



## Third-Party Risk Management

It was a pleasant day. The contractor who had been building a breezeway addition to connect two buildings on the church property was nearing the end of the job. One of the employees of the contractor was handing aluminum planks to another employee standing on the roof of the breezeway. As he pulled one plank up, it hit the overhead power line and the contractor employee was badly shocked and fell to the ground. He suffered a broken back and lost two toes.

An engineer prepared the plans for the work however, he carried no insurance. There was no written contract to perform the work. There was a purchase order, but no hold harmless agreement.

The claimant alleges the church did not provide a safe workplace and therefore is responsible. The church has a policy of \$1,000,000, which is now in demand. While the church's insurer considers liability doubtful, it is expected the defense costs will be \$350,000.

Does this sound like your worst nightmare? This type of loss can happen to your church. It also demonstrates some of the many pitfalls that can be avoided when dealing with contractors or service companies.

Contractors and service companies provide many valuable services, which are needed by United Methodist churches. Some services may be provided on a regular basis, such as snow plowing, lawn care or painting. Other services are performed only on occasion, such as building additions, renovations or roof repairs.

In either event, contractors and service companies may expose the church to significant losses or liability. Therefore, appropriate steps need to be taken to make sure that the financial responsibility for

losses also rests with the contractor or service company.

Contractor and service company risk control is a very broad subject. The appropriate control measures will vary depending on a variety of factors, such as the business relationship with the contractor or service company, and the nature and hazard of the work being performed.

The remainder of this MPM will refer to contractors. Many of the exposures to loss presented by service companies are similar and should be handled in a similar manner.

### HAZARDS

There are numerous hazards that can cause losses. Some of the more common operations and hazards which need to be controlled include fires, excavating and working at elevations.

- Fires can be caused by contractors who cut, weld, solder, grind, use torches or perform electrical work. Roofing, plumbing, gutter or demolition work are examples of work where this hazard is commonplace.
- Excavating can result in damage to gas, electric, communication, water and other utilities with potentially disastrous effects.
- The use of flammable liquids can occur with painters and other contractors. Some stains, solvents and finishes are subject to spontaneous combustion. Fires from spontaneous combustion can be especially serious, since they frequently start hours after the workers have left, when the building may be unattended.
- Contractors who work at elevations are subject to serious injuries from falls.

### SELECTING A CONTRACTOR

Selecting the right contractor is the most important part of controlling the risks. Ideally this should be done through a prequalification process. The prequalification process should result in two or more acceptable contractors who will be allowed to bid on the actual work. The alternative to prequalifying contractors is to qualify the contractors during the bidding process for the specific job.

Factors to consider in prequalifying contractors include:

- Company experience: Ask for experience with similar projects, years in business, geographic territory/location, references, and previous customers. Make sure to ask for references and contact them.
- Senior management: Look for experience and at least 3-5 years tenure with the firm.
- Ask about the company: operational and hiring procedures, safety and training programs, safety record and overall company turnover.
- Current projects/backlog: Ask for how many projects, what size, where they are located, and project status versus schedule completion.
- Financial status: Ask for copies of contractor's bond.
- Insurance coverage: Ask for certificate of insurance.

## CONTRACTS

Contracts and agreements will vary considerably in content and format depending on the size of the job and the contractor. Some contracts will be lengthy and formal and others will only be a page long. The larger the job or the higher the hazards involved, the greater the need to ensure the church's interests are protected. Any subcontractors the contractor uses should be held to the same contractual requirements. An attorney should review contracts before they are signed.

Make sure to review the hold harmless or indemnity provision in each contract. Under a hold harmless or indemnity provision, one party to a contract agrees to pay another, if the latter suffers a specified loss. The terms of hold harmless and indemnity provisions should be written in favor of the church, since the contractor has the control over the actions of his or her employees.

These clauses vary considerably in the way they are worded and to the extent they transfer liability. Work with local legal counsel when entering into these agreements. Hold harmless and indemnification clauses are useful to clarify and pinpoint accountability. However, their value without insurance or other secured financial transfer devices is limited.

## INSURANCE

Contractors should provide satisfactory evidence of insurance before starting the job. The best protection is for the church to be named as an additional insured on the contractor's general liability, auto liability, property or workers compensation insurance policy. Having additional insured status will provide the following benefits:

- Defense costs and other claim costs are paid by the contractor's insurer.
- It is unlikely the contractor's insurer will subrogate against the church.

The next best level of protection is to obtain a certificate of insurance from the contractor. The certificate should indicate the insurance company, types of coverage, coverage limits, and term of the policy. It should be signed by an authorized agent of the insurer or an officer of the insurance company. The contractor should provide renewal certificates of insurance thirty (30) days prior to the expiration of the current policy. The church should establish a diary for contractors and use it on a regular basis to ensure that up-to-date certificates are maintained when it enters into long-term contracts.

Certificates of insurance should cover workers' compensation, general liability, property and automobile liability. The limits of coverage should normally meet or exceed those of the church's insurance policy. For high-hazard work, higher limits may be appropriate. The contractor should also be bonded.

If an addition is being constructed, the increased property values need to be reported to your conference administrator and the PACT Service Center to maintain the proper amount of insurance on the church's property policy. If you are required to provide builders' risk call the PACT Service Center.

The contractor may also carry a builders' risk insurance policy, which will provide property insurance coverage on the addition until the construction is completed, at which time it will need to be added to the church's policy.

The contractor should not have significant limitations on coverage from their insurer. For example, if the contractor is going to be performing any excavation or underground work, use explosives, or perform work

which could result in building collapse, there should not be an XCU (explosion, collapse, underground) exclusion on the policy. The conference administrator or PACT Service Center can provide helpful assistance reviewing certificates of insurance.

## CONTROL

Before the work of the contractor begins, a meeting should be held so that all parties will understand the work to be performed and to discuss the safety measures that need to be followed.

Once the work of the contractor begins, it is prudent to periodically inspect the work to ensure it is being done in a safe manner. However, excessive control of contractors can result in the contractor being considered an employee of the church, which could increase the liability of the church. Advice should not be given on specific materials or methods to be used or on which employees of the contractor are to perform the work.

Some of the areas to focus on include contractors working at heights or excavating, using flammable liquids or heat-producing equipment. Before closing the church buildings for the day, check any areas where contractors have been working carefully.

Any open holes or hazards should be barricaded and any solvent, stain or oil-soaked rags should be removed from the building. If any heat-producing equipment has been in use check for any smoldering fires, which may ignite at a later time. Also check for tools or appliances that have been left on, trash accumulations, housekeeping problems, unlocked doors and other hazards. New beams, columns and walls should be adequately secured and braced to prevent collapse or damage from high winds.

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