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# PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

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MSP PL 01/00: "Frequently Asked Questions About Professional Liability"

January, 2000



## Frequently Asked Questions

### About Professional Liability Insurance

#### for Architects, Engineers and Environmental Professionals

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Q: What is professional liability insurance?

A: Professional liability insurance is also known as errors and omissions insurance or malpractice insurance. It is purchased by architects and engineers as well as doctors, lawyers, accountants, real estate brokers and other licensed professionals to address business liability risks that arise from rendering professional services.

Q: What does it cover?

A: The policy pays other parties for damages which you are legally liable to pay as a result of negligent acts, errors or omissions in the performance of your professional services. Damages can include property damage, bodily injury, economic loss and legal expenses. The insurance company has an obligation to defend you against such claims, even if the allegations ultimately are

determined to be false or groundless.

Q: How does it work?

A: Policies are generally written for a term of one year on a "claims-made" or "claims-made and reported" basis. These policies cover only those claims made against you and reported to the insurance company during the policy term, and any extended reporting period subject to the retroactive date on your policy.

The retroactive date is the date after which the professional activities of your firm are considered to be covered by the policy. This may be the date on which you first purchased and have since maintained continuous coverage, the inception date of

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1230 Columbia Street, Suite 850  
San Diego, CA 92101-3571

Phone: 619-234-6848 ♦ Facsimile: 619-234-8601

Website: [www.cavignac.com](http://www.cavignac.com)

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your firm, or some other date offered by your insurer.

Remember, the insurance company covering you at the time the claim is made is the one to look to for protection, not the company covering you at the time of the alleged error.

The amount of coverage available depends upon the policy limit you choose, your deductible, and any payments from claims in the same policy period.

**Q:** How is the premium calculated, and what does it cost?

**A:** There are many factors involved in premium determination: the limit and deductible you choose, your discipline, and your firm's size, projects, services and clients. Of course, claims history counts a great deal, as well as your firm's professional track record and business practices.

An average-sized firm (20 employees) with a decent loss history should pay about 1.5% to 2.5% of its gross fees for professional liability insurance.

**Q:** What is the difference between a professional liability policy and a commercial general liability policy for design and environmental professionals?

**A:** A professional liability policy for design and environmental professionals covers their negligent acts, errors or omissions in performing professional services (such as mistakes in the preparation of plans or specifications, surveying errors, or failure to provide services in accordance with the normal standard of care).

A commercial general liability (CGL) policy covers non-professional activities, both inside and outside their office premises (such as when a visitor to their office slips and falls).

**Q:** What is the difference between a claims-made and an occurrence

type policy?

**A:** Professional liability insurance is written on a "claims-made" or "claims-made and reported" basis subject to the policy retroactive date. Claims-made professional liability policies cover only those claims made against consultants and reported to the carrier during the policy period.

Commercial general liability (CGL) insurance policies are written on an occurrence basis because the date of accident or occurrence is readily ascertainable. The occurrence is covered by the policy in force on the date of the event (bodily injury or property damage) no matter how long thereafter the claim or suit is brought.

**Q:** What limits of insurance should design and environmental professionals carry on their professional liability and CGL policies?

**A:** That depends on the firm's risk threshold, what assets it needs to protect, what it can afford and what its clients require. Other factors affecting this decision may include:

- The number and size of projects the firm has performed since the policy's retroactive date.
- The risk level of services provided. For example, if the firm's work is a study, a survey or a preliminary design, less risk is involved.
- The frequency and type of subconsultants used by the firm. The more subconsultants used, the more exposure to vicarious liability, that is, liability for the losses of any uninsured or underinsured subconsultant.

It is important to note that the total construction value of a project is not the measure of risk.

**Q:** Is professional liability insurance available to

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cover just one project?

A: Yes, some carriers offer project-specific insurance. Project insurance usually provides non-cancelable coverage for a pre-selected number of years for the design and construction period as well as a discovery period after construction is complete.

Coverage can begin with design or just before construction begins. Limits are dedicated to the project and cannot be reduced by claims from other projects. Usually the entire design team is named on a project policy. Project insurance premiums are typically between .25% and .50% of construction costs.

Project-specific policies are usually written for projects with construction values of \$1 million or more.

Q: How should a person judge the quality and security of a professional liability insurance company?

A: By asking these questions:

- Does the insurance company specialize in design and environmental consultants' coverage?
- How long has the insurer been consecutively writing professional liability for design and environmental professionals?
- Does the company have claim supervisors who specialize in handling professional liability claims against design and environmental consultants?
- Does the company offer loss prevention programs and other services to help firms avoid potential disputes?
- Does the company use dispute resolution methods to avoid the high costs of litigation?

Q: Should consultants agree to sign a client's proposed contract because it uses standard "boilerplate" language?

A: It depends on the wording of the specific contract – how fair is it? Discussion should take place between the client and the consultant to ensure that the client's project objectives are met and that the consultant's insurance is not compromised or voided. If the contract language voids the consultant's insurance coverage, all parties will lose in the event of a claim.

Business terms regarding payment, termination, insurance requirements, dispute resolution, indemnity and standard of care must be reasonable and fair to both parties. All contract terms should be carefully reviewed and negotiated to fit the specific circumstances of the project.

Contract language should not be onerous, one-sided or attempt to shift undue risk to either party. The allocation of the risks of a project should be equitable and be relative to the rewards/profits to be received by both parties.

Q: Can design and environmental professionals agree contractually to indemnify a client without jeopardizing their professional liability insurance coverage?

A: Yes and no. Professional liability insurance includes limited contractual coverage. Such indemnities are insurable if they are limited to indemnifying only for the negligence of the consultant and they do not include responsibility for the negligence of any other party.

If, however, you agree to be responsible for not only your negligence, but the negligence of your client as well, then the portion of liability that extends beyond your own negligence is not covered.

Q: Can the client be named as an insured or an additional named insured on the consultant's professional liability policy?

A: No. This is normally opposed by professional

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liability underwriters. However, the client can be named as an additional insured under most commercial general liability policies.

and environmental professionals?

A: Very few claims are made during the design phase of a project. Studies have shown that roughly a quarter of claims are made during the design and construction periods.

Q: Is there a time span when most claims are made against design

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The material for this article was excerpted from the pamphlet *Questions and Answers about Professional Liability Insurance for Architects, Engineers and Environmental Consultants* issued by the Professional Liability Agents Network (PLAN). A complete copy of this pamphlet as well as the following PLAN materials are available from Cavnac & Associates:

- *Essential Steps to a Claims-Free Practice*, a booklet that discusses 29 loss prevention techniques to help design professionals better manage their business practices.
- *Project Representative's Manual*, a loss prevention booklet that discusses the responsibilities of design and environmental professionals.
- *The LOL Handbook: A Guide to the Use of Limitation of Liability for Design Professionals* that contains information on how to protect design and environmental professionals from lawsuits and better manage their risks.
- *Expert Witness, A Guide to Service as a Forensic Professional and Expert Witness*, a booklet for design and environmental professionals who provide expert witness services. ✦

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**Disclaimer:** This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

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