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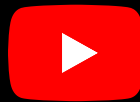
Risk Management and the Development / Construction Industry

January 24, 2019



What is risk management? How do you analyze risk? What are some best practices for managing and mitigating risk? In this podcast, construction and real estate attorney Scott Pence answers

these questions in a brief discussion on risk management as it relates to the development industry.

Transcript:

Scott: So what is risk management? Risk management is not insurance. I hear these terms used interchangeably all too often. It's important to understand, while insurance may be the mechanism that is chosen as part of the overall risk managment plan and may manage a large part of the overall anticipated risk, insurance should just be one part of the overall risk management plan.

Risk management is a process, and finding a knowledgeable insurance professional to help in developing an organization's risk managment plan is important. The goal of a good risk managment plan is to protect the organization's assets and minimize the cost of risks, should they occur. A good insurance professional will help your organization do this and not simply try to sell insurance.

The first step in the process is to identify the possible risks. Based on the organization's business model, what kind of losses are anticipated? There can be direct property losses. An owner or developer of property will need to protect against damage to its real property as well as materials and equipment to be incorporated into the project. A contractor will need to protect against damage to its personal property, such as tools and equipment it owns.

There can also indirect property losses. For example, if a hurricane delays the completion of an apartment project, a developer may be unable to lease apartments and will be indirectly damaged by the lost profits. Similarly, the developer may have additional costs due to that delay, such as additional insurance premiums or additional carrying costs on a loan.

There can also be liability losses. For example, a design professional will need to protect itself against design liability. Or a developer may be required to defend a claim by a third party for alleged bodily injury or damage to their property resulting out of the development.

Finally, any organization with employees will need to protect itself against injury to its employees during the course of their employment. Once all of these risks are identified, the second step in the process is to analyze those risks.

One part of this step, is to determine the likelihood of the loss occurring and the cost of the loss, should it occur. For example, the likelihood of a hurricane occurring in Florida in September is much higher than a hurricane occurring in West Virginia during that same time period.

Losses can be categorized in all different manners, ranging from very unlikely to happen to almost definitely will happen. And then the cost associated with any loss, if it does occur, can range anywhere from very little cost to severe.

Once all of the risks are analyzed and reasonably categorized, the third step in the process is to develop an overall plan to manage those risks. This is where many organizations procure insurance to protect against anticipated losses. However, there are other measures to protect your organization beyond procuring insurance.

For example, organizations can take measures to try and control the risk, either by taking steps to reduce the frequency with which a certain loss may occur or to reduce the severity of the loss, should it occur. Additionally, organizations can retain the risk. This is often referred to as self-insurance even though it really means no insurance. Finally, organizations can transfer that risk to other parties contractually. Ultimately, if a loss is not transferred to another party contractually or retained by the organization, the organization can procure insurance to transfer the financial risk of that loss to an insurance company.

All of these mechanisms to either control or finance a specific risk can be implemented in any combination and it is not uncommon for an organization to implement several of these risk management mechanisms at the same time. A couple of examples may help to further illustrate this step in the process.

One example could be the risk of loss due to a fire in a warehouse. While the property owner likely will procure insurance to protect against that risk, they also will likely implement risk control measures such as installing sprinklers in the building to mitigate the damage associated, should one occur. Additionally, they may elect to implement employee training or other rules and regulations designed to reduce the frequency of that loss occurring. For example, an employer may restrict its employees from welding within certain areas of the property to reduce the likelihood of a fire being caused by those activities.

Another example could involve the risk of loss associated with hazardous materials on the construction site of a new building. A contractor may insist that its contract with the owner contain a provision making it clear that the owner assumes all risk associated with any preexisting hazardous materials discovered during the course of that project. At the same time, it may elect to procure and maintain pollution liability insurance to protect itself against liability from a third party claiming it was a damaged as a result of the contractor acting negligently with respect to any hazardous material.

The fourth step in the process is to put whatever plan is developed into action. In other words, procure the insurance, implement the training, or dedicate funds to pay for the risk of losses that the organization elects to retain. This may seem like it goes without saying, but sometimes implementations of the plan can fall through the cracks or be done in a manner that is inconsistent with the plan. This can be especially true in larger organizations where direct oversight of the plan may be more difficult.

The final step in the process is to review that plan periodically. How is it working? Is it achieving the results you expected? This is the time to determine whether or not any changes are warranted. This is likely where the entire process actually starts all over again. A good risk management plan is one that is continually adjusted to meet the ever-changing needs of you organization.

Presented By

Scott P. Pence

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