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The Named Game: When Your Client Asks to Be a Named Insured

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

It is neither uncommon nor unreasonable for a client to demand that a design firm carries adequate professional liability insurance. However, when a client goes one step further and asks to be a “named insured” on that policy, it’s time for a little client education.

We know of many cases where a client or a client’s risk manager or attorney requests an architect or engineer to make the client (or the client’s client) a named insured on the design professional’s professional liability policy. They mistakenly believe that having the client named as an insured provides an added measure of protection. But these clients, risk managers and attorneys are ill informed, since obliging the request could actually cause client protection to evaporate should he or she file a claim on the policy.

Why You Should Not Make Your Client a Named Insured

Professional liability coverage is typically issued to a design firm and it specifically covers the firm's registered professionals who sign and seal instruments of service. This type of coverage was created to give design professionals adequate financial resources in the event that their errors, omissions, or negligent professional acts damaged a client.

Professional liability insurance is not like other policies that compensate insureds who are damaged by their own negligence. For example, drivers who negligently wreck their cars and are injured receive compensation from their own insurance company. If a homeowner smokes in bed and his house burns down, his insurance will compensate the negligent owner for the self-inflicted damages.

But professional liability insurance is different. It is designed solely to make payments to people *other than* the insured professional in the event the insured’s negligent act, error or omission causes damage to a second party.

The clients' failure to understand how professional liability insurance works is the crux of the problem. They don’t understand that being named an insured on the policy does not provide added protection against a design firm’s negligent acts. And they need prompt, patient explanations as to why being a named insured is a bad idea.

Why is it a bad idea? Because should a client become a named insured under your policy, the client would be covered to the same extent as your firm. In other words, the policy would "kick in" to protect your firm and the client in the event either was accused of an error, omission or negligent professional act. As such, were a named-insured client to file a claim against you, that client -- from an insurer's viewpoint -- would be filing a negligence claim against itself. Such coverage is not afforded by a professional liability policy. For that reason in particular, most professional liability insurers will not permit a client to become a named insured.

There is a second reason why it is disadvantageous for your client to be a named insured. If a third party files a professional liability claim against your firm, your client could be jointly liable for your acts. Your client could find itself having to defend a claim involving design activities it had absolutely nothing to do with. And it could get even worse. A claim against the client might be denied by the insurer since the client has voluntarily assumed a *contractual* liability it would not otherwise have under common law. The client would likely have to pay for its own legal counsel to extricate itself from a situation and pay any damages assessed against the firm.

Now, consider the situation where your client has one or more registered design professionals on staff. Were the client to become a named insured, its design professionals might be automatically covered by your policy, too. Your policy might be called upon to pay for claims against your client or the client's design professionals even though those claims have nothing to do with the project you are working on. *This can be unfortunate for your client as well*, for two reasons:

1. Suppose the client's on-staff architect performs moonlighting design work for a disabled elderly homeowner on a fixed income. The architect makes several serious errors and omissions, causing expensive damages. Through discovery, the homeowner's attorney learns that the architect lacks the assets to defend a suit, let alone pay damages. Counsel then decides to move on the theory that the ability to moonlight was a salary-supplementing benefit provided by the architect's employer and, accordingly, your client shares some liability. The counsel assumes, with good reason, that a judge will permit this approach due to the plaintiff's wretched situation. Given the green light, counsel then files suit against your client and, through discovery, learns that the client is a named insured under your policy, thus creating professional liability protection for the defendant architect. Assuming your insurer agrees to defend and indemnify its newfound insured, and settles the matter for the full amount of coverage available, the aggregate amount left in the policy to protect the client becomes zero!
2. Suppose your client has its own coverage for professional liability exposures. In that case, given the same hypothetical circumstance of the moonlighting staff architect, a question would arise about which insurer should provide protection. Because the situation would be such a complex mess, your professional liability insurer would probably decline to provide coverage -- and the other provider may do the same. As such, your client would probably have to sue both insurers in order to get either to cover.

And here's yet another potential problem. Suppose you agree to a client's contractual request to be a named insured on your professional liability policy. You later discover that your insurer refuses to cover the client. If you do not advise your client that your insurer has declined coverage, you have now breached your contract with your client. Now consider that the client has uninsured design professionals on staff. Such a client could state that you failed to provide coverage to the client's design professionals, something the client bargained for and was counting on. You and/or your firm could wind up having to defend a claim from your client and possibly having to defend the client's design professional, *most likely without the help of your professional liability insurer*. (Neither professional nor commercial general liability insurance covers contractual liabilities except for those that are tantamount to covered conditions.)

Dealing with a Client Request

Sooner or later you will be presented with an onerous contract condition like this:

The Design Professional shall carry professional liability insurance of a type and in an amount acceptable to the Client, and the Design Professional shall make the Client a named insured under said policy.

What do you do?

The first course of action is to educate the client. Explain why the request is not in the client's best interest. The client may only half hear you, however, and say something along the lines of, "So & So Associates accepts this provision all the time." To that remark, your best response may be, "They may accept it, but I doubt they can insure it. Do you have anything on file indicating that the condition has been accepted by So & So's insurer?"

Also, given the liability exposures that a firm can create for itself by accepting this request, you might wish to add, "A firm that apparently is unconcerned about its own liability exposures can hardly be expected to care about yours."

Suppose that a professional liability insurer actually agrees to accept your client as a named insured. Does that mean your client has extra protection? Absolutely not. Remind your client that a professional liability insurance policy has a stated amount of capacity – the policy limits. Being a named insured does not increase that amount. However, a possibility exists that, should a client make a claim against the insured architect or engineer, the insurer that permitted the client to be named on the policy could deny coverage. "Why," ask your client, "should you take that chance?"

Assume you get the client's attention, but the client still wants some contractual language that ensures the project is protected by insurance. While it is foolhardy and indeed impossible to guarantee that you will always have insurance, you can include language that demonstrates your intent to be insured under reasonable circumstances. Consider offering the client the following language:

INSURANCE

The Consultant agrees to attempt to maintain professional liability insurance coverage for a period of design and construction of the Project, and for a period of ___ years following substantial completion, if such coverage is reasonably available at commercially affordable premiums. For the purposes of this Agreement, "reasonably available" and "commercially affordable" shall mean that more than half the consultants practicing the same professional discipline in the state where the project is located are able to obtain such coverage.

Winning the "Named" Game

Your client may request to be a named insured on your professional liability policy in the mistaken belief that it provides "extra" protection. In such instances it is your duty to educate your client and explain that being a named insured only muddies the waters and may actually decrease the protection your client desires.

If your client or its attorney balks at your explanation, schedule a meeting with your client, its legal counsel, your firm and your professional liability agent to explain the facts about professional liability insurance:

- Being a named insured in no way provides added protection – it can only decrease protection or, at the least, muddy the waters.
- Many professional liability insurers will not allow the client to be a named insured on the policy.
- If the client is added as a named insured, the insurer may deny an owner's claim against the designer.
- Being a named insured may make the owner liable for claims filed by third parties.
- This increased exposure may lead to third-party claims that exhaust the policy limits – thus stripping away the client's protection.

To simply play the "named" game and agree by contract to add your client as a named insured only creates risks for you and your client that are wholly unnecessary. This is simply a game where you and your client are both likely the losers.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.