

Insurance Coverage for Business and Professional Liability

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There are many risks that can jeopardize the future of one's practice, one's firm, and one's own financial well-being. This article is intended to familiarize the architect with terminology and the necessary considerations and alternatives when selecting business and professional liability insurance for one's firm.

Risks for Architects

When you stare into the abyss, the abyss stares back at you.

- *Friedrich Nietzsche*

Architects face a wide range of risks every day. They must protect their firms against litigation alleging negligence, protect their offices against theft or destruction of property, protect against personal risks ranging from health and disability to life and retirement - and share similar concerns regarding their own employees. Newer and perhaps lesser-known but nonetheless virulent risks also exist - such as those inherent in unproven sustainable products and design, the changing standard of care, hidden electronic "meta" data in our offices, contracts that imply a fiduciary duty, and others.

What are all of these risks that can jeopardize the future of one's practice, one's firm, and one's own financial well-being? And once aware of possible risks, what actions should one take? What are the major considerations - including the cost of mitigating those risks - or the cost of ignoring them?

For architects, one of the most devastating professional and business risks is from litigation alleging negligence in performing professional services. These alleged negligent acts, errors, or omissions may cause damage to owners, contractors, or other third parties, and the architect's firm may be found liable for these damages.

Risk Management

There are also a growing number of newer and lesser known risks, inherent in the growth of technology and sustainability. With new innovative products, processes, and performance expectations in projects where there are no precedents, the standard of care must now also be defined anew. Because architects contract directly with owners, an architect may be exposed to the risk of a suit for breach of fiduciary duty. There are also important issues now raised by electronic data - including the requirements of the rules of discovery and what must be produced in the event of litigation. In addition, the

existence of Metadata or hidden data in documents can divulge information detrimental to one's firm. There are new liabilities associated with the protection of client confidential data and information as well.

Modern day design professionals are constantly expected to find new ways of building projects better, faster, cheaper and greener, while at the same time they are too often viewed as professionally and financially responsible if those new methodologies and materials do not succeed to the full extent of their hoped-for results. - David A. Ericksen, Esq; Severson & Werson (A Sustainable Standard Of Care? AIA Trust white paper, 2011)

Emerging Practices and Risk Management

Architects must also protect their own property including their offices, intellectual property, and technology. The risks range from fire and theft to a disaster forcing business interruption to an accident injuring employees or clients, to an employee suing for harassment. Architects must protect themselves personally as well, looking after their own health and welfare, including that of their families. This includes the immediate considerations of health and dental insurance, ongoing concerns for disability and life insurance, and long-term considerations such as retirement planning and long-term care insurance.

As an employer, a firm owner must share similar concerns for employees in order to ensure a healthy, productive, and dependable workforce. These concerns extend to legal requirements regarding national healthcare legislation requirements, worker's compensation requirements, and liability regarding employee bonding and employment practices. In addition, any benefit provided to employees must conform to mandated regulations such as required filings for retirement programs.

Take calculated risks. That is quite different from being rash.

– General George Patton

Insurance is one means to manage risks by transferring them to an insurance company. Other methods of managing risks include transferring risk by contract and avoiding the risk entirely if it is judged potentially too costly. As a firm owner and licensed professional, an architect obtains insurance coverage for professional liability, property loss, business income loss, liability arising from use of automobiles, and exposures arising from personal risks. As a firm grows, it is useful for the well-being and longevity of the firm to consider staff benefits, which impact staff recruitment and retention, such as various insurance and retirement plans.

Terminology: What Does All This Mean?

It is important to understand the terminology in professional liability insurance and what each element means and how it will impact an insurance policy and a firm.

Admitted or licensed. An Admitted Carrier is an insurance company licensed and authorized to do business in a specific state and subject to regulation by the state insurance commissioner. Non-admitted carriers are not subjected to such scrutiny nor included in coverage by the state guarantee fund. Many states require brokers to seek coverage from admitted carriers first, placing coverage in an excess and surplus (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.

Claim is a demand for money, services or property based upon a right usually found in contract or by operation of law. The Claim expense is the cost associated with the handling of a claim, such as defense-attorney fees, investigation costs, and expert witnesses. There are policy triggers to report a claim such as when one receives a demand for money or services with an allegation of a wrongful act. Importantly, the threat of an action or any troubling circumstance requires alerting the insurance company to a potential problem that may not necessarily become a formal claim - and failure to report a claim in a timely manner may jeopardize coverage.

Claims-made policies for professional liability insurance means that the date the claim is finally made is the triggering event for coverage.

One of the unique aspects of professional liability insurance for architects is that the coverage trigger differs from most liability insurance. For example, with general liability or automobile liability coverage, if there is an occurrence such as an auto accident that results in a claim made in the future, the coverage trigger is the date that the “occurrence” or “accident” takes place. In other words, if the date of the accident is January 1, 2013, and a lawsuit is brought July 1, 2015, it is the policy in force on January 1, 2013 that will defend and pay any subsequent judgments. In some cases, depending on the statute of limitations in different states, the claim may be made several years after the date of the occurrence.

With “claims made” coverage, in the above example, the “claims made” date which triggers the coverage will be July 1, 2015. In the above case with professional liability insurance, the date that the claim is finally made is the triggering event. Therefore, if there was an event that an architect was unaware of prior to the firm’s current claims-made professional liability policy period, it is critical that the architect continue to maintain professional liability coverage with no restriction as to a “retroactive date.” A fairly typical definition of a “retroactive date” is the date on or after which any alleged or actual act, error or omission must have first commenced in

order to be considered for coverage under the policy. A declarations page of a professional policy might indicate “full prior acts” in which case, there is effectively no “retroactive date” and thus no restriction as to the date of the alleged or actual act, error or omission

Claims-made insurance requires that the claim be made while the insurance policy is in force for coverage to apply. A claims-made policy without retroactive coverage does not cover claims arising out of services performed prior to a date stated in the policy that defines when the coverage commences.

Deductible is a provision requiring the insured to pay a specified portion of the loss on each claim - it could be as low as \$1,000. Increase the deductible to lower the premium cost. It is important to consider the balance between deductible, premium, and coverage. There will be a new deductible obligation with each claim.

Endorsements and exclusions modify coverage. An Endorsement is a written amendment or rider affecting the declarations, insuring agreements, exclusions, or conditions of an insurance policy and records a change to the insurance contract. An exclusion specifically eliminates coverage for a certain hazard from an insurance policy.

Hold-harmless, synonymous with "Indemnification," is a contract provision whereby one party assumes another's legal liability, a legally acceptable practice as long as the contractual transfer of liabilities is not against public policy and can be covered by insurance or available assets. Refer to AIA Document A201, General Conditions of the Contract for Construction.

Look for hold-harmless provisions before signing any contract for professional services. If the promise is a contractual obligation, the promise may not be covered by insurance. Note that a hold harmless 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.

Indemnification is essentially a hold-harmless provision, an agreement by one party to pay certain specified losses or damages incurred by another party.

Licensed carriers are those insurers admitted or licensed to write insurance business in a particular state. Each insurer must apply to be licensed in each state and each state has certain minimum financial requirements for each carrier. There is regulation by each state as respects policy forms and rates charged. Also, if a licensed or admitted carrier becomes insolvent, there are generally insolvency or “guarantee” funds which agree to replace the insurer and pay claims on behalf of insured in that state. Each state has different limits of liability and coverage which are included in such guarantee funds. See ‘Admitted’ definition above.

Prior Acts is an insurance provision to consider when changing carriers or buying coverage for the first time. 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 prior-acts coverage varies from insurer to insurer. Often prior-acts coverage is available to eligible firms after they have been covered by a carrier for some specified amount of time.

Surplus lines refer to insurers which are not licensed in a particular state but are non-admitted or excess and surplus lines insurers. Policies are written by surplus lines insurers because licensed or admitted insurers will not provide the needed coverage. Licensed carriers may not want to write the coverage because the coverage line presents catastrophic loss exposures, unique risks or professional liability risk similar to Architects and Engineers Professional Liability. As a surplus lines insurer, there is little regulation relating to pricing or policy forms. Most A&E Professional Liability coverage is written by this market.

Tail Insurance addresses the question of protection upon retirement or withdrawal from practice. Some programs offer professional liability coverage to continue the protection needed by architects who withdraw from active practice. Typically, an architect who retires may purchase an extension to a firm's policy to be covered for all prior acts, even if claims are made in the future. Usually this "tail" coverage is arranged by endorsing the basic policy. In most cases, the coverage is available to architects who have been insured for a minimum number of consecutive years with their insurer prior to retirement; the policy then covers the retired architect for prior acts. Some states require admitted carriers to provide some level of tail coverage at an extra cost to the insured. Coverage is similarly available to protect the estates of deceased architects if this is warranted.

He who is not courageous enough to take risks will accomplish nothing in life.

~ Muhammad Ali

Professional Liability Insurance

A professional liability insurance policy (sometimes called errors-and-omissions or E&O insurance) agrees to defend and pay on behalf of the architect for claims alleging an error or negligence in the performance of professional duties, in exchange for the premiums paid to the insurance company. Some firms decide not to purchase professional liability insurance, a business decision usually based on the cost of the coverage, which could ultimately put the firm and its architects in jeopardy. However, it is important to note that even with professional liability coverage, a firm continues to retain some risk such as expenses within their deductible, costs exceeding their policy limits, or costs for claims that are excluded from the scope of coverage.

There are many reasons why an architect should consider the purchase of professional liability insurance:

1. Business survival

Defense costs alone plus potential damages can easily bankrupt an architectural firm due to the liability loss potential.

2. Continuing operations

If an architect is involved in a professional liability suit, professional liability coverage provides the financial resources to defend such a claim while preserving the firm's reputation and maintaining cash flow in order to remain in business. The firm should also have earnings stability to continue working during suit proceedings.

3. Contract requirements

Many projects include a requirement for professional liability insurance subject to a certain predetermined limit. Certain projects require separate project professional liability insurance for the project work alone, independent of any other work done by the architect.

4. Social responsibility

A properly designed professional liability policy can protect the architect, the architect's employees, customers and others against losses and provide an avenue of resources for those entities that are harmed.

Basic Considerations

There are a number of considerations when selecting professional liability insurance for a firm. The coverage limits, deductibles, and cost of the insurance are the most obvious but also important are the endorsement options, exclusions, and the core policies themselves. The first step in assessing professional liability insurance needs and selecting coverage is to consider a firm's exposures.

A broker can help firm owners evaluate the basic policy forms and endorsements and how suitable they are to their practice. It may be prudent to conduct a cost-benefit analysis for the extra expense of add-ons such as increased limits or lowered deductibles. The stability of the insurance carrier is paramount - think about a low-cost insurer like a low-bid contractor. Looking at the carrier's size, rating, and years in the A/E business are all valid criteria when assessing the stability of an insurance provider.

It is paramount to review the claims support services offered - this is when firm leaders really need their insurer to be great. A professional liability carrier may be best defined by its claims handling process and whether they have specialized expertise with a claims manager who is familiar with architectural practice along with defense counsel who has the knowledge, interest, and sensitivity needed to be effective.

Other information a broker can provide include whether an insurer has excellent claims and customer service specifically relating to contract review and pre-claims defense assistance. Other support services such as educational and risk management

assistance programs, contract review, and first dollar defense all contribute to a valued insurance carrier.

Top Considerations when Selecting an Insurance Carrier

Top Considerations: In an AIA Trust survey, architects were asked what every firm should use as its top consideration when selecting professional liability insurance coverage for the firm:

1. The carrier's reputation in facilitating and reaching fair settlements.
2. Understanding all of the various coverage options and choosing based on the architect's priorities.
3. Claims service of the insurance carrier.
4. Specific knowledge of the A&E professions.
5. Experience.
6. Strong Best's rating.
7. Outstanding customer service.

Who Are These Insurers?

While a broker will be able to provide bids from various insurers, it is good practice to also evaluate all the potential insurance carriers available. There are more than 50 professional liability insurers providing coverage to architects throughout the United States. How does an architect know which one to approach and which is the best carrier for to use for their firm? A simple way to do this is to consult the AIA Trust Database of Professional Liability Insurers which lists the top 30+ insurers in the A/E marketplace. The database provides the basic facts about each insurer to serve as background information for the architect to develop important discussion points with a broker. The database includes information ranging from financial size category and A.M. Best rating, to the states and countries where coverage can be obtained, to specific benefits and coverage offered. Importantly, the architect can see what kinds of practice restrictions there may be on coverage and other limits.

In addition, the AIA participates in an Annual Professional Liability Insurance Survey with the National Society of Professional Engineers (NSPE) and the American Council of Engineering Companies (ACEC), the results of which are also posted on the AIA Trust website. While the annual survey attempts to secure as much information as possible, carriers are reluctant to disclose anything considered proprietary. While that survey provides some interesting information and comparisons between the carriers, only about 15 carriers respond on an annual basis.

Another approach is to work with an independent insurance consultant who does not sell insurance but can offer professional advice to guide a firm. These consultants help clients manage risk in a cost-effective manner, including tasks such as broker selection, insurance audits, risk identification, claims management, and the development of loss control programs; they may also be able to improve a firm's coverage. The

Society of Risk Management Consultants (SRMC) serves as a referral source for those who need a risk management, insurance or employee benefits consultant, including generalists and those uniquely credentialed in specific industries.

In a recent survey commissioned by the AIA Trust, the Trust asked architects their top considerations in purchasing professional liability insurance. The top three considerations are premium price, relationship with local brokers, and excellent claims service, with premium price being the most important motivation for a change. It is clear that architects rely heavily on their insurance broker in the selection of a professional liability insurer. Therefore, a critical step in choosing the best insurer for professional liability exposure is in the selection of the broker to access the marketplace.

Key Advice for Selecting Professional Liability Insurance:

1. Get as many quotes as possible.
2. Research the broker with the best reputation in the area.
3. Research an insurance carrier's claim service and longevity in the market.
4. Ask other firms for their recommendation and experiences with brokers and companies.
5. Look for a history of long-term relationships with the broker.
6. Select knowledge, service and track record over price.
7. Work with a broker in whom you have confidence and interview current clients of the carrier that you consider using.
8. Consult professional literature and insurer surveys that benchmark policies and carriers before making a decision.

- AIA Trust Broker Survey, March 2012

Choosing a broker

A broker should represent the interests of the insured. An agent represents the insurance company. Some brokers may also be agents for different insurers. It is important that the architect knows the difference and which role an agent or broker are fulfilling when speaking with them. As a practical matter, most insurance placements for professional liability for architects are made with a broker as the intermediary - not an agent. Since the broker represents the architect, they cannot speak for the insurer. Note that if a broker says that a policy is bound, the broker must secure evidence of that from the insurer since the broker is not in a position to speak for the insurance company.

When considering which broker or brokers to use, the architect needs to carefully scrutinize their qualifications, services offered, cost, chemistry, and commitment. An architect needs to ask every broker under consideration about which carriers they use, their relationship with each carrier, and the total premium volume that they handle with each carrier. An important question is whether architects should use one broker or several brokers to approach the insurers on their behalf. The brokers would prefer that only one is selected and then allow that broker to access the available markets.

However, that overlooks the special relationships that some brokers have with certain insurers and also the fact that brokers do not have relationships with every potential insurer. How does each broker then differentiate themselves among several brokers who are interested in proposing on a firm's professional liability policy?

Once discussions have taken place with two or three brokers, review the list of questions below with them and compare each broker's list of carriers for overlaps and conflicts. Where there are conflicts, it is important to know the relative relationship each broker has with a carrier to determine which broker should be assigned that market. An architect can and should control which insurance companies are used by competing brokers for the professional liability quotes. An architect can assign insurance markets to the insurance brokers by issuing a broker of record letter telling an insurance company which broker can approach the insurer for a quote. This process guarantees that brokers do not block competing insurers and ensures competition for the architect's business. It is critical in this process that the architect control which broker is assigned to which markets in order to receive the best possible offers. It is also possible that, based upon a firm's risk profile, only one broker should approach the marketplace on its behalf. That can be determined by a review the brokers' responses to the questions below and by knowing which markets they wish to approach.

The AIA Trust recently prepared a broker survey with several questions about marketing professional liability insurance. The broker respondents recommended that an architect ask the following questions of a prospective broker in order to determine the broker's ability to secure the best product. The suggested questions to ask potential brokers are:

- Does your company specialize in professional liability for architects and engineers?
- What services does your agency provide other than the procurement of insurance?
- What architects do you represent that are similar in stature and practice to my firm?
- Which insurance companies do you have access to and which do you use regularly?
- How many other architectural and engineering clients do you represent? (Give references)
- What is your approach to marketing professional liability insurance for our firm?
- How much architects and engineers professional liability premium volume do you place with various insurers?

Finding A Qualified Broker

There are specialty insurance broker networks which include as members only those brokers with Architect and Engineer Professional Liability expertise. Two of the most well known and respected networks are A/E Pronet and PLAN. Certain Professional Liability insurers and/or managing general agents who act as underwriters also have expert agent and broker networks. Victor underwrites for CNA (the AIA Trust-sponsored program) and can recommend brokers in all areas of the country that have the necessary expertise. Victor calls them A/E Choice Brokers. XLDP, a large Architect Professional liability insurer, only assigns one broker in each state to market their products.

The Devil is in the Details: Completing the Application

A good broker is an extension of an architect's staff and provides a very valuable function. One of the frequently overlooked functions is assistance in the completion of the professional liability application. The application is critical to the underwriter being able to provide a comprehensive quote. Applications can be as simple as one page and as long as ten pages or more. Applications for small firms (firm less than \$1,000,000 in billings) are generally shorter and fairly simple. Applications for medium size firms (\$1,000,000 - \$5,000,000 in billings) and large firms (> \$5,000,000 in billings) are more complicated. They ask very specific questions as respects the percentage of billings in different practice categories, specific questions about contracts, sample contracts, questions concerning sub-consultants, etc.

Warranty Statement

The difference between the application for professional liability insurance and other potential applications, such as for property and general liability insurance, is that the professional liability insurance application includes a warranty statement – which generally involves two statements. The first is whether or not any claims have been made or legal action brought in the past ten years against the firm, its predecessors or any past or present principals, partners, officers, directors, shareholders or employees. If there is a 'yes' answer to any of those, the insurer will request supplemental information. Per the terms of that question, research into the past practices of any current employee, officer, partner, principal, etc., who has been with the firm less than ten years, is required. However, the ability to secure any information about those past claims and practices may be difficult.

The second warranty-related statement asks whether any of those same principals, partners, officers, employees, etc. have knowledge of any act, error,

omission, fact, incident, situation, unresolved job dispute, accident, or any other circumstance that is or could be the basis for a claim under the proposed insurance policy. Again a 'yes' answer will require significant details. It is this last question that has the potential to present significant difficulty if and when a subsequent claim is presented. One of the first questions that the insurer's claims adjuster will ask the architect is whether or not they were aware of the act, accident, error, etc. prior to the current claim being made and whether they had that knowledge prior to signing the application. A broker's experience in assisting in the completion of the application and their ability to explain the intent of various application questions is very important. While they will not complete the application for the architect, they will be of great assistance in completing it appropriately.

When to Seek Alternatives

One question often pondered by architects is *how often they should request alternative proposals for professional liability insurance*. When asked, one broker responded that an architect "should never have to seek alternative proposals. A high quality A&E broker is always going to be engaged in that activity on behalf of their clients." There are any number of issues that could necessitate an architect seeking proposals such as changes in professional practice, poor claims history, a change in the Best's rating of an insurer, a change in personnel at the brokerage, a change in underwriting practices by the insurer, an unwarranted increase in premium or reduction in limits or other coverage restrictions - all are reasons to seek alternatives.

The insurance market for professional liability remains competitive although pricing may be on the increase. There has been an extended period of very competitive pricing for architects and engineers professional liability insurance with significant growth in the number of insurers participating. The key is to know when it is time to seek alternatives. ***Periodic discussions and seeking proposals from other brokers are in the firm's own best interest.*** The end result may be discovering that the current broker has adequate representation in the marketplace - or that alternative proposals would be useful. Either way, it is important to investigate.

Even if alternative proposals are not sought and secured from different brokers or different insurers with the same broker, it is critical that an architect and the broker or brokers do a side-by-side comparison of the policy forms of the different insurers. The wording of one may be preferable to another and while forms are generally similar, they are not identical. Exclusions may appear in all forms in different fashions. When considering switching carriers, it is critical to understand the "claims made" feature of the contract and whether a new carrier will insist on a new "retroactive date." If a new carrier is much less expensive than the firm's current carrier for the same limits and deductibles, but has a retroactive date that is the same as the inception date of the new policy, then the policy is not of much use.

It is critical when replacing carriers that the "retroactive date" if any, be no later than the "retroactive date" on the prior policy. In a "claims made" policy for A&E

Professional Liability, the insuring agreement agrees to pay on behalf of the insured damages and defense expenses for claims made during the policy period caused by a wrongful act committed on or after the retroactive date identified on the declarations page. In other words, the Architect's work, advice, plans, etc. must have taken place after this date. If the work took place prior to that date, the policy will not cover the claim. ***Retroactive dates are extremely important for an Architect considering a switch in Professional Liability insurers.*** As the market becomes harder, or if the firm reports incidents which may result in a claim, then policy provisions may become more restrictive and move forward a retroactive date. The brokers should discuss the implications of any such restriction with the architect and make an appropriate recommendation.

It is important to be aware of some of the issues that underwriters will want to review prior to making a proposal and which will need to be discussed with the broker. These include the following:

- Size of total billings
- States of operation
- Professional liability claims history
- Use of written agreements on all projects
- Other firm services including pollution clean-up, remediation or containment
- Percentage of billings in various professional categories such as architecture, construction management, interior design, landscape architecture, etc.
- Whether the firm is also involved in providing civil engineering, structural engineering, mechanical engineering, etc.
- Billings applicable to feasibility studies, master plans, construction management or program management, facilities or operations
- Percentage of all project types, such as airport facilities, apartments, bridges, condominiums, hospitals, single family residential, parking structures, schools, etc.
- Project requirements
- Contract requirements

Important Tips to Remember:

- The policy form, claims services, pricing and length of time writing A/E professional liability insurance is most important
- Non-admitted carriers often have flexibility of rate and form filings that can prove useful in customizing coverage.
- Downside to the flexibility of form filings is that coverage forms can sometimes have serious shortcomings that may not be revealed until there is a claim.
- Price should not be the sole reason for an architect to select a surplus lines insurer.
- Having a "licensed" carrier as the professional liability insurer is not as critical as in years past.

AIA Members Suggest Some Professional Liability Pitfalls to Avoid:

- Premium price too high
- No multi-year policy offered
- Level of coverage too high
- Too loyal to prior agent.

Policy Limits

An important question not often addressed in any literature or articles about professional liability insurance is what limits of professional liability insurance a firm should carry. There is no easy answer or standard that can be applied to the firm's size or location or type of practice that will give an architect an exact answer. In some cases, the fact may be that a firm cannot purchase high enough limits to cover the potential exposure of a project. When dealing with large value locations such as stadiums, dams or any large construction project, the potential professional liability limits that an architect can purchase will not be sufficient to cover all of the potential bodily injury, property damage and loss of use claims that could arise from a major disaster.

Small firm insurers generally offer a minimum of \$500,000 or \$1,000,000. That limit of liability shown on the declaration page of the policy is generally both a per-claim limit as well as an annual aggregate limit. Claim expenses such as defense costs are generally subject to and included within the overall aggregate limit of liability. This means that the costs of lawyers in defending a case will reduce the amount of limit available to pay damages. It is not unusual in the event of a serious case that the cost of defense and expert witness fees could be several hundred thousand dollars.

Other factors regarding professional liability insurance coverage limits that should be considered are:

- Limits required by client contracts.
- Contracts that limit an architect's liability for damages by gross negligence, the architect's fees, or limits of insurance coverage.
- What other similar size firms with similar practices carry for limits.
- Limits of liability equal to annual billings.
- Quality control practices the architect may employ on projects to guard against loss.
- Loss frequency for the type of projects for the firm.
- Potential loss severity for the types of projects of the firm.

Most brokers would suggest that a minimum of \$1,000,000 is appropriate for a small firm with minimum limits of \$5,000,000 for a medium size firm. It is also important to remember that umbrella liability coverage purchased by the firm does not apply to professional liability claims, but only to automobile liability and general liability.

Important Attributes of Professional Liability Insurers

In a recent survey, the AIA Trust asked several well-known national insurance brokers that specialize in Architects and Engineers Professional Liability several questions about the most important attributes of a professional liability insurer. In order of priority, they answered:

- Policy form
- Claims handling expertise
- Product price
- Longevity in the Professional Liability market
- Financial stability
- Loss control services
- Knowledgeable underwriting staff
- Ability to redesign coverage for design/build, Building Information Modeling (BIM) and Integrated Project Delivery (IPD)

Plays Well With Others

Consultants are routinely retained by design professionals. Their relationship means that the design professional has vicarious liability for any damage caused by the consultant's negligence. Insured design professionals will want to review their consultant's insurance status since they will serve as their insurer if that status is inadequate. 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 the design professionals' insurer. When design professionals serve as sub-consultants to other professionals (or subcontractors to construction contractors), it is important to examine the primary design professional's coverage or the construction contractor's coverage to determine where there are gaps in coverage that could result in the sub-consultant becoming the target of a claim.

Joint ventures, from a legal standpoint, are similar to partnerships, the main difference being that a joint venture usually 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. Some broad policies provide automatic joint venture coverage while other 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 to provide for the insured's legal liability for professional services performed on behalf of the named joint venture. Coverage for other participating firms in the joint venture would not be provided by such an endorsement. Each member of a joint venture should obtain evidence from the other joint venture partner(s) that their policies have been properly endorsed as needed

to cover participation in the joint venture, usually accomplished by obtaining a certificate of insurance and a copy of the joint venture endorsement.

In any joint venture situation where firms rely on their separate policies, it is best for the policies to be with the same carrier with similar limits and deductibles for all firms. Otherwise, some firms may serve as “deep pockets” for others.

Project Team Agreements

Strategic Alliances are business ventures and must be protected by insurance with the same concern as with any joint venture or partnership. Clients, or other parties, claiming harm from the actions of a strategic alliance may be able to recover from any member of the alliance. From the injured party’s perspective, the alliance may be viewed as one integrated responsible entity. Whenever a contractor’s responsibility and liability goes beyond construction to project design or construction management, the need for contractors to carry professional liability insurance becomes more critical.

All strategic alliance partners may be held liable for the actions of all, but each looks to the others to be responsible for their own areas of expertise and obligations. From a professional liability perspective care must be taken to match final liability with eventual responsibility. It is far more practical and better protection for the interests of the strategic alliance to be covered by a separate professional liability insurance policy. As a result, coverage disputes and internal indemnification or contribution obligations can be minimized.

Project professional liability 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 pre-determined 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 owner who wants coverage beyond that normally carried by the firms. A Project policy ensures that a separate annual aggregate limit is available for that particular job and that the limit is not reduced by claims against a firm arising out of other design work. Project insurance is useful when the project is of such increased scope that it drastically affects the cost of basic coverage and as a way to get coverage 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 have begun to receive coverage for design professionals practicing in roles such as design/builder, construction manager, and land developer. While some companies offer endorsements for these services to the basic policy under some conditions, potential gaps should be investigated to prevent

uninsured liability. For example, a construction manager acting as advisor (CMa) to the owner is covered under most professional liability policies; the construction manager constructor (CMc)—acting as a general contractor—is not.

Integrated Project Delivery (IPD) is another new concept and thus exposure in the architect's potential risks today. Insurers are determining how best to approach this new collaborative multi-dimensional approach to projects. The concept of sharing more information and cooperation between unrelated entities flies in the face of traditional boundaries between owners, architects, engineers and construction companies. Insurers are still trying to assess the new risks presented by IPD.

Settlement Issues require both the insurer and the insured to be involved. Professional Liability policies generally require consent of an insured before the insurer can settle a professional liability claim against an insured. An architect may strongly believe that there was no negligence or error in the design or supervision work performed but the insurer may still want to settle. If the architect refuses to settle and subsequently a judgment is entered against the architect for an amount greater than the suggested settlement, the architect may have exposure for the excess amount. Often called a "hammer" clause, an architect needs to be aware of the implications of that clause. In many cases, the insurers will either limit the architect's exposure to a percentage of that excess amount or may eliminate the exposure entirely.

Similarly, an architect cannot negotiate the terms of any settlement without the insurer's permission. Any attempt to settle a case in this way will result in no coverage for the claim because the policy requires the insured to cooperate with the insurer. In any attempt to settle a potential claim before a suit is filed, be sure to get the permission of the claims adjuster from the insurance company even if the amount is less than the deductible.

A Common Problem with Insurers

It is common when submitting a potential professional liability claim to an insurer that the insured will receive back a "reservation of rights" letter from the insurer. That letter basically points out exclusions or other conditions of the policy that might preclude coverage of the claim presented. It will say that they will defend all allegations of the claim unless and until it is evident that an exclusion will eliminate coverage entirely. The insurer is "reserving their right" to deny coverage later, once all the facts are uncovered affecting the claim.

Commercial General Liability

Almost every architectural firm or component office depends on some kind of specialized property to do business, such as an office, valuable documents, or equipment. Property and casualty coverage (often referred to as P&C) is insurance for specific business exposures, such as computer equipment, laptops and cell phones, valuable papers and media, accounts receivable, and even business property off premises. Property coverage protects against loss of or damage to essential pieces of the business as it can only take one disaster to wipe out all documents and equipment.

For a firm to cover their own technology exposure, there may be computer virus coverage included as a sublimit to their P&C policy. Cyber liability coverage may be available as a separate policy, but it would be expensive and limited. A firm's best protection is always through solid risk management practices (virus and security protection, backing up computer memory and storing off-site duplicates, redundancy for critical operations, etc.).

Commercial general liability insurance covers liability from *incidents* that occur on or off the policyholder's premises or the non-professional aspects of the insured's practice. The three basic coverage areas of this type of policy are property damage, bodily injury and personal and advertising injury (such as libel, slander, or copyright infringement). Also included are premises and operational liability, medical payments and contractual liability.

General liability coverage is the most basic type of commercial insurance and one of the most important - it may even be required by a landlord. General liability coverage immediately protects the firm from injury and property damage claims that could seriously and detrimentally impact the business. Every claim can cost money, either in paying the legitimate ones or defending against the fraudulent ones. General liability coverage protects a business from these lawsuits and provides the kind of basic peace of mind needed to be an effective business person. General liability policies set definite dollar limits on the amounts an insurance company is obligated to pay for each type of claim, e.g., bodily injury and property damage combined, or personal injury, and on the total dollar amount for all claims.

Employment practices liability coverage helps to protect against claims brought by employees, such as discrimination, sexual harassment, and wrongful termination. Coverage should pay damages and defense costs; look for policies which include staff educational resources as well.

For those operating out of a home office, a modification is required to the Homeowners policy. All basic Homeowners policies include physical damage coverage to the home itself and liability protection. However, the policy will also include a business exclusion meaning that there is no coverage for business property or for liability claims arising out of business pursuits. A separate endorsement will be necessary to provide coverage for both exposures.

Workers' compensation is insurance providing wage replacement and medical benefits to employees injured in the course of employment in exchange for mandatory relinquishment of the employee's right to sue his or her employer for negligence. Workers' compensation laws are designed to ensure that employees who are injured or disabled on the job are provided with fixed monetary awards, eliminating the need for litigation. These laws also provide benefits for dependents of those workers who are killed because of work-related accidents or illnesses. Some laws also protect employers and fellow workers by limiting the amount an injured employee can recover from an employer and by eliminating the liability of co-workers in most accidents. State statutes establish this framework for most employment. Recovery for medical claims is limited to what is set in each state's medical benefit schedule. Similarly, coverage for lost wages is limited to each state's indemnity payout schedules. There is no specific recovery for elements such as pain and suffering.

Intellectual Property Insurance coverage protects companies for copyright, trademark or patent infringement claims arising out of the company's operation. Generally, this insurance will pay defense costs and any judgment up to the policy limits. Intellectual Property insurance protects the firm from suit by a competitor for infringing on an idea belonging to someone else. It is important for architects and other design professionals to know about principles of intellectual property law relating to the creation, reproduction, and use of original drawings and documents and as well as issues regarding compensation, professional credit, and professional liability.

Business interruption insurance reimburses the architect for ongoing expenses and loss of profits in the event of a fire or other casualty that interrupts normal business operations. This insurance can be written to cover fire, windstorm, extended coverage perils, computer crashes, and other hazards. Coverage is available for an agreed limit or for actual gross earnings based on the firm's history. There are usually options available for reimbursement of the extra expenses associated with continuing business at another location while the damaged premises are being repaired.

Fidelity bond is appropriate for all persons involved with the custody or disbursement of funds, management of firm finances, authorization of payments, purchasing, and other activities requiring the use of funds. A blanket form of bond covers all employees for the theft of funds. Comprehensive bonds or blanket crime policies are available. These combine coverage for loss of money, securities, and other property under a blanket fidelity bond and a check forgery bond. Crime insurance can insure money, securities, checks, and other negotiable paper both inside and outside the insured's premises under a broad-form money and securities policy to include loss by robbery, burglary, theft, and disappearance and destruction by fire or other causes. A professional liability policy does not cover claims and losses from the dishonest acts of associates or employees.

Technology liability coverage in some form and sometimes different names is now offered by most professional liability insurers. The policy agrees to defend and pay claims on behalf of the architect for claims arising out of an alleged negligent act in managing the security of a computer system. If network security is compromised which

causes a network or data breach, then there is protection from subsequent suits alleging injury or damages. Lower sub-limits and separate deductibles normally apply to such claims. There are no standard forms for this coverage so every competing form should be reviewed prior to making a final decision. A broker or consultant's expertise can help greatly in comparing policy forms.

Disciplinary, Regulatory or Administrative expense reimbursement is a frequently overlooked protection afforded in many architect professional liability policies. Generally written with a separate and lower sub-limit, this coverage agrees to reimburse the architect for reasonable legal fees and expenses incurred in any disciplinary, regulatory or administrative action commenced directly against the architect. These actions could include those brought by a state licensing or regulatory board, or a federal agency under the Americans with Disabilities Act, the Fair Housing Act or the Occupational Safety and Health Act. Defending against such actions can be quite costly.

Contractual liability. Business contracts, including office leases, purchase orders, service agreements, may contain a hold-harmless provision that will contractually transfer another's legal liability to the architect. One of the most important lessons to learn in an architect's business life is to understand contracts and their importance to insurance and risk management. Whether an office lease, a purchase order, an insurance policy or a contract for architectural services, each has potential hazards for the architect. There is contractual liability coverage in a general liability policy but that assumption only applies to bodily injury or property damage. Some policies may extend to personal injury but generally not.

Most professional liability policies exclude liability of others assumed under any contract or agreement except if the architect would have had the liability in the absence of the agreement. In other words, if the architect assumes risk in a contract for services beyond their negligence for services rendered, there would be no coverage for that assumed risk. Thus, contract review for an architect is extremely important. Certain insurers will actually give a premium credit for firms that have a policy of having signed contracts for every client which include certain agreed upon indemnification language.

Coordination of liability insurance. Professional, general, automobile, and other liability policies are interrelated. It is important to verify insurance coverage and amounts to avoid gaps in protection or duplication of coverage - as well as to correlate insurance limits. Umbrella or excess liability policies may sometimes be needed to provide higher limits than those the basic liability coverage offers.

Business automobile liability should also be considered since architects are also exposed to auto claims and business use of automobiles by the policyholder, by employees, or by others may extend to the firm. Whether the architect uses a personally owned vehicle, a firm-owned auto or has employees using their own vehicles, at some point, each is driving on business. Whether it's an owned, non-owned or a hired auto, the architect or the firm can be liable for auto accidents while the autos are operated within the scope of employment.

Auto accidents can also be the most catastrophic exposure sometime faced by an architect. If an employee while on business has an at-fault accident, the employee's personal auto policy will be primary and will protect the architect and the firm as well -- but only up to the limits purchased -- which may only be the minimum limits as required by each individual state. Once the employee's limits are exhausted, then the architect's or the firm's limits are at risk. Auto liability limits are often overlooked whether on a personal auto or a business auto policy. An architect or a firm should carry sufficient auto underlying liability limits so that an Umbrella liability can be purchased in excess of the primary auto limits.

Umbrella or Excess liability policies provide higher limits in conjunction with underlying general liability, automobile, and employer's liability policies. Umbrella policies are usually written in multiples of \$1,000,000. They generally do not apply excess of a professional liability policy. An Umbrella should be purchased on both a corporate and individual level.

Two Case Studies

I. Professional Liability

An architect was retained to provide architectural and engineering services for a sports facility in a northern state. The prime architect then retained a local architect and structural engineer. The design team provided a performance specification for a standing seam metal roof.

About three years after substantial completion, a section of the dome blew off during a windstorm. The roof was repaired for \$250,000. The sports dome's property insurer paid for the repairs and two years later filed suit against the prime architect. The city filed their own lawsuit, claiming \$5,000 in damages, which was the amount of their deductible, and other unspecified damages. Both suits alleged negligence, breach of contract, and breach of warranty.

Shortly after the claims were filed and while warranty work was being performed on the dome, it was determined that there were structural problems with the standing seam roof. In addition, the city identified problems with the parapet walls, the placement of the vapor barrier below the roof, and the attachment of the standing seam metal roof. The city also raised concerns about snow accumulation and resulting avalanches. The city subsequently increased the amount of their lawsuit to \$8 million. The contractors and the roof manufacturer were added as codefendants.

The city later decided that they would pursue a complete replacement of the roof structure and installation of snow fences, ground level roofs, and landscaping to address avalanching, recover their out-of-pocket expenses of \$1.7 million, and made their total claim for \$6.7 million.

The design team argued that as much as \$2.5 million of the city's replacement costs amounted to betterments or improvements. The design team also raised some legal defenses such as the contractual statute of limitations in AIA Document B141,

Standard Form of Agreement Between Owner and Architect. Using standard form agreements such as those developed by The American Institute of Architects (AIA) and the Engineers Joint Contract Documents Committee (EJCDC) may help reduce risks.

After negotiation, the design team settled the city's claim for \$2.4 million. Legal fees, expert expenses, and the policyholder's deductible added \$1,270,000 to the cost, bringing the total cost for this claim to \$2,670,000. The case and settlement was covered and paid by the firm's professional liability insurance carrier, less the firm's deductible.

Large public-use centers can result in severe claims. Clearly, there should be some re-evaluation of the design team's risk management practices. Whether they adequately assessed their risks prior to taking on this project, had sufficient experience with this project type, gave adequate consideration to the geographic and weather considerations that might increase risks, and whether it was the right design, performance specifications, and materials for such a structure or appropriate all should have been thoroughly considered. In the end, implementing good risk management practices while ensuring adequate professional liability coverage and an appropriate deductible will protect the firm.

II. Commercial General Liability

Commercial general liability (CGL) insurance provides coverage primarily for liability arising out of non-professional acts (violations of the personal, business, or property interests of private citizens) that result in bodily injury, property damage, or personal and advertising injury. CGL insurance is designed to cover an insured's liability arising out of incidents on the insured's premises or from the nonprofessional aspects of the insured's practice.

An example of Bodily Injury/Property Damage, one component of CGL, involved a surveyor working on an airport runway. The surveyor left his tripod and prism standing upright on the side of the runway when he left for lunch. A small Falcon 900 airplane came in for landing and the leading edge of the right wing, which was extended over the edge of the runway, clipped the equipment. The surveying equipment created a dent in the leading edge, but there were no injuries. However, the repairs to the plane and other expenses, such as down time, parts, and labor, totaled more than \$114,000. This claim illustrates the importance of having an established risk management program - and having adequate general liability coverage.

A design firm's professional liability policy provides coverage for that firm's *professional negligence*. A design firm's CGL policy provides coverage for the firm's *non-professional negligence*. In the surveyor's claim example, a compelling argument could have been made that the damage arose out of the surveyor's professional services and, therefore, should have been covered by the PL policy. The surveyor's claim example illustrates a situation where the CGL insurance carrier could argue that the claim should have been covered by the surveyor's PL policy while the PL carrier could have argued the same against the CGL carrier. One way to minimize the risk of this situation is to have both the CGL and PL policies with the same insurance carrier.

The focus would then shift to resolving the claim instead of debating which policy should respond to the claim.

Another example of a general liability claim would be if a visitor walks into an insured design professional's office lobby and slips on the marble flooring after a rain storm and breaks her ankle. The injury occurred on the named insured's premises and the injured woman would make a claim against the insured for her medical expenses resulting from her broken ankle. This example illustrates the importance of maintaining safe building premises and CGL coverage. It should be noted that this coverage does not cover the insured or the insured's employees since those claims would likely be covered by workers' compensation insurance.

Conclusion

Managing risk is part of the practice of architecture. Professional liability insurance brokers were asked what they saw as emerging trends in this marketplace over the next few years. Some highlights of the future:

- Carriers will seek to push to raise rates and restrict capacity as they continually seek a 15% return on equity, which has not been achieved in the A&E market segment for many years.
- New products will be developed to address full-blown (pure) Integrated Project Delivery (IPD) projects.
- Additional coverage extensions on policies will be developed for cyber liability.
- Rates will trend up with a new focus on claims service.
- Clients will require higher limits for their policies.
- The impact of broader use of Building Information Modeling (BIM) on professional liability exposures for architects is unknown at this time. Insurers will respond once claim activity begins. Some carriers may provide sub-limits on their exposure until they see some claim results.
- State Guaranty Funds will continue to limit their exposure.

The AIA Trust is a *free risk management resource* for AIA members. In its role as a risk management resource for members, the AIA Trust develops tools to help AIA Members manage their firms effectively, available on the [AIA Trust website](#). These include current reports on liability issues addressing the standard of care, sustainability, meta-data, fiduciary duty, and others; a new [database on professional liability insurers](#) with tips on buying liability insurance; claims trends and guides on starting a firm - or retirement planning. In addition, the AIA Trust offers a wide variety of risk management products that include professional liability & business owners protection insurance.