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ASSEMBLING THE MODERN *Contractor's Professional Liability Policy*



Construction businesses continue to experience tremendous growth. In fact, the Bureau of Labor Statistics and a report from Timetric's Construction Intelligence Center (CIC) project construction to be one of the fastest growing industries into 2020.¹ According to the Q1 2018 Commercial Construction Index, 80% of contractors report either steady or increasing amounts of jobs² and a 12.4% increase in construction starts for structures like offices, parking garages, and transportation terminals.³

What has contributed to these positive projections?

The constant demand for efficient work has led to the development of modular construction designed with cutting-edge technology. Green building has also become an integral part of various projects. Owners, developers, and project managers are increasingly building Leadership in Energy and Environmental Design (LEED) certification, sustainability, and net zero demands into their specifications.⁴

AS BUSINESS GROWS, SO DOES THE MARGIN FOR RISK

Ultimately (and unfortunately), the widespread rise in building activity has increased the margin for risk for contractors. As such, there is ongoing potential for environmental liability that can derail the closure of commercial sales, the building of new structures, and/or the renovation of old buildings based on suspicion alone.

These risks are partly due to the need to abide by stringent regulations requesting transparency among owners and investors, as well as the potential costly remediation of environmental problems (i.e., groundwater contamination and the identification of mold and bacteria).

Additionally, new building trends have eliminated boundaries previously separating the roles of contractors, architects, and other building professionals. The current trend toward design-build, fast-tracking, and other accelerated delivery

methods coupled with the desire to take on new projects requiring more specialization has not only created new job opportunities for building professionals, but has also made them more susceptible to liability.

NAVIGATING & MANAGING CONTRACTORS PROFESSIONAL LIABILITY INSURANCE

Contractors Professional Liability Insurance (CPrL) has expanded to accommodate the changing construction marketplace, and more contractors seek to purchase this form of coverage. There is growing awareness of the risks that accompany green building opportunities.

CPrL provides coverage for damages arising from negligent acts, errors, and omissions related to the professional services performed by or on behalf of any construction company whether it is a GC, design-builder, construction manager (at-risk or agency), or specialty subcontractor. Other CPrL benefits surround the continued expansion of terms to accommodate changing construction marketplace exposures.

CONTENT OF CPrL COVERAGE

CPrL programs have expanded and commonly consist of three primary parts: professional liability, protective indemnity, and rectification/mitigation.

Professional Liability

Professional liability offers third-party protection for liability arising out of negligent acts, errors, or omissions in the issuance of professional services performed by or on behalf of the contractor.

Protective Indemnity

This first-party protection is for damages incurred by the insured that the insured is legally entitled to recover from errors created by design professionals. This is an excess coverage that pays for the difference in value between the total damages and the damages paid by the professional liability limits available to the insured from the design professional.

Rectification/Mitigation

This first-party protection is for the 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. This is a primary coverage.

However, it's the liability that continues to be considered the "core" aspect of CPrL. The main benefit relates to the coverage of damages incurred by third parties as a result of negligent acts, errors, and omissions in performing professional services. This typically includes both in-house and subcontracted professional services and covers both direct and vicarious liability.

Coverage for Professional Services

Professional services can be described as the "portal" to coverage. If a claim is made against the insured for services not listed or defined in the policy, then the result could lead to a denial. It is crucial that the definition of professional services as defined in the CPrL policy reflect the services performed.

The common definition for professional services identifies that they are performed by a policyholder for a specific project in their capacity as an architect, engineer, designer, planner, land surveyor, landscape architect, LEED Green Associate, interior designer, construction manager, project manager, owner's representative, environmental consultant, technical consultant, scientist, or other professional specifically listed in an endorsement to this policy.

This definition covers nearly all professional capacities where professional liability may arise in a construction project, including construction management, technical consulting, and other related consulting services.

Furthermore, the definition does not list specific services other than the services performed in their professional capacity and does not preclude any project delivery methods. As long as the insured is performing these services, it does not matter which delivery method is used.

The definition of a professional claim is also important, as a claim triggers coverage accordingly. Determined by the oral or written demand made by a third party, claims may include lawsuits, complaints, petitions, or other regulatory actions asserting negligence. However, some carriers may define the claim more broadly, such as "demand for money to pay for damages" or "the correction of professional services." Ultimately, it is prudent for this definition to be as broad as possible.

Outside of the construction industry, it is common to find bodily injury or property damage exclusions to insure against financial loss under professional liability policies. However, architects, engineers, and contractors may not have coverage



for bodily injury or property damage under any other policy or insurance, so insureds should maintain they are covered for *any damages* arising from the negligent performance of professional services under a CPrL.

In some instances, CPrL policies are written to only cover bodily injury or property damage and not the pure financial loss of third parties, including the economic damages resulting from delay damages, acceleration costs, lost income, remedial design, reconstruction, or any other damages that can be the direct cause of error in professional services.

Because of this restriction, these are not typically considered true professional liability insurance policies due to lack of coverage for economic damages. In addition, they may violate contract insurance requirements that require a contractor to evidence professional liability insurance.

When it comes to exclusions, it's also important to ensure the coverage does not exclude construction manager (CM) services. While many 2018 CPrL policies are free of CM exclusions, there are several carriers that still apply construction manager at-risk (CMAR) exclusions in their policy forms. If the contractor utilizes or performs CMAR services, then coverage is limited.

Coverage for Construction Means & Methods Claims

Construction means and methods (CMM) claims are comparably different from professional claims associated with the permanent structure being designed and built.

Ideally, no exclusions should exist for services performed within the realm of CMM due to possible professional liability risks associated with those services. Just because a structure is temporary does not mean design or engineering errors will not cause project delays.

As a strong backup, exclusions should only apply to bodily injury/property damage. While this may not be ideal, it is better than a total exclusion.

Contractors also have a backup under the commercial general liability (CGL) policy via CG2279 or 2280 endorsements; however, this alternative only affords coverage for pure bodily injury/property damage.⁵

Contractual Liability Exclusions

Faulty workmanship exclusions exist (specifically the cost to replace or repair) in many policies with nearly all excluding faulty work or installation created by the insured. As a result, these exclusions should involve an exception for professional

services. This exception ensures coverage, or at a minimum provides for a defense, in the event the insured is required to and is negligent in properly monitoring or inspecting the subcontractor's work in an instance where the work fails to meet the specifications or design plans.

Contractual liability exclusions remain in CPrL policies for contractually assumed obligations but do not interfere with the coverage for common law tort negligence. For example, certain American Institute of Architects (AIA) contracts on large design-build civil projects may apply higher or expanded standards of care on design-builders by requiring them to indemnify the owner for any acts, errors, or omissions regardless of negligence.

Further, those same contracts often require design-builders to warrant that their work and design plans are free of defects. These contracts go well beyond the intent of coverage under a CPrL policy, which is why it's so important to be aware of exclusions as well as related contract provisions.

NEW COVERAGES IN MODERN-DAY CPrL PROVISIONS

CPrL policies are currently being updated to include secondary coverage like pollution, technology, cyber, and more. Technology coverage includes the negligent acts, errors, and omissions in the performance of technology services as defined by the policy. These can include:

- data/warehousing/hosting;
- software programming and support;
- network management and training;
- internet services; and
- consulting.

These coverages are usually provided as part of the overall policy or by endorsement.

Cyber liability or network security coverage also commonly appear in newer CPrL policies. This coverage is not necessarily tied to a negligent act, error, or omission, but covers damages arising from security breaches occurring during the performance of the insured's professional or construction services.

While a CPrL is not truly cyber coverage (as is separately offered in the marketplace) because it does not cover first-party exposures related to the insured's data or information, it does afford some element of liability coverage.⁶

Other supplemental insurance forms now commonly found in CPrL policies include:

- *Crisis management* – Assists the insured in managing the media and developing a PR plan in a crisis situation.
- *Subpoena expense* – Pays for the counsel fees and expenses accrued during the response to subpoenas.
- *Regulatory proceedings* – Assists the insured in defending regulatory or administrative actions brought under the *Americans with Disabilities Act of 1990* (ADA) or the *Fair Housing Act* (FHA).
- *BIM extra expense* – Covers the additional expenses arising from the loss of or damage to information due to the inherent malfunction of any software used in connection with any BIM system.

Additional CPrL policy considerations also include:

- *Defense and settlement provisions* – When it comes to defense and settlement, insureds need to understand the hammer clauses incorporated in each. While most continue defense funding, others will discontinue it if the settlement offer is not accepted. Others will agree to pay 50% of the defense costs above the settlement offer.
- *Assumption of liability* – Most carriers do not want insureds to admit or assume liability and/or agree to pay anything until their consent is given. This is a strict policy term that can result in the claim's denial if not followed implicitly.
- *Selection of counsel* – When it comes to selection of counsel, some carriers are open to accepting the law firms offered by the insured, provided they pass the litmus test. This means they are qualified to handle construction-related professional liability (not just any PL insurance) and offer agreeable rates.

RISK MANAGEMENT IS A PROJECT MANDATE

The construction industry is rapidly evolving with growing opportunities across a wide spectrum of commercial sectors. This coupled with a renewed emphasis on infrastructure spending should see construction profits rise well into 2020.

Unfortunately, enhanced bottom lines and the prospect of a continual flow of new jobs have accompanied an environment filled with pitfalls.

Quickened timelines, increased sustainability demands, and a dearth of experienced labor have all combined to greatly increase the level of liability in an already litigious atmosphere.

As a result, risk management has become a project mandate. From design through construction, there are many variables that can go wrong.

Errors and omissions can lead to anything from costly delays to full-scale tragedies. This is why it is so important to examine the project's professional risk very closely while assembling the CPrL necessary for insuring against even the simplest challenges. Even relatively minor flaws can lead to multi-million dollar claims if not handled with diligence and reported on time to carriers under their specified handling procedures. ■

Endnotes

1. www.tradesmeninternational.com/construction-technology/construction-industry-growth-predictions.
2. www.uschamber.com/sites/default/files/q1_2018_cci_2-28_final.pdf.
3. Ibid.
4. new.usgbc.org/leed.
5. www.northstarmutual.com/UserFiles/Documents/forms/policyforms/Current/CG%2022%2079%2004%2013.pdf.
6. It is important to note that contractors that truly want cyber coverage are best served by going to a true cyber market.

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