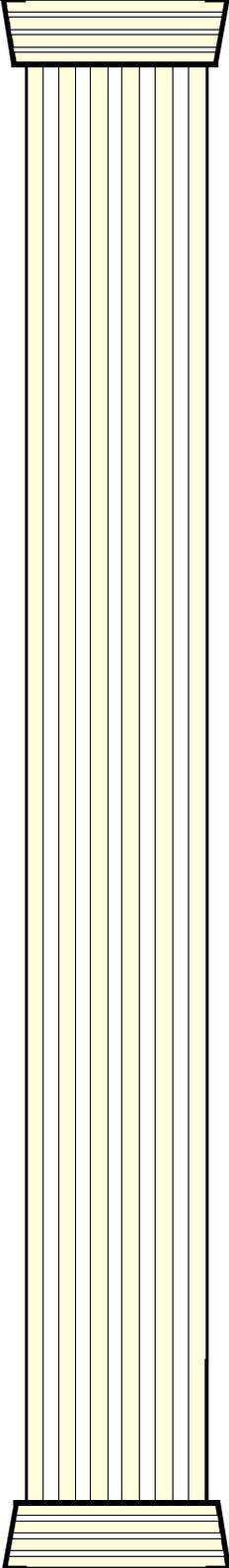

PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 03/2004: "Condominium Projects"

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Condominium Projects Insurance Implications for Design Professionals

By Jeffrey W. Cavnac, CPCU, RPLU

Condominium and other common ownership, multi-family, for sale projects are the riskiest types of projects a design professional can work on. One of the major insurance companies providing professional liability insurance for architects and engineers estimates that a condominium project is ten times more likely to give rise to a claim than a commercial type project, and the loss ratios on these projects range from 228% to over 900%, depending on the discipline.

Nevertheless, condominiums are going to continue to be built, and someone is going to design them. Assuming that "someone" is you, how can you minimize the risk, and what's the best way to insure it?

Contractual Agreements

From a contractual standpoint, a number of items can be incorporated into your agreement with your client.

1. **Contractual Certificate of Merit** – A real certificate of merit, not the watered-down version provided by law in California.

2. **Time Bar to Litigation** – Ideally, this private statute of limitations runs not only from the architect to the developer, but also from the developer to the home buyer. It would set a realistic time frame within which claims could be brought against you, as opposed to our present Statute of Limitations, which is 10 years from substantial completion in most cases.
3. **Corporate Protection, or Limitation to Corporate Assets** – This negates the possibility of litigation against an individual of your firm, and restricts the exposure to the corporate entity.
4. **Indemnification and Additional Insured Status** – We prefer an indemnification agreement running in your favor from the developer wherein

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you are only responsible for your sole negligence. You might also consider making this indemnification personal. In other words, the developer himself, rather than some corporate shell that could easily be folded, is responsible for indemnifying you.

You should also obligate the developer to contractually require his general contractor to (a) hold you harmless and indemnify you and (b) name you to the general liability policy as an additional insured in the same manner that the general contractor is providing these items for the developer.

5. **Limitation of Liability** — You should insist on limiting your liability to your fee or a certain dollar amount. Your fallback position would be to limit your liability to “available” insurance.
6. **Attorneys Fees Clause** – This requires the losing party to pay the prevailing party’s legal costs and fees.
7. **Maintenance Manual** — Require the owner to develop a maintenance manual that requires the homeowners association to maintain the premises in accordance with the manual. The by-laws might also contain an appropriate waiver of damages and indemnity in favor of the owner, the architect, the architect’s subconsultants, and the contractor if the maintenance recommendations contained in the maintenance manual are not performed.
8. **Contingency Fund** — This is a fund wherein a certain amount of money is set aside for possible ambiguities or inconsistencies in the drawings.
9. **Construction Observation Disclaimer** – This defines the limited role the design professional plays during the construction process.

Other Risk Management Considerations

1. **Quality Control During Design And Construction** – A qualified forensic architect or consultant should review your plans before the project is built, and ongoing inspections during construction would ensure quality control. This not only helps build a better product, but also helps

with your defense in the event that you are involved in litigation.

2. **Protective Provisions in Project Documents** – Protective provisions in consumer sales contracts and CC&R’s can also lower your exposure to loss. This would include alternative dispute resolution (ADR) procedures, such as mediation, binding arbitration and waiver of a jury trial, and other provisions, such as notice to the builder of claim defects, builder right of access to inspect, test and repair, and provisions imposing consumer inspection and maintenance obligations on the homeowners.
3. **Proactive Customer Service** – Working with a developer or client that employs well-trained representatives, authorizes response in a timely manner, and is equipped to mobilize rapidly the appropriate trade contractors to respond to customer service issues will also lower your exposure to loss.
4. **Additional Fees** – Recognizing that litigation is a distinct possibility with a condominium project, you might consider including a charge for the ultimate cost of your deductible as well as the time and expense involved in defending a claim. This charge would not be insignificant, and depending on the size of your deductible, might range from \$50,000 to \$100,000 or more.
5. **Pick the Right Team** – A well-built condominium is much less likely to be litigated than a poorly built condominium. It is critical to work with both developers and general contractors that are familiar with and have a track record of successfully building this type of product. Don’t overlook the quality of your subconsultants as well.
6. **Proactive Provisions in New Home Warranties** – Rather than continue to use an off-the-shelf warranty document, you should encourage your builders or clients to take a fresh approach to their warranty as a risk reduction tool. Depending upon State law, the builder may be permitted to include binding ADR provisions in its contracts.

Moreover, virtually every builder warranty can be improved to include a clearer road map of warranty claim procedures, and to include an effective disclaimer of implied warranties.

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7. **Condominium Conversions** – A condominium conversion carries most of the risks inherent in new condominium construction. As a matter of fact, the insurance industry treats them the same. You should take the same steps to protect yourself on a conversion project that you do on new construction.
8. **Apartments** – Apartment projects have a tendency to be converted into condominium projects. The changeover from an apartment to a condo may be perfectly legal, but it substantially increases the designer's liability.

When designing an apartment complex, you can add a provision to your contract that requires the developer to hold you harmless and indemnify you for any liability you may incur except that arising out of your sole negligence.

You can also include a termination provision in your contract that allows you to terminate your services if you learn that a project originally intended to be an apartment is to be converted into condominiums.

Insurance

- **Professional Liability** – There is no ideal solution for professional liability insurance. Certainly you can rely on your practice policy. It is uncommon to see condominium exclusions in a professional liability policy, but this is no guarantee that they won't be there in the future. If condominiums represent too high a percentage of work, it is conceivable that your rates will either go up dramatically or coverage will be unavailable.

As a rule of thumb, most underwriters will allow up to 10% of condominium work; anything between 10% and 20% is underwritten carefully, and anything in excess of 20% could jeopardize your ability to obtain coverage.

- **Professional liability insurance for condominium projects** is virtually non-existent. The last market to write this coverage (Lexington) ceased offering such policies in January 2003. Even when coverage was available, it only provided a few years of extended reporting coverage and had large, per unit deductibles. Since

the majority of construction defect claims are usually brought eight to ten years after substantial completion of the project, the coverage was relatively worthless.

- **Owner Controlled Insurance Programs (OCIPs)** – Although owner controlled insurance programs, also known as “wrap-ups,” are still being written on condominium projects, prior to April 2002 it was not uncommon to extend limited professional liability insurance to design professionals. Coverage was limited to professional liability that resulted in bodily injury or property damage, but did not extend to pure economic damages. Regardless, the limited professional liability option is no longer available.

Conclusion

As previously indicated, condominiums are extremely challenging from a liability perspective. You should also recognize that condominium work will have a material effect on the price and availability of your professional liability insurance coverage.

If you design condominiums, the likelihood is that you will be sued. You can lower your risk contractually, and also transfer some of the risk to an insurance policy, but you can't transfer all the risk. The assistance of an experienced insurance broker and attorney familiar with construction in general and condominiums specifically are a great help in identifying and reducing your exposure to loss.✧

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