

Design Professional Liability Coverage

Options and considerations





Why Aon's Professional Services Group?

Aon Risk Solutions' Professional Services Group is Aon's unified global team of insurance brokers, reinsurance brokers, and insurance consultants/advisors dedicated solely to serving professional service firms; including accountants, architects, engineers, surveyors, and other design and project professionals, consultants, lawyers, solicitors, and notaries.

Overview

Large construction projects almost always involve discussions regarding general liability, workers' compensation, professional liability, and builders' risk coverage. Many owners do not appreciate, however, that general liability coverage is relatively limited in scope, and responds only if a "sudden and accidental occurrence" causes bodily injury or property damage. Professional liability is much broader, and is the only coverage that will respond to purely economic loss (increased cost of construction, lost profits or loss of use, for example) attributable to negligent design or other errors in the performance of services. If bodily injury or property damage results from wrongful acts in the performance of professional services (architecture, engineering, construction management, etc.), any such damages are also covered under a professional liability form.

From either an owner's or an architect's perspective, it is essential that the professional liability coverage be as broad as possible. With fast-evolving project-delivery methods, the multitude of issues implicated by building information modeling (BIM) technology, "sustainable design," and other relatively novel issues, current policy forms vary dramatically with respect to the breadth of coverage provided. The broadest forms go well

beyond covering claims arising out of services provided in the insured's capacity as an architect or engineer, and expressly cover services provided as a construction manager, planner, scientist, or technical consultant in the provision of services related to LEED certification, BIM, and other such ancillary exposures.

Once the breadth of coverage is verified, thought should be given to the appropriate amount of coverage for a particular project. Any construction project that is unusual from either the owner's or the designer's perspective, whether because of its size, complexity, or strategic importance, should involve careful consideration of appropriate security and risk transfer options as respects the design and construction management teams. Though there are more exotic and constantly-evolving products that deal with contractor-led design build, integrated project delivery, public-private-partnerships, and other nontraditional delivery methods, basic professional liability structures and options include: practice policies for architects and engineers; project-specific professional liability insurance; contractor's protective professional indemnity insurance and owners' protective professional indemnity insurance.



Reliance on the Architects' and Consulting Engineers' Practice Policies

As should be expected, the least expensive option is also the riskiest option for both the owner and the design team. Nearly all reputable architectural and/or engineering firms have professional liability coverage that provides some security to owners that may sustain damages from a design firm's negligent performance of services. Because such policies apply to the practice generally, owners are not expected to contribute to the cost of such policies. However, the limits purchased by firms of various size and sophistication vary dramatically; small- and mid-sized firms often buy only \$1 million or \$2 million of coverage, whereas the very largest firms often procure limits in excess of \$100 million per claim.

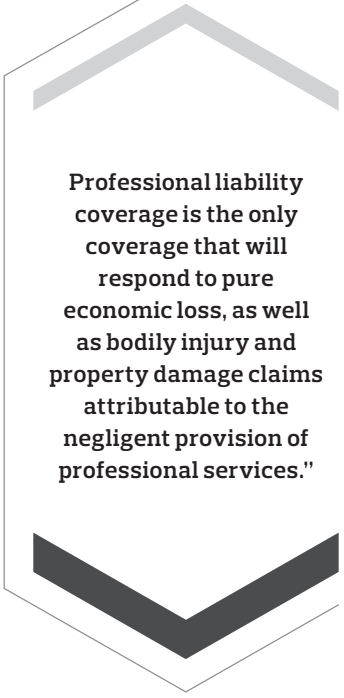
Owners and developers need to scrutinize the adequacy of such limits with the following in mind:

- Firms' annualized practice policies are intended to cover any claims that may be made within a 12-month policy period, without regard to when the services giving rise to the claim may have been provided. In other words, the limit provided is exposed for purposes of both defense costs (attorney and expert witness fees, as well as other costs of defense erode the available limit on professional liability policies) and indemnity (judgments and settlements paid to claimants) on any project on which the design firm has participated within the past 10 to 15 years. Thus, the limits reflected on a given design firm's certificate of insurance could easily be eroded or even exhausted by unrelated claims on unrelated projects.



- Because design firm professional liability policies are written on a “claims-made” basis, it is of no help to an owner if the architect had a policy with a \$5 million limit at project inception. What matters is that the architect has a policy with available limits at the time a claim is made and reported – often 2 or more years after the project is completed. It is essential that the owner-architect agreement require that such coverage be renewed at the requisite limit through substantial completion of the project, plus a reasonable discovery period post-completion. Appropriate follow-up should be made to ensure the limits have been properly renewed and maintained for 2 to 5 years beyond issuance of the certificate of occupancy.
- Most sophisticated design firms realize that their clients will require some professional liability limits, and that such coverage is essential to their firm’s continued existence, as even the best experience claims. However, the limits

purchased by the vast majority of firms are very low as compared to other “professional services” firms, such as law and accounting firms, and bear little relation to the exposures assumed. Most insurers that write this class of business will, however, make available one or two “project-specific excess” endorsements to a given insured. Such endorsements are reasonably priced, as the excess coverage is implicated only if the underlying (base policy) limit is exhausted. Note, however, that if an architect buys a \$2 million per-claim limit, underwriters are unlikely to put up more than \$2 million of project-specific excess limits, for a total of up to \$4 million of coverage. Because such endorsements are tied to the firm’s “master policy,” they have to be renewed annually in order to be of any assistance at the time a claim is made. Note also that any “project-specific” coverage must be in place prior to construction beginning in order for the coverage to “relate back” to the inception of design services.



Professional liability coverage is the only coverage that will respond to pure economic loss, as well as bodily injury and property damage claims attributable to the negligent provision of professional services."

Project-Specific Professional Liability (PSPL)

An alternative to the project specific excess endorsement, PSPL insurance provides a dedicated limit covering the entire design team (with the architect, or other “prime” designer as the first named insured) under a single policy. Such policies are paid for, and issued prior to the commencement of construction, but need not be renewed – they are written for a multi-year term that expires at the end of the project’s completion, after which an extended reporting period (typically 3 to 5 years) applies during which the policy will respond to any claims alleging loss or damage from design or other errors. Benefits include:

- A single limit (and deductible obligation) that will respond to claims against any and all members of the design and CM team, conflicts and “allocation of fault” issues are eliminated – often expediting the dispute resolution process significantly.

- Owners, and in the design build scenario design builders, can sometimes be named for purposes of vicarious liability, which provides owners with defence cost coverage in the event that they are named in a design error claim.
- The policy need not be renewed annually, and the limits are not subject to erosion or exhaustion on unrelated projects.
- Coverage terms and conditions can be customized to meet the particular needs of a given project’s circumstance and delivery method.

The disadvantage is cost. That is the cost of the project specific placement needs to be built into the cost of the project.



Owners' Protective Professional Indemnity (OPPI)

As the name implies, OPPI – unlike the products described previously – is written in the owner's name (not the architect's), and it is the owner that is the named insured. OPPI is analogous to under-insured motorists' coverage. The product sits excess and "DIC" of the architect's annualized practice policy, protecting an owner against damages resulting from errors or omissions on the part of the design team for which the architect or engineer's policy is either inadequate or otherwise not available. OPPI coverage includes the following notable benefits:

- **Excess indemnity provision:** On first-party claims brought by owner against the design team, OPPI indemnifies owner for loss or damage in excess of the limits available from the architect and its subconsultants. If the architect's contractually-required limits are available, and the OPPI attaches as true "excess" coverage, no deductible or self-insured retention will apply.
- **Primary coverage:** If the architect's policy limits are not available due to having been exhausted by an unrelated claim, OPPI will respond on a primary basis, subject to a self-insured retention (SIR).
- **"DIC" coverage:** The scope of coverage provided within OPPI policies is often broader than that provided under the annualized policies purchased by design firms to cover their practices generally. If an owner's claim is excluded by the architect's professional liability policy and the OPPI policy's terms and conditions are broader due to a "difference in condition," the OPPI will again drop down and respond as primary coverage, paying owner's loss or damage, subject to the SIR.
- **Third-party coverage:** If a third party sues an owner alleging direct liability for design, construction management, or other relevant professional services, the OPPI provides owner with a defense and indemnity to and against any such claims. It bears noting that some OPPI forms include "development activities" in the definition of professional services which can be a significant benefit to developer/owners that may not otherwise have adequate errors and omissions coverage.
- **No subrogation:** While the owner is the only named insured and direct beneficiary, architects, engineers, and construction managers get significant protection as well. To the extent that the architect has its contractually-required limits intact and available at the time of a claim, OPPI policies do not permit any subrogation action against the design team seeking recovery of damages paid to the owner as a result of the design team's error and omissions.

- **Accommodation of limitation of liability clauses:**
Some projects have such significant professional liability exposure (e.g., power plants, stadiums, large infrastructure projects) that even very large design firms buying tens or hundreds of millions of dollars of professional liability limits are not willing to expose the entirety of those limits. In such instances, OPPI coverage can be structured to attach (sit excess of) at some contractually agreed limitation of liability, rather than at exhaustion of the prime design firm's policy limit.



Contractors' Protective Professional Indemnity (CPPI)

As the name implies, CPPI – unlike the products described previously – is written in the general contractor's name (not the architect's), and it is the contractor that is the named insured who is protected from losses arising out of negligent professional services performed either by themselves or by design professional for whom the general contractor is legally responsible. The product can also sit excess and "DIC" of the design professional's annualized practice policy, protecting the general contractor against losses resulting from errors or omissions on the part of the design professional for which the design professional's policy is either inadequate or otherwise not available. CPPI coverage includes the following notable benefits:

- **Third-party coverage:** If a third party sues a general contractor alleging direct liability for design, construction management, or other relevant professional services, the CPPI provides general contractor with a defense and indemnity to and against any such claims.
- **Excess indemnity provision:** On first-party claims brought by general contractor against the design professional, CPPI indemnifies general contractor for loss or damage in excess of the limits available from the design professional. If the design professional's contractually-required limits are available, and the CPPI attaches as true "excess" coverage, no deductible or self-insured retention will apply.
- **Primary coverage:** If the design professional's policy limits are not available due to having or exhausted by an unrelated claim, CPPI will respond on a primary basis, subject to a self-insured retention (SIR).
- **"DIC" coverage:** The scope of coverage provided within CPPI policies is often broader than that provided under the annualized policies purchased by design firms to cover their practices generally. If a general contractor's claim is excluded by the architect's professional liability policy and the CPPI policy's terms and conditions are broader due to a "difference in condition," the CPPI will again drop down and respond as primary coverage, paying general contractor's loss or damage, subject to the SIR.
- **No subrogation:** While the general contractor is the only named insured and direct beneficiary, architects, engineers, and construction managers get significant protection as well. To the extent that the design professional has its contractually-required limits intact and available at the time of a claim, CPPI policy does not permit any subrogation action against the design team seeking recovery of damages paid out as a result of the design team's error and omissions.
- **Accommodation of limitation of liability clauses:** Some projects have such significant professional liability exposure (e.g., power plants, stadiums, large infrastructure projects) that even very large design firms buying tens or hundreds of millions of dollars of professional liability limits are not willing to expose the entirety of those limits. In such instances, CPPI coverage can be structured to attach (sit excess of) at some contractually agreed limitation of liability, rather than at exhaustion of the prime design firm's policy limit.

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For more than 160 years, in one form or another, Aon Reed Stenhouse has been a major force in the Canadian insurance industry.

Aon Reed Stenhouse, operating under the brand name Aon Risk Solutions, is Canada's leading insurance brokerage and risk management services firm. We serve an extensive client base, handling more than \$2 billion in annual premiums on behalf of our clients.

- Insurance brokerage
- Risk management
- Employee health and benefits

Our 1,600 professionals serve clients from 23 offices located across Canada. We provide our clients with a wide range of innovative solutions. Each day, Aon professionals work to deliver the best solutions to our clients.

About Aon

Aon plc (NYSE:AON) is the leading global provider of risk management, insurance and reinsurance brokerage, and human resources solutions and outsourcing services. Through its more than 72,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative and effective risk and people solutions and through industry-leading global resources and technical expertise. Aon has been named repeatedly as the world's best broker, best insurance intermediary, best reinsurance intermediary, best captives manager, and best employee benefits consulting firm by multiple industry sources. Visit aon.com for more information on Aon and aon.com/manchesterunited to learn about Aon's global partnership with Manchester United.

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