

Design-Build Professional Liability: **CGL Policy vs. PL Policy**

Owners, in their continued search for more efficient project delivery, are increasingly turning to design-build, which allows them to contract with a single source to provide both the design and construction of a project. Design-build has historically been utilized primarily by the private sector. Public sector use, while continuing to increase, is typically limited by restrictive legislation and licensing laws. Through the efforts of various design and construction industry associations legislative breakthroughs have occurred at the federal and state government levels, opening the way for increased use of design-build procurement.

A design-build project team may take any of several forms. A firm may be truly integrated, maintaining both design and construction capability in-house; or the needed expertise may be acquired through a subcontract, joint venture, or some other arrangement which best fits the business situation at hand. Industry sources indicate most design-build is contractor-led, with the design subcontracted. The professional liability insurance concerns with contractor-led design-build with subcontracted design are subsequently addressed.

Professional Liability Concerns

Many contractors assume that there is design coverage under their commercial general liability (CGL) insurance policy only to discover after a claim is made that there may be limited coverage at best. While the CGL policy itself does not contain a specific exclusion regarding design-build, coverage afforded is limited to damages which fall within the parameters of “Bodily Injury” and “Property Damage” arising from an “Occurrence” as defined in the policy. Most professional liability claims involve passive economic loss, such as damage from delay due to negligent design, which is not covered by the CGL policy.

One method of expanding CGL coverage involves attachment of ISO endorsement CG 2280 to the CGL policy. This provides limited coverage for professional design services performed in house or under subcontract to a design firm for a design-build project. As with an unendorsed CGL policy, coverage is limited to damages that fall within the parameters of “Bodily Injury” and “Property Damage” arising from an “Occurrence” as defined in the policy. Again, no coverage exists for passive economic loss types of claims.

Alternatively, insurance markets not willing to provide even limited design errors and omissions coverage under the CGL policy may attach ISO endorsement CG 2279. This endorsement specifically excludes “professional services” as defined and thus will entirely preclude coverage for any claim arising from professional design services whether performed in-house or under a subcontract. Thus with the attachment of this endorsement a major design coverage gap exists. However, coverage is still provided for the construction means and methods of the contractor subject to the parameters of an “Occurrence” and “Bodily Injury” and/or “Property Damage” as referenced in the preceding two paragraphs.

To cover the design errors and omissions liability gap, contractors have historically relied upon the design errors and omissions/professional liability policies maintained by the design firms they engage. While this has been a moderately effective solution, it is not a totally satisfactory one in the design-build method of project delivery. A claim example follows to illustrate the design errors and omissions issue present in the design-build project delivery method.

After the building is complete, the owner brings a claim and or a lawsuit against the contractor. The owner alleges that the HVAC system does not adequately control the interior environment; productivity of their work force has been reduced resulting in lost profits; or worse yet the owner has to lease other facilities as the newly constructed building is untenable. The CGL policy may provide a defense, but a coverage gap can occur as noted in the paragraph below.

The CGL policy may respond to the claim associated with the HVAC system provided by a subcontractor in the case of the unendorsed CGL policy or if the policy has ISO CG 2280 attached. However, the loss associated with the alleged passive economic damages, current and future lost productivity and increased expense associated with leasing alternative facilities, do not fall within the definition of “Bodily Injury” and “Property Damage”. Further, an “Occurrence” as defined in the CGL policy may not have transpired as it is difficult if not impossible to determine when a design error took place.

Since a claim has not been made against the design professional, coverage has not been triggered under the errors and omissions policy of the design firm. Thus, the errors and omissions insurance company is not obligated to investigate and defend the claim made against the contractor. Typically the contractor will notify their CGL insurer of the loss and also assert a claim against their design firm partner demanding the design firm provide the contractor with a defense and indemnification. The contractor brings a claim against the design firm based upon the indemnity agreement contained in their contract with the design professional. A further complication may arise as some design errors and omissions policies do not provide coverage for design-build projects. This may result in the contractor being forced to defend and pay for design losses that were assumed to be covered by the errors and omissions policy of the design firm.

The Claims-Made Difference

Another important factor to keep in mind is the fact that design professional liability insurance is available only on a claims-made basis. The term claims-made means just that--the insurance must be in force at the time a claim is made. Thus, if the claim is made and the design professional no longer maintains errors and omissions coverage for what ever reason, or the policy limit has been exhausted by a single claim or a series of smaller claims, there is no coverage (defense or indemnity) for the contractor to rely upon.

The claims-made design errors and omissions policy differs from an occurrence form CGL policy in that the CGL policy simply must have been in force at the time the damage occurs even if a claim is made after a policy has lapsed or expired. Thus, a design-build contractor who subcontracts design is unsure whether design errors and omissions coverage will be in force and with adequate limits at the time a claim is made.

Contractors, in assuming responsibility for both design and construction have sought coverage in their own name for liability arising out of the negligent acts of the design professional. Similarly, owners in adopting the design-build mode of project delivery, i.e. single point responsibility, are requiring evidence of insurance in the name of the entity with whom they contract.

Policy Choices

The insurance market has responded to these issues by developing errors and omissions coverage for the contingent liability when a contractor leading the design-build project subcontracts design. There are several insurance markets that have developed a claims-made annual policy to provide contingent design errors and omissions coverage. Some of these policies may also offer other coverage features such as Value Engineering/Constructability Reviews, Agency Construction Management, At-Risk Construction Management, and job site safety claims to name a few.

Traditional project specific policies are also available for the design team members of a design-build project. However, they have a number of disadvantages when compared to an annual policy. Those disadvantages include: pricing being significantly higher for a project policy versus an annual policy; an application must be completed for each project insured which places an administrative and financial burden on the contractor; and in most cases, a project policy may not cover the project for the relevant length of time that a design claim may be brought under a particular states' Statute of Repose.

Also, available in the marketplace are "Owners Protective Project Indemnity" policies that provide excess limits coverage to owners above the professional liability limits maintained by a design firm. Such policies are yet another alternative to address design exposure under a design-build project. These policies, as they are excess of the primary annual policy of a design firm, can be a more cost effective way of obtaining higher limits dedicated to a specific project when compared to the cost of a traditional project specific professional liability policy.

The development of an annual design errors and omissions policy for the contractors' contingent design liability arising from design-build projects with subcontracted design offers the contractor numerous advantages. The contractor has their own policy in force with coverage limits maintained to adequately protect the assets of the company. Senior management and the risk manager are secure in the knowledge that the errors and omissions insurance company will be there to defend and indemnify the company in the event of a negligent design claim. When bonding is required for a design-build project the surety company may be more inclined to bond the project with such coverage in place.

Conclusions

Allied recommends that its clients discuss their operations in detail with their Account Executive to identify and address, as appropriate, any necessary change in operations before the actual change occurs. Only by undertaking an in-depth and detailed review of all operations can both the client and Allied be in a position to determine an appropriate course of action to implement via a combination of risk mitigation and transfer methodologies for ever changing operations.

The contractor that maintains their own design errors and omissions policy strategically positions their company to respond to the ever increasing demand of owners, lenders and surety companies stipulating that such coverage is in force. If your firm is contemplating use of the design-build project delivery method it is an opportune time to discuss this exposure with your Allied Account Executive.

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Architects, Engineers & Construction insurance veteran Terry Tennant brings a unique combination of professional liability expertise and extensive underwriting, claims and risk management know-how to his role as Senior Vice President of Allied Risk Solutions, a division of Allied North America.