PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

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The "Obligation to Defend" Your Client: Why You Shouldn't Agree

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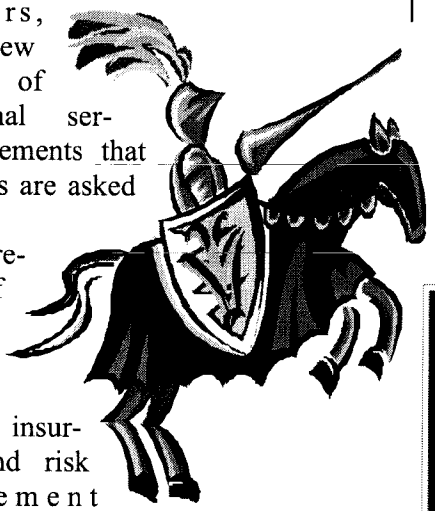
As insurance brokers specializing in professional liability for architects and engineers, we review hundreds of professional service agreements that our clients are asked to sign.



Our review of these documents is from an insurability and risk management standpoint only. In other words, we review the contract to determine if our clients are entering into agreements which could possibly be uninsurable, or for which other risk management techniques are available to lower risk.

One of the most common changes we request is that the word "defend" be stricken from an indemnity agreement. Many design professionals' clients (usually owners) don't understand this, since the contractors they do business with don't have a problem with it.

The main problem is that the contractual liability coverage provided under a commercial general liability policy typically carried by a contractor is broad, while the contractual coverage provided under an architect/engineer's professional liability policy is limited. Whereas

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the contractual coverage under the commercial general liability policy allows the contractor to assume the liability of the client, and provides coverage for defense, the professional liability policy does not.

The purpose of a professional liability policy is to indemnify the owner for a design professional's errors or omissions. However, the indemnification must take place *AFTER* the negligence of the design professional has been established, not before.

It should be noted that if the design professional's clients defend themselves, and ultimately it is determined that the design professional was at fault, then the design professional's professional liability policy would indemnify the clients for the costs that they incurred to defend themselves (not to mention any indemnity or judgment). What it will ***not*** provide, however, is the defense "up front," before liability is determined.

One of the leading authorities on professional liability is Grant Weaver of RA&MCO Insurance Services. To quote Mr. Weaver, *"We generally cannot accept any tender of defense by our policyholder's indemnitee, regardless of what may be required contractually."*

Mr. Weaver points out that *"our coverage contemplates only insuring (and defending) the interests of our insureds as to the competence of their professional services according to having met or failed to meet the professional standard of care — that is, the risk insured, as reflected and expressed in our filed rates and rules, with respective regulatory bodies. We do not insure them [design professionals] against purely 'business' undertakings or risks or exigencies contractually agreed for business or marketing concerns...."*

In addition to this, there are inevitably going to be actual or prospective conflicts between the interests of an insured design professional and its client, the indemnitee. This could require the design professional and its insurer to provide a separate defense for the design professional's client.

If the design professional has to provide a separate defense for its own client, the design professional would be paying the client to, in all likelihood, build a case against the design professional. This would put the insurance company in the odd position of funding a separate defense to trigger coverage under its own policy. This payment of defense would reduce the limits available to pay any claims to begin with, not to mention that the insured design professional's deductible would be called into play. Needless to say, this is not a preferred situation.

Mr. Weaver goes on to add, *"In my opinion and experience, no responsible insurer can accept a tender of defense imposed by an insured's contractual obligations* per se. *Occasionally, an insurer may defend another party in conjunction with its insured when it is in the best interests of the insured to do so, there is absolutely no conflict of interest between their insured and the other party, and when therefore both parties can be defended jointly by agreement by the same legal counsel, but that is a careful, case-by-case determination."*

Mr. Weaver concludes by stating, *"Any party that incurs expense or pays damages because of its vicarious liability to others from the services of an insured is entitled to be indemnified to the extent such was caused by an insured, and an insurer will expect to pay this as a measure of third-party damages on its insured's behalf. The problem, per the above, is the affirmative contractual obligation to 'defend,' which is a wholly different matter from the obligation to 'indemnify.'"*

In summary, it is generally acceptable and insurable for a design professional to agree to hold harmless and ***indemnify*** a third party for the consequences of its own negligence. The contractual obligation to "***defend***," however, can create an uninsurable and, in most cases, an unacceptable position for the design professional. ✳