From the Desk of Jeff Gerrick

Date: July 28, 2005

To:

Re: **Standard of Care / Indemnity / Liability Insurance**

You, and those in your firm who are authorized to bind the firm under contract, must recognize contract language that exposes the firm to uninsured liabilities so that you can seek counsel in negotiating favorable contract terms. In order to keep this discussion manageable, I will greatly simplify the issues, but I can provide you with volumes of reference material for a more in-depth study should you be interested.

There are two areas of the law that we must address: **common** (**tort**) **law** and **contract law**. Under common law, we are required to conduct our affairs in a reasonable and prudent manner so that we do not cause injury or damage to those around us. When we fail to act in a reasonable or prudent manner we are said to be **negligent**. There are four requirements that must be met in determining negligence: 1) the existence of a duty; 2) breach or violation of that duty; 3) measurable damages; and 4) evidence that the breach of duty was the proximate cause of the damages. Lacking one of these elements, there is no negligence.

Standard of Care

Due to the specialized training that engineers, architects, doctors, attorneys or other professionals possess, there is a greater duty imposed upon them than upon others who lack that specialized training. To determine if a professional has been negligent, the concept of **standard of care** has been developed in which the particulars of a situation are evaluated based upon what another reasonable and prudent professional would have done under the same or substantially similar circumstances.

As civil engineers / surveyors, you are judged by what your peers, (in your case other civil engineers or surveyors experienced in residential / commercial subdivision projects currently practicing in Maricopa County), would consider to be reasonable and prudent. As interpreted by courts throughout the country, perfection is not expected or required. The indeterminate nature of the many factors an engineer must consider in providing services makes it impossible for that engineer to accurately gauge them in each and every instance.

The protections afforded you under common law can be modified, or even eliminated, under contracts that you sign. Much of what will be discussed hereafter will address such contract issues.

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Any agreement you sign that heightens the standard of care beyond the customary standard will make it difficult, if not impossible, to defend yourself in a legal action. Depending upon the particulars, such an agreement may be construed as a guarantee or warranty and thus become subject to exclusion in your professional liability policy.

Therefore, when a client's contract seeks to heighten the customary standard of care, it is recommended that such language be eliminated. If they are adamant that your level of performance be addressed in the contract, offer something similar to the following:

Services provided by the Engineer under this Agreement will be performed in a manner consistent with that degree of care and skill ordinarily exercised by members of the same profession currently practicing under similar circumstances.

Should a client express concerns over the discovery of errors or inconsistencies in your plans and specifications, you could agree to add the following:

.. similar circumstances. Upon notice to the Engineer and by mutual agreement between the parties, the Engineer will correct those errors or inconsistencies without additional compensation.

Indemnity

In its most basic form, the common law principal of indemnity requires that you reimburse an injured party for certain costs and expenses incurred, but only to the extent that you were determined to be responsible for them (Note - it does not require you to undertake their defense). The obligation to indemnify exists without a contract between the involved parties, but adding it to a contract gives the indemnitee an additional avenue through which to seek recovery from the indemnitor (adding a contractual count to the existing negligence count) as well as an opportunity to broaden the basis for indemnity.

The basic form has been expanded into intermediate and broad forms that have become so complex that even members of the legal profession have difficulty predicting how they will be interpreted when an agreement is brought into court. Under the intermediate and broad forms, you are asked to assume responsibility for costs beyond what common law indemnity would ascribe to you. An exclusion in virtually **all** Professional Liability policies bars coverage for liability assumed under contract in excess of that which would have existed only under a common law negligence claim.

A typical example of an uninsurable indemnity might be as follows:

To the maximum extent permitted by applicable law, the Consultant assumes the entire responsibility and liability for, and agrees to indemnify, defend and hold the owner and its agents harmless from any and all damage or injury of any kind or nature whatsoever (including death resulting therefrom) to all persons whether employees of the Consultant or otherwise, and to all property (including loss of use thereof) caused by, resulting from, arising out of or occurring, in whole or in part, due to the acts, errors, fault or negligence of Consultant.

A more acceptable version of this might be as follows:

~~To the maximum extent permitted by applicable law,~~ TO THE EXTENT CAUSED BY THE CONSULTANT'S NEGLIGENT ACTS, ERRORS OR OMISSIONS IN THE PERFORMANCE OF

PROFESSIONAL SERVICES UNDER THIS AGREEMENT, the Consultant assumes the ~~entire~~ responsibility and liability for, and agrees to indemnify and hold the owner and its agents harmless from ~~any and all~~ CLAIMS FOR damage or injury ~~of any kind or nature whatsoever~~ (including death resulting therefrom) to all persons whether employees of the Consultant or otherwise, and to all property (including loss of use thereof). ~~caused by, resulting from, arising out of or occurring due to the fault or negligence of Consultant.~~

In the original version of the above indemnity, your obligation to indemnify and defend is not limited to your negligent acts, errors or omission. The fact that you provided services does not trigger responsibility for indemnity, nor are you required to provide an affirmative defense before there has been a determination of your negligence.

Time and space constraints do not permit a more detailed analysis of the indemnity agreement cited above, but a discussion of the insurance coverage available under your General and Professional Liability policies will more clearly illustrate the problems with it.

Insurance

In consideration of the premiums that you pay, your General Liability and Professional Liability policies will not only pay for damages assessed against your firm (subject to policy exclusions), they will also pay for your defense against a suit seeking those damages.

A. General Liability

Your General Liability policy is designed to pay on your behalf those sums you become legally obligated to pay as damages because of Bodily Injury, Property Damage, Personal or Advertising Injury because of an "occurrence" (defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions") arising out of the conduct your business activities as an engineering / surveying firm. Among other things, the policy will specifically exclude coverage for claims arising out of the rendering of professional services and certain duties assumed under contract.

Some of the services you provide require your physical presence at sites which are not owned or controlled by you. Since the owner, or general contractor to whom the owner has surrender control of the premises, has an exposure from your presence at the site, it is expected that they will be named as Additional Insured's under your General Liability policy. Because of the nature of the insuring agreement, this falls within the scope of coverage provided by the General Liability policy and, under the Supplementary Payments provisions of the policy, extends defense coverage to them if you have executed an indemnity agreement requiring that you provide for their defense. Once your policy limit has been expended on a judgement, the insurer's obligation to continue defense for the additional insured's ends (at which point your contractual obligation may put the burden back on your firm).

B. Professional Liability

The **Insuring Agreement** of your Zurich American **Professional Liability** policy reads as follows:

We will pay on behalf of the "Insured" all sums in excess of the Deductible ... that you are legally obligated to pay as "Damages" because of "Claims" ... provided that: A. the "Claim" arises out of an actual or alleged **negligent** (emphasis added) act, error or omission with respect to "Professional Services" rendered or that should have been rendered by you...".

The **Exclusions** under the **Professional Liability** policy include:

The "Policy does not apply to any "Claim" ... based upon or arising out of:

H. any express warranty or guarantee;

I. liability of others assumed by you under any contract or agreement, unless such liability for "Damages" arises from your negligent act, error or omission in the rendering of or failure to render "Professional Services" or the negligent act , error or omission of your sub-consultants;"

Note that coverage exists for **negligent** acts, errors or omissions! A claim which does not assert actual, or at least an allegation of negligence will fail to trigger coverage under the policy, leaving you to defend the claim without the benefit of insurance. While the insuring agreements in some policies may be worded differently than the cited Zurich language, all arrive at the same conclusion – no negligence, no coverage!

Duty to Defend

Due to the nature of its insuring provision (coverage for claims arising out of Professional Services), the Professional Liability policy does **not** allow anyone to be named as an Additional Insured, nor does it have a Supplementary Payments provision extending defense coverage to your clients, the general contractor or anyone else for that matter.

Given the difference between the General Liability and Professional Liability policies with regard to "defense" for third parties, you can see why there is confusion in so many contracts. When insurance companies included this provision in the General Liability policy, they paved the way for our current dilemma. Most attorneys who draft contracts are not familiar enough with insurance policy coverage to recognize the difference between the two policy forms. The language they draft works fine for claims against the various construction trades or for claims against design professionals that fall under their General Liability policies, but fails to take into consideration that most claims against design professionals fall under their Professional Liability policies!

If you agree, under contract, to "defend" anyone, there is no coverage under the Professional Liability policy to fund that defense obligation (i.e. the duty to defend exists because of your contractual assumption of that obligation, prior to the determination of your negligence, which is excluded from coverage). To the extent that you were determined to have been negligent after the adjudication process, the Professional Liability will indemnify (i.e. reimburse) the plaintiff for its damages and costs, subject to policy restrictions and limitations (i.e. punitive & exemplary damages, etc.).

If you cannot get the duty to "defend" removed and intend to pursue work with clients who refuse to delete this requirement, you are certainly entitled to an additional fee since your scope of services has now been expanded to provide engineering / surveying and legal services!

One approach that might be considered is to utilize a split indemnity which includes the "defense" language for claims falling under the General Liability policy, but does not include it for claims falling under the Professional Liability policy. We have had mixed responses from insurance company attorneys with respect to this approach, so you must proceed very carefully.

Another approach, without splitting the indemnity agreement, would be to include the following clause after the word "defend":

"...indemnify, defend (to the extent coverage exists under the insurance policies required under Article X of this contract) and hold harmless ..."

Again, we have had mixed responses from insurance company attorneys with regard to this approach. You might discuss these options with your legal counsel to get their input.

I trust this discussion will help you better understand the insurance issues that plague us relative to the contract language that is so pervasive today. I know of no simple solution other than to educate clients as to the existence of these issues and negotiate each contract based upon the relative merits of each project.