

THE CLIENT'S RESOURCE

Intro to Professional Liability Insurance

Professional liability policies are designed for a specific risk—the risk of loss caused by the negligent performance of professional services by design professionals. As clients, you have a legitimate right to know that the design professionals you hire have the financial capacity to stand behind their professional services. You also should have an understanding of the limits of professional liability (PL) coverage.

The insurance requirements of some clients reflect a misunderstanding of the nature and scope of PL coverage for architects, engineers, surveyors, and other design professionals. When you attempt to mandate specific insurance coverage, you usually do so to seek financial protection and to structure insurance requirements in what you consider to be standard terms. In some cases, it is impossible for design professionals to comply with such requirements. It is a good idea to become educated about the nuances of PL coverage. This is especially important when the requirements, as stated, are actually adverse to your interests or are simply impossible to meet under the terms of the design professional's PL coverage.

This guide is intended to help you understand some commonly misunderstood features of PL insurance, though it is not meant to be exhaustive in its explanations. You should also consult an insurance advisor knowledgeable about requirements for design professionals' PL coverage.

Naming the Client as an Additional Insured

You may think that you will be better protected against third-party claims by being included as a named insured or an additional insured on the PL policy. This may be true for some forms of insurance, but it is not an option in the Victor program nor most PL policies. The reason is that since you do not perform professional services, you do not assume the risks that the PL policy is designed to cover.

Unlike other types of insurance policies, the PL policy does not make payments to the insured. Instead, the PL policy pays on behalf of the insured in the event that the insured's negligence in rendering professional services causes damage or injury. If you were named as an insured under the PL policy, you would be unable to collect damages since an insured cannot make a claim against itself and recover under the PL policy. Professional liability claims are complex, and often involve multiple parties and an absence of clear responsibility. This complexity is one factor that distinguishes PL policies from other policies such as the commercial general liability (CGL) policy, which does allow additional insureds.

Some clients believe that additional insured status will provide adequate coverage for their in-house design professionals. You would be better served by purchasing your own PL policy to cover the activities of in-house design professionals. By doing so, you can better manage your risks by obtaining coverage and policy limits that meet your specific needs.

Contractual Liability Coverage

Some clients may ask design professionals to have their PL policy endorsed to specifically insure contractual liability—that is, the risks the design professional assumes under the professional services agreement.

Clients often ask for contractual liability coverage from design professionals because such coverage is found under a contractor's CGL policy. Such a request is problematic, however, because CGL contractual liability is broad form coverage due to the contractor's broad risk exposure. Conversely, the PL policy has a limited form contractual liability because the design professional's risk exposure is limited to professional negligence.

The Victor PL policy automatically includes a limited form contractual liability coverage to the extent that the liability is predicated on the insured's negligence in the rendering of professional services. If your request for contractual liability coverage is consistent with the coverage already provided by the policy, a special endorsement is unnecessary.

On the other hand, if the coverage requested goes beyond what the policy already covers, you have put the design firm in the position of assuming a business risk that is uninsurable. Examples of uninsurable contractual liabilities include express warranties and guarantees, representations that services will be free from fault and defect, and representations that the project, when finished, will be fit for its intended purpose. It is to your benefit to have contractual obligations that are insurable so that there's an increased chance of availability of a remedy to address any claim caused by the design professional's negligence.

Professional liability coverage is designed to pay on behalf of an insured firm that does not meet the standard of care in fulfilling professional obligations; it is not designed to stand behind all contractual obligations. By law, design professionals are liable for their own negligence as well as for the negligence of those they have assumed vicarious liability (generally, professional consultants). If design professionals agree by contract to accept liability for more than this negligence, they are assuming a business risk that is not covered under the Victor PL policy, which ultimately may prove to be a risk for you.

Insuring an Indemnity Provision

Another form of uninsurable contractual liability can be found in broad form indemnity provisions that go beyond the coverage of a PL policy. Examples of this include:

- The design professional agreeing to indemnify you for claims, damages, and losses that are not caused by the design professional's negligence; and
- The design professional agreeing to indemnify you for your negligence.

The Victor PL policy, without any special endorsement, provides limited form indemnity coverage. Such coverage is provided to the extent that your damages are caused by the design professional's negligence in performing or furnishing professional services.

Your insistence on a broad form indemnity agreement may not be beneficial to you. Rather than expanding the coverage available to you, it will have no effect on coverage because:

- The agreement is inconsistent with the coverage provided under the PL policy—the very coverage you require the design professional to carry; and
- Such an indemnity provision may prove to be of little value to you if the design professional lacks adequate financial resources, absent the protection provided by the PL policy, to honor the indemnity agreement when a claim is made.

COMMON INSURANCE REQUIREMENTS REQUESTED BY CLIENTS

Sometimes, you may request professional liability insurance requirements or endorsements without realizing that they are inappropriate. Such requirements may include:

- Naming you or another party as an additional insured on the professional liability policy;
- Requiring coverage for contractual risks that go beyond the design professional's responsibilities; and
- Requiring an indemnity obligation that is broader than the coverage provided in the professional liability policy.

Sample Contractual Indemnity Language

Each party should be willing to be responsible for losses and claims to the extent that they are caused by that party's negligence. We offer the following as a contractual provision that addresses this issue:

> **Sample provision:** To the fullest extent permitted by law, Client and Consultant each agree to indemnify the other party and the other party's officers, directors, partners, employees, and representatives, from and against losses, damages, and judgments arising from claims by third parties, including reasonable attorneys' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error, or omission of the indemnifying party or any of the indemnifying party's officers, directors, members, partners, agents, employees, or subconsultants in the performance of services under this agreement. If claims, losses, damages, and judgments are found to be caused by the joint or concurrent negligence of Client and Consultant, they shall be borne by each party in proportion to its negligence.

Purchase of Insurance by a Client

Since you do not provide professional services, Victor does not allow you to purchase a PL policy on behalf of another party as that may put you in a position of conflicting interest because you would be making a claim against a policy you purchased. You can, however, require the design professional, via contract, to purchase insurance and continue doing so for a certain period of time. You may also reimburse the design professional for the premium of a specific project policy, if one can be obtained, to cover all design professionals on a particular project.

If the design professional has a contractual obligation to obtain and continue coverage, but does not provide that coverage, you may have a cause of action in contract, as well as in tort, against the design professional. Such action is based on the design professional's negligence in the rendering of professional services.

Technical Insurance Requirements: Insurance as Primary Coverage

Below you will find some inappropriate and uninsurable requests under a typical PL policy—requests that may increase your risk exposure. Stating that an insurance policy is "primary" recognizes that the policy begins to pay at the first dollar of loss after the deductible has been exceeded. The primary insurer has an obligation to provide defense for covered claims until the limit of coverage is exhausted through payment of expenses, settlements, awards, or judgments. Although this type of requirement makes sense in property insurance and other forms of coverage, it generally does not apply to PL policies because there is no other PL policy to turn to after the "primary" policy has been exhausted. Umbrella and wrap-up policies typically will not include coverage for PL claims.

Policy Form: Claims-Made vs. Occurrence

All PL policies are written on a claims-made, not an occurrence, basis. Sometimes, contractual requirements incorrectly characterize PL insurance by requiring the coverage to be provided on a per-occurrence or per-incident basis; the difference is significant. Under a claims-made policy, the availability of coverage is determined by the date that a claim, as defined by the policy, is first made. Conversely, the availability of coverage for a claim made against an occurrence form policy is determined by the date that the situation giving rise to the claim occurred, not when the claim was made. Therefore, referring to the limits of coverage as applying per-occurrence is misleading because it may imply an obligation by the design professional to provide coverage that is unavailable. The appropriate language for stating the limits of coverage under a PL policy is "per-claim with an aggregate limit."

Another important aspect of a claims-made policy is prior-acts coverage, which may not be available on all policies. It is also important that all policy requirements are met to maintain policy coverage.

Notice of Cancellation to Clients or Third Parties

Clients and other parties relying on the services of a design professional want to minimize the possibility of finding out after the fact that the design professional has canceled, modified, or reduced PL coverage to a level or form that is unsatisfactory. Therefore, clients, lenders, and others often require that they be notified if the design professional's policy is canceled or "materially changed."

Victor cannot provide notice of "material changes" because "material" is not a well-defined term. What constitutes a material change for one certificate holder may not be deemed material by another. Therefore, it would be extremely difficult, if not impossible, to determine whether or not each policy change would affect each certificate holder. If, however, a certificate of insurance demonstrating the presence of PL insurance is issued, Victor will provide notice to the certificate holder(s) in the event of cancellation, nonrenewal, or reduction in policy limits by endorsement.

Sometimes, the design professional can accept the responsibility to notify you of material changes. In such instances, the professional services agreement needs to define what you and the design professional consider material. If the notice requirement identifies a specific notice period, such as before the cancellation of a policy, the Victor program will accommodate up to a 30-day maximum notice period.

Availability of Coverage Into the Future

Some clients may require design professionals to maintain PL coverage for a minimum number of years following substantial completion of a project. Because of the claims-made nature of the PL policy and the knowledge that most PL claims occur shortly after completion of a project, some clients want contractual assurance that the claims-made policy will remain in effect during that period. Neither design professionals nor their insurers can guarantee that a policy will be continually renewed for a specified period of time. The one exception, if available, is a project-specific policy, which in today's market is increasingly difficult to obtain. Such a policy can be written to cover the design and construction period or up to five years beyond substantial completion of the project.

The design professional also cannot guarantee that it will be able to purchase equivalent coverage in the event of cancellation of the policy. Sometimes, coverage may be withdrawn and the design professional may decide to drop coverage if the policy would require a significantly increased premium. Any contractual obligation to retain coverage for a specified period should allow you and the design professional to assess alternatives that might permit the design professional to attain insurance conditions that are acceptable to both. It is to your benefit and best interests that the requirements for the design professional's PL coverage are reasonable so that coverage can be maintained. If the design professional does replace the PL policy, it is important that full prior-acts coverage is obtained.

Claims-made vs. Occurrence Trigger

ABC Engineering has had claims-made policies for the last three years. Nation's Insurance Co. provided coverage during 2019, XYZ Insurer provided coverage in 2020, and Main St. Insurance provided coverage in 2021. In 2021, ABC received notice of a claim from a client, even though the event leading to the claim occurred in 2020 (see the timeline below).



QUESTION: Assuming that the allegations are within the PL policy's coverage, which insurer—Nation's, XYZ, or Main St.—would be obligated to provide defense for ABC and possibly pay the client's damages?

ANSWER: CLAIMS-MADE. The claim occurred in 2021, while Main St. Insurance's policy was in effect. Main St. would respond to the claim.

ANSWER: OCCURRENCE. The event leading to the claim occurred in 2020, while XYZ Insurer's policy was in effect. Thus, XYZ would respond to the claim.

Sample Contractual Language for PL Insurance Requirements

When negotiating a professional services agreement with a design professional, you may consider the following provision regarding PL coverage:

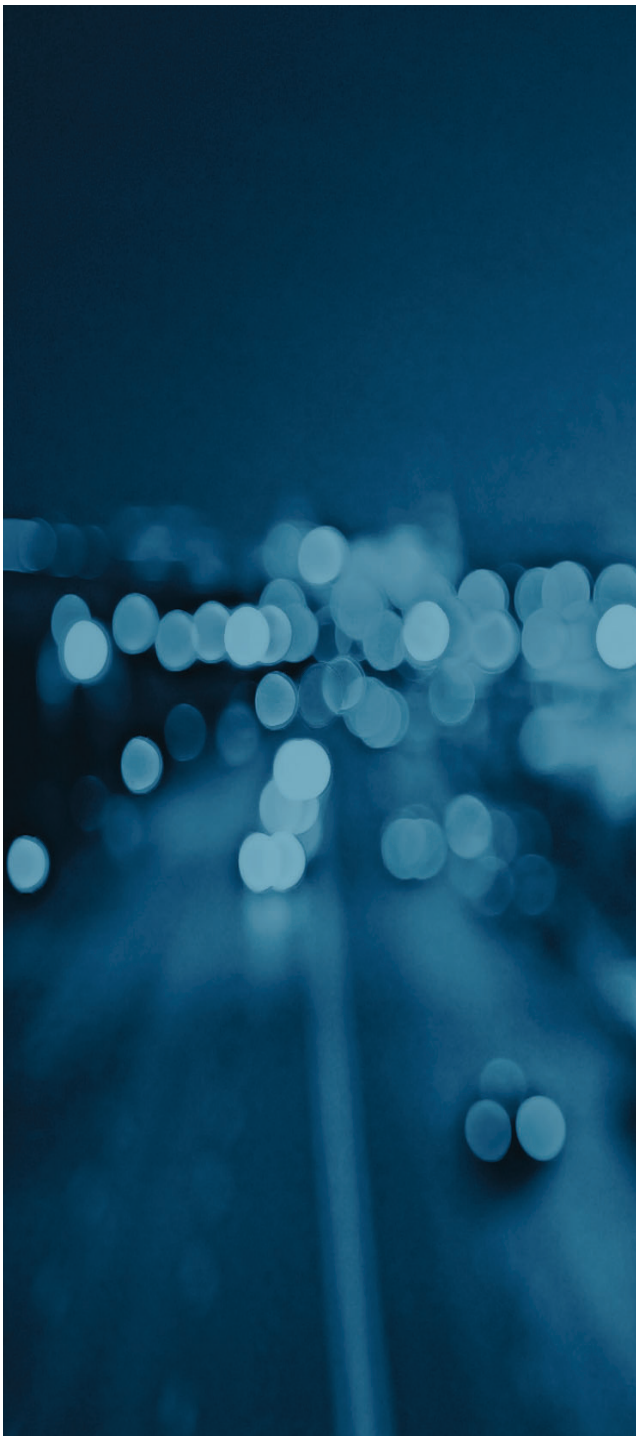
> **Sample provision:** Consultant shall obtain professional liability insurance, with a minimum limit of $_____ per claim and in the aggregate covering the negligent acts, errors, or omissions of Consultant in connection with the performance of Consultant's services. Such insurance policy shall be maintained with an insurance company authorized to do business in the state of _____ and reasonably acceptable to Client.

Summary

You and your advisors often request specific insurance requirements of the design professionals you retain. These requirements are often incorporated into professional services agreements. Failure to meet these contractual requirements may lead to breach of contract claims.

Often, however, there is a misunderstanding of some important differences between insurance coverages such as CGL and PL. Too often, professional services agreements will include requirements that are appropriate for CGL, such as naming you as an additional insured, but are inappropriate or unavailable under a PL policy.

This guide addresses some common client-requested insurance requirements that are problematic under a PL policy. Our intent is to provide information that explains some of the unique features of a PL policy as well as some benchmarking information regarding limits of coverage so that you, and the design professionals you hire, can incorporate appropriate requirements into professional services agreements. For more information on Victor insurance coverages, go to our website at victorinsuranceus.com.



Benchmarking Insurance Requirements

Often, clients will contractually require their design professionals to carry certain limits on a per-claim basis. Many variables such as project location and type, discipline of the design professional, experience of the firm, and your and the design professional's appetites for risk are all factors to consider.

There is no magic formula to determine what are appropriate insurance limits. The charts on the following page examine what other similar design professionals carry and may offer some guidance for many clients.

Per-Claim Limits (Annual Billings)

KEY

Smaller Firms
$5,000,000 or less

Larger Firms
over $5,000,000

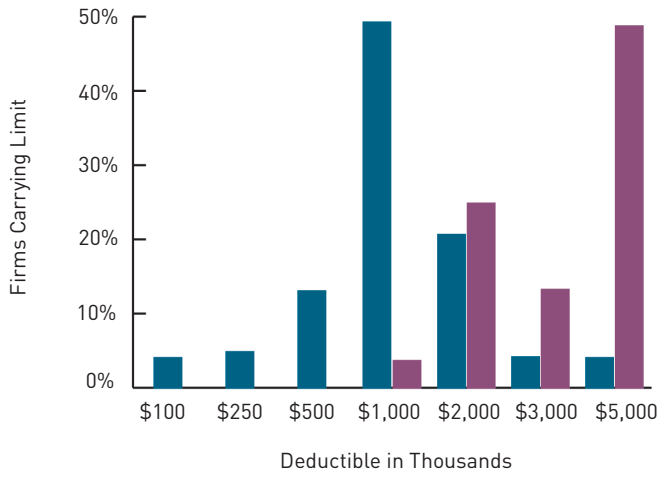
ARCHITECTS The most often purchased per-claim limits for architecture firms in the Victor and CNA program. This graph indicates the percentage of firms in each category that purchased the limits.

Architecture firms are often the prime consultants on projects. As such, they face PL exposures not only for their own negligence, but also for the negligence of their subconsultants. This vicarious liability exposure is usually a factor in their selection of per-claim limits of PL coverage.

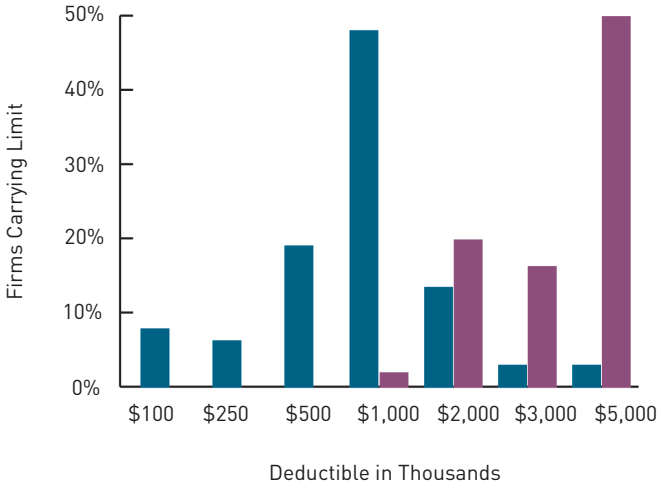
ENGINEERS The most often purchased per-claim limits for engineering firms in the Victor and CNA program. This graph indicates the percentage of firms in each category that purchased the limits.

SURVEYORS The most often purchased per-claim limits for surveying firms in the Victor and CNA program. This graph indicates the percentage of firms in each category that purchased the limits.

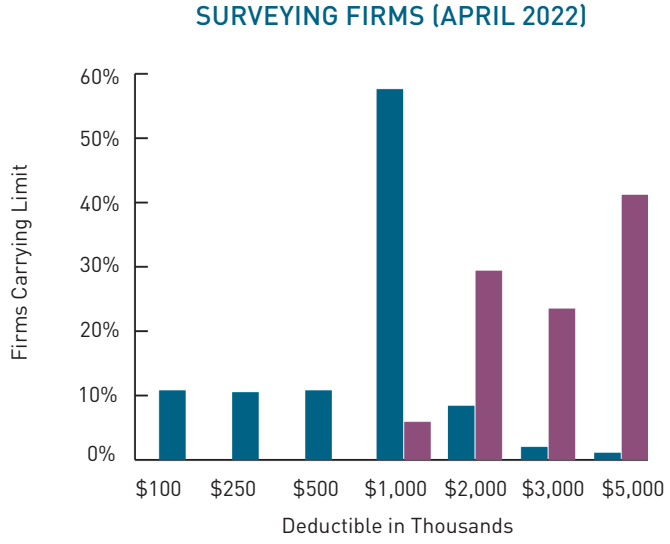
ENGINEERING FIRMS (APRIL 2022)



ARCHITECTURE FIRMS (APRIL 2022)



SURVEYING FIRMS (APRIL 2022)



Partial Glossary of Key Insurance Terms

Additional Named Insured: A party added to the coverage of an insurance policy with the right of recovery, but without the obligation to pay the premium or meet the other terms of the policy.

Aggregate Limit: The total amount payable under a policy, regardless of the number of claims. This is usually based on an annual total.

Claims-Made Policy: A policy that covers only those claims that are made against the insured during the policy period arising out of acts or omissions occurring during the policy period. When a policy is continuously renewed, the policy period includes the entire time since the original claims-made policy was placed with the insurer.

Contractual Liability: Liability assumed under any contract or agreement over and above that which may be imposed by law.

Indemnification or Hold-Harmless Agreement: A contract provision whereby one party assumes certain legal liabilities on behalf of another party. Such a contract provision could be of limited form, where a party reaffirms responsibility for its own negligent acts, thus protecting another party from vicarious liability; an intermediate form, where a party reaffirms its responsibility and agrees to share responsibility for joint and concurrent negligence of both parties; or a broad form, where a party assumes responsibility for all liability including that arising out of the sole negligence of the other party.

Limit of Insurance: The maximum amount that an insurance company agrees to pay in the case of loss.

Named Insured: The one named in the policy. It could be any person, firm, or corporation or any of its members specifically designated as insureds in the policy as distinguished from others who, although unnamed, are protected by the policy definition. A named insured under the policy has rights and responsibilities not attributed to additional insureds.

Occurrence Insurance: An insurance contract whereby coverage is provided for losses stemming from an event when the insurance policy was in force even if the claim is not made for several years.

Prior-Acts Coverage: Retroactive coverage for negligent acts or omissions occur ring prior to a claims-made policy period so long as the claim is first made against the insured during the policy period and, upon the inception of the policy, no insured had knowledge of the act or omission precipitating such claim.

Visit us at victorinsuranceus.com/schoolofriskmanagement to learn more.

This document is for illustrative purposes only and is not a contract. It is intended to provide a general overview of the program described. Please remember only the insurance policy can give actual terms, coverage, amounts, conditions and exclusions. Program availability and coverage are subject to individual underwriting criteria.

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