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Mitigating Design-Build Risks

CONSTRUCTION RISKS ARE MORE BROAD AND COSTLY THAN EVER. KNOWING WHAT THEY ARE CAN HELP PREVENT LIABILITY PROBLEMS.

Design-build has become a growing phenomenon within the commercial building industry. According to the Design Build Industry of America (DBIA), “over half of owners have already or will use design-build in the next five years.” This represents approximately 44% of the construction spending expected to take place in the nonresidential, highway/street and water/wastewater marketplace by 2021.

As a result, contractors and construction firms are increasingly incorporating in-house design capabilities into their services and business initiatives. According to the 2019 AGC Risk study conducted by FMI, “over 43% of contractors are implementing in-house design capabilities” with 25% of the remaining respondents saying they’re likely to consider those services in the future due in large part to the methodology’s many advantages.

INCREASED CONTRACTOR ACCOUNTABILITY

While blurring the lines between the traditional roles of all the players, the contractor stands as the single-point-of-contact for every project detail. The success and financial rewards as well as the liability, complaints and potential litigation all fall squarely on the prime’s shoulders.

For these reasons, the risks have never been broader, more intense and costlier for design-build contractors. This is especially true for those builders looking to expand in-house capabilities with design services.

BULKED UP RISK MANAGEMENT

Subsequently, many firms are strengthening their risk management strategies with Contractor’s Professional Liability (CPrL) policies to cover the damages arising from the negligent acts, errors and omissions performed by or on behalf of any construction firm. This includes construction firms

that are currently expanding their services with in-house design capabilities to better accommodate the increase in design-build opportunities.

In fact, some CPRL programs now offer first-party coverage, such as “protective” or rectification coverage (otherwise known as mitigation) to better protect against design problems and challenges. For example:

- **Protective Indemnity** (first party) will protect against the damages incurred by the insured (contractor) that the insured is legally entitled to recover from design professional errors. As excess coverage, it also pays for the delta between the total damages and the damages paid by the professional liability limits available to the insured from the design professional. This is especially pertinent for contractors, who subcontract design/build activities to third-party design professionals (DP).
- **Rectification/Mitigation** (first party) pays for expenses reasonably incurred during the mitigation or rectification of a negligent act, error, or omission arising from professional services (performed by or on behalf of the insured) that would otherwise lead to a professional liability claim. In addition, rectification coverage essentially replaces the DP’s insurance solely with respect to the costs incurred by the named insured to remedy the design errors discovered in the course of construction and would have resulted in professional liability claims.

ENHANCED EXPOSURES

During a recent analysis of RT Specialty’s ECP book of business, we found that nearly 40% of the CPRL claims made throughout 2016 and 2017 consisted of design and in-house engineering errors. These findings were further supported by the AGC/FMI’s 2018 risk study in which 92% of its participants admitted that design documents they received were less complete than in the past. Some of the contributing factors included more owner-driven schedules that demand quicker delivery times and an inadequate sharing of the associated design and construction risks.

In the past, such problems led to numerous claims and settlements.

For instance, a contractor hired an engineer



Important Issues to Consider

With design-build, everything from design and construction to the management of subcontractors and specification of materials are under the prime contractor’s purview.

Contractors, however, often enter design-build agreements without fully understanding the depth of their responsibilities or even properly implementing the methods needed to establish direct communications between construction and design teams.

This is particularly concerning in an environment that is terribly unforgiving of the big and small errors that can result in costly delays, overrun budgets and the dire financial consequences that in extreme circumstances can actually ruin companies and businesses.

to develop the preliminary design of a bridge to be built over the Intracoastal Waterway. The contractor used the plan to win the design-build contract that was \$6 million less than other bids. Since the preliminary plan was under-designed, the contractor was responsible for supplying the 400,000 pounds of steel needed to complete the project. Given the design-build bid was won with a guaranteed maximum price, the contractor was obligated to finish the project with little room built in for errors or delays.

The engineer’s exposure was in excess of policy limits, so the claim settled for \$1,091,000.

Another example occurred when an architect was retained by a design-builder to design loft condominiums. Built in a commercially zoned area, the sleeping spaces were constructed as live/work lofts. Once completed, the homeowners association sued the developer due to noise complaints from all 46 unit owners.

The architect’s counsel determined that a jury would have decided against their client, and the claim was settled for \$125,000.

EXPANDING CPRL COVERAGE

Ever-evolving to support the needs of design-build contractors, insurers have steadily expanded the coverage terms of CPRL policies by loosening protective and rectification restrictions; widening professional service definitions; and providing more consistent offerings paired with competitive pricing options. Today’s market also consists of approximately 30 domestic and international carriers that regularly supply rate reductions to the firms, which demonstrates a consistent revenue increase pending the absence of adverse claims and a static palate of services. This includes project-specific coverages for smaller-sized projects (construction values less than \$100 million), stable rates for larger projects and limited faulty workmanship coverage.

In a market that’s always looking for the next competitive advantage, CPRL is becoming the go-to risk management method to protect against potentially catastrophic claims that commonly result in eight-figure demands. **NU**

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