

# Talk to Me About A&E: Episode 12

VALERIE ONDERKA: I would say for engineers, especially who are contemplating design build or who have been involved in design build, continue to enhance the communication and the collaboration, and continue to live the real elements of design build in the spirit of a team-- design build team approach.

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SPEAKER 1: Welcome to Talk to Me About A&E, a podcast series focused on risk management for architects and engineers. Host, Dan Buelow, managing director of Willis A&E, will engage experts across the A&E spectrum on topics ranging from contract details to the broadest trends impacting design professionals in North America.

DAN BUELOW: Hello, and thank you for joining us for another episode of Talk to Me About A&E. A Willis A&E podcast series for architects and engineers on managing risk. I'm Dan Buelow managing director of Willis A&E, and our topic today is on assessing design build risk from an underwriter's perspective. And my special guest is Valerie Onderka, vice president of Ironshore's Designers and Contractors Professional Liability. Welcome to Talk to Me About A&E, Val.

VALERIE ONDERKA: Thank you very much for having me. My pleasure, Dan.

DAN BUELOW: It's great to have you. So, I've known Val for many, many years and I can't think of anyone that has had more experience and expertise in underwriting complex A&E professional liability risks than Valerie Onderka. In particular, on large design build projects.

Valerie Onderka leads Ironshore's Designers and Contractors Professional Liability program, which focuses on providing underwriting and risk management services to architects, engineers, and design build contractors throughout the construction industry.

Over the span of her 43-year career and professional liability insurance, Valerie has specialized in the designers and contractors market segment, assessing designers and contractor's professional liability exposure, and providing coverage and risk assessment and solutions at all tiers of the construction project delivery process.

So, I wanted to talk to Val today about design build, and the significant challenges insurance carriers and underwriters have been faced with in assessing this risk. It's important to note that while much of what we will discuss today can be applied to all design build types of projects, where we have seen the vast majority of claim activity is in fact, on infrastructure design build projects. We simply haven't seen the level of claim activity on vertical design build projects, for example, that we have seen on infrastructure projects.

In a recent Willis A&E survey that hopefully you've seen-- we did a survey and generate a report of claim adjusters from 12 leading A&E architects and engineers professional liability carriers, and design build was cited in that report and that survey of these carriers as a significant concern, as an emerging trend of claims. And the vast majority of these same carriers stated that they are seeing adverse claims trends in this area of design build projects.

In fact, Lexington AIG recently announced that they were exiting the project specific insurance marketplace, which was newsworthy given the fact that Lexington AIG had been one of the leading markets for professional project specific professional liability insurance. And the reason they cited their decision to exit this market was due to the claims that they have experienced in design build projects. Infrastructure projects in particular. We've also seen a number of very reputable engineering firms exit the design build market due to the claims and exposures associated with this project delivery method.

So, Val, what's going on here? Why is design build such a challenge, and what are the inherent risks that concern you most as an underwriter when it comes to design build?

VALERIE ONDERKA: Yeah, so the difference between design build and design bid build has created inherent risks-- a greater risk in the design build delivery method. The project procurement contractual risk allocations and assessment of those risks are very different in design build.

In design build, the owner often holds the design builder responsible for risk for the entire project, design risk, construction risk, commercial risk, financial risk, and that design builder flows that risk down to the design professionals. There are shortened schedules usually, and what's called fast tracking is usually practiced in the design build delivery. And that has created problems in the Project Procurement of design build in the past several years.

DAN BUELOW: In my own experience as an underwriter and then a broker for the last 20 plus years working with architects and engineers, I've seen design build work and I've seen it fail miserably. And I've seen it work when you bring together real partners that are collaborating, and there's an exchange of information, and really all the inherent benefits that you would think you would get out of design build.

Unfortunately, I've seen it fail miserably when it's being kind of thrown together because an owner wants something faster, quicker, cheaper. And we really don't have those relationships, those partnerships. There's little collaboration. And at the end of the day, you also are going to often strap the design professional with the lowest bid contractor, and you slap on top of that an onerous contract with onerous flow down provisions.

My question to you is that, do you agree with that, and then what have you done? Have you made any changes recently to your approach to underwriting design build given these adverse trends that we've been talking about?

VALERIE ONDERKA: Yeah, I do agree wholeheartedly that these trends have evolved in the last several years, probably over the last 10 years.

After the recession in 2008, things kind of came to a halt, and then when things kind of ramped up again, these owners had resources available to do some of these large infrastructure projects that were well overdue. And they put them out to bid and that's where you got these teams teaming up, our contractors and design professionals who may not have had experience working together in the past. And the allocation of the risk and the contractual practices really took a left turn and there were definitely some deficiencies in the way that the project delivery evolved.

The most important thing that we saw was that there was a requirement in the request for proposal, the RFP, that the bid be submitted in a very shortened schedule and at a very low design level.

So, the contractor teamed up with the design professional, gave them some preliminary information about the requirements and specifications of the job, and the design team produced 30% or less documents. That means that the entire project, sometimes in the range of hundreds of millions or billions of dollars, was only designed at 30%. At which time the contractor took those numbers and created a guaranteed maximum price and agree to that price in that preliminary bid submission. And therefore, the contractor and inadvertently the design team took on that risk to deliver that project for that agreed amount. All be it; the project was only designed at 30%.

DAN BUELOW: So, what you're saying here is that they're going forward, essentially with an incomplete set of drawings. And in fact, it's an interesting fact that most claims that we've seen on these infrastructure projects, in particular, against design professionals on design build projects are, in fact, made prior to the start of construction even. Whereas every other project type and delivery method, it's really during construction or well after substantial completion. And I think to your point, it's fair to say that this is the result of budgets being established and actually set to stone based on an incomplete set of drawings.

VALERIE ONDERKA: That's absolutely correct. And the behavior that was manifested and demonstrated, and it was in most of these projects, the larger ones anyway, resulted in these problems. Because everybody kind of took on the same routine, the same bad behavior, in that they didn't collaborate and communicate effectively during the bid process.

And you touched upon things that are being done to change things now. But it was very unusual to realize that these teams didn't adequately assess the job, the scope, the requirements, the specifications together to sit down and really review thoroughly the request for proposal to make sure that they hit upon all of the elements and the scope of the job while they were going through this bid process. It was just accelerated and for some reason, they believe that they can put out a number there and somehow figure out how to design and build that as they went along.

And time after time again in recent years, these projects have demonstrated that they've been under bid by tens or hundreds of millions of dollars.

DAN BUELOW: And as part of your underwriting process, Val, are you reviewing the teaming agreements or the design build contracts with the owners, and are you getting access to that information, and what are you looking for?

VALERIE ONDERKA: That's a great question because in going forward, we are seeing some improvement and change in behavior in the procurement of these projects. Then there's something that we're calling a progressive design build that we can elaborate on.

But basically, we're seeing more collaboration early on where the design build team, including the design professionals sit down and they do review the RFPs together, and they assess risk, and they qualify the different risks of the project and assign risk factors to them. They call that risk registers and otherwise. And if they have to call in others to do third party cost estimates on the cost of that ultimate design of that element, they're taking the time to do that.

So, these teaming agreements, as you refer to, are very important, and that's an agreement that's entered into early on during the bid process between the design builder and the design professional. And it should be very detailed in the articulation of the scope and the responsibility of the design team at that time, how much design are they responsible for? Are they responsible for investigation, geotechnical soils analysis or otherwise? And any other kind of preliminary design to determine exactly what their ultimate risk is going to be in the execution of the contract.

DAN BUELOW: It reminded me of this claim that we had with one of our engineering clients, it was a civil engineering client, and it was a very serious claim. In fact, it blew through a significant project policy and then went into their practice policy. It was that significant.

And while the claims-- there were multiple claims that stemmed from all of this but really what it was rooted in, in our opinion, looking at this and living with this for years, is that they were "partnered", and I use that word in quotes, up with the lowest irresponsible bid contractor. And when we worked with them to kind of do a postop on this whole thing, they were very excited when they won the project until the envelopes were opened, and they found that their contractor partner was the lowest bid contractor by over 30 some percent. And shame on the DOT for not sending this back out to bid.

But they went forward with the stock boy special and as you can imagine, it went downhill from there because it was ultimately disastrous because it was grossly underbid. And so, you had all these RFIs and change orders and just was a mess. How unusual is that story in your experience? I mean, have you heard anything like that?

VALERIE ONDERKA: Yeah, well, as you can imagine, I mean, that has happened numerous times and you had mentioned that I've been involved in design build projects of insuring the contractors sometimes, but also and mostly, the design professional teams. And I would say in the last 5 to 7 years, there have been some very bad claims, very deficiently budgeted projects that have manifested in this same exact way.

And this all goes down to the fact that they were bidding at less than 30% design and now we say that we look for a minimum of 50% design. Because we think that logic says the more of a project that you actually design and have the opportunity to envision how it's going to look and ultimately what it's going to cost, the more accurate you're going to be in you're in your ultimate bid, right?

So, the other part of that was-- sounds like, perhaps in your example, which is prevalent with a lot of these situations, there was not that collaboration during the bidding process. And one thing that we look for and it's that C word, that contingency that the design builder and the design professional need to develop and evaluate. And again, in the spirit of design build being a collaborative teaming approach, it's important that they both understand the elements of the design of the project and ultimately, what it's going to cost.

And if they don't know exactly, and they haven't gotten specific bids from their subcontractors at that point, they should definitely evaluate a certain amount of contingency for those known/unknowns as the design does develop past that 50% point. What is it going to cost for that design development and the ultimate cost to build the project? And those contingencies need to be transparent. They need to be discussed openly. I mean, what's the secret here? Over the years, it's always been a big mystery as to what the contractor's contingency is built into their budget.

Unfortunately, because of competitiveness in the last decade or so, those contingencies have almost disappeared. There's very little margin in these projects because of the competitive nature of the way that they've been bid. We're looking for the collaborative development of the preliminary design cost associated with that, and then those contingencies that you'd be able to draw upon as you develop the design.

DAN BUELOW: You mentioned progressive design. And again, everything we talk about-- and you brought this word up here, transparency. And there just has been a lack of transparency, where it seems the inherent benefit of design build, if it's really going to work again. This partnership is coming to the table and reduce all the defensive detailing and RFIs and you're trying to work through to bring something more efficient and so on. That seems to have been lost as you kind of described there.

So progressive design build. It's kind of this buzz word that we're hearing now. What do you want to see ultimately around this progressive design build as you assess a given opportunity to insure a project?

VALERIE ONDERKA: So simplistically put, progressive design build says that the establishment of that final cost of that bid price is delayed, if you will, until there's 50% or 60% design completed. Once again, the parties sit down collaboratively and develop a design to a level after also assessing the risk of the known/unknown yet design portions of the risk. And they sit down periodically throughout the bid process to be able to more adequately price for the project. The key is developing a bid that you're going to be able to build the project for that amount that you've determined in your bid.

DAN BUELOW: You don't want to be in silos, right? I mean, to try to do this in a vacuum or in silos. Again, you're losing the inherent benefits of this delivery method but that's kind of seam where things have gone up to this point. So as an underwriter, you're trying to get folks to the table essentially, and how do you do that? I mean, how is the owner? I mean, in the end of the day, it begins with, I think, a lot of these DOTs that are seeding risk downhill to the design build contractor, then that just flows it back down to the poor engineers in these infrastructure projects. What's the answer to that?

VALERIE ONDERKA: Unfortunately, there's a change in the insurance marketplace for professional liability as you might know. And right now, as you also mentioned, the insurance underwriters are retracting and there's less capacity out there to insure these design professionals, contractors, and project specific.

And I don't think that the owners are completely aware of what's happened over the years because they got that piece of paper that said we're going to build this project for x amount and that's all they cared about, and they had already allocated that risk away from themselves.

Unlike with design bid build, there's a lot of risk that's kept the risk of design and otherwise, by the owner. Well, they were able to, where permissible by statute or otherwise, to allocate risk for different site conditions, geotechnical elements, that kind of thing to the contractor. And the contractor now has assumed the complete design and construction of the project. Well, when that's the case, they need to be more aware of, and more collaborative, and more communicative, and I think that's the answer.

So, when you go to the owner and say, well, there's only 2 bidders where there used to be 7 on this job. There's a reason.

DAN BUELOW: And you're paying twice as much.

VALERIE ONDERKA: And you're paying twice as much, Yeah. Now, the bid should come in at a more responsible amount. But it should be explained to the owner that the bid is what it is because we are endeavoring to price for the ultimate cost of the project.

DAN BUELOW: I'm sorry, you were talking about the bidders being the engineers. I was thinking about it from the insurance market that they're getting pressure from the insurance community. To your earlier point is that look at, this is not sustainable, right? I mean, you're not going to have-- you're not going to get supported by insurance market. We've already seen it tightening up significantly and it's only going to be more difficult for these owners to get viable insurance unless they come to the table, unless they address this transparency issue and some of the things that you've pointed out here.

VALERIE ONDERKA: I totally agree, and I believe that that's possible. I mean, there are associations and groups, whether they're contracting groups, design professional groups, insurance groups, IRMI, ACEC, DBIA, AGC, and they are becoming more aware of these problems. And their membership will become aware of it and they're going to be able to share these thoughts with owners.

DAN BUELOW: It has to be those best practices that are out in front and people have to be willing to really listen and the parties need to come together. Something we've talked a little bit about though is on the insurance side here. And on these large project policies, we are seeing project specific insurance, and certainly it's even often, but on the very large projects, we're seeing it's required in part of the bid.

And in the absence of having this project policy, you're going to rely on your practice policy which you've got to be very careful and certainly, you're going to want that project policy. And then in addition, you have to also be aware that certainly from a design professional's perspective, there's often an owner control program or for design build, a CPPI, a contractor policy, there that's providing just the contractor as that's who's hiring the design professionals.

We're going to bring you back, Val to have a conversation around that because I think there's a lot of things to be thinking about when it comes to this insurance and also what goes into the underwriting and pricing of that insurance. But I think that we reference the cost and the constriction of the marketplace. We've seen a real constriction in the project's Pacific marketplace, haven't we?

VALERIE ONDERKA: Absolutely. Absolutely. And there's going to have to be some evidence that behavior has changed before you get the kind of capacity back into the marketplace from the underwriting perspective.

I think that there's got to be almost a pledge, if you will, from the project participants that they're going to change their behavior, and the procurement, and the contractual risk allocation from what has been done in the past years because it is unsustainable. It's just inevitable that these projects are going to be underfunded if they're not bid

properly and the behavior and the collaboration is not manifested throughout the project-- the project timetable from the very beginning.

As you mentioned, there are claims when the contractor starts to bid out their packages before there was actually construction begun, and they determined that these bids were too low and now they-- and they don't have the ability to go back for equitable adjustment to the owner. They're stuck. They're stuck. So, there's got to be a change in that behavior, and a change in the criteria and the measures that the parties take on in order to steer these projects in a more sustainable, successful trajectory here.

DAN BUELOW: And you and I were talking earlier, and you raised the point about, really the design professional needs an off ramp as the design develops here and the parties don't agree, what's the recourse other than to go forward with something that is just going to be ultimately a bad claim. Talk to us a little bit about that.

VALERIE ONDERKA: Part of this progressive design build has the element of this collaboration with the owner. The owner reviews the design that's been developed thus far, and they back check the costs that have been established and determine if this is all feasible. And they do that periodically. So, they're not accumulating a large amount of cost and risk without adequate design.

And at some point, there may be a situation where, well, we had questions about this design, we evaluated it as being a higher risk, and we put aside time and money to review that as the design ultimately developed. And as you go along, if you realize that there was a disconnect there, the solution should be to reveal that manifest with all the parties right away so that you can reverse that situation without delays and cost overruns in the project.

DAN BUELOW: And you had mentioned on the hiring of the Geotech, right? As well as that has changed over time, right, where the owner used to take more responsibility, Hey, it's your dirt. But that's been shifted over to the design builder, and the GC, and the professional, and the consultant even. Have you seen any changes in that or any advice or thoughts on that exposure?

VALERIE ONDERKA: Yeah, there are some legal elements in design build procurement that affect some of the Geotech and site conditions. But nevertheless, because there have not been extensive geotechnical studies done at the time of the bid and not enough contingency put aside for the further studies of what you have there, as you say, the owner owns the dirt but if the contractor has agreed to take on the risk of what's under that dirt, if you're extending a road widening, a road, there's utilities, there's existing materials there, who is responsible for that?

Well, if that isn't studied and addressed adequately, that's one of your first causes of delays and cost overruns in some of these large infrastructure projects. Not having adequate geotechnical studies early on, and then not articulating who ultimately is responsible for those studies. We've experienced situations where the contractor said, well, you're the engineer. You should have could have known that situation might have arisen and brought that to our attention. That's your claim.

DAN BUELOW: Yeah. And lastly on this is that we've talked about the source of these claims. But we've also seen a rash of these bodily injury suits in these claims against design firms that have been on these projects, whereas the design firm is often brought into a claim where third parties involved in an auto accident at or near the project site.

And you have a very sympathetic plaintiff and little or no recourse against DOT against sovereign immunity, or what have you, and the design firm is often left holding the bag.

I don't, I don't know how you underwrite against that other than a firm having good practices in places around documentation and such, but have you seen any of that as well? I mean, we certainly have seen it and it came out in our survey. It was noted by a few carriers.

VALERIE ONDERKA: Yeah, so over the years, and this goes back quite a while, you mentioned sovereign immunity. So, the DOT or the agency that owns the project is protected by the amount that they would be liable for to an injured party, right?

But the scope of the design team, especially in the engineering of these infrastructure projects includes what's called the maintenance of traffic. So, they're designing the temporary detours and maintenance of traffic because they don't completely close the road down 100%. I mean, there's traffic detours that you're driving past the construction all the time. And it's that responsibility to design those traffic patterns that allegedly caused these traffic accidents.

And so, it does have a lot to do with signage documentation, making sure that all the cones are placed properly. The contractor should be responsible for that kind of safety on the job site. Before you leave for the night, to make sure that everything is clear and legible. That kind of thing. So Yes, we've seen some frequency in those types of claims.

DAN BUELOW: Well, Val, this has been great. Can you give us some parting comments and advice that you might offer for any firm that's contemplating of doing another or going into a design build project opportunity?

VALERIE ONDERKA: I would say for engineers, especially who are contemplating design build or who have been involved in design build, continue to enhance the communication and the collaboration, and continue to live the real elements of design build in the spirit of a design build team approach. Continue to do that because there is hope in turning this around. And I look forward to being part of it in the years to come.

DAN BUELOW: That's great. Well, thank you, Valerie Onderka. That concludes our program in assessing design and build risk from an underwriter's perspective. I what to thank Val. Thank you, Val.

VALERIE ONDERKA: You're very, very welcome.

DAN BUELOW: Absolutely. And thank you for joining us for another episode of Talk to Me About A&E

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