Contract Insurability Negotiation Guide

Presented by Lockton® Companies in conjunction with XL Catlin and Morris Polich & Purdy LLP

Your Showdown With The "Hateful Eight" Identifying and Negotiating The Top Eight Uninsurable Contract Clauses

The purpose of this reference guide is to help design professionals identify uninsurable contract clauses and to provide some talking points that can help design professionals negotiate more insurable agreements with their clients.

In this guide, we'll analyze eight commonly proposed uninsurable clauses. For each of these, we'll explain the coverage problem in simple terms and suggest alternative language that the client might accept (with the caveat that such language must be reviewed and approved by the design professional's lawyer).[1] And we'll review arguments that the client likely will make in support of its uninsurable contract language, and some talking points with which the design professional can respond.

We are not suggesting that these negotiations will be easy, or that design professionals will be able to negotiate all uninsurable risk out of their professional services contracts. But discussing insurability issues with clients—before signing their contracts—can enable both parties to win.

The truth is that insurability benefits design professional **and** client. If the design professional has no professional liability insurance coverage for its errors or omissions, the resulting financial liability may be well beyond the design professional's means, and, if so, the client who exacted the uninsurable contract terms from the design professional may turn out to have won a pyrrhic victory.

We hope that design professionals will use this guide and share it with their employees who have responsibility for client relationships and contracts so that they are well-prepared to negotiate insurable agreements. Indeed, we hope that design professionals will add to this guide, modify it, and personalize it, inserting new talking points and addressing additional uninsurable contract clauses that are proving troublesome.

[1]By suggesting this, the authors are not just engaging in the usual butt-covering. Many of these clauses must be worded in a certain way to be enforced in the applicable jurisdiction, and an experienced construction lawyer will able to advise the design professional about any "magic words" that need to be used.

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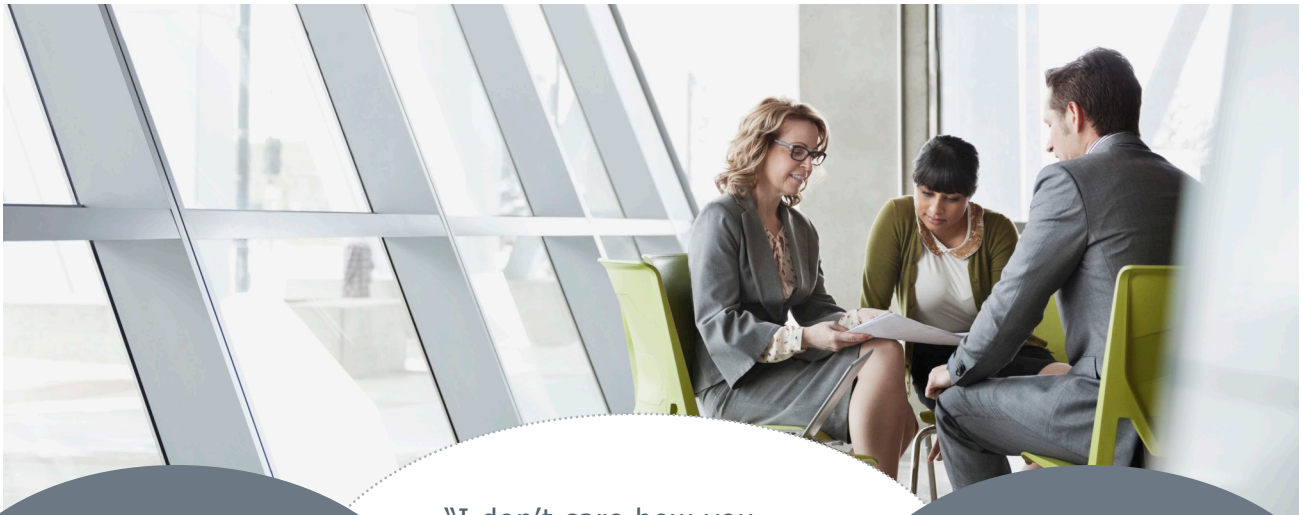
TALKING POINTS FOR THE "COMMON OBJECTIONS"

When design professionals object to contract terms on the basis of insurability, there are certain responses that they will hear, time and again. Here are a few of those "common objections" and some counter-arguments that design professionals can make.



"Someone else will sign this contract if you don't."

Another firm may be willing to sign that contract, even though many of the risks it represents are beyond that "someone's" control and are not covered by their professional liability insurance, either. But our firm wants to make sure that if there is a problem, and we need to make things right for our client, that we have the financial resources to do so in the form of professional liability insurance coverage.

"I don't care how you pay for your errors and omissions—whether or not something is covered by your professional liability insurance is your problem."

Our firm wants to make sure we have the financial resources to make it right for our clients in the unlikely event that our negligent performance causes damages. For us, professional liability insurance is the best way to offer them that security.

Your contract requires us to carry professional liability insurance with __ limits, for __ years after the project is complete. Unless our agreement is insurable, that promise is an empty promise. The coverage you contracted for won't help either of us if there's a claim.

"We're not interested in contracting with a design professional that doesn't stand behind its work."

We stand behind our work, and we want to make sure our professional liability insurance does, too.

PROBLEM #1: ELEVATED STANDARD OF CARE

Example of language your client might propose

"Design professional shall perform the services in accordance with the highest standard of care …"

What's the insurance problem?

Professional liability policies have a Contractual Liability exclusion that bars coverage for liability your firm assumes by contract unless your firm would have been liable in the absence of that contract.

Without the proposed language, you would simply owe your client a duty to perform your professional services as a reasonable, similarly situated design professional would do under similar circumstances.

The proposed language changes that standard—it essentially requires perfect performance. Insurers are not in the business of insuring against a sure thing. No project is perfect, and no design is perfect. An insurer who backs a promise of perfection is on a collision course with reality and financial ruin.

Example of language that you might propose as an alternative

"Design professional shall perform the services with the care and skill ordinarily used by members of the same profession practicing under similar circumstances at the same time and in the same locality."

Client arguments and talking points for the design professional

"I want my design professional to adhere to the highest standard of care."

- You don't need to put this extreme language in the contract to give our firm an incentive to perform well. We want to make our clients happy and maintain the excellent reputation that our firm enjoys in the marketplace.
- All that putting this language in the contract will do is create a coverage problem in the unlikely event that you make a professional liability claim against our firm. If our negligent performance causes you damages, we will want to make that situation right as soon as possible. But disputed professional liability coverage will delay and hamper settlement. Neither one of us wants that.

"Why don't you just go and buy better coverage?"

- Professional liability insurers are not willing to provide coverage for promises of perfect performance. They know, as we do, that no project is "perfect" and they refuse to insure promises that they know their insureds can't keep.

PROBLEM #2: INDEMNITY WITH DUTY TO DEFEND

Example of language your client might propose

"Design Professional shall defend, indemnify, and hold harmless Owner, its officers, directors and employees from and against any and all claims, damages, causes of action, or allegations in any way arising out of or relating to Design Professional's work on the project."

What's the insurance problem?

Professional liability policies only provide coverage (including a legal defense) for the negligence of the insured design professional. The indemnity and defense language in this provision suggests that the design professional will defend (and indemnify) the owner irrespective of whether the design professional is negligent. This is not insurable because the insurance company is being asked to pay for the defense and damages (indemnity) obligations of a noninsured.

Another coverage problem arises from the Contractual Liability exclusion discussed in Problem #1, which exclusion bars coverage for liability assumed by contract unless the design professional would have been liable in the absence of that contract. Here, a defense obligation to the owner would not exist without the "defend" language in the contract, as there typically is not any legal requirement outside of a contract that a design professional pay for the owner's lawyers, even if the claims being made involve issues of design professional negligence.

And, finally, there are implications beyond insurance for this provision, because in some states there is law stating that the defense obligation could arise as soon as there is a hint of any possible design issues on the project, even if it is ultimately proven that the design professional was not negligent. Therefore, the defense obligation should also be eliminated for this reason.

Example of language that would fix the duty to defend problem

"Design Professional shall indemnify and hold harmless (but not defend) Owner, its officers, directors, and employees from and against any and all damages to the extent caused by Design Professional's negligent acts, errors, or omissions in the performance of professional services on the project." (The highlighted text resolves an additional insurability problem, discussed in Problem #3.)

Client arguments and talking points for the design professional

"You (the design professional) need to be prepared to pay for your mistakes."

- We will pay for any issues or claims that legitimately result from our negligence, but if we didn't do anything wrong, we shouldn't have to pay. Our insurance covers damages caused by our negligence, but only after they are proven to have resulted from our negligence. And, if we don't use the proper language in the contract, then there will be insurance coverage problems if it happens to be a claim. We don't want to have to fight that battle because it will hinder swift resolution of that claim.

"The other design professional I have been considering for the project hasn't objected to this provision, and agreed to it on a project he did for me 5 years ago."

- The other design professionals you work with may not be aware of the coverage issues that this language creates. Our firm's insurance company and broker have done a good job of informing us about what my professional liability insurance does and does not cover, which benefits both you and our firm by keeping us from getting into a situation where everyone has to hire lawyers just to determine if my firm actually has coverage.

"Why don't you just go and buy insurance coverage that pays for my lawyers?"

- There is no known professional liability insurer (at least in the U.S. market) that provides substantive coverage for this defense obligation. A couple of insurers have tried to craft a policy endorsement to provide the coverage, but they were not successful.

"If your negligence results in a third-party claim against me, why shouldn't you have to pay for my defense against that claim?"

- If a claim against you arises out of our design, it's almost certain that our firm will be named in that claim, too. Our insurance company will defend our firm and our design, and to the extent that our design is proven nonnegligent, that will help you defeat the claim against you, too.
- One of the risks of being a project owner is that third-party claims may arise from the project or its operations. By proceeding with this project, you have presumably determined that the benefits of project ownership outweigh that risk. Our firm and its insurer will be there to defend against allegations of negligence in our design, and to pay damages caused by our negligence if those allegations are proven. But we cannot serve as the guarantor of your project.

PROBLEM #3: INDEMNITY FOR DAMAGES NOT CAUSED BY DESIGN PROFESSIONAL'S NEGLIGENCE

Example of language your client might propose

"Design Professional shall defend, indemnify and hold harmless Owner, its officers, directors, and employees from and against any and all claims, damages, causes of action or allegations in any way arising out of or relating to Design Professional's work on the project."

What's the insurance problem?

An evil stepsister of the duty to defend language discussed in Problem #2 is the clause that requires the design professional to pay the owner (i.e., indemnify) for damages that are not caused by the negligence of the design professional. This is not insurable because professional liability policies only provide coverage (including a legal defense) for damages caused by the negligence of the insured design professional. Damages caused by other parties and damages caused by nonnegligent conduct of the design professional are not covered.

Moreover, professional liability policies contain a Contractual Liability exclusion, which bars coverage for liability assumed by contract unless the insured design professional would have been liable in the absence of that contract. The duty to indemnify the client for damages caused by others or by the design professional's nonnegligent conduct wouldn't exist without this contract language, so the Contractual Liability exclusion operates to preclude coverage for this assumed liability.

Example of language that you might propose as an alternative

"Design Professional shall indemnify and hold harmless (but not defend) Owner, its officers, directors and employees from and against any and all damages to the extent caused by Design Professional's negligent acts, errors, or omissions in the performance of professional services on the project."

Client arguments and talking points for the design professional

"This is just boilerplate stuff. The Anti-Indemnification Act probably bars enforcement of it anyway."

- But it could be found to be enforceable, and we want to stand behind all of the promises in our contract. Indemnifying you for damages caused in part by other parties won't be covered by insurance and likely falls into the category of promises that we can't keep.
- In the unlikely event that you bring a lawsuit against our firm for malpractice, we both know that the case will probably not go to trial. Chances are that it would settle—and if your lawyers insisted our living up to this obligation to pay for damages caused by others, we might not be able to fulfill that promise, because it isn't covered by insurance. So we can't include it in our contract.

"I don't want to have to wrangle over who's responsible for the claim. I just want to be made whole."

- I appreciate that many different parties contribute to problems on a project, and that it can be difficult to apportion responsibility. Our firm—and its insurer—are willing to stand behind our professional services, but we cannot be the guarantor of other parties' performance.

"What do you mean you're not covered for non-negligent errors?"

- The truth is that no project is "perfect" or "error-free." And the law recognizes this fact because it does not require perfect performance by design professionals. Instead, we are required to meet the professional standard of care—to perform our services with the degree of care and skill that a reasonable design professional would use under similar circumstances. If we fail to meet that standard, and our failure causes damages, we are negligent and our firm's professional liability insurance covers that. But our insurer knows, as we do, that perfect performance is impossible, and they won't back our promise of an "error-free" design, or our agreement to indemnify our client for all damages, whether or not they result from our negligence.

"How could an error not be negligent?"

- Here's an example. Let's say our firm specifies a waterproofing product for use in a particular design. We would, of course, do our due diligence with respect to that product and its suitability for the project. But suppose that ten years after we specify the product, it turns out—to everyone's surprise—that the product ceases to work after a certain time. If our decision to specify the product was reasonable at the time we did so, we would not be negligent under the law. The law does not require us to guarantee the performance of our projects—and if we were to make such a guarantee, it wouldn't be covered under our professional liability insurance.

PROBLEM #4: OWNER AS ADDITIONAL INSURED

Example of language your client might propose

"Design Professional shall name Owner as an additional insured on all policies …"

What's the insurance problem?

Your professional liability insurer will not add your client as an additional insured to the policy.

Example of language that you might propose as an alternative

"Design Professional shall name Owner as an additional insured on all policies (except professional liability and workers compensation[2]) …"

Client arguments and talking points for the design professional

"But the contractor does it . . .!"

- That's true. But the contractor's Commercial General Liability (CGL) policy allows the contractor to add you and others as additional insureds on the policy. We can do that on our CGL, too, but not on our professional liability policy.

"So why can't you do it on your professional liability insurance policy?"

- There are a couple of reasons that the professional liability carriers won't allow their insureds to name clients as additional insureds on the policy. First of all, the professional liability policy provides coverage for damages caused by a design professional's negligent performance of professional services. But you are not a design professional, so the coverage would not apply to you.[3] Second, even if we could name you as an additional insured on our professional liability policy, that policy has an exclusion—it's standard in the industry—for claims made by one insured against another (the "Insured vs. Insured" exclusion). By adding you as an additional insured, we'd be destroying coverage for any professional liability claims you made against our firm—which is exactly what we're trying not to do!

[2]You can't name additional insureds on workers compensation policies, either.

[3]And even if your client were a design professional, it would still need to purchase its own professional liability insurance coverage. Your professional liability carrier will not add as an additional insured a design professional whose risk it has not underwritten. Anyway, even if you could add your client as an additional insured, the "Insured vs. Insured" exclusion would bar coverage for claims made by your client against your firm – the exact opposite of the desired result.

PROBLEM #5: GUARANTEES AND WARRANTIES

Example of language your client might propose

"Design Professional warrants that the project will comply with all laws, codes and regulations …"

What's the insurance problem?

There are a couple of insurance coverage problems here.

First, professional liability policies typically exclude liability assumed through "Express Warranties and Guarantees," unless your firm would have been liable in the absence of those warranties and guarantees. When you guarantee or warrant something, you are promising that something is unequivocally true and totally accurate. And there are other "absolute-promise" words that work the same way, e.g., certify, ensure, insure, assure. Except where you can and do know something to be a fact – for example, "I visited the jobsite on Tuesday, March 15" – giving a guarantee, warranty, or other absolute promise is likely to cause a coverage problem.

Second, professional liability policies have a Contractual Liability exclusion, which bars coverage for liability your firm assumes by contract unless your firm would have been liable in the absence of that contract. Normally, the law requires the design professional to perform its professional services as a reasonable, similarly situated design professional would do under similar circumstances—it does not require a guarantee of the project, your performance, or other outcomes.

Example of language that you might propose as an alternative

"Design Professional shall make reasonable professional efforts to comply with applicable laws, codes, and regulations …"

Client arguments and talking points for the design professional

"Why can't you guarantee that the project will meet code? Isn't that your responsibility, anyway?"

- You're right that I have a duty to comply with law and building code. But it's entirely possible for codes and laws to conflict such that it's impossible to comply with "all" of them. And we both know that sometimes building inspectors differ in their opinions about what the code requires. I stand behind my professional judgment, and so does my professional liability insurance. But if we leave the word "warrant" in this contract clause, we're creating a coverage problem where none needs to exist.

PROBLEM #6: PREVAILING PARTY FEE CLAUSES

Example of language your client might propose

"… The prevailing party shall be awarded its attorneys' fees and costs …"

What's the insurance problem?

Professional liability policies have a Contractual Liability exclusion, which bars coverage for liability your firm assumes by contract unless your firm would have been liable in the absence of that contract.

In the absence of a contractual provision to the contrary, courts in the United States generally do not award attorney's fees to the "winner" or prevailing party. Each party remains responsible for its own legal fees. But a "Prevailing Party" clause changes that arrangement, and to the extent it obligates the design firm to pay legal fees and costs it otherwise would not have had to pay, it will not be covered by professional liability insurance.

Example of language that you might propose as an alternative

Delete the clause. No great alternatives here.

Client arguments and talking points for the design professional

"We always have a Prevailing Party clause in our contract."

- Because this is not covered under my professional liability insurance policy pursuant to the Contractual Liability exclusion, all that putting this language in the contract will do is create a coverage problem in the unlikely event that you make a professional liability claim against our firm. If our negligent performance causes you damages, we will want to make that situation right as soon as possible. But disputed professional liability coverage will delay and hamper settlement. Neither one of us wants that.

"Having a Prevailing Party clause helps deter frivolous lawsuits."

- I can't speak to whether or not that is generally true, but it's hard for me to see how that principle applies to our professional relationship. If we have a problem serious enough to merit your filing suit against our firm, it's in both of our interest to have full insurance coverage, as that will make resolution of the claim simpler and swifter.

PROBLEM #7: GUARANTEEING CONTRACTOR'S WORK

Example of language your client might propose

"Design Professional shall inspect the Contractor's Work to ensure that it is in strict accordance with the contract documents …"

What's the insurance problem?

There are a several insurance coverage concerns with this provision. First, as discussed in Problem #3, this provision purports to require the design professional to be responsible for and pay damages for the contractor's negligence in executing its work. This is not insurable because professional liability policies only provide coverage for the negligence of the insured design professional, and no one else. The Contractual Liability exclusion may bar coverage for this provision not only because the design professional is assuming liability for the contractor's performance, but also because the design professional could arguably be said to have agreed to an elevated standard of care with respect to construction observation.

Second, as discussed in Problem #5, professional liability policies typically exclude liability assumed through "Express Warranties and Guarantees," unless your firm would have been liable in the absence of those warranties and guarantees. To the extent that this contractual language amounts to a guarantee of the contractor's work, it is uninsurable.

Example of language that you might propose as an alternative

"Design Professional shall observe the Contractor's Work to endeavor to determine, in general, whether it is in accordance with the contract documents …"

Client arguments and talking points for the design professional

"You are billing me for site visits; why can't you make sure the contractor is doing his job properly?"

- The site visits are only to observe for general compliance of the work. They are limited in duration and scope, and are not continuous, detailed, or exhaustive. It is beneficial to you to have me provide construction administration, including the appropriate number of site visits, that may reduce the probability of contractor errors—but the design professional cannot guarantee the contractor's work.

"Don't you inspect the work when you go to the site? What's this business about "observe"?

- Again, the site visits are for a limited duration and scope. My firm cannot look at every nail, beam, connection, etc. It is the responsibility of the general contractor and subcontractors to make certain they perform their work properly, and the design professional does not perform that extreme (and uninsured) level of service.

PROBLEM #8: RESPONSIBILITY FOR SITE SAFETY

Example of language your client might propose

"Design Professional shall report all safety hazards at the job site to Owner …"

What's the insurance problem?

By agreeing to the proposed language, you are taking responsibility for a duty that belongs to the general contractor. The contractor has a continuous presence at the jobsite, supervises the workers, and is trained in jobsite safety. By contrast, the design professional visits the site from time to time, does not control the workers or the site, and typically has little or no site safety training.

You might think that the proposed clause simply obligates you to report any safety hazards you happen to spot when you visit the site. But there is another, more dangerous interpretation of this language. If a worker is injured at the jobsite and sues your firm, that worker is likely to cite this contract language as evidence that you took responsibility for identifying all safety hazards at the jobsite and reporting them to the Owner. Although that may sound unreasonable to you, experience tells us that this sort of allegation is quite likely.

If you are sued by an injured worker, coverage will depend—even more than it usually does—on the way the complaint is pled. The suit might fail to allege that you performed any professional services at all, in which case coverage under your professional liability policy might be in jeopardy. Your commercial general liability (CGL) policy might afford you some coverage, but might also reject the claim or reserve its rights, citing the "professional services" exclusion to the CGL policy. You might say that suits of this type fall on the "fault line" between the professional liability policy and CGL—and that's not a good place to be when you want solid coverage for a claim.[4]

Example of language you might propose as an alternative

"… Design Professional shall not have control over, charge of, or responsibility for the construction means, methods, techniques, sequences or procedures, or for safety precautions and programs in connection with the Work, nor shall Design Professional be responsible for the Contractor's failure to perform the Work in accordance with the requirements of the Contract Documents."

Client arguments and talking points for the design professional

"Are you kidding? You're not going to tell me if you see a safety hazard?"

- You can count on our team to act appropriately on the site if we spot a safety hazard. But putting this language in our contract makes us responsible for a risk we don't and can't control, and makes us a target for injured workers who will claim that we had a duty to prevent their injuries.
- Safety is and should be the general contractor's responsibility. We won't make the jobsite safer by assuming a responsibility that rightfully belongs to the contractor, and that our firm is not qualified to undertake.

[4]Because of this risk, your contract should require your client to have the general contractor name your firm (and your client and subconsultants) as additional insureds on the general contractor's CGL policy.

CONCLUSION

When a design professional is negotiating a professional services agreement with a client, the argument that a contract clause is not "fair" may be of limited value. It will likely be much more effective to point out that the client has as much interest as the design professional does in having professional liability insurance coverage for the contract.

Having this discussion with the client has many benefits, whether or not the client agrees to any changes in its proposed contract. Contract negotiations are a valuable means of evaluating a prospective client and its attitudes toward risk and the role of the design professional in the success of the project. A client who expects the design professional to become the guarantor of the project, whether or not insurance coverage exists to cover a loss, represents an extremely elevated risk that must be taken into account when considering whether and on what terms to take on that client's design project.

Negotiate boldly. If nothing else, you will distinguish your firm from those who "didn't have a problem" with unfair and uninsurable contract terms, and educate your client about the risks that your firm is—and is not—willing to take on.

Although you cannot turn away every difficult client, consider declining to serve clients who require you to bet the livelihood of your firm on an uninsurable contract. Remember that you come to the negotiating table with something extremely valuable to offer, namely your firm's talent, experience, and desire to do an outstanding job for every one of your clients. Those assets are hard-earned, and decisions to wager them on uninsurable contracts must be made carefully and with eyes wide open to the risks of making such bets.

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