

Building Effective Professional Liability Programs for Owners

You're about to embark on a complex, \$500 million construction project. You expect your designers, contractors, and others to deliver services effectively — error-free and in a timely manner — but it's vital that you protect against the risk that they don't. Is it enough to rely on the professional liability coverage they purchase? Or do you need coverage of your own?

From architects and engineers to contractors and subcontractors, every party involved in a complex construction project faces significant risk. That risk can extend to owners, which may end up being on the hook for millions of dollars in potential losses during and well after construction, including injuries to passersby, damage to neighboring properties, design errors, and more.

While some project owners have historically been content to let other stakeholders purchase insurance coverage on their own, many owners are now looking to take a more hands-on role in procuring insurance and managing project-related professional liability risks. As they look to better manage their risk, here are the options available to owners and what they should consider before starting on a construction project.

A&E Coverage

Professional liability policies are designed to protect insureds from claims arising out of their negligent acts, errors, or omissions in the performance of professional services. In the construction industry, architects and engineers typically



purchase architects and engineers (A&E) professional liability policies, which respond to claims alleging third-party bodily injury, property damage, and economic loss. A&E professional liability policies are typically purchased annually and on a “practice” basis, meaning they extend coverage to all of an insured’s services and projects.

In some cases, project owners can rely on A&E professional liability policies purchased by their projects’ lead designers. But several factors related to a specific project — including its size, length, and complexity — could mean that designers’ coverage is not enough. The concerns for owners include:

- **Inadequate limits.** Given their high cost, architects and engineers often carry minimal limits, even as both the frequency and severity of claims against design professionals

have increased in recent years. What's more, A&E professional liability policies typically specify that any costs paid by insurers to defend insureds against losses are included in policy limits. This means that attorney fees and other defense costs alone can completely erode a policy's limits.

- **Claims-made coverage.** Unlike occurrence policies, A&E professional liability policies are written on a claims-made basis and are triggered by any claim made during the policy period or an extended reporting period (ERP), if applicable. That means they cover all work performed by insured design professionals since a retroactive date that is defined in the policy, which may be well before a specific project has begun.

PSPL Coverage

One alternative to a standard A&E professional liability policy that can be attractive to owners is project-specific architects and engineers professional liability (PSPL) coverage. A PSPL policy is typically purchased by a lead designer to provide dedicated coverage for a single project. PSPL policies can also be purchased by owners, which can benefit from being involved in negotiations and placement of coverage, including participating in discussions regarding project audit provisions. Lead designers generally have closer relationships with professional liability underwriters than owners do; owners, however are increasingly procuring such coverage on behalf of their design teams.

A PSPL policy allows for consistent terms and conditions for all consultants and can offer several advantages for both owners and design teams. For owners, it provides dedicated, comprehensive professional liability coverage for catastrophe losses, allows for joint defenses, and offers better control over coverage and fewer administrative burdens. For design teams, a PSPL policy offers a claims experience that does not affect a practice policy and ensures that subconsultants, joint ventures, limited liability corporations, and other parties have dedicated catastrophic professional liability coverage. It's also advantageous because an owner can pay or reimburse premium and elect to fund some or all of a policy's self-insured retention.

Coverage under a PSPL policy typically begins at the start of construction, with the retroactive date picking up any design exposure prior to that. While project-specific policies have historically only offered coverage for 10 years total — to include both the construction phase and ERP — more favorable market conditions now enable insurers to offer longer periods of coverage. In some cases, coverage is available for the construction phase plus an ERP of up to 10 years.

Named insureds on PSPL policies do not include owners; listing them as named insureds would preclude owner claims against design teams because of the insured vs. insured exclusion that

commonly appears in professional liability policies. Instead, an owner can be included (by endorsement) as an indemnified party; in the event of a third-party claim against an owner for work performed by insured design professionals, which allows the policy to defend the owner.

Although PSPL coverage can be attractive for owners and design firms, it can also be expensive. Despite new market entrants that have helped make it possible to arrange limits in excess of \$100 million for a single project, the PSPL market remains somewhat limited. For large projects, premiums and self-insured retentions are often quite significant — typically \$1 million or more for a nine-figure project.

Project-Specific CPPI Coverage

In addition to or instead of a PSPL policy, some owners elect to require a separate project-specific contractor's protective professional indemnity (CPPI) policy for a project's design-builder, contractor, or construction manager. A CPPI policy is similar to a PSPL policy but provides primary professional liability coverage for design-builders, contractors, or construction managers, along with excess coverage over any professional liability coverage carried by design professionals they hire. It does not protect design professionals, which must instead look to their own practice or PSPL programs to cover professional liability exposures.

A contractor is the named insured under a CPPI policy, which has two main coverage parts:

- The third-party professional liability component covers third-party claims made against a contractor alleging an error in the performance of professional services performed by the contractor or on its behalf by another party for which it is legally liable.
- The protective indemnity portion provides coverage to a design-build contractor in the event the contractor has a professional liability claim against a designer with insufficient limits or coverage that is not as broad as the contractor's.

Other forms of coverage can be added to a CPPI policy. These include contractor's pollution liability and rectification coverage, which reimburses a contractor for its actual expenses incurred to keep a project on track when it discovers design errors during the construction phase.

A CPPI policy requires that a contractor impose a minimum insurance requirement upon any design professional it hires. Limits of at least \$2 million — depending on the project size — are typically required for lead designers, structural engineers, and geotechnical engineers; limits of \$1 million are generally sufficient for all other consultants.

OPPI Coverage

Given the limited capacity and high cost of PSPL policies, an owner can instead consider purchasing an owner's protective professional indemnity (OPPI) policy. This can offer protection in the event that policies purchased by design firms, consultant, subconsultants, construction managers, and other stakeholders are exhausted by other claims or provide less extensive coverage. As its name suggests, an owner is the named insured under an OPPI policy. The policy does not provide direct coverage for design professionals and requires owners to impose minimum insurance requirements on such professionals.

Like a CPPI policy, an OPPI policy provides two main forms of coverage but allows for other forms of coverage, such as contractors pollution liability, to be added. The primary forms of coverage on an OPPI policy are:

- Coverage for third-party claims made against an owner alleging errors in the performance of professional services by design firms, consultants, construction managers, and other professional services firms that the owner has contracted.
- Coverage for an owner in the event that its designers or other professional services firms have insufficient limits or narrower coverage than the OPPI policy.

Purchasing an OPPI policy can be attractive for several reasons. Most important are the significant cost savings it can offer: 35% to 50% compared to a PSPL policy. An OPPI policy also provides owners with dedicated limits, excess and difference-in-conditions coverage over design professionals' practice policies, and the flexibility to schedule any directly held contracts evidencing professional liability for excess coverage.



Which Approach is Best?

There's no simple answer to the question of which of these policies is the right one to purchase. Project-specific policies may be most appropriate in some circumstances, but not necessary in others. And a combination of the policies described above may ultimately be the most effective solution.

As owners weigh their options, they should consider the following questions:

- **Who should control the purchase of project-specific coverage?** Oftentimes, a design-build team can purchase such coverage, but owners may wish to have a role in the process, including having their broker representatives participate in negotiations to make sure their interests are considered.
- **Can an owner rely on the practice policy limits of project participants?** Leaving to chance whether these policies will provide sufficient limits to protect them may not be the ideal approach.
- **Should we grant limitations of liability (LOL) to design firms?** This can be problematic for owners. OPPI coverage normally sits excess of a design firm's total professional liability coverage — not just the amount evidenced on its certificate for contractual compliance. Granting an LOL reduces the amount of the owner's claim for which the designer is responsible. OPPI insurers would prefer not to be restricted to a certain dollar amount and generally require that all LOLs be disclosed to them, approved, and endorsed to OPPI policies. In most cases, OPPI underwriters will agree to LOLs that are equal to the required professional liability insurance coverage; when an LOL is less than the required limit, insurers typically impose that as the owner's self-insured retention.

Owners should look at all of their options and discuss these questions with their insurance advisors. And regardless of which approach they choose, it's important to start the process of obtaining appropriate coverage early — well before construction begins. The last thing an owner will want to do is to invest significant time and resources in a project before considering questions of liability and insurance.

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