OPINION

Heightened growth, heightened risk

As the outlook for AEC firms remains bright and professional liability insurance rates stay competitive, the time is right to make sure your firm has adequate protection.

Rob Hughes

GUEST SPEAKER

Things are looking up for design firms. They are doing far better than they did 10 years ago at the onset of the Great Recession. Today, most construction professional firms are busy and even have work backlogs. Most also experienced steady revenue growth in recent years and expect that trend to continue.

Nonetheless, all is not perfect. Qualified professionals are hard to find, as are current/future leaders and owners in firms. Competition for staff may be driving up salaries and overhead costs are rising. Yet, one cost that has decreased since 2008 is the cost of professional liability insurance.

The soft commercial insurance market, flush with numerous competing carriers, began around 2011-2012 – perhaps earlier given modest rate increases of 2008-2010 – when design firm revenues fell sharply.

Today, claim activity seems on the rise, along with the cost of defending professional liability claims. The latter may be a function of lawyers and experts now charging higher hourly rates than in 2008. Meanwhile, there have been too many headline-grabbing professional liability claims: multi-million-dollar resolutions of several traffic volume/revenue projection claims in P3 projects; and the devastating pedestrian bridge collapse in south Florida.

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NAVIGATING A NEW LANDSCAPE. Can design firms draw from these situations and implement an

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"investment" based approach to the limits they carry on their professional liability policy?

The vast majority of construction professional firms carry limits of liability ranging from $1 million to $2 million per claim. Granted, most design firms are relatively small with annual revenues in that range or lower. However, even many larger firms (with annual revenues of $10 million to $20 million), carry limits of less than $5 million per claim. As a contra example, a law firm with five or six lawyers and annual revenues of $1.5 million likely has limits of $5 million per claim – that includes law firms defending AEC firms!

An "investment" approach considers not just your firm's day-to-day risk and operations, but your intermediate and long-term plans. The day-to-day reality is that nearly all, if not all, AEC firms are working on jobs where the exposure exceeds $1 million to $2 million.

An architect set up as a solo-practitioner was retained as a consultant on the demolition of a four-story, unoccupied building in Center City Philadelphia. The exposure? Seven killed and 12 injured in the neighboring Salvation Army outlet store (that remained opened throughout demolition), when there was a catastrophic collapse of the building undergoing demolition. The resulting civil case settled for $227 million.

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The transition plan, whether internal succession or external sale, that took so much effort to put together will be moot if the firm has to declare bankruptcy. Higher limits, say $5 million per claim/aggregate, may still fall below the full exposure relative to situations such as those mentioned in Philadelphia and south Florida. However, as a former defense attorney and in-house claim executive at a professional liability insurer, I can say that type of limit is much more effective with plaintiff's counsel and the judge than "minimal" limits of $1 million to $2 million.

Higher limits can also be a reinvestment, not an additional cost to your firm. Consider a recent professional liability renewal of a "typical" engineering firm – doing both public and private work with a typical civil/site-related scope of service. In 2009-2010, the firm had about $14 million in annual revenues and carried a "split" limit of $2 million per claim/$4 million aggregate with a premium of about $115,000. At its latest renewal, the firm's annual revenues had risen to about $23 million and it increased its limits to $5 million per claim/aggregate. The insurance rate for this renewal was about 10 percent less than in 2008-2009. And that's not even a full measure of the discount; the original rate was for the $2 million/$4 million limits and today's rate was for the $5 million limits.

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The design firm's decision-makers reasoned that the exposure is there, given the type of projects. The higher limits are not offering that much more coverage, as we are now double the size; so, the limit is spread over that much more revenue. Lastly, the higher limit is essentially a free benefit of the soft market – the rate (unit cost of the coverage or premium divided by averaged, annualized revenues), is actually lower than what we had been paying.

While this illustrates one firm's decision-making process, the approach is transferable:

1) How does your professional liability insurance limit compare to your firm's current and projected revenues, as well as what they've been historically?

2) Talk to your project managers and your specialty broker. What is the worst-case scenario across your typical projects? Insurance and risk management advisors often talk in terms of "reasonable, probable maximum loss." In engineering terms, this is akin to buying insurance not for the 500-year storm, but the 100-year event. How does this exposure estimate compare to your current coverage limits?

3) What is the state of your firm? Is it undergoing internal or external transition? Is it an easy decision to invest a few thousand dollars more to increase the coverage limit to address under-insured exposures?

4) Don't fall trap to the "rumor" that buying higher limits will automatically just attract more claims. That's simply not true.

As the outlook for AEC firms remains bright and professional liability insurance rates stay competitive, the time is right to make sure your firm has adequate protection. A knowledgeable insurance advisor can help assess your insurance needs and design your program, accordingly.

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