

ProNetwork News

Risk Management Tools for the Design Professional

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Project Insurance: Benefits and Cautions

By Timothy Corbett, President: SmartRisk, Pasadena, CA

In this first installment of a two-part article, the author explains the origins and principles of project coverage and introduces the reader to two of the four main types of this insurance product.

Project insurance for design professionals was initially established to provide higher, dedicated limits for larger and more complex projects. The other main driving force behind the development of project coverage was to provide owners the security of having project specific limits both during and after the project was complete. Project insurance has evolved and continues to change based on market needs and conditions, as well as insurance company underwriting standards and "appetite," or the desire to write certain kinds of risks.

More recently, the collaborative project delivery method sometimes referred to as the integrated delivery (ID) or integrated project delivery (IPD) process has impacted project insurance. In IPD, design professionals are no longer the sole authors of the project design: greater contributions are provided by other entities, including the general contractor and the major trade subcontractors. A few select insurance companies have begun to offer project specific policies tailored to the methods and exposures of IPD.

The key to selecting the correct coverage is theoretically simple: match the benefits of the insurance with the entity or entities requiring the protection. Will one option meet that goal? That's a very good question: you may need a combination of alternatives to accomplish your insurance and risk management objectives. You should also be aware that even obtaining project insurance has been a challenge in the past, and continues to be so today.

AVAILABILITY AND UNDERWRITING CRITERIA

Each insurance carrier offering some variety of project insurance has its own underwriting criteria, minimum and maximum limits, and various deductibles and extended reporting period options. Some only offer project policies on certain project types, and some demand that the prime design professional has a professional liability practice policy with that carrier, and not elsewhere. Of course, some insurers that write

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design professional practice liability do not offer project coverage at all.

The following information is typically required by carriers in developing a project specific coverage quote:

- Name, location and complete description of the project
- Name and address of the project's prime professional
- Description of the design team's experience with similar types of projects
- Design team's loss history
- Names and addresses of all the design sub-consultants
- Total estimated construction values and professional fees
- Duration of design and construction phases, and
- Limit of liability and deductible desired

BASIC TYPES OF PROJECT INSURANCE

There are four basic options for project insurance available today:

1. Project Professional Liability Insurance
2. IPD Project Specific Insurance
3. Project Specific Insurance Limits
4. Owner Controlled Insurance Policies

Let's examine each in turn, and discuss their benefits, typical features and cautionary points one at a time.

Project Professional Liability Insurance

The project professional liability insurance policy typically provides the broadest coverage for design firms on a construction project. A firm requesting a project policy must have a practice policy in place to obtain one.

Benefits and Typical Features of Project Professional Liability Insurance:

A project policy:

- Provides primary protection for the entire design team (at least the primary players), establishing consistency in coverage from one design professional to another.
- Provides a limit of liability dedicated to a specific project.
- Can replace the design team's professional liability insurance, allowing that limit to act as excess. (This can vary, and is an important factor to be aware of.)
- Is offered on a project-specific basis for up to 10 years (the extended reporting period or ERP is included in that time period), and annually for all construction ("blanket" coverage) of the named insured.
- May offer limits of liability up to \$25 million with a single insurer.
- May offer higher limits through use of multiple insurers.
- Provides non-cancelable coverage, except for non-payment of premium.

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- Provides a guaranteed rate based on construction value.
- Requires a deductible for each claim.
- Provides simplicity in maintaining insurance certificates.

Cautionary Points:

As with any purchase of professional liability coverage, there are many factors to consider when evaluating a project policy.

- Careful review is needed to determine if the project insurance is primary or if it is excess over the firm's practice policy limits. On the surface, many project insurance policies may appear to be providing primary coverage. However, policy wording such as the following can turn the project policy into excess coverage:

"Our coverage typically serves as primary but will be deemed to be excess to other valid and collectible insurance."

- An important point to remember is that with project insurance programs, there is a greater potential of exhausting the limit of liability in the event of a claim or claims. Coverage is extended to numerous insureds under one project policy limit. Defense costs alone can greatly reduce the limit of liability left for compensatory damages.
- Beware of situations where owners control the purchase of the project policy. They may have little experience with architects and engineers' professional liability insurance. The owner may select a policy and insurer based solely on price without regard to policy coverage language, exclusions, length of available extended reporting period, or the financial stability and claims handling expertise of the provider.
- Project policies usually come with large per-claim deductibles, sometimes as high as \$500,000. If the owner will not be paying the deductible, the design team members should agree in advance on how to allocate the per-claim deductible expense.
- Owners may want to be added as an additional insured or a named insured under the policy. They need to be reminded that this is a professional liability coverage for the design team. Adding the owner is not in the best interest of the design team, and further, project policies typically exclude claims made by one insured against another insured.
- That's an important point that needs to be repeated for its potential applicability to other situations: be aware that project policies typically exclude claims made by one insured against another insured.

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This type of policy is intended to cover the entire design team. There may be other parties to the transaction who have their own opinions and may wish to exercise control. It's clear that firms entering into a project policy need to consider multiple factors before committing to it.

IPD Project Specific Insurance

The use of an Integrated Project Delivery (IPD) process is gaining momentum in certain building and construction sectors. The objective of IPD is to have all the parties involved in design aspects (including contractors and construction managers) share risk to protect project-based interests. Current professional liability insurance policies are not aligned with the interests of all these parties.

The IPD Project Specific Policy is intended to cover design exposures under one policy for the prime design firm, sub-consultants and other parties with design responsibilities on the project. The design contributions from the various project players using the IPD process mark a significant break from the traditional standard design-bid-build project delivery method. It requires a new IPD project specific insurance product.

Benefits and typical features of IPD Project Specific Insurance:

- Provides insurance coverage for design responsibilities for all project entities under one policy.
- Bridges the gap by developing professional liability coverage for all project members providing design, or design and construction services.
- May include as Named Insureds the project owner, design team, construction entity and construction manager.

Cautionary Points:

- Incorporates shared risk/shared profit collaboration between the parties with the professional relationships contractually defined.
- As with Project Professional Liability Insurance, careful review is needed to identify if the insurance is primary or excess over the firm's practice policy limits.
- Available on a limited basis by certain carriers, who may restrict availability based on project types or construction values.
- IPD is a new concept that uses multiparty agreements which may include extensive waivers of rights, limitations of risk and unclear lines of responsibility. It is difficult to know how the courts will view and handle conditions when conflicts arise.
- Strict underwriting conditions may apply including coverage made available only for experienced design teams, 10 years of documented loss runs and confirmation of a practice policy with required limits.
- Restricted policy limits with minimum self-insured retention (SIR) for the design team apply.
- The extent and use of Building Information Modeling (BIM) may affect premium pricing.

This article is intended for general discussion of the subject matter and shall not be taken for a complete analysis on the subject or as providing legal advice. Readers are advised to consult with appropriate advisors for advice applicable to their individual situations or circumstances.



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In next month's issue of *ProNetwork News*, the author will discuss the two remaining types of project coverage: Project Specific Insurance Limits and Owner Controlled Insurance Policies.

Broker's Notes

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