

Project Insurance: Benefits and Cautions

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BACKGROUND

Project insurance has evolved and continues to change based on market needs, conditions and insurance carrier underwriting appetite and standards. Project insurance was initially established to provide higher, dedicated limits to designers, particularly for larger, and more complex projects. Other driving forces were to provide project owners with the security of having project specific limits for the project team during and after the project was complete.

More recently, a more collaborative project delivery method has been introduced that is being called an integrated delivery (ID) or integrated project delivery (IPD) process. The term IPD will be used in this article for describing the process and insurance options. In IPD, greater contributions are provided by other entities including the general contractor and the major trade subcontractors in the aspects of design. The design professionals are no longer the sole authors of the project design. With the use of IPD, providing a specific project insurance policy is another option that is being made available by a few select insurance carriers today.

This article describes project specific insurance alternatives in the industry identifying benefits and cautionary points. At times, it has and continues to be challenging in obtaining project insurance. The key to selecting the correct coverage is simple - match the benefits of insurance with the entity or entities requiring the protection. Will one option meet that goal? Very good question - you may need a combination of alternatives to accomplish your insurance and risk management objectives.

PROJECT SPECIFIC INSURANCE INFORMATION

Each carrier offering project insurance has their own underwriting criteria, minimum and maximum limits, and various deductibles and extended reporting period options. Certain insurers do not offer project policies while others only offer policies on certain project types and when the prime design professional has a professional liability practice policy with the carrier. The following identifies information required by carriers in developing a project policy 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

The following describes the primary project insurance options available today along with benefits and cautions:

PROJECT PROFESSIONAL LIABILITY INSURANCE

The project professional liability policy typically provides the broadest coverage for design firms on a construction project. A requirement for obtaining a project policy is the firm requesting the policy must have a practice policy in place.

Benefits:

- Provides primary protection for the entire design team (at least primary players) - establishing consistency in coverage from one design professional to another.
- Provides a limit of liability dedicated to a specific project.
- Replaces the design team's professional liability insurance allowing their limit to act as excess.
- Policies are offered on a project-specific basis for up to 10 years (the extended reporting period or ERP included in that term) and annually for all construction ("blanket" coverage) of the named insured.
- Limits of liability can be secured up to \$25 million with one single insurer.
- Higher limits may be obtained through use of multiple insurers.
- Provide non-cancelable coverage, except for non-payment of premium
- Provide a guaranteed rate based on construction value
- Require a deductible for each claim.
- Simplicity in maintaining insurance certificates.

Cautionary Points:

1. Careful review is needed identifying if the project insurance is primary or excess over the firm's practice policy. On the surface, many project insurance policies may appear to be providing primary coverage. However, policy wording has been used similar to:

"Our coverage typically serves as primary but will be deemed to be excess to other valid and collectible insurance."
2. An important point to remember is 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 insured's under one project policy limit. Defense costs alone can greatly reduce the limit of liability left for compensatory damages.
3. If the owner controls 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.
4. 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.
5. Owners that want to be added as an additional insured or a named insured under the policy 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.
6. Project policies typically excludes claims made by one insured against another insured.

7. Firms should consider all factors before entering into a project policy. This policy is intended to cover the entire design team. There are other parties to the transaction who have their own opinions and may wish to exercise control.

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 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. With the contribution of design from various project players using IPD, it is a significant break from the traditional standard design-bid-build project delivery method requiring a new project specific insurance product.

Benefits:

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

Cautionary Points:

1. Incorporates shared risk/shared profit collaboration between the parties with the professional relationships contractually defined.
2. Similar to the Project Professional Liability Insurance, careful review is needed regarding identifying if the insurance is primary or excess over the firms practice policy.
3. Available on a limited basis by certain carriers including restrictions on project types and construction values.
4. IPD is a new concept using multiparty agreements with 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.
5. Strict underwriting conditions may apply including coverage made only available for experienced design teams, 10 years of documented loss runs and confirmation of a practice policy with required limits.
6. Restricted policy limits with minimum self-insured retention (SIR) for the design team apply.
7. The extent and use of Building Information Modeling (BIM) may affect premium pricing.

PROJECT SPECIFIC INSURANCE LIMITS

One of the more commonly strategies used today for obtaining increased limits on a specific project basis is through a "Project Specific Insurance Limit." This is provided by endorsement through your current practice policy insurance carrier. At times, design professionals are being requested, by clients through contracts to carry a higher limit than the firm usually carries. This can occur on all types of projects but more often on larger, higher risk project types and more recently on public projects.

Benefits:

- High project specific limit for the firm, for a specific project
- Obtain a higher project limit rather than paying a higher premium for increasing the practice policy limit.
- Removing the fees associated with the project from the calculation of premium for the firms practice policy.
- Incurred cost of a project-specific limit as a reimbursable expense.

Cautionary Points:

Having a project specific increased limit may not always be the best strategy or made available by your carrier. From an insurance carriers and underwriter perspective, comparing construction costs to policy limits is part of the underwriting process. Construction value and requested limits must not be in line with exposures. If not, it could increase a firm's risk, placing a target on the firms back with the higher limits that could be used as a cost recovery method strategy.

1. Ensure requested limits are in line with exposures and construction costs. Example: Is it necessary to require a \$5 million limit of professional liability insurance from a firm performing services on a \$20 million project?
2. Contact the contract administrator - state that by size firm and exposures, your firm normally carries a lower E&O limit than requested, and is consistent with industry practice. Inquire if your current limit will be acceptable.
3. 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 POLICY (OCIP)

Engineering and design professionals need to be knowledgeable of Owner Controlled Insurance Policy (OCIP) programs, which are also called a Wrap-up policies. OCIP's were developed responding to situations where coverage was difficult to obtain 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.

OCIP as a GL policy, excludes Professional Liability (PL) coverage. Design professionals providing professional services have been added by a manufactured endorsement to these policies. However, there has been a misconception that these endorsements provide "professional liability" insurance coverage for the design professionals, which is almost all cases, is not true. OCIP's can be beneficial to A/E firms, however it is vital to understand the coverage's provided, and most importantly, what is not covered under these policies.

Benefits:

- OCIPs are attractive for public entities seeking greater control over insurance programs affecting those projects.
- OCIP's as GL insurance polices are naming all contractors, and at times, design professionals who are "enrolled" in the project policy program as insured's on a single policy.

- The policy 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.
- 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:

1. OCIP's are GL policies. When project Owners state there is Professional Liability coverage under the policy, be cautious. Ask for a copy of the policy, and review all terms and conditions with an insurance professional.
2. The usual case; the General Liability insurer has "deleted the Professional Liability exclusion." If this situation, GL coverage is provided for Bodily Injury and Property Damage caused by professional services.
3. 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.
4. OCIP policies do not provide coverage for Consequential Damages such as delay, lost profits, and loss of use.
5. The design professional should enlist the assistance of a professional liability insurance specialist in understanding the vast differences and moving parts of the OCIP policy.

OWNER PROTECTIVE INSURANCE POLICY (OPPI)

Another project specific insurance program design professionals should be aware of is the "Owner Protective Insurance Policy" (OPPI). In certain situations, Owners may have indicated they have purchased a "project" policy. That is true, however in reality, it is an Owner's project policy. The Owner "protective" policy provides first party indemnity for damages, which is excess of the design professional's professional liability insurance that the Owner incurs as a result of negligence of the design professional. This policy works in opposite of the project "protective" policy and sits over the design professional's professional liability practice policy and insurance limit of liability.

Benefits:

- Coverage can be provided for the liability of the owner's professional services in the event the owner has a design professional on staff.

Cautionary Points:

1. The policy is a supplement to the design professional's professional liability policy providing direct benefit to the Owner. Meaning - the design professionals practice policy will be eroded first - used as primary coverage.
2. Review you contract and insurance requirements carefully. There are minimum insurance requirement placed on the design professional by the insurer offering coverage.

3. Watch for "self-insured retention" (SIR) requirements in the contract and insurance requirements. In the event the underlying design professional's policy is intact (limits and coverage) at the time of claim payment, the self-insured retention under the "protective" policy does not apply for the Owner.

SUMMARY

Project insurance options have and will continue to change driven by market conditions, underwriting strategies and project delivery methods including the use of more collaborative approaches such as IPD. This article has summarized project specific insurance alternatives used in the industry today. Each project insurance product has there own application, benefits and associated cautionary points to be considered. Evaluating and matching benefits for protecting your firm along selecting the correct project insurance option is not an easy one. A well-written project policy should provide important insurance protection for the design team and coverage stability for the owner. Obtaining advice from insurance professionals that specialize in design professional insurance is critical when making all insurance options. Once a project policy is purchased, it is very important to insist on receiving a copy of the policy for your project file.

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