Design-Build Professional Liability Insurance

Are You Covered?

Since 1987, the annual domestic volume of design-build construction has grown from $6 billion to $56 billion. It now represents 18 percent of the non-residential U.S. market, according to Jeffrey L. Beard, executive director of the Washington D.C.-based Design Build Institute of America. Industry observers expect this growth to continue, eventually accounting for 50 percent or more of domestic non-residential construction.

Design-build allows project owners to contract with a single source to provide both the design and construction of a project. Industry sources indicate most design-build is contractor-led, with the design subcontracted.

Professional Liability Concerns

Many contractors assume they have design coverage under their commercial general liability insurance policy; only after a claim is made do they discover that there may have only limited coverage at best. While the CGL policy itself does not contain a specific exclusion regarding design-build, available coverage is limited. Most professional liability claims involve passive economic loss, such as damage from delay, which is not covered by a CGL policy.

One method of expanding coverage involves adding an endorsement to the policy. The endorsement would provide limited coverage for professional design services performed in-house or under subcontract to a design firm. As with an unendorsed CGL policy coverage is limited. Again, no coverage exists for claims involving passive economic loss.

Alternatively, insurance markets not willing to even provide limited design services coverage under the CGL policy may attach an endorsement specifically excluding professional services. This will entirely preclude coverage for any claim arising from professional design services, whether performed in-house or under a subcontract. A major design coverage gap exists with this type of attachment. However, coverage is still provided for the construction means and methods of the contractor.

To cover the design liability gap, contractors have historically relied on the design errors and omissions/professional liability policies maintained by the design firms they engage. While this has been moderately effective, it is not a total solution in the design-build method of project delivery.

For example, let us say that after a building is completed, 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. Workforce productivity has been reduced, resulting in lost profits. Or, worse yet, the owner must lease other facilities because the newly constructed building is untenable. The CGL policy may provide a defense, but a coverage gap can occur.

The CGL policy may cover the claim associated with the HVAC system provided by a subcontractor in the case of the unendorsed CGL policy, or if the policy has been endorsed to cover professional services. But 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 taken place, as it is difficult to determine when a design error occurred.

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

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contractor will notify its CGL insurer of the loss and assert a claim against the design firm partner demanding it provide defense and indemnification. The contractor brings a claim against the design firm based on the indemnity agreement in its contract with the design professional. A complication may arise as some design errors and omissions policies do not provide coverage for design-build projects. This can result in the contractor being forced to defend and pay for design losses.

**The Claims-Made Difference**

Another important factor is 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, or the policy limit has been exhausted by a series of smaller claims, there is no coverage (defense or indemnity) on which the contractor can rely.

The claims-made design errors and omissions policy differs from an occurrence form CGL policy in that the CGL policy must be in force at the time the damage occurs even if a claim is made after a policy has 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 when 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.

The insurance market has responded to these issues by developing errors and omissions coverage for the contingent design liability when a contractor leading the design-build project subcontracts design. Several insurance markets have developed a claims-made annual policy to provide contingent design errors and omissions coverage. Some of these policies also may offer other coverage features, such as value engineering/constructability reviews, agency construction management, at-risk construction management and jobsite safety claims. Contractors should discuss company operations in detail with their
insurance agent and obtain a policy to best address their coverage needs.

**Policy Choices**

An annual design errors and omissions policy for the contractors’ contingent design liability offers the contractor numerous advantages. The contractor has its 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, a surety company may be more inclined to bond the project with such coverage in place. Project-specific policies are still available for members of the design team in a design-build project. However, compared to annual policies, they have a number of disadvantages, including these:

- Contractors are not a named insured and are not entitled to the same rights and privileges.
- The policies are priced significantly higher.
- These policies require applications from all design team members, which places an administrative and financial burden on the contractor.
- They may not cover a project for the full period that a design claim may be made under a particular state’s statute of repose.

A contracting company that maintains its own design errors and omissions policy strategically positions itself to respond to the ever-increasing demand of owners, lenders and surety companies who require such coverage be in force. Now may be an opportune time to review your current insurance program if your firm is considering the design-build project delivery method.

**About the Author**

With 11 years of insurance-industry experience, Terry R Tennant, is a design-build consultant with CNA PRO, a unit of CNA. He is a member of the Associated General Contractors of America and the Design-Build Institute of America. He also serves on the Insurance and Surety Committee of the Builders Association of Greater Chicago and the Legal and Licensing Issues Committee of DBIA.