

Plan Credit constant for 2015. Premium increase continues for a second year.

Volatility of claims remains a concern with new challenges on the horizon

2015 PLAN CREDIT: 10%

In 2012 profit was negligible and, for the first time, there was no Plan Credit for 2013. In the following year, the results were more positive and a Plan Credit of 10% was provided.

Graph 1 on the following pages shows similar results for 2014. This year, based on the positive results, the Board has again decided upon a Plan Credit of 10%.

Graph 1 also illustrates why volatility in claims has been a major concern to Pro-Demnity in recent years. Annual fluctuations in the number and cost of claims have significantly affected the Company's financial

results, and the trend is expected to continue. The result will be variances in the amount of the Plan Credit each year recognizing claims are so unpredictable and are a major cost to the Company.

The Plan Credit is based on the net profit for the last year after allowances for the retention of capital recommended by our independent actuary. The amount is then distributed to policyholders in accordance with their pro-rata contribution towards that year's premium.

2015 PREMIUM INCREASE: 2½ %

As we reported last year, in response to these fluctuations in claims and costs, combined with virtually static investment income, the Board introduced small increases in premiums each year to continue until enough profit is being generated to cushion the impact of the fluctuations.

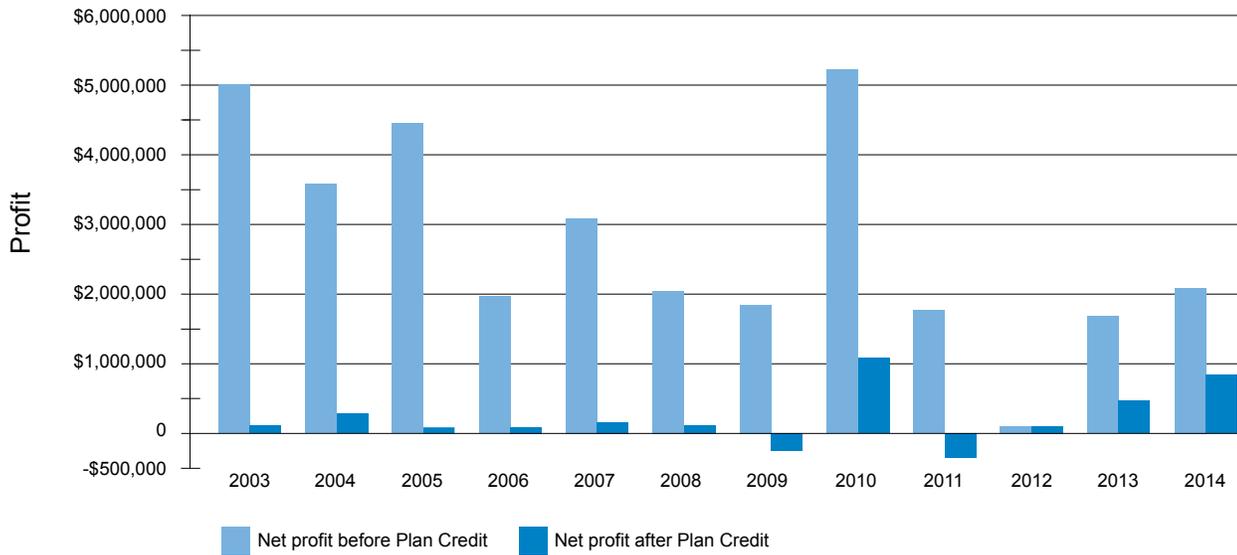
This approach will allow us to pay for normal claims through annual premiums, and for catastrophes by means of reinsurance.

Regardless, annual surpluses will continue to be returned to policyholders as Plan Credits unless those funds are again required to be retained as capital, by our actuary, auditor or insurance regulator.

The purpose of this Bulletin is to show policyholders what is happening in the claims portfolio and to explain why fluctuations in annual claims and profits affect the Plan Credit, and premiums.

GRAPH 1: NET PROFIT COMPARISON

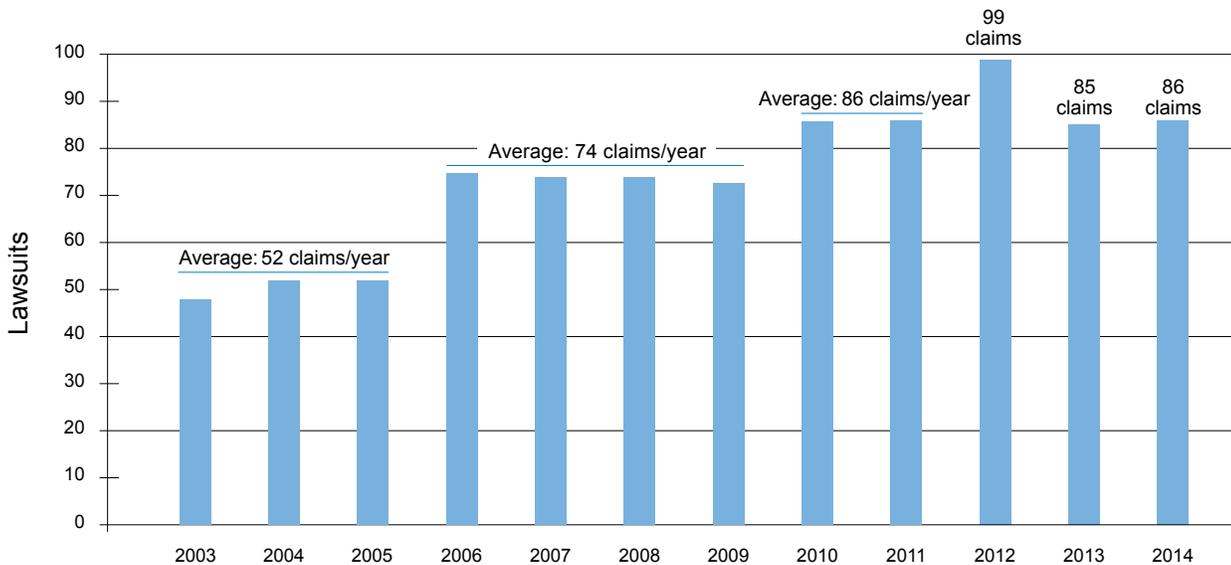
Key fact: Profits have fluctuated dramatically in recent years.



Key facts about claims numbers & costs

GRAPH 2: NUMBER OF LAWSUITS

Key fact: The number of lawsuits reported to us has almost doubled over the past 10 years.



As you can see from Graph 2, in 2014 the number of lawsuits against policyholders remained virtually unchanged from the previous year, although experience has shown that it is not possible to predict that future numbers will continue below the high established in 2012.

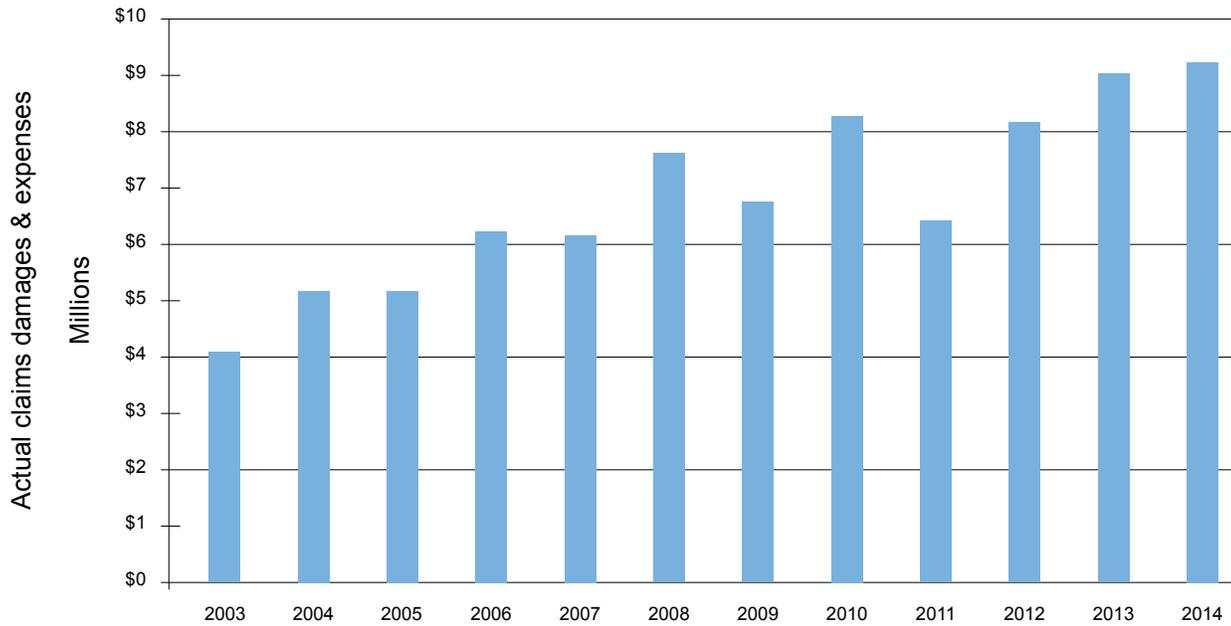
Also, as noted for the last two years, Graph 2 illustrates that the number of lawsuits against architects has risen steadily, in steps, to almost double in what they had been a decade ago.

However, the number of policyholders has risen only 10% over the same period.

This means there are now significantly more lawsuits per policyholder than ever before – and only a modest increase in the number of policyholders paying the premiums.

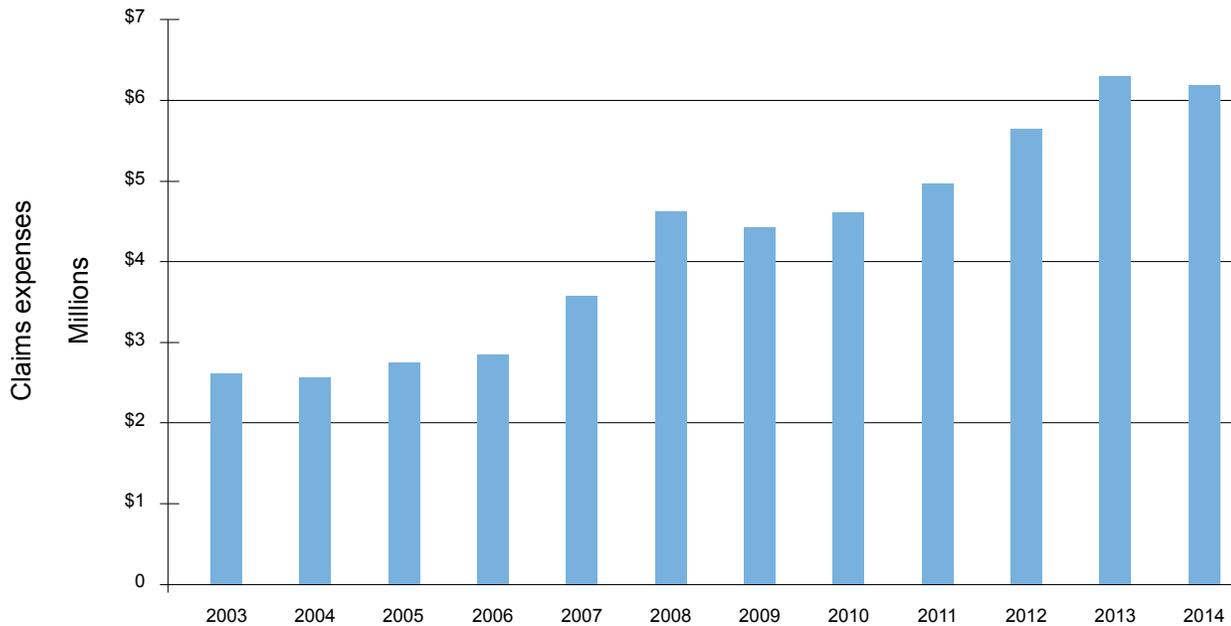
GRAPH 3A: CLAIMS ACTUALLY PAID FOR DAMAGES & EXPENSES

Key fact: Actual payments of damages and expenses reached an all-time high in 2014.



GRAPH 3B: ACTUAL CLAIMS EXPENSES PAID

Key fact: Actual payments for claims expenses reached an all-time high in 2013, and remained at a similar level for 2014.



Actual payments of damages and expenses are the highest they have ever been in the Company's history.

As Graphs 3A and 3B illustrate, actual payments for damages and expenses made in 2014 exceed those

of all previous years. Expenses paid are down slightly; however, increases in damages paid more than offset the small reduction.

Things could have been worse. Although we have identified the *Limitations Act, 2002* as having a major impact on the scope and cost of claims, an unexpected benefit of the Act is that over 100 claims recorded against our policyholders have been able to be closed in the last few years due to the expiry of the Act's two-year deadline for initiating lawsuits.

The increase in the ratio of defence costs to claim limits reflects the inevitable inflationary rise in the cost of legal and expert services over more than 25 years compared to a static (and eroding in value) claim limit of \$250,000.

Why defence and expert costs keep rising

The Bulletins addressing the Plan Credit for 2013 and 2014 included extensive explanations of some of the factors that are contributing to the increase in defence costs borne by your insurance program. These include:

- Impacts of the two year discoverability period under the *Limitations Act, 2002*
- Projects are larger and more complex; expenses and damages are higher
- New technologies and approaches mean less experience and knowledge
- Stress in the construction industry means design and construction expertise have been spread very thin

- "It's someone else's fault" mindset, notably for delays and cost overruns
- Litigation has become more complex.

The full explanations of these factors are contained in the 2014 Plan Credit Bulletin. It can be located in the Pro-Demnity section of the OAA website (www.oaa.on.ca) or via a link to the Pro-Demnity Bulletins and Notices on the Pro-Demnity website (www.prodemnity.com). Member log in is required.

New Challenges on the Horizon involving Engineers

Pro-Demnity has been increasingly concerned about the extent to which claims against architects involve engineering failures. The underlying concern is that where engineers are underinsured, Pro-Demnity is incurring costs and damage payments respecting engineering services without the engineer contributing premium revenue to the architect's insurance program. We perceive this phenomenon to be increasing.

Pro-Demnity is undertaking a comprehensive research project to attempt to better understand and quantify the impacts of engineering claims on architects' insurance in order to assess what measures may be warranted to address the concerns.

The preliminary results are startling. Of 237 claims that arose in the sample period, about 60% of the costs were on claims where an engineer or consultant was involved. The research project has been expanded to encompass

a full five-year period to provide assurance that the information is reliable before any conclusions are reached.

We have already identified liability for engineers and other consultants assumed by architects as a significant factor impacting defence costs and damages in a number of major claims.

Contractual liability generates insurance costs for architects

Many architects retain engineers as subconsultants, thus assuming contractual liability to the client for the engineer's services. Where a claim is based on the engineer's error or negligence, the architect who retained the engineer will be the primary target of the client's lawsuit due to the contracting arrangement.

Pro-Demnity incurs costs to defend the architect in these instances even though the error may be entirely the fault of the engineer.

To defend the architect, Pro-Demnity will “claim over” against the engineer, pointing out that the engineer is the party who made the error and the engineer should be held responsible for any damages arising from its negligence.

However, there is no assurance that the engineer’s own insurance will be sufficient to pay damages assessed against the engineer. Where the engineer’s limits are insufficient to pay damages and costs assessed against the engineer, the architect will become liable for the difference.

Under this arrangement, the architect and Pro-Demnity can end up providing insurance for the engineer by default. In effect, part of the premiums architects pay for their insurance is required to cover these engineering exposures, and the amount appears to be increasing.

Engineers’ insurance may be insufficient

Another concern is that engineers may purchase insurance without the same features that apply to Pro-Demnity policies for Ontario architects. A common example is an engineer’s policy where the claim and aggregate limits are the same, meaning that one claim on a project can diminish or eliminate the limits available to the engineer for another project or claim.

Engineers also purchase insurance where the costs to defend the engineer come out of the claim limits. This type of policy can mean the engineer’s insurer opts to invest very little in defending the engineer recognizing that the available limits will be needed to satisfy damages.

Pro-Demnity has found that, in the absence of a vigorous defence by the engineer’s insurer, it has had to make significant expenditures defending the engineer in order to effectively defend the architect who will otherwise be held contractually liable for damages awarded against the engineer due to an insufficient or ineffective defence.

Even where the architect does not retain the engineer directly, it can find itself named in a lawsuit on a purely engineering matter. A common allegation in these situations is that the architect failed to “coordinate” the work of the engineer.

Pro-Demnity will defend the architect in such instances pointing out that “coordination” doesn’t require the architect to second guess the engineer or practice engineering. However, the role does expose the architect to liability for damages where its own coordination services prove inadequate.

Pro-Demnity is currently providing Risk Management advice and Bulletins related to underinsured engineers and contracting relationships with engineers and other consultants.

Elliot Lake Mall Inquiry points to changes for architects and engineers

On June 23, 2012, a section of the roof-top parking deck at the Algo Centre Mall in Elliot Lake collapsed into the shopping mall below, killing two women and injuring many others. The rescue attempt to save the two women was unsuccessful and drew great criticism.

A Commission of Inquiry under Justice Paul Bélanger was established to investigate the causes of the disaster, assess the rescue efforts and make recommendations to prevent a recurrence.

The Inquiry questioned over 1300 witnesses. Amongst them were many engineers, architects, expert witnesses (professionals), building experts of many trades, government officials, current and past owners of the building, tenants, fire and police officers and officials.

There were twenty-four individuals and organizations given standing at various levels including the Association of Professional Engineers.

Pro-Demnity participated in an active manner to support the architects involved.

- We engaged lawyers to act for the five architects called to appear before the Inquiry.
- We engaged a Building Code expert to opine on code issues.
- We paid for a law clerk to attend whenever a matter of construction was being discussed to prepare a daily transcript of evidence presented.

The Inquiry revealed that there were many parties to blame for allowing the structure to deteriorate. The Centre had leaked seriously from the beginning of its life in 1979, there was no proper roofing or waterproofing surface to its rooftop parking, its steel frame structure rusted visibly, was observed by many, reported on by a series of engineers and architects but received little meaningful maintenance or repair until its collapse in 2012.

It has now been demolished.

Pro-Demnity provided representation

As well as the original architect, four architectural firms, in addition to many engineering firms, had at various times worked on the Centre for either the owner, tenants or a prospective purchaser.

Pro-Demnity provided representation for each of the architectural firms involved and appointed counsel to examine the evidence that was or would be produced, to advise them and accompany them at the time of their cross-examination by Inquiry counsel.

In addition to being requested to appear at the Inquiry each architect had received visits from the OPP who in some cases demanded their files and took them away.

There was very real risk of charges being laid; otherwise the OPP would not have been involved. One engineer has indeed been charged with “criminal negligence causing death”, which carries a maximum life sentence.

The architects and others had all received “Section 17” (of the Provincial Inquiries Act) Notices from the Inquiry informing them that findings could be made of a “professional misconduct” based on testimony provided, and to govern themselves accordingly.

Pro-Demnity counsel were therefore instructed to inform the Inquiry of the nature of an architect’s obligations and their responsibility to their employer

and the Chief Building Official, as well as ensure that the actions of the various architects during the lifetime of the building were accurately portrayed to Justice Bélanger.

The Elliot Lake collapse was a tragedy and no one who played any part in it has reason to be other than concerned that this loss was preventable and yet drifted towards the tragedy “in full view” of inspectors, engineers and indeed architects.

The Province is hopefully going to enact legislation to put rules in place for regular, meaningful inspection of public buildings.

Pro-Demnity has expended approximately \$500,000 for legal and expert costs including transcripts of the proceedings. The basis for the payments was Endorsement No.1 to the Pro-Demnity policies, Sections 7 & 8 which provided for defense costs not to exceed \$100,000 for each of the architect firms summoned to appear.

We believe that Pro-Demnity’s representations on behalf of the architects named in the Inquiry limited the amount of negative comment in the report, affording protection to some of the architects called as witnesses from serious legal actions and assisting prepare a defence for those caught up in lawsuits arising from the Mall collapse.

Litigation against architects has arisen from the collapse

There were potentially a very large number of possible legal actions and dozens of potential plaintiffs.

To date, Civil Lawsuits against three of the architects are underway. One is facing three lawsuits, including a Class Action Suit. We are defending each of them. As a result of the work for the Inquiry much of our defense material is assembled and we have expert reports available for these actions.

In October, 2014, Justice Bélanger’s Final Report was issued. Its content includes 33 recommendations, some of which directly impact engineers and architects. The recommendations are currently being reviewed by the Province, and other affected organizations including the OAA and PEO.

The Final Report of the Inquiry including an Executive Summary for Part 1 (causes of the collapse) can be located on the Inquiry website: www.elliottlakeinquiry.com

Questions you may want to ask us

Do you expect the trend of increasing costs to continue to rise?

A lot will depend on the volume of professional services provided by our policyholders and the number of alleged building deficiencies arising out of these services. In the past, we have seen that the end of a boom phase often creates an increase in claims made against those providing professional services – sometimes because those who suffer a loss as the boom ends seek compensation from parties with presumed “deep pockets” – i.e. professionals and their insurers.

In the short term, we do expect to see more claims and higher costs as the increased number of claims proceed through the litigation process.

In the long term, even if we see a downturn in activity, we expect it will be some time before we see a related decrease in claims reports and costs.

What can policyholders do to help bring down the cost of claims?

1. Since 2005, Pro-Demnity has been delivering loss prevention events and seminars across Ontario. We also daily provide architects with advice on insurance and liability considerations. But advice is only useful if it is acted on: Architects should adopt more effective and proactive risk management activities in their own practices.
2. About half of all claims made against architects arise out of the work of subconsultants. Pro-Demnity incurs legal expenses to defend the architect, even though the architect did not cause the loss. Some clients are dramatically increasing the number of subconsultants that they require an architect to retain. Engineers may have insufficient insurance. Architects are well advised to carefully consider the number, type, capability and insurance of any subconsultants.

What lies ahead for Plan Credits and premiums?

This is impossible to predict due to the fluctuations in claims that have been occurring each year.

The challenge is to match the premiums to future increases in the cost of claims.

- If claims continue to grow, premiums and other revenue will have to adjust accordingly.
- If claims decline and net profits rise, the Plan Credit will rise, too.

Why both a Plan Credit and a premium increase?

One is based on the past; the other prepares us for the future.

The Plan Credit is linked to the past year's operations. It is a mechanism for returning any surplus to our policyholders.

Premium increases prepare us for future fluctuations in claims in order to establish a buffer that is sufficient to absorb them.

Nevertheless, each year any surplus will be returned in the form of a Plan Credit if no provisions are required by the actuary, auditor or insurance regulator.

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