

## Workshop W9

*Wednesday, October 11, 1:30-3 p.m. and 3:30-5 p.m.*

# ***INSURING CONTRACTORS' PROFESSIONAL LIABILITIES***

Presented by



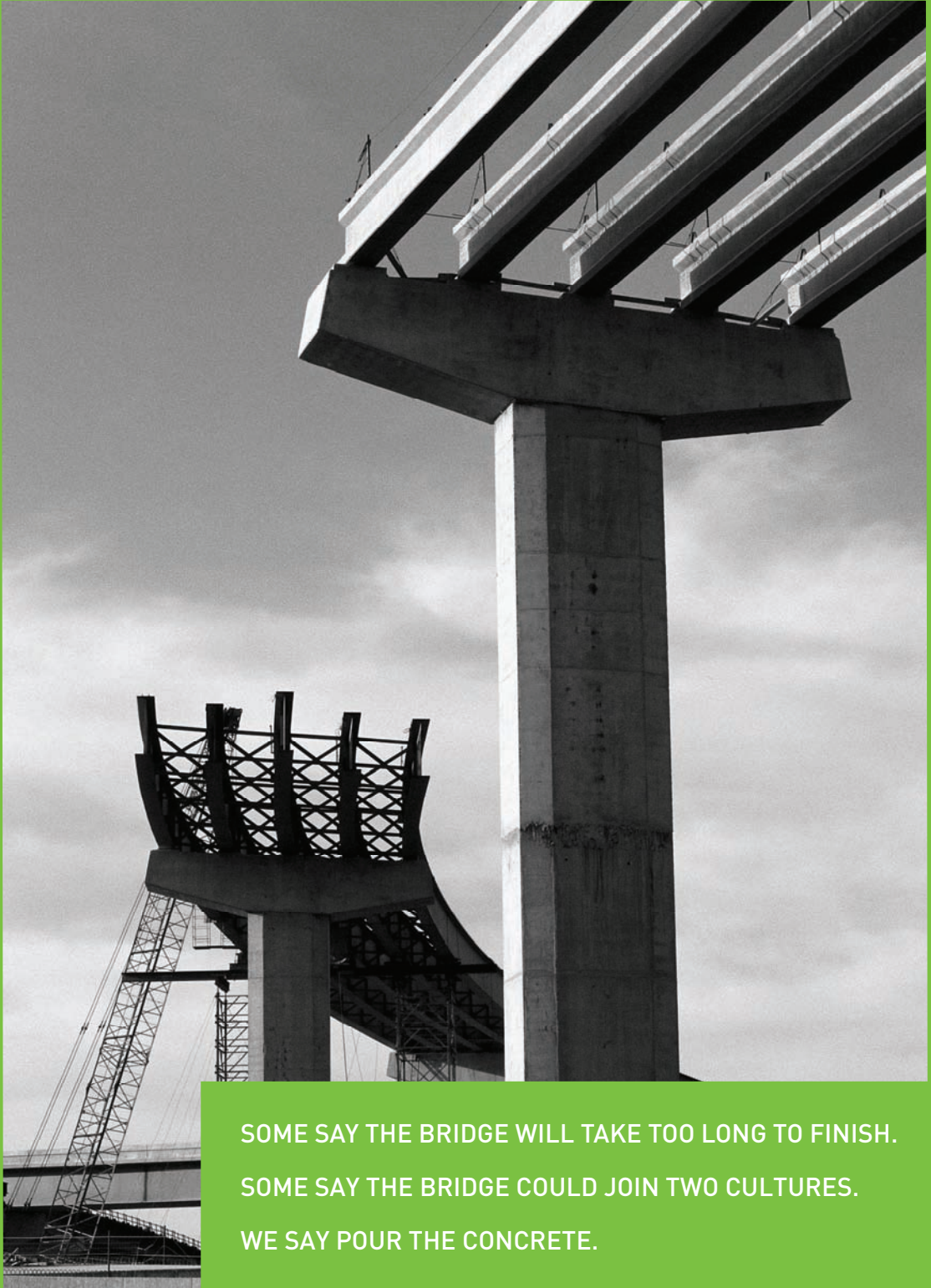
**Gregg Bundschuh**  
Partner  
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**David H. Collings**  
Partner  
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For many contractors, professional liability insurance is no longer considered a “specialty” coverage, but is a core part of their insurance program. Yet some aspects of the coverage remain a mystery for contractors and insurance professionals alike. In this workshop, professional liability insurance brokers review trends in and explain key aspects of this increasingly important coverage.

- Examines key issues pertaining to contractors professional liability insurance, including program design, negotiation, placement, and rating.
- Reviews the market for contractors professional liability coverage, including general pricing and availability, as well as any problem markets.
- Provides an overview of key coverage terms and conditions contractors should consider in the negotiation of this coverage.



SOME SAY THE BRIDGE WILL TAKE TOO LONG TO FINISH.  
SOME SAY THE BRIDGE COULD JOIN TWO CULTURES.  
WE SAY POUR THE CONCRETE.

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INSURING PROGRESS™

**Gregg Bundschuh**  
**Partner**  
**Ames & Gough**

Mr. Bundschuh, cospeaker for Wednesday afternoon's Workshop W9, "Insuring Contractors Professional Liabilities," is a Partner in Ames & Gough, a leading insurance firm specializing in design and construction risk. Mr. Bundschuh counsels and serves clients involved in the construction industry and provides special expertise in large, complex construction projects. Prior to joining Ames & Gough, he was a Managing Director, Global Construction Leader, and Environmental Practice Leader at Marsh, Inc. He was General Counsel to a national architecture and engineering firm and practiced construction law with an Atlanta firm.

Mr. Bundschuh has 21 years of construction insurance, risk management, and dispute resolution experience, during which he has written and spoken extensively about issues affecting owners, developers, design professionals, and contractors. His experience includes:

- Development of insurance and risk management programs for stadiums and arenas, airports, justice facilities, infrastructure, health care, brownfield redevelopment, mixed use/residential and petrochemical facilities
- Placement of manuscripted policies for liquidated damages, delayed completion, force majeure, "acceleration," and cost overrun
- Participation in the development and modification of industry standard form contracts including AIA, EJCDC, AGC, and AOD

Mr. Bundschuh is a Fellow of the American College of Construction Lawyers, an elective organization formed for the purpose of enhancing the skill, expertise, and the standard of the practice of construction law. He is also the former Chairman of the Corporate Counsel Division of the American Bar Association, Forum on the Construction Industry. Additionally, he has served as an arbitrator for the American Arbitration Association. He received his Bachelor of Arts from Wake Forest University and his Juris Doctorate from the University of Georgia.

**David H. Collings**  
**Partner**  
**Ames & Gough**

Mr. Collings, cospeaker for Wednesday afternoon's Workshop W9, "Insuring Contractors' Professional Liabilities," is a partner in Ames & Gough, a leading insurance and risk management consulting firm specializing in design and construction risk. Mr. Collings serves clients involved in the architect, engineer, and construction industry and provides special expertise in risk management research and large project risk management. Prior to joining Ames & Gough, he was a Managing Director with Marsh and served as the North America Marketing Director and the Design Firm and Design-Build Practice leader. Mr. Collings has worked in Atlanta, London, New York, and Philadelphia.

Mr. Collings has 27 years of industry experience. He is a frequent speaker to the design and construction industry and has published many articles. His experience includes:

- Designing and negotiating a Web-based project-specific professional liability program for a multi-billion-dollar mass transit system
- Developing insurance and risk management programs for ENR top 50 firms including those serving the petrochemical, infrastructure, transportation, and residential markets
- Publishing benchmark studies on design firm professional liability insurance, project-specific professional liability insurance, and owner's protective liability insurance
- Developing and negotiating project insurance for privatized bridge and road toll projects
- Designing and placing a project-specific professional policy for a \$250 million fast-track stadium project
- Serving on ACEC national committees for risk management and the institute for business management

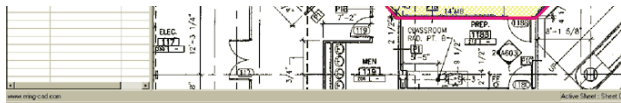
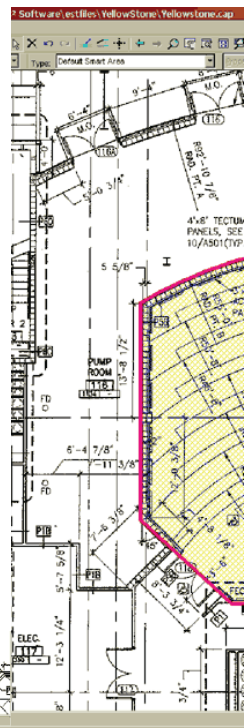
Mr. Collings holds a B.B.A. degree in risk management and insurance from the St. John's University.

Mr. Collings has participated in, written for, or spoken on behalf of the following organizations and publications: AIA CFO Large Firm Roundtable, American Bar Association Forum on Construction, American Council of Engineering Companies, American Council of Engineering Companies of Georgia, Associated General Contractors of America, The CA/T Professional Liability Reporter, Civil Engineering Research Foundation, Construction Business Review, Construction Financial Management Association, Construction News Record, Construction Specifications Institute, International Risk Management Institute, Design-Build Institute of America, Design Finance Officers' Group, Design Professionals Coalition, Educational & Institutional Insurance Administrators, Engineering News Record, Florida Institute of Consulting Engineers, Georgia Government Purchasing Association, Hazardous Waste Action Coalition, Missouri Bar Association, National Council for Public/Private Partnerships, Professional Liability Underwriting Society, Public Transit Authority Annual Conference, University of Colorado, and Wylie Construction Law Update.

# Insuring Contractors' Professional Liabilities

26th IRMI Construction Risk Conference  
San Diego  
October 11, 2006

Dave Collings, Partner  
Gregg Bundschuh, Esq., Partner  
Ames & Gough



## Contractors' Professional Liability

- ▲ Why is it needed?
- ▲ What type of losses occur?
- ▲ What does it cover?
- ▲ What are the exposures?
- ▲ How do contracts, risk, and insurance fit together?
- ▲ Who buys it?
- ▲ How do I apply for it?
- ▲ Who are the insurers?
- ▲ What are some of the key coverage issues?
- ▲ What are the limitations?
- ▲ How does it fit with other coverages?
- ▲ What does it cost?



## Underwriter Survey

- ▲ There are 17 contractors' professional liability insurers
- ▲ The market is highly fragmented and for each type and size of contractor, there is a limited number of qualified and interested insurers to underwrite their professional liability risk
- ▲ We asked the underwriters to participate in the survey
  - Seven declined since they provide coverage as an accommodation to other insureds they pursue—architects, engineers, or environmental contractors—and are not significant underwriters of this risk.
  - Of the remaining 10 insurers, seven agreed to participate in the survey. Because some insurers underwrite from more than one division, we received nine survey responses.



## Why do contractors need professional insurance?

- ▲ Because many contractors are providing services directly or through subconsultants that perform professional services:
  - Design-build
  - Agency construction management
  - Construction management at-risk
  - Design delegation



## Why?

- ▲ Because general and umbrella liability policies do not cover professional or pollution losses:
  - No coverage for “economic damages only” loss; bodily injury/property damage only
  - Professional liability exclusions
  - Pollution liability exclusions
  - Harbor Insurance Company v. Omni Construction Inc. (1990)

## Why?

- ▲ Because significant losses occur:
  - Water intrusion due to design error on a project - \$4.2 million
  - Delay in completion due to negligent CM services - \$3.1 million
  - Cost overrun due to a design subconsultant's error - \$1.4 million
- ▲ Even if your firm is not ultimately liable, defense costs are significant.

## What does it cover?

1. **Professional:** Third-party liability arising from professional services performed by your staff or your subconsultants
  - Coverage does not exclude pollution, but typically excludes mold and related exposures
2. **Pollution:** Third-party pollution liability arising from your operations
3. **First-Party Loss:** Loss your firm suffers that is caused by one of your subconsultants



## What makes a risk “professional?”

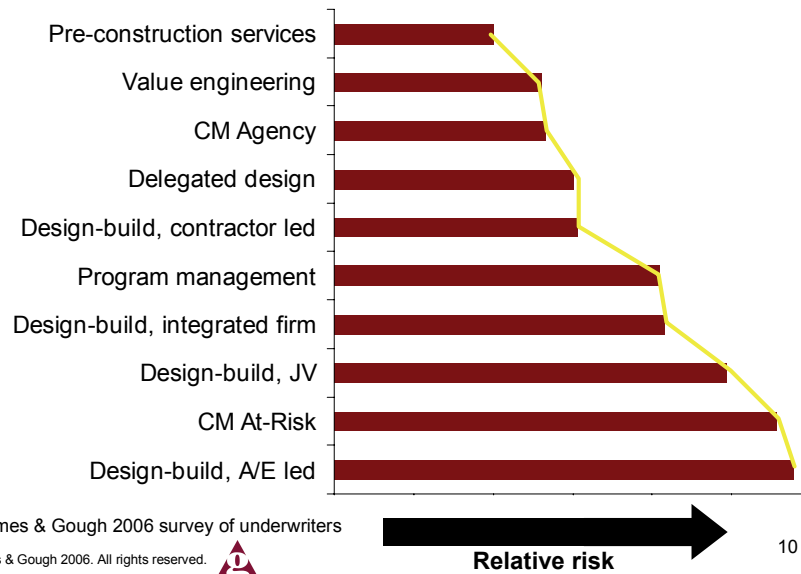
- ▲ Being compensated for services that require:
  - Extensive training, study, and mastery of specialized knowledge
  - Certification and licensing
  - Compliance with ethical standards set by an association
- ▲ Failure to perform the service properly can result in bodily injury, property damage, or economic only damages



## What are the exposures?

- ▲ Design-build
  - ▲ Agency construction management (CM)
  - ▲ CM at-risk
  - ▲ Value engineering
  - ▲ Design delegation
  - ▲ Design assist
  - ▲ Constructability reviews
  - ▲ Pre-construction services
  - ▲ Program management
  - ▲ And many other confusing variations
- ▲ The terms are familiar, but not the definitions or how they affect contracts, insurance, and risk

## Underwriters' Analysis



## But life's not that simple

- ▲ Assignment of design firm to CM after development of GMP pricing
- ▲ Use of BIM (Building Information Modeling)
- ▲ O&M services which include engineering, life cycle analysis, etc.
- ▲ “Flash track” project eliminates a complete design phase
- ▲ “Agency CM” who contracts with some trade contractors but not others
- ▲ “At-Risk” program management

## How do contracts, risk, and insurance fit together?

- ▲ Example: **Design-Build**
  - Performance bond
    - For design and construction or construction only
  - Professional liability
    - Contractor's professional
    - A/E professional
    - Right of direct action by owner against A/E
    - Limitation of liability for design
  - Performance guarantees associated with design
    - Bond or professional liability?

## How do contracts, risk, and insurance fit together?

### ▲ Example: Design Delegation

“..If the professional design services or certifications by a design professional related to systems, material, or equipment are specifically required of the Contractor by the Contract Documents, the Owner and the Architect will specify all performance and design criteria that such services must satisfy.”

Article 3.12.10 of AIA Document A201-1997

- The architect must coordinate the delegated design with the overall project design
- The contractor is not responsible for the adequacy of the performance or design criteria



## How do contracts, risk, and insurance fit together?

### ▲ Example: Shifting Design Liability

- Design vs. performance specifications
  - Design specifications set forth in detail the material to be employed and the manner in which the work is to be performed
  - Performance specifications set forth an objective or standard to be achieved
- Most requirements are a blend of performance and design specifications and determination of responsibility is difficult to predict



## Contractors with design responsibility

- ▲ Steel erectors, fabricators, installers
- ▲ Mechanical, electrical, and plumbing contractors
- ▲ Curtain wall manufacturers
- ▲ Suppliers of pre-engineered buildings and building components
- ▲ Building controls

## Who buys it?

- ▲ Contractors over \$150 million in revenue
- ▲ Specialty trade subcontractors over \$20 million in revenue
- ▲ Smaller and mid-sized contractors involved in design-build projects
- ▲ Large fee developer
- ▲ Firms that perform CM only or other professional services do not buy as often
- ▲ Most underwriters believe that less than half of the contractors that need professional coverage buy it

## How do I apply for coverage?

- ▲ Complete the insurer's application for coverage
- ▲ Because of the wide range of contractors' professional exposures, "one size does not fit all" for applications

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## Tips for completing an application

- ▲ Take the time to identify, understand, and disclose all of your exposures
  - An undisclosed exposure may not be covered
- ▲ Develop a spreadsheet of your "net professional exposure"
  - Underwriters assumption of the "net" exposure may exceed the actual amount
- ▲ Check your Web site to see what project delivery methods your firm provides
  - Underwriters will check it!

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## Case study

- ▲ \$245 million annual revenue general contractor
  - \$35 million in “design with construction” revenue
  - 3 engineers on staff (value engineering, not stamping drawings)
  - Limited CM At-Risk work, none shown on application, question is left blank (actual gross amount is \$20 million)
  - Net professional service exposure is \$1,500,000
- ▲ From the application and contractor’s Web site the underwriter infers:
  - Design fees are 8% of the \$35 million in “design with construction” revenue
  - Engineers are stamping drawings
  - CM At-Risk work is more significant than disclosed
  - Determines real “net” exposure is \$6,300,000 (4 times higher than actual)

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## Who are the insurers?

### Non-Environmental

- ▲ CNA (Victor O. Schinnerer)
- ▲ Houston Casualty (RA&MCO Insurance Services)
- ▲ Lexington Insurance Company
- ▲ Lloyds of London (AVRECO)
- ▲ Travelers
- ▲ XL Specialty Insurance
- ▲ Zurich (Construction)

### Environmental

- ▲ ACE Environmental
- ▲ AIG Environmental

### Both

- ▲ Arch Insurance Group
- ▲ Zurich (ZenPro)

### Others

- ▲ Beazley
- ▲ Liberty

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## Capacity

| Insurer                     | Minimum Premium   | Minimum Deductible                    | Minimum Limits | Maximum Limits                         |
|-----------------------------|---|---------------------------------------|----------------|--|
| AIG Environmental           | \$20,000  | 50,000                                | \$1,000,000    | \$25,000,000                           |
| Arch Insurance Group        | \$25,000  | \$5,000                               | \$250,000      | \$10,000,000                           |
| CNA (Schinnerer)            | \$4,000 Specialty<br>\$7,500 General<br>Professional Only | \$5,000 Specialty<br>\$10,000 General | \$1,000,000    | \$10,000,000                           |
| Houston Casualty (RA&MCO)   | \$5,000   | \$10,000                              | \$500,000      | \$5,000,000                            |
| Lexington Insurance Company | \$25,000  | \$25,000                              | \$1,000,000    | \$15,000,000;<br>more with reinsurance |
| Lloyds of London (AVRECO)   | \$2,500   | \$1,400                               | \$250,000      | \$5,000,000                            |
| Zurich (Construction)       | \$25,000  | \$50,000                              | \$1,000,000    | \$50,000,000                           |
| Zurich (ZenPro)             | \$25,000  | \$5,000                               | \$500,000      | \$30,000,000                           |

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## Target Market – By Size

| Insurer               | Contracting Revenues (in millions) |              |              |               |                |                  |              |
|-----------------------|------------------------------------|--------------|--------------|---------------|----------------|------------------|--------------|
|                       | Under \$10                         | \$10 to \$25 | \$25 to \$50 | \$50 to \$100 | \$100 to \$500 | \$500 to \$1,000 | Over \$1,000 |
| AIG Environmental     |                                    |              | ✓            | ✓             |                |                  |              |
| CNA (Schinnerer)      |                                    | ✓            | ✓            | ✓             |                |                  |              |
| Houston Cas. (RA&MCO) |                                    | ✓            | ✓            |               |                |                  |              |
| Lexington             |                                    | ✓            | ✓            | ✓             | ✓              | ✓                | ✓            |
| Lloyds (AVRECO)       | ✓                                  | ✓            |              |               |                |                  |              |
| Zurich (Construction) |                                    |              |              | ✓             | ✓              | ✓                | ✓            |
| Zurich (ZenPro)       |                                    |              |              |               | ✓              |                  |              |

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## Target Market – By Type

| Insurer               | Type of Contractor |                            |           |                |                 |
|-----------------------|--------------------|----------------------------|-----------|----------------|-----------------|
|                       | General Contractor | Integrated Design-Builders | EPC firms | Specialty subs | Other           |
| AIG Environmental     |                    |                            |           | ✓              |                 |
| CNA (Schinnerer)      | ✓                  |                            |           | ✓              |                 |
| Houston Cas. (RA&MCO) | ✓                  |                            |           | ✓              |                 |
| Lexington             | ✓                  | ✓                          | ✓         | ✓              | ✓               |
| Lloyds (AVRECO)       |                    | ✓                          |           | ✓              |                 |
| Zurich (Construction) | ✓                  | ✓                          |           |                |                 |
| Zurich (ZenPro)       |                    |                            |           |                | Infra-structure |

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## Risks Underwriters Prefer to Avoid

- ▲ Every underwriter cited “residential” as a concern
- ▲ Other issues cited include:
  - Geotech
  - Petrochemical
  - Nuclear
  - Contractors with significant “design for others” exposure

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## What are the limitations?

- ▲ CM and CM At-Risk
  - Most insurers do not exclude this exposure, but most exclude or restrict coverage for delay
  - Only one insurer, Zurich, does not exclude delay arising from the scheduling and sequencing of trade subcontractors (within a CM At-Risk contract)
- ▲ Cost overruns are excluded by some insurers



## What are the limitations?

- ▲ Scope of coverage is typically limited to architect, engineer, landscape architect, land surveyor or planner, construction manager, interior designer/space planner
- ▲ Contractual liability is limited to liability you would have in the absence of a contract
- ▲ Mold and fungus are normally excluded



## What are the limitations?

- ▲ Contractor-led design-build with GMP
  - If a design subconsultant commits an error that results in a cost overrun, the design-build contractor must absorb the loss
  - The design-build contractor can recover from the design subconsultant's professional liability insurance, but there is a risk the insurance will be insufficient to cover the loss
- ▲ A few insurers, led by Zurich, offer protection for this exposure
  - Coverage needs to be coordinated with subconsultants contracts



## What are the limitations?

- ▲ Joint ventures
  - JV partners are jointly and severally liable for liability arising from the JV
  - A JV partner's liability can exceed its ownership interest in the JV
  - Some contractor professional liability policies do not automatically cover JVs and others are limited to the insured's interest in a JV



## How does it coordinate with other coverages?

- ▲ General, umbrella, and professional liability coverages need to be coordinated
  - Contractor’s general and umbrella liability policies normally have multiple conflicting professional liability exclusions
- ▲ To avoid gaps and overlaps, there should be one professional liability exclusion on the general and umbrella liability policies and it should include the following sentence:
  - Professional services do not include services within construction means, methods, techniques, sequences and procedures employed by you in connection with your operations in your capacity as a construction contractor.

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## What does it cost?

- ▲ Minimum premiums range from \$2,500 to \$50,000
- ▲ Some underwriters determine “net” exposures and apply a rate
- ▲ Others apply an “overall” rating factor to gross revenue to determine premium
- ▲ Based on “normal” construction and favorable losses, the premium should range from less than 1% of “net” exposure for large firms to 3% to 4% of “net” exposure for smaller firms
- ▲ Cost will vary based on limits and deductible selected

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## Appendix - Definitions

**Agency CM:** A fee-based service in which the agency CM is responsible exclusively to the owner and acts in the owner's interests throughout each stage of the project. An agency CM does not contract with subcontractors. The agency CM offers advice on optimum use of available funds, control of the scope of the work, project scheduling, optimum use of design and construction firms' skills and talents, avoidance of delays, changes and disputes, enhancing project design and construction quality, optimum flexibility in contracting, and procurement.

**Underwriter's reaction from Ames & Gough survey:** All underwriters agreed with the above definition.



## Appendix - Definitions

**CM At-Risk:** The CM is chosen based on qualifications before the design stage is complete. CM services include, but are not limited to, early coordination during the design phase, value engineering, and constructability reviews. The at-risk CM delivery method entails a commitment by the CM to deliver the project within a Guaranteed Maximum Price (GMP). The CM acts as consultant to the owner in the development and design phases, but as the equivalent of a general contractor during the construction phase. In addition to the services described above, the at-risk CM is responsible for selection, scheduling and sequencing of trade subcontractors.

**Underwriter's reaction from Ames & Gough survey:** Two-thirds of the underwriters responding agreed with the above definition and one-third did not. Comments from three of the underwriters included:

- ▲ Does cm at-risk always entail a guaranteed maximum price?
- ▲ We prefer negotiated lump sum contracts.
- ▲ Their profit is contingent upon the price for which they bid and deliver the project. The other variables (e.g., whether or not design is complete) do not determine whether the CM work is at-risk.



## Appendix - Definitions

**Constructability Reviews:** A review of project documents by mechanical, electrical, structural, construction, and design professionals prior to a request for bids. The purpose of the review is to identify potential claim or problem areas and deficiencies that may occur as a result of errors, ambiguities, omissions, discrepancies, and conflicts in design documents.

**Design Assist:** The contractor assists the design team early in the design process during the stages of programming, schematic, and design development to offer information relative to cost, schedule, quality, and the project's constructability.

**Design-Build:** A single firm provides a single point of responsibility for design and construction. The most common approach is for a contractor to serve as the lead firm and it hires an A/E firm as subconsultant to perform all design.

**Underwriter's reaction from Ames & Gough survey:** 80 percent of the underwriters agreed with the above definition. Some underwriters have the perception that most design-build projects are JVs or LLCs and others see them primarily as contractors with A/Es on staff.



## Appendix - Definitions

**Design Delegation:** Performance of design by trade subcontractors. This can occur within any type of project delivery method. The lead A/E normally provides performance specifications and the subcontractor performs design and construction.

**Underwriter response:** All underwriters agreed with the above definition.

**Pre-construction Services:** This activity allows the CM to provide early input to the architects and engineers to help keep the project within budget parameters. Services include, definition of goals, documentation of Existing Conditions, development of space and site program, alternate Scheme Analysis, and budgeting and value engineering.



## Appendix - Definitions

**Program Management:** Providing services which consist of acting as the owner's representative and/or as an extension of the owners staff with respect to the management of a single project or multiple projects.

**Underwriter's reaction from Ames & Gough survey:** Underwriters generally agreed with the above definition, but had the following comments:

- ▲ PM can be so broad we ask to see the contracts under which professional services are being rendered.
- ▲ I agree, but PM is not well defined in the industry. We always have concerns over including PM services.
- ▲ Usually involves ongoing operations as opposed to construction.



## Appendix - Definitions

**Value Engineering:** The systematic application of recognized techniques by a multi-disciplined team to:

- ▲ identify the function of a product or service,
- ▲ establish a worth for that function,
- ▲ generate alternatives through the use of creative thinking, and
- ▲ provide the needed functions to accomplish the original purpose of the project at the lowest life-cycle cost without sacrificing safety, necessary quality, and/or environmental attributes of the project.

Source: U.S. Department of Energy




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