



# Understanding Professional Liability Insurance

Part 1

By Gail Kelley, P.E.

**L**ike most businesses, architecture and engineering (A/E) firms generally carry commercial general liability (CGL) insurance to cover their liability for injury or damage to others. Because CGL policies are written on a standard form developed by the Insurance Services Office (ISO), an insurance-industry trade association, the coverage provided by different insurers is fairly similar. While the standard CGL form does not exclude professional liability coverage, most insurers add an endorsement stating that the policy does not apply to injury caused by “the rendering or failure to render any professional service.” An A/E who wants coverage for professional liability must thus purchase a separate policy.

This is the first of a two-part article that presents a general overview of E&O policies, the professional liability policies that cover claims against A/Es. In contrast to CGL policies, there is no standard E&O insurance form, and the coverage available from different insurers varies considerably. In addition, because insurance is governed by state law, policies issued in certain states may have special exclusions or qualifications.

## Professional Liability Coverage

Under a professional liability policy, the insurer agrees to pay damages that the insured party is legally obligated to pay as the result of claims that are covered by the policy. The insurer also agrees to pay the expenses associated with defending against the claim. These are, respectively, the insurer’s duty to indemnify and duty to defend.

E&O policies will give the insurer the right to examine the insured’s books and records, as they relate to the professional liability coverage. If the insurer discovers any material risk, hazard, or condition that the insured did not disclose in its policy application, the insurer has the right to modify the policy, charge an additional premium, or void the policy. Similarly, the insurer has the right to void the policy if the insured submits a fraudulent claim.

## Definition of a Claim

Professional liability policies define a claim as a demand for money or services that alleges a

wrongful act, where a wrongful act is a negligent act or omission by an insured, or a person or entity that the insured is legally liable for. Although E&O policies invariably state that the wrongful act must occur in the performance of professional services, the term professional services is usually not well defined. For example, the policy may simply say that professional services means those services that the insured is legally qualified to perform for others in the practice of engineering, architecture, landscape architecture, surveying, or construction management.

Most E&O policy applications require the A/E to list and describe the services it provides. To minimize disputes over what is covered, the A/E should provide a detailed description of its practice areas and services. An A/E who is concerned about coverage of certain services can ask its broker to include an endorsement (amendment) stating the coverage limits for those services.

## Claims Made and Reported/Claims Made

Under the current ISO form for CGL insurance, policies are written on an “occurrence basis” which means that there is coverage for an injury or property damage that occurs during the policy period, regardless of when the claim is made. In contrast, professional liability policies are typically written as either “claims made and reported” or “claims made.” Under a claims made and reported policy, a claim is only covered if it is first made against the insured during the policy period and is reported to the insurer during the policy period, or any applicable extended reporting period. Under a claims made policy, a claim must be first made against the insured during the policy period. However, the policy usually only requires that the claim be reported to the insurer “within a reasonable time.”

Because of the additional reporting requirement, claims made and reported insurance is generally less expensive than claims made insurance. However, the reporting requirement means that coverage could be denied for a claim that was made against the insured during one policy period and not reported until the next policy period.

## Retroactive Date

One of the key elements of a professional liability policy is its retroactive (prior acts) date. Most professional liability policies are for a period of one year, but if the policy is a renewal, coverage for wrongful acts will typically be retroactive to the inception date of the first policy obtained from the insurer.

Claims arising from wrongful acts committed before the policy’s retroactive date are not covered, even if the claim is made during the policy period. Many policies also specify a “knowledge date” (typically the inception date of the policy). The policy may preclude coverage of any claim that the insured knew about prior to the knowledge date, even if the wrongful act was committed after the retroactive date.

If the insured changes insurers or allows its policy to lapse, the retroactive date of the new policy will normally be its inception date. However, most insurers allow the insured to purchase coverage for acts committed before the inception date of a new policy, provided the insured had comparable insurance from another carrier. This is often referred to as “nose coverage.” When changing insurers, the insured may want to purchase nose coverage such that the retroactive date of its new policy is the same as the retroactive date of its previous policy. Even with nose coverage, however, the new policy will not cover any claims the insured knew about at the inception of the new policy, as such claims should have been reported to the previous insurer.

## Step Rating

Each time a claims made or made and reported policy is renewed, the insurance carrier’s exposure increases because the retroactive period is a year longer. The rate tables for most insurance carriers reflect the increased exposure by “step rating” their policies; until a policy is full rated, the premiums increase yearly, even if the insured has not had any claims.

Rate tables vary, but most policies become fully rated within five to ten years of inception. At that point, changes in premium will reflect the claims history of the insured or the insurance carrier, changes in the insured’s practice areas or coverage limits, and changes in the general insurance environment.

## Coverage of Damages

Professional liability policies cover the insured's liability for awards, settlements, and monetary judgments, including interest. Although criminal fines, penalties, taxes, and matters that are uninsurable under the applicable state law are not covered, if the insured is legally liable for a tax, fine, or penalty assessed against a third party, it will generally be covered.

Some policies cover punitive damages, provided punitive damages are insurable under the applicable state law. (About a third of the states do not allow insurance to cover punitive damages as a matter of public policy.) Policies typically do not cover a reduction of fees because of a design error, unless the reduction is agreed to in advance by the insurer. Likewise, policies typically do not cover charges for services provided by the insured for redesign work.

## Limits of Liability

The limits of liability of a policy will be stated on the policy's declarations page. Most policies have a limit for each claim, as well as an aggregate limit for the policy period. The limits of liability are the most the insurer will pay, regardless of the number of insureds, the number of claims, or the number of individuals or entities making claims. When the limits of liability are exhausted, the insurer's obligation to defend and indemnify against claims made during that policy period is fulfilled.

## Multiple/Related Claims

Multiple claims arising out of a single act or omission, or a series of acts or omissions, are generally treated as a single claim for the purposes of coverage limits. Coverage applies only if the earliest claim was first made against the insured during the policy period.

## Deductibles

Most policies have a deductible for each claim; some also have an aggregate deductible. If there is an aggregate deductible, the insured is not liable for any more expense claims during the policy period once the aggregate deductible is reached. If there is no aggregate deductible, the insured is liable for expenses up to the deductible on each claim. Policies generally state that only reasonable and necessary claim expenses qualify in satisfaction of the deductible, and that the insurer will determine whether expenses incurred by the insured qualify. On most policies, the limits of liability apply as excess over the deductible.

## Notice

The insured is typically required to provide the insurer with written notice of a claim, but most policies allow e-mail and fax correspondence as well as regular mail.

## Potential Claims

Most policies state that if the insured becomes aware of circumstances that might lead to a claim, there will be coverage for a claim made after the end of the policy period, provided the insured gives notice of the potential claim before the end of the policy period. The notice must state the alleged wrongful act and implicated professional services, the specific nature and extent of the alleged injury or damage, and how the insured became aware of the potential claim.

## Extended Reporting Period

A claims made and reported policy will typically include an automatic extended reporting period (grace period) of 30 or 60 days for no additional premium. Coverage is provided for a claim reported to the insurer during this grace period, as long as the claim was first made against the insured during the policy period. If the policy is not renewed, the insured can

purchase an additional extended reporting period. This optional extended reporting period, often referred to as "tail coverage", is usually purchased in yearly increments, with the premium being a percentage of the policy premium.

The limits of liability applicable to the extended reporting periods will be the limits of liability remaining under the terminated policy. The right to give notice of a potential claim terminates at the end of the policy period, however; there is no right to give notice of a potential claim during an extended reporting period.

## Conclusion

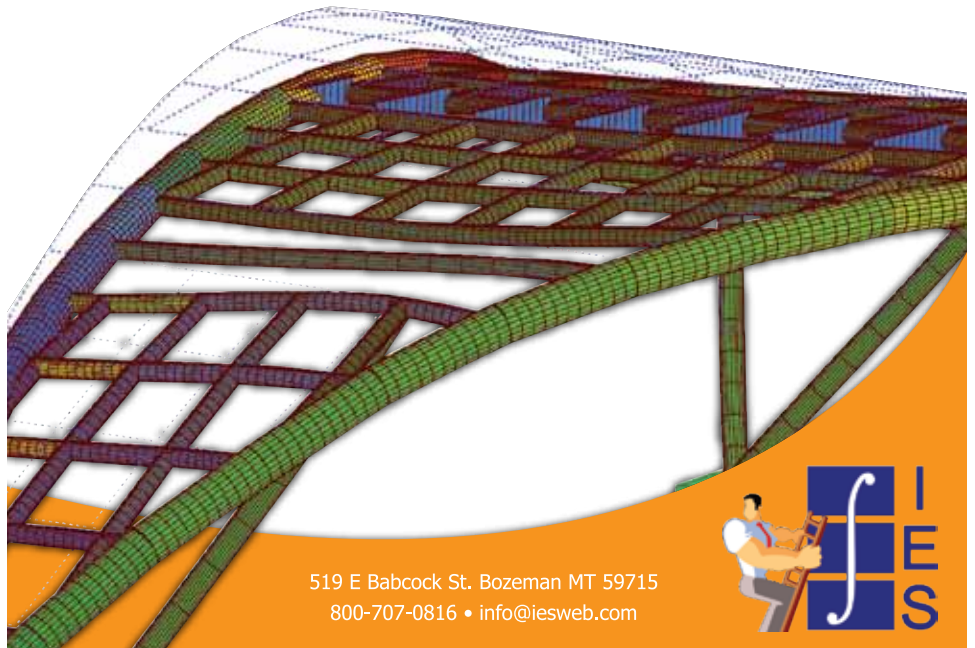
The first part of this two-part article has discussed general issues related to coverage of claims; the second part looks at the insurer's duty to defend and its right of subrogation as well as common exclusions to coverage. ■

*Gail S. Kelley, P.E. is a LEED Accredited Professional as well as a licensed attorney in Maryland and the District of Columbia. Ms. Kelley is the author of Construction Law: An Introduction for Engineers, Architect, and Contractors, published in 2012 by John Wiley & Sons.*

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