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## PROFESSIONAL LIABILITY INSURANCE COVERAGE

As participants in the highly complex design and construction process, design professionals encounter a variety of risks that can result in financial losses to numerous project participants. Insurance is a means of managing those risks by transferring them to an insurance company in return for a premium payment.

In operating private businesses, licensed design professionals consider insurance to cover certain risks, including professional liability, risk of property loss and risk of personal loss. As firms grow and consider providing benefits for their staff, they may participate in health insurance, life insurance and pension plans. Sole proprietors consider acquiring insurance to protect themselves and their families from injury. In any case, insurance is an important business decision for firms of all sizes.

### Professional Liability

For design professionals, a key set of professional and business risks arises from the possibility of causing harm because of their negligence in performing professional services. These negligent acts, errors, or omissions may cause damage to clients, contractors or other third parties, and the firm may find itself liable for these damages. In buying a professional liability insurance policy (sometimes inappropriately called *errors and omissions* or *E&O* insurance), the firm is asking a broader financial entity—the insurance company—to absorb a portion of the costs of claims in exchange for a premium paid to the insurance company.

Not all firms elect to purchase professional liability insurance. This business decision is made as part of the firm's overall approach to managing its practices and risks. Even those firms that do buy professional liability insurance retain the risk for expenses that fall within their deductibles or exceed their policy's limits of liability—or that are excluded from their coverage.

### Sources of Professional Liability Insurance

Most design professionals purchasing professional liability insurance coverage do so through independent brokers. These brokers represent the interests of their clients and not those of the insurer. By contacting a broker experienced in professional liability insurance, a firm can shop around for insurance. The professional can usually obtain access to many insurance markets and, with the professional advice of the broker, decide which carrier best fits its needs.

Some insurance companies are represented by agents who are authorized to place policies on behalf of that company in a predetermined territory. These insurance agents represent the interests of the particular insurance company and may not have access to the entire insurance marketplace.

Regardless of whether a firm chooses an independent broker or an exclusive agent, the firm will want to select its broker or agent in much the same way it selects its lawyer and accountant—with care and scrutiny of qualifications, services available, cost, and, not least, chemistry and commitment.

In evaluating insurance options, design professionals will find that each professional liability insurance policy is different in some respects from all the others. The design professional must reconcile coverage and cost, but the variety of coverages available through endorsements, exclusions, and the core policies themselves makes reasonable cost comparisons very difficult. It is important to carefully evaluate endorsement options, coverage limits, and deductibles. The added costs for some of these add-ons, including increased limits, can be minimal.

In addition, the service and stability of the insurance carrier must be considered. Services provided by professional liability insurance companies range from extensive educational and management assistance programs, such as those offered by CNA/Schinnerer, to little or no information, advice or guidance. The true value of a professional insurance policy is probably best defined by the claims handling process. The specialized expertise of a claims manager familiar with design and construction, combined with the knowledge, interest and sensitivity of defense counsel, may be the most critical characteristic for selecting an insurer.

While it is often difficult to rank competence and service above the cost of coverage, the “low cost” insurer may be quite like a “low bid” contractor. Certainly, the attraction of a lower initial premium cost should be weighed against the potential of future, significant rate increases and the risk that the carrier might not continue to offer professional liability insurance. In the insurance industry, carriers enter and leave the professional liability arena as business conditions change. In some past “hard” insurance markets, the number of carriers offering insurance on an admitted basis in a given state has dropped to a single provider—the CNA/Schinnerer program that is the Institute’s Commended Program of the AIA, NSPE and ACSM.

### Admitted Companies

States permit insurance companies to sell their products on either an admitted or non-admitted (what is usually called excess-and-surplus or E&S) basis. Companies that sell insurance on an admitted basis subject themselves fully to the oversight of the state and must have their rates, coverages, and policy forms reviewed (and, in many states, approved) by the state. In addition, admitted companies must contribute to a state guarantee fund to be drawn upon to pay claims should that company be declared insolvent and lack the financial wherewithal to pay the claim itself. This entire process protects the consumer.

Non-admitted carriers are not subjected to such scrutiny, nor are they included in the state guarantee fund. Accordingly, they have an easier time moving in—and out—of the insurance market. For these reasons, many states require brokers to seek coverage from admitted carriers first, placing coverage in an E&S market only when admitted carrier coverage is not available for the specific firm. Some states even require brokers to warn the insured person or firm that they are placing their coverage with a non-admitted carrier by stamping the policy to that effect.

### Claims-made Basis

The possibility of encountering a limited number of admitted insurance carriers might leave the design professional in a difficult position due to the traditional claims-made nature of many professional liability insurance policies. “Claims-made” means the policy must be in effect at the time the claim is made against the design professional—even though this can be years after completion of construction. Claims-made policies are common to professional liability insurance and should not be confused with *occurrence* policies common to general liability insurance. This distinction is important to understand.

Under a *claims-made policy*, all coverage ceases when the policy is canceled or not renewed (by the firm or the insurer), even though the design professional may have been insured when the services were rendered. Under an *occurrence policy*, a claim filed after policy cancellation or renewal will be covered if the policy was in force when the incident that caused the claim occurred, regardless of whether the insured was covered when the claim was made.

The claims-made basis is used for professional liability insurance coverage because it makes costs to the insurer more predictable. If coverage for professional liability risks were offered on an occurrence basis, the cost of such coverage would be prohibitive because the insurers would have to include contingencies for many more

unknowns. This distinction, however, means that firms that buy insurance as a risk management tool have to keep it in force on a continuing basis for continuing protection. When a firm remains with one carrier, the claims-made nature of the policy is not an issue. If a firm switches carriers, *prior-acts* coverage is usually available to cover the risks from the earlier period.

Individuals practicing in firms may or may not be affected by the above attribute of claims-made coverage after they leave their firms. If the firm retains coverage, former partners and employees who were “named insureds” on the policy will enjoy coverage for those services they rendered during the course of their partnership or employment. If the firm drops coverage or ceases to exist, these individuals lose coverage.

The claims-made feature raises the question of protection upon retirement or withdrawal from practice. Professional liability coverage is available in a few programs to continue the protection needed by design professionals who withdraw from active practice. Usually this “tail” coverage is arranged by endorsing the basic policy. Some states require admitted carriers to provide some level of tail coverage at an extra cost to the insured.

For example, the CNA/Schinnerer program has coverage available to design professionals who have been insured for three consecutive years prior to retirement; the policy then covers the retired design professionals for prior acts. Coverage is similarly available to protect the estate of a deceased design professional if this is warranted.

### **Prior Acts**

Firms can buy coverage for professional acts and services that took place before they first became insured or when they were insured by another carrier. The scope and availability of this “prior acts” coverage varies from insurer to insurer. As an example, the CNA/Schinnerer program provides prior acts coverage (to the day the firm started practice) that is available to eligible firms after they have been in the program for two years.

### **Coverage**

Generally, a professional liability insurance policy covers the insured firm’s liability for negligent acts, errors, or omissions arising out of the performance of professional services as a design professional, provided these services are performed within the territory defined in the policy. All policies cover the U.S., and many offer worldwide coverage in the basic policy or by specific endorsement.

A basic policy provides legal defense of claims covered by the policy and pays defense costs subject to the policy limit and deductible. Most insurance companies retain attorneys who are experienced in the defense of professional liability claims. When a defense attorney is selected and appointed to defend the policyholder, it is that firm—not the insurance company—that is the defense attorney’s client. Some firms, however, may be able to select their own defense counsel.

Broad policies insure not only the firm as the “named insured,” but also any partner, executive officer, director, stockholder, or employee of the insured firm when that individual is acting within the scope of professional duties. Some lower-cost policies may not automatically provide such broad coverage.

### **Endorsements and Exclusions**

Policyholders and insurance companies can modify coverage through endorsements and exclusions. Exclusions are sometimes added to specifically preclude coverage for identifiable risks. This can be done to reduce the cost of the policy or to allow coverage in situations where risks cannot be determined. Sometimes endorsements that expand coverage have an additional premium cost; sometimes they are included automatically at no extra cost.

Firms should be aggressive about having their broker or the insurance company's agent check into those expansions of coverage that they need for their practice or that fit into their practice management goals. For example, endorsements include first-dollar defense, special project additional limits, expanded equity interest, and design-build coverage. In other words, a firm can negotiate its coverage based on its practice needs. Insured firms should review these sections annually; practice needs change over time, as do the demands of the firm's clients.

### **Limits of Liability**

How much insurance a firm buys is a function of its financial needs (including those of its principals), its tolerance for risk, its confidence in its risk management abilities, and the demands of its clients. Minimum annual and aggregate limits of liability for errors and omissions insurance are usually set at \$100,000, with maximum limits running as high as \$15 million. Higher limits can be arranged for special circumstances.

"Annual and aggregate" limits of liability are available to pay for claims and associated legal expenses in a policy year. The costs of claims and legal expenses that exceed the limits must be absorbed by the firm. With most policies, the firm receives a new limit each policy year. Some insurance programs, such as the CNA/Schinnerer program, permit their policyholders to buy excess limits for specific projects or to buy "split limits," with one limit per claim and another for the aggregate in a year. The insurance company can determine the cost of these variations for the insured to consider (without an obligation to purchase).

### **Deductibles**

To encourage risk management techniques within a firm, insurance companies require a firm to have a deductible that the firm must pay to defend each claim or after each determination of negligence. Deductibles as low as \$1,000 are available, but many firms increase their deductibles to lower their premium costs. As with most insurance, the higher the level of risk retained by the insured—that is, the higher the deductible—the lower the premium cost. Determining the balance between the deductible, the premium, and the coverage requires weighing probabilities and finances and is best carried out by the firm with the advice of its broker. In making this decision, the firm will want to remember there is a new deductible obligation with each claim.

### **Costs of Insurance**

Each firm's premium is calculated individually based on such factors as the firm's practice, project mix, claims experience, coverage needs, and resulting risks to the insurer. Hence, comparing premiums of different, but seemingly like, firms is difficult. This is true because firms, just as insurance policies, differ from one another. Thus, a firm should pay attention to its application and work with a broker who can present the firm well to the insurance company. Because prudent insurers must increase the cost of insurance if risks cannot be clearly delineated, the more specific and unambiguous the information provided, the more likely the premium will be minimized. A prospective policyholder should also feel free to call the company (with its broker) to ask how the firm's premium is determined.

### **Contractual Liability**

Professional liability insurance companies provide coverage only for the insured firm's negligence in performing or furnishing professional services. Coverage for express warranties and guarantees—separate contractual promises—is excluded under most policies. Certifications that have the effect of warranties—for example, those that do not state a known fact or express a qualified professional opinion—are also excluded. Promises to absorb costs of errors and omissions, absent negligence, are also excluded because such promises have the effect of a warranty.

Insurability problems also arise when design professionals are asked to contractually indemnify and hold harmless their clients. An extension of coverage is needed when a design professional agrees, either in writing or orally, to indemnify and hold harmless the client or contractor—unless the design professional is indemnifying the other person for the design professional's own negligence, at which point coverage under many policies is automatic. In most contractual liability situations, such coverage may not be possible.

A hold harmless or indemnity clause essentially is a contractual assumption of another's legal liability. Under many circumstances, use of a hold harmless clause is an acceptable practice as long as the contractual transfer of liabilities is not against public policy and can be covered by insurance or available assets. For instance, in AIA Document A201, *General Conditions of the Contract for Construction*, a clause is included to require the contractor to indemnify and hold harmless the client and design professional for bodily injury or property damage claims arising out of the contractor's negligent performance of the work. Many states have "anti-indemnity" statutes to regulate the use of indemnity clauses in construction contracts; some states prohibit these clauses completely.

The design professional should take care to look for hold harmless provisions before signing any contract for professional services. A clause that otherwise appears innocuous might contain such a provision. A design professional who finds or suspects such a clause should submit the provision to the design professional's attorney and insurance advisor. A promise to indemnify may fall within the scope of professional liability insurance coverage, but broad wording may mean that the promise is a contractual obligation that cannot be covered by insurance.

### **Inter-professional Relationships**

Design professionals routinely retain consultants. This relationship means that the design professional also has vicarious liability for any damage caused by the consultant's negligence. Insured design professionals will want to review their consultant's insurance status as they, for all intents and purposes, will serve as their consultant's insurer if that status is inadequate. Similarly, if a design professional agrees by contract to limit the liability of a consultant, the design professional may find that the risk of the consultant's negligence has been shifted to the design professional and its insurer. At times, design professionals are subconsultants to other professionals or subcontractors to construction contractors. Examining the prime design professional's coverage—or the professional liability coverage of a construction contractor through which services are provided to a client—can alert the subconsultant design professional to gaps in coverage that could result in the subconsultant becoming the only target of a claim.

### **Joint Ventures**

From a legal standpoint, a joint venture is quite similar to a partnership; the main difference is that a joint venture normally has a more limited scope or purpose. If a professional liability claim is filed against a joint venture, one or all of the members can be held liable for any judgment rendered against it. Broad policies—such as those of CNA/Schinnerer program—provide automatic joint venture coverage. Some insurers exclude joint ventures from the basic policy; coverage for joint ventures with other design professionals may be available by special endorsement for specific situations. The endorsement extends the coverage under the basic policy to provide for the insured's legal liability arising out of professional services performed on behalf of the named joint venture. However, coverage for other participating firms in the joint venture is not provided by this endorsement. Special care should be taken when firms do not formally create a joint venture, but instead hold themselves out to a client as an "association" or a "team." Such alliances will usually be seen as joint ventures and each party may be held liable for the negligence of the other.

Each member of a joint venture should obtain evidence from the other joint venture partner(s) that their policies have been properly endorsed, if necessary, to cover participation in the joint venture. This can usually be accomplished by obtaining a certificate of insurance and a copy of the joint venture endorsement.

## Project Professional Liability Insurance

Project insurance covers the design team participants—even those who are uninsured. The policy covers the design professional and named professional consultants for the term of the project plus a predetermined discovery period after completion of construction. Depending on the insurance carriers of those firms covered by a project policy, coverage may then revert to the individual firms' professional liability policies.

Project insurance is intended to cover only one project and is usually paid for by the client who wants coverage beyond that normally carried by the firms. Such insurance is also useful when the project is of such increased scope that it drastically affects the cost of basic coverage, or when coverage is needed for underinsured or uninsured consultants. From the design professional's standpoint, the billings associated with a project-insured project (and the cost of any claims) do not affect the premium set for the firm's practice policy. A broker is necessary to compare coverage.

## Expanded Project Delivery Approaches

Insurance companies have begun to provide coverage for design professionals practicing in roles such as design-builder, construction manager and land developer. While some companies offer endorsements to the basic policy for these services under certain conditions, potential gaps should be investigated to prevent uninsured liability. For example, a construction manager (as advisor to the client) is covered under most professional liability policies; the at-risk construction manager—one acting as a general contractor—is not.

## Claims

In the world of professional liability insurance, there are two common ways to define claims. The first is objectively defined: a demand for money or services with an allegation of a wrongful act. This definition produces a clear reference point indicating when the insured and the insurance company should intervene. It is also broad enough to cover not only a lawsuit, but also that angry call from the client demanding that the architect "fix it." The second definition is subjective and requires alerting the insurance company to a potential problem. Such a problem may not necessarily become a formal claim, but rather a threat of an action-or just a very troubling circumstance. A careful review of these policy terms is important, as failure to report a claim in a timely manner may jeopardize coverage.

Most policies require the insurance companies to have the consent of the insured before settling claims. In cases involving a disagreement between the insured and the insurance carrier on settlement, the insured may be liable for the cost of any judgment above the amount for which the insurance company could have settled the claim. Similarly, the insurance company may be liable for the cost of any judgment above the amount that the insured asked the company to settle. This check-and-balance approach encourages both the insurer and the insured to work together to manage claims.