



» Anticipating the Migration of Design Claims into the Surety Relationship

As design-build, integrated project delivery, and other forms of project delivery continue to develop and take an increasing share of the construction market, the traditional rules of insurance and surety will be challenged. Certainly one of the trends of which sureties should be aware is the possibility of the migration of what have routinely been professional liability or design-related claims into the guarantee of the completion of construction.

Contractors, especially those who are in any way involved with design-build, have a significant design liability exposure. Additionally, the client demand is leading the design and construction process into various forms of integrated project delivery, and the distinction between design decisions as a professional service and the “means, methods, techniques and sequences” of actual construction have become increasingly muddled. In the minds of clients—and eventually the courts—the concepts of what constitutes design and what separates design from construction will be confused. With that confusion comes the need for responsive design liability protection. Unless that protection is in a professional liability insurance policy, the performance bond might be an unsuspecting recipient of the exposure.

Traditional Design and Construction is Eroding

The market will see the development of complex hybrid systems of design and construction, and current economic conditions will accelerate that process. While an integrated project delivery approach in which separate companies provide design services and manage the construction activity may seem to preserve specific duties for separate parties, such a differentiation may exist more in the intent of the separate companies than in the law. When construction managers, general contractors, and specialty trade contractors become involved in the design decision process at an early stage in a project, they no longer can claim that design decisions are independent from their construction work.

Performance bonds are not a vehicle for protecting project clients from design errors. The accuracy of the plans and specifications and a project's compliance with codes are issues properly addressed through professional liability insurance. It is likely, however, that sureties will be forced into a situation where, in essence, they “insure” the portion of a project's design in which the contractor is involved through the bonding of the performance of the contract. As claims migrate from often underinsured design firms to companies that actually put work in place, sureties must carefully evaluate the actions of contractors and clearly limit bonding to the construction activity.

Design Liability Claims Against Contractors Show the Scope of the Exposure

One way to anticipate claim situations that could migrate from design liability into surety bonding is to examine the statistics of Victor O. Schinnerer & Company, Inc. In addition to insuring over 22,000 design firms, the Schinnerer program with CNA insures integrated design-builders and the professional or design liability exposures of contractors and others in the construction industry.

Design liability claims against contractors are a type that, in the absence of professional liability coverage, could become demands that sureties will need to address. Even before the growing confusion over construction project roles and blurred responsibilities in design and construction, contractors were targets of significant design-related claims.

Below are some examples from the Schinnerer program.

- During an engineer-construct situation in which the contractor aided in the design of a production

facility, problems in the completion of construction of the plant and the installation in equipment led to lengthy delays and increased costs. While the engineering firm absorbed much of the claim from the owner, the contractor, because of its own "design deficiencies" ended up paying \$4,000,000.

- On a project where the contractor "participated" in the design of a parking garage, multiple parties were held responsible for structural engineering problems. Corrective work to cracked support beams resulted in a payment of over \$865,000 by the contractor.
- A contractor constructing a grain storage and transfer facility faced a problem with differential settlement. The facility required significant remedial work during construction, and the project suffered significant delays. Because the contractor was involved during the design of the facility—including decisions on the foundations—the professional liability policy was hit for almost \$845,000 for harm to the client and the delay in bringing the facility online.
- A specialty trade contractor responsible for a curtain wall installation ended up paying over \$500,000 in delay costs because it was unable to design, fabricate, and install the window and mullions within contractual time constraints.
- A general contractor was held responsible for the design errors of a mechanical subcontractor when the HVAC system delayed the occupancy of a dormitory complex. The general contractor paid almost \$270,000 to rectify design errors which made the system unacceptable and in compliance with the contract documents.
- The design of the fire protection system in a religious complex was delegated to the contractor. Design deficiencies kept the building from opening on schedule and necessitated a redesign by an independent professional and a reconstruction of portion of the facility. The contractor's payment for the delay costs alone totaled over \$240,000.

While these design-related claims may seem unusual, the overall statistics show that contractors often have such exposures. Only one in five claims against contractors actually ends up with the contractor being held responsible for a design error through its involvement in providing, assisting, or influencing the design. But since 2004 the average indemnity payment made—the amount paid beyond the firm's deductible obligations—on behalf of these contractors for design and construction deficiencies has been about \$370,000. Clearly, the design liability of contractors will see both an increase in frequency and severity as the involvement of contractors in design increases by choice or necessity.

The Surety Industry Should Take Underwriting Precautions

The surety industry may not be able to rely on the assumption that the use of integrated design and construction activities through building information modeling and other technological and communication advances will preserve the fundamental and traditional relationship between a design firm and a construction entity. The law—because of the increasingly common meld between design and construction—is unlikely to clearly separate design as being provided by a licensed design professional and distinct contractor responsibilities for constructability and the means and methods of construction.

Certainly, owners anticipate that the collaboration of design and construction entities and the integration of decision-making will result in greater efficiency and fewer disputes. But sureties bonding those projects should have more critical concerns. Formulating underwriting criteria for the risks of an industry without clear lines of demarcation between design and construction will be an immediate challenge. Supplementing normal approval requirements with the emphasis that insurance is in place to cover the design exposures seems imperative. Sureties should demand that contractors assess their design risks and manage them through appropriate contract language, management procedures, and professional liability insurance coverage.

Contractors Need Information on Their Design Liability Exposure

Sureties can assist in the education of contractors on the difference between bonding and design liability insurance. One of the most convenient ways of doing so is by sharing the Schinnerer website for contractors – <http://www.planetcontractor.com/>. In addition to providing information on available coverages, the website includes educational information such as "Contractor War Stories." It also aids contractors in determining the coverage they need through a checklist, a purchasing guide, and "7 Compelling Reasons to Insure Your Business." Of course, more information always is available from the Schinnerer underwriting manager for contractors, Gene Todaro, who can be reached at phone: 301-961-9828 or e-mail: Gene.A.Todaro@schinnerer.com.

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