

RISK MANAGEMENT PRESENTATION TO PMINZ

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AON PROFILE

Global

Aon Corporation is the largest insurance broker in the world trading on the New York, Chicago and London Stock Exchanges. Aon globally employs 47,000 staff, operates 500 offices throughout 120 countries and globally, generate in excess of US\$10 billion revenue.

New Zealand

Aon is New Zealand's largest Insurance Broking and Risk Consulting company with over 580 staff operating through a network of 59 branches.

Services of interest to PM's include:

Business Risk Management

Aon have engineers/analysts who provide advice to clients in the design and implementation of risk management programmes, business continuity, emergency response planning, security audits and legislative compliance.

Professional Risks

Aon have a designated team of specialists to provide support clients on any professional risk issue.

Construction Specialists

Aon have a specialist Construction Division which becomes involved in construction related issues and those contracts requiring specialist input, contract vetting or principal controlled construction projects.

Financial Services

Aon Financial Services provides a wide range of financial services for both individuals and companies. Products include income protection, trauma, health and life insurance.

Superannuation Funds Management

Aon Consulting have a successful superannuation funds management division that provides flexible superannuation options to employers and individuals including AonSaver (Aon's Version of KiwiSaver).

COMMERCIAL ENVIRONMENT

Contract/common law exposure

Your delivery of services to your client will usually be agreed and provided for under a contract that will either be an “expressed” written contract or an “implied” contract. The contract could be a simple letter formalising the outcome of pre contractual negotiations or a formal standard terms and conditions of engagement generated by your client or by you or your company. Regardless of the form of contract, an implied duty to exercise reasonable care and skill in the discharge of your services will always exist. Your breach of the contract that results in a financial loss to your client either directly or as a consequence of a claim on your client may result in your client bringing a claim against you or your company for damages and costs.

This action for damages can be brought concurrently in the law of contract, tort and statute. The tort of negligence may give scope for greater claims than those that would otherwise be limited by the terms of the contract. In addition, the statutory head of action, breach of the Fair Trading Act that deals with misleading conduct and misrepresentations, will usually be pleaded. Under this Act, intent to mislead or deceive does not have to be proven. The mere fact that someone was misled or deceived is enough. The Consumer Guarantees Act may also be pleaded where the retainer is for domestic as opposed to business services but this merely reinforces the reasonable care and skill requirement.

The common law duty of care or negligence can extend beyond your client to the ultimate beneficiary of your services or even subsequent beneficiaries where it can be established it was reasonable to rely on your services regardless of no contractual relationship. This is a relevant exposure where you are sub contracting your services to your client who in turn is sub contracting their services to another party or directly contracting to the ultimate principal. The principal will not be constrained by the terms of your contract with your client that may include limitations of liability.

If you engage a sub contractor to assist you in the delivery of your services, you will be liable to your client for any loss arising from the sub contractor’s performance.

Be aware that a requirement to provide insurance under a contract is not in itself a waiver of liability for loss in excess of the insurance provided. It is merely a mechanism whereby the client can satisfy itself that you have the means to meet a claim to a certain amount.

The statutory period of limitations within which to bring a claim in contract is six years from the breach of the contract. It is six years also in negligence, but time runs from when the cause of action accrues which may not be until the claimant should have reasonably discovered damage for example. In relation to buildings, a ten year backstop applies from the completion of construction beyond which no claim can be made.

The Fair Trading Act limitation is three years from the breach of the Act.

Therefore, liability can remain with you throughout your entire life for negligence!

Corporate/personal liability

So how are you protected by the company you work for?

So long as your company has contracted with your client and you are an employee or a director of your company, then the services are provided by the legal entity that is your company. As your company is incorporated with limited liability, your company can only be liable to pay any claim to the extent of its assets. However, the principles relating to the law of "limited liability" are not absolute and directors' liability may arise in certain and expanding situations.

As a director of a company, you should ensure that your contract with your client provides that no claim shall be made on any director or employee of your company to emphasise that the contract is between your company and the client. All communications including fee billings should be undertaken in the name of the company. Any instructions passed on to other parties on behalf of the principal should be quite clearly conveyed in your capacity as agent for the principal if you are thus retained.

As an employee of the company, the company will be vicariously liable for your negligence. Although it is in the public interest that an employer should not recover loss off an employee who has acted in good faith and in the interests of their employer, this is not established in law beyond doubt. You should therefore ensure that your employment contract includes a waiver of any claim the company may have against you and an indemnity from the company in respect of claims made against you personally. However, if the company has insufficient assets or no longer exists, you could be liable for the claim if you were the provider of the services. This is more likely if you were a director of the company.

Where you have contracted in your personal capacity, for example, as an Engineer to the contract as required under NZS 3910:2003, then your personal wealth may be exposed to claims.

Notwithstanding these steps to mitigate your exposure to personal liability, it is prudent to take asset protection measures.

Claims examples/Case studies

1. **Time over run (Professional Indemnity)** – IT Project ran seriously over project target dates for launch. PM accused of not performing. Matter complicated by “project creep” to the point where the system capabilities were compromised. Was deemed that PM had some partial liability in making all parties aware of tracking and deadline issues. Claim was for \$500,000. Loss settled at \$185,000 plus costs \$56,000.
2. **Business failure (Professional Indemnity)** – Project ceased when principal contractor failed. PM joined as part of class action against all attached to the development. Defence costs only as PM had done nothing wrong - \$32,000.
3. **Fee dispute (Professional Indemnity)** – When seeking payment of outstanding fees, PM served with a counterclaim for negligence. No real basis in accusation, but triggered a defence under the PI policy – Costs \$5,200
4. **Breach of contract (Professional Indemnity)** – IT PM accused of negligence in duties defined in engagement contract. Contract terms not well defined. Claim motivated by claimant’s desire to remove PM from position. Damages and costs were sought, settled under mediation totalling \$42,000.
5. **Damage to equipment (Public Liability)** – Whilst on IT Project, PM accidentally damaged a computer server (dropped a cup of coffee on it). Total replacement required of \$5,500 plus data loss/reconstruction costs of another \$4,000.
6. **Injury on site (Statutory Liability)** –. Worker injured on Building site – OSH investigation of who had the duties and responsibility of on-site safety. PM deemed to have a duty to take steps if he could have been reasonably “aware” of a hazardous situation on site. Defence costs \$6,800. Fine – not insured.
7. **Breach of Fair Trading Act (Statutory Liability)** – Civil claim for breach of FTA taken in an attempt to get the contractual liability restriction set aside (maximum liability in PM contract was set at 3 times fee charged). Court found that it was reasonable that the PM couldn’t contract out from causing loss to claimant if there was a “reasonable” argument that they had been negligent. Claim taken for claimed losses of \$340,000 rather than 3 times fees of maximum of \$22,500.

RISK MANAGEMENT

Disclaimer/limitation/standard terms and conditions of engagement

Transferring the Risk when all other options have been analysed.

Reliance on disclaimers to mitigate liability is risky but has its merits so long as use of a total disclaimer is avoided – an all care, no responsibility approach will not succeed. A disclaimer should be obvious to the client and specifically agreed to. A disclaimer will stand up better where the contracting parties are on an equal footing especially where there is identified consideration. Rather than a full disclaimer of liability, it is prudent to approach risk with a limitation of liability that provides compensation either as a fixed amount or a multiple of fees in respect of claims brought within an agreed time frame that is a consequence of your breach of contract or negligence.

There is an opportunity to manage your exposure to risk in your contract. We often find that it is a mismatch of expectations and outcomes arising from inadequate communication that drives claims. Therefore care taken from the outset to clearly detail the scope of your services and responsibilities that are then set down in writing and agreed to by your client and supported by a robust and documented communication process throughout the term of the project will help you in your defence of any claim. It follows that any variations to the retainer are agreed in writing and a documentary trail is established. In the absence of such documentation, a judge may prefer the word of the disaffected claimant especially if the claimant is not commercially experienced.

Your contracts need to avoid your providing a guarantee of your services (unless implied), assuming abnormal liabilities (expert v. standard for the profession) or waiving recovery rights (for example against sub contractors).

You need to ensure that you avoid assuming liability for anything other than compensatory damages in your contracts. Liability should be avoided for liquidated damages, penalties, punitive damages.

Where there are multiple parties to a project typical of a building construction, it is essential to provide for proportionate liability. Our legal system works on a last man standing approach which can leave minor tortfeasors carrying the entire judgment.

Avoid personal liability by ensuring the contracting party is your company and support that in your communications and conduct.

Insurance Solutions

Professional indemnity insurance is available to provide a source of funds to defend and pay claims.

This insurance will cover your liability to pay compensation for claims that arise from your negligent act, error or omission or that of your employees in the conduct of your provision of professional services. An advanced form of this insurance provides the broader civil liability cover inclusive of negligence, breach of contract and Fair Trading Act. Whilst you will also be insured for your vicarious liability that arises from the act, error or omission of your sub consultants, your insurers will expect to recover loss from your sub contractor. It is therefore important that you do not waive your right of recovery. To do so, will leave you uninsured. We recommend that you require any sub contractors you engage to provide evidence of professional indemnity insurance for the duration of the contract and for at least six years thereafter.

This insurance is arranged on a “claims made and notified” basis. This requires that the insurance is current at the time you both discover and notify a claim to insurers that arises from an act, error or omission alleged to have been committed after the retroactive date. The retroactive date excludes claims arising from act, error or omission occurring prior to the retroactive date. If you have not previously been insured, it is usual for insurers to apply a retroactive date equivalent to the commencement date of your insurance to cover claims arising out your services going forward.

This basis of insurance is different to most insurances you would be familiar with. For instance, a motor vehicle policy is required to be current at the time you have the accident for cover to apply whereas professional indemnity insurance is required to be current at the time of your knowledge of the accident!

Being a claims made policy, it is necessary to maintain the insurance from year to year to cover your business history and “any skeletons that might jump out of the closet”.

PMINZ LIABILITY INSURANCE FACILITY VIA PMINZ WEB SITE

<http://www.techcertain.com/regpmi.aspx>

The insurances included under this facility are:

- Professional Indemnity (insuring errors and omissions)
- General Public Liability (insuring property damage and personal injury)
- Statutory Liability (insuring fines for breach of statute)
- Directors and Officers Liability/Company Reimbursement (optional) (insuring “managerial” errors and omissions)

The **professional indemnity** insurance covers “Civil Liability”. This broadest form of professional indemnity covers liability for financial loss arising from breach of contract as well as a breach of the duty of care in the tort of negligence.

Cover includes breach of the Fair Trading Act 1986 (sections 9 - 14), Defamation, Breach of intellectual property rights, joint venture liability (own), dishonesty of employees, vicarious liability for consultants and sub-contractors, breach of fiduciary duty, loss of documents, late notifications subject to continuous insurance with Lumley, automatic reinstatement of the limit of indemnity, severability of insurance for multiple insureds, non disclosure or misrepresentation of material facts and costs of representation at disciplinary proceedings. Unlike most professional indemnity insurance policies issued to PM’s, this exclusive insurance to PMINZ members is inclusive of cover for cost and time overruns and greater weathertightness cover than the insurance market is normally prepared to offer.

The minimum level of cover has been set at \$1,000,000 any one claim and \$2,000,000 to meet the aggregate of all claims subject to an excess of \$2,000 applicable to the sum of defence costs and settlements. Defence costs are covered in addition to the limit of indemnity.

\$1,000,000 is a realistic minimum level of cover. Although some client contracts will specify a lower insurance limit e.g. \$500,000, this cannot be interpreted as a limitation of liability. You can still be sued for an amount beyond the specified insurance limit. Even if a limitation of liability is available, a duty of care exists to parties beyond the contract who will not be constrained by any contractual limitations.

The professional indemnity insurance is complemented by **general public liability** insurance at \$2,000,000 any one occurrence with defence costs payable in addition, covering liability to pay compensation for personal injury or property damage. This insurance is free of any excess application.

Cover can be extended to non PM activities undertaken by IT PMs such as software design. A combined errors and omissions and general liability insurance specifically designed to respond to the fitness for purpose issues arising from the provision of technology products or services will be utilised.

The above insurances are accompanied by **statutory liability** insurance at \$500,000 to meet the aggregate of all claims including defence costs covering liability to pay fines and penalties under most Acts of parliament including the Resource Management Act and reparation costs under the Health and Safety in Employment Act. This insurance is free of any excess application.

An option is available to extend the insurance programme to include **directors' and officers' liability** insurance which essentially responds to "managerial" errors and omissions as opposed to "professional" errors and omissions. This is worth considering given the trend of professional indemnity claims to extend to directors of companies with allegations of mismanagement resulting in sub standard professional service delivery.

With the exception of the general public liability insurance, these insurances are on a "claims made" format. This format requires a claim that arises out of professional services provided subsequent to the retroactive date, to be discovered and notified to insurers during the period of insurance. The retroactive date will be equivalent to the commencement date of the insurance. If the member has been previously and continuously insured and this insurance is replacing that insurance, the same retroactive date will apply.

Premium Guide

For members falling within the automatic quotation and acceptance parameters of the facility where their proposal does not have to be referred to insurers for underwriting.

The annual premium is calculated on a sliding scale approach based on risk factors determined by the industry sectors members operate in and their activities.

An IT PM earning \$150,000 can expect to pay an annual premium of \$650 + GST for the liability package based on PI cover of \$1m.

A Construction PM earning \$150,000 can expect to pay an annual premium of \$1,530 + GST for the liability package based on PI cover of \$1m.

The scale also differentiates between the categories of membership so that advanced members receive preferential rating.

Premiums for the optional directors' & officers' liability insurance will be quoted separately. Based on a company with assets of no more than \$250,000 and revenues up to \$500,000, we expect an annual premium of \$450 + GST would apply for a limit of indemnity of \$500,000 any one claim and the aggregate inclusive of defence costs based on a nil excess for claims that are not indemnified by the company where an excess of \$1,000 would otherwise apply.

PMINZ liability insurance facility application process

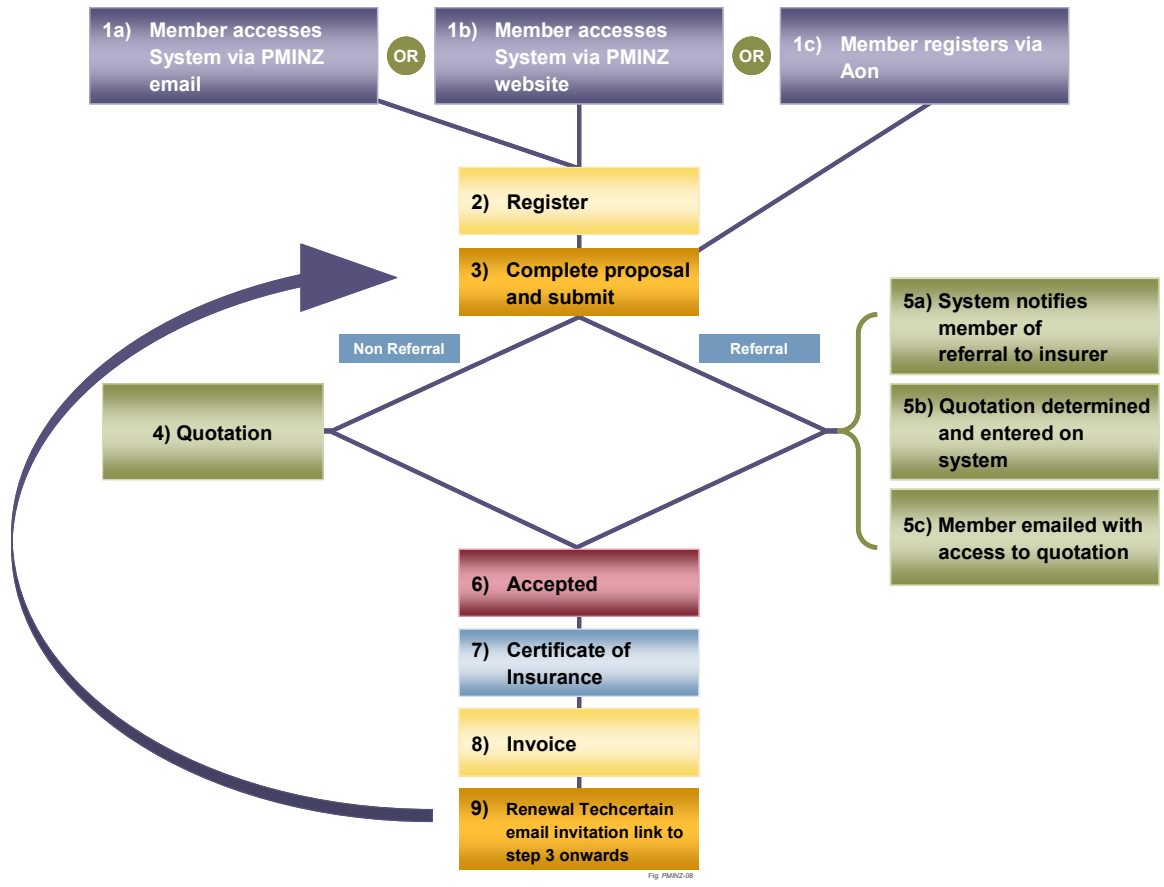


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