



Lean Construction Institute

Building Knowledge in Design and Construction

Please comply with the Lean Construction Institute's Usage Policies and Attribution Guidelines at <http://www.leanconstruction.org/usage.pdf> when using this file. Thank you.

Insuring Integrated Project Delivery

James Evans, Albert Risk Management Consultants
Kurt Dettman, Constructive Dispute Resolutions



What We Will Cover Today

- Introduction to project insurance coverages
- What is different about IPD Projects?
- What does an Owner want?
- Risk Allocation and Insurance
- Traditional Risk Allocation and Insurance
- Thoughts on evolving approaches for IPD projects
- Potential insurance structure in the IPD setting

Project Risk Subjects

IPD Speak

- Project Outcomes
- Project Performance
- Project Risk
- Internal Project Team Issues
- “Traditional” 3d Party Claims

Insurance Speak

- Performance Bonds
- Professional Liability
- Builder’s Risk
- General Liability
- Auto Liability
- Pollution Liability
- Umbrella Liability
- Workers’ Compensation
- Aircraft/Watercraft Liability

Insurability

- Not all risks or exposures are insurable. Sometimes must use another method of financing loss.
- Another consideration is how well an insurance policy performs in the event of a loss.
- There is often a disconnect in expectation and/or performance among (i) the requirements or specifications, (ii) the actual language in the resulting purchased policies, and (iii) the applicability of the coverage to a specific set of facts in the event of a loss.



Typical Construction Insurance

- Builder's Risk
- General, automobile, pollution and umbrella liability
- Worker's compensation
- Professional Liability (Errors and Omissions)

Builder's Risk

- Builder's risk protects against damage to property, including the project works arising out of natural and man-made perils, e.g., fire, flood, windstorm, theft.
-
- No fault. Insurer has rights of subrogation against other project participants.
- Deductible or retention applies.



General Liability

- Protects against liability (defense and judgments/settlements) for bodily injury or property damage arising out of premises, operations, completed operations, automobiles, watercraft/aircraft or pollution events.
- Fault or negligence based.
- Deductible or retention may apply.

Workers' Compensation

- Protects against bodily injury to employees.
- Discharges statutory obligation of employer.
- No fault basis. Suits against employer barred.
- Injured employee (and family) retain right to sue third parties responsible for injury (“third-party action over claims”).

Professional Liability

- Protects against claims for breaches of professional duty that cause injury/damage.
- Claim (fault-based) must be asserted against insured.
- Defense part of insurance limits. (Defense estimated at 35% to 40% of insurance company costs.)
- Aggregate limits apply. Insurance is a “wasting asset.”

Our Diagnosis

Insurance Challenges Of IPD

- IPD presents a transformed set of exposures that:
 - are NOT consistent with the traditional risk allocation and insurance mindset of owners
 - are NOT effectively addressed by existing construction risk insurance products



Insurance Challenges Of IPD

- IPD insurance arrangements often driven by existing insurance products and underwriters' preferences
- Challenge is aligning an Owner's preferences with the Owner's IPD objectives and making them clear to brokers/insurers



The Owner's Objectives

An Owner's objectives for a construction project are:

- That the project is completed in a reasonable time frame,
- That the completed project functions as planned for a reasonable time after completion, and
- That the ultimate cost is reasonable.



The Challenge

- How can risk allocation (contractual provisions) and the insurance requirements imposed on the parties to the contract must support the owner's objectives?



Background: Risk Allocation

- Before we tackle the specific issue of insuring an IPD Project, it would be appropriate to put insurance in the context of project risk allocation.
- Risk allocation for a particular project flows from the terms and conditions of the contract. Insurance is a major means to manage or transfer risk.

Fundamental Principles of Risk Allocation

- Proportionality. No party should be expected to assume risk that is disproportionately greater than its financial stake in the transaction.
- Residual Default. Residual risk is, by default, allocated to Owner.
- Efficacy. Risk should be allocated to the party with the best ability to *avoid, mitigate, absorb* or *insure against (transfer)* a particular risk.



Three Key Elements

- Duty
- Liability (exposure)
- Ability to discharge duty

Appropriate risk allocation depends on a rational balance of these elements. Problems arise when one of the three key elements is separated from the others.



Risk Allocation Components

- Duty/Standard of Care Provisions
- Indemnification Provisions
- Limitations of Liability/Exculpatory Provisions
- Waivers and Releases
- Dispute Resolution
- Insurance Requirements
- Miscellaneous exposures (security, safety, trade partner/supplier insurance, bonds/surety, liquidated damages)



Risks (Exposures) to be Allocated

- Damage to property (the work and/or owner's property)
- Injuries to third-parties (including employees)
- Breaches of professional duty
- Default or inability to perform by contractors or subcontractors
- Efficacy of the project



Special Features of IPD Projects

- “Blurred” responsibility with BIM participation
- Shared decision making (“safe harbors”?)
- Modification of traditional roles (design vs. means and methods)
- “No Blame” ethos and practices



Risk Allocation in Traditional Setting

- Indemnity transfers risks to party who controls the risk and is potentially more culpable for loss.
- Insurance requirements imposed on all. Everyone brings their own insurance to the project:
 - Contractors carry primary insurance for liability and workers' compensation.
 - Design responsibilities remain with designer with requirement to carry professional liability coverage.
 - Owner may carry builder's risk. Waiver of subrogation usually applies.
- Mutual waiver of consequential damages usually in force.



Traditional Insurance Program Elements

- Builder's Risk or Property in the course of construction (Owner or Contractor) with or without so-called "soft costs" extension
- General (plus Automobile, Umbrella and Pollution) Liability (Contractor)
- Workers' Compensation) (Contractor and trades)
- Professional Liability (Designers and consultants) on either a practice or project specific basis.
- Performance Bond (and/or trade partner default insurance) (Contractor)



Characteristics of Typical Program

- Each policy insures the interest of the policyholder (with an exception for Additional Insured status)
- Liability (both general and professional) based on liability (usually negligence based) to another party, requiring the other party to bring an action or claim--in other words, coverage is “fault” based
- Claims may be brought by any party (subject to contractual limitations and waivers)
- Costs of insuring against internal project party (owner, designer, constructor) claims are a significant portion of all insurance costs



Some Insurance Alternatives Have Evolved

- Project Specific Errors and Omissions policies
- Owners Professional Protective Insurance
- Controlled Insurance Programs (for workers' compensation, general liability and pollution liability)

Changes have been driven by insurance market conditions, changes in project delivery methods (design-build and CM at risk), and owner preferences.

CCIPs and OCIPs

- Micro-laboratory for IPD concept
- Coverage for all “enrolled” parties, including owner, CM, GC or Prime Contractor, selected sub-contractors, but usually not including designers.
- Shared limits
- Joint defense
- Coverage typically restricted to WC, GL and Pollution with high limits.
- Driven by economics of cost avoidance and loss reduction.



Back to IPD

- Insurance program design depends on advice owners get from (i) their advisers, (ii) outside experts and (iii) the IPD team members.
- Insurance coverages available may drive the risk allocation rather than vice versa.
- Recent experience suggests that advisers start with (i) Professional Liability and (ii) some form of Coordinated Insurance Program (CCIP and OCIP). And the current state of IPD agreements reflects this state of affairs.



Market Barriers

- Individual policies may not adapt to shared risk
- Insuring an SPE may be difficult
- Some shared risks may not be insurable for some IPD team members
- Consequential damage waivers may not be acceptable to certain parties
- Waivers of subrogation may not be acceptable to certain property underwriters
- Liability for third-party claims cannot be waived
- No underwriting experience with IPDs

Conceptual Shift in Risk Management

Traditional

- Individually managed
- Transferred as much as possible (maximum insurance)
- Focus on litigation and damages among the three parties
- Mirrors compensation and reward

Integrated Project Delivery

- Collectively managed
- Appropriately shared (minimize intra-party claims/insurance)
- Focus on management controls and third-party exposures
- Mirrors compensation and reward



Observations On Owners' Preferences

- Owners may not recognize that they ultimately bear most risks and costs
- Owners (and their advisers) may believe in fault based risk allocation
- Owners (and their advisers) may not fully understand what the insurance they require actually covers
- Owners often default to traditional insurance requirements and risk allocation approaches



Antidotes To Traditional Advice

- Recognize that the Owner pays for almost everything-- focus on shared (project) economic risk not individual economic risk
- Understand that a significant percentage of the insurance overhead relates to liability exposures to parties within the IPD contract
- Realize that individual economic risk placed on the IPD constructor or designer will already be insured



Our Prescription

- Focus on First Party coverages for the Project Core Group (including “joined” trade partners and consultants)
- Provide broad liability coverage for claims brought by Third-Parties
- Negotiate IPD agreement that reduces intra-team liabilities and the attendant needs/costs/problems to insure
- Procure needed insurance on a Project level basis

Elements of IPD Insurance:

First Party Coverage

- A sizeable, shared deductible
- Recovery of remediation costs for design and construction errors (similar to current Owner's Professional Protective Insurance)
- Coverage for traditional natural and man-made property losses (similar to builder's risk policies)
- Coverage for delayed start-up, soft costs, consequential damages, and efficacy and "liquidated damages" like events

Elements of IPD Insurance:

Third-Party Coverage

- Coverage for general liability, excess or umbrella liability, and professional liability
- Coverage for all IPD team members against third party claims based on the team's activities (whether or not professional in nature)
- Coverage against (i) completed operations claims and (ii) after-project claims against the IPD team
- Approach essentially the same as current OCIPs and CCIPs, but based on IPD principles and practices



Some Thoughts on Procurement

- The traditional approach involves many parties (brokers/agents and insurers)
- An integrated approach would have a single intermediary (broker/agent) and small number of prequalified insurers
- Insurance procurement approach should mirror the overall IPD procurement model--involve both the broker and the likely insurance companies early on in the program design
- Some independent voice is still required to avoid an insurance-centric solution to the IPD risk issues



Some Thoughts on Execution

- The owner's IPD approach should encompass the risk allocation and insurance decisions. The contract should reflect the collaborative culture and goals of IPD.
- Involving brokers/insurers at the planning stage makes sense since the development of IPD specific insurance products depends on the owner's definition of risk exposures and underwriters' understanding of the transformed exposures.
- Getting the brokers/underwriters to think like part of the IPD team and to understand the resultant shared risk exposures is key to getting the right insurance at the right price.



Conclusion

Recommended IPD Insurance Approach

Professional liability is no longer the main focus of the insurance program; the insurance coverages match the IPD contract terms

IPD agreement should have appropriate risk allocation terms, including risk-sharing provisions, waivers, and allocation of deductibles or retentions--and the insurance program should match it.