

Construction Industry Update

Design Build: Risk Management and Insurance Considerations

BY JEFF CAVIGNAC, CPCU, ARM, RPLU, CRIS
PRESIDENT—CAVIGNAC & ASSOCIATES

The Design Build Project Delivery System, which dates back to at least the master builders of ancient Greece, continues to gain in popularity. The major appeal of design build is that it provides the project owner with a single point of contact for both design and construction. This can lead to both lower costs and compressed construction schedules. A recent study by the Federal Highway Administration (FHWA) determined that on average, design build projects were completed 14% faster than the traditional "design-bid-build" projects. Design build projects, however, expose contractors to risks that they don't have under the traditional delivery method. The additional exposure arises out of what is known as the "Spearin Doctrine."

The Spearin Doctrine traces its roots back to a 1918 United States Supreme Court decision (*United States v. Spearin* [248 U.S. 132]). Basically, when the project owner provides information (plans and specifications to build a project) the owner impliedly warrants that they are acceptable. The contractor will not be liable to the owner for loss or damage which results from the insufficiencies or defects in the plans. When the contractor takes on responsibility for design, the protection provided by the Spearin Doctrine is taken away. Since the contractor is responsible for design, he/she is also responsible for damages and costs arising out of inaccurate or flawed

design documents. Although a majority of the risk can be transferred contractually to the design professional subconsultant, the contractor still retains additional exposure.

Risk Management Considerations

Because of the increased potential liabilities arising out of Design Build projects, the contract between the parties takes on added significance. Careful attention needs to be paid to each party's work scope, indemnification clauses, insurance requirements, and dispute resolution provisions. The Design Build Institute of America (www.dbia.org) has done a thorough job of drafting appropriate design-build contract documents. The AIA, EJCDC and AGC have also published standard form agreements for this project delivery method. These "template" documents are good starting points, but need to be amended to fit each specific project.

Work Scope To maximize the benefits of design build, it is essential that each party's responsibilities and obligations be clearly defined under the contract. This applies to both the Owner/Contractor Agreement and the Contractor/Design Professional Agreement. A well written Scope of Services will spell out what each party will and will not do, and what they can do for an additional fee. It is critical that this be clear at the outset; if it isn't, spend some time and get it right. If you can't agree on who is supposed to do what at the start of the project when everyone is on good terms, you certainly won't be able to figure it out at the end of a project when relationships may have deteriorated.

A Scope of Services agreement will not only decrease misunderstandings as to who is responsible for what; it can also prevent duplication of effort. Likewise a

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“teaming agreement” is helpful to make sure that all parties to the project work together to maximize project successes and minimize potential disputes.

Indemnification The indemnity agreements are critical – both the contractor’s obligation to indemnify the owner and the design professional’s obligation to indemnify the contractor (assuming the contractor is subbing out the design). In many cases, the owner will require the general contractor to execute a Type I indemnity in the owner’s favor. With a Type I indemnity, the indemnitor (in this case the contractor) is responsible for everything that goes wrong on a project unless the indemnitee (the owner) is solely (100%) negligent. While this isn’t fair, it is legal, and for the most part insurable under a Contractors General Liability policy. Unfortunately, most design professionals will resist signing a similar indemnity in the contractor’s favor. The reason for this is that the contractual liability coverage provided under a design professional’s professional liability policy is not as broad as the contractual coverage in the Contractors General Liability policy. Whereas the general contractor is probably insured if they sign this type of agreement, the design professional will not be. The ultimate indemnity the design professional is willing to agree to will come down to a negotiation between the contractor and design professional. For a detailed discussion on indemnities you can review our position paper on the topic here.

Insurance An integrated insurance program is critical to any construction project. The project owner, contractor, and design professional all have insurance issues to deal with, and these should be clearly spelled out in the agreement.

Builders Risk Insurance Builders Risk Insurance, also known as Course of Construction Insurance, is a first party property insurance that covers the real property during construction. Whether this is secured by the owner (which we recommend), or the contractor, several elements should not be overlooked:

- Coverage should be written on a "special peril" (all risk) basis.
- Hard costs (cost of construction) and soft costs (design costs, finance charges, insurance

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premiums, future profits) should be carefully evaluated to make sure the limits are appropriate.

- All stakeholders should be named insureds on the policy.
- The value of a well written builders risk policy should not be underestimated. It is always better to have a loss paid under a property policy than a liability policy (a liability policy is usually triggered by a lawsuit).

The Contractors Insurance Insuring a design build project from a general liability, automobile, and workers compensation standpoint is not much different from a design-bid-build project. The challenge is the "Professional Liability" exposure that the contractor assumed when taking on responsibility for the "design." Certainly the contractor should ask the design professional to indemnify them from the design professional’s negligence. Most if not all design



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professionals will be agreeable to this; however there are some issues a contractor should be aware of:

- A design professional liability policy only provides coverage if the design professional is negligent. The law does not require the design professional to be perfect, and the perfect set of plans has yet to be drafted. In other words, there can be errors in the plans that don't fall below the standard of care. In situations like this the design professional is not negligent; the contractor will have to bear this risk.
- A design professional liability policy is written on a "claims made and reported" basis (as opposed to most General Liability policies which are written on an occurrence basis). If the design professional drops their coverage before a claim is made, there will be no coverage, even if they had the insurance when they did the design.
- A design professional liability policy covers all the work the design professional has done. It is conceivable that when a claim is made against them, their limits could have been exhausted by other claims.
- Design Professionals historically have not carried significant limits of coverage. \$1,000,000 or \$2,000,000 in total limits is common, even for firms designing significant structures. As mentioned, above this limit is for all the design

firm's work and also includes defense costs within the limit.

For these reasons contractors should strongly consider purchasing Contractors Professional Liability insurance. Contractors Professional Liability Insurance (CPL) not only covers the Contractor for its legal liability arising out of its own professional services, but also protects the Contractor from its vicarious liability arising out of the negligence of its subconsultants. In addition to Professional Liability, a CPL policy can also include Contractors Pollution coverage. Since there is no guarantee that the design professional's insurance will be in force when a claim is made, purchase of a CPL policy is the only way to make sure that coverage will be available.

Although a number of insurance companies offer this coverage, all policy forms are different and should be evaluated carefully. (For a better understanding of Contractors Professional Liability insurance, see our July 2010 newsletter on the topic here.)

Dispute Resolution Identifying potential problems and resolving disputes in a timely matter is critical to the success of a project. Stakeholders should be encouraged to discuss concerns before they become claims. Ideally these issues are worked out amongst team members. If, however, this is unsuccessful, the next step should be mediation. If mediation is unsuccessful, you have to consider arbitration or litigation. On smaller dollar items arbitration may be appropriate. On larger issues, however, unless both parties agree to arbitration, the default should be litigation. Regardless of whether you have to resort to arbitration or litigation, whenever you use a form of adversarial dispute resolution it gets very expensive and it destroys relationships. This is why, if it is at all possible, the dispute should be settled by the parties to the dispute.

Final Comments

There are pro's and con's to the Design Build delivery system. The pro's however seem to be winning out as Design Build becomes more popular. Effectively managing risk on a Design Build project requires identifying exposures to loss, figuring out ways to reduce the frequency and severity of those exposures, and then arranging appropriate insurance. ✂

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.



Articles courtesy of Cavignac & Associates Employee Benefits Department

LIVE WELL, WORK WELL

Ease Stress to Improve Heart Health

This month, focus on reducing your stress, which can improve your heart health and lower your risk of heart disease.

Did you know that the heart and brain have a significant connection and impact on each other in your body?

Due to this, mental health can have a dramatic effect on heart health, and vice versa.

When you experience stress, which is a response in your brain, the body responds by increasing:

- Blood pressure
- Respiratory rate
- Heart rate
- Oxygen consumption
- Blood flow to skeletal muscles

If you experience frequent stress, you are putting your body at an increased risk for heart disease.

How do you combat stress? There are many strategies and techniques for reducing stress in your life:

- Meditate. Try sitting down in a quiet, comfortable room, and focusing your attention on one word, phrase or image in your mind. Repeat this thing over and over, refocusing if your mind wanders.
- Read a book or listen to calming music.



- Exercise. Getting your blood pumping is an excellent way to relieve stress, and is also great for your

heart.

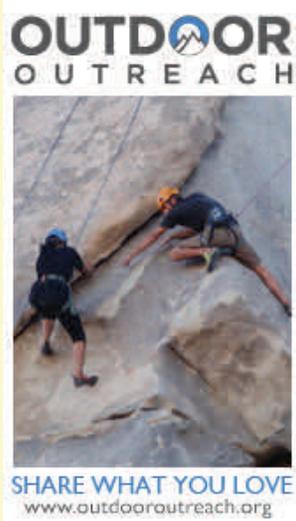
- Eat nutritiously—don't turn to junk food, alcohol or tobacco. Healthy food will energize you, while other options have negative effects on your body.
- Confide in a loved one.
- When feeling overwhelmed, plan and prioritize instead of trying to tackle everything at once. Also try taking a break from the situation.✂

Cut Your Grocery Bill in Half

Looking to save some money on groceries—or anything else you're buying? If you're not taking advantage of couponing, you are leaving hundreds of dollars on the table. Extreme couponing is a trend in the media recently, but you don't have to dedicate your life just to save money with coupons. Here are some tips:

- Look for manufacturer's coupons online or in the newspaper, and always use them when the item is also on sale at the store to maximize your savings.
- When shopping online, browse around for free shipping codes and other coupons before buying.
- Whether buying in-store or online, always shop around.
- Some retailers offer e-newsletters with sales, promotions and coupon codes. Find some and sign up.
- Follow your favorite retailers on social media to stay up to date on sales and "insider" deals.
- Buy according to sales cycles. For example, buy fruit in season, buy summer clothes on sale in August.
- Join daily deal sites, such as Groupon or Living Social.✂





Women Give San Diego

