

OPINION



Policy quest

As 2018 approaches, A/E firms may want to revisit professional liability insurance limits, and find optimal solutions for their requirements.



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**GUEST
SPEAKER**

As design firms look ahead to 2018, the time may be right to reassess their professional liability insurance limits. In recent months, design firm clients have been contractually requiring design firms to carry increasingly higher amounts of coverage.

Historically, most design firm clients accepted whatever limits A/E firms carried or set relatively minimal amounts; \$1 million per claim/aggregate was standard and most design firms had at least that amount of coverage in place.

Yet, during 2017, more contracts require limits of \$5 million to \$10 million – not just for prime designers, but for the various sub-consultants as well.

In prior years, when most design firms carried limits of \$1 million or \$2 million, they were based on such factors as:

- **Total revenues and assets.** Larger firms with greater assets typically have more to insure and protect.

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- **Average project size.** This is measured by an A/E firm’s fees and total construction value. The bigger the project, the bigger the potential claim (i.e., 10

See ROB HUGHES, page 8



ROB HUGHES, from page 5

percent cost overruns on a \$1 million project represent far less exposure to the design firm than a 10 percent threshold on a \$10 million project).

- **Specialty and type of projects.** Geotechnical and structural engineers may carry higher limits than landscape architects or civil/site engineers, as the impact of errors by the former is likely to result in a larger claim (i.e., damages derived from a building settlement are far greater than if a roadway is laid out improperly or grading plan is slightly off).

Meanwhile, the professional liability insurance market remained relatively soft. Some design firms have used the favorable market conditions to increase their limits; using potential premium savings to raise their limits from \$1 million or \$2 million to \$3 million or higher.

Although generally available, limits of \$5 million and above are typically not carried by design firms with under \$20 million in annual billings. In choosing their insurance limits, A/E firms balance risk/reward and cost to obtain what they feel is appropriate coverage.

MEETING NEW REQUIREMENTS. Lately, however, that process has been affected or taken away by design firm clients that have contractually required limits of at least \$5 million per claim/aggregate. Consider a recent example:

“Professional liability insurance shall be provided and the limit shall not be less than \$10,000,000 per claim and in the annual aggregate.”

Another approach ties required limits to the construction costs:

| Party | Construction Value | | |
|---|-----------------------|----------------------------|-------------------------|
| | Less than \$1 million | \$1 million to \$5 million | \$5 million and greater |
| A/E Firm | | | |
| Professional Liability/Errors & Omissions Limit | \$1 million | \$5 million | \$10 million |

A/E firms can try to negotiate to have the client accept their existing limits or they can comply by increasing their coverage to comply with the standard.

One approach in negotiating with clients is to explain that your insurance is not the only coverage available in the event of a professional claim. There is a “stacking” of limits assuming the prime designer retains sub-consultants for some or all sub-disciplines, such as MEP, structural, interior design, landscape design, etc. If a claim arises, the relevant insurance includes that of the prime, as well as the sub or subs whose scope of work is at issue; multiple policies may trigger, making available multiple limits.

A/E firms also might walk clients through reasonable and even worst-case loss scenarios to illustrate if they might even approach a loss nearing the contract limit. Consider: Why would a \$2 million project “need” a \$5 million PLI limit? Suppose the building is nearly complete when a

catastrophic design error is discovered, warranting a tear-down and complete rebuild. Is there a reasonable scenario where the damages would be two-and-a-half times the original construction costs? Probably not.

If the requirement for the higher limits remains, insurance solutions are available. Your firm might increase its overall practice policy limit to the required level; this will be costly because it applies to all your work, not just this project/client. An alternative: Add an additional limit to the policy for this project or all projects for a particular client.

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In their pricing, insurers typically start at a minimum premium for each additional million needed, which typically ranges from \$2,000/\$1 million limit up to \$5,000/\$1 million limit. A/E firms must pay a full-year premium for the additional limits regardless of the time remaining on the policy expiration date, and subsequently will have to be renewed through the duration of the project and possibly for a stipulated number of years post substantial completion.

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SAVING COST BY BUNDLING ADDITIONAL LIMITS. A few insurers now offer the ability to “bundle” all additional limits projects/clients onto one endorsement. Instead of adding three separate endorsements for three different clients, you may only need to add one endorsement and one extra premium charge. The carrier will review annually the number of contracts under the endorsement, as well as project types, scope of service, etc., and total revenues billed and expected in the future.

Another option: Consider a project-specific policy to insure the entire design team. Two decades ago, the market was basically down to one insurer offering this coverage for “mega” projects. Today, however, with market competition, project policies are more readily available from a number of different insurers. They may even be willing to offer terms on projects as small as \$20 million to \$25 million in construction costs.

As A/E firms anticipate their future project opportunities, many may involve new contractual requirements for higher professional liability insurance limits. Careful planning may help determine the best approaches for negotiating with potential clients and optimal solutions from the insurance market. ▀

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