

# A/E RISK REVIEW

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**FINANCE INSURANCE, LTD.**  
Quality Service For Your Insurance Needs

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## Top 10 Risk Management Questions Facing Design Firms Today

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

With a nod to TV's late-night host David Letterman, here are the top ten professional liability concerns we have been hearing from our A/E clients and prospects. It's not a scientific poll, mind you, but a fair reflection of what's on the mind of many of today's design firms when considering their professional risks. In no particular order:

### **#10. Should I consider expanding the scope of services my firm offers in order to increase our annual revenues, or is this risky business?**

As a rule, expanding your scope of services on each project is an excellent way to increase revenues. What effect such a move will have on your risks depends largely on what types of new services your firm offers to your clients.

Some new services may actually lower your risk. For example, expanded jobsite observation services can help spot potential problems in the early stages and avoid project upsets. Where you might increase your risks is expanding into services in which your firm has limited experience – branching into designing complex medical facilities, for instance.

Realize that any increase in revenues may result in an increase in the size of your premiums, since annual fees are a key component in determining the cost of your PL insurance. This, however, does not necessarily reflect an increase in your risks.

### **#9. Is mold covered on my professional liability policy?**

Generally, yes. While specific mold exclusions have shown up on homeowners' policies and other types of personal and commercial property insurance, they are not typically found on professional liability policies. This doesn't mean, however, that mold is not a significant risk factor for design professionals.

A mold exclusion could be added to a professional liability policy if an insurer feels your work presents a particularly high mold exposure due to factors such as geographic location or project type. And even without an exclusion, mold could present exposures outside of your professional liability policy. For example, you could be brought into a construction defect claim that triggers a class-action lawsuit alleging bodily injury due to long-term exposure to toxic mold.

Your best advice is to design with mold in mind. Be aware of mold risks in your local and with your project types. Don't skimp on mold-control measures. Pay close attention to plumbing, HVAC equipment and humidity-control systems, ventilation and filtration, window and door installations, drainage and runoff controls, and roofing and envelope systems.

### **#8. Should I sign my client's take-it-or-leave-it contract?**

This is a very difficult question to answer. First, the fact that a client would take such a stance should send up a

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red flag. Is this the type of entity or individual you want to do business with? But if it's a project or client that is attractive to you from a business standpoint, a client-drafted contract is not necessarily a bad thing. The key is to ensure the contract does not contain onerous language you simply can't accept.

First of all, READ the contract – or have legal counsel do so. Highlight any language that you feel presents risks to your firm. Look for language that asks you to indemnify the client from risks that might otherwise logically belong with the client. For example, does it ask you to take responsibility for the client's negligence or actions? Once you've reviewed it, send it to us with your comments. We can focus on your areas of concern and review it for insurability issues. Keep in mind, if you agree to accept liabilities that would not be yours absent the contractual obligation, those liabilities will most likely NOT be insured!

In the end, it comes down to a risk-versus-reward business decision. We'll be happy to provide advice, but only you know whether you can live with the contract conditions.

#### **#7. Whatever happened to project insurance?**

Long ago and far, far away, most professional liability insurers offered a product called project-specific insurance. Generally, this type of insurance covered all of the design firms working on a single project up to the policy's dedicated limits. It was typically paid for by the project owner and the fees earned by the design firms did not count in the calculation of their practice policies.

Sounds great, right? Who could lose when project owners had guaranteed coverage up to their desired limits and the design firms avoided most if not all the cost? The insurance company, that's who! These policies, for a variety of reasons, resulted in monumental losses for insurers. As claims and loss ratios hit the stratosphere, insurance companies pulled their products off the market and project policies went the way of the dinosaur.

Actually, there are still a few insurers who may offer project policies under the right conditions, but prices are extremely high and policy conditions are not as attractive as before. If you or a client think a project

policy may make sense, we'll be happy to investigate options. However, don't expect us to be able to find the same type of attractive product offered back in 1990's.

#### **# 6. Are condos still no-no's?**

Condos remain one of the riskiest types of projects in the eyes of insurance underwriters. They have a horrific claims history due to a number of factors: fly-by-night developers, low fees for design professionals, poor maintenance, and sue-happy lawyers who petition homeowners' associations.

That said, not all condo projects are bad. The name of the game is designer beware. Check the history of the developer and the litigious environment surrounding condos in your area. Do expect, however, that as your book of condo projects grow, you may find professional liability insurance more expensive and perhaps harder to get. Take these factors into consideration when deciding whether to design condos and what to charge for such services.

#### **#5. Will my clients really accept a limitation of liability (LoL) contract provision?**

You'll never know until you try! The fact is, many clients accept LoL contract provisions once the reasoning behind them is explained.

The primary line of reasoning goes something like this: The client has the most to gain from a successfully completed project. The designer's gain is limited to project fees minus expenses. So if the owner has the bulk of the reward, shouldn't it also be willing to accept its fair share of risk?

The best negotiating stance is to avoid a yes/no decision. Provide your client an option – you can either perform your services with unlimited liability for one fee, or you can lower that fee if the client is willing to accept the LoL. We'll be happy to help you in your negotiations of this important contract clause.

#### **#4. What's up with BIM – will it lower or increase my risks?**

Building Information Modeling (BIM) has great promise in reducing professional liability risks. By having all project information contained in a single,

continuously updated database, it should be easier to manage the accuracy of data and integrate all aspects of the project during the design stage. This leads to better specifications, estimations, budgets, schedules and compliance.

However, most in the insurance and design industry agree that BIM may actually *increase* a design firm's liabilities in the short term. New processes are rarely adopted without trial and error. Since the prime designer now compiles and manages virtually all project information, contractors and others who rely on the prime for complete and accurate project information will likely point fingers when any project error occurs. There are also liability issues regarding ownership of that information.

The insurance and legal fields will be challenged to adapt to BIM and establish new standards regarding the allocation of liabilities. So, short-term, be prepared for new liability challenges; long-term, you should reap benefits with time and experience.

### **#3. Should my firm be going "green," and what are the liability issues?**

Like BIM, green design represents a significant portion of future design work. Every design firm needs to investigate the skills needed to design green buildings and move forward boldly with education and training if it decides to go in that direction.

As with BIM, however, new processes invite errors. Liabilities may increase initially. Plus, green design has an added danger – unrealistic client expectations. Building owners will be expecting significant savings in operating costs as the result of increased energy efficiency. If these savings aren't immediately achieved, they'll likely consider it the designer's fault. So, managing client expectations will be a significant risk management tool for those going green.

### **#2. How much will my PL insurance cost next year?**

That's going to depend on a whole slew of factors. Your premiums will be based on your annual fees, your claims history, the types of projects you've worked on and whether you take advantage of cost-saving opportunities offered by your insurance company –

such as completing loss prevention education programs or including prescribed risk management practices.

All things being even, insurance premiums are currently pretty stable. The market is fairly soft and rates may even decrease if it remains soft in the future. However, be sure you consider the entire cost of professional liability protection, not just your annual policy premium. You might find an insurance agent or broker offering significantly reduced premiums. But if you end up with inferior policy coverage or inadequate support and advice in the event of a project upset or claim, buying that cheap policy may turn out to be the most expensive decision you've ever made.

### **And the #1 professional liability concern of design firms is: What is the best thing I can do to reduce my PL risks?**

That one is pretty easy – manage your client relations. Claims studies show that non-technical factors are the leading cause of claims, and topping the list are communication problems between designers and their clients.

Stress within your firm the need to have open, honest and clear communications with your clients. Good communications go a long way to uncovering misunderstandings, omissions and errors at the earliest stage possible, before they require an expensive fix.

Equally important, if you have a solid, open and trusting relationship with your clients, they are more willing to seek amicable solutions to any project upsets that arise, rather than immediately calling in their lawyers and threatening you with claims. When your client's attitude is one of "how can *we* fix it?" rather than "how are *you* gonna fix it?" you've won half the battle.

### **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 preventives, 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.*