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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 second installment of a two-part article, the author briefly reviews last month's material and introduces the reader to the remaining main types of this insurance product. In order to further differentiate coverage purchased by the owner, he has expanded it into two types.

Project specific coverage is the insurance industry's response to demands from both the design community and from owners for higher, dedicated limits for large and complex projects. Such limits would thereby be available during design, construction and after project completion. The product continues to change based on market conditions, as well as on the processes used by architects and engineers.

A more recent driving force in the evolution of project coverage is the collaborative project delivery method called integrated delivery (ID) or integrated project delivery (IPD). In this model, the design professionals are no longer the sole authors of the project design: greater contributions are made by other parties such as the general contractor and the major trade subcontractors.

BASIC TYPES OF PROJECT INSURANCE

There are five basic available project insurance options:

1. Project Professional Liability Insurance
2. IPD Project Specific Insurance
3. Project Specific Insurance Limits
4. The Wrap-Up Policy
5. Owner's Protective Insurance

Let's recap the characteristics of the first two types before moving on to types 3 - 5.

1. Project Professional Liability Policy

- Covers the design team.
- Is typically the broadest coverage type.

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- Provides a dedicated project limit for a predetermined number of years.
- Typically requires a practice policy to be in place for the prime design firm.
- Is intended as primary for the specified project, but watch coverage wording to see if your practice policy can apply as excess coverage.
- Requires up front agreement as respects deductible allocation and responsibility.
- Typically excludes claims made by one insured against another insured, so it's generally not a good idea to name the owner.

2. IPD Project Specific Insurance

- Provides 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 along with the prime design firm.
- Is available on a limited basis based on project types and construction values.
- As with Project Professional Liability Insurance, is intended as primary coverage.

With IPD Project Specific Insurance, it is unknown how courts will handle new multi-party agreements that may include extensive waivers of rights, limitations of risk and unclear lines of responsibility.

Now, let's examine the remaining three types of project coverage.

3. Project Specific Insurance Limits

Sometimes, contracts demand that design professionals carry a higher limit than they usually do. This can occur on any kind of project, but is more common on larger, higher risk projects, and more recently, on public ones. One of the more common strategies for obtaining increased limits for a project is through a Project Specific Insurance Limit. This is provided by endorsement through your current practice policy insurance carrier.

Benefits and typical features of Project Specific Insurance Limits:

- Provides a higher limit for the firm, for a specific project only.
- Can be more cost effective than raising the limits on the entire practice policy.
- Makes the cost of the project-specific limit a reimbursable expense.

Cautionary Points and Tactics:

Having a project specific increased limit may not always be the best strategy, and it may not even be available from your practice policy carrier. From an insurance company's perspective, comparing construction costs to policy limits is part of the underwriting process. Construction value and requested limits may not be in line with the insurer's potential exposure: those higher limits requested could place a target on the design firm's back. The insurer doesn't want to provide the higher limits that could be used as a cost recovery strategy.

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- Ensure that requested limits are in line with exposures and construction costs. For example, is it necessary to require a \$5 million limit of professional liability insurance from a firm performing services on a \$20 million project?
- Contact the contract administrator, and state that your firm normally carries a lower professional liability limit than requested, and that it is consistent with industry practice. Inquire if your current limit will be acceptable.
- * Include language similar to the following in your contract:

"The expense of any additional insurance coverage or limits requested by the Owner in excess of that normally carried by the firm shall be a reimbursable expense paid by the Owner."

OWNER CONTROLLED INSURANCE POLICIES (OCIP)

We will look at two sub-types of Owner Controlled Insurance Programs, the Wrap-up Policy and the Owner Protective Insurance Policy (OPIP). To clarify an extremely important point, one policy provides some coverage for design professionals, and the other does not.

4. The Wrap-Up Policy

The Owner Controlled Insurance Program (OCIP) called A Wrap-up Policy can be beneficial to design firms, and provide some coverage, but it is vital to understand what exposures they address and what they do not.

Wrap-Ups can encompass a number of policies but are typically limited to general liability (GL) and Workers compensation (WC). Professional Liability (PL) coverage will not be included. Design professionals have been added by manuscript endorsements to these policies, but there has been a misconception that these endorsements provide "professional liability" insurance coverage for the design professionals, which in almost all cases, is not true.

OCIPs were developed to respond to situations where coverage was difficult to obtain for subcontractors, including construction defect litigation involving primarily residential and mixed use, multi-family projects. Contractors had difficulty working on these projects and were unable to obtain general liability (GL) insurance.

Benefits and typical features of the Wrap-Up Policy:

- Is attractive for public entities seeking greater control over insurance programs affecting those projects.
- As GL insurance, names all contractors, and sometimes, design professionals as "enrolled" in the project policy program, and therefore, are insureds on a single policy.
- With a design professional endorsement, GL coverage may be provided for Bodily Injury and Property Damage caused by professional services.
- Typically provides occurrence coverage for a period of ten years from the date of completion of the project, thus eliminating the need to purchase ongoing policies for the duration of exposure to construction defect claims.



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- Includes the general contractor, subcontractors and design professionals under one policy with pre-determined limits and deductibles allowing for consolidated claims handling among the parties.

Cautionary Points:

- If project owners state there is professional liability coverage, ask for a copy of the policy and review it with an insurance expert.
- The insurer has typically "deleted the Professional Liability exclusion." This means that GL coverage is provided for Bodily Injury and Property Damage caused by professional services.
- If enrolled in an OCIP program, watch for the conditions related to cost sharing of the deductible or self-insured retentions (SIR). These programs usually have very large SIR's requiring all enrolled parties to contribute to the cost, regardless of contributing factors.
- OCIP policies do not provide coverage for Consequential Damages such as delay, lost profits, and loss of use.

The design professional should enlist the assistance of a professional liability insurance specialist in understanding the vast differences and moving parts of the Wrap-Up policy.

5. Owner Protective Insurance Policy (OPIP)

Owners may tell you they have purchased a "project" policy, when in reality, it is Owner Protective Insurance.

Benefits and typical features of the Owner Protective Insurance Policy:

- Provides first party indemnity for damages that the Owner incurs as a result of negligence of the design professional.
- Acts as excess of the design professional's professional liability insurance.
- May provide coverage for the liability of the owner's professional services in the event the owner has a design professional on staff.

Cautionary Points:

- The policy is a supplement to the design professional's professional liability, providing direct benefit to the Owner. This means your practice policy will be eroded first – used as primary coverage.
- Review the contract's insurance requirements carefully. There are minimum insurance requirements placed on the design professional by the insurer offering the coverage.
- Watch for "self-insured retention" (SIR) requirements in the contract. In the event the underlying design professional's policy is intact (as to limits and coverage) at the time of claim payment, the self-insured retention under the "protective" policy does not apply for the owner.



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One final tip: Once any kind of project policy is purchased, insist on receiving a copy of the policy for your project file.

SUMMARY

Obtaining project insurance can be a challenge due to its complexity and its relative rarity in the insurance marketplace. While the potential benefits can be a large consideration in your overall loss control program, buying project coverage requires the expert advice of an insurance professional who specializes in this area.

A well-conceived project coverage strategy should provide important insurance protection for the design team and coverage stability for the owner. A hasty or uninformed choice can be costly to your practice, so take the time and effort to consult with a pro, and then concentrate on your own profession: design.

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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