



ARCHITECTS AND ENGINEERS | PROFESSIONAL LIABILITY INSURANCE

Professional liability insurance 101

An overview for the clients of design consultants

Professional liability policies are designed for a specific risk—the risk of loss caused by the negligent performance of professional services by design consultants. Clients want to know that the design consultants they retain have the financial capacity to stand behind their professional services. The professional liability insurance policy is one tool that can provide that capacity.

It is important that clients understand the nature and scope of professional liability coverage for architects and engineers so that they make realistic requests regarding the terms of such insurance. It is also important to understand that in some cases, it is impossible for design consultants to comply with a client's insurance requirements. This bulletin is aimed at helping clients understand the nuances of professional liability coverage. Clients should always consult an insurance broker knowledgeable in professional liability insurance in order to obtain advice to fit their needs.

Naming the client as an additional insured

As the client of a design consultant, 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 their professional liability policy. This may be true for some forms of insurance, but it is not an option under professional liability policies. Since you do not perform

professional services, you do not assume the risks that the professional liability policy is designed to cover.

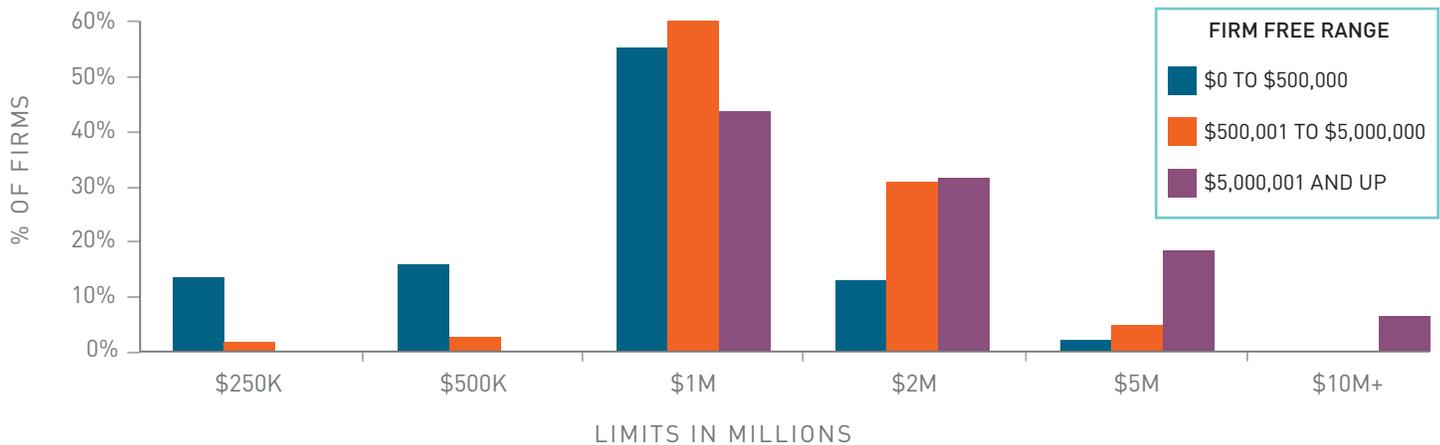
Unlike other types of insurance policies, the professional liability policy does not make payments to the insured. Instead, the policy pays **on behalf of** the insured in the event that the insured's negligence in rendering professional services causes damages or injury. If you were named as an insured under the professional liability policy, you would be unable to collect damages under the policy since an insured cannot make claims against itself and recover under the professional liability policy.

Some clients believe that the additional insured status will provide adequate coverage for their own in-house design consultants. You would be better served by purchasing your own professional liability insurance to cover the activities of in-house design consultants. Consult with your insurance broker to ascertain the availability and terms of such coverage.

Breach of contract coverage

In their agreements with design consultants, clients will often require that the professional liability policy be endorsed to specifically insure contractual liability—that is a breach of the professional services agreement. Clients ask for this because of the availability of this coverage to some degree under a contractor's CGL policy. However, with respect to the professional liability policy, this request cannot be fulfilled because the professional liability policy does not provide coverage for breach of contract allegations. The professional liability policy provides

A&E LIMIT PROFILE



coverage for the design consultant's legal liability arising out of an **error, omission or negligent act** in the rendering of professional services.

If the coverage you request the design consultant to obtain goes beyond what the policy covers, you have put the design firm in the position of assuming an uninsurable business risk. 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 completed, will be fit for its intended purpose.

Indemnification agreements

Another common term of a client agreement with the design consultant is the indemnification agreement. The client requests that the design consultant agree to indemnify, defend and hold the client harmless from and against any and all claims, demands, damages, actions, losses and expenses. The professional liability policy will not provide coverage for any and all demands made against the design consultant. Again coverage is limited to the insured's legal liability arising out of an error, omission or negligent act in the rendering of professional services. A suitable indemnification clause then would be as follows:

"The consultant shall indemnify the client for damages caused by errors, omissions or negligent acts of the consultant in providing professional services under the project."

The purchase of professional liability insurance by the client

Since you, as the client, do not provide professional services, Victor Canada would not accept your request to purchase a professional liability policy on behalf of a design consultant. However, clients often ask the design consultant, by way of their agreement, to purchase insurance and to maintain such insurance for a certain period of time. To ensure that such insurance is maintained for a project, you may wish to consider the purchase of a project-specific policy to cover all design consultants rendering services on a particular project or require that the lead design consultant arrange for the purchase of such coverage.

Technical insurance issues

As mentioned previously, some insurance requirements you request may not be available under a professional liability policy. Consider the following.

CLAIMS-MADE VS. OCCURRENCE-BASED POLICIES

Sometimes your agreement with a design consultant will incorrectly characterize professional liability insurance by requiring that a certain limit of liability be provided on a per occurrence or per incident basis. This cannot be accommodated as the professional liability policy is not written on that basis.

Professional liability policies are written on a claims-made (and reported), not an occurrence, basis. Under a “claims-made and reported” policy, coverage is triggered as of the date that a claim made against the design consultant is first reported to the insurer. The claim has to have been both made and reported during the policy period. Conversely, the availability of coverage for a claim under an occurrence-based policy form is determined by the date the situation giving rise to the claim occurred, not when the claim was made and reported.

Therefore, the appropriate language for stating the level of the limits of liability you require is “per claim with an aggregate limit.”

NOTICE OF CANCELLATION

Clients relying on the services of a design consultant want to minimize the possibility of finding out that the design consultant has cancelled, modified or reduced their professional liability coverage to a level or form that is unsatisfactory. Therefore, clients or other Certificate of Insurance holders often require that they be notified if the design consultant’s policy is cancelled or “materially changed.”

Victor does not provide notice of “material changes” because that term is not well-defined. What constitutes a material change for one certificate holder may not be considered material by another. However, when requested, where Victor has issued a Certificate of Insurance demonstrating the issuance of professional liability insurance, we will provide notice to that certificate holder in the event of cancellation.

CONTINUED AVAILABILITY OF COVERAGE

Some clients require design consultants to maintain professional liability coverage for a minimum number of years following substantial completion of a project. Because of the claims-made nature of the professional

liability policy and the knowledge that most claims occur shortly after the completion of the project, clients want assurance that the policy will remain in effect during that period. Neither design consultants nor their insurers can guarantee that a policy will be continually renewed for a specific period of time. The one exception is a project-specific policy which can be written to cover the design and construction period as well as a specified period beyond substantial completion of the project.

The design consultant also cannot guarantee that, in the event of cancellation of the policy, the design consultant will be able to purchase equivalent coverage. Sometimes, the design consultant may wish to reduce the coverage if a significantly increased premium is charged. Any contractual obligation to retain coverage for a specified time period should allow you and the design consultant to assess alternatives that might permit the design consultant to obtain insurance conditions that are acceptable to both. It is to your benefit that the requirements you set for the coverage are reasonable in order that coverage can be maintained. If the design consultant changes insurers, you will want to ensure that the replacement professional liability policy provides full prior acts coverage.

DETERMINING THE APPROPRIATE LIMITS OF LIABILITY

Often, clients require their design consultants to carry a certain amount of policy limit on a per claim basis. Many variables should be considered by both the client and the design consultant in determining the appropriate insurance limits: project type, location and construction value, discipline of the design consultant, experience of the firm and the design consultant’s risk appetite. To help you with your determination, see the chart on page 2 showing the most commonly purchased per claim limits of liability for engineering firms insured with Victor.

Visit us at victorinsurance.ca to learn more.