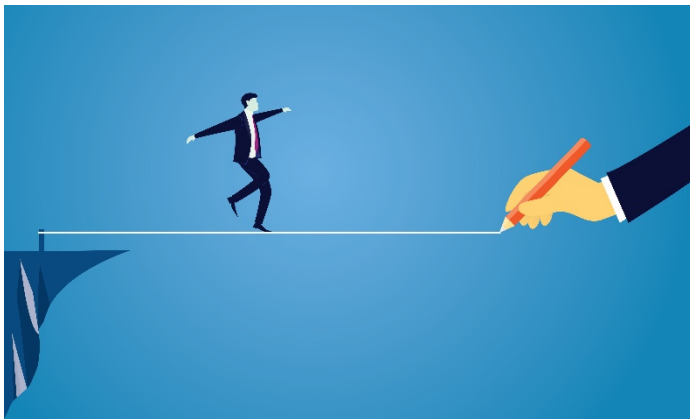


## How to Manage Catastrophic Construction Risk

Take control of unexpected problems with a CPrL policy

By Raymond F.H. Bustamante  
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According to the Design-Build Institute of America, design-build methodologies now represent 40% of the nonresidential construction marketplace and are likely to support more than \$1 trillion in building projects between 2018 and 2021. This is primarily due to the ability to deliver projects faster and at lower

cost than either design-bid-build or construction-management-at-risk projects. Another advantage includes the management of every project element from design to construction from one single point of contact.

The downside of this process involves the blurred lines of responsibility that result with the general contractor absorbing a large share—if not all—of the risk when things go wrong. Consequently, Contractor's Professional Liability (CPrL) policies, which include protective coverage, have become a necessity for overcoming potential catastrophic challenges through the transfer of financial exposures to third-party carriers in an environment that can be both highly litigious and fraught with costly delays.

Furthermore, these policies have been specifically developed to help alleviate the typical shortcomings of the architect's professional liability insurance. That's because these policies usually only cover all of the architect's prior and current work on a claims-made basis, which means that the policy's limits are exposed to numerous projects. Additionally, the limits of liability can also be eroded by defense costs. Simply put, after many years of litigation, there is no guarantee as to the availability or adequacy of the architect's professional liability insurance limits of liability.

It is for these reasons that construction firms should seek to supplement the architect's existing professional liability insurance with a CPrL policy, which includes protective coverage to guard against the errors and omissions committed by the architects, designers and subcontractors working under their control and management.

## How Does a Protective Policy Work?

A protective policy leaves the professional liability insurance policy of the architect alone and provides first-party indemnity to the contractor for damages incurred as a result of negligence by the architect. Being the named insured on a protective policy imposes a duty on the insurance provider to have the contractor's claim(s) managed and settled with the utmost good faith. In addition, the contractor controls how their policy is accessed so that unrelated losses can be redirected to where coverage is more appropriate.

Over 95% of payments made under protective policies are made to the contractor on an indemnity basis. While third parties can seek recovery under a protective policy, these claims are very rare. An example of a third party may be a governmental agency, a homeowner association or another entity alleging intrusion or effect on their property due to the negligent design of the project. Physical injury claims are typically made against other insurance policies due to the limited control an architect has over the physical activities (work) of the project.

Third-party coverage under a protective policy cannot be broadened to cover contractor claims because these first-party disputes are settled contractually. However, a contractor dealing with such a claim would benefit from the help their protective insurer could provide to position their loss, if any, as the result of design negligence that will enable the contractor to make a claim against the architect to offset any damages paid to the contractor.

The protective policy should stand on its own terms and assist the contractor to position their claim in the best way possible so that they can recover their substantiated damages. It should also fill the potential gaps in coverage due to unknown exclusions that may exist in the architect's professional liability insurance policy. In addition, it should guarantee coverage for the life of the project, plus a specified extended period after the work is completed.

The protective policy is not dependent on the architect maintaining their professional liability insurance and is also not affected by the architect's policy limit being reduced or exhausted by payment of other claims. The cost of schedule extensions or added work should also be negotiated up front so there are no surprises.

## How Much Protective Insurance Is Enough?

Architects usually purchase \$1 million or \$2 million limits of liability on their professional liability insurance policies. When deciding on the limits of liability for a protective policy, the contractor should consider potential severe losses from design negligence that can affect the project, as well as the contractor's risk management philosophy and their financial ability to retain risk.

Protective policies can be purchased on an individual project basis or can include a portfolio of construction projects. Your broker is the best source of information for determining the limits of liability that are appropriate for a project(s).

## Not All Protective Policies Are the Same

Terms and conditions for protective policies vary widely. Each insurance carrier creates their own policy with unique coverages customized for each construction project. Therefore, it is important that you carefully review each policy before making a purchase. Some protective policies may demand payment of all of the underlying design team's professional liability insurance policies before accepting any liability.

Other protective policies may demand that the architect continuously maintain insurance or, in a worst-case scenario, deny the claim if the architect's professional liability insurance is not maintained. Lastly, some protective policies may have cancellation clauses, while others only specify the reasons that exist for cancellation.

Just as the financial strength, experience and customer-service review of any insurance provider is essential, it is as important to delve deeper into how a protective insurance provider's actual claims management and other services will be provided. The following are a few questions to ask your insurance provider:

- Do they have a proactive mentality and service capabilities to assist the contractor in substantiating their claim?
- Do they offer the specialized services that are required to properly validate damages and how are these services provided?

- Are these services provided with in-house risk consultants who may be biased or by third parties?
- What is the experience and credibility and success rate of these third-party service providers?

Only after asking these questions and assessing the answers can contractors effectively evaluate each protective insurance offering. Again, working with your broker is the best way to find the answers to these questions prior to purchasing a protective policy.

## Insuring Construction Business Owners from Catastrophic Loss

A catastrophic event is always unexpected and unwelcome. Therefore, construction business owners should carefully assess their insurance protection and indemnity obligations before executing contracts for upcoming projects.

Protective policies are cost-effective vehicles for insuring owners against catastrophic loss and protects them from the design errors and omissions that can negatively impact any construction project. By taking control of their potential risks, a contractor can significantly increase its chance of having a successful and profitable project.

### About the Author



Raymond F.H. Bustamante is the managing director at [Berkley Construction Professional](#), a Berkley Company. He has more than 25 years of experience underwriting design and construction professional liability insurance. He originated many of the owners and contractor's protective insurance coverages recognized industrywide as the preferred approaches to underwriting project specific design and contractor's professional liability.

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