When Clients Ask for Sky-high Insurance Limits

The ACEC's 2014 Professional Liability Insurance (PLI) survey shows that 72% of member engineers carry $2 million or less in professional liability insurance limits. Surveys of architects show similar results. Such limits have traditionally been considered reasonable and customary for all but large design firms with annual revenues of $50 million or more.

But that may be changing. As the economy rebounds and owners bring more and larger projects to the table, we've recently noticed that many of our A/E clients are being asked to carry higher PLI limits.

What happens should a client demand that their architect or engineer have PLI limits of $5 million, $10 million or even $25 million? Some design firms may feel that higher insurance limits are only a phone call away, and they can adjust their fees accordingly to offset some or all of the increase in premiums. After all, wouldn't an insurance company relish the thought of selling you more insurance and charging you more money?

Unfortunately, things are not so simple. In fact, most insurance companies are reluctant to increase your PLI limits beyond what they consider a reasonable level. They are concerned that huge limits make you a primary target for future project claims. Therefore, your request for higher limits may be met with a flat "no."
So how should you handle a client demand for high insurance limits?

Always Ask Why
Start by determining why the client wants higher limits in the first place. It might be that your client simply thinks higher limits are better than lower limits and is not familiar with the PL insurance marketplace. Sometimes, a simple explanation that higher limits are difficult to get, expensive and really not necessary will do.

In other cases, however, clients have what they consider valid reasons for asking for higher limits. It's not uncommon for a client to ask for limits equal to the construction value of the project. In such cases, you can try to reason with the client that the chances of having a claim equal to the total value of the project is miniscule, and that such high limits are unnecessary -- particularly when the requirements are applied to the contractor, the lead design firm and all subconsultants. Try to convince the client that insurance limits should reflect the reasonable liabilities of each party to the project, and that limits of $1 million or $2 million should be more than adequate for the majority of small to midsize design firms.

Clients who are municipalities or large institutions may have strict insurance requirements that are applied to all parties to any projects. In such cases, it may be difficult to convince the client to change policy. This may be the time to call in some subject matter experts, such as your agent or insurance underwriter, to try to convince the client that their limit requirements may be excessive and in need of reconsideration.

A/E firms who are subconsultants on a project may get a demand for higher insurance limits from the prime designer. This is typically because the prime was required to have higher limits as well, and the project owner may even demand in their contract high limits on all subs. In such cases, it may be time to for all designers on a project to present a unified front and seek lower limit requirements from the project owner.

When Push Comes to Shove

Suppose despite your best efforts to convince the project owner to reduce its PLI requirements the client remains steadfast in its demands. Your next step is to work with your agent to present the request for higher limits to insurance underwriters in the best possible light. When reviewing the request, the underwriter will consider:

- The project contract. Explain to your client that chances of obtaining higher limits will be greatly improved if the contract does not contain onerous clauses such as one-sided indemnities or warranties, and includes a limitation of liability clause.
- Your scope of services. Having construction observation services as part of your scope could help convince an underwriter to increase limits.
- Your experience with the client and with the project type. A claim-free history working with this client or on these types of projects may increase the underwriters comfort level.
- Project construction values. High values on a big project may help justify the client's need for higher limits.

Options for Higher Limits

When a client demands higher PLI limits, your first thought may be to simply increase the limits on your current practice policy. Indeed, with claims severity on the rise, coupled with the ever-growing number of projects you have worked on over the years, higher PLI limits may be in order.
However, if increasing your aggregate practice policy limits is not needed for your situation (outside of pleasing one demanding client), or if the increase in premiums is simply too big of a hit on your pocketbook, you can consider these less-expensive options that may provide the added protection a client or prospect requires:

1. **Specific-project excess.** With specific-project excess coverage, you can maintain your current limits on your practice policy while purchasing an endorsement that provides a higher limit to cover a specific project. For example, you can maintain a $2 million practice policy and purchase a $5 million limit on one project for substantially less than raising your entire policy limit to $5 million.

2. **Specific-client excess.** Suppose you find a new client who wants you to work on multiple projects, but demands higher insurance limits across the board. Specific client excess is similar to specific project excess, except the higher limits apply to all projects performed for a particular client. Again, this increased coverage is usually more affordable than raising your entire practice policy 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 DRA about Project Insurance

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

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

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

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

Secure coverage: Most project policies cannot be cancelled 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 typically 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 won't necessarily be counted to determine practice policy premiums, a design firm saves money on its annual insurance costs.)

Unfortunately, insurance companies have suffered severe losses on project policies and have become quite selective in writing them. Some insurers no longer issue project policies and, among those that do, the cost and the required deductibles can be high. Because we specialize in professional liability insurance for design firms, we can help you determine whether such coverage is available. We can also help explain the benefits and costs of the project policy to your client, coordinate implementation, and provide loss prevention assistance throughout the life of the project.

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

Owner's Protective Professional Indemnity (OPPI) Insurance

An owner's protective professional Indemnity (OPPI) 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 effect first. Then, if the responsible party's practice policy limits are depleted, the OPPI policy covers some or all of the additional damages, depending on the policy conditions and limits. This enables the project owner to secure the policy limits they desire for their project without you having to increase your practice limits.

Because the OPPI policy comes into force only after the practice policy of the design firm has been exhausted or is otherwise unavailable, owner protective insurance is often less expensive and more available than a project policy. OPPI policies can be purchased annually or for the life of the project. In some cases, retroactive coverage can be added to projects already in the construction phase. Environmental engineering exposures can also be covered. "Blanket" OPPI policies may also be available for an owner's multiple projects.
In most cases, the design firms must maintain a minimum level of PLI 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. Conversely, since the owner is the named insured on the project, OPPI limits will not be depleted by the legal defense fees incurred by the design firms.

As an example of an OPPI 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 OPPI 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.

Not Always the Perfect Solution

There may be instances where design firms find themselves between a rock and a hard place -- the client continues to demand high PLI limits and you simply can't find an insurer who will provide the requested coverage. You may lose the project.

In most instances, however, a solution can be found. Either the client can be convinced to lower its demands or we can find you an insurer who can provide a solution via higher limits on your practice policy or one of the innovative alternate solutions we've just discussed.

Finally, if you can find the higher practice policy limits your client asks for, consider the following negotiating stance: Offer to provide the higher limits only if you are reimbursed for the additional costs.
The owner may just choose the lower limits and you don't have to raise your practice policy limits.

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.