



Professional Liability Insurance Concerns for Structural Engineers

By David J. Hatem, P.C., Donna Hunt, Esq., AIA and Sue E. Yoakum, Esq., AIA

Professional Liability Insurance is the fundamental strategy structural engineers utilize to transfer and mitigate their greatest risk. The primary insurance risk for structural engineers is their exposure to professional liability claims. Such claims typically fall under an engineer's errors and omissions or "E&O" insurance coverage. Most professional liability claims against engineers allege negligence, but breach of contract claims are also common. Breach of contract and negligence claims are frequently deeply intertwined. A generic example would be a claim or suit for breach of contract for the failure of a structural element where the purported contractual breach is the engineer's deficient load calculations. The liability analysis in such a circumstance would still predominantly be a negligence analysis. As a practical matter, lawsuits often raise both breach of contract and negligence in order to "cover all bases."

In legal-speak, negligence is a tort, or a civil wrong. Payment under a professional liability policy under a negligent performance theory against an engineer in the performance of professional service is thus linked to the legal elements of a tort. To prove negligence, a claimant or plaintiff must establish four elements: (1) the engineer had a *duty* to perform relevant professional services, (2) the engineer *breached* that duty, (3) the engineer's breach is the *cause* of the claimed damages, and (4) the claimant suffered those *damages*. If a claimant fails to establish each of these four elements of negligence, the claim should ultimately fail.

Weak or missing elements of negligence are factored into a defense attorney's evaluation of a claim, and may dictate how a matter is defended. Claims and cases which have missing or questionable elements may still settle due to the high cost of litigating a matter, but it is generally the missing elements which permit them to be settled at a very low nuisance value level. Strong negligence cases, those containing credible proof of each element of negligence against an engineer, are more challenging to defend. This variety of cases can only be defended successfully when the engineer, his attorney,

and the engineer's professional liability carrier work as a team in confronting the claim or litigation.

Professional liability insurance policies typically define "professional services" as those services that the insured is legally qualified to perform for others in their licensed capacity as an architect, engineer, land surveyor, landscape architect, or construction manager. In some instances, additional, non-traditional services may be covered by a professional liability policy if the additional service is specifically included in a specialized endorsement (addition) to the insurance policy. Professional services are frequently defined in insurance policies and in statutory language as those services for which special training, education, or licensing is required. Selected examples of types of professional services include: design; preparation of reports and studies; observation of contractor's performance and resident engineering services; review and evaluation of contractor's shop drawings and other submittals, change order proposals, value engineering proposals; recommendations regarding rejection of contractor's work and/or acceptance of work; and, forensic engineering/expert services.

It is customary for owners to require engineers to carry a certain amount of professional liability insurance as a negotiated term of a project's contract. An owner can require professional liability insurance in the form of coverage under the engineers' general practice policy. This is the typical E&O policy which is maintained in the engineer's ordinary course of business. In addition, depending on the scope and nature of the project, an owner may elect to purchase or require the purchase of a project specific professional liability insurance policy covering the design team involved in the particular project. In a rare example of the insurance industry being simple and direct, this type of professional liability insurance is frequently referred to as "a project policy."

The project policy concept has been around for decades, but is applicable to only a small percentage of construction. The most common way to insure a design

professional against negligence claims is the conventional E&O practice policy. The practice policy usually supplies coverage for all of the engineering firm's projects. Most firms carry \$1–\$2 million in professional liability coverage. Some engineers who work on larger scale projects will carry larger limits.

Engineers should review their level of coverage with their brokers frequently. The undertaking of new work should be discussed with the broker to make certain that adequate coverage is always available. Engineers should also seek value from their brokers in selecting a policy. In some instances, a professional liability carrier will provide its clientele with additional services, such as contract review and risk management advice, at no additional charge. Engineers should not hesitate to have their broker's research carriers who provide this valuable assistance.

An owner of a large project or megaproject will often require project specific professional liability insurance. This dedicated insurance for a particular project could provide coverage in the range of \$10 to \$50 million. Policies of this type often require a deductible or self insured retention (SIR), in a greater than usual amount. Amounts of \$250,000 to \$2 million are not uncommon, depending on the size of the given project.

Some project policies serve as the primary professional coverage for the engineer for the project. The engineer's own practice policy may sit in excess or on top of the project specific professional policy in an umbrella coverage capacity. The details of how this works depends on each engineering firm's practice policy and the particular insurance company providing the practice policy. Projects which require a project policy require additional consultation on coverage with an engineering firm's broker. Legal advice should also be sought on all contracts which require insurance coverage greater than a company's typical practice policy.

While project policies are an innovative and often necessary insurance product, they are not without their potential pitfalls. There are three common problems associated with project policies from an insured's perspective. While these are not always unmanageable,

they can present challenges to an insured if it is not properly educated on the project policy's terms, and the financial or other obligations imposed upon the insured as a condition of the project policy coverage. These typical problems are; 1) very high deductible or SIR obligations, 2) limited coverage for architect and engineer sub-consultants on Design-Build Projects, and 3) professional protective insurance policies.

As noted above, project policy deductibles and SIRs tend to be much higher than a practice policy deductible. This could be a trap for the unwary if an engineering firm is not mindful that it must contribute \$250,000 or more in order to get to the point where the policy's coverage "kicks in." If an engineering firm is unable to meet this financial burden, the protective coverage of the project policy might not come into play. In situations where a project policy is purchased by an owner, higher deductibles and SIR obligations are often selected in order to reduce the owner's cost of the project policy. Some project policies are written with a \$5 Million or \$10 Million per claim SIR. Clearly, such a policy with absurdly high SIR are of no comfort to the designer.

Some project owners may attempt to mitigate the significant per claim SIR funding obligations of the engineer by agreeing to pay all or a significant portion of the SIR obligations. If that is the case, that specific obligation of the owner must be set forth clearly and concisely in the Project's contract documents. Engineers should note that even if this term appears in a contract with a public entity, the term may be interpreted by a Court as a conflict of interest or be otherwise unenforceable. Such a term might also create accountability or ethics concerns for public owners. A public owner's agreement to pay an insured's SIR could also raise concerns with project overseers, regulators and grantors at both the state and federal levels.

In projects where there is a higher than usual deductible or SIR, engineers need to be very careful in establishing their fee for services. Risk and expenses associated with a high per claim deductible or SIR must be factored into the project's costs. Failure to consider this critical factor carefully or the failure to discuss the implications of a high deductible or SIR with the engineer's broker and attorney could create a situation where an engineer's insurance obligations on a project diminish or eliminate entirely the intended profit.

Another frequent concern with project policies arises in the Design-Build project context, and involves exclusion of coverage for claims by the Design-Builder against the Design-Builder's engineering sub-consultants. The exclusion of that coverage renders dysfunctional any joint defense between the Design-Builder and its engineer sub-consultants. This scenario may require the sub-consultant to attempt to obtain professional liability insurance coverage from their practice policy even if there is a project policy. If that does not occur, the Design-Builder may wind up being responsible for the negligent acts and omissions of its sub-consultants through vicarious liability. That is an unenviable position to be in on a project if you are a Design-Builder engineering firm, and there are owner based claims alleging errors and omissions of a sub-consultant engineer.

There may be professional liability risk for an engineering sub-consultant under its practice policy in addressing claims from the Design-Builder if that the sub-consultant is not eligible for coverage under the project policy. Another problematic scenario is that the sub-consultant engineer may have a deductible and SIR obligations under both a project policy and its own practice policy before any coverage comes into play. To further complicate things, some practice policy professional liability insurers have exclusions under their practice policies for claims against the engineering insured on projects in which a project policy is in effect. Because of these various potential problems, sub-consultant engineers should review their practice policy, and any applicable project policy thoroughly with their broker and legal counsel before entering into a sub-consultant agreement where a project policy is believed to be in effect.

Another issue involving practice policies has to do with the particular type of practice policy purchased. The procurement of an Owner Professional Protective Insurance Policy (OPPI) by the project owner, or Constructor Professional Protective Insurance (CPPI) by the contractor or Design-Builder, will have ramifications on coverage to an engineer working on the project. These policies initially provide coverage only to the procurer, either the project owner, constructor or Design-Builder, but not the engineer. Although not specifically excess in nature, coverage under these policies is triggered once the

underlying practice coverage limits of the engineer (or a defined sub-limit thereof) have been exhausted. The existence of these professional protective policies often is not disclosed to the engineer. The OPPI or CPPI insurer also may reserve rights to subrogate against the engineer.

Conclusion

The simple fact that a project owner may be supplying a project policy does not necessarily eliminate an engineer's professional liability insurance concerns on a project. In fact, as several situations discussed above illustrate, project policies can complicate an engineer's intended insurance coverage. Project policies are frequently an ideal insurance product for a specific situation. However, engineers must know and understand the terms and obligations of a project policy in order to determine whether it supplies an actual benefit. A project policy with a deductible or SIR so high that the engineer can never pay it, is of no practical value and could easily jeopardize the viability of the engineering firm in the event of a large claim. When it comes to obtaining and evaluating professional liability insurance, whether it is a practice policy or a project policy, an engineer's broker and his lawyer are his best resources. Engineers should seek the advice of these professionals, both before entering into contracts and immediately upon the presentation of a claim, in order to protect themselves and their businesses. ■

David J. Hatem, PC is the founding Partner of the multi-practice law firm Donovan Hatem LLP. He leads the firm's Professional Practice Group. He can be reached at dbatem@donovanhatem.com.

Donna Hunt, Esq., AIA is the Director of Claims/Risk Management Services at Lexington Insurance Company. In addition, Donna is responsible for the management of Lexington's Professional Lines Risk Management Programs, and is a licensed architect. She may be reached at donna.hunt@chartisinsurance.com.

Sue Yoakum, Esq., AIA is an attorney and a licensed architect at Donovan Hatem LLP. Ms. Yoakum focuses her practice assisting design professionals. She can be reached at syoakum@donovanhatem.com.