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Government Contractor Risk Management

Risk Management is a broad term that can be used to describe any number of methods of avoiding financial and/or physical loss. Some of different types of Risk Management include: Avoidance, Retention, Risk Transfer, and Insurance. In developing and executing a Risk Management plan, most Government Contractors (GCs) will employ several of these methods at one time or another. Each method presents its own set of issues that should be carefully reviewed and understood.

Perhaps more than any other method outlined above, the Insurance Risk Management method is commonly, and frequently, the most misunderstood. Many companies feel they have adequate protection in place when they do not due to coverage gaps in the policies or there is a lack of understanding of the potential risks involved. Others are unaware of the exclusions contained in some of their existing policies; additionally, many companies are simply paying too much for the insurance coverage that they have.

Federal Government Contracting Background

Why does the federal Government contract out so much of its work?

- Frequently, it is economically more efficient to have the work performed by a GC rather than by government employees. For a variety of reasons, the government can save taxpayer's money by using GCs to perform a task.
- Government employees may lack the expertise necessary to perform the work, and it is not considered efficient or in the best interest of the taxpayer for the government to hire, train and retain employees with the technical expertise required.
- Government employees may lack the facilities and tools of production to perform the work, even if they do have the expertise.
- When the government fulfills its role, it is frequently dealing with new issues or problems that require innovative solutions and often desires the creativity and diversity necessary to propose a solution.
- The tasks or responsibilities of the federal government change on a daily basis and requires the flexibility represented by the universe of GCs available to propose.

Why risk Management is So Important!

Risk management as defined in the world of insurance and commercial companies has been largely unaddressed for government contractors (GCs). It is important that GCs more precisely define their “cost of risk” and, more importantly, the relative severity of their exposure to loss. Is this subject important? Consider:

- Every GC is required to purchase at least minimal levels of insurance. The premiums they pay are directly, or indirectly, reimbursed with Government funds from U.S. taxpayers.
- The number of companies able to compete for a particular government contract can be affected by the cost and availability of insurance – and the number of competitors can be correlated to the costs bid for the work and paid with tax dollars.
- GCs can build a reputation and history of profitability only to have it destroyed in a single instance by an uncovered claim.

Example: Recently, a subcontractor on a satellite construction project was tasked with moving the satellite and allowed it to tip over, apparently destroying the \$400 million piece of hardware. Not a good day at the office!

How are Government Contractors Different (to an insurance underwriter)?

Insurance underwriters are concerned with the following:

- Perils – causes of loss (example: fire)
- Hazards – conditions that increase perils (example: frayed wiring)
- Exposures – being exposed to certain perils (example: an office located next to a foundry would have a higher than normal exposure to the peril of fire)
- Policy Language – both what is covered and what is excluded.

There are several unique aspects of the world of government contracting that justify treating GCs somewhat differently from similar companies whose clients are commercial entities. Performing an identical task, with the same employees and tools of performance (computers, forklifts, etc.), for a government customer creates a different exposure to risk than if the customer is a commercial entity (banks, hospitals, construction company, etc.). From the perspective of the insurance and risk management professional, the underwriting, loss control, claims procedures and philosophies that work with insureds who have commercial customers must sometimes be modified if the customer of an insured is a government agency. Unfortunately, many government contractors appear to do work that can frighten off an insurance underwriter. (Too many perceived exposures to loss.)

- Why is there a material difference in the exposures of Government Contractors? Some of the reasons include:
- The terms and conditions of federal contracts vary from that of commercial contracts, and the contractor may have little, if any, control over that language. Best practices for contract risk management are different in the government world and, thankfully, better in many instances.

- The law behind federal contracts and the history of litigation over those contracts creates a different legal environment for GCs, as compared to a contractor in a dispute with a commercial customer.
- The ways in which federal programs are funded, and contractors are paid for their performance, can vary from the world of commercial work.
- The government is immune from suits by private parties in a wide variety of circumstances, and contractors performing the work of the government can enjoy that immunity as well (the *Government Contractor Defense* or “GCD”). The GCD is especially important to understand when underwriting contractors to federal agencies such as the Department of Defense, the Department of Homeland Security, the intelligence agencies, or NASA.
- Some of the work performed by GCs is rarely, if ever, analogous to commercial work – e.g. designing weapons systems or performing work for intelligence agencies – and can be regarded, at first, as high hazard from an underwriting perspective.
- The competitive environment for GCs can be markedly different from contractors with commercial customers. For example, a GC may compete with another GC to be the prime on a contract, lose the competition, and then be a subcontractor to the winning prime contractor.
- Government contract awards can be protested by losing bidders in a manner unique from the commercial world.
- The methodologies used by the federal government to pay GCs, and the standards for record keeping and accounting, can vary from the commercial world.

Do Government Contractors Have Special Risk Management Needs?

Doing business with the U.S. Federal Government is different from the commercial environment and while it limits your exposure to loss in some areas, it increases your risk in others. It is a complex subject but some of the reasons for government contractors receiving special attention include:

- The Federal Acquisition Regulation (FAR) contain numerous clauses that can make a contractor responsible for government furnished equipment, property, or motor vehicles when the contractor is in possession of or using those items. Conversely, the FAR can also offer the government contractor immunity from responsibility for damage to these items if the right clauses are invoked.
- The FAR can also offer some immunity from certain product and professional liability suits. From an underwriter's perspective many products and services developed by a government contractor are high risk, especially if the contractor cannot share the government's sovereign immunity. The art of products and professional liability underwriting is understanding to what degree, if any, the GC can face liability suits from the public.
- Many contract officers for federal agencies are experts in the subject but do not necessarily understand or appreciate how a particular contract's wording can affect the contractor's ability to obtain insurance at a reasonable cost. Anticipating problems and educating contract officers can solve many problems before they mushroom into a costly area of risk.
- Much of the products and professional liability underwriting standards used in the insurance industry revolve around the contract used by the insured with their customers. You usually won't have the luxury of using your own contract and will have to use the FAR and/or language proposed by the federal government. Understanding contract risk management techniques, especially if you are using your customer's proposed contract, is key to limiting the likelihood and severity of a suit.

- Although the federal government may not sue their contractors often for products and professional liability, it has the recourse to terminate for default or convenience, delay payments, or suspend the award of future contracts to the GC. In other words, the government still carries a big stick with significant financial implications for the GC. Therefore, understanding the customer and how to keep them satisfied is just as valid for the GC as it is for a company selling to commercial customers. Again, contract risk management is important for managing the customer.
- Federal jobs can be structured so that you, the contractor, do not know if you will have certain exposures until you receive a task order and, even then, you may not be able to quantify the exposure. Telling an insurance underwriter "I may need Defense Base Act coverage but I'm not sure if we'll be sending anyone" or "I don't know yet if we'll be responsible for storing hazardous chemicals" can lead to higher premiums or lack of interest by underwriters without the right broker explaining the ins and outs of government contracting.
- Contracting with the federal government can mean unusual exposures to loss such as civilian employees on military equipment or vessels; in high hazard environments such as Afghanistan or Iraq; or working at government facilities with unusual risks. Workers Compensation coverage in these situations must be done correctly to protect the GC for its legal responsibility.
- Even though your end customer is a federal government agency, you may have commercial subcontractors or be a sub yourself. Although the contract may be governed by the FAR to a great degree, the relationship between two contractors also has commercial and common law elements. Failure to deliver a working product, on time, that results in another contractor losing payments from the federal agency customer can still result in a products or professional liability claim.
- Understanding the legal theory and background of the government contractor defense and the similar provisions for product liability immunity in the Homeland Security Safety Act are critical to placing products liability for many of the GCs. Aviation exposures are also common to many GCs but throw up a red flag for insurance underwriters.

GCs are often assigned a 'high risk profile' with higher costs because most insurance brokers and insurance underwriters misunderstand the nature of your business. In reality, typical insurance claims and losses are less likely to occur with GCs than with commercial-based companies. Hence, there is a basis for a lower risk profile, meaning better terms and lower costs.

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AH&T Insurance has worked with Government Contractors for over 20 years and acts as the out-sourced risk manager for their clients. They understand the liability issues faced by Government Contractors and know how to identify and limit risks inherent in government contracts. They have reviewed the case law associated with Government Contractors, the Federal Acquisition Regulations (FAR), and current business practices between the U.S. Federal Government and its contractors, to develop best practices that help their clients lower the "cost of risk."