

Subcontractors: How a common business practice could lead to a mountain of insurance costs

Rachel Soich, ACAS, MAAA



Utility companies can be plagued by a variety of unforeseen catastrophic losses ranging from a worker's indefinite hospital stay from a major chemical burn to a fatal fire due to faulty wiring.

Unexpected claims of this magnitude can be incredibly detrimental to your company's profitability. However, the traditional uncertainty associated with large losses is further amplified if the party involved is your subcontractor which neglected to obtain proper insurance coverage. Careless subcontractors can carry a potentially devastating hidden cost to your company. What are the risks associated with uninsured subcontractors and what can you do to prevent them from threatening your bottom line?

Subcontractors are widely used in industries such as construction and utilities. They benefit companies with specialized knowledge to ensure product quality at a lower cost, but there are additional liability risks associated with their own work and safety. Your company must ensure that hired subcontractors have an insurance policy to cover their losses to avoid significant additional costs, which could increase your liability and negatively affect your financial results.

Which coverages does your subcontractor need?

Your company should confirm hired subcontractors are covered by general liability, errors and omissions (E&O), and workers' compensation insurance policies. General liability coverage protects subcontractors causing property damage or physical injuries to another person. E&O coverage provides protection for subcontractors' oversights and mistakes in their professional services. Workers' compensation coverage provides relief for costs associated with an injured subcontractor. For example, electrical subcontractors are regularly exposed to live wires and potentially unsafe construction sites, which can cause unexpected large losses.

Liability risk can be fully transferred to your subcontractors if they have their own insurance policies. You can add them to your company's insurance plan, but that expanded coverage results in additional costs to cover employees not under your company's immediate discipline. However, this decision for coverage can only be made if you are aware of your subcontractors' insurance status.

What happens when a subcontractor is uninsured without your knowledge?

If your company inadvertently hires an uninsured subcontractor, your company could be blindsided with an additional insurance premium to cover those subcontractors, or worse, be on the hook for an unexpected catastrophic claim. Depending on your insurance policy's language, that claim may not be covered by your insurer, leaving your company to foot the entire bill and threatening your bottom line.

Held in 44 states and the District of Columbia, a general contractor becomes legally liable if its subcontractor is uninsured and causes a loss.¹ If your insurer discovers your subcontractor is uninsured, the insurer retains the right to charge additional premium to cover potential losses, even if your company was unaware. This has been supported in practice per the verdict of *The Travelers Indemnity Company v. T&S Drywall Finishing Inc.* The court upheld T&S's obligation to pay the additional premiums when the insurer learned the company hired uninsured subcontractors.² However, the insurer's penalties may be the least of your company's concerns if an uninsured subcontractor is seriously injured or causes significant harm on the job. In addition to the claim scenarios described above, there are endless circumstances that could lead to catastrophic claims.

1 Workers' Compensation – The General Contractor's Responsibility. (August 1, 2008). Retrieved January 18, 2018, from <https://www.mynewmarkets.com/articles/92397/workers-compensation-the-general-contractor-s-responsibility>.

2 Workers' Compensation Insurance: Contractor Charged for Subcontractors' Employees. Woods & Aitken LLP. Retrieved January 18, 2018, from <https://www.woodsaitken.com/workers-compensation-insurance-contractor-charged-subcontractors-employees/>.

Even at the fault of your subcontractor, these catastrophic claims can become your company's responsibility.³

Unforeseen disastrous claims can also drastically change your company's loss history if you become responsible for a subcontractor's loss. Loss history directly affects future insurance rates, so these losses can lead to unexpected inflated rates or even dropped policies. Dropped policies could cause future difficulties in finding affordable insurance or securing a policy at all. Even if there is no claim occurrence, your company can still suffer these same consequences because of your insurer's exposure to uninsured subcontractor liability risk without the proper knowledge. Ultimately, protecting your company and your shareholders involves simple measures such as verifying your subcontractors' insurance coverages or requiring proof of insurance. These risk management techniques can be the difference between profitable growth and insolvency.

3 Subcontractors without Workers' Compensation will cost you. (March 18, 2013). Retrieved January 18, 2018, from <https://blog.nari.org/2013/03/18/subcontractors-without-workers-compensation-will-cost-you/>.



Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

milliman.com

CONTACT

Rachel Soich
[rachel soich@milliman.com](mailto:rachel.soich@milliman.com)