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Professional Liability Assumed by Contract

Most design professionals rely on professional liability insurance to mitigate the risk of claims arising from their professional services. Design professionals expect that any claim will be covered. The professional liability insurer will defend the claim, and pay damages.

However, many design professionals do not realize that some commitments made in their contracts may not be covered by professional liability insurance. For example, all A&E professional liability insurance policies expressly exclude coverage for liability assumed by contract. Generally, there are two forms of exclusion for liability assumed by contract. The first form is narrow; it excludes *only* the liability of others the insured design professional assumes by contract (such as the liability of another assumed in an indemnity and hold harmless agreement). The second form is broad; it excludes *any* liability a design professional assumes by contract (including liability a design professional would not be exposed to, but for the design professional's contractual assumption of the liability). The broad form of exclusion for liability assumed by contract could apply in any of the following circumstances:

- Defense and indemnification from claims brought against the insured design professional after the applicable statute of limitations or statute of repose has run, but still within an extended contractual limitations period agreed to by the insured design professional;
- Payment of damages agreed to by an insured design professional that are in excess of, or of a different type than those recognized or recoverable under the applicable law, such as liquidated damages or remote consequential damages;
- A contractual commitment by an insured design professional to defend third-parties from claims, or to reimburse their defense costs;
- The insured design professional's promise to pay damages or expenses not caused by the design professional's negligence.

How can design professionals avoid contractual commitments that may be excluded from insurance coverage?

First, design professionals must understand their insurance coverage. They should review the insurance policy with an attorney or insurance broker, including specifically the "liability assumed by contract" exclusion. Also, because professional liability insurance policies are renewed or replaced each year, design professionals should confirm that coverage provided by future policies is consistent with coverage in the current policy. Otherwise an insurable commitment made this year, may not be insured by next year's policy.

Second, design professionals should develop guidelines for acceptable contract terms, and a process for reviewing and negotiating contracts for consistency with those guidelines, and to assure that contractual commitments remain within the scope of the insurance coverage. Third, most clients do not intend to require that design professionals assume risk that is not insured, so long as the design professional maintains sufficient insurance to respond to insured risks. Accordingly, when negotiating contracts, design professionals should be prepared to demonstrate that they maintain appropriate insurance coverage, and that objectionable clauses are outside the scope of that coverage. Usually, a written interpretation or explanation from the design professional's insurance broker is sufficient. However, sometimes, the design professional may have to direct a client to the applicable language in the professional liability insurance policy, or even engage counsel to address the coverage question.

Finally, design professionals that are not able to negotiate away an uninsurable contract clause should consider whether the project is worth the uninsured exposure, or whether the uninsured exposure can be limited by additional contract terms, such as a limit of uninsured liability, a waiver of personal liability, indemnity and hold harmless provisions, or similar clauses. There may also be an opportunity to mitigate uninsured risk by modifying the design professional's scope of services or its project delivery practices.

Ultimately, design professionals must be cognizant of how terms in their professional service agreements can affect their professional liability insurance coverage. In particular, design professionals should beware of contract terms that may fall within the coverage exclusion for liability assumed by contract. Design professionals should develop contracting practices to assure that their contractual commitments are within the scope of their professional liability insurance coverage.

As always, Mark W. Jacobsen, P.S. is here to help.

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