PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

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The "Obligation to Defend" Your Client: Why You Shouldn't Agree

by Jeffrey W. Cavignac, CPCU, RPLU
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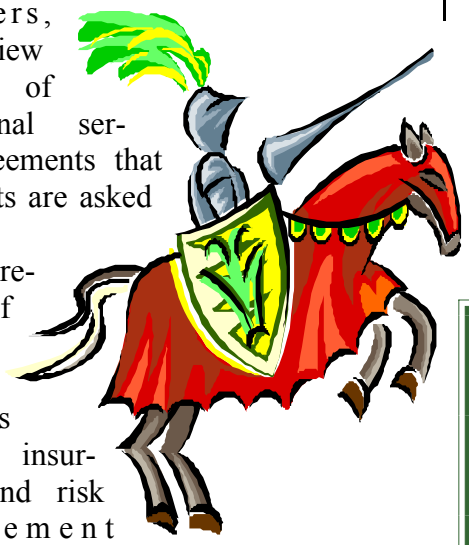
As insurance brokers specializing in professional liability for architects and engineers, we review hundreds of professional service agreements that our clients are asked to sign.



Our review of these documents is from an insurability and risk management standpoint only. In other words, we review the contract to determine if our clients are entering into agreements which could possibly be uninsurable, or for which other risk management techniques are available to lower risk.

One of the most common changes we request is that the word "defend" be stricken from an indemnity agreement. Many design professionals' clients (usually owners) don't understand this, since the contractors they do business with don't have a problem with it.

The main problem is that the contractual liability coverage provided under a commercial general liability policy typically carried by a contractor is broad, while the contractual coverage provided under an architect/engineer's professional liability policy is limited. Whereas

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"Obligation to Defend" *(Continued from page 1)*

the contractual coverage under the commercial general liability policy allows the contractor to assume the liability of the client, and provides coverage for defense, the professional liability policy does not.

The purpose of a professional liability policy is to indemnify the owner for a design professional's errors or omissions. However, the indemnification must take place *AFTER* the negligence of the design professional has been established, not before**.**

It should be noted that if the design professional's clients defend themselves, and ultimately it is determined that the design professional was at fault, then the design professional's professional liability policy would indemnify the clients for the costs that they incurred to defend themselves (not to mention any indemnity or judgment). What it will ***not*** provide, however, is the defense "up front," before liability is determined.

One of the leading authorities on professional liability is Grant Weaver of RA&MCO Insurance Services. To quote Mr. Weaver, *"We generally cannot accept any tender of defense by our policyholder's indemnitee, regardless of what may be required contractually."*

Mr. Weaver points out that *"our coverage contemplates only insuring (and defending) the interests of our insureds as to the competence of their professional services according to having met or failed to meet the professional standard of care — that is, the risk insured, as reflected and expressed in our filed rates and rules, with respective regulatory bodies. We do not insure them [design professionals] against purely 'business' undertakings or risks or exigencies contractually agreed for business or marketing concerns...."*

In addition to this, there are inevitably going to be actual or prospective conflicts between the interests of an insured design professional and its client, the indemnitee. This could require the design professional and its insurer to provide a separate defense for the design professional's client.

If the design professional has to provide a separate defense for its own client, the design professional would be paying the client to, in all likelihood, build a case against the design professional. This would put the insurance company in the odd position of funding a separate defense to trigger coverage under its own policy. This payment of defense would reduce the limits available to pay any claims to begin with, not to mention that the insured design professional's deductible would be called into play. Needless to say, this is not a preferred situation.

Mr. Weaver goes on to add, *"In my opinion and experience, no responsible insurer can accept a tender of defense imposed by an insured's contractual obligations* per se*. Occasionally, an insurer may defend another party in conjunction with its insured when it is in the best interests of the insured to do so, there is absolutely no conflict of interest between their insured and the other party, and when therefore both parties can be defended jointly by agreement by the same legal counsel, but that is a careful, case-by-case determination."*

Mr. Weaver concludes by stating, *"Any party that incurs expense or pays damages because of its vicarious liability to others from the services of an insured is entitled to be indemnified to the extent such was caused by an insured, and an insurer will expect to pay this as a measure of third-party damages on its insured's behalf. The problem, per the above, is the affirmative contractual obligation to 'defend,' which is a wholly different matter from the obligation to 'indemnify.'"*

In summary, it is generally acceptable and insurable for a design professional to agree to hold harmless and ***indemnify*** a third party for the consequences of its own negligence. The contractual obligation to "***defend***," however, can create an uninsurable and, in most cases, an unacceptable position for the design professional.✳

Going Bare

Making the Decision to Drop Professional Liability Insurance

By Jeffrey W. Cavignac, CPCU, RPLU

Professional liability insurance for architects, engineers and environmental professionals is written on a "claims made and reported" basis. In other words, coverage must be in place at the time a claim is reported for coverage to apply, regardless of when the negligent act took place.

You should also be aware that if you elect to non-renew your professional liability policy, and you later decide to repurchase professional liability insurance, you might not be able to obtain coverage for your prior acts. In other words, you may only be able to buy coverage for negligent acts, errors or omissions that take place ***after*** the inception date of the new policy.

Most professional liability carriers offer an "extended reporting period" (ERP) endorsement. For an additional premium, you can extend the period of time within which you can report claims for negligent acts, errors or omissions that took place during the regular policy period (***not*** during the extended reporting period).

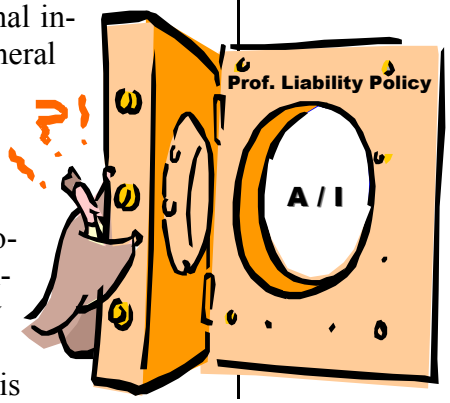
As a final note, if you are aware of any "incidents" or circumstances that could give rise to a claim that have yet to be reported to your insurance company, they should be disclosed ***before*** coverage expires.

The decision to drop your professional liability coverage is a major one. You should only choose this option after you understand the ramifications of doing so.✳

Professional Liability Insurance and Additional Insureds

by Jeffrey W. Cavignac, CPCU, RPLU

As a general rule, professional liability insurers will not add "additional insureds" to professional liability policies. This often perplexes owners, who are used to being added as additional insureds under their contractors' general liability policies. *"Why,"* owners wonder, *"can't I be added to a professional liability policy?"*



To begin with, unlike the broad general liability policy, professional liability coverage is limited in scope. Professional liability policies cover ***only*** design errors and omissions. Since the owner is usually not a designer, and is therefore incapable of making design mistakes, there can be no coverage for the owner.

Furthermore, the professional liability underwriter has evaluated the risk of the *named insured* design professional. The policy was never intended to cover any of the acts, errors or omissions of the owner, even if the owner has its own design staff.

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"Additional Insureds" *(Continued from page 3)*

In addition, many reinsurance agreements (insurance companies for insurance companies) prohibit additional insureds in their contractual arrangements with the primary insurer.

This is further complicated by the fact that most professional liability policies don't contain a "severability of interests" clause. A "severability" clause basically allows one insured (usually the additional insured) to sue another insured (usually the named insured). Because professional liability policies don't have these clauses, if the owner were named as an additional insured, he or she would have ***no coverage*** if she or he sued the named insured (the design professional).

How can owners make certain that they will have coverage if the design professional makes an error? First and foremost, owners need to require professional liability insurance. Secondly, owners need to include in their contracts for professional services an indemnification that requires the design professional(s) to hold the owner harmless and indemnify him/her for all costs and claims expenses that result from the design professional's negligence.

In other words, once the design professional's negligence has been established, most professional liability policies will reimburse an owner's cost of defense and also indemnify the owner for any claims payments it is required to make as a result of the policyholder's negligence.

To summarize, professional liability policies are written to provide coverage for the negligent acts, errors or omissions of the named insured design professional. They are ***not*** written, nor priced, to provide additional insured status for anyone other than the named insured.✳

The Second Commandment of Loss Prevention:

Do Not Become the Insurer or Guarantor of the Success of the Project

Excepted from "Ten Commandments of Loss Prevention" by Gunther O. Carrle, Esq.

As a design professional, you agree to perform your services in a non-negligent manner. The standard by which your performance is judged is typically defined as "the reasonable and prudent (architect or engineer) exercising usual and customary professional skill and care." Avoid contract language which either: raises that standard of performance or makes you a guarantor of performance.

- Frequently owners, particularly governmental agencies, will ask you to perform "in the best and most acceptable manner" or "in accordance with the highest professional skill and care." This language increases the likelihood that a deviation on your part will be the basis for liability.
- Frequently owners will ask you to warrant a certain aspect of your services; i.e., compliance with codes and regulations, absence of hazardous substances, that the design can be used for a stated purpose. This language makes you strictly liable for a deviation. Thus, if you warrant compliance with the code and there is a deviation from the code, you are liable even if the omission was one which a "reasonably prudent engineer would also have made."✳