

# Managing Construction Professional Liability Risk



## Presented by



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- 25+ years in loss prevention education for A/E professional liability insurance
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- Has led in-depth claims studies to understand A/E risks and has translated that into meaningful education programs



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- Nearly 30 years of experience underwriting construction professional and environmental liability insurance
- Authored several construction professional and environment liability articles

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## Presentation Outline

1. Risk Management Overview
2. Risk Allocation
3. Importance of E&O Insurance for Contractors
4. Understanding Professional Liability
5. Loss Prevention Strategies and Techniques

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### Section 1



## Risk Management Overview



## Types of Risks

1. Business or Trading Risk
  - The calculated risk for profit or loss associated with any business
  - Not typically possible to insure against every possibility of this type of risk
2. Pure or Insurable Risk
  - Unexpected or unanticipated situation that leads to loss
  - Principle of indemnity

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## Insurable Risks



### Direct Property Losses:

- Perils of fire, explosion, earthquake



### Indirect Property Losses:

- Business interruption



### Liability Losses:

- lawsuits or claims by clients or third parties



### Personnel-related Losses:

- Worker's compensation

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## Definition of Risk Management



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## Risk Management Approaches

- **Small and predictable losses:**  
Manage and self insure
- **Large and unpredictable losses:**  
Actively manage through enhanced training, organizational accountability and transfer of certain risks to others who can better manage and control them by a combination of contract language and insurance



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## Goals of Risk Management

- **Primary:** Protect the assets and financial well-being of the entity
- **Secondary:** Minimize the cost of risk through
  - Implementation of loss control program
  - Administration of risk management program
  - Insurance purchase as last option



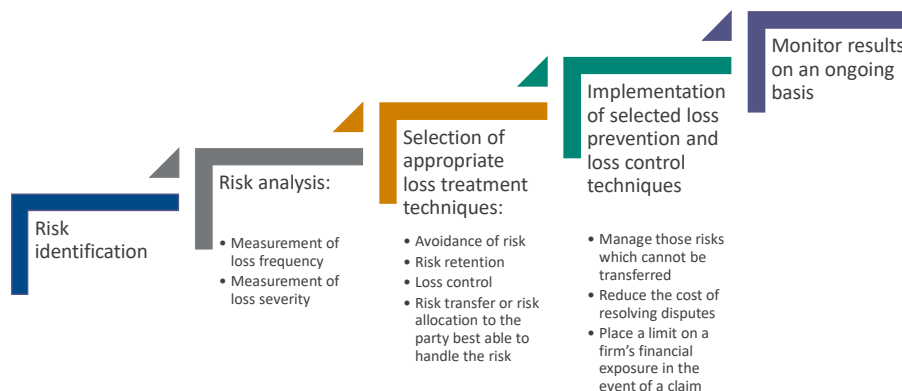
*An effective risk management program brings the cost of risk to a normal or below-industry level*

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## 5 Steps of Risk Management



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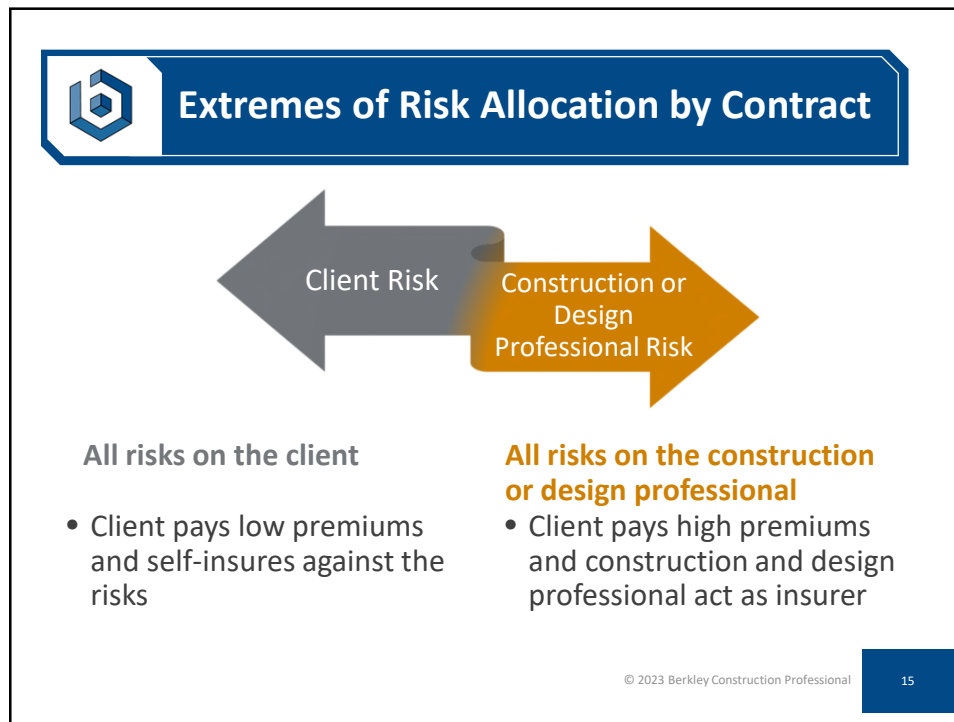




## Allocating Risk by Contract

- In Construction, general rule is that all risks are rightfully the project owner's unless transferred or assumed by the construction or design professional for fair compensation
- Questions that frame the basic principles of risk allocation are:
  - Which party can best foresee the risk?
  - Which party can best control the risk?
  - Which party can best bear the risk?
  - Which party benefits or suffers if the risk materializes?
- The Owner **holds the key to risk allocation** through its approval of contract language with the construction and design professional





### Risk Allocation: The Project Owner's Risks

- Responsibility for obtaining and providing information about the site (e.g. surveys, geotechnical, environmental reports)
- Obtaining rights of ways and easements
- Obtaining permits and governmental approvals
- Site ownership access, availability
- Coordinating services and work between multiple prime contractors and consultants
- Pre-existing site conditions
- Financing
- Defining the project's requirements

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## Risk Allocation: The Contractor's Risks

- Responsibility for the means, methods and procedures of construction
- Warranties and guarantees for the Work
- Timeliness of performance
- Site safety
- Subcontractors



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## Risk Allocation: The Designer's Risks

- Responsibility for their professional services
  - Preparation of plans, drawings, specifications and reports
  - Observation of work to determine general conformance with design requirements (typically without exhaustive reviews or guarantees)
- Responsibility for any subcontracted professional services to subconsultants
- Process submittals and RFIs, administer change orders



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## Why a Contractor Needs E&O Insurance

While it is true that most General Contractors are not directly involved with design, their Professional Liability exposure can come from several areas:

- Design-Build
- At-risk construction management
- Agency construction management
- Contracted subs performing their own design (e.g., electrical, HVAC)
- Final design delegated from A/E (e.g. steel detailing, handrail systems)



## Why a Contractor Needs E&O Insurance

Construction Management exposure takes many forms:

Scheduling and sequencing of sub-contractors and trades	Pre-constructability reviews	Value Engineering	Use of Building Information Modeling
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## Why Traditional Liability Policies Don't Work

1. An unendorsed GL form excludes coverage for professional services
2. If the GL policy has a professional services exclusion, it must be endorsed to include the CGL 2279
3. CGL 2279 provides coverage for Professional Liability, but limits it to Bodily Injury and Property Damage only within the means and methods
4. Professional Liability claims mostly arise out of economic loss and do not involve a BI/PD component

*The screenshot shows a 'Professional Liability' exclusion section in a policy, stating that coverage is excluded for professional services unless specifically endorsed.*

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## Who is a Professional?

- One who possesses **specialized skills and experience** in architecture, engineering or construction management
- May or may not be licensed or regulated but performs the mental task of providing a design or management service
- Possesses a special form of competence the result of acquired learning and aptitude developed by special training and experience

*An airplane pilot may appear to meet the criteria of a professional but actually performs a physical task of flying a plane—same with crane operators or highly regulated activities such as waste haulers.*

*These individuals are **not** professionals*

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## What is a Professional Service?

- The act or service must be such that draws upon the use or application of special learning
- It is more than mere proficiency in the performance of a task
- It implies intellectual or mental skill
- The labor or skill is predominantly mental or intellectual, rather than physical or manual

***Lawyers, accountants, and A/Es are professionals***

*Doctors span both professional and non-professional since in practice they employ their highly specialized learning (only known exception)*

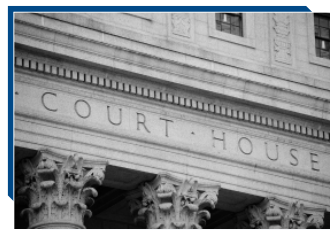
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## Establishing Professional Liability

- Where do a professional's duties come from?
  - Statutes
  - Case Law
  - Common Law
  - Generally accepted standards within their profession
- When these duties are breached and damages are the proximate result, liability is established
- Society relies upon professionals to exercise intellectual judgment in their particular areas of knowledge
- Failure to meet the standards of the profession establishes liability





## How Does Liability Arise?

- Contractual liability arises out of your contract with the Client and the Client's contracts with others
- Tort liability can arise from:
  - **Negligence**  
The failure to carry out services in a manner consistent with normal and accepted standards of practice
  - **Strict Liability**
  - **Joint and Several Liability**  
That is, a party only partially responsible may be found totally liable in the absence of financial responsibility of other negligent parties, despite a lesser degree of fault
  - **Statutory Liability**



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## Elements of a Contractual Claim

To successfully maintain a breach of contract action, the plaintiff must prove:

The existence of a contract, oral or written, between the plaintiff and the construction firm or design professional;

That the contract was breached;

That the plaintiff suffered damages; and

That the plaintiff's damages were caused by the construction firm or design professional's breach of contract

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## Additional Notes on Contractual Claims

- Implied in most professional services contracts is the promise that the construction entity or design professional's services will be performed in a non-negligent manner
- The same conduct may give rise to a separate cause of action for negligence that may be asserted by the Client along with a breach of contract claim



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## Elements of a Cause of Action for Negligence

To recover in a cause of action for professional negligence against a professional (the defendant), the plaintiff must prove:

The existence of a duty or obligation recognized by law requiring the defendant to conform to a certain standard of conduct for the protection of others against unreasonable risks

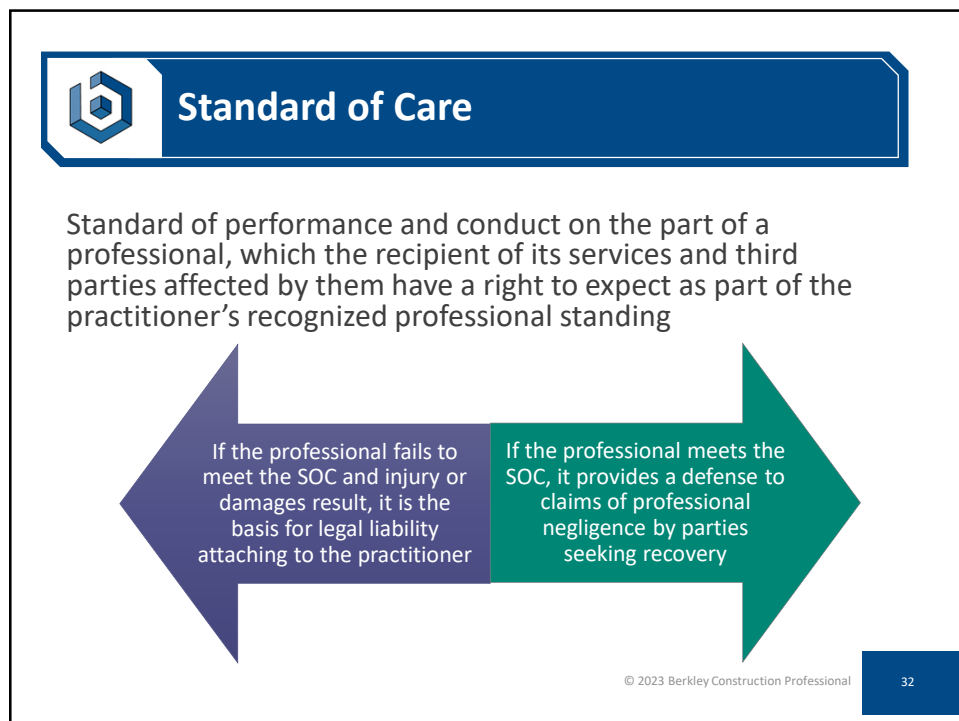
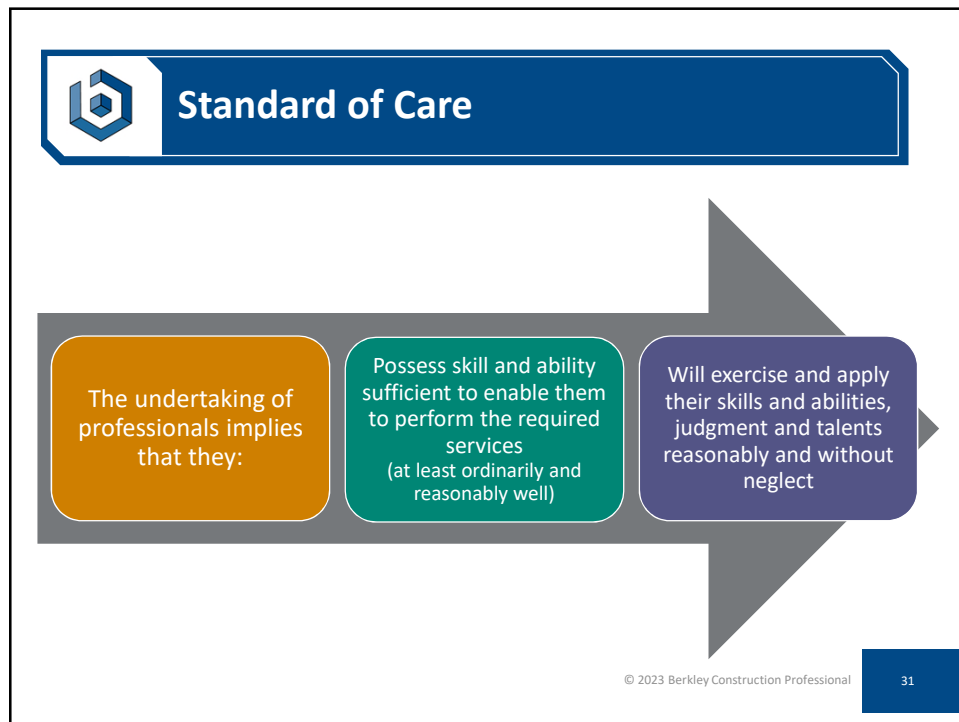
The failure on the defendant's part to conform to the standard required (that is, a breach of the duty to the plaintiff, usually referred to as the "negligence" element of the cause of action)

A close causal connection between the conduct and the resulting injury or damage (usually referred to as "proximate cause")

Damage resulting to the plaintiff from the defendant's act or omission

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## Special Notes on the Standard of Care

- A professional undertaking does not imply or warrant a satisfactory result
- There is no implied promise that errors or omissions will not occur
- Not every mistake is a negligent one
- An error in judgment is not necessarily evidence of a lack of skill or care—human imperfections are expected (and a professional is usually not liable for honest errors in judgment)



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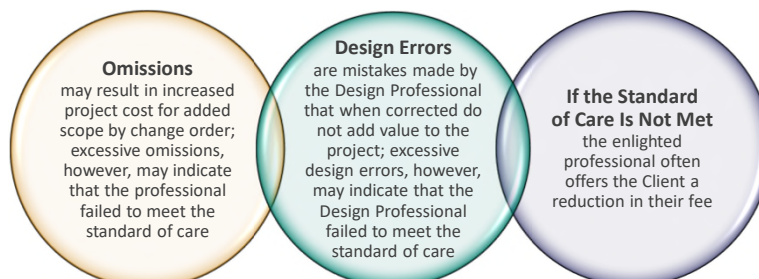
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## Design Errors and Omissions

The Standard of Care requires professionals to:

- Possess “ordinary skill and ability” necessary to serve their Client’s needs
- Use “reasonable and ordinary care” in the practice of their profession



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## Properly Evaluate Clients and Projects

### Consider:

- Past experience with the Client or designers
- Financial resources of the Client or designers
- Sophistication of the Client or designers
- Reasonableness of the Client's expectations
- Existence of unusual requirements

### Perform:

- Financial reviews, credit checks, referral background checks

### Avoid:

- Low fee–high risk work:
  - Inspections
  - Certifications
  - Loss control
  - CM Agency with broad contractual liability and “absent owners”
  - Shoring/foundation design only
  - Structural only reviews



## Client Assessment Questions

- Is this Client financially solvent and will they continue to be?
- Do they have a history of filing lawsuits?
- Are they willing to negotiate?
- Have you worked with this Client previously? What was your experience?
- Do they have a reputation for making slow payments?
- Do they understand that in order for you to produce quality work, there must be an adequate budget?
- Does this Client recognize what professional services are insurable and what are not?
- What do other references of this Client say?

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## Upfront Steps to Manage Your Client's Expectations

- Carefully assess the Client's needs
- Discuss liability concerns with the Client
- Don't make unrealistic promises that increase the Client's expectations of you that may potentially cause problems
- Discuss and come to an agreement about how problems will be resolved when, and if, they occur during project execution



Know your bottom line and be willing to walk away from a project or client that you perceive to be too risky

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## Staffing Considerations

- Prescreen employees and verify their education and credentials
- Develop and recruit strong project leaders
- Don't have a "B" team
- Grow organically—not for the sake of top-line growth or for taking out the competition



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## Prepare Equitable Professional Services Agreements

### Strive for Agreements that are:

- Thorough and accurate in their reflection of your services and the obligations you have to others project participants
- Fair in their allocation of risks you retain
- Consistent with other project documents



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## Key Elements to Negotiating an Equitable Agreement

### Be sure to:

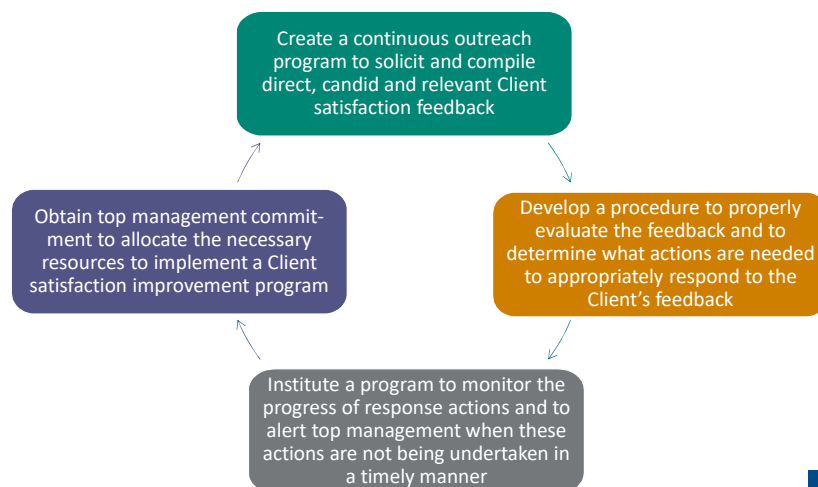
- Charge appropriately for your services
- Educate your Client as to why you cannot accept certain terms
- Use fairness as a mutual goal
- Require the Client to agree to non-binding mediation before initiating arbitration or litigation
- Require the Client to include a mediation provision in its contracts with other consultants and contractors
- Avoid full releases or limitations of liability to A/Es

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## Establish a Client Satisfaction Program



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## Minimize the Potential for Disputes

1. Expend great effort in the pre-construction process to make sure that all constituents are on the same page
2. Make sure that project staff:
  - Recognize warning signs of potential problems when they arise
  - Communicate problems immediately to the principal-in-charge
3. Identify necessary changes in work scope and communicate this immediately to your Client along with a request for an appropriate adjustment in your fee

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## Minimize the Potential for Disputes



4. Monitor any overdue fees on a regular basis and query the Client (this sometimes indicates that the Client has identified a problem)
5. Carefully manage sub and vendor payments
6. Maintain good project records that document all communications, particularly for significant events and key decisions
7. Consider the potential for a counter-claim from the Client before making a fee claim for services rendered

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## At the Completion of the Project




Evaluate what worked	Identify what didn't work
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*Make appropriate adjustments for  
future projects*

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## The Loss Prevention Top 10

1. Stay focused be aware of your “professional” responsibilities
2. Define your scope of services
3. Control your contracting and project approval process—stay within protocols
4. Work as best you can with design firms you know or make sure you follow through on researching the referrals of new ones
5. Think globally act regionally—know your markets and legal environment
6. Make certain your subs live by the same rules that you do

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## The Loss Prevention Top 10

7. Never begin complex services until your contract is fully executed (after executing your contract, adhere to its terms and modify them only by written agreement with the Client)
8. Manage (avoid or understand) your fast-track or hard-bid construction work such as untested technologies or cutting-edge design
9. Maintain continuity of management at the project level
10. Employ Peer Review—have peer review performed within your firm and foster environment of sharing of best practices (second set of eyes)

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## Questions?

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