

SURETY BONDING & CONSTRUCTION RISK MANAGEMENT 2020 CONFERENCE

January 27-29, 2020 | Bonita Springs, FL



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**AGC's Surety Bonding & Construction
Risk Management 2020 Conference**

January 28, 2020

The Evolution of Contractor's Protective Coverage

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Agenda



- Professional Liability
- Protective Indemnity
- Mitigation/Rectification Coverage
- Other Miscellaneous Coverages
- Key Contractual Issues Impacting Coverage
- Claim Examples
- Takeaways

Evolution of Contractor's Protective Coverage

PL  Protective  Rectification  Pollution

Professional Liability Coverage



Coverage for third party losses arising out of Professional Services

- Claims-Made coverage
- Third party coverage
- Bodily injury (BI) and/or property damage (PD)
- Economic damages
- Additional insureds – Not applicable
- Claim reporting requirements – Notice of circumstances
- Defense within limits (eroding limits)

Claims Made Coverage Issues



Notice – General rule is that claim against insured must be made during policy period **and** reported in writing during policy period or any applicable ERP

But see...

- Pitzer College v. Indian Harbor Ins. Co., 447 P.3d 669 (Cal. 2019)
 - Notice/prejudice is fundamental public policy of CA and trumps NY choice of law provision

Professional Liability Coverage



Consent to Settle Clauses

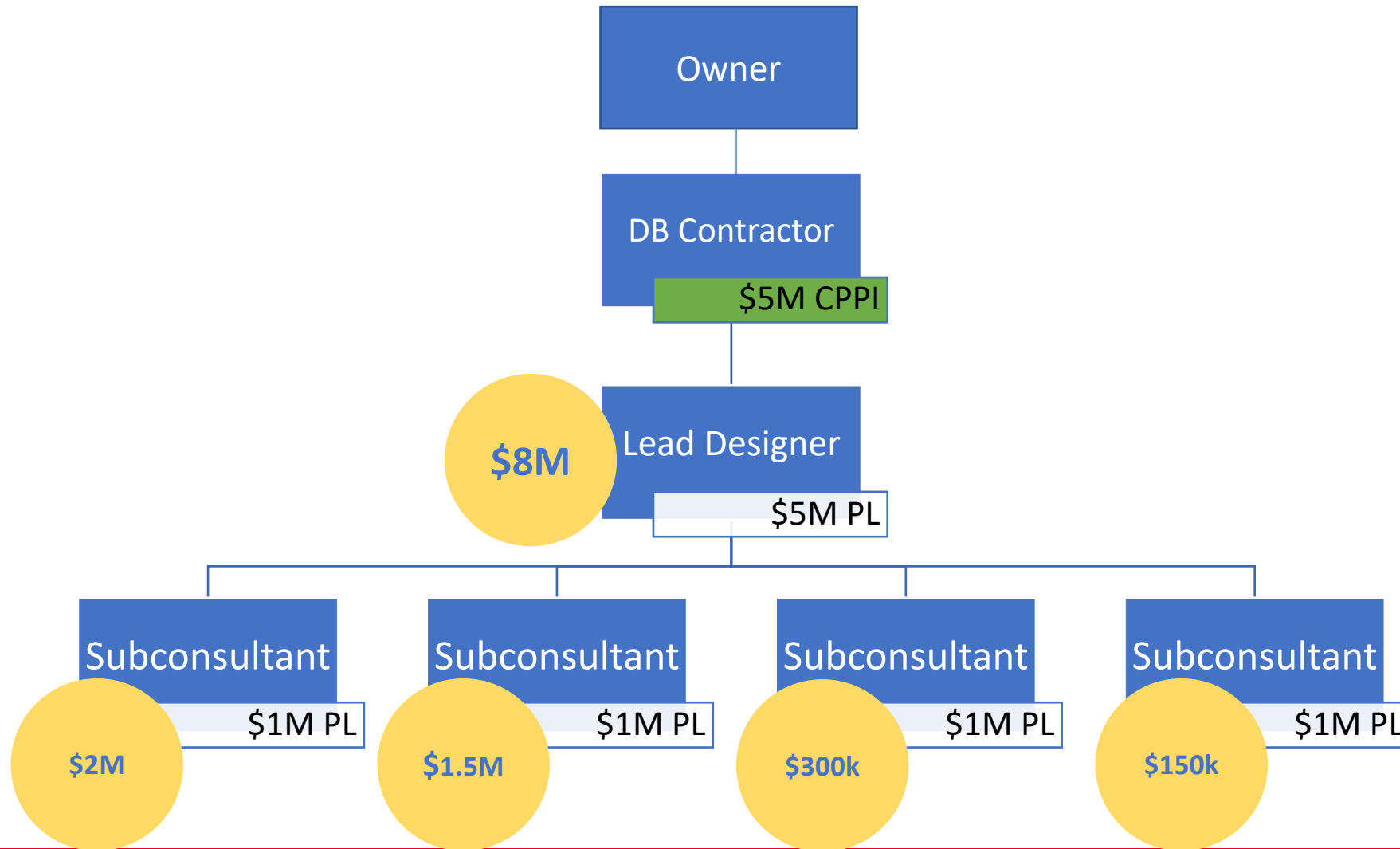
- “We have the right to investigate, conduct negotiations concerning and, with your written consent, settle any **Claim** we deem expedient.”
- Designed to help you but be aware of hammer clause if consent is unreasonably withheld:
 - “If you refuse to consent to a settlement or compromise recommended by us and acceptable to the claimant, then our Limit of Liability under this Policy with respect to such **Claim** shall be reduced to the amount for which the Claim could have been settled, including all **Claims Expenses** up to the time we made the recommendation to you.”
- Rawan v. CNA - Massachusetts Supreme Court
 - Consent to settle clauses are enforceable

Protective Indemnity



- First party insurance
- An excess limit above design professional's and other construction professional's liability insurance policies and any applicable SIR
- Indemnifies the Contractor/Owner for their established (litigation) or negotiated (arbitration/mediation) damages, caused by negligence of a subcontracted design professional or other professional consultant
- Triggered by action against the design professional and reported during policy period

Protective Indemnity



Protective Indemnity Coverage



The Insurer shall indemnify the **Named Insured** for **Ultimate Loss** on a **Protective Claim**, as established by final judgment or a settlement to which the Insurer agrees in writing, in excess of all **Design Professional's Insurance**, provided that: ...

4. the **Named Insured** has made all reasonable efforts to recover all **Ultimate Loss** from all responsible **Design Professionals**.

Protective Indemnity Coverage



Ultimate Loss means any compensatory sum the **Insured** is legally entitled to recover from each responsible **Design Professional**.

Protective Indemnity Coverage



- Indemnity for Ultimate Loss or Protective Loss may be limited to any contractual limitation of liability contained in DP's contract

Example:

“Protective Loss” means:

1. Any amounts you are legally entitled to recover; or
2. In the event the Protective Claim is made against a Responsible Entity in whose favor you have granted a Limitation of Liability **permitted by this Policy**, any amounts you would have been legally entitled to recover in the absence of such Limitation of Liability

Permissible Limit of Liability



H. No Limitation of Liability

You shall not limit the liability of any Responsible Entity, except to collectible insurance, without our prior written approval.

Limitation of Liability – Example



- \$10M claim
- Contractor limited Design Professional's Liability to \$3M without asking insurer
- Creates \$2M gap in coverage – Design Professional's coverage must respond first

Contractor's
Tower of
Coverage

\$5M

Design
Professional's
Tower of
Coverage

\$5M

\$2M

\$3M limitation of liability

Protective Indemnity Coverage



Design Professional's Insurance means all available professional liability insurance policies insuring any **Design Professional**, or any **Design Professional's** subconsultant, or any person or entity for whom the **Design Professional** is legally responsible. (Section III.I.)

Protective Indemnity Coverage



All available professional liability insurance...

- The order in which protective indemnity coverage applies in excess of all available coverage may be impacted by any contractual limitation of liability contained in DP's contract

Example:

Recoverable Insurance is defined as:

all available liability insurance providing applicable coverage to any Responsible Entity or any person or entity for which the Responsible Entity is responsible; or

In the event the Protective Claim is made against a Responsible Entity in whose favor you have granted a Limitation of Liability permitted by this Policy, such as Limitation of Liability.

Mitigation/Rectification Coverage



- First party insurance
- Separate coverage outside of liability coverage
 - Sub-limit or supplemental limit
- Indemnity for mitigation costs incurred by insured in correcting a design defect
- Subject to SIR
- Triggered by discovery/reporting of design defect during course of construction
- Subject to strict reporting and consent requirements



Rectification Endorsement



...with the **Company's** prior written approval, the **Company** agrees to indemnify the **Named Insured** for the **Named Insured's** actual cost incurred in rectifying a **Breach of Professional Duty** in any part of the construction works or engineering works for any project upon which the **Named Insured** is providing design/build services provided:

- A. The **Named Insured** provides prompt prior written notice to the **Company** during the **Policy Period** of the **Insured's** proposed corrective action after discovery of such **Breach of Professional Duty** but in no event after any certificate of substantial completion has been issued; ...

Rectification Endorsement



- When did you know about the Breach of Professional Duty?
- When did you identify the appropriate corrective action?
- Did you obtain insurer's consent for rectification/mitigation costs?

Mitigation/Rectification – Reporting



- Increasingly aggressive reporting language
- Example:
 - “Before incurring any **Mitigation Cost**, you must demonstrate to us the reasonableness and necessity of the proposed cost in light of the projected benefit in terms of mitigating or avoiding a covered Claim, and we provide our express written consent for such **Mitigation Cost**, such consent not to be unreasonably withheld.”

Other Misc. Coverages



- Markets continuing to differentiate by adding new coverages into the mix
 - i. Examples include: Pollution, Cyber, Media
- Beware: Eroding limits with other coverages

Contractual Issues Impacting Coverage



- Waiver of subrogation
- SIRs
- Does contract address liability for consequential damages (loss of profits, interest charges, financing charges, loss of use) or LD's?

Waiver of Subrogation



Example:

C. Subrogation

In the event of any payment under this Policy, we shall be subrogated to all of your rights of recovery thereof. You shall execute and deliver all requested instruments and papers in furtherance of such rights to us and do whatever else is reasonably necessary to secure such rights. **You shall do nothing to waive or prejudice such rights.** We shall have priority in any recovery, and any amounts recovered in excess of our total payment and the cost to us of recovery shall be paid to you. However, we waive our rights of subrogation under this Policy against your clients and their designees (except for a **Responsible Entity**) to the extent such a waiver is required by a written contract with you executed prior to the **Claim**.

For Coverage A only, we will not subrogate against a **Responsible Entity**, provided it has maintained **Recoverable Insurance**, regardless of whether or not such **Recoverable Insurance** is exhausted or reduced.

Self-Insured Retentions



- Example: \$1M SIR on Design Professional's Coverage
 - Design Professional cannot pay
 - Who is responsible for SIR? Will DP's insurance respond?
- Solution: Prohibit high SIRs.
 - Request and review policy, COI, etc.

Claim Examples – FIU Bridge Collapse



- Collapse of concrete truss pedestrian bridge
- 6 dead
- 12+ injured
- 18 civil lawsuits
- Potentially \$1.5 billion in total damages

Claim Examples

- **Site Design** - The design build contractor hired subcontractors for design and construction of slope/grade for of site of new multistory office building. The project owner suffered damages when a section of the slope failed due to a heavy rain event. The owner demanded repair of the failed slope and replacement of the additional slopes onsite with same design as well as damages due to project delay. Damages were in excess of \$2,000,000 and multiple policy sections were triggered along with the builders risk coverage and possibly general liability.
- **Notice Issue** - Contractor was hired to design and build a warehouse facility within an industrial park. Post completion the project owner made claims demanding rework and from alleged design errors to rainwater retention ponds onsite. The contractor made multiple failed attempts to remedy the situation. When costs to remedy the problems were going to exceed \$1.5M; the contractor made claims against their GL and PL policies. The GL policy denied due to allegations of design error and the PL policy denied because of late notice provisions.
- **Curtain Wall** – contractor subcontracts the design and installation of curtain wall. Curtain wall components are mostly assembled off site but certain components are assembled in field. Subcontractor uses wrong size screws/bolts and certain pieces dislodge and fall from building. Curtain wall also results in water infiltration. Contractor liable for both negligent construction and negligent design.

Claim Examples continued...



Protective Indemnity:

- Contractor hired to provide design build of an MRI room for a hospital rehab. The design firm hired to engineer the structural unistrut supports, the unistrut supports connections failed resulting in significant deflection post project completion. It was determined that the engineering sub-consultant hired made calculation errors which caused the unistrut to fail. The Design Builder brought claim against the engineer, however the engineering firm had gone out of business in the time between project completion and the failure. There were no limits available from the engineer and the protective coverage covered in excess of \$250,000 to remedy the failure and other damages from loss of use.

Takeaways



1. Make sure DP's insurance is primary re: all design services
2. Report potential matters / circumstances timely
3. PL policy's consent provision goes two ways
4. Don't admit liability / use care in communications prior to reporting claims
5. Document wisely
6. For mitigation/rectification claims, keep carrier informed throughout process
7. Make sure contract addresses responsibility for SIR's or deductibles
8. Review choice of law / limitation of suit provisions

Thank You!



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