Insurance Considerations in Public-Private Partnership Projects

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Insurance considerations are one of the key elements to the successful planning and execution of a public-private partnership project. Investigation into and research on the requirements and availability of insurance coverage should be considered from the outset of any P3 project.

There have been many articles, white papers, and books addressing the insurable aspects of P3s in the past several years. This chapter is not intended to be a reiteration of those documents but rather a vehicle to identify, evaluate, and match the risks of the various participants in a P3 project with the appropriate insurance products.

Most risk exposures can be transferred through the use of a combination of traditional insurance and surety products available in the current marketplace. While these traditional products are available on an individual basis, the real challenge is to combine the products successfully into a cohesive, all-encompassing program. Otherwise, the result of a piecemeal approach is a lengthy and incomplete exercise, with inconsistencies not discovered until the proverbial horse has left the barn. Because of the complexities and diverse interests inherent in P3 projects, it is more beneficial and cost-effective to develop during the design and construction phases a comprehensive program with a combination of insurance policies written on a specific-project basis for all exposures. In addition, at the completion of the project, there are options available for annual policies that provide the level of risk transfer that appropriately addresses the contractual risk allocation among the parties in the P3 relationship.
Benefits of a Comprehensive Insurance and Surety Program

It is recommended that a single team of insurance consultants, attorneys, brokers, underwriters, and risk management and claims experts be engaged in the early stages of the project to identify, assess, and plan the management of risk for each phase of the project. Ideally, consistent coverage terms and conditions aligned with contractual risk allocation can be achieved if procured through a single insurance company or a group of affiliated insurers. A team of knowledgeable underwriters at a single insurance company can work together to provide a comprehensive insurance and risk management program as opposed to an array of insurance policies. There are reputable insurance companies in the current marketplace who have the capabilities to provide such a program.

Ultimately, a comprehensive program provided by a single insurance company can offer robust risk protection and cost-saving benefits through the avoidance of gaps in coverage and by minimizing overlaps and redundancies. This type of global buy-in approach combined with the team members’ early and continuous evaluation of the project insurance requirements and risk allocation allows all parties to benefit together from the efficiencies of collaboration rather than as separate entities and stakeholders operating independently of each other. For instance, one benefit of having contractors’ professional liability (CPL) and general liability (GL) coverage with the same insurance carrier is that underwriters for each coverage can identify the allocation of risk and insurance requirements for all parties and then collaboratively develop insurance policies that adequately protect the parties while eliminating gaps and avoiding redundancies in coverage. Specifically, a well-written definition of professional services covered under a CPL policy can be mirrored as an absolute exclusion of coverage on a GL policy. This would assure that claims related to the professional liability of the contractor are covered by the appropriate policy.

Furthermore, compared to multiple insurers, a single carrier, has the ability to efficiently expedite the resolution of claims by eliminating finger-pointing between multiple insureds, thereby avoiding redundancies of adjustment and legal expenses. For instance, a claim that involves property damage to a third party, property damage to the project itself, and allegations of design deficiencies can be investigated early by one team of claims experts representing a single insurer. The coordination of the claims adjustment process prevents multiple insurance companies from posturing against each other and incurring unnecessary defense expenses on behalf of their respective insureds. A single insurance carrier can simultaneously engage claims adjusters for the general liability, builder’s risk, and architects and engineers professional liability policies to respond to complex claims.
Identifying the Parties and Selecting the Appropriate Insurance Coverages

Let’s review the entities who are most likely to be parties in a public-private partnership, their respective contractual relationships, roles, and risks in order to clearly identify and select the appropriate insurance coverage for each entity. The entities will include the public owner, concessionaire, shareholders, financiers or lenders, financier’s or lender’s engineer, design-build contractor and all trade contractors, design professionals of all tiers as sub-consultants to the design-builder, design professionals under contract to the lender or owner, and operations and maintenance contractor (see Figure 1).

Public Owners

Role and Contractual Relationship

A public owner, whether a federal, state or local department, agency, municipality, or other public entity, continues to face the responsibility of safely operating and maintaining public assets and infrastructure. As described in this book, deficiencies in funding and public resources have compelled public owners to venture into public-private partnerships as a delivery method to finance, design, build, maintain, and operate public projects. The public owner embarks on a long-term relationship with a private-sector entity called a concessionaire or a special purpose entity (SPE) under a written concession agreement. The concession agreement, also called a development agreement, describes the roles, responsibilities, and allocation of risk between the public owner and the concessionaire for the design, construction, maintenance, and operation of the project.

The public owner operates under certain statutes and legal precedents that may or may not apply to the private partner, such as sovereign immunity statutes, state condemnation, eminent domain and rights-of-way procedures, and local zoning laws. Numerous states have passed legislation and there have been several court cases that determine the legal rights and obligations of both public and private parties involving the use and development of public land.¹ How do these laws apply when sovereign immunity statutes permit public owners (e.g., states and DOTs) to cap their liabilities for damages to third parties? Is the private party granted the same immunities? What happens when concessionaires are not afforded such immunities and therefore have enhanced risks for the operation and maintenance of public assets? It is recommended that public owners and concessionaires become familiar with applicable laws and statutes in order to allocate the risks and appropriately manage those risks through insurance when feasible.

The amount of risk and responsibilities vary with each concession agreement, though there is typically a tremendous amount of risk transferred from the public owner to the concessionaire in the concession agreement. For instance, risks related
to subsurface conditions and environmental permitting may be borne by the public owner, but for purposes of identifying appropriate insurance and risk management products for the public owner's risks and exposures, the common practice is for the owner to transfer the risk by contract for all design, construction, maintenance, and operating elements of the project, as permitted by law, to the concessionaire.

**Risks**

The public owner minimizes its risks and exposures since it presumably transfers most of the risks and responsibilities for the funding, design and construction of the P3 project to the concessionaire. The primary risks requiring management on the owner's behalf are mainly associated with quality assurance, design errors and construction defects, and premises/operations of the construction phase and the completed projects. The concession agreement may require that the concessionaire
and all downstream participants procure certain insurance coverages to protect their own risks and exposures and also protect the public owner for its liabilities arising out of the participants’ services and operations.

Public owners may also engage in direct contracts with independent engineering consultants, commonly referred to as “owners’ engineers,” to provide preliminary investigations, schematic design concepts, and studies pertaining to the feasibility of the project. They may also hire project managers on an agency construction management basis to provide quality assurance, coordination, and oversight of the entire project as an owner’s representative. Although these professional firms do not have any contractual relationship with the concessionaire, it is prudent to define the roles and responsibilities of these professionals as they relate to the concessionaire’s and to the design-builder’s and project engineer’s scope of services. The primary risks resulting from the professional consultant’s or project manager’s services are transferred from the public owner to the consultant or project manager in a well-articulated contract.

**Insurance Coverage Recommendation**

Insurance requirements for the owner’s independent engineering consultants and project managers are similar to those for traditional project delivery methods. It is recommended that the public owner require that the engineering and project management firms purchase architects and engineers and construction managers professional liability insurance. It is more than likely that the public owner and perhaps the concessionaire will rely on information provided by the owner’s engineer throughout the design and construction phases of the project. It should also be anticipated that the public owner or concessionaire will rely on an agency construction manager to provide professional services over the duration of the project. Therefore, it is recommended that the professional liability coverage for each entity be in effect with a retroactive date from when the earliest services commence until substantial completion of the entire project. The public owner’s risk should be protected through an equitable indemnity in the contract and perhaps with an indemnified party endorsement on the owner’s engineer’s professional liability policy, further described herein. Because these types of professional services are provided directly to the public owner, the procurement of separate professional liability policies that insure these parties is an efficient way to manage the public owners’ risks. To the extent that other project participants including the concessionaire and the design-builder may rely on the information provided by the owner’s engineer, those entities may also be included, subject to underwriters’ discretion, as indemnified parties on the owner’s engineer’s professional liability policies.

Although a public owner’s liabilities may be capped by statutes and the owner endeavors to transfer significant risk to the concessionaire, claims from third parties are inevitable. Third parties are described as an entity or person that does not have a contractual relationship with any participant in the P3. Such claims for damages or
injuries against public owners relating to preliminary engineering and project management services can be managed by naming the public owner as an indemnified party on the architects and engineers project-specific professional liability insurance policy. This coverage indemnifies or reimburses the public owner for expenses that it incurs to defend third-party claims to the proportional extent that the injuries or damages were cause by the negligence of the insured professionals. Third-party claims relating to construction operations of any contractor on the project can be managed by naming the public owner as an additional insured on all contractors’ general liability and environmental liability insurance policies.

Concessionaire

Role and Contractual Relationship

The concessionaire is commonly a joint venture or limited liability company (LLC) established specifically for the purpose of developing, designing, constructing, maintaining, and operating the project. Typically the concessionaire has no current assets other than the loan proceeds from construction lenders and capital investments from shareholders. Future assets may include expected revenue from post-construction infrastructure, i.e., tolls, leases, and operational income.

As previously noted, the concession agreement is a written agreement, often voluminous, between the public owner and the concessionaire. The agreement describes the member parties, their roles and responsibilities, and the intended use and performance of the project. A comprehensive concession agreement includes the public owner’s objectives and expectations, budgetary criteria, and timeframe criteria. At this time, there is no standard, industry-wide concessionaire agreement in the U.S., so the format and contents of these agreements vary from project to project. It is critical that the public owner and the concessionaire establish fair and equitable terms for the allocation of risks. The traditional concept that risks should be allocated to the participant that is most capable of controlling and managing them certainly applies to all P3 projects. It is not unusual for the lender and the design-build contractor to also be involved in the drafting of the concession agreement in order to participate in the risk identification and allocation process.

It is customary for the public owner to transfer the rights and obligations, and the inherent risks and exposures for the financing, design, construction, operation, and maintenance of a project to the concessionaire for a specified length of time. A time period is designated for the design and construction phases of the project, after which a “concession period” defines the time (usually between 25 and 50 years) during which the concessionaire will operate and maintain the asset. The public owner also relinquishes management and control of the design and construction of the project to the concessionaire, including the inherent risks which the concessionaire may assume, transfer through insurance, or pass down to sub-entities through written subcontracts.
Risks

Simply stated, the concessionaire has the entire risk of delivering the project on time and within a guaranteed maximum price budget. As described in previous chapters, the concessionaire has presumably assumed substantial risk pertaining to the development, design, construction, operation, and maintenance of the project that would otherwise be retained by the public owner in a traditional project. With that comes ancillary exposures related to business operations and control of the project site. The concessionaire may attempt to transfer a significant amount of that risk, including subsurface and/or environmental conditions, to its design-builder and ultimately to design professionals and trade contractors. But the role of developing the budget, funding, scheduling, and obtaining permit approvals, as described in the concession agreement, may be retained and performed by employees of the concessionaire or by lawyers, accountants, and other consultants hired under specific contracts to perform these services.

Fiduciary liability, limited partnership liability, directors and officers liability, and employment practices liability are exposures that should be assessed by qualified insurance brokers and consultants. While developing the physical site, the concessionaire is responsible for bodily injury liability, property damage liability, and environmental liability resulting from the project. The concessionaire may also be responsible for the direct damage to property in their control before the design-builder assumes that risk. These are direct risks that will be borne by the concessionaire throughout the life of the concessionaire agreement and should be handled appropriately. While the concessionaire may have successfully transferred significant risk and exposures to its downstream participants, the concessionaire is still vicariously liable for the design, construction, and operation of the project that will be performed by designers and contractors.

Insurance Coverage Recommendations

Professional services that have been contracted to lawyers, accountants, and consultants should be insured by those respective entities. A well-written contract between the concessionaire and those contracted professionals should contain fair and equitable hold-harmless and indemnity agreements. It is reasonable for the concessionaire to require that such professionals provide evidence of professional, general and environmental liability insurance with indemnified party endorsements and additional insured status in favor of the concessionaire.

Fidelity/crime insurance, management liability, and employment practices liability insurance policies are available to insure the concessionaire for exposures arising out of fiduciary liability, limited partnerships, and employment practices. It is recommended that a project-specific or annual renewable general liability policy be purchased in the name of the concessionaire to insure its liability for all of the general operations of the project. To protect the concessionaire from third-party claims arising out of any services or operations provided by any entity downstream in the
contractual structure, each contract should contain appropriate insurance requirements. The design-builder and their subcontracted design professionals should provide an indemnified party endorsement in favor of the concessionaire on its contractors and architects and engineers professional liability policies. Wrap-up (or general liability) policies, environmental liability, and excess (or umbrella) policies should name the concessionaire as an additional insured. An all-risk property policy can be purchased with mutual waivers of subrogation to insure property that is owned or controlled by the concessionaire before it is legally transferred to the design-builder.

Lenders or Financiers

*Role and Contractual Relationship*

Lenders or financiers may be banks or financial institutions that provide financing to the concessionaire for the design and construction of the project. Lenders understand that the concessionaire, a special purpose entity, has limited assets and its obligations are not often guaranteed by the parental companies of the member firms. David Hatem has written at length about the relationship between the concessionaire and financiers, a portion of which has been reproduced here.

*Project Financier Design and Construction Risk Concerns and “Bankability”*

Concessionaires typically form single-purpose entities as the vehicle to contract and undertake obligations on PPP Projects. Unless “backed” by guarantees of parent companies (of the Concessionaire sponsor members) with substantial (and preferably liquid) assets, the Financier will be in the position of lending substantial sums with minimal security at the point of loan commitment and loan proceeds disbursement. As recourse and security for satisfaction of the loan obligation, the Financier will depend upon the revenue stream or other repayment mechanism triggered upon satisfactory completion (or operational commencement) of the project. Thus, the Financier will want to conduct a prudent underwriting process to identify and evaluate the various risks and obligations of the Concessionaire that may impair the ability of the project to be completed within budget, on schedule and in accordance with performance and operational requirements and expectations. This process leads to the Financier’s assessment as to the “bankability” of the project.

The traditional perspective is that the Financier is risk-averse and, therefore, seeks to avoid or transfer to others risk exposures of its debtor (i.e. the Concessionaire). Given the “value for money proposition” and other factors promoting the Concessionaire’s substantial risk assumption in PPPs, a fair observation would be that the Concessionaire’s entrepreneurial spirit and optimism bias, and the Financier’s underwriting conservatism are destined to clash, with loan commitment and adequacy of loan amounts to be challenging propositions at best.
Certainly, the Financier, most often (and prudently) with the assistance of one or more due diligence advisors (including a consulting engineer or other design professional) will, as part of the underwriting process, identify and assess design and construction risks; assess the achievability of the performance expectations and requirements for the completed project; evaluate the financial capability or resources of the Concessionaire; evaluate the qualifications and experience of the Concessionaire, as well as other factors relevant to evaluating its willingness or level of interest in committing to a loan and, is so, under what terms and conditions. This assessment process will also affect the premium rate for the loan. The Financier may play a proactive (surrogate) role in negotiating the terms of the Development Agreement, especially as relates to provisions that may impact risk assumption of, and risk allocation to, the Concessionaire. The Financier’s objective in this process is to reach a level of comfort that the Concessionaire’s risk assumption remains within prudent and reasonable bounds. For similar reasons, the Financier will be interested in the extent to which the concessionaire may contractually flow-down risk to lower-tier project participants, such as the Design-Builder and the Design Professional Consultant. Also, as importantly, the Financier will want to be comfortable that the concessionaire is taking prudent steps to procure all of the available insurance coverages with sufficiently robust limits, so as to maximize the concessionaire’s ability to align and transfer contractually assumed risk with such coverages.4

Therefore, lenders are often attentive to the responsibilities of the parties and allocation of risk in a P3 project. They will often hire independent engineers or consultants, referred to as “lender’s engineers,” to perform feasibility studies, due diligence, and technical reviews before they agree to provide financing for the project. As noted above, lenders will impose risk management and insurance requirements in concession agreements and flow-down design-build contracts at all tiers and will require performance guarantees and adequate insurance and surety bonds to assure completion of the project. It behooves the lender to make sure that the risks and responsibilities are transferred through contracts to the parties most able to control those risks.

**Risks**

It is common to describe lenders as “risk-averse.” It is no different with those financiers who are considering a loan to a concessionaire for a P3 project. The lender wants to be assured that the project will be designed and built in accordance with the performance specifications and will operate as expected in order to generate revenue to repay their loan. “A good risk for a lender is no risk at all.” The lender’s goal is to make sure that all of the elements of the feasibility, design, construction, and operation of the project are adequately assessed and contractually allocated to the appropriate project participant.
Insurance Coverage Recommendations

As with the requirements imposed on the owner’s engineer, the lender may request that engineering firms and consultants engaged in the due diligence process provide them with evidence of professional liability insurance for those services. Most importantly, the lender must be satisfied that the project participant to whom risk has been transferred adequately manages that risk with insurance products when available. Because of the lender’s investment in the P3 project, the lender may take an active role in reviewing the overall insurance program to make sure that the insurance coverages are appropriately aligned with each participant’s risk and exposures. For example, the lender may insist that the design-builder carry a certain amount of contractors professional liability coverage to insure design defects for which the contractor is vicariously liable. More commonly, lenders will require contractors to procure general liability and workers compensation, builders risk insurance, and surety bonds on a project-specific or wrap-up basis, while designers must evidence adequate professional liability insurance, also on a project-specific basis. To protect themselves from third-party claims, lenders may require that they be named as an additional insured on all contractors’ general liability policies.

It is also recommended that the lender be named as an indemnified party on the lender’s engineer’s architects and engineers professional liability policy. This will ensure the lender has protection and recourse for defense costs related to third-party claims from other project participants who may allege economic damages resulting from the engineer’s negligence.

Shareholders

Role and Contractual Relationship

Shareholders are individuals or investor groups who invest capital and hold equity in the P3 project. Payment terms and conditions are set forth in a well-drafted shareholder agreement between the concessionaire and the shareholders. The shareholders’ debt is usually expected to be repaid with the proceeds generated from the operating revenue of the project as it is put to its intended use. Occasionally, though less common, a shareholder may share in the revenue stream that is provided by the operation of the completed project.

Risks

The risks of the shareholders are similar to those of financiers or lenders. As an investor in the project, shareholders want to be assured that all design services, construction operations, and operations and maintenance of the project are adequately identified and managed by (1) risk assumption, (2) contractual risk transfer, or (3) appropriate insurance.
Lender’s Engineer

*Role and Contractual Relationship*

As mentioned above in the discussion of their roles and contractual relationships, lenders will often hire engineers and consultants to provide due diligence services including feasibility studies, technical reviews, constructability assessments, revenue forecasts, and studies such as traffic analyses on transportation projects. These lender’s engineers engage in direct contracts with the lender to provide reports that will be relied upon by the lender and often other project participants. It is recommended that the contract between the lender and its engineer be very specific about what information is requested and who will ultimately rely on this information. If the lender is specifically engaging the engineer to provide feasibility studies and revenue forecasts for financing purposes, it should be clear that other project participants are not permitted to rely on this information for their own risk assessment.

*Risk*

The lender’s engineer’s risks are economic consequences associated with the performance of professional services. It is critical that the engineer understands the scope of the project and the owner’s and concessionaire’s expectations in order to provide appropriate information on which the lender will rely during the financing process. It is possible that if the project for which the lender provided financing did not generate the expected revenue, the lender may allege that the engineer’s technical reviews or revenue forecast were erroneous and the engineer was negligent in the performance of professional services.

*Insurance Coverage Recommendation*

As with the owner’s engineer, the lender’s engineer should be required to provide evidence of architects and engineers professional liability insurance. This may be on an annual or project-specific basis. The objective is that the engineer has enough insurance in place for an adequate period of time. It is likely that the accuracy and credibility of the reports and studies that the engineer provided to the lender may not be determined until the project is put to its intended use and generating revenue. Therefore it is important that the lender’s engineer’s insurance be in effect from when their services commence and remain in force for a period of time after the project has been put into use.

Design-Build Contractor and All Subcontractors

*Role and Contractual Relationship*

The design-build agreement between the concessionaire and the design-builder describes the design and construction of the project. The design-build agreement may be an industry-standard agreement, such as one sponsored by the Design-Build Institute of America, American Institute of Architects, Engineers Joint Contract Doc-
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Because there is no specific P3 agreement in the U.S., it is common to see an industry standard agreement with modifications regarding indemnities, guarantees and warranties, and scopes of service. Often, one or more members of the design-builder entity are affiliated with the concessionaire. The actual contractual relationships in a design-build agreement are very consistent with traditional design-build projects. It is prudent for the design-builder to assess the responsibilities and risks they have assumed in the design-build agreement and determine how best to manage those risks. They will assume certain risks, insure others, and transfer significant risk to their downstream design professionals and trade subcontractors.

**Risks**

The actual level of risk and responsibility of the design-builder for the design and construction of the project is determined by the amount of risk that the concessionaire has assumed in the concessionaire agreement and then transferred to the design-builder. As previously mentioned, it is not uncommon for upstream participants such as public owners, lenders, and other stakeholders to influence the amount of risk that is transferred to the design-builder in the design-build agreement. In reviewing risk transfer, the potential magnitude of risk transferred from the concessionaire to the design-builder is described as follows.

The Design-Builder in a Public-Private Partnership is expected to take all the risk associated with the design and construction of the project that the Concessionaire agrees to in the Concession Agreement. The Concessionaire is driven to shed all risk given that it is a special purpose entity created for this project and that the lenders will demand that such entity retain no significant risk. The result is that the Design-Builder will enter into a back-to-back design-build agreement and that the Concessionaire does not have the same motivation to achieve equitable risk allocation.

If the Design-Builder understands that it will essentially assume all risks in the Concession Agreement associated with the design and construction of the project and the Concessionaire is not incentivized to aggressively negotiate equitable risk allocation, the Design-Builder will assume a prominent position at the negotiating table with the public sector owner. The Design-Builder will aggressively pursue contract comments and modifications and will attend all negotiations with the owner and assert its position. The astute Design-Builder will quickly identify the key risk allocation issues with the Concessionaire in the form of a term sheet so that the Concessionaire and the lenders understand the Design-Builder’s risk position at an early point in time.

The typical risks of the design-builder are both professional and non-professional exposures. The non-professional risks and exposures include direct damage to property, supplies, and materials related to the project; property damage and bodily injury resulting from the contractor’s operations on the project premises and occurring
after completion of the project; environmental exposures resulting from the release or dispersal of hazardous materials form the project site; railroad liability exposure for operations within 50 feet of a railroad; and payment and performance guarantees, including obligations to complete the project within a certain schedule according to certain performance specifications. The design-builder is responsible for the safety of all employees and third parties on the project site. Accidents on the job site may result in workers compensation claims and OSHA fines and penalties.

The design-builder’s professional liability exposures are related to the design services assumed in the design-build agreement with the concessionaire and then subcontracted to design professionals on the project. As described in previous chapters, the level of design risk that the design-builder assumes in the design-build agreement may vary from very onerous to fair and equitable. The design-builder is concerned with geotechnical exposures, differing site conditions, environmental liabilities, and vicarious exposures for design defects.

Other Risk Exposures

Insurance coverage concerns for the design-builder encompass a wide range of risk exposures related to the many different services it may provide. Typically, a design-builder can expect claims against its builder’s risk insurance, construction wrap-up insurance, commercial general liability insurance, contractors pollution liability insurance, railroad protective liability insurance, surety bonds, automobile insurance, or workers’ compensation insurance policies.

Builder’s Risk Insurance

A builder’s risk insurance policy provides coverage for direct physical damage to the project that may occur during construction. Builder’s risk insurance is considered “all risk” coverage, and such coverage is afforded under the policy unless it is excluded. Builder’s risk insurance typically covers “hard costs” associated with the repair of the project and “soft costs” such as design fees, testing and inspection services, and legal expenses.

Builder’s risk policies cover property and materials while the structure is under construction. More specifically, the policy covers materials at the job site prior to installation, materials in transit intended for the job, and the value of the property while under construction. Covered perils include: fire, lightning, hail, windstorm, theft, and vandalism. Most policies carry limited coverage for collapse. Standard exclusions in builder’s risk policies include earthquake, employee theft, war, government action, mechanical breakdown, or intentional acts of the owner. In addition, because the intent of a builder’s risk policy is to provide coverage for sudden or accidental events, damages resulting from faulty design, planning, workmanship, and materials are excluded.
Commercial General Liability Insurance

Commercial general liability insurance is the primary insurance for bodily injury and property damage. Again, both designers and contractors carry this coverage. Typically, contractors carry higher liability limits than the designers because the work of the contractor generally results in a greater risk of occurrence of bodily injury or property claims. Because the contractor is in control of, and responsible for, the site and workers’ safety, the majority of claims against it relates to bodily injury and property damage that occur on the site during construction.

Automobile Coverage and Workers’ Compensation

Automobile and workers’ compensation coverage is necessary coverage and dictated by state law. Depending on the type of project and number of workers on the project, the limits could be significant.

“Occurrence Based” Coverage

Builder’s risk, commercial general liability, automobile, and worker’s compensation coverage operate on an “occurrence basis,” meaning that coverage attaches at the time the damages or injury occurs, not at the time the claim is made.

Professional Liability Insurance

A design-builder may be tempted to add a requirement to the design professional’s service agreements requiring the design professional to include the owner, concessionaire, or design-builder as an “additional insured” on the designer’s professional policy. Do not give into the temptation. A design professional cannot add owners, concessionaires, or design-builders on their professional policies because such policies specifically insure only licensed design professionals. A design professional’s professional liability policy protects the designers from claims to the extent caused by their negligent performance of professional services. Because the owners, concessionaires, and the design-builder are probably not design professionals providing professional design services, professional liability insurance would not be an option to cover them. In addition, there is another, sometimes forgotten but critical fact to remember: Because most professional policies contain an “insured vs. insured” exclusion, a design-builder, concessionaire, or owner should not want to be named as additional insureds, because if they were, they would be unable to bring a claim against the design professional under the policy. A professional liability policy provides coverage for professional services and cannot be extended to cover others unless they are providing the same kind of professional services.

Nonetheless, there is an alternative available to a design-builder or other enti-
ty to being named as an additional insured on the designer’s professional liability policy, namely a design-builder’s indemnification endorsement that is added to certain project-specific professional liability policies. This type of endorsement allows a design-builder to be specifically named as an indemnified party. As an indemnified party, the design-builder can seek recovery from the insurance company for damages or judgments, including reasonable attorneys’ fees and reasonable costs incurred by a design-builder from third-party claims asserted against it to the extent caused by a breach of the designer’s professional duties. This type of endorsement is the appropriate option for the design-builder, instead of being named as an additional insured, because it allows the design-builder to recover damages it incurs to the extent caused by the designer’s negligent performance of professional services under the sub-consultant design agreement.

In addition, a design-builder may carry its own professional liability insurance coverage for professional services (i.e., design services) that it may provide from time to time. A contractor’s professional liability policy operates the same as a designer’s professional liability policy. Therefore, whether the insured on the professional policy is a designer or a contractor, the discussion above pertaining to recovery and additional insureds is applicable.

Design Professional as Subconsultants to the Design-Builder

As described in previous chapters, certain design professionals’ roles in a P3 may begin very early in the project planning and may extend through to the operations and maintenance phase. Such services may be provided under one or more contracts. Design professionals engaged in preliminary services as an owner’s or lender’s engineer or project manager will contract directly with the owner or lender, whereas design professionals retained by the design-builder are most likely entering into a design professional consultant agreement as a subconsultant to the design-builder. Under this arrangement, the design professional may be engaged to perform the design services required in the contract between the concessionaire and design-builder. The design-builder may attempt to allocate all design-related risks downstream to the design professional and their respective subconsultants of all tiers.

Risks

The anticipated risk exposures for a design professional on a P3 project can include claims of negligence in the performance of professional services, errors and omissions, delays and cost overruns, and misunderstanding conceptual (RFP) design criteria or other project requirements. David Hatem further describes how the degree of risk for a design professional will vary depending on the scope of services and standard of care described in the design consultant agreement.

More specifically, the professional standard of care relating to design may be expressed as “free of error, omission or other defect” rather than expressed
in more conventional negligence-based terms. In addition, in lieu of a negligence-based standard of care, contract documents on P3 projects often state that the Design Professional’s Consultant’s design shall be fit for the project purpose or warranted to achieve that purpose. In legal effect, such contractual provisions impose significant professional liability risk upon Design Professionals for project failures and disappointments which may be only partially, if at all, due to a design deficiency.

Insurance Coverage Recommendations

Taking into consideration the complexity of the project and contractual structure, the number of design professionals, and the ultimate goal to meet time and cost requirements, it is highly recommended that project-specific professional liability insurance be procured for all entities that provide design and related professional services on the P3 project. Because of the magnitude and specificity of risk that is flowed down to the design-builder’s subconsultant design professional, it is critical that the entire design team purchase project-specific professional liability insurance. A detailed comparison of coverage under a traditional annual practice insurance policy and a project-specific policy will illustrate the benefits of the latter.

The options available to design professionals to fulfill the coverage requirements on a P3 project are the professional liability annual practice policy alone or a project-specific professional liability policy. The professional liability annual practice policy is issued by the insured company to cover all risks in the performance of professional services up to the policy limits, on an annual basis. The project-specific policy is a policy issued for a specific project for the duration of the project plus an extended reporting period of up to 5 years. The issue is whether the chosen policy will be able to respond to a design professional’s risk on the specific project.

Professional Liability Practice Policy vs. a Project-Specific Professional Liability Policy

Characteristics of a Professional Liability Policy or Annual Practice Policy

Let’s review the characteristics of a professional liability annual practice policy and a project-specific policy, pointing out the characteristics of a professional liability annual practice policy that would not support the P3 contract structure. A design firm’s professional liability annual practice policy provides coverage for that its exposure only. If there are multiple design professionals engaged in the P3 project and a project-specific policy was not written for the entire project, each design firm would be insured under a professional liability annual practice policy, subject to differing policy limits, self-insured retention obligations, independent claim defense, and settlement consent provisions. The policy would not include dedicated coverage limits to the project, it would be annually renewable, there would be no specific
alignment of coverage with project-specific risk exposures, and the policy would not provide any mechanisms for contractual risk allocation.

When each design professional has its own policy, each insured and its insurer control the defense and settlement of claims brought against it and make decisions about how to pursue claims against other design firms involved in the project, including subconsultant firms and joint venture partners. Not only is it more costly for each design professional to fulfill its separate deductible obligation, it can also be counterproductive if design team members assume defensive positions against each other. As soon as there is a break in the solidarity of the design team, team members become easy targets for claims. Money, which should be spent on resolving the owner’s claim, is instead used to pay for defending against claims from each other, which, in turn, reduces coverage limits otherwise available to indemnify for professional liability claims.

Professional liability annual practice policy limits are not dedicated to any specific project and are therefore subject to significant reduction or exhaustion based on claims on unrelated projects. This is a very important condition for firms working on a large project. In addition, defense costs are “within the policy limits,” meaning that any expenditure for legal defense fees reduces, dollar for dollar, available coverage. Another practical business issue to keep in mind on long-term projects is that there is significant potential for a practice insurer to mandate coverage limitations or exclusions on future claims arising out of a specific project based upon adverse claims history or other adverse experience on that project. For example, a designer has contracted to provide services on Big City A’s Tunneling Project which has a construction term of five years plus a five-year extended reporting period (ERP). In year 4, a claim for professional negligence is brought and settled against the design professional for an amount just below the limit of its professional liability practice policy. When the policy is reviewed for renewal, the insurer adds an exclusion for “any claims arising from or relating to Big City A’s Tunneling Project,” or, worse, the current carrier fails to renew. Now the design firm is without coverage and needs to secure professional liability coverage to meet the requirements and levels stated in the Big City A’s Tunneling Project contract signed four years earlier.

A professional liability annual practice program also carries additional market and administrative risks that should be reviewed and negotiated every year. An annual claims-made policy carries terms and conditions, deductibles, and limits, all of which are subject to change. Further, future economics or market conditions may lead to lower available limits. Each year, a design professional must review the terms of its policy to be certain that it is adequate to cover the contracts it has in force.

**Characteristics of a Project-Specific Liability Insurance Policy**

Project-specific liability insurance is a policy issued for a specific project for the duration of the project plus an extended reporting period of up to five years.
Project-specific liability insurance is insurance where, in the P3 setting, the owner, concessionaires, and lenders can be named as indemnified parties. The purpose of the project-specific policy is to provide professional liability coverage to the design team collectively. The entities insured under the policy are provided with insurance coverage tailored to their risks and exposures for one specific project.

**Joint Defense**

A typical requirement under a project-specific policy is that all claims be defended jointly. Ideally all design professionals who provided professional services related to the alleged damages are defended jointly through a coordinated process by a single team of claims examiners, defense counsel, and a program manager. Using a joint defense promotes collaboration and the sharing of defense costs among the involved design professionals. It is most effective when the design team determines as soon as the policy is purchased how they will allocate the costs within the self-insured retention (SIR), so that when a claim is made, procedures are already in place to engage and pay the defense counsel.

**“Insured vs. Insured” Exclusion**

Another key characteristic of a project-specific policy is an “insured vs. insured” exclusion, which prohibits one insured design professional to make a claim against another insured designer. The insured vs. insured exclusion furthers the joint defense objective of alleviating redundancy in expense costs and forming a united front in order to facilitate a speedy resolution to claims.

**Dedicated Policy Limits**

A primary benefit of a project-specific policy, which works to the favor of owner, concessionaire, and design-builder, is policy limits that are designated to one specific project and are not shared with other projects. The amount of policy limits purchased on a specific project should be adequate to insure the specific risks and exposures for that project. All present and future design professional firms and their subconsultants at all tiers who have entered into the P3 agreement may be jointly insured under the project-specific policy. This blanket coverage eliminates gaps and inadequacies in coverage for the specific risks and exposures for each design firm that is participating on the project.

**Indemnification Endorsement**

Including a specifically tailored indemnification endorsement in a P3 agreement can protect the public owner, concessionaire, and design-builder from third-party
claims arising out of the design professional’s negligence in the performance of professional services. Typically, a contract between a project owner and design professional will include an indemnity, or “hold harmless,” clause, in which the design professional will indemnify the owner for damages and expenses that arise out of its negligent performance of professional services. When drafting the indemnification, the design professional should not agree to defend all claims against the indemnitees because the indemnitees may be partly liable for damages and defense costs incurred due to claims made by other parties, such as contractors and the public. Overlooking this detail could place the design professional in an uninsurable position in which the damages and expenses sought do not arise out of its negligent performance of professional services. It is also feasible for a project-specific policy to include an indemnified party’s endorsement to reimburse the owner (the indemnified party) for “reasonable” defense costs that are directly associated with defending covered claims made by third parties that arise out of the designer’s negligence in the performance of its professional services.

As mentioned above, a real benefit to the P3 team, particularly the owner, concessionaire, and design-builder, is that policy coverage is guaranteed for the entire policy period (typically through substantial completion of construction), so all professional services, including design and contract administration services, are covered for the duration of the project. An automatic extended reporting period (ERP), which allows claims to be made against an insured for a specified period of time after the project is complete, is included in a project-specific policy. The extended reporting period can last up to five years. This is an important condition, because design errors typically manifest themselves after the construction of the project is complete and turned over to the owner.

An owner, concessionaire, or design-builder faces many risks in the timing of claims that a project-specific policy can help alleviate. Why should timing matter so much if the firm will have insurance year after year? The underlying issue is whether a design professional’s practice policy is adequate to address the potential liabilities of a specific project and whether there is a risk of insufficient or non-existent limits when a claim is brought against the project. Because construction claims tend to be made after the completion of a project by months or sometimes years the owner, concessionaire, or design-builder could face several risks relating to the timing of claims. What are those risks?

First, is the negligent design firm still in business? If not, the likelihood of a current policy is minimal. Because design professional practice policies are “claims made,” which means that the claim is made at the time the claim arises and attaches to the current policy in place, there must be a policy in place for insurance to respond to claims against the design professional.

Second, if there is coverage in place, is the design professional able to pay the policy retention in order to access the policy coverage?

Third, have the limits of practice insurance been exhausted by other claims? Practice coverage is a set annual limit for all claims brought during that policy year.
It is very possible to have multiple claims on a single policy which erode or extinguish the policy.

Fourth, is the “future” insurance carrier financially able to pay a legitimate claim? Practice policies renew on an annual basis. A firm could change its carrier from one year to the next. It is feasible that the new carrier is not financially able to pay a legitimate claim at the time the payment is due.

These are all very real risks that are inherent in a design professional practice policy that may influence an owner, concessionaire, or design-builder when looking to insure design risks in a public-private partnership project.

A project-specific policy can be written to provide coverage for prior acts, also referred to as retroactive coverage. Retroactive coverage insures professional services, including preliminary design, as of the date that those services were originally provided by the insured design professional.

**Benefit of Risk Management Incorporated into the Project-Specific Policy.**

If a project-specific policy is selected to insure the design professionals, special attention should be paid to the selection of the insurance company providing the policy. Not all project-specific policies and insurance companies that offer this coverage are the same. Be sure to review and understand the risk management services that may be included with the purchase of the project-specific policy, and the experience and qualifications of the risk management team in the evaluation, defense, and resolution of professional liability claims, especially in the specific context of mega-projects and major design-build projects. A good project-specific risk management program from a professional insurance provider can be a valuable asset to the design team on a P3 project in assisting with claims mitigation, management, and monitoring. Some project-specific liability providers offer risk-management programs and others do not. A comprehensive risk-management service program may include:

- Preliminary risk assessment, including an early comprehensive evaluation of local statutes and laws applicable to each team member;
- Early evaluation of the allocation of risk among all P3 participants;
- Development of procedures to assess and monitor changes in established project parameters throughout the execution of the P3 project; and
- Dedicated program manager appointed to:
  - Provide legal advice and claims management at no cost to the insured design team;
  - Monitor defense counsel;
  - Coordinate meetings with owner and insureds to review the status of claims, in order to keep communications open;
  - Provide reports to insureds regarding status of claims; and
  - Work with the insurance company, defense counsel, insureds, and owner for a speedy resolution of claims.
Insurance companies and attorneys who defend design professionals know that risks can be managed, if allowed, during the project. If an insurance company requests that certain risk management procedures be implemented as a part of their project-specific coverage and placement, this request should be embraced. Experienced project-specific policy insurers generally tailor a risk-management program for each project-specific policy. These risk-management programs are designed to be minimally intrusive on project members, and the benefits can be huge. One of the

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<thead>
<tr>
<th>P3 Entity</th>
<th>Risk Exposure</th>
<th>Insurance Solution</th>
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<tbody>
<tr>
<td>Owner</td>
<td>Design and construction defects; preliminary engineering services</td>
<td>Name public owner as indemnified party on design professional’s liability insurance and as additional insured on all contractors’ general liability insurance policies</td>
</tr>
<tr>
<td></td>
<td>Property exposures</td>
<td>Builders risk insurance with mutual waivers of subrogation</td>
</tr>
<tr>
<td>Owner and lender(s)</td>
<td>Premises/operations of construction and completed project</td>
<td>Name public owner and lender(s) as additional insured on concessionaire’s and design-build contractor’s general liability policy</td>
</tr>
<tr>
<td>Concessionaire</td>
<td>Cost schedule, revenue projections, lawyers and accounts liability, economic consultant’s liability</td>
<td>Miscellaneous professional Liability insurance policy</td>
</tr>
<tr>
<td></td>
<td>Fiduciary liability, limited partnership liability, and employment practices liability</td>
<td>Fidelity/crime insurance; management liability and employment practices policy</td>
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<td></td>
<td>Funding risk</td>
<td>Miscellaneous professional liability, management liability insurance</td>
</tr>
<tr>
<td></td>
<td>Legal requirements, permits, and approvals (e.g., incorrect identification, technical errors resulting in failure to obtain or achieve approvals, etc.)</td>
<td>Miscellaneous professional liability insurance policy</td>
</tr>
<tr>
<td></td>
<td>Environmental and site risk</td>
<td>Pollution liability insurance</td>
</tr>
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<td></td>
<td>Vicarious design and construction defect risk</td>
<td>Indemnified party on design professional’s and additional insureds on contractor’s general liability insurance policies</td>
</tr>
<tr>
<td></td>
<td>Premises and completed operations on finished project</td>
<td>Annual general liability insurance policies; additional insured on all contractors, including operations and maintenance general liability policies</td>
</tr>
<tr>
<td></td>
<td>Property exposures</td>
<td>Builders risk insurance with mutual waivers of subrogation</td>
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most beneficial and common forms of risk management is a formal process of project monitoring. Project monitoring requires the policy participants to report periodical-ly on project schedule, construction costs, financing, changes in scope, and changes in team members. These reporting requirements are useful in discussions during the project when costs, schedule, financing, and other changes occur. There are certain “markers” that, if followed and monitored, can give early warning of future prob-lems and allow for real-time collaborative resolution between the owner, concession-
aire, design-builder, and design professionals. Real-time resolution is always less expensive and more efficient than later litigation.

Often, an owner purchases separate general liability, workers’ compensation, and excess insurance policies for the contractor’s construction exposures (OCIPs.) A project-specific professional liability program can include mechanisms and procedures to address coverage disputes and mutual waivers of subrogation. A successful P3 insurance program assesses the available coverage in all policies for the designers and contractors and aligns that coverage to best insure the risks of each party while simultaneously avoiding coverage gaps and redundancies.

Operations and Maintenance Contractor

Roles and Contractual Relationship

It is not uncommon for a concessionaire to commit to financing, designing, building, and then maintaining and operating a project for 25, 35, or even 50 years! Whether the project is a toll road, a bridge, or a water treatment plant, the concession agreement with the public owner usually stipulates the terms and conditions of loan payments, revenue collection, and maintenance and operations of the completed asset. The concessionaire typically hires contractors and qualified businesses to provide these services. The contracts may be multi-year master service agreements or specific contracts for certain tasks.

Risks

Although public entities are able to cap their liabilities by means of statutes and legal precedents, the private sector concessionaire and thus the contractor hired to operate the completed project (concession) may not enjoy the same legal protections. The new and evolving challenge is to manage risks that were previously limited or non-existent for the public owner. A significant risk for the operations and maintenance contractor is bodily injury and property damage liability that may occur from the operation of the concession. The contractor may also be responsible for direct damage to property while it is under its care, custody, and control. Another exposure is environmental liability that may be caused by the release of hazardous materials on or from the completed project site.

Insurance Coverage Recommendations

General liability and excess/umbrella policies can be purchased by the operations and maintenance contractor to insure bodily injury and property damage claims that result from occurrences on the premises of the completed project. The concessionaire may request to be named as an additional insured in these policies to protect them as the “owner” of the completed project.

The maintenance and operations contractor may purchase a comprehensive environmental insurance policy that covers both the clean-up costs for the release of pol-
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Pollutants and hazardous materials on the site and environmental damages and clean-up costs for legal liabilities resulting from a release of pollutants on to others’ property.

An all-risk general property policy is recommended to cover direct damage to property that the contractor is responsible to maintain. Earthquake and flood insurance is available from certain specialty insurance markets, if required.

Insurance coverage is crucial to the successful planning and execution of a P3 project, and researching the requirements and obligations should be undertaken from the outset of any P3 project. A qualified team of insurance brokers and consultants, insurance carriers, and attorneys should be involved in the P3 project as early as the request for proposal stage, when prospective concessionaires are invited to submit their proposals. This team can assess the risks as they are being allocated to the respective participants, recommend equitable risk allocation, and then determine the available insurance and risk-management services that will most appropriately control those risks.

Notes


