

# 2018 Global Market Overview

Design and Construction Professional Liability

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# Market Trends

Our last edition of Crib Notes (*Issue 9 Q2 2018*) reported that in the US there was a plentiful market for contractor's professional liability, but a "firming" environment for architects & engineers and the acceleration of these changes over the past four months has parallels with other markets outside the US.

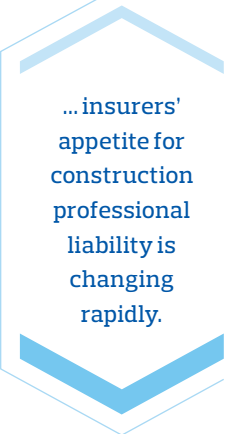
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Initially it was thought that the severe property losses following 2017's US hurricane season would influence reinsurance capacity, but the expected rate increases were much less than expected, and were not focused on professional liability. Unfortunately, reinsurance is only one of many factors which is considered by insurers, and there are an increasing number of large losses affecting a significant portion of the professional liability markets in the US, Canada, London and Australia.

Despite insurance being established on the premise of a portfolio approach – where a single loss can be absorbed by the insurer's portfolio – the construction professional liability losses sustained are both large in number and quantum, which has now made some insurers' portfolios unsustainable. The professional liability claims have been in the form of both damages as well as considerable legal costs in defending claims, and in the US there is a macro view wherein it is believed that for every \$1 paid by insurers, some \$0.60 relates to plaintiffs' and defendants' legal costs.

The trend regarding frequency and quantum of claims has been increasing for nearly twelve years, with no adjustment of insurers' terms, so why is the market changing so rapidly now? Supply and demand of

insurance market capacity is the biggest influencing factor; and 2018 has seen no new entrants to the construction professional liability market, as well as consolidation following insurer mergers. The lack of new entrants may be due, in part, to other parts of the economy performing better than insurance. However, poor underwriting results are driving insurers' decisions, with five insurers withdrawing from underwriting architects & engineers in the US. In the UK and Australia, the situation is less focused, with certain insurers no longer underwriting construction professional indemnity generally (i.e. not just architects & engineers), and others have made the strategic decision to reduce their exposure to such risks.



...insurers' appetite for construction professional liability is changing rapidly.

In Canada, the marketplace remains stable for construction professional liability, but there is growing uncertainty regarding the future of the project specific market. While capacity and appetite for this coverage remains, the market is starting to pull back with certain terms and conditions, and what used to be readily available now requires negotiation with insurers. This change in the market appears to be coming off the back of a major shift in one large Canadian professional liability program, with the insurer electing not to continue due to its claims experience. Specifically, there is growing concern around the inclusion of carve backs to the 'Insured vs. Insured' and 'Related Entities' exclusions found in Canadian project specific policies. While these exceptions are still currently available, the number of Canadian domestic markets offering them have significantly reduced, and even London carriers are starting to reevaluate, with some now electing to no longer offer the carve back.

... the main reason for the lower premiums is the lack of claims in these territories.

There are some places that are exhibiting different trends than US, UK, Australia, and Canada. In the Middle East and Asia, large projects flooded through the entire market, and one recent project specific policy for USD50m was placed for less than USD500k. The policy wordings tend not to be of the standard expected in US, UK, Australia, and Canada; however, the main reason for the lower premiums is the lack of claims in these territories.



#### M&A Activity → Reduced premium volumes

As recently reported in Engineering News Record, the number and size of mergers and acquisitions continues unabated, and it is estimated that over the last twelve years the amount of construction Professional Liability has reduced by some 40% due to M&A activity and a softening insurance market.



#### Insured vs. Insured and Related Parties Exclusion carve backs

In order to address concerns around the Design-Build and P3 project delivery models, insurers (particularly in London), provided carve backs to non-US projects for the 'Insured vs. Insured' and 'Related Entities' Exclusions, which allowed claims to be brought under the project policy, even when such claims could emanate from either a related party (like a concessionaire in the P3 delivery model) or an insured on the policy (like a Design-Builder bringing a downstream claim against a subcontracted designer).

# Snapshot of US Market Segments

## 2018 Outlook

Architects & Engineers			Design-Build and Owners Protective	
One third of insurers have indicated that pricing is expected to increase	↑	Pricing/ Rates	↔	Pricing is expected to stabilize on CPPI, however, carriers are seeking sizeable rate increases for poor performing risks
Price increases are likely to thwart increases in Limits	↔	Limits	↑	Many clients are considering increasing their limits due to capacity available at attractive terms and growth in the size of claims
Increases are expected given unabated claims inflation	↑	Deductibles/ Retentions	↑	With the advent of larger claims Insurers are looking for increased retentions
Coverage stable as previous enhancements are seen to take effect	↔	Coverage	↔	Coverage stable as previous enhancements are seen to take effect, however, there continues to be pressure on carriers to amend policy terms to adapt for Alternative Delivery Methods (i.e. Insured vs. Insured, Related Parties)
Overall market capacity has reduced as some insurers have exited the market	↓	Capacity/ Appetite	↔	While overall market capacity has likely stabilized, still expect some insurers to enter the construction Professional Liability space
Losses are increasing in severity and frequency	↑	Losses	↑	Losses are increasing in severity and frequency



# Implications of Grenfell Tower Fire for Professional Service Firms



It may take many years to determine responsibility for the Grenfell Tower fire, but insurers are not waiting for this determination and have taken, and will continue to take, action in response to the loss.

## What Happened

Grenfell Tower is a 24-story social housing block located in London, originally constructed in 1974. In 2016 a new cladding system incorporating aluminum composite material (ACM) panels with a polyethylene core and PIR foam insulation was installed over the original concrete panel façade in an effort to improve the building's energy efficiency and appearance. The new cladding system was dangerously flammable and unlawful according to the UK building code. In June 2017 a fire started on the fourth floor in a refrigerator near an outside wall, burned through a window to the flammable cladding and thereafter spreading around and to the top of the building via the cladding. The fire penetrated other flats through windows and spread throughout the structure resulting in the loss of 72 lives. The tower itself is considered a total loss and is slated to be demolished in 2018.

## Why It Happened

There are a variety of factors that are thought to have contributed to the loss, both technical and systemic. Amongst the technical issues, the flammable ACM and insulation cladding system has been identified as a major factor and is drawing the greatest amount of interest from Professional Liability insurers; additional technical issues include:

- Insufficient cavity barriers in the cladding system;
- New windows with combustible frames with improperly protected gaps between the windows and concrete panels;
- Doors on flats did not provide the required level of fire protection, and almost half of the door closers on such doors were missing or not working;
- Lack of an internal sprinkler system in the building;
- Only a single stairwell for egress by occupants and ingress by firefighters;
- Lack of a wet riser to readily provide firefighting water within the building;
- Combustible panels were not in Design.

Amongst the systemic issues, failure of building code officials to detect the usage of an unlawful, flammable cladding system has been identified as a major factor.

The UK Government has committed to overhauling building regulations and safety oversight, and a new regulatory approach is expected.



## The Implications for Professional Liability Clients

The Professional Liability market in the UK for Architects, Engineers and Contractors involved in the cladding industry was already constrained before the Grenfell loss. Grenfell has since created even more difficult conditions for such firms, as well as firms performing fire safety and inspection work. Insurers' response to the Grenfell loss and other cladding problems include:

- Premium increases of up 1,000%
- Retention increases of up to 250%
- Exclusions or other restrictive policy terms for combustible materials and facades incorporating ACM panel products

Insurers are limiting their exposure by reducing the policy limits, resulting in quota share placements or new excess layers of coverage. In some instances, insurers have not offered renewal of the policy. Insurers are also asking additional questions relating to projects involving ACM panels, now and over the past 10 years. Such questions typically include:

- What is involved in the design, specification, procurement or installation of cladding systems?
- Have such systems included combustible ACM panels and/or insulation?
- Were such materials applied to structures over 18m in height?
- What is involved in the inspection, safety assessment and/or approval of such systems?
- Details of any complaints or resolution of any issues with respect to such systems
- Provide details of the five largest cladding projects undertaken.

Even firms not involved in the cladding industry or performing fire safety and inspection work are being affected, with a general upward trend in premiums and retentions in the UK market as a result of the Grenfell loss and residual exposure for similar combustible cladding losses.



## Claims Implications for Professional Liability Clients

With the UK Government committing to funding the cost of remediating social housing with combustible ACM panels (estimated at GBP400m), potential cost to remediate all affected structures across UK (public and private) could be excess of GBP2bn. Professional Liability claims can be expected to recover the cost of remediation, and even if not directly responsible, there could be allegations/claims for failure (duty) to warn of dangerous conditions.

Coverage for claims will be dependent on the specific fact-pattern and applicable policy provisions. Exclusions for reckless/willful behavior and prior knowledge may come into question as well as the claims reporting provisions of the policy. If a firm is aware of previous projects involving combustible ACM panels, we recommend notifying insurers as soon as practicable of a possible circumstance, and certainly insurers should be notified if a firm receives any complaints or formal claims.

## ACM Exposures Elsewhere in the World

Significant fires, in some cases somewhat comparable to Grenfell, have occurred in the Middle East, Australia, France and China. In many cases, other fire safety features, such as sprinklers, were successful in mitigating the loss of life and internal building damage; however, extensive external building damage has frequently occurred in such cases. As a result, local building regulations are being changed in many of these regions including curtailing the use of combustible ACM panels and mandating the replacement of such panels on existing projects.

A similar loss is unlikely to happen in the US where there is generally a stricter culture of safety in building construction. This includes the adoption of the International Building Code (IBC) and NFPA 285 (governing the testing of fire propagation of exterior non load-bearing wall assemblies containing combustible components) by virtually all states and territories. A handful of states and DC have waived the NFPA 285 requirement where other fire protection measures, such as sprinklers, are present.

There have not been any observed changes thus far for US firms with primarily domestic operations directly resulting from the Grenfell loss, although subsidiaries of global US-based firms are experiencing increasing inquiry from Professional Liability insurers.







# Don't Forfeit Coverage Under Your Professional Liability Policy

Can an insured waive coverage under its professional liability policy if they admit liability, accept responsibility, begin settlement discussions, or enter into a final and binding settlement agreement with the claimant before giving notice to their carrier?

## Rule

An insured's failure to comply with relevant policy conditions including, but not limited to, the Notice Provision, Cooperation Clause, Consent-to-Settle Clause, and Voluntary Payments Clause (collectively referred hereafter as the "policy conditions"), may forfeit coverage under their policy, even if the insurer suffers no prejudice from the insured's actions.\*

## Analysis

The rights and duties of insureds and insurers are firmly rooted in contract and are guided, in large measure, by the plain language of the policy which forms the essence of the contract. The underlying tenets of a professional liability policy include the insurer's contractual obligation to pay on behalf of the insured all sums that they become legally obligated to pay as a result of the insured's professional negligent act, error, or omission and the insured's obligation is to fulfill certain obligations and duties within the policy. Besides the obligation to pay the premium amount, the insured must fulfill other obligations of the contract including reporting all claims in a timely manner, restraining from admitting liability or reaching a settlement with a claimant before seeking approval from the insurer. Second, the insurer has the duty and right to defend any suit against its insured

alleging a covered liability. In addition to the foregoing, the insurer has the right to investigate and settle any covered loss.

When an insured receives notice of a loss, the policy requires that they notify the insurer of the loss during the policy period, cooperate in the insurer's investigation of the defense, mitigate damages, and preserve the insurer's subrogation rights.

In order to perfect its claim under the policy for which it seeks to obtain insurance proceeds therefrom, the insured must, in addition to proving that it has complied with the policy conditions, also demonstrate that the claim falls within the terms of coverage and is not subject to exclusion.

The insured's obligations under the policy operate to protect the insurer's right to investigate any loss and to safeguard them

\* This article acknowledges that some courts take a more lenient position to an insured's non-compliance with policy conditions and, instead of vitiating the insured's rights under the policy, attempt to balance the interests of the insured and insurer in interpreting and enforcing the policy conditions, but does not rely on this approach. Said another way, this article relies on the principle that the insured's violation of the policy conditions vitiates the policy, rather than requiring the insurer to affirmatively prove that the breach caused prejudice.

from paying unnecessary or excessive settlements. While every court has found these provisions to be enforceable, some courts have taken a more lenient position to the insured's non-compliance with policy conditions and, instead of vitiating the insured's rights under the policy for indemnity and legal fees, they have attempted to balance the interests of the insured and the insurer in interpreting how strictly the policy conditions are enforced.

The simple point of this article is that the policy conditions are straightforward and the insured should be capable of complying with them in order to avoid any needless and uncomfortable litigation.

Perhaps the most important of the insured's duties is complying with the Notice Provision which requires that the insured notify its insurer of a loss in a timely manner – typically “as soon as practicable”. So, when in doubt – report.

Equally important is the Cooperation Clause which is designed to protect the insurer from collusion between the insured and claimant and requires that the insured cooperate with the insurer in the defense and settlement of the loss and the pursuit of any right of contribution or indemnity against the claimant. It further requires that the insured does nothing after the loss to impair the insurer's subrogation rights.

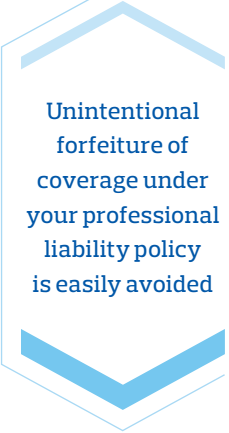
The Consent to Settle Clause implicates the insurer's right to control settlement of underlying claims against the insured. As such, insureds are often prohibited from, among other things, incurring claim expenses, reaching a settlement, assuming contractual obligations or admitting liability with respect to a claim without their insurer's prior written consent, which is not to be unreasonably withheld.

The spirit of the Voluntary Payments Clause is to avoid the instance where an insured settles a claim without first obtaining the insurer's consent.

Under all professional liability policies, the insurers are given the right and power to investigate a claim, determine whether liability exists, contest liability, deny the claim, settle the claim, develop a defense to coverage, participate in settlement negotiations, have input as to the value of a claim, and control the defense of their insureds, including controlling settlements under the policy to avoid any potential collusion between the insured and the claimant. Under some state laws, the mere violation of these policy conditions may abolish the insurer's obligation to indemnify or pay costs associated with the loss. Other states require the insurer be prejudiced before the policy conditions can be imposed. But why take such risks? We can assist you in reporting claims or circumstances, furthering cooperation with your insuring partner, and then allowing us to advocate on your behalf throughout the lifespan of the claim, if needed.

## Conclusion

Forfeiting your rights under a professional liability policy is easily avoided. Notify your insurer contemporaneous with, or immediately thereafter of, any loss which may have a component of professional liability of which you've been notified. We recommend that you do not discuss the claim with the claimant, admit or assume liability, begin settlement discussions or reach a settlement, pay monies, or take any other acts or omissions to prejudice your insurer's rights under the policy. A prompt note, email, or call to your insurance carrier can help mitigate many defenses to coverage that could be raised.



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coverage under  
your professional  
liability policy  
is easily avoided

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