



Stephen S. van Wert

Stephen S. van Wert is the President of Founders Specialty, a Managing General Agent based in Tampa, FL that specializes in the development of innovative insurance solutions for professionals. Stephen graduated with honors from Duke Law, and has held executive positions with Brown & Brown and Willis, before starting Founders Specialty in 2016.

Phone: (703) 992-9480
stephen.vanwert@foundersspecialty.com



Eric A. Moore, CIC, LIC
Moore Insurance Services
www.mooreinsuranceservices.com
emoore@mooreinsuranceservices.com

O (517) 439-9345
M (517) 416-0940

CONTRACTUAL DEFENSE PROTECTION® – A NEW SOLUTION FOR THE OLD “DUTY TO DEFEND” PROBLEM

by Stephen S. van Wert

Imagine this scenario – you are retained by an owner to design a new office building. In front of the office building are stairs and a corresponding ADA-compliant ramp to the front door. Shortly after the building is opened to the public, a visitor slips and falls on the ramp and suffers bodily injuries and sues the owner.

A slip-and-fall like this should be covered by insurance, right? Yes, it should be, as the insurance industry handles slip-and-falls on a daily basis. But because it may be unclear whether the fall was due to improper maintenance of the ramp by the building owner or due to the architect’s negligent design of the ramp, it is likewise unclear whether the claim should be handled by the Owner’s commercial general liability policy or by the A&E’s professional liability policy, or both.

Duty to Defend Provisions

In the meantime, somebody has to respond to this slip-and-fall claim. Fortunately for the Owner, it required the inclusion of a “duty to defend and indemnify” clause in your contract. The purpose of this clause is to protect the Owner against any claims brought by third parties that arise out of your negligence in the design of the building. This clause places the burden on you to pay the cost of the Owner’s attorney fees in defending itself against the third party’s claims.



During the negotiation of the contract with the Owner, you asked your insurance broker how such a provision would be handled by your professional liability carrier. You were reminded that while you are covered for a reasonable indemnity obligation arising from your negligence, your coverage will not include your obligation to defend your client.

How can this be? Insurance companies handle slip-and-falls all of the time. Why are they not able to cover this exposure?



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Template of Reasonable Contract Clauses for Design Professionals

Key risk allocation clauses in design professional contracts that routinely require editing to make the risk 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. This is not legal advice, and before adopting contract language for any specific situation, consultations with legal counsel is recommended. Enforceability of contract language varies from state to state. [\(LINK\)](#)

PRONET PRACTICE NOTES

The Changing Face of Indemnity

An unfavorable indemnity clause signed today can create a catastrophic risk that will not come to pass until some unknown time in the future. There is an alarming trend with regard to the scope, breadth, and dangerous risk transfer associated with the insistence by owners (both private and public) to include onerous indemnity clauses in their contracts with design professionals. This trend has accelerated over the past 10 to 20 years to the point where design professionals know that in just about every form of contract that an owner prepares, it will include some form of indemnity clause. [\(LINK\)](#)



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Dave Johnston, Executive Director

info@aepronet.org
www.aepronet.org

No Insurance Solution

There are basically two reasons why this exposure is not covered under the typical A&E professional liability policy. First, the claimant is suing the Owner and not you and the Owner cannot be included as an additional insured under your professional liability policy. Second, your professional liability policy contains a "contractual liability exclusion" which typically states that there will be no coverage for "any liability assumed by any Insured (the A&E) under any contract or agreement unless such liability would have attached to the Insured in the absence of such contract or agreement".



In addition, if you wanted to look to your commercial general liability policy for coverage, you would be disappointed there as well. Although the standard Commercial General Liability policy provides coverage for an "insured contract" which provides coverage to an insured for "that part of any other contract or agreement pertaining to your business....under which you assume the tort liability or for another party to pay for "bodily injury" or "property damage" to a third person or organization", it may also contain an exclusion for Professional Services.

Simply Don't Agree!

Therefore during your contract negotiation, you tell the Owner that you cannot agree to a duty to defend the Owner because there is no insurance to provide coverage for that exposure. Many Owners respond simply by saying "if you don't agree to it, the A&E down the street says that they will, and I will award the business to them". Faced with the binary option of losing the work to a competitor you decide to assume the uninsured exposure and hope for the best.

You would not be alone as this scenario has been playing out for decades now, and as a result, you and your colleagues have had to swallow this exposure to win business from a certain percentage of Owners that are not willing to forego this duty to defend obligation. In particular, governmental entities have become particularly inflexible regarding these duty to defend provisions. Therefore, any A&Es that regularly negotiate contracts with governmental entities are very aware of the duty to defend exposure that they have been forced to absorb.



Legislative Solutions

Seeing that no real solutions were available, many A&E trade associations attempted to have state legislatures solve the problem simply by making such duty to defend provisions against public policy and therefore unenforceable. Although there has been limited success in some states such as California and Georgia in this regard, most states have not agreed to declare such duty to defend obligations illegal. Even in those states where some legislative progress has been made, they do not declare that such duty to defend provisions are illegal if the A&E is in fact negligent. They will allow the provisions to work to the extent of the A&E's negligence. And once again, since that cannot be readily determined in these situations, these new statutes do not alleviate the A&E from having upfront and immediate duty to defend an Owner from a third party claim.

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PRONETWORK BLOG

Copyrights and Wrongs

Copyright seems like a rather lofty notion. Few put copyright at the top of their list of must-haves in contract negotiations, and even fewer take the time to actually register their documents for copyright protection. But you do have copyright protections under current law. That copyright can come in handy as a risk management tool as well as leverage in a fee dispute. Unfortunately, many design professionals give away their rights vis-à-vis their contracts without a full appreciation of the implications of their actions.

[\(LINK\)](#)

The Contractual Defense Protection Policy

Founders Specialty, Aspen Insurance and ae ProNet collaborated on developing a new approach. This resulted in creating a new insurance policy that works in conjunction with the typical A&E professional liability policy. Basically, the policy covers the duty to defend obligation that the A&E agreed to in their contract with the Owner. There is no deductible but instead the policy contains a coinsurance clause that splits the costs of defense on an 80%-20% basis whereby the insurer pays 80% of the costs and the insured pays the remaining 20%. The insured's obligation however is capped on a per claim basis. The coinsurance amount is established by the size of the firm and is approximately 1% of revenues.

It is important to keep in mind that the retroactive date in the CDP policy applies not only to any act or omission that would result in a trigger to the duty to defend provision, but also applies to any contracts entered into prior to such date.

ae ProNet and Risk Strategies

The CDP policy is distributed on an exclusive basis with member agencies of ae ProNet (aepronet.org) and Risk Strategies Companies (www.risk-strategies.com). Premium indications are very simple to obtain. Just send the ae ProNet or Risk Strategies broker your current practice policy together with your 5 year loss runs, and your last professional liability insurance application, and they will be able to provide you with an estimated cost of the coverage. A bindable quote can be obtained if you also complete the short 2-page CDP application which is available for downloading at www.foundersspecialty.com/cdpprogram.

Moore Insurance Services - is a member of **a/e ProNet** - a national association of insurance agents/brokers that specialize in providing risk management and insurance services to design professionals. These services included risk management publications, contract language review tools, seminar materials and other useful information to help design professionals manage their risks.

We offer many professional liability and property & casualty insurance programs. Many of these programs are endorsed or commended by the professional associations and organizations that we support including: The American Institute of Architects (AIA), American Council of Engineering Companies (ACEC), Michigan Association of Environmental Professionals (MAEP) and Michigan Society of Professional Surveyors (MSPS).

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