

## At Issue

# Advancements of Professional and Environmental Liability Insurance Products for Construction Firms

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The insurance marketplace has greatly expanded over the past two to three years to accommodate the growing demands of the construction industry for enhanced and encompassing forms of environmental and professional liability coverage. As a result, the market now consists of a variety of policies that address these risks with an assortment of new products as well as old ones that have been updated with new twists.

### **CONTRACTORS PROFESSIONAL LIABILITY PRODUCTS**

Traditionally, construction firms were

viewed as providing a tangible product or work that could be specified and measured in one way or another. Today, many contractors are hired based upon their expertise, experience, and qualifications - depending on the project delivery method and are treated more as construction "professionals." While this may more accurately describe the role contractors actually play in the building process, it also exposes the firm to a different type of liability - professional liability. This role or service crosses over into the realm of professional services where standards of care can be established - bringing about new liabilities that now need attention and management.

In addition, the possible exposure to professional liability has also been greatly advanced in the construction industry by trends that now include the creation of construction team collaborations. For instance, programs such as Leadership in Energy and Environmental Design (LEEDS), Building Information Modeling (BIM), Private Public Partnerships (P3) and Integrated Project Delivery (IPD) have all caused contractors to enter the construction process earlier so owners and designers can capture their expertise at the very outset of the project planning phase. Unfortunately, while this can offer a prudent and common sense approach to construction, it can also directly in-

crease a contractor's professional liability risks.

As a result, most contractors should strongly consider some form of contractor's professional liability (CPrL) that provides coverage against third party suits alleging negligence in the performance of professional services. In fact, in recent years asset protection and the demands of owners and general contractors (GCs) have been among the leading drivers of CPrL insurance purchases. This is due to the increased awareness of exposures and the potential for professional liability among owners and GCs as well as the desire of contractors to finance professional liability loss through CPrL coverages.

In addition, contractors who purchase CPrL coverage will be better enabled to bid projects that pose potential professional liability risks, while offering greater protection to their organizations.

## **CONTRACTORS' PROFESSIONAL LIABILITY (CPRL)**

CPrL is a third party liability policy providing coverage for damages that result from negligent acts, errors and omissions in professional services performed by or on behalf of the named insured. It is also available for all types of firms performing construction services including design-builders, construction managers (at-risk and agency), general contractors (involved in various pre-construction consulting), environmental engineering/remediation firms and specialty trades such as Mechanical/Electrical/Plumbing (MEP) contractors, who are typically responsible for both design and installation.

CPrL is also offered on both practice/blanket as well as project policies. However, many insurance companies will only offer CPrL on a project policy if they currently insure that specific construction firm. This puts a tremendous burden on the contractors who are required to carry CPrL via contract but have no practice program in place. Terms for practice programs are annual while project terms range between three to five years with extended reporting periods (ERP) available up to 10 years. However, the common practice is to limit the total program to 10 years, which includes the construction period plus ERP.

Today, approximately 15 domestic and foreign carriers offer various forms of CPrL coverage. However, this market can be difficult to navigate since nearly all offer dramatically different appetites. For example, one carrier may offer CPrL to environmental firms while another may only provide it to construction managers, design/build firms and non-environmental construction companies. In addition, some of these insurers will only take an excess position or cover smaller or middle market specialty trade contractors.

Furthermore, each of these carriers offer their own manuscripted policies, making it necessary for contractors to pay special attention to wording accuracy. It is estimated that annual CPrL premiums are in the \$300,000,000 range and growing at a rate of about 15 - 20% each year.

## **COMBINED CPRL WITH CONTRACTORS POLLUTION LIABILITY (CPL)**

Combined CPrL and Contractor Pollution Liability (CPL) programs were created to offer a cost-effective financing solution to contracting firms possessing both professional liability and environmental liability exposures. Simply put, CPL insurance covers bodily injury, property damage, defense and clean-up as a result of pollution conditions caused by contracting operations performed by or on behalf of the contractor. Subsequently, this combined form of insurance offers the ease of providing both forms of coverage without the issue of two premiums, two retentions and differing terms and conditions.

Because of these benefits, over the past five years the construction marketplace has seen a dramatic increase in contractors buying the combined program versus separate CPrL or CPL policies. In this way, coverage isn't sacrificed for cost and through the use of a combined program contractors can increase the aggregate to twice the per-claim limit as well as enjoy the benefits and flexibility of both.

Two prominent coverage enhancements that are not included in the above forms but can be purchased as supplemental insurance are Contractors Protective ("protective") and Mitigation of Loss ("MOL") coverages.

## **CONTRACTORS PROTECTIVE**

Coverage. Protective coverage is a first

party coverage that indemnifies the named insured for costs it incurs, excess of the design professional's professional liability insurance, that the named insured is legally entitled to recover, as a result of negligent acts, errors and omissions committed by design professionals under contract with the named insured.

In addition, it also affords difference in coverage (DIC) above the underlying design professional's professional liability policy in the event the underlying policy is deficient. Such deficiencies may include exclusionary language for mold or other pollution conditions, habitational exclusions, cost overrun exclusions, or quantity estimating exclusions that may exist in a design professional's (DP) practice program. Essentially, the protective supplements the design professional's professional liability insurance program by providing direct benefits to the named insured, which is the contractor.

The best example used to illustrate the value of this protective coverage includes a design builder, who enters into a contract with a design professional on a mixed use retail/condominium project. The contractor carries a \$5,000,000 CPrL program including protective coverage. Unfortunately, the design professional designs the project with the improper sized rebar, which is discovered after the completion of extensive work. After a thorough review of the project, it is determined that the cost to demolish and rebuild would be approximately \$3,000,000. - less than the cost to proceed, altering design and expediting construction. Since the design aspect of the project is the contractor's responsibility, the contractor is obligated to absorb the additional cost of demolishing the existing structure and then starting the project anew.

One of the few alternatives includes the contractor reaching out to the design professional's professional liability insurance carrier to pay for these additional costs. This policy carries a \$1,000,000 limit. The claim is made against the designer's professional liability insurance policy, which should pay \$1,000,000. and the protective coverage would then pay the \$2,000,000 balance that the contractor incurred. There is one aspect of the protective coverage that is often overlooked. It is an excess coverage. Therefore the protective coverage will not respond until the coverage applicability of the underlying DP's policy is

determined. In other words, it may take years to settle the claim under the DP's policy and until then, the protective coverage does not respond. Even so, the value of such coverage is undeniable.

Other important aspects to note about Contractors Protective include:

#### **SELF INSURED RETENTIONS (SIR).**

The protective coverage usually, but not always, carries a self insured retention, which only applies in the event the underlying DP's professional liability insurance is not available as a result of previous claims, exclusionary language, cancelled policy and so forth. In the event the underlying DP's policy is intact, the SIR does not apply.

#### **MINIMUM INSURANCE REQUIREMENTS (MIR).**

Typically, carriers offering protective coverage require contractors to work with only DPs that have a minimum of \$1,000,000 in professional liability insurance. This impacts coverage in two ways - 1) in the event the MIR is met at the time of claim no SIR applies and 2) the carrier agrees to waive subrogation rights against the DP. If not, the carrier may subrogate back against the design professional for expenses incurred.

#### **MITIGATION OF LOSS COVERAGE.**

Whereas contractor's protective coverage supplements the DP's professional liability insurance, mitigation of loss (MOL) essentially replaces the DP's insurance solely in respect to the costs incurred by the named insured to rectify design issues discovered during the course of construction and would otherwise result in professional liability claims if not corrected. In addition, while the protective coverage is an excess coverage, MOL is primary coverage subject to a self insured retention. In theory, MOL coverage allows for the construction to proceed with funding for the rectification costs coming from the carrier rather than the contractor. The carrier may then subrogate back against the design professional for expenses incurred.

Because of the broad scope of MOL coverage, carriers offering this insurance can control their limits by offering and managing their risk with significant SIRs, usually starting at \$500,000; coinsurance requirements; and exclusions on internal cost and profits so both the

contractor and carrier's interests are aligned to ultimately recover as much as possible from the responsible firm or firms.

Applying MOL coverage to the same mixed use project described in the protective coverage, the policy would then indemnify the named insured, starting from the time the error is discovered, for the total of \$3,000,000 (subject to the SIR). The carrier would likely then subrogate back against the negligent design professional to recover its costs. The primary benefit of MOL coverage is the fact that it is a primary coverage that is merely subject to an SIR, unlike protective coverage, which is an excess coverage. However, on the downside, a MOL form of coverage can expose the contractor's program to a greater probability of loss and potentially even impact the contractor's future insurability.

One other important aspect to note about MOL coverage is that when it is attached to a combined CPrL and CPL form, MOL coverage applies to pollution as well. The best example would be the first party costs incurred to remedy mold growing on a project during the course of construction. Currently, there is little to no insurance solution for such an exposure. However, with MOL coverage, the contractor now has such a solution.

In addition, both protective and MOL coverage parts can be added inclusive of the policy limits of liability, in addition to the limit of liability or offered on a project specific basis in conjunction with the base CPrL product.

## **CONTRACTORS POLLUTION LIABILITY PRODUCTS**

While there have been no new products introduced to insure a contractor's environmental risk, there have been several dramatic enhancements to the primary product - Contractor's Pollution Liability (CPL). The CPL product has now been expanded by many markets to address virtually all major construction firm exposures - job/site or operational risk, real estate related risk, disposal and transportation.

In general, the CPL is either a claims-made or occurrence-based policy that provides coverage for third party liability resulting from bodily injury, property damage, defense and

clean-up as a result of pollution conditions (sudden/accidental and gradual) caused by contracting operations performed by or on behalf of the contractor. The CPL policy can afford coverage to environmental or remedial contractors to general contractors and specialty trades. In addition, CPL has become a viable financing option for environmental loss in that it provides insurance for large or even catastrophic loss scenarios at a reasonable premium that can start at \$5,000. These policies are also often offered on a project or blanket program basis with project programs and terms as long as 13 years (including construction period and completed operations/extended reporting periods).

Major coverage enhancements include:

- **Transportation.** Depending on the size, construction firms face environmental exposures involving transportation. These include hitting objects such as pole-mounted transformers and above ground storage tanks, etc. as well as the transport of contaminated soil and fuel. Unfortunately, while nearly all CPL policies exclude such coverage once the vehicle has left the project site, the good news is nearly all offer amendatory endorsements, which are affordable and relatively easy to include. Oftentimes, this coverage is not included initially because the proper questions weren't asked at the outset of the process. In addition, coverage may be expanded to afford coverage for all modes of transportation and not only automobiles or trucks.

- **Owned or Leased Premises.** Many construction firms think that by buying CPL coverage they have "environmental liability coverage for the company". As explained, the intent of the CPL policy is to provide coverage for contracting operations - which usually take place on a project site unrelated to the construction firm. It should be understood that the base CPL product is not intended to provide coverage for owned or leased property.

For example, a large heavy highway contractor generates about \$100,000,000 in annual revenues and has three quarries that mine aggregate. The CPL will provide coverage for the heavy highway construction work or contracting work, but it does not extend to the environmental liability associated with the quarries, or any other properties for that matter - maintenance garages, landfills, batch plants, etc.

This is often misunderstood and generally excluded under CPL policies. Fortunately, there are two alternatives that address this exposure. The first includes securing coverage under a separate Pollution Legal Liability (PLL) policy. The second is by endorsement to the CPL policy. PLL provides coverage for bodily injury, property damage, clean up costs and related defense costs arising from pollution on, at, under or emanating from a designated location. The PLL may or may not provide both sudden and gradual pollution coverage. Many carriers today are eliminating the gradual coverage to ease the underwriting process while allowing an insured to consider some element of PLL coverage.

Other issues can also arise when exploring real estate-related risk. These issues often occur with properties temporarily leased by contractor's from third parties to store equipment, stockpile soil, stage activities, and so forth in conjunction with a project site. Under the real estate/property exclusions in many CPL policies, this exposure would be uninsured even though it's part of the work at the job site. The good news is, many CPL carriers modify the policy, upon request, to allow for such coverage. This too can be easily overlooked.

• **Disposal Liability.** Disposal liability coverage or Non-Owned Disposal Site (NODS) Coverage affords coverage for an insured's legal liability arising out of the disposal of waste or materials. Coverage includes expenses incurred for the investigation, removal, disposal

or treatment of pollution conditions on, at, under or emanating from a NODS. It typically defines NODS as a location(s) used in the storage, treatment, processing or repository of waste material that originates from the performance of contracting operations, provided that it is:

- Not managed, operated, owned, or leased by the insured
- Permitted and/or licensed by required Federal, State and local authorities to accept such material as of the date of disposal
- Not listed on a proposed or final Federal National Priorities List (NPL) and/or a State-equivalent NPL, Superfund or Hazardous Waste List prior to the inception date of this Policy.

In the past this coverage was available as long as the disposal site was designated or listed on the policy. However, this became increasingly cumbersome especially for larger construction firms. Today, NODS coverage is available on a blanket or non-scheduled basis to provide the insured with greater flexibility in coverage and eliminate the issues determining the designation of sites.

What makes the process of securing the proper professional and environmental liability coverage so difficult is that each carrier offers different terms, conditions, language intent, risk appetite and underwriting requirements. In addition, many forms need to be customized via endorsement to ensure coverage matches risk, while contactors often make the mistake

of agreeing to the intended coverage in "spirit" as the actual intent is lost when endorsements are drafted. To better serve the industry and their contracting clients, insurance professionals must thoroughly understand every aspect of the environmental and professional liability insurance marketplace to become complete technicians offering only optimal solutions.



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