

THE EVOLUTION OF CONTRACTORS PROFESSIONAL LIABILITY INSURANCE

DOES A CARRIER'S CLAIMS PHILOSOPHY REALLY MATTER?

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Have advances in contractors professional liability (CPrL) insurance policies created differentiation in the efficiency of claim resolution? In my mind, the answer is a resounding “yes.”

According to FMI, a leading management consulting, investment banking and research company serving the construction industry, design-build as a project delivery method is anticipated to grow 18% from 2018 to 2021 and represent up to 44% of construction spending in several major segments. As a result, contractors are assuming—directly or indirectly—liability for the design of their projects, which significantly increases the need for broad CPrL coverage.

Since its introduction almost 25 years ago, CPrL insurance has continuously evolved to address the increasingly complex needs of contractors. This includes the increased integration of design and construction. This evolution in project delivery methods has not only affected CPrL policy forms, it has also affected claims management policies and procedures. Because efficient and effective claims resolution is of paramount importance to policyholders and their brokers, this factor must be incorporated into the CPrL insurance purchase decision.

Along with the growth of designbuild and an increase in CPrL exposures, several new carriers have entered this specialized niche in recent years. It's important in such a crowded market for agents and brokers to understand each carrier's policy form and its claim management philosophy prior to making a recommendation, because forms and philosophy can—and do—vary widely.

Several coverages should be included in a CPrL insurance policy, and these can affect the manner in which a CPrL insurance carrier manages claims.

Protective coverage

CPrL insurance carriers have incorporated into their policies protective language that facilitates and expedites claims resolution. The intent is to resolve disputes quickly during construction and keep projects on schedule and not have them grind to a litigation-driven halt. The process calls on a CPrL carrier's claims management expertise and ability to validate and value a claim shortly after it is made, and this can benefit all parties involved in the project.

Here's an example: A contractor discovers a design error during the construction of an office building—the exit stairwell does not meet the building code. The cost for repair is \$2 million, which exceeds the designer's professional liability insurance limits. The contractor makes a claim against the designer and proceeds with incurring the costs to correct the stairwell issue. Protective professional indemnity (protective) coverage and effective protective claim handling provide a degree of advocacy on the contractor's behalf to ensure that the designer appropriately contributes to resolution of the matter; this minimizes the likelihood of the contractor being stuck holding the bag for the costs arising from the designer's error.

Proactive coverage

An innovative coverage, proactive has, for all intents and purposes, bypassed the entire litigation process with respect to design liability. With proactive, a CPrL insurance carrier receives all the information regarding the claim for vicarious design liability, then independently validates the claim—essentially admitting liability—and then pays its portion of it. Once evidence of the payment is provided to the design professional insurer, the traditional relationship between the designer and insurer is disrupted and, in general, a more realistic settlement is made rather than continuing the drawn-out litigation process and risking the potential for bad faith action.

Consider this scenario: A contractor is the design-builder of a large hotel and hires both designer and construction trades. The contractor installs almost all of the piping for an HVAC system. Near the completion of the piping project it's discovered that the designer incorrectly specified piping and epoxy that are not recommended for the type of water in the area. Then an expert determines that the piping needs to be removed and replaced with proper HVAC piping and epoxy, at a cost of \$3 million. The designer's professional liability insurance policy has limits of \$2 million per claim, which leaves a \$1 million shortfall.

Here, the CPrL policy proactive coverage would respond and fund the differential even before the designer's professional liability insurance pays its share of the removal/replacement costs. The piping project would be completed to code, which would allow the construction project to continue. The design-builder's reimbursement for the \$3 million repair/replacement costs would be achieved more promptly as a result of the proactive claim resolution process. Once the CPrL proactive carrier has paid its excess portion of such costs, it would be very difficult for the designer's professional liability carrier to deny its liability and continue unproductive and limit-eroding defensive activities.

Mitigation coverage

Mitigation of damages or rectification (mitigation) coverage has further benefited projects in need of prompt resolution of issues so that construction can continue. While mitigation coverage may advance monies to alleviate design-related issues during construction, it also is a much-contested coverage because it imposes a strong burden to prove damages, compelling the insured to be more honest and realistic about the amount of money recoverable under the policy. An insurance carrier's claims

management philosophy with respect to mitigation coverage could dramatically impact the amounts recovered under a CPrL insurance policy.

For example, a general contractor (GC) notices that improperly specified fireproofing material has been installed on a residential nursing home project and pervasive mold growth has occurred. The subcontractor who installed the fireproofing material and the designer who specified it refuse to remediate the mold. The GC's CPrL mitigation carrier steps in and funds approximately \$1 million for the removal of the mold, helping the GC avoid fielding claims from the project owner (schedule delay and cost overruns) and from the nursing home's residents (bodily injury). In this situation, the GC's CPrL mitigation carrier would then pursue the subcontractor and its designer for recovery of the funds paid. Ultimately, the GC's project is fixed, has avoided delay, and is turned over to its end users promptly.

Faulty workmanship coverage

The recent release of a new CPrL product offering non-negligence-based faulty workmanship is taking the evolution of coverage in an entirely different direction. This innovative coverage addresses the gap in the commercial general liability policy for "your work." It provides coverage for the cost to repair or replace faulty workmanship performed by the insured; it also covers damages associated with the loss of use of tangible property resulting from the insured's faulty workmanship and the installation of faulty products. This coverage is already showing benefits to policyholders.

Here's an example: An electrical contractor installs the entire electrical and audio-visual systems for an office building. The contractor fails to see that the plans require, per the building code, that all of the wiring is to run through conduit as opposed to running freely through the wall cavities. All of the wiring needs to be torn out and replaced to comply with the code. The CPrL policy faulty workmanship coverage would respond to the claim. This keeps the project on schedule and also preserves the relationship between the contractor and the project owner due to the efficient resolution of this issue.

The interrelationship among these coverages and the perceived duplication or overlap among them has been a frequent cause of confusion among many insureds. When put in proper perspective, however, the usefulness and importance of each individual coverage becomes understood and all of the coverages should be included in the minimum requirements for a CPrL policy.

As most agents and brokers know, simply choosing a carrier with the lowest premium is not a strong long-term strategy when it comes to purchasing any type of insurance; however, in today's market, it is a particularly weak strategy when it comes to CPrL. While policy form differences are more evident because you can actually read the language, it is that language combined with the claims philosophy of a carrier that makes the real difference among CPrL carriers. And that's why it is vitally important for agents, brokers and their contractor clients to carefully review policy forms and ask about each carrier's claims management philosophy and depth of claims team expertise prior to making a final decision on which carrier to select.



The author

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