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Professional Liability Policy in Wisconsin Provides no Coverage to Engineer against Claims by its Own Client (but only covers Third Party Claims)

By J. Kent Holland, Jr., *ConstructionRisk*, LLC

A federal district court in Wisconsin held that the contractual liability exclusion of a professional liability policy means that the policy only covers third party claims against an engineer and affords no coverage for claims against the engineer by its own client. Crum & Forster persuaded the court that the “contractual liability” exclusion of the policy meant no claim that arises out of contractual obligations is covered under the policy, even if the breach of contract claim was based on negligent acts, errors and omissions.

Here is the court’s explanation of the Crum & Forster coverage and the applicability of the contractual liability exclusion:

“The manifest intent of the breach of contract exclusion is to avoid making Crum & Forster a guarantor of DVO’s contractual obligations. Crum & Forster agreed to insure DVO against liability it incurred to third parties for its negligent error or omissions; *it chose not to insure DVO for liability it incurred to its own customers for failing to meet its contractual obligations.*”

Since most claims against design professionals are brought by their own clients, this decision effectively means that design firms will obtain little benefit of purchasing a Crum & Forster professional liability policy. I would hope that instead of other professional liability carriers relying upon this court decision to deny coverage for claims that a designer would reasonably expect to be covered under its policy, they would instead use the decision as a marketing tool to demonstrate why it is important to purchase a professional liability policy from a carrier with a focus on providing such coverage.

A particular irony of this decision is that there are so many court cases that hold that a client cannot sue its engineer for tort (e.g. negligence) since there is no independent duty of care (outside of the contract) owed by the engineer to the client. Most courts explain that the negligent act or error is what gives rise to a breach of contract action. According to most courts, the client therefore must sue for breach of contract and then prove via expert testimony that the engineer was negligent and therefore breached its contractual obligations.

The “economic loss” doctrine in many states prevents a client from making negligence-based claims against design firms for purely economic damages, and restricts the

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Template of Reasonable Contract Clauses for Design Professionals, by Kent Holland. Key risk allocation clauses in design professional contracts that routinely require editing to make the wish more manageable or insurable include those presented in this template. The language set forth below is suggested as reasonable compromise language to onerous terms and conditions. [Read More](#)

PRONETWORK BLOG

Insurance Coverage on Construction Projects. In the Spring 2015 BrickerConstructionLaw.com Newsletter we read, "Proper insurance is a crucial risk management tool for contractors, design professionals and project owners. Each is generally required by contract, statute, or sense of self-preservation, to purchase and maintain appropriate insurance coverage. Since everyone has insurance, it is easy to assume that most risks on a construction project are covered. [Read More](#)

GUEST ESSAYS

Stirring the Pot: Workplace Drug Policy Implementation in the Era of Legalized Medicinal and Recreational Marijuana by Stephanie K. Rawitt, Clark Hill. In a wave of change that children of the 1960s only dreamed, debated and theorized about, almost half of the states in the United States have now passed laws legalizing the controlled distribution of medicinal marijuana, and two states have even legalized the sale of recreational marijuana. [Read More](#)



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parties to a breach of contract action – where the parties are then subject to the terms of their bargain – including any risk allocation terms and conditions.

Crum & Forster's argument turned the law on its head, and the court got the decision exactly opposite of what it should have held. *Crum & Forster Specialty Insurance v. GHD, Inc.*, 325 F.Supp.3d 917.

The engineer in this case (GHD, Inc./DVO) was engaged in the business of designing and building anaerobic digesters. Their client, a project owner, sued the engineer for breach of contract based on its claim that the engineer "failed to fulfill its design duties, responsibilities and obligations under the contract because it did not properly design substantial portions of the structural, mechanical and operational systems of the anaerobic digester, which caused substantial damages...."

Coverage under the Crum & Forster policy was for "those sums the insured becomes legally obligated to pay as 'damages' or 'cleanup costs' because of a 'wrongful act' to which this insurance applies." The term "wrongful act" was defined as "an act, error or omission in the rendering or failure to render 'professional services' by any insured."

In the exclusions section, the policy stated that it "does not apply to 'damages', 'defense expenses', 'cleanup costs', or any loss, cost or expense, or any 'claim' or 'suit' based on or arising out of: (a) breach of contract, whether express or oral, nor (b) any 'claim' for breach of an implied in law or implied in fact contract, regardless of whether 'bodily injury', 'property damage', 'personal and advertising injury' or 'wrongful act' is alleged."

In analyzing the situation, the court agreed with the engineer that the alleged failure to meet the design requirements met the definition of a "wrongful act." The initial lawsuit by the plaintiff, therefore, fell within the initial coverage grant, said the court. But, although the claim fell within coverage, **the contractual liability exclusion took that coverage away, concluded the court.**

The engineer argued that to permit the contractual liability exclusion to apply to the claim in question would render coverage under the policy illusory – meaningless because it would render the exclusion broader than the grant of coverage. The engineer argued as follows:

"The breach of contract exclusion includes the phrase "arising out of," which Wisconsin courts have explained is "very broad, general, and comprehensive; and [is] ordinarily understood to mean originating from, growing out of, or flowing from." [citation omitted]. "All that is necessary is some causal relationship between the injury and the event not covered." DVO notes that the Wisconsin Supreme Court has explained that every contract contains a common-law duty to perform the contract with care, skill, reasonable expedience and faithfulness. ECF No. 20 at 10 [citation omitted]. Every failure to perform a professional contract with care, skill, reasonable expedience and faithfulness is a professional error or omission. It thus follows, DVO argues, that there are no acts, errors or omissions that could occur while rendering professional services designing and building an anaerobic digester that would not "arise out of" a breach of DVO's contract with WTE. For this reason, DVO concludes that it could never be covered for its errors and omissions and the E & O coverage it purchased is therefore illusory."

In response Crum & Forster argued the following:

"Crum & Forster argues that DVO reads the policy agreement too narrowly and the exclusion too broadly. It notes that the E & O policy also includes coverage for "clean up" costs that may arise out of DVO's professional services and

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would not be excluded under the breach of contract exclusion. Additionally, Crum & Forster argues that the policy must be read as a whole, including the other coverages, such as CGL, third party pollution liability and contractor's pollution liability. Because coverage can be envisioned, Crum & Forster argues the coverage is not illusory."

The court rejected the engineer's argument. It explained:

"[Engineer's] reading of the exclusion and its assertion that no wrongful act in the rendering of professional services giving rise to liability could occur without there being a breach of contract, either express or implied, is too broad. [Engineer's] argument is predicated upon the Wisconsin Supreme Court's explanation that "[a]ccompanying every contract is a common-law duty to perform with care, skill, reasonable expedience, and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract." [*Colton v. Foulkes* citation omitted]... In essence, *Colton* held that as between the parties to a contract, a claim that the defendant had failed to use due care in performing his duties under the contract with the plaintiff could be both a breach of contract or in tort. But that does not mean that every claim for injury or property damage against a party to a contract is based upon or arises out of a contract."

In conclusion, the court held in favor of Crum & Forster – finding the exclusion barred coverage. It stated:

In this case, a reasonable insured would believe, based on the plain language of the exclusion, that liability for breach of contract would be excluded, but not liability to third parties who were not parties to the contract. Reforming the policy to so read, however, would not help DVO since DVO's entire liability in the underlying lawsuit was for breach of its contract with WTE and not to any third parties. In other words, even if reformation were granted, DVO would still be without coverage. It thus follows that Crum & Forster had no duty to defend or indemnify DVO.

Comment: This federal court decision was decided under Wisconsin law, and was based on the application of what the court believed was required by Wisconsin state court precedent, which I believe it misinterpreted and misapplied. Contractual liability exclusions in insurance policies are intended to exclude coverage for liability assumed by the insured by contract for matters such as indemnification obligations that it would not have at common law. The exclusion is not intended to eliminate claims by the insured's client against it for breach of contract based upon negligent performance. Most insurance brokers and insurance carriers would reasonably believe that the most important risk to be covered by a professional liability policy is the risk of liability from claims by the insured's own client.

The court relied on Wisconsin case law applying an exclusion for coverage for breach of contract in the context of a general liability policy. And indeed, breach of contract is a business risk that is not generally insurable under a CGL policy. But that same analysis does not apply to professional liability policies where the breach of contract action is not based on failure to perform work or install widgets, but rather is based on the negligent performance of the work under the contract that causes alleged damages to the client. One can only hope that this terrible decision is appealed and the decision reversed.

In the meantime, however, insurance brokers and risk managers doing business in Wisconsin will need to take precautions to manage their risk and that of their design professional client's by obtaining an endorsement to the professional liability policy stating that the carrier will in no way rely upon the erroneous decision of Crum & Forster



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and will not apply the contractual liability exclusion, to deny breach of contract claims that are based on allegations of negligent performance of professional services. Without such an endorsement, it would seem that a professional liability policy in Wisconsin will provide no protection against the claims that are most likely to be made against the insured design professional.

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