

Pitfalls of Adding Clients or Other Design Professionals as Additional Insureds

By Thomas Hay and Kevin Kieffer

Architects and engineers who obtain professional liability insurance should understand that adding a client as an “additional insured” under their professional liability policy is fraught with risk. As discussed in more detail below, adding the client as an additional insured can be against the best interests of the design professional in that it can create numerous, unintended consequences. For example, adding the client as an additional insured can erode or even exhaust the professional liability insurance available for the design professional, make it harder for the design professional to obtain insurance in the future, give rise to new avenues of uninsured exposure for the design professional, and also limit the coverage available to the design professional under its own professional liability policy.

In short, when an architect or engineer is negotiating a contract with a project owner, contractor, or any other client who requests to be added as an “additional insured” on the architect or engineer’s professional liability policy, the design professional should tread carefully and be aware of the potentially significant downside risk.

Primer on “Additional Insured” Coverage

Generally, there are four different types of insureds under an architects and engineers (“A&E”) professional liability policy:

Named Insured: The Named Insured is typically identified on page one, item one of the Declarations Page of most A&E professional liability policies. This is the entity that has purchased the



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insurance coverage for itself and all other “insureds” under the policy. The Named Insured has certain obligations under the policy, including but not limited to submitting the policy application, paying the premium, satisfying retentions, receiving notices, tendering claims to the insurer, and requesting cancellations.

Additional Named Insured: Some policies amend the definition of “Named Insured” to include certain people or entities - typically subsidiaries or joint ventures of the Named Insured. This coverage can be limited in some way; sometimes by duration (e.g., offering “Additional Named Insured” coverage for claims arising during a particular sub-period or involving alleged wrongful acts that occurred during a defined period of time) or for claims arising out of a specific project, or both.

Insured: the “Insured” typically includes employees of the Named Insured, directors/officers, partners, principals, or other, similar individuals or entities depending on the corporate structure of the Named Insured.

Additional Insured: the Additional Insured - on whom this article focuses - is none of the above. The Additional Insured is not an “Insured” as defined by the policy, but instead is an outside third-party who has requested, typically through contractual negotiations with the Named Insured, to be added as an Additional Insured under the Named Insured’s professional liability policy.

In general, “additional insured” coverage is provided in one of two ways.

First, the policy could include a blanket additional insured endorsement. This endorsement provides additional insured coverage under the policy for any person or entity for whom the Named Insured has agreed to provide such coverage pursuant to a written contract. Second, the policy could also include an endorsement that specifically names certain individuals or entities (known as “scheduled additional insureds”) as additional insureds under the policy.

The scope of “additional insured” coverage that can be provided varies greatly based on: (i) the language of the particular endorsement; (ii) how that language is interpreted in the relevant jurisdiction; and, in some instances, (iii) the interplay between the contractual requirement to provide additional insured coverage and the language in the particular additional insured provision. Some additional insured endorsements restrict coverage for the Additional Insured to situations where the Additional Insured’s liability arises out of the work performed by or on behalf of the Named Insured for the Additional Insured. These types of endorsements may only protect the client (as the Additional Insured) from vicarious liability arising out of the design professional’s actions. Other types of additional insured endorsements, however, may provide broader coverage for the client that is not just limited to vicarious liability arising out of the design professional’s actions.

Although all types of additional insured coverage present risk to the design professional, the broader form of additional insured coverage, which extends coverage beyond vicarious liability, is particularly risky.

Possible Pitfalls in Adding the Client as an Additional Insured

As discussed below, there are a number of potential pitfalls and unintended consequences that could occur when a design professional adds its client as an Additional Insured under its A&E professional liability policy.

(1) Erosion of Policy Limits Available to the Named Insured

A chief risk of adding the client as an Additional Insured is that doing so makes the entire policy limit available to that Additional Insured. In other words, as an Additional Insured, the client will have rights to defense and indemnity coverage under the design professional's policy. Thus, the payment of defense or indemnity costs by the insurer on behalf of the Additional Insured will reduce the amount of the policy limit available to the Named Insured and all other Insureds under the policy. By allowing a client to be added as an Additional Insured, the design professional creates a situation where the insurance that it has paid for could be partially or wholly eroded for future claims.

Further, in many instances, the client will ask the design professional for Additional Insured status to be conferred on a "primary and non-contributory" basis, which means that the A&E professional liability policy would provide coverage to the Additional Insured without contribution from the Additional Insured's own insurance carrier. Thus, the Additional Insured would receive defense and indemnity coverage under the limits purchased by the design professional - while at the same time preserving its own insurance coverage to use if the design professional's policy is exhausted.

This scenario could be particularly galling in the situation noted above: where a design professional agrees to name the owner as an Additional Insured and the policy includes coverage for the Additional Insured's own negligence. In such situations, the design professional may have, in effect, contractually agreed to deplete the amount of insurance available to the design professional for claims caused by the negligence of the Additional Insured.

In short, this is a serious risk and design professionals should carefully evaluate their available insurance, and their ability to "self-insure," in the event of policy exhaustion, before agreeing to name a client as an additional insured under their professional liability policy.

(2) Increased Premium and Increased Difficulty in Obtaining Future Insurance

If there are claims made against the Additional Insured under the A&E professional liability policy, the end result could be that the design professional has more difficulty obtaining insurance in the future due to increased underwriting scrutiny. Likewise, the design professional could also be asked to pay an increased premium during renewal, even if the only loss was for the Additional Insured.

(3) Potential for Triggering the Insured versus Insured Exclusion

The Insured Versus Insured ("IvI") Exclusion contained in many insurance policies, including A&E professional liability policies, generally excludes coverage for claims made by one Insured against another Insured. By adding the client as an Additional Insured under the A&E professional liability policy, the design professional may create a situation where a future claim by the client against the design professional could be excluded by the IvI Exclusion. Thus, for example, coverage for one of the primary avenues for liability that a design professional faces – a claim by the project owner against the design professional for some form of tort liability (negligence, etc.) – could be excluded under the A&E professional liability policy merely by including the client as an Additional Insured.

By precluding one of the more likely types of potential claims, the end result here could be a significant decrease in the scope of professional liability coverage that the design professional had intended to purchase.

(4) Increased Likelihood of Claim for Failure to Procure Insurance

There are two additional steps that are required once the design professional contractually agrees with the client to add the client as an additional insured under the A&E professional liability policy. First, the design professional needs to make sure that its A&E professional liability policy is endorsed to add the client as an Additional Insured. Second, the design professional needs to ensure that the scope of "additional insured" coverage provided by its A&E professional liability policy is the same as the scope of coverage contemplated by its contract with the client.

Failing to satisfy both of these steps could give rise to contractual liability for the design professional. Consider this scenario: a claim is made against the client and the design professional. The client, in turn, seeks coverage as an additional insured under the design professional's A&E professional liability policy. Despite contractually agreeing with the client to add the client as an additional insured under its A&E policy, the design professional never actually does so. Further, the professional liability policy does not contain a "blanket" additional insured endorsement. Thus, there is no coverage for the client as an additional insured.

The client, in this scenario, could argue that the professional liability insurer should be liable for the Named Insured's failure to procure insurance coverage. Courts, however, have rejected this argument. See *Office Structures, Inc. v. Home Ins. Co.*, 503 A.2d 193, 197 (Del. 1985). There, the Delaware Supreme Court held that an insurer was not required to provide coverage under a general liability policy for the Named Insured's failure to procure insurance. *Id.* The court reasoned that, although bodily injury or property damage may have occurred, the Named Insured's liability is not "because of" bodily injury or property damage, but because of a separate contractual liability the insurer is not obligated to cover. *Id.*

"In many jurisdictions, a party that fails to procure adequate insurance, when under a contractual obligation to do so, bears the risk of loss to the extent that the damages are not covered by insurance."

With recovery from the carrier foreclosed, the client could then decide to pursue a breach of contract claim against the design professional for failure to procure insurance. In many jurisdictions, a party that fails to procure adequate insurance, when under a contractual obligation to do so, bears the risk of loss to the extent that the damages are not covered by insurance. Accordingly, by contracting to provide additional insured status to its client, a design professional increases its potential un-insured exposure significantly in the event that: (1) it fails to procure an insurance policy that actually adds the client as an additional insured; or (2) the insurance policy that it does procure adds the client as an additional insured, but the scope of the additional insured coverage does not match - or is perceived not to match - the scope of coverage required by the contract with the client.

Additional Exposure

Below we briefly discuss two examples where a design professional could end up eroding the limits of its A&E policy by providing broader coverage than intended to the Additional Insured.

Scenario #1: Personal Injury Lawsuit by the Design Professional's Employee

The architect or engineer agrees to add the client as an additional insured under its professional liability policy. During work on the project, the design professional's employee is seriously injured. The employee brings a personal injury lawsuit against the project owner. The employee does not name the design professional as a defendant in the personal injury lawsuit, however, because in the relevant

jurisdiction, the employee's exclusive remedy against the design professional is a workers-compensation claim.

The client, in turn, tenders the defense of the personal injury lawsuit to the design professional's insurer for coverage as an Additional Insured. Thus, the limits of the design professional's professional liability insurance policy are at risk of being depleted in defense of a serious personal injury claim for which the architect or engineer is not a defendant. The defense costs in these types of actions, in addition to any damages award or settlement, could significantly erode or even completely exhaust the limits of the A&E professional liability policy.

Scenario #2: Defense of Routine Contractor or Third-Party Claims

In normally routine disputes between a contractor and the project owner (for things like contract administration, delay damages, site administration, etc.), some contractors will "throw in the kitchen sink" by asserting numerous allegations and numerous theories of recovery, often including a single allegation of "design professional negligence" or "design errors and omissions." The same goes for other types of relatively routine post-construction claims by third-parties, such as adjacent landowners. Indeed, savvy contractors or other third parties may "tack on" claims of design professional negligence just to determine if the owner has access to more potentially available insurance.

In this situation, the presence of even one, stray allegation of design professional negligence could be enough to trigger the duty to defend a design professional's client as an "additional insured." As with scenario one, this is a situation where the design professional's liability insurance would be depleted for claims that have nothing to do with the design professional. While there likely would not be indemnity coverage in this scenario, the defense costs could significantly erode or even exhaust the limits of the A&E professional liability policy.

Conclusion

In conclusion, agreeing to add a client as an additional insured creates numerous risks for a design professional and could also cause undesired, unintended consequences. If the design professional's client insists on obtaining additional insured status, the design professional should press for as limited of additional insured coverage as possible (i.e., no coverage for non-professional risks), and if that is not possible, carefully consider whether the work makes financial sense.

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