OPINION

Take a look

AEC firms have new options for addressing the 'Duty to Defend' obligation in indemnification provisions.

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GUEST SPEAKER

As clients continue to look for ways to transfer greater amounts of project-related risk to design firms, it has become increasingly important for architects and engineers to review their contracts carefully before signing. Indeed, the use of onerous contractual wording by owners and contractors can significantly expand the design professional's overall exposure, including potentially large uninsured liabilities.

AEC firms should recognize that their professional liability policy is intended to cover claims arising from the firm's professional negligence or malpractice. The policy addresses claims made against the firm for bodily injury and property damage, as well as economic loss. It also allows the firm to indemnify a client if a client is sued due to the firm's negligence.

However, professional liability policies also have a contractual liability exclusion which denies coverage for exposures policyholders agree to accept by contract unless they would otherwise be liable for them under common law. Courts have consistently held that the "duty to defend" in indemnification provisions goes beyond common law liability and is therefore a contractual liability taken on by a firm that would invoke the contractual liability exclusion.

To reduce this uninsured exposure, firms should attempt to negotiate the removal of onerous contractual wording, such as the "duty to defend," as well as consider exploring new opportunities to transfer risk through insurance.

- The "duty to defend" clause can be a key area of controversy in many indemnity agreements. In reviewing their contracts, firms should try to strike any obligations to "defend" a client from claims made by third parties as this obligation will not be covered by their professional liability policy. Historically, that exposure wasn't covered under any other policy, but that has changed.
- When negotiations fail to remove or modify onerous "duty to defend" wording, design firms can now explore new insurance coverage options. The extended

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soft commercial insurance market for architects and engineers has produced a number of new coverage innovations. One new solution enables design firms to insure at least some of their contractual liability related to the "duty to defend."

In what may be the first of many new coverage solutions, Aspen Insurance (working with Founders Professional) has begun offering a "Contractual Defense Protection" policy. This stand-alone policy, which is in addition to a professional liability insurance policy, works as follows:

Suppose you have contractually agreed to defend your client under an indemnification provision. A third party makes a claim against your client that may be related to your firm's negligence and your client asks your firm to defend them on the basis of the indemnification agreement. You would submit the claim to your primary professional liability insurer, which most likely will decline the claim as an uncovered contractual commitment.

In that case, you would then notify Aspen under the CDP policy. Aspen would work with you to select the appropriate legal counsel to defend your client under the terms of the duty to defend provision in the indemnification agreement.

The new policy offers limits from $250,000 to $1 million per claim/aggregate. While the CDP policy has no deductible, it does contain an "80/20 co-insurance clause." In this case, the insured pays 20 percent of defense costs incurred – up to a set limit typically based on a small percentage of the design firm's annual revenue – and the insurer, Aspen, pays the remaining 80 percent. Premiums typically range from 5 percent to 10 percent of the insured firm's professional liability premium, but may be higher or lower depending on individual underwriting considerations.

Under the policy, Aspen will help insureds select counsel to fulfill their "duty to defend" obligations. However, should the client or insured choose a different defense counsel, reimbursement may be limited to what the policy defines as "reasonable" costs, based on Aspen's standard rates, with some restrictions.

Thus, if the insured agrees to a "duty to defend," it is important to agree only to be responsible for "reasonable" attorneys' fees. Design firms considering this coverage should work with their attorneys to modify the contractual "duty to defend" language. For example, they might consider inserting clarifying language, such as the following:

Indemnitee agrees to use panel counsel recommended by [design firm's] insurer and the duty to defend obligation is expressly limited to claims where there is also an allegation of the [design firm's] negligence in the performance of professional services.

"Professional liability policies have a contractual liability exclusion which denies coverage for exposures policyholders agree to accept by contract unless they would otherwise be liable for them under common law."

Finally, be aware that Aspen's CDP policy only covers contractually agreed-to defense obligations; it offers no professional liability coverage. So, any firm purchasing a CDP policy will need to maintain its professional liability program. The policy does not provide coverage for "duty to defend" provisions entered into prior to its inception date. Furthermore, as this is a new policy that has yet to be "tested" with claim activity, it's important to work closely with an experienced broker to review the policy's terms and conditions, and understand how it works with your professional liability coverage.

By taking time to review contractual language carefully and negotiating to remove onerous wording, as well as exploring new insurance coverage options, design firms can take on a wider range of new projects. This may go a long way to helping them meet their growth goals, as they maintain their protection from potentially significant exposures.

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