



# CANADIAN DESIGN-BUILD INSTITUTE

## Practice Bulletin #4

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# Project Specific Professional Liability For Design-Build Projects

On a typical design-build project, there is no shortage of professional liability insurance. Many times, perhaps more so in the USA than in Canada, the contractor, the design firm, the design sub-consultants and some sub-contractors all carry professional coverage. It may seem everyone is protected in the event of a loss. But what happens if:

- ◆ The limits available today are gone tomorrow because of a previous loss under the annual renewable coverage due to claims and defense costs eroding aggregate limits?
- ◆ The loss exceeds the limits available?
- ◆ The loss exceeds the design firm's limitation of liability clause in its contract irrespective of higher limits under their professional liability policy?
- ◆ A loss occurs and all of the insurers point fingers at one another instead of settling causing a plethora of potential resultant difficulties?
- ◆ The lead design firm goes out of business and does not renew its coverage?
- ◆ The owner is sued directly, but has no protection because it could not be named as an additional insured on any professional policy due to exclusions such as Insured versus Insured, which would negate protection for the owner?

A solution to the problems described above is to purchase a professional liability policy dedicated to the project. Known commonly as Project Specific Professional Liability Insurance, these policies are negotiated as dedicated limits over a deductible or retention amount and the policy term is from the beginning (preferably a date prior to) of design, through construction plus three to ten years afterward. Project specific policies automatically replace the practice policy of each design team member and may be procured by either the owner or the lead design-builder, although the premium is normally paid entirely by the owner. Coverage can be placed up until the start of construction and **most** underwriters will backdate coverage to the beginning of design or bid preparation. Coverage can be arranged with **some** insurers after the construction start date, but this is a perilous practice as Insurers may deny coverage or restrict it in some way, to avoid the unknown but already sustained event. You also lose significant marketing advantage. The coverage runs for the duration of the project, including usually a maintenance term afterwards. The maintenance term can run for a number of years, six is desirable if available, due to the statute of limitations (in Canada). In any case, the maintenance term should never expire prior to the final warranty expiration date.

The advantages of a project specific professional liability policy include:

- ◆ Non-cancellable coverage, premium and limits are dedicated to the project: reduced threat of eroded limits or other inadequacies.
- ◆ Single source of responsibility for claims: fewer lawyers and fewer insurers arguing over a claim, resulting in hopefully more expedient settlement.

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*A Special Committee of the Canadian Construction Association*

400 - 75 Albert Street, Ottawa, Ontario K1P 5E7  
Tel: (613) 236-9455 Fax: (613) 236-9526 [www.cdbi.org](http://www.cdbi.org)



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- ◆ Coverage for all professional consultants including design work delegated to contractors
- ◆ Owner can be sometimes be named as an additional insured, this varies from insurer to insurer.

### What limit should we buy for our Project Specific Professional Liability Policy?

Unfortunately many organizations purchase coverage according to benchmark analysis. While benchmarks may be a good starting block to establish your beginning limit threshold, we suggest you work with your advisors to identify and if possible roughly quantify the risks inherent with the professional services being rendered. If your advisor says that the rule of thumb is 10% of the project value then we recommend that be substantiated and then you enter a detailed discussion with your advisor about the professional services to be covered, their risks and loss expectations from those risks.

Your advisor will never be able to establish a perfect limit choice, but you will very likely end up with a more comfortable feeling about your choice of limits after having firstly studied the risks. When assessing these risks, take into consideration not only bodily injury and property damage liability potential, but also financial loss, whether brought about by damage to property or not.

### We cannot afford such high limits, this is expensive coverage.

True, professional liability insurance for design-build and other construction related delivery methods remains quite expensive. This is where your "risk appetite" comes in to play. By "risk appetite" we mean your confidence level that there is a low likelihood of a loss combined with your ability to sustain a certain amount of "pain" prior to utilizing the insurance policy.

There are ways to offset the cost of this coverage to some degree, such as:

- ◆ Buy lower limits – as long as you are confident that there will be no claims, but remember that any claims that arise that exceed those limits will have to be accounted for somewhere. ***This is not advisable practice.***
- ◆ Buy higher deductibles/retentions – this is a more common way to offset cost of coverage. This is where the "pain" threshold is better explained. The more of the loss you can contain yourselves, usually the lower the cost of the coverage. One still has to review Insurers' terms to ensure that their lower costs are proportionately worthwhile, as compared with the lower deductibles. There are many approaches to deductibles and retentions and your advisor should be able to review these with you to help you determine the method most suitable to you. (If you are the Owner purchasing the coverage on behalf of the Design-Builder, you will need to take into consideration that the Design Builder may not be able to sustain the same deductible as you can. This may involve a side agreement whereby you indemnify the Design-Builder for a share of the deductible, if you wish to keep costs at the lower level.)

A final word of warning – please always always always ensure that the final contract does not in any way contain indemnification (or other) limitations that conflict with the limits of liability available under the Project Specific Professional Liability policy. This is a sure-fire way to provide an Insurer with a means of denying a claim payment. Before finalizing either the insurance or the contract please give them a double check for consistency.

A key ingredient to a well-designed project specific professional program is working with an experienced insurance advisor. The advisor should have extensive commitment to managing construction risk. In addition they should demonstrate their qualifications through evidence of contractors, design-builders and design firms they represent as well as projects they have been involved with. The advisor should demonstrate an understanding of the unique risks presented by design-build project delivery.

Simon Fenn is the Risk Management Committee Chairman of the CDBI, as well as Senior Vice President and National Construction Leader at Marsh Canada Limited. He encourages your correspondence and inquiries and can be reached at Marsh Canada Limited through the following contact methods:

Telephone – 416 349 4893

E-mail – [simon.j.fenn@marsh.com](mailto:simon.j.fenn@marsh.com)

Facsimile – 416 349 4518