

PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 03/99: "when Owners Demand Higher Limits"

March, 1999

When Owners Demand Higher Limits

It's an ideal project! Large fees, a reasonable schedule, and the building type is right up your alley. There's only one problem. The owner is demanding higher limits for professional liability than you currently carry. Not only that, they're asking for guaranteed coverage for a number of years.

We all know that professional liability insurance is offered on a claims-made basis. Since it only covers claims made and reported during the term of the policy, there's no way you can guarantee that coverage will be there five or ten years down the road when a potential claim may arise.

And even if you can afford the higher policy limits they want, what if another claim arose that ate into those limits? That would leave the owner with less coverage than expected – and maybe no coverage at all.

Fortunately there are a number of options that can help appease a demanding owner and not cost you an arm and a leg to provide the needed coverage.

Higher Limits

You currently carry \$1 million in professional liability limits, but the owner wants \$5 million. Can you afford it? Today, more than ever, professional liability limits are very affordable. With

claims severity on the rise – not to mention the ever-increasing number of projects you have worked on over the years that are now subject to potential claims – higher limits may be in order regardless of this current owner's demands.

Other options available are less expensive than raising your overall policy limit, but will still satisfy your clients' demands:

1. Specific project excess – It is possible to maintain your current limit on your practice policy while purchasing a higher limit to cover this specific project.

For example, you can maintain a \$1 million practice policy and purchase a \$4 million excess limit on this one project for substantially less than raising your entire policy to \$5 million.

2. Specific project primary insurance – This endorsement provides primary insurance to cover a specific project, with the practice policy limit

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then becoming excess.

The principal advantage to the design professional is that the specific limits must be exhausted before the practice policy limits can be accessed.

3. Specific owner excess – This is similar to specific project excess, except the higher limits apply to all projects performed for a particular owner.

4. Split limits – Instead of purchasing a \$5 million practice policy you might purchase a \$2 million/ \$5 million split limits policy. Here, the policy limit on a single claim is capped at \$2 million, but the total coverage for any one year is \$5 million.

This eliminates the chances that your policy would be wiped out by another claim and increases the chances that coverage will be there for your new client's project.

The problem with any of the above options (which are all endorsements to your practice policy and not stand-alone policies) is that the owner still has no guarantee that coverage will be there five to ten years down the road when it may be needed.

In the future, you could lower your practice policy limits, or drop coverage entirely. And what about all the other consultants and sub-consultants working on the project? Are they all going to have adequate limits as well?

Perhaps your potential new client is not aware of another option that can not only provide the higher limits desired, but can guarantee that the coverage will be there up to five years (sometimes longer) following project completion.

At the same time, this option could reduce the future premiums on your practice policy, because the fees you collect on this project will be deducted from the annual fees used to calculate your practice policy premium. This valuable alternative is called "Project Professional Liability Insurance."

Liability Insurance

Traditionally, project owners have had to rely on design firms to maintain individual practice policies to provide professional liability protection. This presents coverage uncertainties for the owner due to the potential that other claims may be filed against the design firm, not to mention that the design firm could either reduce or even drop insurance coverage entirely.

What's more, project insurance eliminates the owner's administrative burden of gathering and tracking multiple certificates of insurance from design team members. With a project policy, the owner realizes the following benefits:

- A single policy for a single project – All members of the design team can be covered under one policy. The owner and the prime professional gain greater flexibility in selecting design team members. Practice policy limits become a moot point.
- Full control over policy terms – The owner chooses the policy limits and the duration of coverage, available up to five years (occasionally longer) after substantial completion. The coverage can begin with the design phase or just prior to the start of construction. Owners no longer have to worry about a design firm dropping coverage or lowering limits.
- Guaranteed coverage – Coverage is written for a guaranteed term of up to ten years. Most project policies are noncancelable as long as premiums are paid, policy conditions aren't breached and no material misrepresentations or concealment have been made on the application.
- No premium rate surprises – Like a contractor's surety bond, the project policy premium is determined according to a guaranteed rate based on final construction cost. Premium rates are typically set per thousand dollars of construction cost (currently averaging about \$5 per thousand of construction costs). So if project construction costs are adjusted up or down, the premium is adjusted accordingly. The

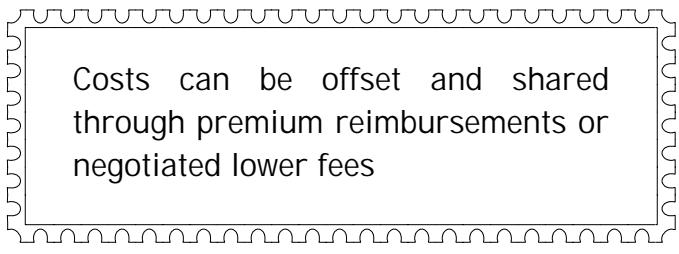
Project Professional

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- premium rate per thousand of final construction cost, however, is locked in at policy inception.
- Dedicated limits – The policy limits cover the owner's project – and that project only. There is no chance of limits being exhausted by another project owner's claims.
 - Single-point claims responsibility – Insuring the entire design team with one policy makes it easier to solve problems with less finger pointing and more cooperation. The owner deals with one insurance company for all design-related professional liability issues.
 - Additional options to fit specific needs – Some insurers offer unique value-added services to their project policies that can help ensure a smooth-running project that comes in on time, on budget.

For example, the insurer may provide loss prevention training for the design team or share the cost of a formal "partnering" program to promote a commitment to common goals and effective problem solving among project participants.

So what's the catch? Why would an owner turn



Costs can be offset and shared through premium reimbursements or negotiated lower fees

down the project policy option? Typically, project owners must pay for the project policies, since they benefit most from the coverage.

However, costs can be offset and shared with design firms through premium reimbursements or negotiated lower fees. (Since fees on the project likely won't be counted to determine the design firm's practice policy premiums, designers save money when working on projects covered by project policies.)

Brokers who specialize in professional liability insurance for architects and engineers are invaluable in arranging project insurance. They can answer coverage questions for the owner, handle implementation and provide loss prevention assistance.

Brokers can advise on contractual agreements that are uninsurable under a project policy and work to tailor coverage to serve the owner's needs. They can also help the owner determine the best way to structure the cost of the coverage. The broker's services to the owner and the design team are available through the life of the project.

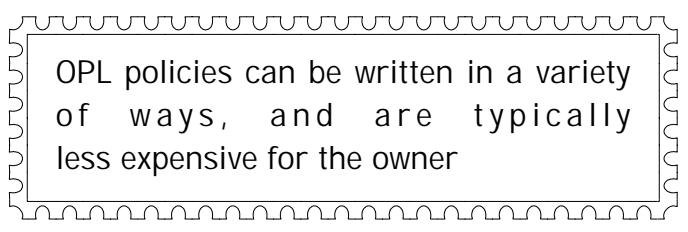
Despite the advantages, some owners may be unwilling to incur the cost of a project policy. A less expensive alternative may be an "owners professional liability insurance" policy.

Owners Professional Liability Insurance

An Owners Professional Liability (OPL) policy provides protection for the project owner in the form of excess coverage over and beyond the architect/engineers' underlying practice policy. In other words, if a claim should arise, the design team's individual practice policies would provide primary coverage. If their limits were unavailable or depleted, the OPL policy would come into effect to cover some or all of the additional damages, depending on the policy conditions and limits.

Because the OPL policy comes into force only after the practice policy of the design firm has been exhausted or is otherwise unavailable, owners professional liability insurance is typically less expensive for the owner than a practice policy.

Owners professional liability policies can be purchased annually or on a project-specific basis.



OPL policies can be written in a variety of ways, and are typically less expensive for the owner

Environmental engineering exposures can also be covered.

If the owner has an incidental design exposure or a design professional on staff, coverage can be extended to cover that exposure as well.

Owners professional liability policies can be written in a variety of ways. Typically, the policy applies when (a) the design firm's underlying policy limits

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are exhausted, or (b) when damages reach a pre-determined, per claim self-insured retention amount, whichever figure is higher.

The self-insured retention amount may automatically come into effect when the design firm's policy has been reduced below a certain level because of other claims, or when the firm failed to maintain the minimum amount of coverage specified in the OPL policy.

The policy usually does not cover the expense to the owner in bringing the claim. This exclusion of defense costs is necessary in order to discourage owners from bringing frivolous lawsuits against their design firms. The OPL would cover excess defense costs from a third-party claim against the owner that is ultimately determined to be the result of negligence on the part of

a covered design firm.

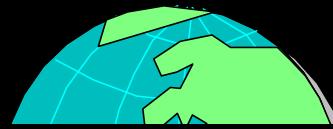
Your Broker is Your Ally

More and more, design firms are finding owners with increased demands for professional liability coverage. As shown above, there are a number of options that design firms can discuss with project owners, including excess policies, project policies and owners professional liability insurance.

A qualified professional liability broker should be more than willing to help you educate an owner on the various options available, as well as help you bring an owner with unreasonable or uninsurable demands back to realistic coverage expectations. ♦

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

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Have You Been Had?

Tips to detect a fraudulent claim

If a person slips and falls in your business and files a lawsuit against you, how do you know the claim is real?

Insurance fraud is a far too common occurrence, and those who are looking for a quick buck — or maybe a million — search every day for unsuspecting businesses.

Next time, it could be yours. And if the claim is a serious one, it could close your doors forever.

Ask yourself the following questions:

- Does the claimant seem anxious to settle the claim and receive immediate payment?
- Has the claimant sought legal advice?

According to the National Insurance Crime Bureau (NICB), the answers can indicate whether a bodily injury claim could be fraudulent.

If you suspect that an accident victim is not telling the whole truth, call your insurance broker.

You can also call the NICB at 800-TEL-NICB, or visit them at www.nicb.org for additional information about insurance fraud. ♦