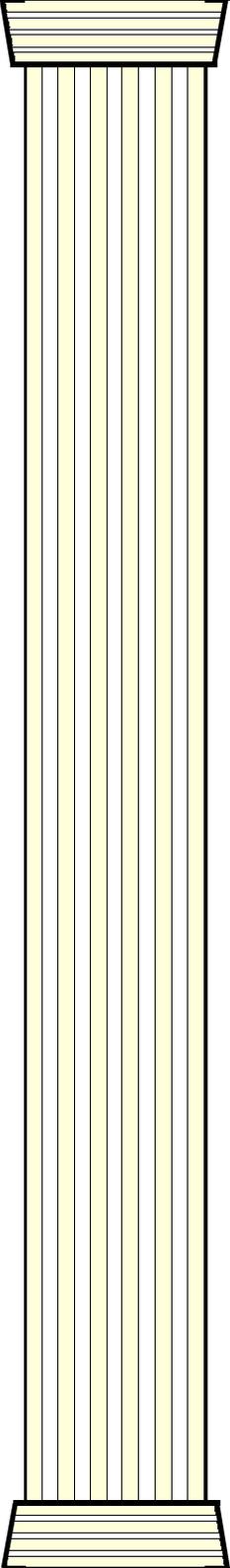

PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 11/01: OCIPs: How Much Protection Do They Provide for a Design Professional?

November, 2001



Owner-Controlled Insurance Programs: How Much Protection Do They Provide for a Design Professional?

Owner-controlled insurance programs (OCIPs) or “wrap-up” programs, as they are sometimes called have been around for many years. Historically, they have been used to insure jumbo projects, usually \$100 million in construction value or larger.

Basically, an OCIP is an insurance program designed to cover the jobsite risks of the owner, contractors and occasionally the design professionals and other consultants on a construction project. The program sponsor (the entity that buys the insurance) purchases certain coverages on behalf of some or all of the parties working at the jobsite rather than having each firm supply its own insurance.

OCIPs commonly include general liability and workers compensation, and can also include builders risk, pollution liability and professional liability insurance coverages.

For larger projects, the main reasons for a wrap-up policy are cost savings and enhanced control from both an insurance and a safety perspective. In Southern California, however, wrap-ups

are being used frequently on multi-family attached housing and other residential construction projects.

The reason that OCIPs are being used on multi-family housing projects in Southern California is due to the fact that typically these types of projects have been fraught with litigation. Many subcontractors are apprehensive about becoming involved in these types of projects, and in some cases can't even get insurance to cover their involvement on such projects. A wrap-up policy enables



ables the developer or owner to attract these subcontractors (and in certain cases, design professionals) that might

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Published by

Cavnac & Associates

INSURANCE BROKERS

License No. OA99520

1230 Columbia Street, Suite 850

San Diego, CA 92101-3547

Phone: 619-234-6848 ♦ Facsimile: 619-234-8601

Website: www.cavnac.com

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not otherwise be interested in working on the project.

A wrap-up policy must be put in force prior to the start of construction. It usually continues through substantial completion of the project plus a number of years thereafter. This period is known as the “extended reporting period” (ERP) or “tail.” Ideally, the tail policy extends through the applicable statute of limitations, which in California is ten years for a latent defect.

The limit of coverage applies for the policy term. In other words, the limit is not reinstated annually. Typically, deductible or self-insured retention starts at about \$25,000, and minimum premiums for residential projects are in the \$75,000 to \$100,000 range. On larger project in which the minimum is not a factor, the rate averages approximately .5% to 1% of construction costs, depending on the size of the project, limits, deductibles, and other factors.

Wrap-ups have been put in force on projects with construction values as low as \$1 million, but typically a project must have construction values of \$5 million or larger to have it make sense.

What type of coverage does an OCIP provide for a design professional?

First of all, don’t confuse an OCIP with a professional liability insurance policy. They are not the same. An OCIP policy on a residential project typically only provides commercial general liability coverage. A commercial general liability policy protects the named insured from its legal liability arising out of its negligent operations that result in tangible property damage or bodily injury. It is critical to note that **if there is no tangible property damage or bodily injury, there is no coverage.**

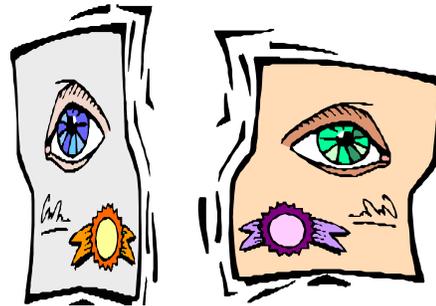
A professional liability policy, on the other hand, covers the design professional’s legal liability, period. There is no requirement that the damages manifest themselves in the form of property damage or bodily injury. As a matter of fact, the majority of claims against design professionals don’t involve either. They involve economic or consequential damages, such as cost overruns, delays, etc.

An OCIP can be endorsed to provide limited coverages for a design professional. If the policy is written correctly, it can be extended to cover the design professional’s negligence if it results in **bodily injury or tangible property damage.**

It is important to note that many construction defect claims involve “tangible property damage.” In other words, a properly written OCIP can provide professional liability type coverage for a design professional if the damages result in tangible property damage or bodily injury. It is still strongly recommended that the design professional retain its own professional liability coverage or purchase a specific project professional liability policy for consequential type damages.

Some of our design professional clients have been comfortable enough with the limited coverage provided by a design professional inclusive wrap-up policy. In these situations, they retain their professional liability practice policies to cover damages other than bodily injury or tangible property damage (i.e., consequential damages).

OCIP policies are unique — no two are alike!



Always have OCIP policies reviewed by both legal counsel and your insurance broker.

We have other design professional clients who go a step further and make certain that the owner purchases a project professional liability policy in addition to the OCIP. If this is the case, the design professional can exclude the fees and the project from their practice policy application, and the fact that they worked on a multi-family housing project will not adversely affect their practice policy pricing. Of course, some of our design professional clients still won’t touch multi-family housing projects at all.

In order to effectively endorse an OCIP policy to provide protection to a design professional, sev-

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eral endorsements are necessary. Specifically, the policy must be endorsed to:

1. Add the design professional onto the policy as a named insured.
2. Extend coverage to the professional services of the design professional.
3. Provide that the OCIP coverage is primary.
4. Amend specific property damage type exclusions within the policy itself.

Collectively, the intent of these endorsements is to cover the design professional for his/her negligent acts, errors or omissions that result in either bodily injury or tangible property damage. However, **an OCIP does not pick up consequential or economic damages**. The design professional will need to rely on her/his own professional liability policy for these types of claims.

The preferred scenario is to purchase a project professional liability policy in addition to the

OCIP. Ideally, this policy would run in tandem with the OCIP, and have a ten year extended reporting period as well. However, these policies are difficult to find, and most professional liability underwriters are apprehensive about extending their policy for the full ten years.

Conclusion

An owner-controlled insurance program can be endorsed to provide construction defect type coverage for the negligent acts, errors or omissions of a design professional (most don't, unless it is specifically negotiated). In addition to the correctly written OCIP policy, however, a design firm will need to obtain either a stand-alone project professional liability policy or rely on its practice policy to supplement the OCIP.

Every OCIP policy is manuscripted. In other words, no two are the same.

We strongly recommend that, prior to entering into or becoming involved in an OCIP, you have the policy reviewed by both legal counsel and your insurance broker. *

***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.*

The Ten Commandments of Loss Prevention

*Excerpted from "Ten Commandments of Loss Prevention" by Gunther O. Carrle, Esq.
Copyright RA&MCO Insurance Services, 1998*

In the next 10 issues of our "Professional Liability Update" newsletter, we will print one of the "Ten Commandments of Loss Prevention" published by RA&MCO Insurance Services.

The commandments are written by Gunther O. Carrle, Esq., an attorney whose practice is limited to the representation of architects and engineers. In addition to his Juris Doctor degree from the University of Pennsylvania Law School, Mr. Carrle also holds a Masters of Engineering degree from Rennselaer Polytechnic Institute with a concentration in structural engineering.

The Concept of "Loss Prevention"

A "loss prevention" program is intended to

- Identify risks

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- Allocate risks to the party best able to handle the risk
- Manage those risks which cannot be transferred

A sound loss prevention program contains four elements:

- Preparation of an Agreement for Services which accurately reflects the client's and your understanding of the scope of your services, the limitations on your obligations and the interplay between you and the other members of the construction process – contractors, consultants, design/build contractors.
- Performance of the Agreement so as to minimize the potential for dispute.
- Recognition and resolution of potential problems when they arise, before they develop into a dispute.
- Proper documentation of the significant events during the project so that, when problems arise, they can be resolved as quickly and as cheaply as possible.

The First Commandment: “Define Your Scope of Services”

Draft a detailed scope of services which avoids ambiguity and creates a definite and clearly understood allocation of obligations in order to avoid a dispute. A scope of services that merely attempts to avoid obligations without defining what is to be done is more likely to create a dispute than to avoid it.

The scope of services should be drafted with third-parties in mind. In many cases third-parties (and not the parties to the contract) will review and interpret the contract. Specificity is necessary to minimize the likelihood that third-parties can expand your duties by reference to custom and practice. In particular, address typical problem areas – shop drawings, design/build, cost estimates, hazardous substances, certifications, site visits and ownership of documents.

The following questions should be asked when reviewing the intended scope of services:

- Are all services that you intend to render clearly set forth in the scope of services, and do you intend to render all services set forth in the scope of services?
- Does the scope of services address areas that are new to you?
- Has enough time and money been allocated to a particular task? Shop drawing review and site

visits are usually undervalued in relation to the potential for liability.

- Have you defined the circumstances under which you are entitled to additional compensation?
- Are the terms consistent with the terms of any specifications or product references that are incorporated by reference?

Frequently, industry specifications and standards are incorporated by reference without a full understanding of what is contained in the most current edition. Particularly, with regard to an A/E's obligation to conduct reviews and issue approvals, the incorporation of a third-party standard can dramatically alter the A/E's obligations. Concern in this area can be addressed with a provision that provides:

“Nothing contained in any standard specification, manual or code shall operate to alter, modify or expand the duties and responsibilities of the Owner, Contractor or Engineer or any of their consultants, agents or employees from those set forth in the contract documents.”

- Are the terms consistent with the terms of other documents — construction contract, specifications including general conditions?*

Condominium Loss Prevention Checklist

Condominiums are far and away the most liability-prone projects design professionals can undertake. Most underwriters consider Southern California condominium projects to be “guaranteed litigation.”

Nevertheless, condominiums are a housing type that Southern California needs. As more and more projects are being planned for urban areas, these will continue to be a viable source of business for a lot of our design professional clients.

If you are going to pursue condominium projects, there are certain steps you can take to reduce your risk (although you will never even come close to eliminating it). Here is a Condominium Loss Prevention Checklist that you might want to consider prior to entering into a condominium type project:

Checklist

- ☑ **Carefully select** your developer/client. Is there adequate financing? Is there commitment to quality? Has the developer done other condominium projects, and were they successful? Does the developer have a long track record, and is it likely to be around in the future? Will the developer build the project with its own forces, or act as a “paper developer?” What are the contractor selection criteria?
- ☑ **Develop** a **fair agreement** that properly addresses the allocation of risks associated with the project. Be certain it contains most, if not all, of the “Deal Maker” clauses for condominium projects. (“Deal Maker” clauses can be seen on our Website, <http://www.cavnac.com>. Click on this link <http://www.cavnac.com/pdfs/Aee-1297>.
- ☑ **Insist** on a **strong indemnity** from the client/developer, and attempt to negotiate a waiver into your agreement.
- ☑ **Investigate** the availability of **project professional liability** insurance and propose that the owner pay for a separate policy for the design team. Make sure your subconsultants are adequately insured.

[pdf#script](#) (“Publications” section of our website; the 12/97 issue of the Professional Liability Update article entitled “Contract Negotiations,” page two.) Is the developer fair and reasonable regarding the contractual protection you seek?

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- ☑ **Find out** how the developer plans to **market** the project. Will the advertising be realistic? Will your name be used?
 - ☑ **Require** a **project peer review** and a constructibility review of the design.
 - ☑ **Make sure** there are **adequate contingency funds** budgeted for the project that will apply to design defects as well as construction problems.
 - ☑ **Insist** on providing full-service **construction observation** and administration. Watch carefully for any substitutions requested by the developer or contractor. Document clearly any objections you may have.
 - ☑ **Carefully document** all meetings and conversations pertaining to the project. In particular, note any recommendations you make that are not followed by the developer or contractor.
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- ☑ **Develop** a **maintenance manual** and have it incorporated into the homeowners' association by-laws. Require that homeowners be educated about their responsibilities for upkeep and for following the stated recommendations. Make the provisions of the manual binding upon the homeowners' association as well as individual purchasers.
 - ☑ **Require** that the developer have each **purchaser inspect** the unit and common areas for defects, and have the purchaser sign some type of certificate of satisfaction.
 - ☑ **Require** the developer to incorporate an **ADR by Covenant** provision into the CC&Rs.
 - ☑ **Consider** requiring an **Owner-Controlled Insurance Program** that extends coverage for bodily injury and tangible property damage to the design team for their professional services. Coverage should be provided through substantial completion of the construction plus the applicable statute of limitations. *