

A/E RISK REVIEW

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Controlling the Cost of PL Insurance

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Nobody wants to spend their hard-earned dollars on professional liability (also called errors and omissions) insurance. A few design firms even forego this type of coverage. They take the risk that they won't make errors or omissions in their professional services and, if they do, that they can resolve the problem without an expensive claim. They sometimes reason that without professional liability (PL) insurance, they don't have "deep pockets" and therefore a claimant will look elsewhere to find remedy.

The logic of this course of action is obviously fraught with risk. Facing a claim without adequate insurance not only puts a firm's assets at risk, but the principals' personal assets can also be in peril. The corporate veil cannot always protect a design professional's personal savings, home and other valuables.

Most prudent design professionals see professional liability insurance as a necessary evil. They need the financial protection that PL insurance provides. They also realize that many clients require their designers to carry adequate insurance limits. In fact, many clients today are asking for higher limits of coverage.

Your best approach to managing professional liability risks is to work closely with a specialist insurance agent who knows the ins and outs of the architects and engineers insurance market and who can help you manage both your risks and your insurance premiums. An agency like ours can help select the appropriate

insurance carrier and recommend the appropriate limits of coverage and deductible. These recommendations will be based on you exposure to claims, your appetite for risk, the types of services you offer and the annual fees you earn. We can then quote you premium costs based on the current market conditions.

You should begin planning today for your next professional liability insurance renewal. Don't wait until 30-60 days before your expiration date. Call us at any time to begin planning your strategy for keeping your insurance available and affordable. Following are some areas for discussion and a few general tips to follow.

Take Advantage of Premium Credit Programs

One sure-fire way to control premium costs is to take advantage of your insurer's premium credit programs. These programs reward design firms with savings of up to one-third or more of their annual renewal premiums by following the insurance company's prescribed loss prevention measures. And remember, as your cost of insurance increase, the number of dollars you can save through these programs also increases. Here are two common types of premium credit programs you should look for and take full advantage of:

Loss prevention education programs. Some professional liability insurers offer premium credits, typically 10%, for firms that take advantage of their annual loss prevention education program. This usually requires that your professional staff attend an education seminar and then successfully complete a quiz or other academic project that tests your new knowledge. Because most of these programs qualify for AIA/CES continuing education credits as well, attendees receive three benefits – lower insurance costs, needed education credits and, perhaps most important, knowledge that helps avoid errors, omissions and disastrous claims.

Limitation of Liability (LoL) programs. Some insurers also provide premium reductions or credits of up to 15% when design firms agree to use LoL clauses in all of their contracts with clients. These contractual clauses establish ceilings on the dollar amount a design firm is liable for in the event of a project dispute or claim as a result of professional errors or omissions. Clients are often willing to negotiate such clauses when they are educated on the risk-reward inequities that most design firms face when such clauses are absent.

Consider Alternatives to Higher Practice Policy Limits

Suppose you currently carry \$2 million in professional liability coverage, but your new client on a large project is asking for \$5 million. Can you afford to increase your practice policy limits?

With claims severity on the rise -- not to mention the ever-growing number of projects you have worked on over the years that are now subject to potential claims -- higher limits may be in order regardless of current client demands. Considering 1) the potential disaster that could occur if you are hit with a severe claim or multiple claims, and 2) the number of jobs you could lose if you have insufficient limits, you have to ask yourself whether you can afford *not* to increase your limits.

The insurance market has been generally stable the last few years. In fact, some well-managed firms are finding that rates have declined slightly. So increasing your practice policy limits could be a wise and affordable decision. But if increasing your aggregate practice policy limits is simply too big of a hit on your pocketbook, you might want to consider a few options that are less expensive but provide added protection for your demanding clients:

1. **Specific-project excess.** Suppose you are offered a dream job on the type of project that is right up your alley, but the client is demanding higher limits than you currently have. With specific-project excess coverage, it is possible to maintain your current limit on your practice policy while purchasing a higher limit (as an endorsement to the project policy) to cover a specific project. For example, you can maintain a \$1 million practice policy and purchase a \$5 million limit on one project for substantially less

than raising your entire policy to \$5 million.

2. **Specific-client excess.** Let's take the previous example one step further. Suppose you find a new client who wants you to work on multiple projects, but demands higher insurance limits. Specific client excess is similar to specific project excess, except the higher limits apply to all projects performed for a particular owner. Again, this increased coverage is more affordable than raising your entire limit.
3. **Split limits.** Instead of purchasing a \$5 million practice policy you might purchase a \$2 million/\$5 million split-limits policy. Here, the policy limit on a single claim is capped at \$2 million, but the total coverage for any one year is \$5 million. This eliminates the chances that your policy would be wiped out by another claim and increases the chances that coverage will be there for all of your clients' projects.

Ask About Project Insurance

There is one coverage option that provides a project owner the higher limits it demands, guarantees that coverage will be there when needed -- and can actually *reduce* your insurance premiums. This unique coverage option is called project insurance.

With a project insurance policy, the owner realizes the following benefits:

A single policy for a single project - and that project only. All members of the design team can be covered under one policy, and the limits are dedicated to that project only.

Full control over policy terms. The owner chooses the policy limits and the duration of coverage -- often available up to five years after substantial completion.

Guaranteed coverage. Most project policies are noncancellable, as long as premiums are paid, policy conditions aren't breached and no material misrepresentations or concealment have been made on the application.

No premium rate surprises. The project policy premium is determined according to a guaranteed rate based on final construction cost.

Single-point claims responsibility. Insuring the entire design team with one policy makes it easier to solve problems with less finger pointing and more cooperation.

So what's the catch? Why would an owner turn down the project policy option? Typically, project owners pay for the project policies, since they benefit most from the coverage. However, costs can be offset and shared with design firms through premium reimbursements or negotiated lower fees. (Since fees on the project likely won't be counted to determine practice policy premiums, a design firm saves money on its annual insurance costs.)

Unfortunately, fewer insurance companies are offering project insurance these days. And among those that do, the cost and the required deductibles can be high. Historically, these policies have not proven very profitable and some insurers now shy away from all but the most plain-vanilla project types. Because we specialize in professional liability insurance for design firms, we can be invaluable in helping you find such coverage, if it is available. We can also help explain the benefits and costs to the owner, coordinate implementation and provide loss prevention assistance throughout the life of the project.

Despite the advantages, owners may be unwilling to incur the cost of a project policy. A less expensive alternative may be owner protective insurance.

Owner Protective Insurance

An owner protective (OP) policy provides protection for the project owner in the form of excess coverage over and beyond the architects' and engineers' practice policies. The design team's individual practice policies provide primary coverage and come into affect first. Then, if the responsible party's practice policy limits are depleted, the OP policy comes into affect to cover some or all of the additional damages, depending on the policy conditions and limits.

Because the OP policy comes into force only after the practice policy of the design firm has been exhausted or is otherwise unavailable, owner protective insurance is typically less expensive than a project policy. OP

policies can be purchased annually or for the life of the project. Retroactive coverage can often be provided on projects already in the construction phase.

Environmental engineering exposures can also be covered. "Blanket" OP policies may also be available for an owner's multiple projects.

In most cases, the design firms must maintain a minimum level of coverage (often \$1 million to \$2 million) on their practice policies. These limits may be higher for projects with substantial construction values. Also, any litigation costs incurred by the owner to bring the claim are not covered.

As an example of an OP policy in action, suppose there is a \$1.5 million loss to an owner's project that is determined to be the result of the negligence of the prime architect. The architect has \$1 million in coverage through a practice policy. The architect's primary policy would cover the first \$1 million in damages and the OP policy would cover the balance of \$500,000. However, if \$50,000 of the losses were made up of the owner's litigation expense, the policy would cover only \$450,000.

We Are Your Ally

As we've shown, there are a number of practice management techniques and coverage options that design firms can consider to help control the cost of professional liability insurance. We are willing and able to help you evaluate your needs, discuss your options and help educate your clients on the various options available. We can even help you bring a client with unreasonable or uninsurable demands back to realistic coverage expectations.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventatives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.