

## Crisis? What crisis?

The rising cost of liability insurance has cast a shadow on the profession. Some practitioners worry that escalating premiums are reducing competition among engineering firms and limiting choice for clients. It's of extra concern in Ontario, due to recent legislative changes. Some are calling for regulators to take a stronger stand to prevent a scenario in which insurance companies—by dint of their ability to withhold coverage—hold sway as to who can practise.

**A**cross the Canadian engineering domain, the professional liability insurance scene is in turmoil. The symbols of this turmoil are manifest in increased premium quotations, reduced coverage options, retroactive exclusions within existing policies, inability to purchase new policies and ultimately, it seems, greater risk for individual engineers.

Some of these changes undoubtedly reflect the wider insurance marketplace. In an era of greater litigiousness and declining return on investment, insurers in practically all sectors claim they have no choice but to send premiums upward. As well, increasing concern about terrorism, natural and

human-induced disasters are playing a part in muddying the insurance waters.

However, at least one major provider of professional liability insurance contends that premium increases are not the result of world events, but rather reflect "adverse claims experience" and low interest rates on premiums invested by insurers. Derek Holloway, senior vice president (architects and engineers) Encon Group Inc.—one of Canada's largest liability insurance providers—says that while engineers enjoyed declining rates for a 10-year period prior to 1999, insurance companies are now playing catch-up. "The increases that are being imposed right now, while significant, are the result of the need for insurers to catch up quickly or face even worse results," Holloway told *Engineering Dimensions*.

By Michael Mastromatteo

Holloway said studies by Encon indicate that the majority of claims against engineers are the result of business practices and procedures. This underscores the need for engineering firms providing services to the public to be ever mindful of liability and risk reduction issues in day-to-day operations.

While few would argue that negative claims experience linked to business practices open the door to rising premiums, what is to be made of practitioners facing onerous premium increases arising from external circumstances? In response to what some of them are describing as a crisis situation, a number of engineering regulators have moved liability insurance issues a notch higher on the priority totem pole. The Association of Professional Engineers, Geologists and Geophysicists of Alberta (APEGGA), for example, recently established an Insurance Review Task Force to consider what might be done in the face of rising premiums, watered down coverage and, in some cases, denial of insurance altogether. The Alberta task force is expected to release its recommendations at any time.

Meanwhile, representatives of the Association of Professional Engineers and Geoscientists of British Columbia (APEGBC) are holding talks with officials from the insurance industry to gain a better appreciation of marketplace realities, and the level of risk faced by engineering practitioners. According to the BC regulator's *Innovation* magazine, APEGBC has been at the forefront in urging the Canadian Council of Professional Engineers (CCPE) to take up the liability insurance issue on a national level to determine if a wider response is in order.

### National task force

Lorelei Scott, CCPE manager of member services, told *Engineering Dimensions* recently that a national task force was struck in May 2003 to examine liability insurance for professional engineers. Anne Garrett, P.Eng., APEGBC executive director, chairs the national group.

"The task group has met on several occasions and it was concluded that it would focus its energies on three main

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strategies—education and awareness, data collection [to determine the existing situation], and government initiatives," Scott said. She added that as of early June, it had not yet issued a preliminary report.

In Ontario, concerns over rising liability insurance premiums have taken on an extra dimension. Much of the current controversy stems from the recent passage of Ontario's Bill 124, the *Building Code Statute Law Amendment Act*, legislation aimed at overcoming delays in the issuing of building permits and construction of

new buildings. Over and above its provisions requiring design professionals to exhibit fluency with the *Ontario Building Code* by passing government code-knowledge exams, the bill makes insurance mandatory for engineering firms submitting plans for building permits. The insurance requirements of Bill 124 are based on a firm's annual billings. Companies with more than \$100,000 in annual fees must carry \$1 million insurance per claim (\$2 million in the aggregate), those that billed more than \$50,000 and less than \$100,000 must purchase \$500,000 per claim and \$1 million in the aggregate, while those with billings of \$50,000 or less are required to purchase \$250,000 per claim (\$500,000 in the aggregate).

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Chris Roney, P.Eng., of Roney Engineering Limited, Kingston, and a member of a PEO task force developing a response to the legislation (see In Council, pp 44-45), might be described as the poster boy for Bill 124's insurance nightmare. While liability insurance premiums had been rising prior to passage of Bill 124, Roney says the new law appears to have opened the premium floodgates. He reported that his firm is looking at staggering premium increases. Four years ago, for example, Roney Engineering was quoted a fixed premium of \$22,798 for \$1 million worth of liability insurance. By 2004, that same insurance costs \$67,645 (or



Peter DeVita, P.Eng.: time to consider options in response to liability insurance situation.

\$78,837, considering the \$2 million aggregate limit). Such increases, he says, can't be absorbed without significant sacrifice.

"If we didn't have these large premiums, we could be employing one or more [additional] engineers," Roney said. "Any time overhead is increased like this, the employees are affected, since the engineering company's profitability is affected. As far as the sole practitioner is concerned, they, too, are directly affected since they hold the Certificate of Authorization (C of A), and therefore the insurance."

Roney's views on Bill 124 are echoed by Leo McCuaig, P.Eng., head of mechanical services, Zenix Engineering, an Ottawa-based building science firm. McCuaig said meeting the requirements of Bill 124 represents the largest single insurance cost increase his firm has ever faced. He added that the higher costs cannot be easily passed on to clients as increased fees for service.

Chris Roney, P.Eng.: most engineers unaware of Bill 124's 'nasty surprise'.

ance companies are dictating who can practise engineering."

DeVita says an OSPE-led self-insurance program, similar to that for Ontario's professional architects, is one possible response to the premium escalation created by conditions in the insurance industry and compounded by the passage of Bill 124 and the filing of its Regulation 305/03 in July 2003. As the advocacy body, OSPE has an interest in insurance matters as part of its member services mandate. DeVita also speculated on other possible remedies, including working to amend Bill 124, having the provincial government underwrite engineers' liability insurance, or transferring the increased costs to clients using engineering services.



mandatory. In these areas, all engineers work under the same conditions as to insurance. If insurance prices go up, they go up for all parties and therefore are irrelevant in the competition between

## The escalating cost of liability insurance is threatening to put small firms out of business

Peter DeVita, P.Eng.

"We are in a competitive market and our fees have steadily been declining over the past 10 years," he said. "If we were able to pass costs along, we and others would hire more junior people for the future stability of our company, and we would be able to provide an enhanced service to our clients."

Roney and McCuaig raise the spectre that an unintended consequence of the *Building Code Statute Law Amendment Act* will be that insurance officials, by virtue of their ability to extend or withhold liability insurance, will in effectively hold sway over who can practise engineering.

"The escalating cost of liability insurance is threatening to put small firms out of business," said Peter DeVita, P.Eng., a newly elected director of the Ontario Society of Professional Engineers (OSPE) and a former president of PEO. "So we have a situation in which insur-

Despite the major impact of Bill 124 on some practitioners, however, Bernie Ennis, P.Eng., PEO manager, practice and standards, notes that not every engineer is affected: "In general, insurance is a concern only for engineers who provide professional engineering services to the public through Certificate of Authorization-holding enterprises, whether that is a sole proprietorship, a partnership or a corporation," he says.

### Some face penalty

Ennis also says rising insurance costs would have little impact on competition among engineering companies if all parties were uniformly affected. "It's not as if a client can decide not to hire an engineer simply because the fee is increased to accommodate the cost of insurance," he said. "Of course, this applies only to those practice areas where insurance is

them. However, in other areas of practice where an engineer can practise without insurance due to the mandatory disclosure option, insured engineers face a penalty when competing with uninsured engineers."

Ennis suggested Bill 124's insurance provisions might also put "moonlighting" engineers out of business. "All engineers practising in this [construction] area will be forced by Bill 124 to get insurance," he said. "For moonlighters, who generally are uninsured, the cost will be too high and they will not be able to continue doing this work."

Under the *Professional Engineers Act*, C of A holders—those offering engineering services to the public—are required to hold a minimum \$250,000 of professional liability insurance, or disclose to every client and have acknowledged that they do not hold insurance.

# Taking Care

At PEO's annual general meeting in Toronto, delegates passed a resolution calling on PEO Council to continue its efforts to oppose aspects of Bill 124 (see News, pp. 12-17). Chris Roney was one of those who spoke out at the meeting about the insurance situation.

(Roney had earlier served on a PEO task force on the recommendations of the government's Building Regulatory Reform Advisory Group (BRRAG), which were incorporated into Bill 124. In its final report to PEO Council in November 2001, which Council approved, the task force recommended that PEO cooperate with the Ministry of Municipal Affairs and Housing in developing the upcoming legislation, so as to have some influence on its final form. In fact, the insurance requirements originally proposed by the ministry (one level of indemnity insurance and insurance for major structural defects) were modified in the final regulation as a result of representations by the insurance industry, which were partly facilitated by PEO. The final requirements are tiered indemnity insurance based on a firm's annual billings. The requirement to be insured for major structural defects was dropped.

On the more theoretical level, Roney echoes DeVita's warning of insurance providers usurping—albeit unintentionally—the role of the regulator in determining who is qualified to practise professional engineering. “Is the government satisfied that the public is best served by giving the insurance industry the power to determine who can and who cannot practise professional engineering?” Roney asks. “Insurers can deny coverage at their own discretion without appeal or stated reasons. They could simply decide that insuring a particular sector is not profitable enough to satisfy their business model.”

As Roney observes, “Many engineers remain unaware of the coming impact of Bill 124. They'll be getting a very nasty surprise next year when they find that their costs have risen dramatically.”

Regardless of the impact of external forces on liability insurance premiums for professional engineers, insurance providers say there are steps practitioners can follow to minimize their exposure.

Liability insurers point to an engineering firm's business practices and claims history in putting together liability protection packages reflective of today's market realities. Insurance providers also stress that policies are continually being assessed and revised to account for changing conditions in the liability area. At least one major insurer, however, cautions that changing conditions don't always mean good news for professional engineers.

“Engineers' professional liability exposure is constantly evolving, but not in a positive manner,” said Derek Holloway, vice president (architects and engineers), Encon Group Inc. As the country's leading professional liability insurance provider, Encon monitors and advises on ways practitioners can avoid legal trouble.

Holloway said premiums for liability insurance have been on the rise for some time. He said these increases are based on a combination of “adverse claims experience” for engineers, as well as on the need for the insurance industry to recoup losses stemming from low returns on investment.

“It is very rare for an insurer to produce a pure underwriting profit,” Holloway said. “Rather, they have relied on the fact that it takes time to settle claims, and therefore been able to rely on investment income to produce profits.”

In addition, Holloway says, “The range of defences available in the event of a claim has diminished over time as courts have become ever more inclined to find ways to compensate parties that have suffered damages. The fact that professionals, including engineers, now face personal liability even if they are working for an incorporated company is particularly troubling.”

The later point, he adds, makes it essential for P.Engs to secure contractual terms that prevent plaintiffs from going after the personal assets of the employee-engineer.

## Assessing risk

Holloway says risk assessment and premium calculations are based on well established formula. To assess risk, Encon examines the engineering discipline and kinds of project undertaken by the insured. Risk factors allocated in

both of these areas are then used to draw up “multipliers” that are applied to base rates.

Calculating premiums, Holloway says, is based on the insurance provider's risk assessment, fee base, amount of coverage requested (the limit), and the client's claims experience.

He says studies indicate that many claims against engineers are based on business practices and procedures, rather than misfortune, negligence or poor work. “These types of claims can often be avoided through the application of appropriate checks and balances within a firm,” said Holloway.

“One of the key messages Encon has for the engineering profession is that they should always use written contracts,” Holloway said. “The days when an oral agreement supported by a handshake were acceptable are long gone. If you want to limit your liability, the only place to do it effectively is in your contract.” To that end, he says, defining the mandate, scope of work, the responsibility of field services and setting payment terms are essential.

Encon has drawn up its Ten Commandments of Good Practice, a common sense approach to risk reduction and loss prevention. The advice is based on the company's four decades of experience in the liability insurance marketplace. The commandments emphasize self-evaluation, realistic expectations, ongoing dialogue with clients, and immediate attention to problem areas as keys to avoiding longer-term, costly dispute resolution.

Open communication, an often overlooked commodity it seems, can also help protect both engineer and client. “A breakdown in or lack of communication are the leading causes of claims against all professionals,” Holloway says. “A clear understanding of the client's needs and having the client understand what the engineer can provide are important and can help avoid claims.”

This is a point seconded by Paul Kevill, P.Eng., of KRG Insurance, a Toronto-based insurance broker. In many cases, open communication applies to a professional's knowledge of the nature and disposition of potential clients, Kevill says. “Having a litigious client is not a good thing,” he says with direct understatement. “It is much better to take on a client who values your work and would much sooner protect you against lawsuits than sic a lawyer on you.”

—Michael Mastromatteo