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## CHAPTER 6

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# Professional Liability Insurance Coverage

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### *Introduction*

To state the obvious, the design and engineering work associated with a construction project is critical to the overall success of the completed structure. Accordingly, to overlook the importance of such work, or to fail to devote the attention and care necessary to ensure that it is executed properly, is to expose the project to the potential for significant losses on, and disruptions to, the project. A structure that is poorly designed or that does not adequately account for the relevant mechanical, structural, electrical, and geographical needs is prone to failure.

Although architects and engineers are largely responsible for the design and engineering of a project, the accountability for such work is not limited to these project members. The owners, as the primary stakeholders in the construction project, can bear a share of the responsibility. Moreover, the lion's share of the exposure to losses for design/engineering work gone awry is often that of the owner in the first instance; this is especially true where the failures cause both a substantial delay in the completion of the project and also bodily injury or property damage.

Additionally, construction managers, whether “at risk” or through their agents, general contractors, subcontractors, and consultants, can also be responsible for design/engineering risks to the extent that their management and oversight responsibilities include any design or engineering aspects of the project or they perform any design or engineering activities, such as preparation or review of shop drawings, incidental design changes associated with making architectural plans conform to the realities of construction, or identification of conflicts or gaps in the project's plans. Finally, since the physical construction work at the project necessarily relies upon the project design and

engineering specifications, the general contractor and subcontractor also bear a tangential risk from inadequate engineering and design. Parties injured by construction work often do not limit their legal claims to those parties contractually or legally responsible for design or engineering flaws, but also name the contractors, construction managers, and consultants as defendants.

When a loss involving design or engineering occurs, the potentially liable parties will want to minimize their losses by submitting claims for defense and indemnity to their respective insurance carriers. As discussed throughout this book, there are many forms of insurance that are associated with the risks involved in a construction project; these insurance products include commercial general liability (CGL) (insuring against third-party claims involving bodily injury and property damage and typically including completed operations/product hazard coverage); builders risk (insuring the parties' interests in the physical construction project during the course of construction); workers' compensation (covering the risk of injuries to workers of the construction participants); environmental (insuring against pollution-related losses and liabilities); and professional liability (insuring against losses from "professional services"). The various insurance policies may have some degree of overlap; it is therefore possible that a loss involving engineering or design problems may be covered under several policies.

By and large, however, the type of insurance that focuses on a construction project's design and engineering risks is professional liability insurance. Accordingly, the procurement of sufficient professional liability coverage, and related additional coverages discussed below such as owner's or contractor's protective and indemnity policies, is a necessary component of effective loss mitigation through risk transfer.

This chapter focuses on the practical and legal issues concerning design and engineering services performed in the construction setting and the professional liability insurance that is available to those within the industry.<sup>1</sup> It includes a discussion of the scope of professional liability coverage; the parties insurable under professional liability policies; the various products, including professional liability and other more specialized insurance, that provide coverage for professional services errors and omissions; the pertinent limitations and exclusions in these coverages; and the role of such coverage as a counterpart to the more commonly utilized CGL coverage.

#### *What Is "Professional Liability"?*

In general terms, professional liability involves the exposure to claims from mistakes in technical or highly skilled areas of work. Such areas of work are commonly defined as "professional services." In the construction context, professional services can include, among other things, the following:

- architectural and other design (including structural, civil, soils)
- planning and scheduling
- land surveying

- mechanical, electrical, and other engineering
- construction management services (logistical work associated with the construction process, including scheduling and project site safety)

Intuitively, professional liability coverage under an architects and engineers professional liability policy (A/E policy) most commonly covers the construction project's architects and engineers as those responsible for the design, planning, and engineering work. Architects and engineers may also agree to undertake construction management services, an added exposure that can be covered under the A/E policy with a proper endorsement. Moreover, if others perform work that potentially falls within the ambit of “professional services” defined by the A/E policy (such as a designer that is not a licensed architect or another entity performing construction management services), there is the potential for coverage to apply to these other “professionals” under a professional liability policy as well, provided that they are identified as named insureds under the A/E policy. Additionally, these participants can sometimes secure endorsements to their standard CGL policies covering such work or services that would otherwise be excluded under those policies.

In certain instances, a general contractor or subcontractor will perform design work in-house or will assume professional management services that subject them to professional liability without even realizing it. When architectural plans lack certain details, and the contractors or subcontractors make modifications or prepare “shop drawings” in order to comport with the realities of project construction or otherwise to design certain components of the project that are not adequately specified in the architect's plans, others (including their CGL insurers) may take the position that they have performed professional services. The same may occur when a general contractor inspects and approves the design specifications for a heating, ventilating, and air conditioning (HVAC) system, devised by a subcontractor and not otherwise specified in the architectural design plans, and mold is caused by the HVAC system's improper retention and dispersal of moist air results. In these situations, the contractors arguably could find themselves exposed to an action for professional negligence. Such risks are particularly inherent in the designbuild method of project delivery where the contractor hires subcontractors to design aspects of the project, and they also are common in public-private partnerships as the consortium seeks to transfer risks to the contractor.

In recognition of these types of situations, the insurance industry has developed products in addition to the traditional A/E policy to address construction management professional liabilities. As its name implies, a construction management liability policy affords coverage for those fulfilling the role of construction manager. On some jobs, a construction manager (CM)<sup>2</sup> is retained directly by the project owner to provide consultation services regarding design and construction. The role also may involve preliminary work, such as cost and time of completion estimations that are also of a professional nature.

On other jobs, a general contractor may assume responsibility for most or all of the management and oversight responsibilities. Another option is for the

management responsibilities to be shared by the general contractor (overseeing scheduling and site safety) and the design professional (overseeing design and constructability aspects of the project).

On those projects where a construction manager has been retained, or construction management duties have been assumed, the entity that fulfills the assigned role may find it prudent to insure itself under a professional liability insurance policy specific to construction management services. One of the key reasons a construction manager is hired, apart from performing inspection and oversight services that an owner is disinclined or ill-prepared to undertake itself, is to shift the risk of liability for damage and injury associated with design, engineering, and construction mistakes away from the owner and onto the retained construction manager. Unless the construction manager is also serving as the design professional on the project, it is not likely to be insured through the A/E policy obtained by these design professionals. Yet even if the construction manager is covered as a named insured under that policy, the coverage afforded may be inadequate due to the specific limits involved, or the "wasting" nature of those policies discussed below.

The degree of risk undertaken by the construction manager is further heightened when it not only serves as a consultant for the owner to perform general inspection and oversight (i.e., a construction manager advisor) but also accepts the responsibility of directly hiring the project's design professionals, general contractor, and subcontractors, and thus controls the actual "means and methods" of the project work. This role is known as a construction manager "at risk."<sup>3</sup> A construction manager's professional liability policy is vital protection for those specifically engaging in project management work. Accordingly, adequately defining the "professional" risks that are being insured is key.

At first glance, the classification of work as "professional" may seem relatively straightforward. However, in reality, whether particular work constitutes a "professional service" is not always apparent. Although most, if not all, professional liability policies, and many CGL policies, offer a definition of this term, the proffered definition does not always clearly describe the full range of acts considered to fall within the scope of professional services, and those that do not. For example, one sample A/E policy defines "professional services" as

[T]hose services that the Insured is legally qualified to perform for others in the Insured's capacity as an architect, engineer, land surveyor, landscape architect, construction manager, interior designer, land planner, space planner, expert witness, or technical consultant with respect to the foregoing listed services.<sup>4</sup>

This definition identifies the particular disciplines that are considered "professional," but does not indicate what specific "services" are considered to be within the "capacity" of an architect, engineer, or other design professional. Moreover, it suggests that if the task is one routinely performed by general contractors, it is not a "professional service" regardless of the level of expertise

or sophistication required and regardless of the inherent design or engineering risk involved. Some case law has shed light on these issues, as follows.

In *Marx v. Hartford Accident & Indemnity Co.*,<sup>5</sup> the Nebraska Supreme Court provided this explanation of professional services:

Something more than an act flowing from mere employment or vocation is essential. The act or service must be such as exacts the use or application of special learning or attainment of some kind. The term “professional” in the context used in the policy provision means something more than mere proficiency in the performance of a task and implies intellectual skill as contrasted with that used in an occupation for production or sale of commodities. A “professional” act or service is one arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill, and the labor or skill involved is predominantly mental or intellectual, rather than physical or manual...In determining whether a particular act is of a professional nature or a “professional service” we must look not to the title or character of the party performing the act, but to the act itself.

Noting that the task involved in that case (filling a sterilization unit with water) was “not an act requiring any professional knowledge or training,” but was “a routine equipment cleaning act that any unskilled person could perform,” the court held that the professional liability carrier did not have to cover the loss. However, the extrapolation of this holding to the construction context can be problematic since many responsibilities of the general contractor require specialized knowledge and expertise; they are not tasks that “any unskilled person could perform.”

The distinction between job title and work duties was further demonstrated by the holding in *Harbor Insurance Co. v. OMNI Construction Inc.*,<sup>6</sup> which involved “sheeting and shoring” design work that was performed on behalf of the project general contractor, OMNI, by its subcontractor. The project suffered settlement damage purportedly caused by errors in the sheeting and shoring. OMNI's excess liability policy with Harbor contained an architects and engineers exclusion for engineering-related work, and Harbor denied the claim. OMNI argued that even if the loss involved sheeting and shoring, the exclusion should not apply because Harbor understood that contractors often performed incidental sheeting and shoring work, and that such work was not commonly undertaken by architects and engineers. In other words, the insured argued that the exclusion should not be applied to work that is known to be routinely performed by contractors and subcontractors. The U.S. Court of Appeals for the District of Columbia disagreed, determining that the language of the exclusion did not except incidental design work performed by the insured:

Under OMNI's preferred interpretation, a loss caused by defective engineering work would be covered if both the engineering and its implementation were done by a single contractor, but not if by

separate engineering and construction contractors. In the former case, the design work would be considered “incidental” to the construction, and hence covered; and in the latter case, it would be considered a professional service, and hence excluded. The rather straightforward terms of Endorsement No. 9 do not admit of such a distinction. Furthermore, the purpose of the Endorsement... is to remit professional liability exposure to the service provider's professional liability carrier. The general liability carrier avoids double coverage by excluding that risk from its policy, and the insured cannot alter the insurers' exposures after the fact by changing the way in which it subcontracts professional and non-professional work.<sup>7</sup>

Finding that the exclusion applied to sheeting and shoring work, the court remanded the case to the trial court to determine whether the loss was in fact caused by sheeting and shoring, or by an event involving general negligence.

The *Harbor Insurance* opinion accepted the premise that the assigned role of the insured does not necessarily dictate the classification of the work as “professional” or not. Thus, simply because a general contractor routinely performs incidental engineering work does not remove that engineering work from the classification of a professional service. (ISO revised its professional services exclusion to address this.)

As these decisions demonstrate, distinguishing professional from nonprofessional services in the construction context is not a simple task. For example, while few would dispute that miscalculations contained within an architect's blueprints involve errors in design and, as such, are covered by a professional liability policy, the identification of other tasks as “professional” is not always easy. Even when an entity that typically performs professional services (such as an architect or engineer) commits an act of negligence, case law holds that the particular act in question does not always qualify as a *professional* service. For instance, an architect's improper billing of its services, while an act of negligence (or perhaps intentional misconduct), may not be held to pertain to design/engineering or otherwise sufficiently involve conduct of a high degree of skill or expertise; therefore, such an infraction may not be considered by a court to involve a professional service.<sup>8</sup> Conversely, however, some courts have held that an architect's billing requires an adequate understanding of the design work for which the fee is charged, and, therefore, such billing is a professional service.<sup>9</sup>

Other examples where the line between professional and nonprofessional negligence is blurred include

- misrepresentations made in the competitive bidding process of the design contract
- faulty erection, operation, and placement of construction equipment
- erroneous project safety recommendations

These examples and others have been addressed by courts across the country. In *American Motorists Insurance Co. v. Republic Insurance Co.*,<sup>10</sup> the Alaska

Supreme Court addressed the question of whether a school design bid that contained material misrepresentations about the insured architectural firm's experience and staff support involved an error in “professional service” sufficient to require the plaintiff to provide professional liability coverage. The court ultimately held that since the particulars contained within the bid, a 160-page document, could not have been prepared by someone outside the architectural field, the claim against the insured was covered under the professional liability policy:

The bid was much more than a price quote. As previously noted, it contained approximately one hundred and sixty pages of information. It included, among other things, an accelerated project schedule, drawings, a project approach, a project team list detailing team member assignments, an estimate of ECI/Hyer's design fee, an estimate of manpower requirements, a selection of subconsultants, an extensive description of ECI/Hyer's experience, and the particulars of designs ECI/Hyer had created for other projects. As a practical matter, and as a matter of Alaska law, only an architect using his or her specialized knowledge, labor and skills could have prepared the bid.<sup>11</sup>

In *Cochran v. B.J. Services Co., USA*<sup>12</sup> (interpreting Louisiana law), the Fifth Circuit addressed the question of whether a worker injury allegedly caused by an engineering consultant's failure to supervise the safe removal of a cement head on a drilling rig involved an act of professional negligence. The court determined that it did not, and therefore found that the insured was entitled to a defense of the injured worker's claim under its CGL policy:

[T]he instant professional services exclusion provision does not release Mid-Continent [the insurer] as a matter of law from covering Drillmark's [the insured] obligations arising from Cochran's suit. Although Drillmark is described as a consulting engineering firm by trade in its insurance contract with Mid-Continent, the parties do not dispute that Drillmark was not hired in its capacity as an engineering firm per se...Rather, it is undisputed that Drillmark contracted...to be the overall supervisor of “company-operated drilling, completion and workover activities” and was charged only with monitoring the progress of other contractors and reporting back to UPR...Drillmark did not contract to provide any package of professional services, such as engineering or surveying, to UPR [Union Pacific Resources Co.]...[R]emoval of a cement head is a routine task that does not require specialized instructions, and which ordinarily is performed by a cementing or drilling crew including, for example, drillers, derrick hands and roughnecks, which are nonprofessionals. It follows that the supervision of (or failure to supervise) cement head removal likewise does not require professional engineering expertise or other expertise of a professional nature.<sup>13</sup>

One job function that is especially difficult to classify as either professional or general, especially if it is not included in the specific definition of “professional services” in the professional liability policy at issue, is “construction management.” The classification of such oversight duties is not always obvious, especially in instances where the party providing the management services wears two hats on the project, such as a general contractor and construction manager. In these scenarios in particular, classifying an error involving project oversight as either a professional or nonprofessional act can be difficult. The outcome can depend upon the subjective interpretation of the court as to whether the particular conduct in question is considered to involve a sufficient degree of skill and expertise, or instead is considered to involve routine construction work.

For example, in *Reliance Insurance Co. v. National Union Fire & Insurance Co. of Pittsburgh*,<sup>14</sup> the court held that a project engineer's failure regarding project safety management did not involve “professional negligence,” and stated as follows:

[I]t is clear that Seelye's [the engineer's] alleged failure in the underlying action to make sure that the contractor at a renovation site remained in compliance with both its contract and the relevant safety laws did not require Seelye's engineering acumen, but rather normal powers of supervision and observation.<sup>15</sup>

In comparison, the Federal District Court for the Southern District of New York, in *Continental Casualty Co. v. JBS Construction Management*,<sup>16</sup> concluded that the project architect's general oversight responsibilities involved “construction management” covered under its professional liability policy for claims involving a construction crane that toppled over. In so holding, the court rejected the insurer's argument that the architect was not engaging in construction management for the reason that it did not perform “design work, construction means and methods, site safety, or duties assumed or required to be performed by the Construction Manager.” Specifically, the court stated:

Notwithstanding the fact that JBS was not the project's nominal “Construction Manager” and was contractually restrained from performing those duties assumed by the designated Construction Manager, some of the tasks it was charged with performing, including monitoring and supervising the construction site, clearly fit within a commonsense understanding of what a “construction manager” does.<sup>17</sup>

The *JBS* court thus considered “monitoring” to involve a sufficiently high level of skill and expertise to constitute a professional service; when undertaken improperly, that failure in “monitoring” was professional negligence.

In *Atlantic Mutual Insurance Co. v. Continental National American Insurance Co.*,<sup>18</sup> the court was charged with the task of determining whether a claim against an engineering consultant, Killam Associates, that was hired to

oversee certain project work was covered by the company's professional liability policy or instead by its general liability policy. The two respective insurance carriers argued the other was responsible for a claim involving negligent supervision of sewer trench work that collapsed, injuring two people. The dispute focused on whether the mutual insured's responsibilities of ensuring proper fortification of the trench involved a specialized skill or, instead, was a routine task that could be undertaken by those not possessing the insured's expertise. The court determined that the claim involved the former:

The supervision by Killam Associates...is predominantly mental or intellectual. It required observation and constant evaluation of the work being done. The main thrust of the original plaintiffs' cause of action was the alleged failure of Killam Associates to observe that the contractor was violating the New Jersey State Construction Safety Code as to the manner in which the trench was fortified. The acts of Killam Associates in this respect clearly required the specialized knowledge and mental skill of a professional engineer.

In comparison, a Texas appellate court in *Aetna Fire Underwriters Insurance Co. v. Southwestern Engineering Co.*<sup>19</sup> found that an engineering firm did not commit an act of professional negligence when a contractor struck an underground pipe while digging a trench at the engineering firm's direction. The court determined that the oversight in question did not unambiguously involve professional services:

We cannot say as a matter of law the physical act of digging for and locating underground pipelines requires engineering education, training, and experience in the application of special knowledge of the mathematical, physical, or engineering sciences, so as to constitute the practice of professional engineering. The least that can be said is that the term "engineering services," not being definitely defined in the contract, is an ambiguous term.<sup>20</sup>

Notably, the holding in the *Aetna Fire* case was based in large part on the fact that the court was construing an exclusion within a general liability policy. Because it found that "engineering services" was an ambiguous term, it narrowly interpreted the exclusion, which was most favorable to the insured.

The *Aetna Fire* case also highlights a significant factor involved in evaluating potential coverage under these two forms of insurance: the distinction between the interpretation of exclusions and the interpretation of insuring provisions. Policy exclusions, such as a CGL professional services exclusion, are generally construed narrowly by courts and against the insurer if there is any ambiguity. Grants of coverage, alternatively, including coverage for errors and omissions in the rendering of professional services, are viewed broadly in favor of the insured. Accordingly, in certain instances it is possible that an act considered to involve general negligence pursuant to a narrow reading of

a CGL professional services exclusion can also be deemed to be a professional service under a broad interpretation of a professional liability policy, thereby resulting in an overlap of coverage. As one court put it, “A court applying [these] maxim[s] might well be inclined to find certain conduct to be both covered by a professional E & O policy but not excluded by a CGL policy's professional liability exclusion.”<sup>21</sup>

These cases highlight the difficulties with classification of work as professional or general services when the negligent act in question does not definitively involve damages or injuries resulting directly from engineering, design, or management work, but instead involves damages arising from other tasks performed by a professional that may (or may not) have a connection to its design, engineering, or management functions. Conversely, as the prevalence of “professional services” exclusions in general liability policies issued to contractors attests, parties not formally charged with the project's design or engineering responsibility often face serious “professional services” risks, which are exacerbated by newer delivery systems.

So, how should the prudent insured address these risks? A key starting point is to understand how “professional services” and “wrongful acts” can be defined in policies available to insureds, as discussed next.

*Policy Definitions of “Professional Services” and “Wrongful Acts”*

Professional liability insurance is specifically intended to protect against liability from errors and omissions that are committed while carrying out “professional services,” including, depending on the policy definitions, those identified above. Certain policies define these errors and omissions as “wrongful acts,” others classify the conduct as “professional negligence,” and others contain no particular definition for conduct that is outside the realm of acceptable work other than to call it a negligent act, error, or omission in the performance of professional services. Compare, for example, the following policy provisions, all of which appear in professional liability policies:

The Insurer will pay on behalf of the Insured all Damages and Claim Expenses...that any Insured, in the performance of Professional Services, becomes legally obligated to pay because of Claims first made during the Policy Period or any Extended Reporting Period and resulting from a Wrongful Act.<sup>22</sup>

\* \* \*

We will pay DAMAGES and CLAIM EXPENSES in excess of YOUR Deductible, subject to all other provisions of this policy, that YOU become legally obligated to pay because of CLAIMS that arise from YOUR negligent act, error or omission in the performance of YOUR professional services....<sup>23</sup>

\* \* \*

We will pay on behalf of the “insured” all sums in excess of the Self Insured Retention noted in Item 4 of the Declarations that the

“Insured” is legally obligated to pay as “Damages” because of a “Professional Liability Claim” first made against the “Insured” during the “Policy Period” and reported to us during the “Policy Period.”<sup>24</sup>

“Professional services” may be defined as any services performed in certain capacities, including:

1. Architect
2. Engineer
3. Land surveyor
4. Landscape architect
5. Construction manager
6. Scientist
7. Technical consultant<sup>25</sup>

However, other definitions of “professional services” require that certain services be specifically detailed in a contract between the insured and a client, such as the following:

Professional Services means:

- A. services that you, or others for whom you are legally liable, are qualified to perform for others on behalf of a Named Insured, in the capacity of an architect, engineer, land surveyor, or landscape architect.
- B. construction management and management of your subconsultants in their capacity as architects, engineers, land surveyors or landscape architects, *but only to the extent such management services are specifically defined in a written contract between you and your client before a wrongful act occurs.*<sup>26</sup>

“Wrongful act” is also defined differently by professional liability insurers. The definition of “wrongful act” may include the term “professional services” or be limited only to “negligent” acts. For example:

Wrongful Act means a negligent act, error or omission in the performance of professional services for others by you or any person or entity, including joint ventures, for whom you are legally liable. A wrongful act cannot arise from dishonest, fraudulent, malicious, or criminal conduct committed by you or at your direction or with your prior knowledge.<sup>27</sup>

Alternatively, “wrongful act” may not be limited only to “negligent” acts, but may also be defined generally as “an act, error, or omission, including but not limited to breach of contract or duty (including but not limited to Fiduciary Duty and Personal Injury).”<sup>28</sup>

Some definitions of “professional services” will include misrepresentations and misleading statements that address, for example, the billing or

bid preparation disputes referenced earlier. Some insureds have successfully negotiated with the insurer to incorporate a litany of tasks “without limitation” into the definition, such as oversight, review, and identification of scope, gaps or inconsistencies in the specifications, bid preparation, estimation, inspection, value engineering, scheduling, and so on.<sup>29</sup> Additionally, some insurers will consent to incorporate all services to be provided under a specific project's contract into the definition of “professional services.” In short, the important thing is to understand what activities will and will not be deemed to fall within the policy's coverage grant, and to negotiate the broadest definition the insurance market will allow at the time you are negotiating.

Even if one has negotiated as favorable a definition of “professional services” and “wrongful act” as possible for the relevant market, the carrier may deny coverage in the first instance. In that case, serious consideration should be given to the retention of an expert that can address the professional nature of the activity at issue. Expert testimony is required when lawsuits are brought against professionals:

Courts have held that in order to establish professional liability, an expert must render an opinion that the professional failed to exercise a reasonable degree of care and skill related to common professional practice and that this failure was the proximate cause of plaintiff's injury.<sup>30</sup>

Further, “[a]rchitectural standards and practices are, in most instances, sufficiently technical to require the use of expert testimony to establish negligence or a lack of reasonable care on the part of an architect.”<sup>31</sup> Accordingly, when a professional liability carrier denies coverage for the reason that the alleged conduct does not involve “professional negligence” or a “wrongful act,” an expert should be considered in order to establish the professional nature of such conduct.<sup>32</sup> Finally, rules and regulations can be another useful source of evidence demonstrating the “professional” nature of the risk.

#### *General Characteristics of Professional Liability Insurance*

The satisfaction of the “professional services” requirement as discussed above, and the application of policy exclusions discussed below, are the most essential issues with respect to professional liability insurance and the most often litigated matters of dispute. Nevertheless, other concepts commonly associated with this form of insurance are also worthy of discussion here. Most of these concepts are applicable to all forms of professional liability insurance and cannot usually be negotiated away. Accordingly, they are important to understand as they apply to engineering and design work.

#### **Injuries and Losses Covered under a Professional Liability Policy**

Damages covered by professional liability policies are often broader than those covered by CGL or other policies. Additionally, professional liability policies

do not typically require bodily injury or property damage to trigger for coverage. The losses and damages covered by typical professional liability policies, and other unique features that trigger that coverage, are discussed next.

#### *Economic Damages*

Professional liability policies, like other liability policies, protect the insured from losses associated with bodily injury or property damage. In addition, however, professional liability insurance also covers nonphysical or purely economic damages. For instance, if a project sustains cost overruns and loss of revenue because of design errors that delay the completion of the project, a policy limited to bodily injury and property damage coverage would not insure these intangible losses. In contrast, most professional liability policies<sup>33</sup> cover these consequential-type losses. Financial losses stemming from design errors can be significant, and can rival or exceed physical loss. Thus, the coverage for economic damages is one of the most critical and valuable aspects of professional liability coverage.

#### *Contractual Liabilities*

As mentioned above, the commission of “professional negligence” is often a required condition of coverage under a professional liability policy. However, the contract between the professional and the owner or contractor (as the case may be) often holds the professional accountable to a standard that exceeds “professional negligence.” For this reason, an act committed by a professional service provider that is considered a breach of contract, or liability based upon contractual indemnity, may not necessarily be an act that is considered to involve “professional negligence.” In such a case, there may be a disparity or gap between the contractual obligations, including the contractual standard of care required by a professional service provider under its service contract, and the standard for “professional negligence” that is covered under a professional liability policy.

The language of a typical design services agreement illustrates this disparity:

**Standard of Performance.** The Architect shall perform the services of the Agreement with reasonable care and competence, applying the technical knowledge and skill which is ordinarily applied by architects of good standing with the [Governing] Board for Registration of Architects (in the case of Engineers, the State Board of Licensure for Professional Engineers and Land Surveyors). The performance of these services shall be consistent with the Conditions of the Construction Contract, and in such a timely manner as will facilitate the orderly progress of the Project.<sup>34</sup>

In comparison, a professional liability policy may provide as follows:

“Wrongful Act” means any act, error, omission or breach of professional duty committed within the scope of professional services.

“Professional Services” means duties and responsibilities undertaken by the Insured pursuant to any written or verbal agreement to provide the professional services described in Item VII of the Declarations, including responsibilities implied by the agreement and assumed by the custom of the Insured’s profession, whether expressly undertaken or not.<sup>35</sup>

While the sample design contract language set out above requires the professional to conform to all conditions of the construction contract, including the facilitation of “the orderly progress of the project,” the sample insurance language limits liability for mistakes that are “within the scope of professional services.” Accordingly, it is possible that a contract violation committed by the professional would be excluded from the insurance provided. If, for example, an architect refused to turn over plans within the time limit proscribed by the project contract, the architect may have breached the contract, but such delay might not necessarily be considered an act of professional negligence that is covered by an A/E policy.<sup>36</sup>

In *Bell Lavalin, Inc. v. Simcoe & Erie General Insurance CO.*,<sup>37</sup> the court addressed the distinction between liability for a contractual breach and insurance coverage for professional negligence. The case involved a breach of contract claim brought by a project subcontractor, Conam, against the construction manager, Bell Lavalin, for, inter alia, the failure to pay Conam for its work. Conam prevailed at trial and was awarded a judgment in excess of \$4 million. Bell Lavalin sought indemnity from its professional liability insurance carrier, Simcoe and Erie, which was denied on the basis that the loss did not involve professional services. The court found in favor of the insurer, holding that “[n]o lay person could reasonably read Simcoe’s policy and expect that it provides coverage for a simple contract dispute in which Conam performed work for which it was not paid.”<sup>38</sup>

In light of the possible disparity between “professional negligence” and a contractual breach, some owners or contractors require the project architects and engineers to obtain professional liability insurance that covers liability for a standard of care that exceeds professional negligence, often through purchasing a policy that provides “insured contract” coverage. Whether such coverage is available is a function of insurance market conditions at the time it is sought.

### **The Form Providing Professional Liability Insurance Is Usually Carrier-Specific**

Unlike many other forms of insurance, including most notably CGL coverage that is often included in standard forms prepared by the Insurance Services Organization (ISO), professional liability policies are not uniform across insurers and are not included in a common insurance form that is widely adopted by the majority of carriers that offer this insurance. Each policy is a semicustom product that is unique to the particular insurance carrier that

offers this type of coverage. Thus, while it is always important for policyholders (and attorneys charged with enforcing and interpreting insurance policies) to review the language of an insuring agreement; a detailed assessment of the specific policy language is especially important for professional liability insurance; what is covered by one professional liability policy may be excluded or significantly limited by another.

### **Professional Liability Coverage Is “Claims-Made” Coverage**

A “claims-made” policy requires that certain conditions be met in order for coverage to apply to a particular loss. These conditions typically include (1) that the conduct subjecting the insured to liability occurs during the policy term (extending backward to a policy-specific retroactive date) and (2) that the party allegedly aggrieved by such conduct make a claim against the insured during the period of coverage. Under a “claims made and reported policy,” the insured also must provide notice of the claim to the insurer within the policy period. In comparison, under the traditional claims-made policy, notice must be provided “as soon as practicable,”<sup>39</sup> which can sometimes occur after the policy period.<sup>40</sup>

As evidenced by these identified requirements, the window of time in which a particular professional liability policy provides coverage is very limited, although the lifetime of a construction-related risk is long. In many cases, defects in design and engineering may not be realized until quite some time after the project is completed. For this reason, policyholders should acquire professional liability policies that contain an extended “retroactive period” and/or an extension of the “claim period.”

A “retroactive period” is the period of time within which the loss must occur in order for coverage to apply. For example, a professional liability policy insuring the period of January 1, 2010, through January 1, 2011, with a retroactive date of January 1, 2009, would allow coverage for a loss that transpired after January 1, 2009, but was not claimed against the insured until a point in time within the January 1, 2010, to January 1, 2011, policy period. In that case, the retroactive date affords coverage for a wrongful act occurring after the retroactive date (i.e., one year prior to the policy period) that is the basis of a claim made against the insured within the policy period. To provide maximum protection, given the length of risk exposure, an insured should seek to purchase a retroactive period that mirrors the governing jurisdiction's statute of repose or that extends back to the date of termination of an earlier policy. This extension is sometimes known as “nose coverage.”

An extended claim-reporting period extends the time period within which a claim against the insured must be brought or reported against the insured. For instance, if the loss occurred during the policy period (or retroactive period), but a claim was not asserted against the insured until a point in time beyond the policy period, an extended claim reporting period would allow the loss to be covered. This extension of time is sometimes known as “tail coverage.”<sup>41</sup>

*Renewal/Replacement of Claims-Made Coverage (Avoiding Gaps)*

When the insured period of a claims-made policy comes to an end, and a subsequent policy is obtained from the same insurance carrier (i.e., a renewal policy), the new policy typically includes a retroactive date that insures wrongful acts that occurred during the prior policy period that were not claimed against the insured until sometime during the current policy period. Importantly, however, when a policy is not renewed with the same insurer, a subsequent policy issued by another insurer will usually not cover losses that occurred prior to the new policy's effective date. Thus, by switching insurers, the insured can be exposed to a gap in its professional liability coverage. This same dilemma occurs in cases where the insured seeks to cancel its existing professional liability policy in the middle of a policy period and purchase a new policy with another insurer. To avoid these gaps, the insured must either obtain sufficient tail coverage from its prior insurer or, conversely, sufficient nose coverage from its current insurer.

*Contrast with "Occurrence"-Based Coverage*

The claims-made policy operates very differently from the “occurrence”-based policy that is commonly provided under other forms of coverage, such as a CGL policy. An occurrence-based policy requires an occurrence (i.e., an accident) that “triggers” a harm that occurs during the policy period.<sup>42</sup> Under an occurrence-based policy, coverage routinely applies to an injury that allegedly occurred during the policy period but does not result in a legal claim until some time well after the injury in a later policy period. For example, environmental claims often arise from conduct the insured does not discover until many years after the incident that caused the harm had transpired. In such cases, it is common that policies issued many years ago may insure against the loss. In comparison, under a claims-made policy, once the period of coverage expires so does the ability to assert a claim under the policy. As one commentator has noted:

In the “occurrence” policy, the peril insured is the “occurrence” itself. Once the occurrence takes place, coverage attaches even though the claim may not be made for some time thereafter. While in the “claims made” policy, it is the making of the claim which is the event and peril being insured and, subject to policy language, regardless of when the occurrence took place.<sup>43</sup>

Thus, a key distinction between an occurrence policy and a claims-made policy is that the former is implicated by the harm that occurs, while the latter is implicated by the claim brought as a result of the harm.

**A Professional Liability Policy Usually Contains  
"Eroding" or "Wasting" Limits**

Professional liability policies insure against third-party<sup>44</sup> liability claims (see chapter 1 for a discussion of the differences between first-party and

third-party liability). Third-party liability claims involve two major kinds of expense: the cost to defend against the legal claims brought by the aggrieved party (“defense costs”), and the amount payable to the aggrieved party either in settlement of the claims or in payment of an adverse judgment award that is rendered by a judge, jury, or arbiter (“indemnity costs”).

Unlike standard CGL policies, not all professional liability policies impose a duty to defend on the insurer. Some merely require reimbursement of defense costs as an element of loss. Although some courts have imposed a standard akin to the “duty to defend” standard for such reimbursement,<sup>45</sup> others have not. Some policies, including especially those with large deductibles or self-insured retentions, impose the duty to defend on the insured with the insurer obligated only to reimburse the defense costs in excess of the deductible or self-insured retention.

Moreover, in most forms of third-party liability insurance, including most standard CGL forms, the costs paid by the insurer in the defense of a claim are outside of, and in addition to, the policy limits. Accordingly, the insurer must pay defense costs until such time as the claim is resolved or the limits are exhausted by indemnity costs.<sup>46</sup> In comparison, under an eroding or wasting limits policy, which most professional liability policies are, the available limits are exhausted both by defense costs and indemnity costs. Thus, the amount spent on defense diminishes that amount of coverage available for the insured's indemnity obligation. The impact of this distinction is significant, especially when the policy limits of insurance are low in comparison to the ultimate risk from professional errors or omissions, as is often the case with A/E policies.

Eroding or wasting limits policies can affect the defense/settlement strategy that would otherwise be undertaken if the defense costs were paid outside of policy limits. Because the limits are eroded by the cost of defense, there may be an incentive to reach a swift settlement even when the claim against the insured is questionable or may otherwise have a low value. A prolonged defense will expend a sizeable amount of policy limits and may hinder the ability to reach what would otherwise be considered a fair resolution later. From an insurer's perspective, the intent behind eroding limits, apart from the obvious purpose of minimizing loss exposure, may be to avoid difficulties with policyholders that would otherwise oppose resolution of a claim that makes sense for business or economic reasons, but does not reflect the true merits of the legal claim. Insurers may believe that a professional will be more likely to stand on principle and continue with defense of a claim for purposes of avoiding a perceived blemish upon a reputation or for personal pride when sufficient funds are available both to defend the professional *and* to pay indemnity costs.

Despite the obvious difficulties the eroding or wasting nature of professional liability policies may pose both for those insured under them, including architects and engineers, as well as, in certain cases, construction managers, general contractors, project owners who may have vicarious liability, subcontractors and consultants, or claimants against the insured themselves, this feature of the coverage is rarely, if ever, subject to negotiation with the insurers

who offer this coverage. For this reason, securing adequate total limits in light of the project risks is essential.

### **A Professional Liability Policy Does Not Afford Additional Insured Coverage to Nonprofessionals**

Unlike other forms of insurance, A/E policies almost never afford coverage on an “additional insured” basis, except to other professionals. This restriction is distinct from most CGL products, to which specific parties may be added as insureds by endorsement or which contain blanket additional insured provisions that cover those parties with whom the named insured has agreed in writing prior to loss to provide additional insured coverage. Under the construction project hierarchy, a general contractor will typically have an owner covered as an additional insured under its CGL policy, while subcontractors, in turn will agree to list both the owner and general contractors as additional insureds under their respective policies. The result of this distinction is to limit the owner and general contractor to indirect recovery under an A/E policy when either or both bring a claim or legal action against a covered professional whose professional liability insurer pays the claim.

### **A Professional Liability Policy May Provide Inadequate Limits for the Relevant Risks Associated with Design and Engineering Errors**

A/E policies characteristically have very low limits when compared to the actual risk of loss associated with design and engineering mistakes occurring on a construction job. Further, while the owners and contractors may have the right to seek indemnity from the architects and engineers, many architect/owner contracts limit indemnity to the contract prices that the architects/engineers agreed to be paid in exchange for their professional services. For example, if an architect agreed to design a multimillion-dollar commercial building for a fee of \$500,000, its indemnity would be capped at that same amount.

Indemnity is also often limited by contractual provisions that restrict recovery against a design professional to actual and direct, as opposed to consequential or indirect losses. When the contract precludes recovery for consequential damages, the expenses associated with a project's shut-down that are necessary to rectify a design failure cannot be recovered directly from the design professional; only the cost of fixing the design failure itself can be recouped.<sup>47</sup>

### **The Comparison between Professional Liability Insurance and CGL Coverage**

A professional liability policy is generally intended to work in harmony with, and not overlap, the coverage afforded under a CGL policy, but some claims can be covered by both types of policies. A professional liability policy insures

those risks that involve the technical design, engineering, and other skilled work associated with a construction project. Its coverage counterpart, the CGL policy, is intended to address liability for the other aspects of a construction project that concern "general negligence" falling outside the scope of professional services.

Standard eGL policies contain exclusions for work that is considered to involve professional liability. For example, the exclusion typically found in an endorsement to the policy may read as follows:

This insurance does not apply to: "bodily injury," "property damage," "personal and advertising injury" arising out of the rendering of or failure to render any professional services by you or on your behalf, but only with respect to either or both of the following operations:

- a. Providing engineering, architectural or surveying services to others in your capacity as an architect engineer or surveyor, and
- b. Providing or hiring independent professionals to provide engineering, architectural or surveying services in connection with the construction work that you perform.<sup>48</sup>

Theoretically, the procurement of both CGL and professional liability policies enables project members to complete the circle of insurance protection by mitigating risk associated with both the general and professional aspects of the project work. The reality, however, is that the CGL policy may provide more expansive coverage because the available limits are generally greater, the time period to submit a claim of coverage is longer because the coverage is occurrence-based, and defense costs are outside of limits.<sup>49</sup> Thus, the acquisition of both forms of coverage is critically important to minimize the risk of having to pay a devastating loss out of pocket.

#### *Standard Exclusions in Professional Liability Policies*

All forms of insurance contain exclusions for certain high-cost and high-probability risks, and professional liability insurance is no exception. Because the exclusions under a professional liability policy vary between insurance carriers, insureds should undertake a careful review of the particular exclusions contained within any given policy both before securing it and at the time a claim is made against the insured.

Certain exclusions are commonly found within professional liability insurance or are otherwise especially noteworthy given their impact upon available coverage. These exclusions are discussed next.

#### **Willful/Reckless Acts**

An implicit condition of any insurance policy is that the loss in question must be fortuitous. Intentional misconduct, or acts committed with a reckless

disregard for a harm that is likely or inevitable to occur, are not thought to be fortuitous and are typically excluded from coverage by the policies in question and sometimes by statute. Professional liability policies often take the added step of making this implicit condition an expressed condition. For example, the policy may state:

We will not cover YOU for any liability arising out of any dishonest, fraudulent or criminal act or omission committed by YOU or at YOUR direction or for other intentional wrongful acts whether or not YOU also intended the magnitude of the resultant DAMAGE.<sup>50</sup>

Such willful misconduct exclusions traditionally required a subjective assessment from the standpoint of the insured, the question being whether the policyholder subjectively intended the harm to occur. When reckless conduct is also excluded, an objective assessment of the conduct in question must be undertaken. Moreover, insurers often contend that some forms of the exclusion impart a “reasonable person” standard.

Generally standard willful/reckless acts exclusions do not include language requiring “final adjudication” to establish that an insured engaged in prohibited intentional conduct under the policy, that is, criminal, dishonest, malicious conduct, or a willful violation. However, if an insured requests a “final adjudication” requirement to be added to the willful acts exclusion, often the insurer will grant it without a premium. Because even such modified language usually does not expressly require the adjudication to occur in the underlying litigation, insurers contend that they can prove the willful act in the later coverage action when the underlying case was settled before a final adjudication.<sup>51</sup> Notwithstanding this argument by insurers, courts have held that the “adjudication” must occur in the underlying case because an insurer should not be permitted to file a declaratory judgment action against its insured to litigate whether settled claims were in fact attributable to the insured's willful acts.<sup>52</sup>

### **Fines and Penalties Imposed by Governmental Agencies**

A professional liability policy will often preclude the costs incurred as a penalty imposed by a governmental agency because such fines are viewed as punitive. The exclusion typically contains language similar to the following:

WE will not cover YOU for any liability for punitive or exemplary damages, fines or penalties or any multiplication of compensatory damages as provided by law sought from or awarded against you.<sup>53</sup>

The exclusion serves to prevent recovery for what the government agency considers an appropriate punishment for improper conduct. Because the fine is deemed a penalty, it is not considered to be a true “loss” or “damages”

sustained by the insured. In *Jaffe v. Crawford Insurance Co.*,<sup>54</sup> a California appellate court discussed this issue, rejecting the insured's claim that it was entitled to coverage for restitutionary payments ordered in relation to fraud claims brought by the State of California:

Jaffe's policy is limited to coverage for “damages” awarded against him. We have no trouble concluding that payments of a restitutionary nature, if sought by the state pursuant to sections 14170 et seq., are not “damages” within the meaning of Jaffe's policy.<sup>55</sup>

### **Contractual Penalties/Liquidated Damages**

In addition to government fines and penalties, professional liability policies also commonly exclude contractual penalties, such as a return of a contract fee or other charges levied as a result of the inadequate performance of the professional service provided. This exclusion is sometimes entitled a “liquidated damages” exclusion and may state that the insurer will not pay or defend any claim:

For liquidated damages in excess of your liability caused by a wrongful act...for fines and penalties imposed on you; or for the failure or refusal of a client to pay money due you; or for return of fees paid to you.<sup>56</sup>

Contractual fines and penalties are considered a consequence of a job not well done or a failure to deliver the work as promised, rather than an actual insurable loss endured by the insured.<sup>57</sup> Courts also often reject coverage for such penalties as a matter of public policy.<sup>58</sup>

### **Faulty Workmanship**

Most professional liability policies exclude coverage for losses involving faulty workmanship, including the cost to repair or replace faulty workmanship in any construction, erection, fabrication, installation, assembly, manufacture, or remediation performed by the insured, including any materials, parts, or equipment furnished in connection with it. Similar exclusions are found in other types of insurance as well, such as builders risk and CGL policies (subject to exceptions for resultant damages that are often disputed).

In the professional liability context, the faulty workmanship exclusion may have limited application in the traditional delivery system for the reason that most design professionals (architects and engineers) do not usually perform the work described within the exclusion, for example, construction, erection, or fabrication. Those professionals performing “construction management” services may be more likely to be engaging in such tasks.

### **Delay Costs**

Some professional liability policies also exclude losses, or portions of losses, from project delays resulting from professional negligence. One sample policy exclusion provides that the insurance does not apply to a claim

arising out of the failure to perform any professional services on time, complete any project on time or any other delay. This exclusion does not apply if your delay or failure is a direct result of a wrongful act in the preparation of drawings and specifications;<sup>59</sup>

Coverage for delay costs is a significant issue when evaluating coverage under a professional liability policy, as these costs are often substantial and can exceed the cost to repair or replace the physical damage related to the design error. Moreover, the inclusion of a delay exclusion greatly undermines one of the most beneficial aspects of the professional liability policy, which is to cover losses other than property damage and bodily injury. Note that the illustrative exclusion above contains an exception to the exclusion, preserving coverage for delay where the delay arises out of defects in plans and specifications. Nevertheless, the value of a policy that contains even this particular exclusion may be less than one that does not exclude delay damages at all.

### **Insured v. Insured**

The commonly included “insured v. insured” exclusion bars defense and indemnity coverage for an insured that has been sued by a party covered under the same professional liability policy. A typical exclusion states, “We will not cover You for any liability that arises from a claim against you by any other insured under this policy.”<sup>60</sup> The exclusion serves as a disincentive for having multiple project participants covered under the same professional liability policy.

To illustrate, if a construction manager sought indemnity against a project architect, and both parties were covered under the same professional liability policy, any recovery against the architect would likely be limited to the architect's own available funds because the insurer would disclaim coverage pursuant to the insured v. insured exclusion. Sometimes it is possible to negotiate exceptions to the exclusion so that, for example, the policy will respond to a claim by the owner against the architect, engineer, or construction manager notwithstanding that the owner is also an “insured” under the policy.

Sharing policy coverage with another project member may call for a cost-benefit assessment regarding the value of the insurance protection received, on the one hand, and the loss of a proverbial “deep pocket” in cases brought against a co-insured, on the other hand. The dilemma may be circumvented by obtaining a policy that does not contain an insured v. insured exclusion or instead contains a specific carve-out for instances where the claim by one

insured against the other involves contribution or indemnity, such as the following provision:

This exclusion shall not apply to any claim brought or maintained by any insured person in the form of a cross-claim or third-party claim for contribution or indemnity, which is part of, and results directly from, a Claim that is covered by this Policy.<sup>61</sup>

### **Pollution**

Pollution exclusions are often broadly worded and have been held by some courts to exclude coverage for losses that are not normally thought of as involving pollution. A typical exclusion may read:

This insurance does not apply to any damages, claim or suit arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants."...

"Pollutants" mean any solid, liquid, gaseous, fuel, lubricant, thermal, acoustic, electrical, or magnetic irritant or contaminant, including but not limited to smoke, vapor, soot, fumes, fibers, radiation, acid, alkalis, petroleum, chemicals, or "waste." "Waste" includes medical waste, biological infectants, and all other materials to be disposed of, recycled, stored, reconditioned or reclaimed.<sup>62</sup>

This language is often referred to as an absolute pollution exclusion. While some courts have limited these exclusions to losses involving "traditional pollution," such as hazardous waste,<sup>63</sup> other jurisdictions have applied them to a wider array of circumstances. For example, in *Deni Associates of Florida v. State Farm Fire & Casualty Insurance Co.*, the Florida Supreme Court applied an expansive interpretation of the pollution exclusion, holding that damage from an accidental ammonia spill at a two-story commercial building was excluded under the clear and unambiguous terms of the exclusion.<sup>64</sup>

The work of design professionals might be viewed as having limited exposure to pollution-related losses. However, it would be a mistake to overlook the potential impact of this exclusion. For example, an improper design of a building's ventilation system or errors associated with heating/cooling ducts that lead to the spread of noxious fumes could be considered by some courts to involve pollution.<sup>65</sup> Moreover, design professionals performing work related to factory construction and those serving as environmental project specialists may have especially heightened risks to pollution-related exposure.

At the same time, there are pollution liability insurance products available in the market to address general pollution-related losses. However, many of these policies exclude pollution associated with "professional services" unless specifically included by a policy endorsement. Professional liability policies that cover pollution are available as well and they should be given due consideration in appropriate circumstances.

*Other Insurance Products That Address Construction-  
Related Design/Engineering Risks*

In light of the fact that loss exposure for design and engineering errors is not limited to project architects and engineers, and for the added reason that the coverage afforded under an A/E policy is often inadequate to compensate other project members for their losses (due to low policy limits that are eroded by defense costs), the insurance market has responded with specific professional liability products that are designed to cover owners, construction managers, and contractors. Owners, for example, can purchase an owners protective professional insurance (OPPI) policy affording greater coverage for first-party and vicarious liability losses related to design exposures. Similarly, general contractors have the option to acquire a contractor's protective professional insurance (CPPI) policy, also insuring the risk of vicarious liability and further protecting against losses from their own direct professional liability. Entities serving in the roles of construction managers likewise have the ability to procure similar policies. Lastly, builders risk coverage may, in some cases, be a viable alternative in limited cases where the loss does not involve faulty design that is usually excluded. Each of these products is discussed more fully next.

**Owners Protective Professional Liability and Indemnity Policies**

An owner's exposure to losses associated with professional negligence can be considerable. This exposure involves both first-party losses as the possessor of the damaged property and third-party losses for liability to others, such as those injured by the errors or omissions of architects or engineers, including adjacent landowners that sustain property damage from the ill-performed professional work. While owners usually have indemnity rights against their architects and engineers, this indemnity may not be sufficient to cover the associated losses because the indemnity provided by the architects and engineers may be capped at the amount of its contract price for the work performed or may preclude consequential losses.

Furthermore, the insurance coverage procured under an A/E policy often provides only a minimum amount of coverage. In many markets, professionals can secure only \$1 million in coverage, and that limit covers both defense costs and indemnity costs.

To protect against the risk associated with inadequate coverage acquired by the professional service provider, an owner can acquire an OPPI. The OPPI works in a manner that is similar to underinsured motorists coverage. The policy obligates the owner to pursue recovery against the professional service provider for the loss incurred or otherwise exhaust the design professional's insurance as a precondition to coverage. Assuming the owner is not fully compensated by recourse to the A/E policy, the OPPI policy steps in and covers the shortfall. The following OPPI insuring agreement is an example of the coverage available:

The Insurer shall indemnify the Named Insured for Damages or a settlement to which the Insurer agrees, in excess of the Design Professional's Insurance, subject to the Limit of Liability designated in the Declarations, provided that:

1. the Claim for such Damages is made and reported in writing by the Named Insured to the Insurer during the Policy Period or Extended Reporting Period; and
2. the Professional Services from which the Claim arises were performed by a Design Professional or Construction Entity for the Specified Project noted in the Declarations on or after the Retroactive Date and completed before the expiration of the Policy Period; and
3. prior to the effective date of this policy the Named Insured had no knowledge of circumstances which could give rise to a Claim as covered herein.<sup>66</sup>

The particular project delivery system used on the project (i.e., the particular method under which the construction project is organized and controlled; for example, the traditional design-bid-build method or the increasingly utilized design-build method) will necessarily affect the scope or amount of professional liability insurance that may be needed by the various project members. Thus, when the traditional design-bid-build method is utilized, and a construction manager at risk is not retained, the owner may have a greater need for OPPI coverage with substantial policy limits than when a construction manager at risk is hired, or a design-build method is in place, as much of its exposure is limited to difference in condition losses for which it can seek indemnity from the general contractor. In such case, the construction manager at risk may obtain a construction management professional liability policy that provides more comprehensive coverage than a policy that a construction manager advisor would procure.

### **Contractor's Protective Professional Liability Insurance Policy**

Just as owners have the ability to obtain OPPI coverage to mitigate their risk exposure, contractors have the option to obtain CPPI policies. The CPPI works in very much the same way as an OPPI with regard to the contractor's vicarious liability for the professional service provider's work. Insofar as the contractor has limited recovery against the professional due to indemnity restrictions or insufficient A/E policy limits, the CPPI insures the contractor for losses above what it can recover from the professional or its A/E policy. The following CPPI coverage grant highlights the insuring requirements:

We shall indemnify you for "Loss" in excess of the "Design Professional's Insurance," subject to the provisions of the Self Insured Retention and Limit of Liability designated in Items 4 and 2 of the Declarations, respectively, provided that:

1. a "Protective Indemnity Claim" is first made by you against the "Design Professional" under contract to you and reported in writing by you to us during the "Policy Period" or if exercised, the Optional Extended Reporting Period;
2. such "Protective Indemnity Claim" arises out of a negligent act error or omission of the "Design Professional" in the rendering of or failure to render "Professional Services," and the act, error or omission took place on or after the "Retroactive Date" specified in the Declarations ...

In addition, a CPPI further provides the contractor with protection associated with its direct liability for any self-performed professional services. For example:

We will pay on behalf of the "Insured" all sums in excess of the applicable Self Insured Retention noted in Item 4 of the Declarations that the "Insured" is legally obligated to pay as "Damages" because of a "Professional Liability Claim" first made against the "Insured" during the "Policy Period" and reported to us during the "Policy Period," the Automatic Extended Reporting Period or the Optional Extended Reporting Period if applicable, provided that:

1. the "Professional Liability Claim" arises out of an actual or alleged negligent act, error or omission with respect to the rendering of or failure to render "Professional Services" by the "Insured" or any entity for which the "Insured" is legally responsible....

A general contractor's need for CPPI insurance is also reflective of the particular project method that is applied. A greater need for CPPI insurance exists under a design-build project than under a design-bid-build project.

### **Builders Risk Insurance**

A builders risk policy is designed to protect the project owner, general contractor, and subcontractors from risks of direct damage to the work that occurs during the period of construction up to the time that the completed work is accepted by the owner. Unlike a professional liability policy or CGL policy, builders risk insurance is first-party insurance; therefore, it will not afford protection from liability claims brought by those injured due to professional negligence. It will cover, however, losses from property damage to the project itself. The particulars of builders risk insurance are more fully discussed in chapter 8, but it is worthy of mention in this chapter because it may provide a more attractive avenue of compensation for claims involving property damage due to policy limits that are usually higher than those provided under professional liability policies.

### Conclusion

The professional liability policy is an important insurance product to mitigate losses associated with the design, engineering, and management aspects of construction. Low and eroding limits, limited “claims made” time limitations, and lack of coverage for “additional insureds,” however, can often lead to inadequate coverage for design-related losses that may occur on a project. Since the primary value of this coverage often arises from the breadth of acts that can trigger it and its coverage for economic or consequential losses that may not be covered by other forms of insurance, sensible owners and design professionals should ensure that the best professional liability policies are in place for the duration of the construction project (and beyond). A sound insurance program, however, also should include other forms of insurance discussed above to cover risk of loss from design engineering and management-related issues.

Moreover/ coverage under all policies depends on analysis of the cause or causes of the loss and the nature of the damage suffered. For these reasons, it is important to analyze losses carefully when they occur.

Professional liability insurance must not be viewed in a vacuum. Instead, it must be thought of as a key element within a spectrum of mechanisms that may be utilized to protect or minimize risk to the owner, general contractor, subcontractors, and design professionals from injuries related to the design and other aspects of a project.

### Notes

1. There are many forms of professional liability insurance that cover losses pertaining to various specialized or highly skilled disciplines. Some examples include medicine, law, and architecture. This chapter focuses upon design-related professional liability as it applies to the construction industry.

2. The background of a construction manager may be from either the design/ engineering practice or the construction practice. Notably, those entities solely acting as construction managers almost always do not perform any of the "hands-on" work that is associated with the construction project. Therefore, the construction manager neither prepares a sketch nor picks up a hammer on the project. Its primary role is to advise and direct. However, the exact scope of the construction manager's role and responsibilities varies depending upon whether the construction manager only contracts with the owner on a consultation basis (a construction manager advisor) or instead is further responsible for hiring and entering into contracts with the general contractors and subcontractors, thus guaranteeing project deadlines and budgets (a construction manager at risk). *See infra* note 52. In general terms, a construction manager is analogous to a chief of staff, advising and answering to a president (owner) and conveying the president's (owner's) directives, or rendering the directives itself, to those on the field (the general contractor and subcontractors).

3. In general, there are two forms of construction managers that may serve on a construction project: (1) a construction manager advisor (agency construction manager) and (2) a construction manager at risk. A construction manager advisor serves in a consulting capacity to the owner and can provide oversight management services, which

can invoke professional liability. A construction manager at risk not only provides the consulting and oversight services, but further contracts with the project's general contractor, subcontractors, and design team. It thus can be subject to vicarious liability for any deficiencies associated with the design and construction of the project.

4. ACE Advantage specimen professional liability policy for design professionals, PF-14373a (Nov. 2006).

5. 157 NW.2d 870,872 (Neb. 1968) (citations omitted).

6. 912 F.2d 1520 (D.C. Cir. 1990).

7. 912 F.2d at 1525.

8. *See, e.g.,* Reliance Nat'l Ins. Co. v. Sears, Roebuck & Co., 792 N.E.2d 145, 148 (Mass. App. Ct. 2003) (“Billing for [professional] services does not draw on special learning acquired through rigorous intellectual training.... The billing function is largely ministerial. There are elements of experience and judgment in billing for [professional] services, but the same goes for pricing shoes”).

9. In a related context, an Illinois court found that improper billing was a professional service under a healthcare professional liability policy. *See* Hartford Fire Ins. Co. v. Whitehall Convalescent and Nursing Home, Inc., 748 N.E.2d 674 (Ill. App.3d. 2001). *See also* Beatty v. Doctors' Co., 871 N.E.2d 138 (Ill. App. 2007) (affirming an arbitrator's determination that the plaintiff's alleged improper billing of Medicare and Medicaid involved professional services and thus entitled plaintiff to a defense under the professional liability policy issued by the defendant).

10. 830 P. 2d 785 (Alaska 1992).

11. *Id.* at 787-88.

12. 302 F.3d 499 (5th Cir. 2002).

13. *Id.* at 507.

14. 262 A.D.2d 64 (N.Y. App. 1999).

15. *Id.* at 65.

16. 2010 U.S. Dist. LEXIS 85467 (S.D.NY. June 30, 2010).

17. *Id.*

18. 302 A.2d 177 (N.J. Super. 1973).

19. 626 S.W.2d 99 (Tex. App.-Beaumont 1981, writ ref'd n.r.e.).

20. *Id.*

21. *Med. Records Assocs. v. Am. Empire Surplus Lines Ins. Co.*, 142 F.3d 512, 515 (1<sup>st</sup> Cir. 1998).

22. Ironshore Specimen Architects and Engineers Professional Liability Policy, AEL-10003-POL (Apr. 2010).

23. InsPro Corp. 2004, Specimen Architects and Engineers Professional Liability Insurance Policy.

24. Zurich-Contractors Protective Professional Indemnity and Liability Insurance, STF-CCP-I00-B CW.

25. Travelers Design Professional Liability Policy, DPL-1001 (ed. Nov. 2008).

26. CNA Contractors Professional Liability and Pollution Incident Liability Policy, G-130914-C (ed. Jan. 2005) (emphasis added).

27. *Id.*

28. *Maher & Williams v. Ace Am. Ins. Co.*, No. 3:08cv1191 (JBA), 2010 WL 3546234, at \*2 (D. Conn. Sept. 3, 2010) (definition of “wrongful act” contained in an ACE professional liability policy).

29. “Wrongful act” also may be defined broadly as “including but not limited to” certain specific acts. *See Maher & Williams*, 2010 WL 3546234, at \*2.

30. *Miller v. Cont'l Cas. Co.*, 2006 Phila. Ct. Com. Pl. LEXIS 519 (Pa. C.P. 2006).

31. *McKee v. Pleasanton*, 750 P.2d 1007 (Kan. 1988).

32. The burden of proof regarding the existence of coverage, and thus the obligation to retain the expert, belongs to the policyholder, as it must establish that its claim falls within the ambit of coverage. In comparison, the insurance company bears the burden to prove that the loss involved professional negligence in order to apply a professional services exclusion in a CGL policy. *See, e.g.,* *Utica Nat'l Ins. Co. v. Am. Indem. Co.*, 141 S.W.3d 198, 204 (Tex. 2004) (“[B]ecause Utica's policy treats the professional services exclusion as an exception to coverage, Utica bears the burden of proof to establish that the exclusion applies in this case.”).

33. Some professional liability policies contain an exclusion for delay damages. *See* “Delay Costs,” *infra* Chapter 12.

34. Ala. Bldg. Comm'n, Standard Articles of the Agreement between Owner and Architects.

35. Draft Liberty Mutual Architects and Engineers Professional Liability Policy.

36. The professional liability policy may also specifically exclude losses associated with breach of contract, unless the conduct in question exposes the professional to noncontractual liability.

37. 61 F.3d 742 (9th Cir. 1995).

38. *Id.* at 746.

39. Other notice provisions require the insured to inform the insurer “immediately” or “promptly” or “within a reasonable time.” These inexact terms allow for a certain degree of subjectivity as to when notice must be given to the insurer. One court has described these terms as “roomy words” meaning “a reasonable time under all the circumstances.” *See* *Young v. Travelers Ins. Co.*, 119 F.2d 877 (5th Cir. 1941).

40. If, for example, a loss involving professional liability occurred during the policy period and a claim was brought against the insured on the very last day of the policy period, the insured would have to provide notice to the insurer on that very same day under a “claims made and reported” policy. However, under the same set of facts, an insurer has extra time to report the claim under a traditional “claims-made” policy as it is confined to reporting the claim within the period of coverage so long as the amount of time that lapsed between the date of the claim and the date of notice is reasonable. Note, however, that some jurisdictions preclude an insurer from denying coverage under a “claims made and reported” policy in cases such as that described above because they find it to be contrary to public policy of the particular jurisdictions to deny coverage when the insured does not have a reasonable amount of time to report the loss. *See* *Root v. Am. Equity Spec. Ins. Co.*, 30 Cal. Rptr. 3d 631, 647 (Ct. App. 2005) (excusing a professional liability policy's “claims made and reported” requirement on public policy grounds where a suit was filed days before a policy period ended but the insured was not served with the suit until after the policy period ended, and therefore could not notify its insurer until after the policy period ended).

41. Retroactive periods and extended claims or reported periods are often included in professional liability policies. Tail coverage and nose coverage, as these extensions are sometimes called, can also be purchased separately. However, when purchased as a separate product, these forms of insurance can be expensive to acquire.

42. For a more detailed discussion of the concepts of “occurrence” and “trigger,” see chapter 3.

43. Sol Kroll, *The Professional Liability Policy “Claims Made,”* 13 FORUM 842, 843 (1978)

44. A “third-party” policy affords coverage for losses that concern liability that the insured owes to someone else. In comparison, a “first-party” policy affords coverage for losses directly sustained by the insured. To illustrate, if a building were to burn down, a first-party policy will cover the insured for the loss of its building. In comparison, if the owner of the building negligently caused the fire, and a bystander was injured, a third-party policy will insure the owner for its liability to the bystander.

45. *See, e.g.*, Fed. Ins. Co. v. Kozlowski, 792 N.Y.S.2d 397, 404, 18 A.D.3d 33, 42 (N.Y. App. 2005).

46. *See* Millers Mut. Ins. Ass'n v. Shell Oil Co., 959 S.W.2d 864, 871 (Mo. Ct. App. 1997) (“An insurer has a duty to defend claims falling within the ambit of the policy even if it may not ultimately be obligated to indemnify the insured...Upon exhaustion of the indemnity limits, however, the insurer cannot ultimately be obligated to indemnify the insured...Based on the unambiguous policy, when the insurer has no potential obligation to indemnify it has no duty to defend.”).

47. *See* Atl. City Assocs. LLC v. Carter & Burgess Consultants, Inc., No. 05-3227 (NLH), 2008 U.S. Dist. Lexis 93684, at \*11-12 (DN.J. Nov. 13, 2008) (where contract for architectural services contained both an indemnification provision and a waiver of consequential damages provision, the architect's indemnification obligation to owner was limited to direct, and not consequential, damages).

48. ISO Form CG 22 79 07 98.

49. It is possible for a party to acquire a professional liability policy with greater insurance protection, such as higher limits, and defense costs outside of policy limits; however, a professional liability with such features would be expensive to purchase.

50. InsProCorp. 2004, Specimen Architects and Engineers Professional Liability Insurance Policy.

51. Bonin v. Westport Ins. Corp, 930 So. 2d 906, 916 (La. 2006) (where a professional liability policy's intentional acts exclusion contained an adjudication requirement, the court held that the adjudication did not have to occur in an underlying suit against the insured; rather, a judicial determination in the insurance coverage litigation that the insured acted in a dishonest way under the policy sufficed to exclude coverage).

52. *See, e.g.*, Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Cont'l Ill. Corp., 666 F. Supp. 1180, 1198 (N.D. Ill. 1987); *see also* Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Brown, 787 F. Supp. 1424, 1429 (S.D. Fla. 1991) (willful acts exclusion did not apply absent a final adjudication in the underlying case), *aff'd without opinion*, 963 F.2d 385 (11th Cir. 1992).

53. *See id.*

54. 214 Cal. Rptr. 567 (Cal. App. 1985).

55. *Id.* at 570-71.

56. CNA Policy GSL 8650XX (ed. Mar. 2010).

57. *See, e.g.*, Cont'l Cas. Co. v. Donald T. Bertucci, Ltd, 926 N.E.2d 833, 842 (Ill. App. Ct. 1st Dist. 2010) (“the lawsuit is a fee dispute and does not allege 'damages' within the meaning of the policy”).

58. *See* Republic W. Ins. Co. v. Spierer, Woodward, Willens, Denis & Furstman, 68 F.3d 347, 352 (9th Cir. 1995) (“The rule [is] that insurable damages do not include costs incurred in disgorging money that has been wrongfully acquired”) (internal citation omitted); Perl v. St. Paul Fire & Marine Ins. Co., 345 N.W.2d 209, 215-16 (Minn. 1984) (“insurance coverage which purports to cover a fee forfeiture by [a professional] for his or her own breach of a fiduciary duty, such as the one here, should not be enforceable as a matter of public policy”).

59. CNA Contractors Professional Liability Policy, G-115692-D 1.

60. Specimen Architects and Engineers Professional Liability Policy, Ins. Pro. Corp. 2004.

61. Specimen ACE Advantage Professional Liability Policy for Design Professionals.

62. *See* James River Ins. Co. v. Ground Down Eng'g, Inc., 2007 U.S. Dist. LEXIS 43203 (M.D. Fla. June 14, 2007) (interpreting a pollution exclusion under an architects and

engineers professional liability policy), *vacated by* James River Ins. Co. v. Ground Down Eng'g, Inc., 540 F.3d 1270 (11th Cir. 2008).

63. *See, e.g.*, Belt Painting Corp. v. TIG Ins. Co., 795 N.E.2d 15, 20-21 (2003) (illness from paint fumes not excluded by the absolute pollution exclusion as not involving a release of pollutants).

64. 711 So. 2d 1135 (Fla. 1998).

65. *See, e.g.*, Bernhardt v. Hartford Fire Ins. Co., 648 A.2d 1047, 1052 (Md. Ct. App. 1994) (carbon monoxide emitted from a defective furnace was a pollutant and therefore a pollution exclusion precluded coverage).

66. Catlin OPPI Coverage Form.

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