

## ALBERTA CONSTRUCTION INDUSTRY COMMUNIQUÉ

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### ENGINEERS & THE LAW

#### INSURANCE PITFALLS: WHAT ERRORS AND OMISSIONS INSURANCE DOESN'T COVER

In today's litigious environment, controlling and allocating the risks of professional liability has become an essential aspect of the business of engineering.

However, unlike other trades or businesses, professional engineers and architects cannot ultimately protect their assets from claims by simply incorporating their businesses. Professionals remain liable, personally, for their acts and omissions in the rendering of professional service or advice whether they act directly or through a corporation.

The unique nature of the services provided by professionals means they also require a unique kind of insurance coverage. The better known forms of liability coverage, such as general liability insurance, builder's risk or wrap-up liability insurance, generally cannot be applied to the risk assumed by the engineer or architect. Most of these policies will exclude coverage for liability arising from such things as faulty design and the provision of professional services.

For professionals, then, the last line of risk defence is professional errors and omissions insurance coverage. In Canada, a number of insurance underwriters offer these policies, which are designed to insure engineers and architects against liability arising from (according to an ENCON policy): "error, omission or negligent act in the performance of professional services for others." Such policies are available for private practitioners as well as for employed engineers.

Like all insurance policies, however, errors and omissions policies have potential issues and exclusions that may limit your coverage in certain situations. Most people are familiar with their monetary policy limits and term limits, but there are other limitations particular to these policies that are not as well known.

#### CLAIMS-MADE POLICIES

The errors and omissions policies issued by most underwriters today are in the nature of "claims-made" policies. This term means that the policy in place at the time the claim is made against the consulting engineer is the policy that will respond to the loss, regardless of when the service to which the claim applies was rendered. Once the term of the policy expires, or is cancelled for any other reason, it will not cover claims arising thereafter. To maintain coverage, one must renew or replace the policy at the end of each coverage term (generally annually).

#### Note:

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The distinction is important because often the service or product that is the subject of a claim being made against a consulting engineer has been completed years before the claim is made. It is therefore vital that claims-made coverage is maintained for years after a project is completed to address issues that may arise later. Even for those professionals retiring from or leaving the practice, claims-made coverage must be maintained as long as potential claims can arise.

How long that vulnerable period may be is a difficult question to answer. In Alberta, the legislature has implemented a so-called 10-year "drop dead" limitation for commencing any litigation. There are, however, situations in which that limitation might be extended and therefore one cannot rely entirely on the 10-year rule.

Further, many professionals will provide products and services for projects situated outside provincial boundaries where many different limitation periods apply.

## **CHANGING INSURERS**

In the current professional liability insurance market and with the expanding nature of engineering practice, firms are regularly doing a market analysis to find the most acceptable and affordable coverage. Because of the claims-made nature of the coverage, however, switching insurers can create problems.

When changing insurers, for example, the policy that is terminated will respond only to claims "made" and reported to the insurer prior to the termination date. The new policy will respond only to claims "made" and reported after it has been initiated.

Consequently, if you had a claim made against you but did not report it to the insurer before you terminated the policy, that policy will not cover you for the loss.

According to the Supreme Court of Canada: "... for a 'claim' to be made there must be some form of communication of a demand for compensation or other form of reparation by a third party upon the insured, or at least communication by the third party to the insured of a clear intention to hold the insured responsible for the damages in question".<sup>1</sup>

It is essential, therefore, that anyone in an organization who might receive the first notice of a potential claim should understand their obligations to immediately report the situation to the underwriter or to the firm's management so as not to risk losing insurance coverage.

## **TERRITORIAL LIMITS**

Every errors and omissions policy limits coverage to professional services carried out within a certain geographic territory. Often they will only cover claims arising in Canada or the U.S. The territory in which a claim arises is governed by the location of the project for which you rendered professional services. It is not necessarily relevant where your office is located or where you carried out the design or consulting work.

Territorial coverage can be extended in errors and omissions policies by an endorsement extending the geographic limitation. Some insurers will also allow the engineers or architects to "declare" certain of their projects that are outside the territorial limits and request that the policy apply to them. The insurer will assess the risk associated with each project and set a premium or deny coverage.

## **DEFENCE COSTS**

One of the most important aspects of errors and omissions insurance is the obligation undertaken by the insurer to defend the engineer or architect against claims. In many cases, the costs of defence can outweigh the costs of potential liability.

<sup>1</sup> *Reid Crowther v. Simcoe and Erie Insurance* [1993] 1 S.C.R. 252 (Supreme Court of Canada)

Defence coverage will apply if the allegations in the claim, if ultimately proven at trial, would give rise to liability that would be covered under the terms of the policy.

However, some policies limit coverage for defence costs in a more restrictive way than they limit coverage for actual liability. These policies may, for example, insure projects located in the U.S., but only cover defence costs for actions brought in Canada with respect to these projects. These policies often pose difficulties for the insured as the litigation arising from a foreign project is most often commenced in that foreign jurisdiction.

Some policies also carry a declining monetary limit. The effect is that any costs incurred in defence of a claim will erode the total amount available for any settlement payout at the end of the litigation. Other policies will cover defence costs over and above any monetary policy limits.

In conclusion, as with any issue related to insurance coverage, it is important to review your errors and omissions policy and requirements with your broker or insurance counsel in order to ensure your coverage is sufficient to meet your business requirements.

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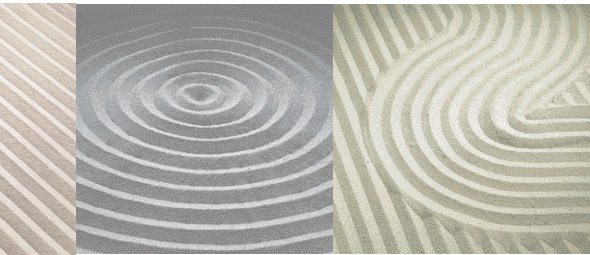
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