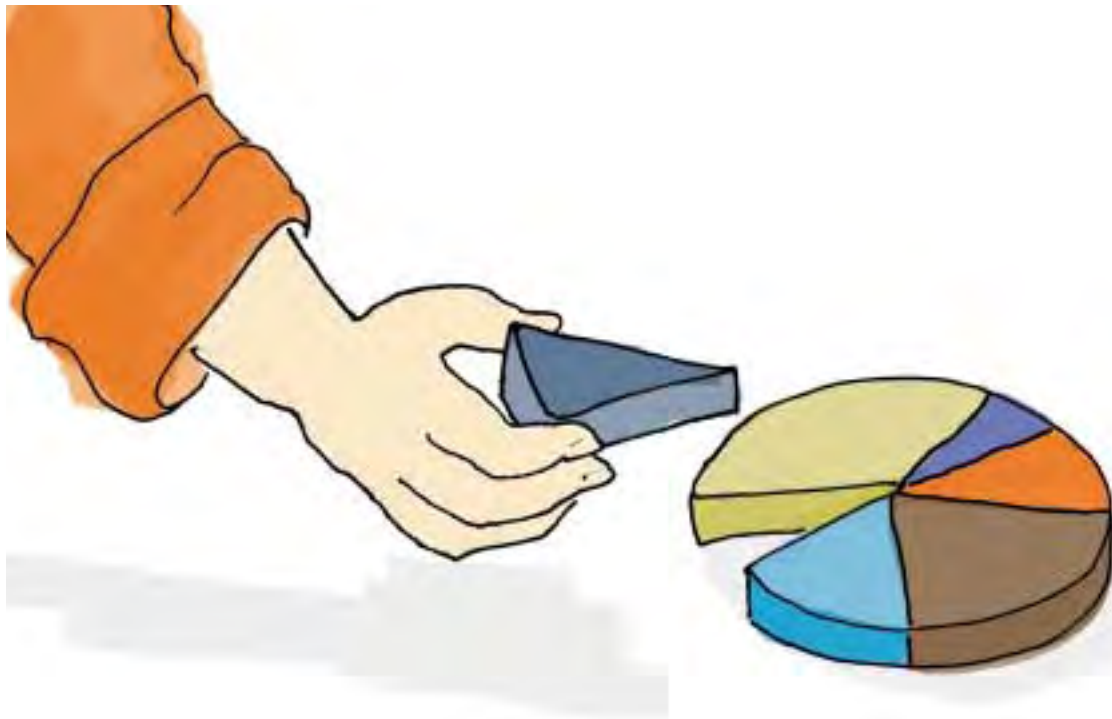
Some risks are so small and predictable, or so expensive to insure, or so unlikely to occur, that you may decide to absorb them yourself. The most obvious example of this for most new home builders and renovators is the first year or two of callback warranty you offer customers on your own forces' work (as stated in the purchase contract). This is something which is difficult or impossible to insure, so you absorb the costs.

Another example is the deductible on your insurance policies. The deductible means you agree to absorb the first \$1,000 or other agreed amount of each loss; the insurer covers the rest, up to the limit specified in the insurance policy. The deductible can reduce insurance premiums by a considerable amount, but those savings should be carefully measured against the frequency and value of your potential losses. Similar considerations can apply to the decision of whether or not to report and claim small

to moderate sized losses. The change in your loss history can have serious impacts on future insurance premiums or coverage terms. Some new home builders and renovators only claim for "catastrophic" losses.

It is important to know what risks you are deciding to absorb, rather than doing so out of a lack of knowledge. Environmental liability took many people by surprise when it first arose in the 1980s. Some new home builders inadvertently took on liability for cleaning up contaminated sites.

When deciding what risks to absorb, you should discuss the implications with your lawyers and your insurers. The decision will come down to an assessment of risks, their probability of occurring, what options you have (if any) for risk reduction, risk transfer and insurance, and the size and frequency of costs.



Which Risks Should Really Belong to Others?

Sometimes, new home builders and renovators take on risks that they don't intend to, simply because of inadequate contract terms, or lack of knowledge. A short booklet such as this can only point to some very general principles and examples, because actual laws vary in different jurisdictions⁵. It is really important to discuss risk prevention with your lawyer and your insurers and/or insurance broker. Here are some of the initial questions:

Do your contract terms with suppliers, subtrades, etc. clearly put responsibilities in the right place?

Do your contract terms with developers expose you to unwarranted risks?

Do your contract terms with customers clearly limit your liabilities to a reasonable level?

What other liabilities do you have which cannot be limited by contract?

Here are a few examples:

Assigning responsibility

Where the client supplies plans and specifications, for example, lawyers recommend the contract contain a clause that specifically says the client has all the liability for any defects in those plans and specifications — including any delays and additional costs for materials, labour, profit and overhead that may be caused by defects. It should specifically state that the new home builder or renovator assumes no responsibility for them. Similarly, the contract should include a statement that the client warrants that he/she owns rights to use the plans. The same considerations apply if clients use their own forces or supply their own materials for part of the work.

Indemnification

An “indemnification” clause is an agreement that one party will assume responsibility for another party. In the example above, the builder would want the client to sign an indemnification clause agreeing to take responsibility for the builder, and “hold (him/her) harmless”, if any claims are made as to copyright infringement, etc.

Limitation of Liability in Contract

Many contracts include an express clause limiting to a specific dollar amount the maximum amount the purchaser can recover against the person supplying goods

5. Nothing in this booklet should be taken as legal advice or applied to a specific situation without review.

or services in any or all suits relating to breach of the contract. Where these dollar amounts are not unreasonable, they have been upheld in court — at least as they apply to the people who signed the original contract. However, they do not necessarily limit the amounts that can be claimed by other people in suits based on negligence.

Unavoidable delay

Most contracts include a “best efforts” clause, saying the builder will use its best efforts to complete construction of the project before the completion date. Some include specific terms for requesting an extension; e.g. within a specific number of days of the cause of the unavoidable delay or of the scheduled completion⁶. Unavoidable delay could “include, but not be limited to” such things as unavailability of materials, inclement weather, strikes, changes in government regulation, acts of governmental agencies or their employees, acts of God, or the failure of the customer or of the architect to perform their responsibilities. These are also called “Force Majeure.”

Liquidated damages

Some contracts and subcontracts include payments which will be made if one of the parties to a contract suffers damages because the other party does not perform its portion. These “liquidated damages” are frequently used to cover unwarranted delays in completion. (Unlike the unavoidable delay clauses discussed in the last section, liquidated damages are generally applied to delays considered “inexcusable”, or to the breach of specific schedule warranties offered by the constructors on time-sensitive jobs.) They are also used to protect a seller in case a buyer later wants to back out of a deal, typically saying that the deposit and any other moneys paid on the contract will be forfeited as liquidated damages. The amounts should reflect actual damages suffered, and not be used as penalties.

6. The Ontario New Home Warranty Program, for example, has a specific system of notification, and responsibilities.

Case Study 3 - Loss of Key Partner

Two brothers have been partners in a new home building company for 15 years. Paul is the businessman. He has the financial and organizational skills that keep the company running. Mark is the creative one — the salesman interested in design and marketing sizzle, the one who appears in front of council and takes contacts out to lunch.

The company is going full blast, and both brothers are working long hours. One Friday, at two in the morning, Mark suffers a major stroke. Paul finds him in the office the next morning, unconscious. He never really recovers. Massive brain damage leaves him partially paralysed and slipping in and out of coma. Mark's family needs an ongoing income. The business is in severe difficulty, and it also may never recover.

What steps can Paul take to keep the company going?

- Essentially, Paul will need to hire someone to replace his brother's most important skills, either as an employee of the company or as a subcontractor.

Which insurance policies would respond to this type of situation?

- Key personnel disability and/or critical illness insurance would be most effective.
- Extended health benefits are also important, to cover things like private room, home care, etc.

What legal terms would have been useful for the partnership or incorporation?

- There should be a buy/sell agreement covering what the partners and their heirs will do, and when, in the case of death, disability and/or critical illness.
- Each partner could give a power of attorney to the other partner to act as their agent in case of mental incapacity. One common approach is to split responsibilities, with one power of attorney used for business issues, and a different power of attorney (naming a family member) used to handle personal and medical issues.

Other considerations:

- From the point of view of insurance and legal arrangements, it is easier to plan for the death of a partner than for a long term disability. A key personnel life insurance policy can be taken out, payable directly to the company.
- Long term disability insurance is key for conditions such as the one described here. Consider benefit amounts and length of payment terms carefully.
- A business owner may return to work in some cases within less than a year after an illness, but at reduced productivity; you may want to consider a critical illness policy with (or in some cases without) a disability program.
- Tax treatment of ongoing payments can differ, depending on who takes out the policy. If it is taken out by the company, the income will generally be taxable; if taken out by the individual, it generally will not be taxable.
- Wills must be up to date and accomplish your desires.
- It is very important that personal planning (wills, powers of attorney) and business planning (partnership agreements, buy-sell arrangements) be coordinated and integrated.

Which Risks Should You Insure?

Purchasing insurance is really another form of spreading the risk to others. In return for premium payments, insurance companies are willing to insure a business against some kinds of risk. The premiums reflect the insurer's calculation of the degree of risk involved. Some risks cannot be insured; some others can only be partially insured. But there is a wide variety of insurance to cover some of the common risks facing businesses.

Insurance is intended to provide coverage for “pure” risks over which you have little or no control. However competently you run your business, you cannot escape the possibility of fire, theft, vehicle accidents, etc. Insurance is not intended to provide coverage for “calculated” risks such as market success or failure, to replace due diligence, or to cover losses caused by an intentional act of the insured.

All insurance policies are strictly interpreted by the exact wording in the contract. They are subject to conditions and exclusions, and provide coverage only up to the identified dollar limits.

Seven key rules for buying insurance:

1. **Insure the right risks** — assess the ones that are the real cause of trouble.
2. **Cover your largest risks first** — those that represent the greatest exposures to catastrophic loss.
3. **Reduce your costs:**
 - a. Examine insurance terms, provisions and rates
 - b. Choose your deductible amounts to remove small cost claims from your insurance plan.
 - c. Negotiate preferential rates, based on low loss experience and good risk management
 - d. Avoid or absorb risks which are impossible/too expensive to insure — many new home builders and renovators do not even report small to medium-sized losses, in order to avoid premium increases.
4. **Get a good insurance broker with expertise in construction, and good insurers**
Look for specialty staff with appropriate experience and knowledge of the industry, good claims service, loss prevention advice, use of technology, etc. Compare companies and score qualifications. Commercial Insurance is a relationship business. Meet your insurer through your broker, strike a relationship, and work with them to reduce your losses. Choose one broker rather than several. Otherwise, each may feel they have only limited responsibility and may not be able to view the situation as a whole.
5. **Review your insurance and your risks periodically**
This includes daily risk management at the office and site, plus the review at the annual renewal of insurance. You may want to review claims with the insurer every quarter and if they are worsening, figure out together how to improve.
6. **Investigate bulk or package policies to keep costs lower**
7. **Prevent, prevent, prevent**

Initial questions:

Have you provided the right insurance for your own operations?

Is your personal and business planning properly integrated?

Are there any new insurance products you should be aware of?

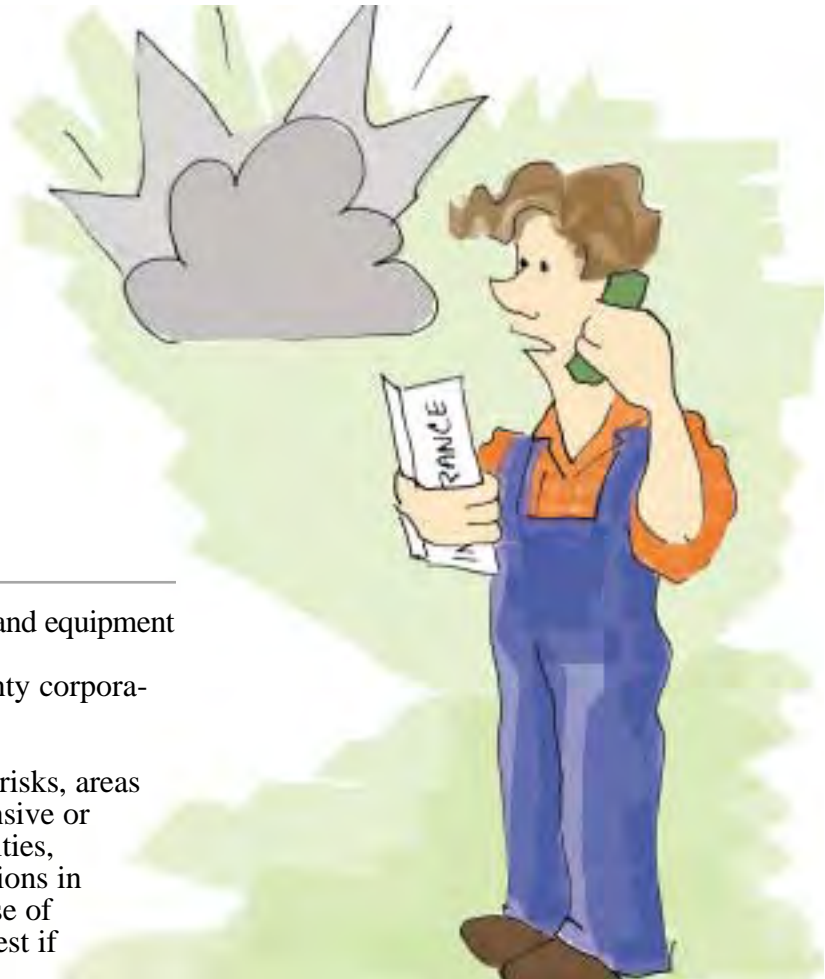
Have you demanded enough insurance from suppliers and subtrades, and is it the right kind?

Are manufacturers' warranties⁷ and any supporting insurance adequate to protect you and your customers?

Do your third party warranties⁸ give enough coverage to your customers, with only reasonable demands for your firm?

What are you currently self-insuring⁹ — intentionally or not?

How can you judge whether making a small to moderate-sized claim would be worth the impact on future insurance coverage?



-
7. on major products, materials and equipment
 8. offered by new home warranty corporations or insurers
 9. deductibles, low-probability risks, areas where insurance is too expensive or not available, personal liabilities, overlooked risks, and exclusions in your policies, and/or purchase of your partner's business interest if something happens to them?

Recommended Minimum Insurance Package

Experts suggest a company with \$2 - 10 million in annual volume should have the following insurance coverages in place, as a minimum package:

- a minimum of \$1 to 2 million Commercial General Liability policy, with completed operations coverage
- a minimum of \$1 to 2 million Builders' Risk policy covering projects in process on a blanket basis, or equivalent project-specific coverage
- appropriate Property policy covering place of business, contents, etc. with extensions for records, computers, owned/rented construction equipment and tools.
- automobile coverage (mandatory)
- New Home Warranty coverage, based on number of homes built (mandatory in some provinces)
- Workers' Compensation Insurance (mandatory)
- extended health and dental coverage for partners and key employees
- life insurance policy, payable to the company, covering death of key personnel
- critical illness and/or long term disability insurance for partners and key personnel, structured to maximize tax efficiency

In addition, all subcontractors and major suppliers/manufacturers should be asked to provide evidence of at least \$1 million in commercial general liability coverage. For some significant trades, you should consider asking to be identified as an "additional insured" on the policy. And, you should ask the insurance company to notify you if those insurance policies are cancelled.

This is a general review, and not a recommendation of what to purchase. Coverage, wording and limits should be discussed with your broker and/or agents. Limits will depend on a number of factors, including volume of work. Increasing limits can be quite inexpensive.

Main Insurance Coverages and Financial Assurance Instruments

Business Property insurance:

This is purchased for property owned or leased by (or the responsibility of) the insured company.

It generally covers loss or damage to your own real property and business personal property due to:

- fire
- lightning
- gas explosion
- smoke, water, extinguishers
- destruction by firemen, or
- collapse of part of the building related to the accident

Most policies also include extended coverage for damage from hail, windstorms, explosions without fire, vandalism, impact by aircraft or vehicles, and breakage of fire protection equipment.

Two basic types of policies are available. “Named perils” policies cover losses caused by perils that are listed (“named”). Loss or damage caused by any other peril would not be covered. The second type of policy is called a comprehensive or “all-risk” contract. It provides protection against property loss caused by any risk that is not specifically excluded.

Coverage will usually cease if you abandon the property, or if you were aware of dangers or were responsible for endangering the property. Standard policies do not normally cover loss of bills, money, securities, company records and manuscripts.

Additional endorsements can add or increase coverage for valuable papers and records, property in transit, building glass, backup of sewers and drains, damage to computer hardware/data/media, and extra business expense caused by loss of computer programs or files, etc.

Contractors’ Equipment floater

This addresses direct physical loss to equipment. Coverage may include replacement costs, plus rental expense reimbursement, debris removal, etc. This type of policy does not cover regular wear and tear, mechanical breakdown, or similar deterioration, but may cover resulting damage (e.g. if electrical breakdown of equipment results in a fire in the building). It can include equipment you own as well as other equipment for which you are liable.

N.B. - Property insurance policies written for homes do not generally cover the additional risks involved in running a home business.

Builders’ Risk insurance

This is a form of property insurance. Builders Risk (Course of Construction) policies are normally written for a specified amount on each building project, and end when the project is completed or occupied. Renovation projects may require coverage for existing buildings and structures.

It is purchased for work under construction.

It generally covers:

- ❑ fire and similar accidents as above
- ❑ may include coverage for materials and equipment in transit and while stored on the construction site
- ❑ may also cover such things as scaffolding and construction forms, debris removal and cleanup, trees/plants/shrubs, pollutant cleanup etc.
- ❑ extensions can include vandalism and malicious mischief

Builders' Risk policies generally have specific exclusions for property damage or loss caused by design errors, faulty workmanship, latent defects, wear and tear and mechanical breakdown - but not the resultant damage to other insured property.

The extent and meaning of these exclusions have been hotly debated, and minor-looking wording changes may cause major changes in coverage. Check with your brokers.

They also often specifically exclude contractors' equipment (which is available as a separate floater policy). It is important to check exclusions and conditions: particularly those dealing with coverage of own forces' work, subcontractors' work, delays causing loss of income, collapse, treatment of design errors, and theft. A construction site is generally difficult or impossible to secure, and thefts are fairly commonplace. Premiums can be high and insurers may require extra security measures.

N.B. — Custom new home builders and renovators need to advise their clients to contact their own insurers to make sure the clients' property and the work will be covered under their property and liability policies.

Common Extensions to the Builders' Risk policies:

Subcontractors

A Builders' Risk policy can be extended to cover subcontractors - which is a form of

“wrap up” policy, intended to avoid disputes among builders, subcontractors and their insurers. In this case, there should be a “waiver of subrogation” clause to protect subcontractors against attempts to recover damages from them.

Business interruption insurance

The indirect losses from an accident can often be greater than the loss itself. If materials, tools and records are destroyed by fire, that can cause work stoppages and delays which seriously affect cash flow, but overheads keep on going. Business interruption policies are designed to cover the period between the accident and the time the company gets back to normal operations. This can include “delay in start up” – the loss of revenue for the days it took to rebuild a project after an accident, beyond the actual projected completion schedule. It can also cover additional soft costs such as engineering fees, permits, etc. for the project. There are also “extra expense” policies, designed for the costs of such things as temporarily renting other office premises.

Vehicle insurance:

Automobile and fleet policies are mandatory in Canada. They combine coverage for direct losses to the insured's vehicles (e.g. due to collision, theft, fire, glass breakage, and damages from malicious mischief) and for liability to others for physical injury and property damage related to vehicle accidents. Rates for automobile insurance vary widely according to the territory, distances travelled, type of vehicle, use of vehicle, age of vehicle and driver, driving record, etc. An owner's form of policy is used to cover vehicles owned or leased by the insured. A non-owned automobile policy is used to cover your liability in cases where employees use their own cars for your business operations.

Commercial General Liability insurance:

Liability insurance is designed to cover the insured's legal responsibilities towards others, such as:

- ❑ damages for accidental bodily injury or damage to the property of others
- ❑ emergency medical and surgical expenses incurred because of an insured accident
- ❑ expenses for investigation, your defence, settlements, etc.

Commercial General Liability (CGL) insurance covers the insured company against its legal liability for property damage or injury to customers, employees, or the general public. This can include everything from a visitor hurt by slipping on ice to a customer who suffers injury from using your products. Usually, a company will want a package of coverages which are written as a commercial general liability policy, renewed annually. These can include:

- ❑ premises and operations liability
- ❑ owners' or contractors' protective liability
- ❑ contractual liability
- ❑ completed operations liability
- ❑ advertising injury
- ❑ tenants' legal liability
- ❑ employers' liability (separate from workers' compensation insurance)

Wording can be crucial. Insurance coverage for thousands or even millions of dollars of damage can turn on whether the construction should be classed as a "work" or a "project", for example. It is important to deal with an insurance broker who understands these subtleties — and to keep all brochures, ads, letters, etc. which help define what the insurance is supposed to cover.

Products or completed operations liability offers some protection if you should face a lawsuit by a customer who used your product or service and, as a result, sustained bodily injury or property damage from it. It is often limited to one year, but longer terms are available.

Damages arising from intentional acts or negligence by the insured are usually specifically excluded. Most policies have excluded damages to the insured's own work, but not "resulting damages" to other work: those could be covered by the policy. Policies taken out by new home builders or renovators may cover damage to or arising out of work performed by their subcontractors. However, wording of policies and specific exemptions can differ substantially. You should check with your lawyers and insurance brokers.

It is very important that your subcontractors and suppliers provide evidence that they carry enough liability insurance to cover their liability to you in the event their actions or products cause loss or damages. In some cases, builders require subcontractors to list them as "named insureds" on their liability policies.

N.B. — Custom home builders and renovators need to check that their clients have contacted their own insurers, and covered liability for work being done on their

property under their property and liability policies. You may want to ask for proof of this extended coverage.

Case Study 4 - Spray Paint and Open Flame

A renovator is hired to build a two-storey addition to an existing home, plus significant renovations, including finishing part of the basement. In the final inspection, the homeowner points out problems with the paint in the furnace room. The renovator sends his painting contractor out to do the touch up. The painter does not turn off the gas-fired furnace. He begins to use the paint spray can just as the furnace burner lights up — the can explodes, injuring the painter and starting a fire, which destroys a large part of the house and its contents. Fortunately, no-one else is injured. Damages exceed the original cost of the renovation project.

What steps could the renovator have taken to prevent this accident?

- Choose experienced trades/maintenance people. Spray painting near an open flame is a known hazard, which experienced trades should avoid.
- Ask trades about the training of their personnel, their ongoing review with new staff, etc.
- Consider providing a checklist of basic precautions.
- Due to the inherent danger, change the painting process from spraying to using paint roller with latex paint (eliminate hazard at source).
- See Case Study 1 for additional recommendations.

Some insurance policies specifically restrict coverage of high-risk operations or impose conditions. For example, insurance may be specifically voided if the spray painting is performed within a specified distance of an open flame.

Who is responsible?

The answer to this question will depend on exactly what the contracts say. In general terms, usually:

- The renovator would be responsible to the owner, under the terms of their contract, for all of the damages.
- The painting subcontractor would be responsible to repay the renovator, under the terms of their subcontract.

In addition:

- If the fire spreads to a neighbouring property, the owner may be held responsible to that neighbour - and the renovator would be responsible for paying the owner back, and going after the painter for reimbursement.
- The painting subcontractor may also be legally responsible directly to the owner and/or the neighbour for negligence (although this is a more difficult claim to pursue).

Who will end up paying?

Again, the answer will depend on exactly what the insurance contracts say. In general terms, and with standard conditions, claims and payment would follow like this:

Scenario 1)

Homeowner's Property Policy

- If the homeowners had notified their property insurance company of the renovation and specifically asked for coverage for both the renovation and the existing construction, they would probably claim against their property insurance. Those insurers would generally pay the claim, up to the dollar limits of the coverage, and then claim back against the renovator. (In this case they assume the homeowner's rights to sue the renovator, a process called subrogation.)
- The renovator would claim against its commercial general liability policy, and those insurers would generally try to recover from the painting subcontractor.

Scenario 2)

Renovator's Builders' Risk

- If the renovator had decided instead to take out a Builder's Risk policy, with an extension to cover the existing home, they would claim against that policy. Ordinarily, a builders' risk policy would contain a waiver of subrogation or recovery rights against other contractors and subcontractors insured within the same policy – which should cover the painter. Those insurers would generally pay the claim, again up to the limits of the coverage.
- It would be important to check time limits, restrictive clauses and any exclusions on subcontractors' work.

Both scenarios

- If the painter was negligent, its own commercial general liability policy would likely pay for the claim for damages, up to the coverage limits. Although damage to its own work would not be covered, that is such a small amount of the total loss it makes little practical difference.
- If the subcontractor breached any of the restrictions or conditions in its insurance agreement, its insurance would not pay for any claim. The only money available to pay for the claim would have been the subcontracting firm's own assets.

Other considerations:

If the painter was one of the renovator's own staff instead of a subcontractor, the situation becomes more complicated. The wording in an exclusion for "own forces' work" may limit coverage to only those parts of the home that were not part of the renovation contract.

If there were restrictive clauses like those in the box opposite in either the Builders' Risk policy or the Commercial General Liability policy, the renovator may find that its insurance does not cover the damages.

**Errors and omissions/
professional liability insurance:**

Errors and omissions insurance provides coverage for legal actions based on negligent performance of duties. It is available for architects, engineers, lawyers, accountants, insurance agents, design/build contractors, and others facing long-term negligence liability. New home builders and renovators who use outside design firms should require them to provide evidence of sufficient E & O coverage. Be sure to check if there are any exclusions for specific types of work or damages. Those doing their own design may want to investigate E & O coverage for themselves, but policies for firms doing both design and building can be very expensive.

Wrap up insurance:

When an accident does occur on a construction project and the responsibility is not clear cut, resolution can become fraught as various parties and their insurers try to avoid unfair costs. Unfortunately, this can delay payment and contribute to further losses. In order to overcome this problem, insurance companies offer “wrap-up” insurance products, covering liability for all named parties on a specific project (including owners, contractors, subcontractors, designers, etc.) under one policy. This type of insurance may be taken out by the owner, or by the prime contractor. It is most often used on large projects.

Pollution liability insurance:

Through accident or vandalism, it is possible to spill hazardous materials into watercourses, or to disturb existing pollution so that it can escape onto neighbouring properties. Pollution liability insurance can address your liability to others in this situation. For example, this policy would cover your liability if you broke an unknown septic tank

during excavation, and released its contents onto neighbouring properties or into a watercourse. There are also new policies to cover some of the major risks of cleaning up a “brownfield” (contaminated) site.

Umbrella or excess liability coverage:

This is really a contract for higher coverage limits above the primary general liability and business automobile policies. It is intended to protect against catastrophic losses. Umbrella coverages traditionally were broader than primary coverages, but now they have many exclusions. Excess liability policies do not generally provide different coverages from the primary policies: they just offer increased limits. There is also a valuable “drop down” feature that replaces eroded aggregate limits. Usually, every time there is a completed operations claim against the general liability insurance, it affects the remaining (aggregate) limits. The umbrella policy will take over the amount of proved claim in excess of the lower aggregate amount under that policy.

New home warranty programs:

Under insured or third party warranty programs, a third party corporation agrees to fulfil the new home builder’s warranty to the home buyer if the builder does not. Where a warranty program has to pay a claim to a customer, it generally goes after the responsible builder to pay it back. The terms of warranty program coverages differ across the country, but normally include a wide one or two-year labour and materials warranty, plus coverage for major structural defects until at least the end of the fifth year, within specified dollar limits. Some programs have additional coverages for certain systems and/or elements of the building envelope. Some are optional, available for an additional pre-

mium. Strictly speaking, they are not all “insured” as defined in Insurance Act(s). They all spread the cost of risks across a pool of warranty holders, similar to the way insurance policies spread the costs of risks across a pool of policy holders.

In some areas, additional coverages are available. Some programs vary premiums based on the builder’s claims experience. Many programs require cash, bonds or personal covenants from builders. Some set design and construction standards beyond those in the building code, and/or require peer review, as a form of risk control. Coverage under a new home warranty is required by law for most new homes in British Columbia and Ontario, and most new low-rise homes in Quebec.

Renovation warranty programs:

A similar type of coverage to that offered for new homes, this is third-party warranty coverage for renovation projects and additions. Broad coverage warranties are not yet widely available. Envelope renovation warranty insurance is mandatory in British Columbia for renovators repairing “leaky condos”.

Inherent defects insurance:

In some other countries (France, for example), a ten-year coverage is available for buildings, which insures the owner against major construction defects. One or two similar products are reported to have been offered here, but so far they are only considered for extremely large projects.

Some insurance policies are written on a “claims made” basis — they only respond to claims which arise while the policy is in place. If the insurance is allowed to lapse or is switched to another carrier, the first insurer usually will not be responsible for new claims, regardless of when the work was done.

Some other policies respond to claims for work done during the time the policy was in force.

Most new home warranty programs cover the actual project, and respond to claims made within the number of years set out in the warranty contract.

Workers’ compensation:

Workers’ compensation insurance is an employer-paid program, which provides compensation to employees injured in work accidents. It offers a relatively speedy response to claims, in return for which employees give up their right to sue the employer directly. Most employers in Canada are required by law to provide coverage under the workers’ compensation program for their employees.

Long term disability insurance:

Principals of small companies can buy insurance offering specific ongoing payments if they should suffer a long term disability. This insurance can be expensive for individuals. Many home builders’ associations offer access to this type of insurance at a reduced “group” rate. In some cases, overhead expense insurance may also be useful: this covers overheads for a professional or small business person who is temporarily disabled.

Critical illness insurance:

This provides protection where an owner/key employee has a critical illness or health problems that do not necessarily leave them disabled but affect their productivity or desire to continue working. It will pay a lump sum or in some cases a stream of income to help the business cover losses caused by absence or lower productivity.

Key personnel insurance:

Small firms can take out life insurance to help cushion the impact of a death of one of their key personnel, such the owners, president, construction superintendent, or designer. Insurance is also available to cover a situation where a key employee leaves the company.

Business continuation insurance:

Many small businesses have a buy-sell agreement saying that the heirs of an owner or partner must sell to the survivors (and they must buy) in case of a death. Rarely do they have the required amount of cash on hand. Life insurance can be used to guarantee a sum of money to fulfil this obligation.

Group health and life insurance:

Small businesses often do not have enough staff to qualify for reduced group rates for supplementary health benefits, dental, or life insurance plans. Many

home builders' associations have negotiated group rates for their members.

Bonds:

There are several types of bonds used in the construction industry: bid bonds, performance bonds and labour and material payment bonds are the most common. A bond is a three-way agreement between the principal (usually the contractor), the obligee (usually the owner) and the surety company.

Essentially, in a performance bond, one part of the agreement says the surety will remedy the default if the contractor doesn't perform the contract properly. Usually, this means arranging for work to be completed or paying the face value of the bond, whichever the surety chooses. The second part says the contractor will reimburse the surety for any moneys it has to pay out. The third part is the contract between the owner and the contractor. Bonds are often taken out for 50% or 100% of the value of the project.

Bonds are commonly required by public sector clients, both on building projects and on subdivision servicing. They are also used on some industrial, commercial,

and institutional jobs, but much less frequently in the residential sector. Most new home warranty programs require financial security from any builders which they judge to pose higher than average risks. Some will accept bonds as an alternative to cash or letters of credit.

Many of the laws governing building and liability are set by provincial governments, and they differ across the country. In addition, liabilities are regularly argued in courts, and the judgements can set important new precedents. New home builders and renovators should discuss their potential liabilities with a qualified lawyer, with expertise in residential construction.

A large new home building company signs a contract with a window manufacturer to supply sealed insulated window units for all the houses at its site. Several months after the first occupants move in, the builder starts getting complaints about water leakage and in some cases damage to sills and walls beneath the units. Quite quickly, it begins to look as though there must be a defect in the windows themselves. The windows have already been installed in 60 completed and occupied homes, and 45 have complaints. The other 15 appear fine. The manufacturer begins by saying the problem must be the installation, and threatens to sue the builder for libel. Then he stops responding to calls. The builder is scheduled to install the windows in 5 more homes where occupancies are due within two weeks. He tries to get alternate windows, but finds he will not be able to get delivery for at least two months, and so he installs the possibly defective units anyway. Half of the homes are still within the builder's own one-year full materials and workmanship guarantee period as contained in the agreement of purchase and sale. The homes are all covered by a third-party warranty program. In the end, he faces problems with all the windows in 65 houses.

What steps could the builder have taken to prevent this situation?

- Deal with a reputable, established window manufacturer.
- Specify known, effective product standards.
- Deal with experienced, skilled installers.
- Meet all code requirements.
- Meet all of the specifications in the contract with the homebuyers (no unapproved substitutions).
- Keep aware of potential problems with products (through analysing complaints and callbacks, attending builder association meetings, keeping up with trade journals, etc.).
- Do not install any more of these windows once they have been shown to be suspect.

Where there has been serious water damage, it is critical to take early and complete action to eliminate toxic mould growth. Recently, several large lawsuits have alleged substantial adverse effects of mould on health of building occupants. Court awards in these cases can go far beyond the costs of repairing the homes.

Who is responsible for replacing the windows?

- ❑ The builder's responsibility will be determined according to the terms of its contract with the home buyers, its warranty program (if any), the provisions of the building code, and other applicable law.
- ❑ For those homes still within the guarantee period, the builder is responsible for replacing the windows and repairing resulting damage — and going back after the manufacturer and/or installer for compensation.
- ❑ After the guarantee period, if the builder has met codes and the terms of its contracts and specifications, it may not have any liability under contract law for windows installed in good faith. In that case, the builder's decision on whether to replace the windows would be a business decision based on reputation and possible future problems.
- ❑ It may have liability under negligence law, for windows installed after the builder knew or ought to have known that the windows were defective. It may also have liability in some provinces, under "implied warranties of fitness" in provincial legislation (check with your lawyers).
- ❑ If the windows were clearly defective, the manufacturers may have very broad liability in some provinces, under implied warranties of fitness.
- ❑ If there is an element of improper installation, the window installers may be responsible to the new home builder under the terms of their contract.

What is the role of the new home warranty program?

- ❑ The terms of new home warranty programs differ from province to province and from company to company. In general, they will make reparations to the homeowner if the builder fails to do so, for items covered under the terms of the warranty. Defective windows would generally be covered, if the builder does not make needed repairs, under the initial "materials and workmanship" warranty period, which is typically one or two years. (Here again, if the windows met applicable codes and standards, and filled contract obligations, the warranty program may not have responsibility to replace them.) If a warranty program has to make good on an item under the initial materials and workmanship coverage period, it will generally pursue the builder to recover the amount it had to pay out.
- ❑ Windows could also be covered under an extended "building envelope" coverage, where that is offered under the warranty program. Term is generally two to five years.
- ❑ Defective windows would not normally be covered under the longer term "major structural damage" coverage. Neither would resulting damage, unless the damage affected the structural integrity of the building.

Who will end up paying?

- ❑ This depends firstly on the size and financial health of the manufacturer of the defective windows. If it has the resources and wishes to stay in business, it may just absorb the costs to replace the windows, or attempt to share them with suppliers of defective parts, etc. However, the fact they are not returning phone calls seems ominous.
- ❑ If the manufacturer has product recall expense insurance, it should respond to this situation if the units were proven to be defective. Not very many manufacturers carry this product liability insurance due to the high costs involved.
- ❑ A manufacturer's standard commercial general liability policy would probably not cover the windows themselves, but might cover claims based on "resulting damages" to other parts of the house.
- ❑ The builder's insurance is unlikely to cover the costs of replacing the windows. Where there are damages resulting from window leaks, the commercial general liability insurance may respond to claims/lawsuits started by owners. However, where there is no actual damage, the insurer is likely to argue that there is no "accident" or "occurrence" causing property damage or loss, and therefore the policy will not respond.
- ❑ In the case of the windows installed after the builder already suspected the windows were defective, its CGL insurer would probably argue that the decision to install the windows was an intentional act, and therefore would not be covered in any case.
- ❑ If a supplier or installer provided a performance bond, and the claims arose during the period covered, there might be a claim against the bond.
- ❑ The CGL insurance carried by the supplier or installer who provided the defective windows will likely cover damages arising from the leaks, but again will not cover the costs involved with replacing its own work, or arising from intentional acts, such as failure to meet codes/contracts, etc.
- ❑ New Home Warranty program coverage issues have already been discussed above.
- ❑ If a court determines that the builder is partially at fault in the case due to negligence, the builder may end up paying for the entire sum of damages and having to try to recover from the manufacturer, supplier or installer also deemed to have been partially at fault. The builder's CGL insurance will likely respond for the damages resulting from the defective windows, but not costs associated with replacing the windows themselves.
- ❑ There is a possibility that the various CGL policies would cover replacement of the windows themselves, if that was judged to be damage "resulting from" a defect in a specific component used in their manufacture, but this will depend on policy wording and can be extremely difficult to prove.
- ❑ Damages relating to mould resulting from the window leaks *may* be covered under certain wordings of CGL policies and/or the homeowner's property insurance, but this issue is still being argued in courts.

If A Problem Happens, What Do You Do?

Even if a problem occurs, there are still ways to control the damage. Here are some of the main questions behind a problem response plan:

What must be done immediately, and who is responsible for doing it?

**Who needs to be informed — within your company?
regulatory agencies? at the insurance company?
others (injured worker's family, homeowners, etc.)?**

What information will they need?

Who should be contacted for advice?

How can you stop this problem from happening again?



Emergency Response — Injuries

The following is an example of emergency response to an injury, loosely based on information from the Construction Safety Association of Ontario. In a small company, it may be the new home builder or renovator who takes these steps him/herself.

Immediate Response:

Assign vital tasks	Ambulance	On learning of a situation with injuries, the superintendent immediately tells his assistant to call an ambulance and provide details on site location, number of persons injured and the nature of injuries.
	First Aid	The superintendent takes the first aid kit from the trailer and follows the safety rep to the accident scene.
	Access	On the way, the super asks one or two workers to make sure there is sufficient access for emergency vehicles from the roadway to the building. He/she tells them to meet the ambulance when it arrives, and direct emergency personnel to the right place.

At the accident scene

Stabilize the situation	Provide protection	Arriving at the accident scene, the super and safety rep — both trained in first aid — quickly evaluate the situation. If there are continuing or further hazards such as fire, unstable equipment or trenching, live wires, traffic, or operating machinery, they deal with those immediately.
	Give first aid	The super immediately goes to the most injured person, while the safety rep looks after any other injuries. First aid can include mouth-to-mouth resuscitation, splints, comforting talk, etc.
Get information	Information about the workers	The super asks the safety rep to write down the injured workers' names, addresses, telephone numbers and the name/number of the subcontractor they work for.
	Name of the hospital	From the ambulance driver, the super learns where the casualties are being taken.

Reporting

Preserve evidence	Isolate the accident scene	As soon as the site is secure from immediate hazards, the super tells all personnel to make sure nothing else is touched. Once the injured workers are safely removed, the super may ask the safety rep to rope off the accident scene and remain there until authorities arrive.
Notify the authorities	Initial calls	The super calls senior management. They immediately notify the local Construction Health and Safety Branch of the Ministry of Labour, the police, and the office of the subcontractor employing the two injured workers. (If no-one is available at head office, the super makes those calls him/herself.) If the incident has resulted in damage or collapse of part of the building, it may be wise to notify building authorities.
	Photographic evidence	The superintendent or safety rep asks an employee to take photos of the accident site, injuries and any property damage.
Reports	Initial accident reports	The superintendent or safety rep records the names of all eyewitnesses with their brief accounts of what happened, explaining that a more detailed account will be required later.
	Police and Ministry of Labour	When the police and the Ministry of Labour inspector arrive, the superintendent escorts them to the accident scene and offers to cooperate fully with their investigation. He gives them the names and information about the injured workers, and the name of the hospital where they have been taken.

Follow-up

Avoid future recurrences	Identify problems and solutions	At the next project meeting, the super describes the accident and reports on the condition of the injured workers. He and the safety rep then lead a discussion on how to avoid similar accidents in future. The group agrees to add some new safety requirements, and to explain them to all affected employees and subcontractors.
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Emergency Response and Claims — Property Damage and Loss

Experts in construction risk management offer these suggestions for responding to property damage or loss on the construction site, insured under a Builders’ Risk¹⁰, Property or Commercial General Liability policy. Since these events can also include injuries, the description below includes notes on dealing with hurt people.

Builder’s Risk Response		
At the scene	Assign vital tasks	Follow similar steps as for injuries above: 1. Notify emergency services (fire, police, etc., as appropriate). 2. Prepare for first aid. 3. Make sure there is clear roadway access for emergency services, and someone to direct them.
	Stabilize the situation	Again, the discussion of injuries, above, contains useful information. 1. If emergency services are on the scene, follow their instructions. 2. If they have not yet arrived, assess the situation and deal with continuing hazards. In case of fire, for example, make sure people in the area are warned, and remove flammables such as supplies of lumber in the immediate area. 3. Give any required first aid.
	Get information	In the case of fire, for example, get names and contact information for anyone working on site, and what operations were being performed. In case of theft, itemize what is missing. Get names and contact information for witnesses, guards, etc. Make sure to get contact information about anyone who is injured, including what hospital they are taken to.

10. See, for example, the remarks by Timothy Pierce, a partner with Thelen Reid and Priest LLP in Los Angeles, to the International Risk Management Institute’s 1999 Construction Risk Conference, as reported at <http://irmi.com/construction/archives/crs19.asp#Builders Risk Claims Strategies>

Builder's Risk Response

Reporting	Notify others	<p>Calls should be made to senior management. Determine whether you are likely to claim against your insurance for the loss – or if anyone else is likely to claim against you. If so, you should notify your insurance advisors immediately.</p> <p>You may also need to contact the offices of any sub-contractors or suppliers affected.</p>
	Avoid assuming blame	It is fine to express sympathy, where appropriate, and state that you will do everything you can to find out what happened and why. However, avoid offering payment or acknowledging guilt until the incident has been properly investigated.
	Preserve evidence	Once you know there is no immediate danger, you may want to rope off the area. Try to make sure nothing important is touched.
	Photographic documentation	Assign someone to take photographs and/or to videotape the site, damage and any potential evidence, signs of forced access, etc. This is especially important if cleanup and repairs must take place before the insurance claims adjuster will be able to inspect the damage.
	Initial evidence	<p>Take statements from anyone who witnessed the damage. You may want to have your lawyer present.</p> <p>If damage was caused by a storm, for example, collect weather reports and news articles identifying the date and extent of damage caused by the storm.</p>
Repairs and Clean up	Separate accounts	<p>Consider hiring a different contractor to make repairs, as you and/or the original subcontractor may be too busy trying to complete the project without further delays.</p> <p>If the same contractor is used, make sure all costs are kept clearly separate.</p>

Builder's Risk Response

Insurance claims	If you're claiming, do it quickly, with full information	<p>Make sure your original claim is accurate and complete, and submitted quickly. Prepare a written notice for the insurer, including date, time and location of the incident, description of what happened, causes, estimate of loss or damage, names and contact information for witnesses and contacts.</p> <p>Include all costs including temporary repairs, costs to stop further damage, etc. in the claim.</p> <p>Consider creating a binder for the claim, with the description of what happened first, and what the damages are. Include copies of records, reports and repair cost invoices.</p> <p>Except for small claims, schedule a meeting with the adjuster. Think about what questions the adjuster may have, and have appropriate people present at the meeting.</p>
Follow up	Identify problems and solutions	At the next project meeting, describe the incident and report on subsequent developments. Discuss how to avoid similar incidents in future. Agree on appropriate changes to safety and security and set up times and procedures to make sure they are explained to all affected employees and subcontractors.

Situation Response — Construction Defects

While accidents, injuries and fires are immediately obvious, and theft is usually discovered quickly, it can take some time for defects in construction to become recognized. All projects have some minor problems which require correction; these are a normal part of after-sales service. It is important to respond quickly to customer complaints, through normal “service calls”. However, sometimes the problems are deeper. A pattern may start to emerge with one home that doesn’t respond to the normal repair procedures, or with a number of homes which seem to show similar problems. Other new home builders or renovators may report similar problems when they get together at association meetings. When faced with this kind of situation, there are some recommended steps:

Construction Defects

- Inform your lawyers and insurers/insurance brokers.
- Try to identify the specific problem as quickly as possible.
- Take photographs.
- If it is a specific piece of equipment or material, contact the subcontractor who installed it, and the manufacturer and/or distributor to rectify the problem.
- Check whether it meets all requirements in codes and standards.
- Check with your home builders’ association to see if anyone else is reporting the problem, or whether it is currently the subject of research.
- Check whether there are credible recommendations, guidelines or standards for repair, from acknowledged experts or recognized groups.
- Take steps to avoid (mitigate) any further damage.
- If you were planning to use the same equipment, material or system in other work, try to find alternatives.
- Document all discussions about defects and repairs, and all repair work.
- If you will have to replace the problem products because the responsible subcontractor or supplier is no longer in business, contact your lawyer and insurance broker/insurer immediately.
- Check the terms of the responsible company’s commercial general liability, completed operations extension, or product recall insurance, and your own CGL policy, to see if it will cover the damages.

Whether you have experienced losses or not, your company should set aside a specific day each year to take stock of its risk management plans and long range planning. You should gather information internally, and confirm its accuracy. Then, it's a good idea to sit down with your trusted advisors – your lawyer, your accountant, your insurance representative – to evaluate your position.

Step 1 – Review Your Risk Assessment

- Are you focussing on the right risks?
 - Your last assessment of risks
 - Your actual loss experience
- What have you missed?
 - Any new foreseeable risks

Step 2 – Review Your Loss Prevention Program

- Do you have adequate loss prevention measures in place?
 - A good basic program
 - See pages 14 – 16 of this Guide for recommendations
- Are new procedures necessary?
- What needs improvement?
 - Measures for new risks identified in Step 1



Step 3 – Review Your Emergency Response Procedures

- Have you trained staff how to handle emergencies?
–See pages 36 – 40 of this Guide for recommendations
- How did management and staff respond to actual incidents?
–What needs improvement?
- Are emergency numbers, first aid kits, fire suppression and security measures readily available?

Step 4 – Review Your Risk Allocation

- Are you absorbing the right risks?
- Are you transferring risks appropriately?
- How are risks shared between your company and your trades/suppliers?
- Do your risk transfer mechanisms really work?

Step 5 – Review Your Business Insurance Coverages

- Do you have the coverage you require?
–See pages 25+ for information on common coverages
- Were there any problems with actual claims?
- What needs improvement?
- Should you consider changes to limits, deductibles, reporting levels?

Step 6 – Review The Fit Between Your Personal and Business Planning

- Have you planned for future personal/business risks?
- Who will continue your business if you should die or suddenly become ill?
- Is there a legal, binding agreement assuring your plans – and is it funded?
- Is your will up-to-date and does it accomplish your desires?
- Do you have appropriate insurance for death, long-term disability and/or critical illness?
- Do you have a "tax wise" plan for retirement benefits for yourself and your key employees?

An annual review of risks, loss prevention and insurance will help make sure you update your plans as necessary, and avoid future losses.

In business, as in life, it's impossible to avoid all risks. But you can go a long way towards protecting yourself from avoidable risks by setting up a good risk management program.

This Guide has set out the fundamental questions you have to answer for a risk management program.

It has given the basic information you need to start answering those questions properly — with examples of common risks, checklists of good management practices, discussion of risk absorption, options for risk transfer, and examples of response plans.

This information should also help you make the best use of your time with your insurance broker and/or agents and your lawyer — who should be key parts of your risk management strategy. Choose them well, making sure they have experience in construction issues. They will give you the expert advice you need about your own situation, and the specifics of laws in your jurisdiction. All of that information helps to support your risk management plan:

You know what risks are important to your company

You've set up procedures to prevent most of them from happening

(safety plans, training, checks on subtrades and suppliers, ongoing monitoring, etc.)

You've taken steps to limit their impact

(risk transfer, insurance, etc.)

And you've planned what to do if one of them happens anyway

(emergency response plans, assigning responsibility, checking with your home builders' association, updating of procedures, etc.)

A good risk management plan gives you the tools to choose acceptable levels of risk, to avoid unacceptable risks, and to know what to do if things start to go wrong. That all adds up to a lot more peace of mind.





The author would like to thank the following people, who provided background information and/or comments on all or parts of this book during its preparation. It would not have been possible without them.

Gary Borodenko
 Association Coordinator
 Federated Insurance Company of Canada
 Bruce Clemmensen
 President
 Clemmensen & Associates Ltd.
 Marc Denhez
 Lawyer, Consultant and Author
 Simon J. Fenn
 National Construction Leader
 Marsh Canada Limited
 David George
 Senior Vice President, Legal and Corporate
 Monarch Construction Limited
 Tony Iatesta
 National Liability Director
 Zurich North America Canada

Heather Loughery
 Senior Vice President
 Commercial Programs
 Zurich North America Canada
 Terry Rausch,
 Director, Life and Financial Services
 Federated Insurance Company of Canada
 John Sammut
 Manager, Training and Advisory Department
 Construction Safety Association of Ontario
 Pat Varcoe
 Vice President, Licensing and Underwriting
 Ontario New Home Warranty Program
 Don Johnston,
 Senior Director, Technology and Policy
 Canadian Home Builders' Association
 and other CHBA Staff Members

How to Manage Risk
is published by the Canadian Home Builders' Association
with the support of Federated Insurance Company of Canada

Writing/Research
Rowena E. Moyes

Illustrations
Rowena E. Moyes and Leslie Lambert

Graphic Design
Sota Production

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ISBN 0865060630
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