

Professional Liability for Contractors



Berkley
Construction Professional
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Presented by

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- Over 20 years of underwriting experience in design and construction professional liability insurance
- Originator of the owners and contractor's protective insurance coverages which are now the preferred approaches to underwriting project specific design and contractor's professional liability





Berkley Construction Professional

Our mission is to be the leading provider of specialized construction professional insurance and pollution coverage for construction-related industry exposures. In addition, we offer leading edge risk management services so that our insureds continue to be best-in-class in avoidance of potential claims.

- Dedicated to the Construction Industry
- Expert Underwriters
- Expert Claims Service
- Real-world Risk Management Education

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Practice management recommendations should be carefully reviewed and adapted for the particular project requirements, firm standards and protocols established by the construction professional.



Presentation Outline

1. Professional Liability Exposures
2. Professional Liability Coverage
3. Coverage Considerations
4. Underwriting Considerations
5. Claims Examples
6. Managing Professional Liability Risk



Section 1



Professional Liability Exposures



Understanding Professional Liability and Design Risk

- Professional and design risk is inherent in every project undertaking where you:
 - Opine on design
 - Perform on design/build the work
 - Are responsible for final engineering of project components delegated in the construction documents
 - Actively engage in the change order process
 - Are seen in a professional management role, i.e., pre-construction, coordination or oversight of work



Professional Liability Exposures – General Contractor



- Contract with owner for construction of project
- Responsible for means and methods of construction and hiring subcontractors
- No implicit responsibility for design or project management professional services



Professional Liability Exposures – General Contractor

General contractors may not directly involved with the design, but professional liability exposure can come from several areas:

- Value engineering
- Scheduling and sequencing of construction subcontractors/trade consultants
- Use/manipulation/management of building Information modeling systems
- Vicarious liability for subcontractors/trade consultants with design responsibility/delegated design liability

***Means, methods, techniques, procedures,
and site safety are non-professional exposures***



Professional Liability Exposures – Construction Manager Agency



- Fee contract with owner for management of project
- No contractual responsibility for construction or subcontractors
- Responsible for managing and administrating project as representative of owner
- No implicit responsibility for design services



Professional Liability Exposures – Construction Manager Agency

- Has a pure professional exposure as their responsibility is to act and manage the project on behalf of the owner
- Pre-design/design stage services:
 - Selection of design team
 - Budgeting/cost estimating
 - Pre-constructability reviews
 - Value engineering
 - Contract bidding/selection of construction team
- Construction phase services:
 - Construction inspection/review
 - Project management/project controls
 - Change order review/project closeout



Professional Liability Exposures – Construction Manager At-Risk



- Contract with owner for construction and management of project
- Responsible for construction and hiring subcontractors
- Responsible for managing project as representative of owner
- No implicit responsibility for design services



Professional Liability Exposures – Construction Manager At-Risk

- CMs At-Risk have a dual role:
 - Managing the design and construction process as an agent for the owner
 - Responsibility for the means and methods of construction
- Pre-design/design stage services:
 - Selection of design team
 - Budgeting/cost estimating
 - Pre-Constructability reviews
 - Value engineering
 - Contract bidding/selection of construction team



Professional Liability Exposures – Construction Manager At-Risk

- Construction phase services:
 - Material selection
 - Subcontractor selection
 - Scheduling and sequencing of construction subcontractors/trade consultants
 - Use/manipulation/management of building information modelling systems
 - Vicarious liability for subcontractors/trade consultants with design responsibility/delegated design liability
 - Coordination of construction team
 - Construction inspection/review
 - Project management/project controls
 - Site safety (?)
 - Hazardous site conditions
 - Change order review/project closeout



Professional Liability Exposures – Design-Build



- GMP contract with owner for design, construction, management and delivery of project
- Responsible for all design and construction and subcontractors/consultants on project
- Responsible for complete project delivery on agreed upon time and budget



Professional Liability Exposures – Design-Build

- Design-Builders have the single point of responsibility and liability for all design and construction services (whether performed in house or subcontracted to design professionals)
- Pre-design/design stage services:
 - Selection of design team
 - Conceptual/schematic/design development
 - Budgeting/cost estimating
 - Pre-Constructability reviews
 - Value engineering
 - Contract bidding/selection of construction team



Professional Liability Exposures – Design-Build

- Construction phase services:
 - Design development
 - Material selection
 - Scheduling and sequencing of construction subcontractors/trade consultants
 - Use/manipulation/management of building information modelling systems
 - Vicarious liability for subcontractors/trade consultants with design responsibility/delegated design liability
 - Coordination of design team and construction teams
 - Construction inspection/review



Professional Liability Exposures – Design-Build

- Construction phase services (continued)
 - Project management/project controls
 - Site safety (?)
 - Hazardous site conditions
 - Change order review/project closeout
 - Subcontractor selection
 - Start-up and commissioning
- Warrants and guarantees delivery of a fully functioning successful project to the owner



Professional Liability Exposures – Trade Contractors



- Contract with general contractor/CM/design-builder for delivery of a specific activity on a project, but not the entire project
- Can be responsible for design, construction and/or installation of equipment, systems, temporary structures, among others



Professional Liability Exposures – Trade Contractors

- Trade contractors can have in-house or subcontracted responsibility for all design and construction services associated with their portion of the project
- Trades with design exposures are:
 - HVAC
 - MEP
 - Structural steel
 - Fire and life safety
 - Concrete and curtainwall



Professional Liability Exposures – Trade Contractors

- Pre Design/Design stage services:
 - Pre-Constructability reviews
 - Value engineering
- Construction phase services:
 - Material selection
 - Subcontractors/trade consultants
 - Use/manipulation of building information modelling systems
 - Vicarious liability for subcontractors/trade consultants with design responsibility/delegated design liability
 - Shop drawings
 - Start-up and commissioning
 - Quality control/code compliance



Professional Liability under the General Liability Policy



- General Liability policies cover physical perils or activities—affirmatively exclude professional services
- Professional losses are of an economic nature
 - Cost overruns
 - Rework/fix it (most troublesome part of cover)
 - Project delays



Professional Liability Under the General Liability Policy



- **CG 2234 – Construction Management Errors and Omissions (E&O) Exclusion**
Excludes bodily injury/property damage (BI/PD) for all professional services on any project where the contractor is a CM
- **CG 2243 – Engineers, Architects or Surveyors Professional Liability**
Excludes BI/PD resultant from professional services rendered by any A/E that is employed by or performing work on contractor's behalf



Professional Liability Under the General Liability Policy

- CG 2280 – Limited Exclusion – Contractors Professional Liability
 - Excludes BI/PD for A/E professional services provided to others in your capacity as an A/E
 - Exclusion won't apply in connection with construction work performed by or on behalf of contractor





A Natural Question

Question: So, the contractor's professional liability exposure is adequately addressed with CG 2279 or 2280, right?

Answer: *Not quite*



The GL Gap

- CGL policies and endorsements only address BI/PD and exclude economic loss
- Professional liability claims generally arise out of economic loss
 - Cost overruns as a result of scheduling/delays
 - Owner's consequential damages
 - Loss of income
 - Business interruption
- In addition, GL policies typically exclude pollution and mold losses

Section 2



Professional Liability Coverage



Professional Liability Policy

Covers contractor for:

- Damages/loss to third-parties arising from the failure to perform/performance of professional services by the contractor or entities for whom the contractor is legally responsible
- Vicarious liability for work performed by subcontractors with professional liability exposure
- Direct liability from design or engineering work performed in house
- Direct liability from subcontracted work to design firms (Design-Build)
- Direct liability from construction management services (CMaR or CM Agency)



Professional Liability Policy



- Damages/loss primarily cover economic damages (can extend to cover bodily injury and property damage if part of damages/loss)
- Negligence based professional trigger



Pollution Liability Policy

Covers contractor for:

- Damages/loss to third-parties arising from pollution conditions created during the performance of construction activities by the contractor or entities for whom the contractor is legally responsible
- Provides coverage for unintentional creation of pollution conditions
- Provides coverage for exacerbation of existing pollution conditions



Protective Indemnity Coverage

- True design-build coverage
- Allows contractor to make a first-party claim against subcontracted design professionals for:
 - Damages/loss to the contractor arising from the failure to perform/performance of professional services by the design professional or entities for whom the design professional is legally responsible
- Coverage is excess and DIC of design professional's insurance policy



Importance of Protective Indemnity Coverage

- GMP contract delivery – contractual liability based claims (rare negligence based claims made from owners)
- Design professional policies are annual and claims-made with no guarantee of renewal
- Design professional policies have aggregate limit covering all retroactive work of firm
- Unknown terms and conditions of policy (specific project/class exclusions, mold/EIFS exclusions)
- Scope of coverage/limit fluctuates with market



Mitigation of Damages or Pollution Loss



- Gives contractor a proactive solution in the event of an act, error or omission that would reasonably result in a professional or pollution loss
- Coverage pays the cost to mitigate or rectify an act, error or omission from the work of the contractor or entity for which contractor is legally liable



Mitigation of Damages or Pollution Loss

- Can occur during the course of construction, warranty period, or...
- Applies to professional and/or pollution events
- Removes faulty workmanship exclusion since source of claims at mitigation stage could involve part of doing work wrong and design problems
- Applies to subcontractors of all tiers

To be blunt, it fixes the problem before it becomes a bigger problem — this has generally been a cost that has come out of the contractor's pocket (or profit!)

Section 3



Coverage Considerations



Professional Liability Coverage

- Definition of professional services/design professional
(CM Agency and CM At Risk, design delegated work, Design-Build, scope of A/E services covered, non-licensed A/Es)
- Definition of insured
(subsidiaries, LLCs, JV coverage)
- Supplemental coverages
(additional coverage extensions)
- Exclusions
(faulty workmanship, products, BI/PD)
- Limit/SIR



Contractor's Pollution Liability Coverage



- Occurrence or claims-made
- Definition of pollution condition (asbestos, lead, silica. various perils)
- Mold coverage
- Additional insured coverage
- Transportation coverage
- Non-owned disposal sites coverage
- Exclusions



Protective Indemnity Coverage

- Does coverage apply to professional and pollution?
- Scope of coverage under definition of design professional
- Does coverage apply primary if design insurance is unavailable?
- Minimum insurance requirement
- Limit/SIR



Mitigation of Damages or Pollution Loss

- Does coverage apply to professional and pollution?
- During what stage of the project can mitigation occur?
- Will faulty workmanship exclusion apply?
- Limit/SIR/coinsurance



Section 4



Underwriting Considerations



Underwriting Considerations

- Revenue breakdown
(CM Agency, CM At-Risk, Design-Build)
- Project types
- Project location, size and scope
- Contract terms
- Quality control procedures
- Financial analysis



Pricing for Risk

- Be transparent
- Make owner active participant on profit sharing or unforeseen escalation on costs to a reasonable extent
- Retain income for warranty exposure
- Be willing to lose on the front end when it comes to trading cost vs. quality (*In the long run, you will win on client loyalty and following*)
- Make money, lots of money!



Section 5



Claims Examples



Third Party – Professional Liability

1. Contractor was sued by subcontractors on a large hospital project for negligent construction management
 - The contractor did not schedule and coordinate the work properly
 - Resulted in significant costs being added to the project that subs did not reasonably expect to incur
 - Total loss was \$2,000,000.



Third Party – Professional Liability

2. Contractor was sued by subcontractors for changing the design of a central chilling plant on a large jail
 - Halfway through the project the contractor changed design from a central chilling plant to a four-stage chilling facility
 - Subcontractors incurred in excess of \$20,000,000 in additional costs due to change in design
 - Total loss was in excess of \$5,000,000 including expenses



First Party – Protective

1. A significant structural design flaws at a mixed-use retail condominium project parking deck
 - Engineer had \$1,500,000 in coverage available
 - Incurred in excess of \$6,000,000 in costs
 - Protective coverage paid the difference between the available limit and the total loss



First Party – Protective

2. Design errors in the HVAC, MEP and structural steel plans and failure to coordinate design with original owner specified equipment
 - Design-Build contractor made a claim against their subcontracted design professionals on a \$20,000,000 medical facility
 - Contractor alleges they incurred \$15,000,000 in cost overruns and delay



Contractor's Pollution

1. Demolition and construction of a new library and the failure to properly identify asbestos in pipes leading to a release during demolition and contamination of an adjacent site
 - Government owner asserted a claim against the general contractor
 - Alleged damages nearly \$12,000,000



Contractor's Pollution

2. Contractor burned material from a project site releasing chemicals in the air
 - Wind blew particulates $\frac{1}{4}$ mile to a new car dealership and corroded paint on numerous cars
 - Total loss of \$300,000 in damages and repair costs



Mitigation of Damages or Pollution Loss Claim

1. During occupancy of the buildings, tenant complained of problems with computer system over-heating and crashing
 - Subcontracted HVAC engineer was able to correct the problem by adjusting the ventilation and air conditioning systems
 - Tenant suffered in excess of \$1M in damages as a result of lost data and production time
 - Contractor received above \$500,000 in mitigation payments



Mitigation of Damages or Pollution Loss Claim

2. Subcontractor of construction manager installed drywall with mold growth into the project during construction
 - Contractor replaced drywall but incurred material cost and delay costs near \$1M
 - Contractor received \$600,000 in mitigation payments and received the remainder from subrogation against subcontractor

Section 6



Managing Professional Liability Risk



The Loss Prevention Top 10

1. Stay focused be aware of your “professional” responsibilities
2. Define your scope of services
3. Control your contracting and project approval process—stay within protocols
4. Work as best you can with design firms you know or make sure you follow through on researching the referrals of new ones
5. Think globally act regionally—know your markets and legal environment
6. Make certain your subs live by the same rules that you do



The Loss Prevention Top 10

7. Never begin complex services until your contract is fully executed (after executing your contract, adhere to its terms and modify them only by written agreement with the Client)
8. Manage (avoid or understand) your fast-track or hard-bid construction work such as untested technologies or cutting-edge design
9. Maintain continuity of management at the project level
10. Employ Peer Review—have peer review performed within your firm and foster environment of sharing of best practices (second set of eyes)



Questions?

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