



Reporting Contractor's Professional Liability Claims

By Janice Greenberg | August 2, 2021



Most construction projects do not go exactly as planned. Architects need to modify plans midway through to correct errors, structural engineers approve an incorrectly specified concrete mix after failing to account for certain variables, geotechnical engineers miscalculate the stress-bearing capacity of the soil, HVAC contractors fail to design a system to meet specified needs—the list goes on and on.

Construction professionals know how to respond to such situations and take corrective action to ensure that projects are still completed correctly and on time. However, sometimes this is insufficient and the project owner's attorney demands that the firm corrects defects or compensates the owner's out-of-pocket costs and lost revenue. Alternatively, the company may be served with a lawsuit from the owner that will incur significant attorney and expert expenses just to defend against.

Claims Confusion

Consider the following hypothetical example of a design-build contractor called the Schnauzer Company. Schnauzer's CEO, Linda, receives a letter from a client's attorney advising that Schnauzer must compensate the client for remediation costs to correct defects caused by Schnauzer's structural engineer. The attorney includes a draft of a lawsuit Schnauzer's client will file if the company does not agree to pay. Initially, Linda breathes a sigh of relief because Schnauzer purchased contractor's professional liability insurance to protect against such situations. She reports the matter to Schnauzer's insurance provider, sends the assigned claim professional all the necessary information, and waits for the letter confirming coverage. However, when the letter arrives, it says that the contractor's professional liability insurance provider is denying coverage because the "claim" was not first made against Schnauzer during the policy period. Linda is confused because she reported the attorney's letter and the draft lawsuit to the insurance provider immediately after receiving it.

Linda frantically contacts Schnauzer's insurance broker for guidance. The broker points Linda to the part of the denial letter that discusses emails between Linda, Schnauzer's structural engineer and the client that were sent shortly after the project was completed a year ago. In those emails, the client advised of various defects that Schnauzer needed to address and provided a report from a consultant who found that the defects were attributable to errors by Schnauzer's structural engineer. The structural engineer, the project team and Linda thoroughly investigated and analyzed the consultant's findings and concluded that there were no errors. Accordingly, Schnauzer responded to the client that the consultant's findings were wrong and Schnauzer would not correct the alleged defects. The client told Schnauzer that it would stick by the consultant's report and, at its own expense, would correct the defects it believed were caused by Schnauzer's structural engineer.

Schnauzer's insurance broker advises that the emails from the client constitute a "claim" as defined by Schnauzer's contractor's professional liability policy. Because Schnauzer did not report the emails to the insurance provider when they were first received, and the emails were received well before the policy period, coverage is unavailable. This is because the contractor's professional liability policy is "claims made and reported," which means that the policy applies only to an otherwise covered claim that is both first made against Schnauzer and reported to the insurance provider during the policy period.

Reporting Obligations

Policyholders are too often unaware of the very different reporting requirements under a contractor's professional liability policy as compared to the more familiar general liability policy. Under a general liability policy, coverage is occurrence-based, meaning that the policy will respond to otherwise covered claims that arise out of an incident that takes place during the policy period.

By contrast, under a contractor's professional liability policy that is "claims made and reported," the policy in effect when an otherwise covered claim is first made will be called upon to respond, even if the errors that are the subject of the claim took place prior to the policy period.

For example, if a design-build contractor receives a lawsuit or letter in May 2021 involving a structural defect that was discovered in October 2019 and allegedly caused by engineering errors committed in August 2017, the contractor's professional liability policy in effect during May 2021 is the policy expected to respond.

A general liability policy typically requires the policyholder to provide timely notice of a claim against it, and failure to provide timely notice is usually considered a breach of a policy condition. In many jurisdictions, however, a policyholder's failure to provide notice to the general liability insurance provider may be excused if the insurance provider cannot demonstrate that it suffered prejudice as a result of the untimely notice.

This is not the case with a contractor's professional liability policy because notice of a claim during the policy period is not a policy condition—notice is at the heart of the policy's insuring agreement. With extremely limited, fact-specific exceptions, a policyholder that fails to report a claim against it during the contractor's professional liability policy period will not receive a defense or indemnity under the policy, even if the contractor's professional liability was not prejudiced by the failure to report. Thus, it is essential for construction professionals to understand what constitutes a "claim" that must be reported under the contractor's professional liability policy.

The definition of a "claim" under a contractor's professional liability policy varies among insurance providers. One example includes "a written demand, demand for arbitration or mediation or suit made against you seeking 'damages' or correction of 'professional services.'"

While this may seem obvious, it is not always clear in practice. For example, in Schnauzer's case, Linda is surprised that the emails with the project owner qualify as a claim that must be reported under the contractor's professional liability policy. Like any business today, Schnauzer receives many emails from clients during the project and after its completion to address one problem or another, and works to correct them. In this instance, Schnauzer conducted a thorough analysis and investigation of the owner's findings and concluded that its structural engineer did not commit any errors. Is Schnauzer expected to report every one of these instances to its insurance provider?

It is impractical (if not impossible) for policyholders to report every single problem that arises with a construction project. Moreover, insurance providers would be overwhelmed if they required policyholders to report every problem. This is precisely why insurance providers define a "claim" and only require policyholders to report those communications that fall within the specific parameters.

Schnauzer's reporting obligation extends to written demands seeking "damages" or correction of "professional services." The emails qualify under this definition. Although Schnauzer determined that the defects were not caused by its structural engineer's errors, the definition does not take into consideration whether or not the policyholder believes it is, in fact, responsible for the defects. Since the emails meet the requirements of a claim and Schnauzer failed to report them, the firm now faces the prospect of defending itself in a lawsuit and paying for any judgment without insurance coverage.

Better Safe Than Sorry

In practice, every situation is unique. Many times, your company may go back and forth with a client about project issues, but it is not entirely clear if the issues involve your company's professional services or if your client intends to hold your company responsible for the costs of remediation or amounts related to project delays. In other words, you may not be sure if the situation constitutes a claim that must be reported to the contractor's professional liability insurance provider.

Situations like these are common in the construction industry and most contractor's professional liability insurance providers account for this by including the option to report a circumstance that a policyholder believes may result in a claim. To exercise this option, policyholders can report the details of any situation that could result in a claim. Then, if a claim arising out of those circumstances ends up being made against the policyholder, it will be considered reported during the appropriate policy period. Therefore, as long as your company notifies the insurance provider of a subsequent demand from the client or a lawsuit, your company should receive the coverage it expected when the policy was purchased.

About the Author



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