Design Professional Liability Coverage

Options and Considerations
Overview

Large construction projects almost always involve discussions regarding general liability, workers compensation and builders’ risk coverage. Such policies are nearly as familiar to owners and developers as they are to the design and construction team. Many owners do not appreciate, however, that general liability coverage is relatively limited in scope, and responds only if a “sudden and accidental occurrence” causes bodily injury or property damage. Professional liability is much broader, and is the only coverage that will respond to purely economic loss (increased cost of construction, lost profits or loss of use, for example) attributable to negligent design or other errors in the performance of services. If bodily injury or property damage results from wrongful acts in the performance of professional services (architecture, engineering, construction management, etc.), any such damages are also covered under a professional liability form.

From either an owner’s or an architect’s perspective, it is essential that the professional liability coverage be as broad as possible. With fast-evolving project-delivery methods, the multitude of issues implicated by Building Information Modeling (BIM) technology, “sustainable design,” and other relatively novel issues, current policy forms vary dramatically with respect to the breadth of coverage provided. The broadest forms go well beyond covering claims arising out of services provided in the insured’s capacity as an architect or engineer, and expressly cover services provided as a construction manager, planner, scientist, or technical consultant in the provision of services related to LEED certification, BIM, and other such ancillary exposures.

Once the breadth of coverage is verified, thought should be given to the appropriate amount of coverage for a particular project. Any construction project that is unusual from either the owner’s or the designer’s perspective, whether because of its size, complexity, or strategic importance, should involve careful consideration of appropriate security and risk transfer options as respects the design and construction management teams. Though there are more exotic and constantly-evolving products that deal with contractor-led design build, Integrated Project Delivery, Public-Private-Partnerships, and other nontraditional delivery methods, basic professional liability structures and options include: practice policies for architects and engineers; project-specific professional liability insurance; and owner’s protective professional indemnity insurance.

I. Reliance on the Architect’s and Consulting Engineers’ Practice Policies

As should be expected, the least expensive option is also the riskiest option for both the owner and the design team. Nearly all reputable architectural and/or engineering firms have professional liability coverage that provides some security to owners that may sustain damages from a design firm’s negligent performance of services. Because such policies apply to the practice generally, owners are not expected to contribute to the cost of such policies. However, the limits purchased by firms of various size and sophistication vary dramatically; small and “mid-sized” firms often buy only $1 million or $2 million of coverage, whereas large firms often procure limits in excess of $100 million per claim.

Owners and developers need to scrutinize the adequacy of such limits with the following in mind:

- Firms’ annualized practice policies are intended to cover any claims that may be made within a 12-month policy period, without regard to when the services giving rise to the claim may have been provided. In other words, the limit provided is exposed for purposes of both defense costs (attorney and expert witness fees, as well as other costs of defense) and indemnity (judgments and settlements paid to claimants) on any project on which the design firm has participated within the past 10 to 15 years. Thus, the limits reflected on a given design firm’s certificate of insurance could easily be eroded or even exhausted by unrelated claims on unrelated projects.
Because design firm professional liability policies are written on a “claims-made” basis, it is of no help to an owner if the architect had a policy with a $5 million limit at project inception. What matters is that the architect has a policy with available limits at the time a claim is made and reported – often two or more years after the project is completed. It is essential that the Owner-Architect Agreement require that such coverage be renewed at the requisite limit through substantial completion of the project, plus a reasonable discovery period post-completion. Appropriate follow-up should be made to ensure the limits have been properly renewed for two to five years beyond issuance of the certificate of occupancy.

Most sophisticated design firms realize that their clients will require some professional liability limits, and that such coverage is essential to their firm’s continued existence, as even the best experience claims. However, the limits purchased by the vast majority of firms are very low as compared to other “professional services” firms, such as law and accounting firms, and bear little relation to the exposures assumed. Most insurers that write this class of business will, however, make available one or two “project-specific excess” endorsements to a given insured. Such endorsements are reasonably priced, as the excess coverage is implicated only if the underlying (base policy) limit is exhausted. Note, however, that if an architect buys a $2 million per-claim limit, underwriters are unlikely to put up more than $2 million of project-specific excess limits, for a total of up to $4 million of coverage. Because such endorsements are tied to the firm’s “master policy,” they have to be renewed annually in order to be of any assistance at the time a claim is made. Note also that any “project-specific” coverage must be in place prior to construction beginning in order for the coverage to “relate back” to the inception of design services.

II. Project-Specific Professional Liability (“PSPL”)

At the other end of the cost spectrum, PSPL insurance provides a dedicated limit covering the entire design team (with the architect or other “prime” designer as the First Named Insured) under a single policy. Such policies must be paid for and issued prior to construction, but need not be renewed – they are written for a multi-year term that expires at the project’s completion, after which an Extended Reporting Period (typically three to five years) applies during which the policy will respond to any claims alleging loss or damage from design or other errors. Benefits include:

- With a single limit (and deductible obligation) that will respond to claims against any and all members of the design and CM team, conflicts and “allocation of fault” issues are eliminated – often expediting the dispute resolution process significantly.

- Owners can sometimes be named for purposes of vicarious liability.

- The policy need not be renewed annually, and the limits are not subject to erosion or exhaustion on unrelated projects.

- Coverage terms and conditions can be customized to meet the particular needs of a given project’s circumstances and delivery method.

The biggest disadvantage is cost. Throughout the 1990’s, PSPL was readily available from a wide variety of professional liability insurers. Unfortunately, many owners, having contributed to the cost of such policies, often made claims alleging significant damages on projects that came in “on time and on budget.” Because the project policy had little or no effect on the cost or availability of the design firms’ respective professional liability policies, their incentive to fight such claims was decreased considerably. Insurers’ losses became so extreme, relative to the premium charged for such coverage, that all but a few insurers quit offering PSPL. Even 10 years later, those insurers that still offer PSPL charge rates that often exceed 20% of the limits purchased – even with significant deductibles or retentions.
III. Owner’s Protective Professional Indemnity (“OPPI”)

As the name implies, OPPI – unlike the products described above – is written in the owner’s name (not the architect’s), and it is the owner that is the Named Insured. OPPI is analogous to Under-Insured Motorists coverage. The product sits excess and “DIC” of the architect’s annualized practice policy, protecting an owner against damages resulting from errors or omissions on the part of the design team for which the architect or engineer’s policy is either inadequate or otherwise not available. OPPI coverage includes the following notable benefits:

- **Excess Indemnity Provision:** On first-party claims brought by owner against the design team, OPPI indemnifies owner for loss or damage in excess of the limits available from the architect and its subconsultants. If the architect’s contractually-required limits are available, and the OPPI attaches as true “excess” coverage, no deductible or Self-Insured Retention will apply.

- **Primary Coverage:** If the architect’s policy limits are not available due to having been eroded or exhausted by an unrelated claim, OPPI will respond on a primary basis, subject to a Self-Insured Retention (“SIR”).

- **“DIC” Coverage:** The scope of coverage provided within OPPI policies is often broader than that provided under the annualized policies purchased by design firms to cover their practices generally. If an owner’s claim is excluded by the architect’s professional liability policy and the OPPI policy’s terms and conditions are broader due to a “difference in condition,” the OPPI will again drop down and respond as primary coverage, paying owner’s loss or damage, subject to the SIR.

- **Third-Party Coverage:** If a third party sues an owner alleging direct liability for design, construction management, or other relevant professional services, the OPPI provides owner with a defense and indemnity to and against any such claims. It bears noting that some OPPI forms include “development activities” in the definition of professional services which can be a significant benefit to developer/owners that may not otherwise have adequate errors and omissions coverage.

- **Low Cost:** In addition to the coverage benefits above, perhaps the biggest advantage of OPPI is its relatively low cost. Like “PSPL,” the coverage is written on a multi-year basis that extends through substantial completion, plus a typically three- to five-year Extended Reporting Period. The key is that the architect’s policy (to the extent available) is still exposed, and will presumably pay for the costs of defense and at least some portion of loss or damage. As are result, and even though OPPI will drop down as primary if the underlying policy cannot respond, OPPI is underwritten as “excess” coverage, and therefore far cheaper than PSPL.

- **No Subrogation:** While the owner is the only Named Insured and direct beneficiary, architects, engineers and construction managers get significant protection as well. To the extent that the architect has its contractually-required limits intact and available at the time of a claim, OPPI policies do not permit any subrogation action against the design team seeking recovery of damages paid to the owner as a result of the design team’s error and omissions.

- **Accommodation of Limitation of Liability Clauses:** Some projects have such significant professional liability exposure (e.g., power plants, stadiums, large infrastructure projects) that even very large design firms buying tens or hundreds of million of dollars of professional liability limits are not willing to expose the entirety of those limits. In such instances, OPPI coverage can be structured to attach (sit excess of) at some contractually agreed limitation of liability, rather than at exhaustion of the prime design firm’s policy limit.

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