

Workshop K

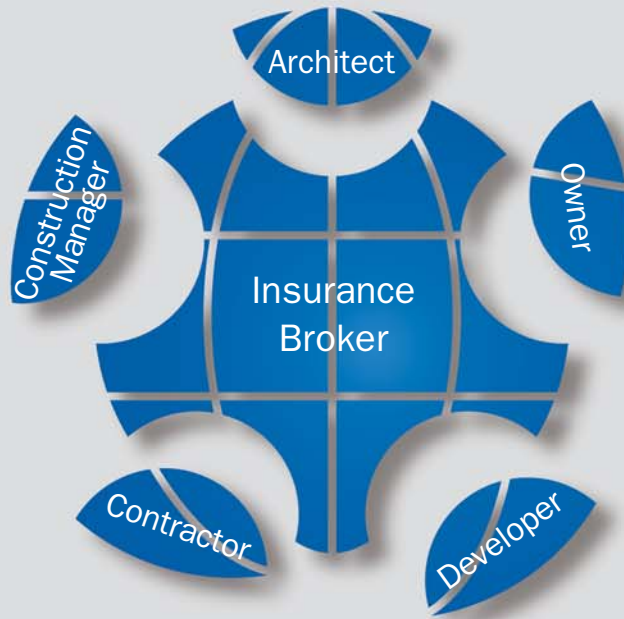
Wednesday, November 9, 9:00 a.m.–noon

DESIGN-BUILD RISKS AND PROFESSIONAL LIABILITY INSURANCE: A DISCONNECT

Panelist

**Sue E. Yoakum
Attorney, Architect**

Despite a strong initial interest, the market for project professional liability insurance has all but dried up, and the few insurers who still offer this coverage do so under strict guidelines. The reasons behind the insurance industry's reluctance to participate in this market are complex, but the bottom line for design-build participants is that their insurance coverage may not match up to their liabilities under the contract. With panelists representing the construction, design, legal, and insurance communities, this session presents a lively discussion of issues that impact the disconnect between design-build construction and project-specific professional liability insurance.



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Sue E. Yoakum
Attorney, Architect

Ms. Yoakum is one of the panelists for Workshop K, "Design-Build Risks and Professional Liability Insurance: A Disconnect," on Wednesday morning. Until recently, Ms. Yoakum was in-house attorney for HOK Sport+Venue+Event (HOKSVE), in one of the world's leading public assembly architectural firms. Her responsibilities included contractual reviews from legal, risk management, and business viewpoints; assisting in management of litigation, law firms, and insurance issues; and supervising day-to-day project risk management for HOKSVE's three offices located in Kansas City, London, and Brisbane, Australia. She developed an interoffice Web site as a legal resource for employees and she regularly presented legal seminars for HOKSVE's employees. Her selected list of domestic contract negotiations include Arizona Cardinals Stadium, New York Yankees, and St. Louis Cardinals Ballpark. Her selected list of international contract negotiations include Ascot Racecourse, Millennium Dome Arena, Dubai Autodrome, and Arsenal Football Club.

Previously, she was General Counsel for an international real estate development company located in Prague, Czech Republic. She was responsible for its in-house multinational legal department and coordinated outside legal services provided by Czech, Italian, English, and American law firms. Prior to practicing law, she was an architect for 10 years in Kansas City.

Ms. Yoakum holds a Juris Doctorate from the University of Missouri Kansas City, School of Law, from which she graduated with honors in 1994 and received the "AmJured Award" in construction law. She also holds a Bachelor of Architecture from Kansas State University, School of Architecture, from which she graduated with honors in 1983.

Notes

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DESIGN-BUILD RISKS AND PROFESSIONAL LIABILITY INSURANCE: A DISCONNECT

**Sue Yoakum
Attorney, AIA**

There is no doubt the design-build procurement method is gaining popularity in the United States and in the international market. Design-build is here to stay. Therefore, professional liability policies that address the particular risks, and liabilities in the design-build procurement method should be a viable and lucrative market.

So, why has project-specific professional liability insurance policies (Project-Specific Insurance) all but dried up?

My design-build project experience is with contractor-led sport projects located in the United States, Europe and Australia. Many of the sport projects in the United States require Project-Specific Insurance. Several sport projects have had claims and some projects with Project-Specific Insurance have paid coverage limits. These sport projects more than likely contributed to the lack of Project-Specific Insurance providers. In my experience, contractor-led design-build projects with Project-Specific Insurance have had more claims than projects insured under practice professional liability insurance policies.

Are design-build projects inherently more risky than other procurement methods, or is Project-Specific Insurance a magnet for claims? The answer to both questions is more than likely yes.

For certain projects, there is a heightened exposure for the architect, when the design-build team is contractor-led and the design services are provided by an architect who is not affiliated with the design-builder. These projects include design oriented “signature buildings” for example, a sport project. Why? The contractor-led design-builder whose experience is in construction will have a natural tendency to understand the “build” aspects of the project better than the “design” aspects. The contractor-led design-builder will more than likely believe that claims or increased costs arise from the design services provided by a third party rather than the build services provided by the contractor. In addition, when the architect has entered into a contract with the design-builder, then the design-builder has the ability to bring claims against the architect. Traditionally, architects have contracted with owners and are accustomed to working with owners,

managing risks and addressing owner's concerns. This traditional procurement method maintains contractual separation between the architect and contractor. The contractual relationship between a contractor-led design-builder and an architect should be approached and managed differently than the contractual relationship between an architect and an owner. No amount of "teaming" or "partnering" can overcome the natural tendency for a contractor to solve a project problem differently than the architect.

Sport projects are typically "signature design" buildings in their communities. These projects are complex from both the design and build viewpoints because they:

- contain non-standard structural and architectural systems.
- often have tight construction schedules.
- are built on urban sites.
- challenge the code requirements.
- are extremely customized for their tenants.
- must function at a high level to accommodate hundreds of thousands of visitors each year.

Other project types such as power plants, waste water facilities, manufacturing facilities, or even "spec" office buildings do not tend to be as challenging. These projects are "function" rather than "form" focused and are a natural fit for the design-build procurement method. Projects that are both "function" and "form" focused are inherently more challenging, and may not favor the design-build procurement method.

Design-builders who entered the contractor-led design-build market wanted to quantify these new design risks, and the market responded with Project-Specific Insurance with low deductibles, high coverage limits, and the insured v. insured exclusion removed. Project-Specific Insurance insured the design-builder, its subcontractors, the architect and its consultants. Policies were placed with coverage limits of \$25 to \$75 million, and aggregate deductibles ranging from \$250,000 to \$1,000,000 million for projects with construction budgets of approximately \$300 million. On a large and complex project there are many project issues that may cost the design-builder more to build than budgeted. Even if the project is delivered for the contract sum agreed upon with the owner, the likelihood of zero change orders that can be remotely or arguably attributed to the architect is rare. This created an opportunity, maybe an incentive, or a potential profit center for the design-builder to bring claims against the Project-Specific Insurance.

As claims increased, changes to Project-Specific Insurance occurred. Changes that are reflected in the current market include:

- an increase in deductible amounts.
- no aggregate deductible.
- reductions in coverage limits.
- the insured v. insured exclusion.

Today, Project-Specific Insurance may have deductibles of \$250,000 to \$500,000 for each and every claim, with coverage limits of \$10 to \$25 million with the insured v. insured exclusion.

Are changes in the costs and coverage limits the solution?

It may not be enough to reduce the “claim magnet” reputation that Project-Specific Insurance has acquired. I believe the insurance industry should continue to provide Project-Specific Insurance, but policies for some contractor-led design-build projects must take into consideration more than higher deductibles, lower coverage limits, and the insured v. insured exclusion.

There appear to be two trends in the current Project-Specific Insurance market:

- a policy which provides coverage for only the architect and its consultants, with the architect as the first named insured on the policy.
- a policy which provides coverage for the design-builder, its subcontractors, the architect and its consultants with an insured v. insured exclusion.

If Project-Specific Insurance continues these trends, then architects beware. Architects will need to become insurance administrators of several insurance policies and may have more than one professional liability insurance policy for one project. For example, when a project has Project-Specific Insurance that provides coverage for the architect and its consultants and the architect is the first named insured on the policy, then the architect has additional responsibilities including:

- actively participate in purchasing the Project-Specific Insurance.
- coordinating Project-Specific Insurance requirements and contract requirements.
- accommodate in its fee the cost of the premium for Project-Specific Insurance and the cost of deductibles.

If the Project-Specific Insurance insures the design-builder, its subcontractors, the architect and its consultants and contains an insured v. insured exclusion, then the architect must require its practice professional liability insurance policy, and its consultant's practice professional liability insurance policies to cover claims that may be brought by the design-builder. For example, when the design-builder is an insured under the Project-Specific Insurance and the insurance policy contains an insured v. insured exclusion, then claims brought by the design-builder will not be covered under the Project-Specific Insurance. In this example, the architect must look to its practice professional liability policy to cover these claims. The architect must coordinate its practice professional liability policy and the Project-Specific Insurance so that potential claims are insured by one of the policies.

In addition, owners should realize they may be asked to pay the premium for Project-Specific Insurance and then share the coverage limits with the design-builder. In a contractor-led design-build project, the design-builder will pass on the liability for the owner's design claims to the architect. Plus, the design-builder may have its own different design claims against the architect that are insured under the Project-Specific Insurance.

Suggested revisions to Project-Specific Insurance include:

- 1) following the current market trend and continue to reduce coverage limits to \$10 to \$25 million.
- 2) adjust deductibles to align with coverage limits.
- 3) remove the insured v. insured exclusion with the following policy revisions:
 - different deductibles for claims brought by an insured.
 - a separate design contingency that must be depleted before a claim may be brought by an insured, perhaps monitored by the insurance provider.
- 4) as a condition of coverage for design-build projects require regular risk management meetings and site visits with the owner, design-builder and architect to discuss cost increases, delays, and potential claims, or a full-time risk manager that addresses these concerns for the insurance provider.

- 5) as a condition of coverage, require timely and prompt reporting of cost increases, delays or potential claims during the project.
- 6) or all of the above.

The design-build market continues to grow and Project-Specific Insurance is a natural fit for this market. With adjustments to Project-Specific Insurance, the market should stabilize and hopefully, insurers will return.

Author Information: Ms. Yoakum is one of the presenters for Workshop K, “Design-Build Risks and Professional Liability Insurance: A Disconnect,” on Wednesday morning. Ms. Yoakum is an attorney and an architect, most recently her experience has been as in-house attorney for an international sport architectural firm, and as General Counsel for an international real estate development company located in the Czech Republic. She can be contacted at 816 926-0454 or sueyoakum@kc.rr.com.

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