

Contractors Protective Professional and Indemnity (CPPI): Protecting Contractors' Balance Sheets



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Why Do Contractors Need It?

Contractors incur professional liability exposure when they self-perform or subcontract design, or provide professional construction management services to a project owner, whether in the role of construction manager at risk or agency construction manager, and particularly if the project delivery method is design-build.

Most contractors' general liability insurance policies include a professional liability exclusion that removes coverage for claims arising from their professional services work. Even without a professional services exclusion, the commercial general liability (CGL) policy only covers bodily injury and property damage. Therefore, no coverage exists for claims involving pure economic loss. For example, the CGL policy would not respond to damages arising out of the installation of an HVAC system that fails to provide the proper room temperature, because this under-performance does not meet the policy's definition of property damage. Professional liability insurance is therefore needed to cover losses arising out of a design or specification error, and to cover the additional activities that constitute professional services.

Coverage Overview

Contractors Protective Professional and Indemnity (CPPI) coverage consists of two main parts, and can be written with or without pollution coverage. CPPI coverage can also be purchased on an annual or project-specific basis.

Part I—Contractors Professional Liability

The first coverage component is designed to provide the contractor with coverage, including defense costs, for third-party losses resulting from professional negligence. Defense costs alone, even if the allegations against the contractor are false and groundless, can present the contractor with a financial burden that can significantly impact its balance sheet when left unprotected by insurance.

Some examples of professional liability allegations against a contractor include

vicarious or direct responsibility for:

- ❖ Negligence in preparing plans, drawings, designs and specifications;
- ❖ Failure to detect faulty workmanship;
- ❖ Negligence in specifying building materials;
- ❖ Subcontractors including, but not limited to, mechanical, electrical, environmental and/or geotechnical.

Part II—First-Party Indemnification

The second coverage component provides the contractor with coverage for first-party losses incurred as a result of subcontracted architect/engineer negligence in the performance of professional services. Coverage is excess over the subcontracted design professional's errors and omissions coverage. This coverage is similar to "rectification," which provides coverage when a design error has been detected, but there is no claim yet from a third party. Rather, the coverage comes into play to indemnify the insured for the costs necessarily incurred to correct an error or omission by a design professional after it is detected. The intent of the coverage is to fix the problem before it results in a claim from a third party.

The coverage is triggered when the contractor first makes a claim against the design professional for negligent acts, errors or omissions. If the design professional does not have adequate professional liability coverage available at the time the claim is made, this component will still provide coverage subject to a self-insured retention. The minimum underlying insurance requirement for subcontracted design professionals is \$1 million.

This coverage forms the distinction between a regular contractors professional liability policy versus a CPPI policy. A standard contractors professional liability policy, without this coverage, will provide direct and vicarious liability to a design-build contractor as a result of a subcontracted design professional's negligence when a claim is made by a third party. But it will not provide coverage for costs associated with correcting design deficiencies prior to a third-party claim. Without this coverage, the design build contractor is left unprotected by insurance and the costs of correcting the defect will fall to the contractor's balance sheet unless the negligent error becomes a claim made by a third party.

Part III—Contractors Pollution Liability

The optional contractors pollution liability component is comparable to today's offerings by most leading stand-alone environmental markets.

Key Markets and Capacity

- ❖ Zurich—\$50 million
- ❖ Great American Insurance Group—\$25 million
- ❖ Catlin—\$15 million
- ❖ Arch—\$10 million

Coverage Trigger

The coverage is claims-made, and is designed to respond to allegations of negligent acts, errors or omissions in the rendering or failure to render professional services as described in the policy.

Commonly Included Professional Services

- ❖ Construction Manager—at risk
- ❖ Agency construction manager
- ❖ Design delegated responsibility performed by the insured
- ❖ Architect
- ❖ Engineer

Common Exclusions

- ❖ Construction means and methods
- ❖ Site safety
- ❖ The cost to repair or replace faulty workmanship from a construction project, unless the project was built in accordance with faulty design
- ❖ Contractual liability
- ❖ Warranties and guarantees
- ❖ Liquidated damages
- ❖ Insured vs. insured

CPPI provides valuable protection for contractors, especially on design build projects. Lockton recommends that contractors work closely with their broker to customize this coverage to meet their unique needs.



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