



## PROFESSIONAL LIABILITY EXPOSURES OF CONTRACTORS

Professional liabilities associated with contracting operations can be a significant exposure for construction firms. The design/build delivery method and construction management services are just two factors that increase a contractor's professional liability. General contractors (GC) and specialty contractors' continued success in the construction industry requires recognition of their professional exposures and implementing risk management procedures to protect themselves from potential catastrophic financial loss.

Recognizing professional exposure starts with understanding the scope of services provided on a project, how the contractor is defined by the project parties, and the project agreement. The following table summarizes professional liabilities associated

with contractor responsibilities. These liabilities vary, are dictated by contract, and are greatest when a contractor is involved with design and consulting during the pre-construction phase of a project.

### PROFESSIONAL LIABILITIES FACED BY CONTRACTORS

PROJECT PHASE	PROFESSIONAL LIABILITY	ASSOCIATED FACTORS
Design	High	Liability exists even if all design is subcontracted and the design firm purchases professional liability insurance. Subcontracting even small portions of a project's design, such as mechanical, electrical, and plumbing results in vicarious liability for the GC/CM. Professional liability exists when providing constructability reviews, value engineering and when making field changes to designs.
Construction Management (CM)	High	Advertising or accepting responsibilities as a specialist in the management of the construction process puts a firm into a consulting role. This increases professional liability. Liability is lower if projects are not complex.
Pre-construction	Medium	Proposing a change that results in construction defects, additional costs and/or failure to discover design defects or constructability concerns exposes you to liabilities more closely associated with a design professional.
Sub-contractors	Medium	Hiring design professionals increases liability as does having responsibility for processing and approving subcontractor payments. Interference with a subcontractor's work can create liabilities, as can the hiring of "specialty contractors" (e.g. environmental contractors) to address unanticipated issues affecting the project schedule.
Budget	Medium	Authorizing change orders that increase the project budget increases liability. Liability decreases when change orders are justifiable.
Schedule	Medium	As a CM, project scheduling is viewed as a professional service because the company is being retained and held responsible as an expert in the construction process. Liability increases if project completion date is critical (i.e., schools).
Field Work	Low	Field changes increase liability.

*This list is intended only to outline some typical professional liability exposures common to contractors and is not all-encompassing.*

## PROFESSIONAL RISK EXPOSURE

Firms performing the role of design/builder, construction manager or general contractor are perceived to have the highest exposure to professional liability. However, subcontractors are not free from this exposure. The professional exposures for all types of contractors and various delivery methods include, but are not limited to, the following:

1. Scheduling and coordinating work as a construction manager
2. Hiring of specialty subconsultants (design, environmental)
3. Providing value engineering
4. Providing constructability reviews
5. Performing quality assurance inspections
6. Making field changes to design
7. Preparing plans and specifications

## PROFESSIONAL LIABILITY CLAIM SCENARIOS

The following examples demonstrate some of the ways contractors can incur professional liabilities.

### Design Professional Error

#### Results In \$1 Million Claim For GC

A general contractor was retained to construct a retail center using the design-build delivery system.



The general contractor entered into an agreement with a design professional to provide the design for the project. The general contractor secured indemnification and hold harmless agreements from the design professional. During construction it was discovered that the design professional had erred laying out the site plan resulting in the retail center sitting several inches above the existing roadways.

Correction of the problem was estimated to cost more than \$1 million. The general contractor made a

demand under the indemnification and hold harmless provisions of the design professional's contract. Unfortunately, the design professional declared bankruptcy and the general contractor remained professionally liable to the project owner.

### Under-Designed Concrete Slab

#### Results In Claim Against GC

A general contractor was contracted by a publisher to design and construct a book warehouse. Upon completion of the building, cracks developed in the second floor slab of the warehouse. It was determined that the slab had been under-designed and required replacement. Cost for replacing the slab, moving and storing the books exceeded \$725,000. The general contractor was held liable for the loss under professional liability arguments.

### Inadequate Drainage System Causes

#### Collapse Of Retaining Wall

A design professional was retained by a developer as the design-builder for an office building. A contractor entered into an agreement to construct a retaining wall for the project. The retaining wall began to fail almost immediately after construction. The design professional erred in designing an adequate drainage system behind the wall. Despite the construction-only aspects of its agreement, the contractor was found professionally liable for a portion of the \$500,000 cost to replace the wall because its services were provided under a design-build contract between the developer and design professional.

### Scheduling Errors Result In Four Month Delay And \$1.7 Million In Damages

A contractor was hired to act as an at-risk construction manager on a casino residence tower. The tower was estimated to be able to produce a gross income of \$45,000 per floor per week from rental income. Additionally, gambling gains from the residents of the rooms was estimated to be \$400,000

per floor per week. Time was of the essence for this project. Due to scheduling errors committed by the construction manager, the tower was completed four months behind schedule. The contractor was determined to be professionally liable for the delay and damages of \$1,750, 000.

### **Shortened Curing Time**

#### **Results In Floor Slab Collapse**

A general contractor was contracted by an airport to develop a retail and transportation center adjacent to the existing airport. The general contractor agreed to schedule, coordinate and quality inspect the project. The project began to fall behind schedule. In order to make up time, the general contractor investigated whether the curing time of a parking structure's cast-in-place slabs could be shortened. The study suggested the time could be safely reduced. Accordingly, curing braces were removed sooner than originally recommended. The study proved to be in error when the fourth floor slab collapsed onto the third floor slab "pancaking" the entire structure. One worker was killed and many more were injured. Under professional liability arguments, the general contractor was held liable for all losses totaling several million dollars.

### **Failure To Properly Manage Project Site Work**

A contractor entered an agreement whereby it assumed responsibility as a construction manager (CM) for supervising the work of all contractors on an office building project. The CM failed to properly manage the work of all contractors resulting in cost overruns for the contractors and owner, delays, overpayment to defunct contractors, interferences with contracts, and business interruption. The CM was held professionally liable for all costs resulting from the aforementioned failures.

### **Failure To Warn And Document Consequences Of Under-Designed HVAC System**

A contractor was retained by the project owner to provide a constructability review of prepared plans and specifications, and to perform a value engineering analysis for construction of a school. The contractor determined from the review that the HVAC system was undersized. The contractor recommended changes to the system which the project owner rejected due to cost. The system was undersized causing extra moisture which fostered mold growth. The school alleged that the contractor was responsible for the mold because it had failed to properly warn the owner of the consequences of an under-designed system. The contractor was held to be partially liable for failing to warn.



### **MEP Design Errors Result In \$9 Million Excess Costs**

A contractor designed and installed mechanical, electrical, plumbing (MEP) and fire sprinkler systems on a hotel project. Design errors in excess of \$9 million were alleged by the project owner because the fire suppression system was found not to be in compliance with code and the electrical distribution system did not work properly. The MEP contractor did not carry professional liability insurance and was forced to seek bankruptcy protection.

*The examples above are intended to illustrate the wide variety of professional liability exposures faced by contractors and the many ways in which those exposures can arise. Insurance coverage in any particular case will depend upon the type of policy in effect, the terms, conditions and exclusions in any such policy and the facts of each unique situation. No representation is made that any specific insurance coverage would apply in the above examples. Please refer to the individual policy forms for specific coverage details.*

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*Accurate as of March, 2011.*