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ARCHITECTS AND ENGINEERS PROFESSIONAL LIABILITY INSURANCE

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Architects and engineers are covered for professional liability or malpractice claims under professional liability insurance policies. Such policies are frequently referred to as "errors or omissions" policies.

Approximately two dozen insurance companies or markets offer professional liability coverage for design professionals. There is no standard form policy used for design professionals. However, many of the policies have common features, although there are differences among the various policies.

Professional Services

The policies insure for legal liability arising from the performance of "professional services." For example, an architect furnishes plans to the owner which contain a defect. The building is constructed and, as a result of the defective plans, the building contains a defect. Ordinarily, the architect's professional liability policy will pay the owner for its expenses in correcting the defect in the building. Or, the defect may result in a catastrophic loss. Again, the architect's professional liability policy will cover any damages incurred as the result of the loss up to the limit of liability of the policy.

Professional liability policies insuring design professionals and commercial or general liability policies insuring contractors both cover claims

arising from bodily injury and physical damage to property. However, commercial liability policies ordinarily do not cover economic loss claims, such as the cost of repair of defective construction or damages resulting from delay. Such claims are normally not covered

- 1) because commercial liability policies generally only cover bodily injury and property damage claims, and
- 2) because of the workmanship exclusion of the standard commercial liability policy.

On the other hand, professional liability policies insuring architects and engineers cover claims for economic loss, as well as claims for bodily injury and property damage.

Occasionally, a question will arise as to whether a certain activity of an architect or engineer is a professional service. If the activity is not connected with the rendition of professional services, then there should be no coverage under the professional liability policy.

Typically, a professional liability policy insuring architects and engineers merely defines "professional services" as those professional services rendered by the insured as an architect

or engineer. Some policies are broader than others in that they will include services rendered as a "technical consultant" or similar capacity in addition to traditional architectural and engineering services.

Sometimes, the declarations page of the policy will list in more detail the services of the design professional and thus limiting coverage only to those services listed on the declarations page. In other instances, the policy only covers those detailed services offered by the design professional that are listed in the application for insurance. In most cases, the application for insurance is included in the policy by reference. This allows the insurer to rescind the policy in the event there are material misrepresentations in the application.

Design professionals also should maintain commercial liability or general liability policies, even though they have professional liability insurance policies. Certain claims made against the architect or engineer are not covered by a professional liability policy. For example, if a visitor slips and falls in the architect's office, incurring injuries, the claim of that visitor should be covered by the architect's commercial liability policy, not professional liability policy.

Claims-Made Coverage

Professional liability policies are written on a "claims-made" basis. They cover claims made during the policy period. Commercial liability policies are usually written on an occurrence basis. They cover legal liability arising from accidents which occur during the policy period.

If the claim is made after the policy period, the design professional has no coverage for professional liability claims, unless he or she has obtained a renewal of its existing professional liability policy or has purchased an extended reporting period endorsement for its terminated policy.

Professional liability policies usually provide that notice of a claim made during the policy period must be given to the insurer within the policy year or within sixty days after expiration or termination of the policy. The sixty-day extension period

protects the insured when the claim is received by the insured on the eve of policy termination. Reporting a claim during the policy term or the subsequent day period is a condition of coverage.

In the event the architect or engineer does not replace his or her professional liability coverage, then many insurers offer the design professional the opportunity to purchase "extended reporting" coverage. An extended reporting period endorsement provides that claims made after the policy expires will be covered, so long as they are made within a specific time of termination of the policy. Further, the endorsement does not cover errors or omissions which occur during the extended reporting period, only claims arising from services provided prior to the commencement of the extended reporting period

Professional liability policies also contain "retroactive dates." The policies provide that the error or omission which results in the claim must take place on or after the retroactive date. For example, an architect purchases a policy on July 1, 2004 with a retroactive date of July 1, 2004. Accordingly, if a claim is made under the policy for services which were negligently performed prior to July 1, 2004, the architect will have no coverage for the claim. Accordingly, the architect should attempt to obtain a retroactive date from the insurer which is as early as possible. If the architect changes professional liability insurers, then the architect should purchase a policy with a retroactive date the same as its prior insurance policy or earlier. Typically, underwriters establish the retroactive date as the earliest date of continuous claims made coverage.

Some insurers will provide retroactive coverage prior to the inception of the first continuously renewed claims-made policy. Sometimes, the insurer will grant full retroactive coverage after one year of coverage, despite the numbers of years that the firm has been in practice. In other instances, some insurers accept an earlier retroactive date, if the insured warrants that he or she has no knowledge of facts or circumstances which may result in a claim.

Professional liability policies also have "discovery" provisions. Some of the policies specifically require the insured to report claims or circumstances which may result in claims made against the insured. Others give the insured the option of reporting matters which may give rise to a claim. In either event, when such a matter is reported to the insurer, the insurer treats it as a claim made during the policy year in which the insurer receives notice of the circumstances which may give rise to the claim.

Those policies which require the insured to report to the insurer circumstances which are likely to result in a claim do so for good reason. No insurance company wants to sell a claims-made policy where the architect or engineer has good reason to believe a claim will be made against him or her, but the claim has neither been made nor suit filed prior to inception of the policy.

Insureds

Professional liability policies for design professionals generally cover the named insured and its officers, directors, partners and employees for services rendered on behalf of the named insured. Some policies also will cover "leased employees" for acts of the leased employees while they were working for the named insured. In addition, some policies also offer protection for the spouse of an insured.

Only the activities of an insured are covered while he or she is working for the named insured. Thus, if one of the employees of the architect "moonlights," his or her activities will not be covered by the professional liability policy. Further, some insurers in the past have refused to insure architects and engineers who "moonlight."

Some insurers offer predecessor firm coverage. A typical provision will cover the predecessor firm if the named insured is a "successor in interest." Professional liability policies also may cover retired or former employees for liability arising from their employment by the named insured.

Professional liability policies may cover the insured's liability arising out of joint ventures.

Usually, the policy has to be endorsed to state which joint venture is covered or there will be no coverage for the joint venture entity itself. However, only acts of the named insured giving rise to the claim are covered. There is no coverage of the joint venture *per se*. The named insured's policy will not pay for any of the damages arising from the wrongful acts of co-venturer. Thus, the co-venturer must have his or her own professional liability policy. In addition, it may be advisable to obtain a specific professional liability policy for the joint venture.

Most, if not all, professional liability policies insuring architects and engineers will not cover additional insureds, unless there is an identity of interest with the named insured.

Defense

Professional liability policies for design professionals pay for the defense of the claim and the amount of any judgment or settlement entered into on behalf of the insured, subject to the monetary limits of the policy. Many of the professional liability insurers will pay punitive damages, unless prohibited by the law of the applicable jurisdiction. However, the policies will not pay fines or penalties, such as a fine paid to the Environmental Protection Agency or a penalty paid to the Internal Revenue Service. Further, the policies usually will not cover the return of professional fees.

Most professional liability policies covering architects/engineers provide that defense costs are subject to the monetary limits of the policy. Thus, as defense costs are paid, the monetary limits of the policy are correspondingly reduced.

Usually, the deductible or retention applies to defense costs as well as loss payments. Thus, the architect or engineer pays the defense costs until its deductible or retention is exhausted. Then, the insurer pays the remaining defense costs. Many professional liability insurers sell endorsements for "first-dollar" defense coverage under which the deductible does not apply to defense costs and the insurer pays all defense costs.

Most professional liability policies insuring architects and engineers provide that the insurer will not settle any claim without the consent of the design professional. However, the policies usually contain a "hammer clause" which states if the insured refuses to consent to any settlement recommended by the insurer, then the insurer's liability shall be limited to the amount for which it could have settled the claim plus defense costs incurred up to the date of refusal.

Batch Clause

Professional liability policies provide for self-insured retentions or deductibles. To limit the exposure to the insured, most professional liability policies contain "batch" clauses, which provide that if more than one claim arises from a single wrongful act, then only one deductible will apply to all claims.

Territory

Professional liability policies contain one of two covered territory provisions. Some policies provide worldwide coverage. Other policies provide claims for worldwide professional services, but only if the suit is brought or claim is made in the United States or Canada.

Exclusions

There are a number of exclusions contained in professional liability policies insuring design professionals. All errors and omissions policies exclude coverage for dishonest, fraudulent or criminal acts, employment liability, automobile liability, workers' compensation claims, and liability assumed under contract.

Many policies contain an exclusion denying coverage for express warranties and guaranties. However, most of these exclusions will provide coverage for warranties or guaranties that the work will meet generally accepted architectural or engineering standards or that the design professional would otherwise be liable for regardless of the written warranty or guaranty.

Many policies will not cover claims which arise from the activities of related or controlled entities. For example, a design firm may be affiliated with

a contractor, either as a subsidiary of the design firm or through common ownership. Ordinarily, professional liability policies exclude coverage for any claims made against the design professional by a company that the insured operates, manages or controls, or any entity that is owned more than 50% by the insured. This could be significant to firms that are doing design/build work and set up a design/build entity which contracts with the design firm.

Some policies may contain an exclusion for environmental liability. However, environmental liability coverage is afforded specifically in other policies or in policies that do not contain any exclusion for environmental coverage. Some professional liability policies will include contractor's pollution coverage for drilling, sampling or other testing necessary to perform professional services. Recently, some insurers have starting excluding coverage for claims for damages arising from mold or fungi.

Some policies contain an asbestos exclusion under which they exclude claims arising from the specification of asbestos or products containing asbestos. Also, many policies exclude coverage for product liability claims.

Generally, professional liability policies exclude coverage for indemnification provisions, unless the insured would otherwise be liable. Thus, a hold harmless provision under which the architect or engineer holds its clients liable only from the design professional's negligence should be covered by most, if not all, professional liability policies.

Project Insurance

A few professional liability insurers still sell project policies covering all the design professionals working on the project. When an architect or engineer is covered by a project policy, he or she does not have to maintain separate professional liability coverage for that project. Accordingly, the design professional can reduce its professional liability premiums by asking its insurance company not provide protection for the specific project, which usually is done by not including the revenues in that project in the revenue calculations for the rate

base for the design professional's liability practice policy. In addition, the architect's or engineer's proposal in bidding for the project covered by the project policy should not include the cost of the architect or engineer's individual professional liability policy. Policy forms are similar to those issued for individual architects and engineers.

Project policies have several advantages. First, all of the design professionals working on a project are covered. Second, the policies are written for the length of the project, so there is no need for any renewals. Third, higher limits can be obtained for project policies and potential disputes among the design professionals are minimized. However, project policies can be costly, may be unattainable, create disputes over who pays deductibles, and may exhaust their limits before the projects are completed. Further, when a project policy is written, the individual professional liability policies of the architects and engineers do not cover claims arising from their services for the project. As a result, the total professional liability insurance coverage for the project may not be as great as if each design professional was insured by his or her policy for claims arising from the project.

Owner's Contingent Protective Insurance

Recently, insurers have marketed owners contingent protective errors and omissions insurance. Such policies provide excess insurance coverage over the underlying policies of the individual design professionals working on the project.

Owner's contingent protective errors and omissions coverage indemnifies the owners for losses exceeding the design professional's policies. Accordingly, this form of owner's protective insurance is similar to excess liability coverage.

Owner's contingent protective errors and omissions coverage provides two basic coverages. First, if the owner sues the project

design professionals for negligence, the owner's protective policy will cover the amount of the claim exceeding the underlying individual professional liability policy(ies). However, under such circumstances, the owner's litigation costs in pursuing claims against the design professionals are not covered by the policy. In addition, the owner's protective policy provides the owner excess insurance above the design professional's individual policies for third party claims.

Design-Build

In recent years, design-build construction has become increasingly popular. Professional liability insurance is available to design-build contractors. Usually, a professional liability insurance policy is written insuring the professional liability exposure, but excluding coverage for construction. This is done either by specifically insuring design losses only, containing a separate exclusion for faulty workmanship, or containing an endorsement excluding coverage for faulty workmanship. Such exposure is not insurable and is retained by the contractor.

If the design-builder is a contractor which retains an architect to design the project, the design-builder should procure its own professional liability policy and also require the architect to have a separate professional liability policy. Moreover, since the contractor probably cannot be named as an additional insured under the architect's errors and omissions policy, the contractor should obtain a written indemnification agreement from the architect or include an indemnification provision in its agreement with the architect. Further, the contractor should probably use indemnification language which does not void the architect's professional liability coverage. The indemnification provision should not contain language which may make it a warranty or guaranty and should be narrowly drafted so coverage for the provision will not be denied by the insurer under the contractual liability exclusion of the policy.