By Michael K. De Chiara, Esq.

MKD: Good afternoon, David. I think it’s fair to say that Lexington is one of the major providers of insurance products for design professionals. Would you tell us something about Lexington Insurance in this regard?

DJB: Lexington is the largest surplus lines carrier in the United States. In terms of written premium, we finished last year just shy of $8 billion in writings. The company is divided into five major divisions. I oversee the casualty operation which represents about $2 billion in business.

Specific to A/E coverage, Lexington has been underwriting for about 30 years. We began as a market for large and challenged engineering firms back in the 80s when the market was very, very tight. As a result, we became known as the insurer for engineering firms, specifically larger firms. In the last five to seven years, we began trying to expand and compete with the CNAs and DPICs of the world by writing middle market and smaller accounts—frankly trying to write as much architectural business as we had written on the engineering side. Today, we have roughly $240 million of A/E professional liability business, including general practice policies and—the more sought after and difficult to get—project-specific policies. We’re very pleased with our place in today’s market, as we are serving the large and small firms in terms of fee size and both architects and engineers.

MKD: What is the importance of experience and sustainability of service to your client base?

DJB: The two items you mention, both longevity/experience and sustainability of service, are very important to the A/E community. Within the last five years, there has been a great deal of change and turmoil in the A&E market that has created uncertainty in the mind of the consumer. At Lexington, we are fortunate to have and been able to sustain a continued and strong presence within the marketplace while enjoying a double-A credit rating. These combined elements build client confidence, particularly the credit rating aspect. A credit rating is an independ-

Continued on pg. 2
Bresnahan Interview

Continued from pg. 1

New carriers entering the market may cut rates in an attempt to increase market share; however, there is not enough margin in the A/E marketplace to tolerate aggressive rate cutting over a long period of time. At Lexington, our clients will continue to enjoy a stable rate environment.

**MKD:** What is Lexington’s position on choice of counsel for insureds who are faced with a claim?

**DJB:** Again, Lexington takes a flexible position. We do believe, however, that this is an issue best discussed and agreed upon at the outset of a business relationship. We ask the client if they have a preference and, if so, we almost always agree to work with the client’s choice.

New carriers entering the market may cut rates in an attempt to increase market share however there is not enough margin in the A/E marketplace to tolerate aggressive rate cutting over a long period of time. At Lexington, our clients will continue to enjoy a stable rate environment.

**MKD:** Has Lexington given any thought to offering a reduction in premiums if an insured can obtain certain contractual protections that minimize or prevent certain exposures?

**DJB:** This concept is good in theory but would be very difficult to effect due to the nature of A/E business. It would be tough, if not impossible, to establish a hard and fast rule, difficult for an A/E firm to track, and difficult for an insurance carrier to monitor. At Lexington, we spend a great deal of time trying to understand each client’s approach to contractual risk management. This determines whether their account is priced with nominal or material credits, impacting how their premium is calculated.

**MKD:** What are the unique challenges faced by design professionals?

**DJB:** Architects and engineers, by nature, are very caring and thoughtful. Unfortunately, what we’ve seen work against some clients, particularly when a claim is brewing, is that they unknowingly neglect to protect themselves adequately compared to litigation savvy contractors. As a result, we’ve seen a variety of issues and challenges emerge. For example, contractors may attempt to buy time, stall or delay once they realize that they’ve underbid a job. Design professionals will engage and respond to any and all requests that a contractor makes of them to keep the project on track. In some cases, by being an active participant in an attempt to move the job along, the A/E unwittingly becomes a party to the eventual law suit. We have seen situation upon situation where design professionals will attempt to solve a problem by methods specific to their profession as opposed to ways that are practical to their businesses.

**MKD:** The area of housing, specifically condo and coop development, is a pretty hot area for litigation. But, it’s also a booming area of work for A/E firms. What are your thoughts on insurability, and what can design professionals do to protect themselves in this volatile but lucrative building sector?

**DJB:** All of the traditional protections, such as contractual risk management, are quickly undermined when condominiums change owners. In most cases, as the HOA flips, you unfortunately lose those protections. For this reason, we see a lot of requests for project-specific coverage in this area. While Lexington doesn’t have a condo exclusion as part of its offering policy, many other insurers do. There is a bit of a coverage vacuum. If a design firm has a significant amount of condo work, they could jeopardize their practice policy, depending on their insurance carrier’s position toward this market sector.

**MKD:** From a societal point of view, there will be tremendous pressure to build more housing — specifically low and moderate income residences. Design professionals will have to have protections. We may even get to a point where a political solution is necessary.

**DJB:** At Lexington, in order to monitor and limit our risk, we attach a material change endorsement to every condo/coop project that we underwrite. The material items include a budget, contingency and design/development assumptions. We list each item and specify a margin of error at the time of binding. If a margin of error exceeds the baseline, Lexington can call a “time out” to reunderwrite or reprice the deal. The material change process has brought a new level of communication and exposure management to project specific insurance.

**MKD:** We see more and more architects and engineers becoming involved in design-build projects. How does Lexington view this type of project?

**DJB:** We consider design-build high risk. In our opinion, design professionals are not well positioned contractually within the team of stakeholders. In bid-build, the design professional has direct contact with the owner. In design-build, the contractor comes between the owner and design pro-
Bonding the Construction Project

By Kevin J. Connolly, Esq.

Soon or later, every participant in the construction industry encounters bonds of one sort or another. Many of those who obtain bonds on a regular basis are unclear about the relationships between the parties.

General Nature of Bonds

A bond is a contract that serves to provide security that another, primary obligation will be performed. It takes the form of a promise to pay a sum of money, known as the penal sum; if, however, the primary obligation is properly performed, then the parties’ liability under the bond is excused. Although the bond reads as if the whole penal sum is forfeited if the primary obligation is not performed, in practice, the liability on the bond is limited to damages sustained by the beneficiary, up to a limit equal to the penal sum.

The party that is to perform the underlying contract is the principal. The party that is benefited by the bond—often being the recipient of the sum—is the beneficiary. The third party on the bond—the insurance company, high-net-worth individual or enterprise that is lending its credit to the principal—is the surety.

The basic rules of bonds are quite simple. The obligation of the surety is found within the “four corners” of the bond, and it is essentially the same as the obligation of the principal, though there are certain conditions that limit the surety’s obligations. “Conditions” is a slippery term that introduces a great deal of confusion, because there are two distinct kinds of conditions. There are conditions subsequent, which state what events have to occur for the parties to be excused under the bond. Payment Bonds, for example, typically provide that if the contractor pays all of the bills incurred in a construction project, then the bond is void. In the arcane language of surety law, such a bond would be said to be “conditioned for the payment of contractors, laborers and suppliers.” There are also conditions precedent, which state the events that must occur before the surety can be called upon to perform. Most bonds provide for a battery of conditions precedent—such as notice and opportunity to investigate and cure defaults—that must be satisfied before the beneficiary can collect on the bond.

Types of Bonds

Bonds come in a variety of flavors. There are bid bonds, which are generally required by public entities as part of a contractor’s competitive bid. The preparation of an invitation to bid and instructions to bidders require especially careful drafting and attention to detail when bid bonds are required. Most bid bonds require that the contract be awarded to the principal before the bond becomes enforceable. If the instructions to bidders provide that no binding contract will be in effect until Payment and Performance Bonds are delivered, the bid bond will most likely be unenforceable.

A second type of bond frequently encountered is the Performance Bond. Such a bond is conditioned on the contractor’s due performance of the construction contract. Performance Bonds carry lots of conditions, including a condition that there must be no “Owner Default.” Thus an unexcused failure by the owner to pay money under the construction contract is a complete defense to a Performance Bond.

Modern Performance Bonds, such as AIA Form A312-1984, permit the surety to elect a substitute performance instead of simply paying out damages incurred by the contractor’s default. The A312 form requires that the owner notify the surety that it is considering declaring a contractor default. The owner must then attempt to schedule a meeting with the contractor and surety to discuss a resolution of the issues. The owner is not obligated to wait more than fifteen days after giving the required notice. Unless there has been an “Owner Default,” the surety has the right and the obligation to do one of four things:

Get the contractor to perform and complete the project;
Reducing Insurance Premiums

Continued from pg. 1
The Insurance Market: Why Have Premiums Increased So Much?

Over the past several years, the entire insurance market has been recovering from concessions given to insureds in the mid-1980’s through the late 1990’s. During that time period, insurance companies were operating in an extremely competitive market. In an effort to capture more premiums, insurance companies offered competitive prices and liberalized the terms of insurance agreements.

The recent change in the insurance market can be attributed primarily to two factors: (1) a change in the economic environment resulting in reduced earnings for insurance companies on their investments and (2) an increase in the volume of lawsuits and the costs of litigation.

The change in the economic environment resulted in reductions of surplus for insurance companies. In order to achieve their own financial goals, insurance companies began increasing premiums and deductible amounts. They also avoided certain types of high risk businesses or dramatically increased the costs of insurance for these businesses. Lastly, insurance companies began excluding certain types of claims from their policies and became more willing to deny coverage for certain types of claims.

The second factor affecting the insurance market concerns the increase in the volume and costs of litigation. Owners and developers have become increasingly litigious with respect to claims for errors and omissions against architects and consultants on their projects. Design errors or omissions resulting in additional costs to owners and developers that, in the past, would have been considered to be within the contingency costs for a project, are being vigorously pursued. In fact, it has been argued that some owners view professional liability insurance policies as funding sources for their projects. The increase in claims by owners is also prompted, in part, by an increase in claims by contractors. Individuals injured while working on, occupying or visiting projects have also become more willing to pursue claims, even when their injuries are caused by their own lack of due care.

What Do Insurance Companies Look for When Setting Premiums?

In light of the increasing number of lawsuits involving design professionals, insurance companies are carefully investigating potential insureds. In determining the premium for an insured, insurance companies rely on a design firm’s claim history, areas of practice, use of a risk management program, level of experience, types of projects worked on, client base, and terms typically included in their contracts. The premium for a design firm with a good claim history and effective risk management program should remain relatively stable, while a design firm with a poor claim history and no risk management program will experience significant increases in insurance costs.

Design firms that engage in businesses with higher risks have found it difficult to obtain affordable professional liability insurance. For example, geo-technical and structural engineers typically incur higher premiums than other design professionals based upon the nature of and risks inherent in the services that they provide.

Ways to Reduce Risks: Risk Management Programs

While design professionals cannot change the economic environment or the litigious nature of our society, there are ways to reduce, or at least stabilize, the costs of professional liability insurance. Design firms that engage in businesses with higher risks have found it difficult to obtain affordable professional liability insurance. For example, geo-technical and structural engineers typically incur higher premiums than other design professionals based upon the nature of and risks inherent in the services that they provide.

While design professionals cannot change the economic environment or the litigious nature of our society, there are ways to reduce, or at least stabilize, the costs of professional liability insurance. By implementing an effective risk management program, a design firm may become more attractive to insurance companies and could also reduce the time and expenses associated with defending claims.

The key to a successful risk management program is awareness. All risks should be identified. Once the risks are identified, techniques can be developed to mitigate the risks. Set forth below are some risk management techniques that may assist design firms in avoiding lawsuits, and ultimately, obtaining more favorable terms from their insurers.

Provisions that Should be Included in a Design Firm’s Contract

Contract negotiations provide the first opportunity for a design firm to limit its exposure to lawsuits. Design firms frequently do not spend enough time reviewing the terms of their agreements or are forced to sign unfavorable agreements after they commence their services in order to get paid.

Insurance companies promote the inclusion of certain provisions in contracts as part of a design firm’s risk management program. This article addresses four types of provisions that can assist design firms in avoiding costly litigation: limitation of liability provisions, indemnity provisions, waiver of consequential damages provisions, and no liability for consultants’ provision.

LIMITATION OF LIABILITY

From a risk management perspective, perhaps the most important provision that should be included in a design firm’s agreement with its client is a limitation of liability provision. A limitation of liability provision is a bargained-for allocation of risk which caps liability among parties. Owners and developers have been increasingly willing to agree to such provisions when they are accompanied by insurance provisions with acceptable minimum insurance coverage requirements. The existence of a limitation of liability provision will prevent catastrophic loss to the design firm in the event of a claim in excess of the design firm’s liability insurance.

New York courts have determined that only certain types of limitation of liability provisions are enforceable. Specifically, courts have upheld limitation of liability provisions that limit a design professional’s liability for economic losses. A limitation of liability provision that attempts to exempt a design firm from liability for personal injuries or property damage will be deemed unenforceable pursuant to New York statutory authority.

In this regard, New York General Obligations Law Section 5-323 states:

Every covenant, agreement or under-
A well-drafted indemnity provision is essential to protect design firms from the costs and expenses of claims by third parties. New York law specifically prohibits the indemnification of a design professional for its own negligence unless the indemnitor is an insurance provider. Specifically, Section 5-322.1 of the General Obligations Law states:

A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances or construction managers.

In states where privity rules permit an owner to commence an action directly against a consultant to an architect, the consultant should insist that the architect ensure that the limitation of liability provision applies to both the architect and the consultant.

Limitation of liability provisions that limit a design firm's liability to the available insurance should not be objectionable where the contract requires specific insurance amounts that the owner deems appropriate. Design firms typically do not have extensive assets. The limitation of liability provision is consistent with the reality that if a design firm is sued, the only real assets to the plaintiff are the available insurance proceeds.

INDEMNITY PROVISIONS

A well-drafted indemnity provision is essential to protect design firms from the costs and expenses of claims by third parties. New York law specifically prohibits the indemnification of a design professional for its own negligence unless the indemnitor is an insurance provider. Specifically, Section 5-322.1 of the General Obligations Law states:

A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances or construction managers.

In states where privity rules permit an owner to commence an action directly against a consultant to an architect, the consultant should insist that the architect ensure that the limitation of liability provision applies to both the architect and the consultant.

Limitation of liability provisions that limit a design firm's liability to the available insurance should not be objectionable where the contract requires specific insurance amounts that the owner deems appropriate. Design firms typically do not have extensive assets. The limitation of liability provision is consistent with the reality that if a design firm is sued, the only real assets to the plaintiff are the available insurance proceeds.

INDEMNITY PROVISIONS

A well-drafted indemnity provision is essen-
Reducing Insurance Premiums

Continued from pg. 5

agrees not to sue the design firm for consequential damages such as business losses. These provisions have become increasingly important after the decision of the New Jersey Supreme Court in *Perini Corp. v. Great Bay Hotel & Casino, Inc.* In that case, the owner was a casino operator that retained a construction manager in connection with a $24 million hotel and casino expansion. A dispute arose between the owner and the construction manager regarding when the contractually defined “substantial completion” of the project had occurred. The parties participated in an arbitration and the arbitrator awarded the casino the sum of $14.5 million for lost profits. The New Jersey Supreme Court subsequently upheld the award.

The decision in *Perini Corp.* was troubling to the construction industry since the construction manager's compensation was only $600,000. Currently, New York law provides that a waiver of consequential damages provision will not be deemed to be unenforceable where the clause is presented to indicate that the parties lacked the meaningful ability to negotiate the terms of the contract.  

**NO LIABILITY FOR CONSULTANTS**

Another provision that should be included in a design firm's agreement with its client is a provision stating that the architect is not liable to the client for errors or omissions in the services provided by other consultants on the project. Such a provision may prevent the architect or prime consultant from being brought into lawsuits that involve claims resulting solely from technical deficiencies in the services provided by a consultant or other designer. A sample provision is as follows:

Architect is not responsible to Owner or any third parties for errors, omissions, or other deficiencies in the services of any other design professional or design-build contractor rendering design, engineering or related services for benefit of Owner or Project, whether retained by Architect or Owner. Architect's sole liability in connection with services of Consultants or design-build contractors shall be to coordinate the Consultant's portion of the instruments of service. Architect shall take whatever action is reasonably necessary, including assignment of rights, to enable Owner to pursue its claims for errors or omissions and deficiencies directly against any Consultant retained by Architect. Owner shall require Consultants or design-build contractors retained by Owner to coordinate their services with those of the Architect and Architect's Consultants.

The inclusion of this type of provision may keep the architect or prime consultant out of claims that are solely related to technical deficiencies by a consultant that had the responsibility for a particular element of the project. Unfortunately, architects and prime consultants are often required to expend significant legal fees merely based on the fact that they retained a consultant. A “no liability for consultants” provision, like the above provision, may prevent the client from asserting a claim against the architect or prime consultant based upon the errors or omissions of consultants.

**Use of Risk Management Techniques During the Design and Construction Process**

The application of risk management strategies should not be limited to contract negotiations. Considerations of risk management techniques are equally important during the course of the design and construction processes. Design firms are often brought into lawsuits for performing services which they are not contractually obligated to perform. Pursuant to New York law, a design professional who performs services outside of his agreement may be considered to have “assumed a duty” with respect to those services. A design professional who assumes a duty to perform services outside of an agreement must perform those services in accordance with the same standard of care as services within the contract.

By way of example, architects occasionally receive requests from their clients to review the designs of other design professionals on a project. The architect who reviews these designs may be held liable if errors or omissions exist and the client or third party is damaged or injured. While it is difficult from a client relations standpoint to refuse to comply with a request by a client to review another professional’s work, there are several factors that must be considered. First, the design professional should determine if he is competent to review the issue. Often, design professionals are sued for reviewing specialty designs for which they lack sufficient expertise. If the design professional elects to perform the requested services, regardless of whether he is being paid for those services, he must exercise the same amount of diligence and care as if the services were required to be performed pursuant to the design professional's contract.

A design professional may also be deemed to have assumed a duty during the course of construction. For example, structural engineers for the base building on a project are often requested by their clients to review conditions during excavation. The structural engineer of record is typically not responsible for the engineering required for the excavation and excavation support activities, and if these activities subsequently cause damage to a neighboring property or injury to a worker, the structural engineer may be sued and could potentially be held partially responsible for any damages incurred.

**Conclusion**

An effective risk management program that addresses risk during contract negotiations and through the design and construction phases is essential to combat the escalating costs of insurance. By utilizing these safeguards, design professionals can avoid lawsuits and help themselves in obtaining affordable insurance coverage.

---

Issues Regarding Notice and Timeliness of Insurance Claims

By Robert L. Honig, Esq.

The Reasonably Practicable Standard

When an insured is aware of a potential claim against him because of personal injury or property damage, the insured must give notice of claim to his liability insurer pursuant to his policy. Generally, an insurance policy calls for anywhere from 30 to 90 days in filing a written notice of claim with the insurer. According to most policies, if notice is not given within the requisite timeframe, the insurance contract will be vitiated and no coverage will be provided. Obviously, a loss of coverage could be catastrophic for the insured. In many policies, express terms such as “as soon as practicable,” “reasonable,” “timely,” “immediate,” or “with due diligence” govern the timing of the requisite notice of claim. But what exactly do these rather generic terms mean?

What Constitutes a Reasonable Delay?

New York's courts have grappled for decades with issues impacting the timely notice of an insurance claim. Many courts have held that an insurer is not obliged to cover the loss of its insured unless the insured gives timely notice of loss in accordance with the terms of the insurance contract. Most of New York's courts have interpreted such notice of loss provisions on a case-by-case basis to determine what constitutes reasonable notice. In the Matter of the Arbitration Between the Travelers Insurance Company and James P. Delosh, 249 A.D.2d 924, 672 N.Y.S.2d 219 (4th Dep't 1998), for example, the Fourth Department wrote that “the meaning of the phrase as soon as practicable is an elastic one and calls for a determination of what was within a reasonable time in the light of the facts and circumstances of the case at hand.” Id. at 925. In the seminal case of Mighty Midgets, Inc. v. Centennial Insurance Company, 47 N.Y.2d 12 (N.Y. 1979), the New York Court of Appeals determined that “it is well settled that the phrase ‘as soon as practicable’ is an elastic one, not to be defined in a vacuum. By no means does it connote an ironbound requirement that notice be “immediate” or even “prompt,” relative as even those concepts often are...” When a delay has occurred in providing notice to the insurer, the court is often asked to determine whether the delay is reasonable and whether or not the insurer will be required to provide coverage under the policy. The burden of establishing a reasonable excuse for the delay, however, rests upon the insured. See Travelers Insurance Co., citing Can-Am Roofing, Inc. v. American States Insurance Company, 229 A.D.2d 973, 645 N.Y.S.2d 253 (4th Dep't 1996). Numerous excuses have been proffered by insureds to establish a reasonable delay and this state's courts have ruled for both the insured and the insurer under several different theories.

New York courts have declared delays of several months or even years “reasonable” as a matter of law when the insured establishes a valid excuse. The most commonly accepted excuse for such a delay is an insured’s reasonable belief in nonliability. This belief is typically measured by whether a reasonable person could have envisioned liability under the circumstances. In Safeguard Insurance Co. v. Angel Guardian Home, 946 F.Supp. 221 (E.D.N.Y. 1996), for instance, the District Court quoted the New York State Court of Appeals in explaining that:

> when the facts of an occurrence are such that an insured acting in good faith would not reasonably believe that liability on his part will result, notice of the occurrence given by the insured to the insurer is given “as soon as practicable” if given promptly after the insured receives notice that a claim against him will in fact be made.

Safeguard also provides a rationale for those insureds who fail to notify their insurer immediately in every instance of potential liability, writing:

> The cases excusing an insured's failure to notify an insurer of an occurrence based on a good faith belief of non-liability are supported by the rationale that if insureds were required to notify insurers of every incident that poses even a remote possibility of liability, insurers would soon be swamped with notice of minor incidents that pose little danger of resulting even in an action by the injured party against the insured, let alone a claim by the insured against the insurer.2 Id. at 227.

Mere knowledge of an incident does not require an insured to notify his insurer where there is a reasonable belief of nonliability. In 875 Forest Ave., Corp. v. Aetna Casualty and Surety Company, 37 A.D.2d 11, 322 N.Y.S.2d 53 (1st Dep't 1971), a three-year-old girl was killed after falling from a window. The owner of the apartment building was informed two days later. The owner, however, failed to provide notice to his insurer until over one year later after he received a letter from the mother's attorney indicating that she intended to assert a claim. The insurance company disclaimed coverage because of the delay in notice. The court, however, ruled that “it is generally recognized that the insured may be excused for a delay or failure in giving the required notice to the insurer where it appears that, acting as a reasonable and prudent person, he believed that he was not liable for the accident.” Id. at 13. With this holding in mind, the Forest Avenue Court determined that knowledge of the incident at the time was not enough to lead the plaintiff to believe there was anything about the accident which would have suggested the possibility of a liability claim. See id. Similarly, in Kelly v. Nationwide Mutual Insurance Company, 174 A.D.2d 481, 571 N.Y.S.2d 258 (1st Dep't 1991), defendant Nationwide denied coverage because of the insured's nearly one year delay in providing notice of a minor traffic accident. The court ruled that Nationwide had to defend and indemnify Kelly because Kelly had believed there was no serious injury and that therefore no claim would be asserted. See id.

New York's courts have historically been extremely generous where an insured can support its reasonable belief in its lack of liability. Indeed, in 1991, the New York court of appeals found a delay of almost 20 years to be reasonable. In St. Clare's Hospital and Health Center v. Insurance Company of North America, 934 F.2d 15 (2d Cir. 1991), the Second Circuit ruled that the insured hospital satisfied its obligation to provide notice of its claim in a reasonable amount of time, and therefore that continued on pg. 8.
Timeliness of Insurance Claims

Continued from pg. 7

its insurer must provide coverage. See Id. at 19. The St. Clare's Court found that the circumstances surrounding the delivery and treatment of an infant in 1967 did not, in and of themselves, provide the hospital with a reasonable belief that it would have liability. The Court determined that even though it was not until 1985 when a claim against the hospital was finally made, the twenty year delay in providing notice to the insurer was reasonable under the particular circumstances. See Id. at 18. More recently, in Medina v. State Farm Mutual Automobile Insurance Co., 303 A.D.2d 987, 757 N.Y.S.2d 178 (4th Dep't 2003), the Court found that a 27-month delay in providing notice of an automobile accident was reasonable under the circumstances. In Medina, the Court accepted plaintiff's argument that it did not become clear to her that she would have to pursue an uninsured motorist claim until her chiropractor told her over two years after her accident that she was unlikely to fully recover from her injuries. See Id. at 989.

A claim of nonliability, however, will not always be sustained where the insured alleges a reasonable belief of nonliability. Courts have frequently found that an investigation into the facts by the insured must take place in order to establish a reasonable belief of nonliability. In Mount Vernon Fire Insurance Company v. DLRH Associates, 967 F.Supp 105 (S.D.N.Y. 1997), the District Court ruled that the trier of fact must determine "whether the circumstances known to the insured at that time would have suggested to a reasonable person the possibility of a claim." See Id. at 108. After a tenant had fallen out the window in the insured's apartment building, the Mount Vernon Court ruled that because the insured had made no investigation into the extent of injuries or circumstances and had not otherwise given timely notice, the insurer was not required to defend or indemnify him. See Id. at 111. Similarly, in White v. City of New York, 81 N.Y.2d 955, 598 N.Y.S.2d 759 (1993), the Court wrote that without an investigation, there can be no good-faith belief in nonliability. See Id. at 958.

In contrast to the above cases, New York Courts have also ruled against the insured in cases with relatively short delays in providing notice. In American Insurance Company v. Fairchild Industries, Incorporated, 56 F.3d 435 (2d Cir. 1995), for example, the Court wrote that "under New York law, delays for one or two months are routinely held ‘unreasonable’ as a matter of law. Id. at 440; citing American Home Assurance Co. v. Republican Ins. Co., 984 F.2d 76, 78 (2d Cir.). In Haas Tobacco Company v. American Fidelity Company, 226 N.Y. 343, 123 N.E. 755 (N.Y. 1919), a frequently cited case, the Court of Appeals of New York found that a delay of 10 days was too long in a case where the insured relied solely upon his own opinion without any investigation into an accident between a truck and a bicycle. See Id. The United States District Court for the Eastern District of New York built upon this holding in M.Z. Discount Clothing Corp., 23 F.Supp.2d 270 (E.D.N.Y. 1998) when it found that “immediately” was a far more stringent standard than “as soon as practicable”.

Rejecting the plaintiff’s late notice of its insurance claim, the District Court refused to excuse plaintiff’s mistaken notification to an entity different than the one identified in its policy. See Id. at 272. Similarly, in Rushing v. Commercial Casualty Insurance Company, 251 N.Y. 302, 167 N.E. 450 (Ct. App. 1929), the Court of Appeals ruled that a 22-day delay in notice did not constitute “immediate notice upon the occurrence of an accident,” as required by the insurance policy. Id. at 304. The Second Department went even further in Vanderbilt v. Indemnity Ins. Co. of North America, 265 A.D. 495, 39 N.Y.S.2d 808 (2nd Dep't 1943), when it suggested that “immediate notice” has the same effect as “as soon as practicable.” See Id. In Vanderbilt, the Court found that a 28-day delay in giving notice of an accident was fatal to the insured's claim where the notice given by the plaintiff did not specifically establish that it was sent “by or on behalf of the insured.” See Id. at 496.

More recent cases have adopted the same rationale as the Courts in some of these earlier decisions. In Horowitz v. Transamerica Insurance Co., 257 A.D.2d 500, 683 N.Y.S.2d 290 (2nd Dep't 1999), for example, the Second Department found that the insured’s 48-day delay in notifying his homeowner’s insurer of a fire was unreasonable as a matter of law, even though the insured argued that the fire at issue destroyed the documents that he needed to identify his insurer and provide the requisite notice. See Id. Similarly, in Goodwin Bowler Associates, Ltd.v. Eastern Mutual Ins. Co., 259 A.D.2d 381, 687 N.Y.S.2d 126 (1st Dep’t 1999), the Court concluded that the plaintiffs’ two month delay in submitting notice of their claim was unreasonable as a matter of law. See Id, at 381. Another excuse for late notice of an insurance claim that has been repeatedly rejected by New York’s Courts is a simple lack of knowledge or mistake in the insured's memory. In Reina v. United States Casualty Co., 228 A.D. 108, 239 N.Y.S. 196 (1st Dep’t 1930), the Court ruled that a 26 day delay was inexcusable where the insured’s only excuse for failure to give “immediate” notice was that he sent his notice to the wrong insurance company by mistake. See Id.

The Role of the Broker

The role of an insurance broker in providing notice of claim to an insurer is also one that New York's Courts have interpreted in a variety of different ways. Generally, notice to an insurance broker is not considered notice to the insurer. In some particular circumstances, however, New York Courts have found notice to the broker to be acceptable. Many Courts have held that an insurance broker is the agent of the insured and that notice to the ordinary insurance broker is not notice to the liability carrier. New York Courts have also found that a broker will be held to have acted as the insurer's agent where there is some evidence of action on the insurer's part, or facts from which a general authority to represent the insurer may be inferred. In Shaw Temple A.M.E. Zion Church v. Mount Vernon Fire Insurance Company, 199 A.D.2d 374, 605 N.Y.S.2d 370 (2nd Dep't 1993), for instance, the Court ruled that a 9-month delay in providing notice was inexcusable because the broker did not have an agency relationship with the insurer and therefore had no power to modify any of the policy’s provisions. See Id. Consequently, if evidence can be presented that the broker does represent the insurer in some way, then notice to the broker will constitute notice to the insurer. See Id.

There are also instances in which a broker’s error has allowed delays of notice to be excused. In Universal Underwriters Insurance Company v. Patriot Ambulette, Inc., 149 A.D.2d 500, 539 N.Y.S.2d 981

8 Quarterly Review Zetlin & De Chiara LLP
(2nd Dep’t 1989), the Court ruled that a 5-month delay in providing notice because of a broker’s mistake in sending the notice to the wrong insurer was permissible as a matter of law. Similarly, in Sparacino v. Pawtucket Mutual Insurance Company v. Imperial Delivery Service Inc., 50 F.3d 141, 143 (2d Cir. 1995), the Court relied on Patriotic Ambulette for its finding that “it is reasonable for an insured to rely on statements of an insurance broker,” even if that broker is wrong in his instruction as to whether the insured is liable for the incident. See id. In Martini & Lafayette Studios Corp. v. Lafayette Studios Corp. & Firemen’s Insurance Company, 177 Misc.2d 383, 676 N.Y.S.2d 808 (N.Y. Cty. 1998), on the other hand, the Court ruled that a 17 month delay based on a broker’s error, was inexcusable as a matter of law. See id. at 388. The Court based its decision on the precept that the broker is an agent of the insured and therefore cannot relieve the insured of its obligation of timely notice of claim to the insurer. See id.

As a practical matter, it is best if the insured immediately notifies both its broker and its insurance carrier directly of any occurrence that may even have the potential to result in a formal claim against an insurance policy. This way the insured will be fully protected from any claim by the insurance carrier that it failed to provide timely notice of its claim, whatever standard the policy contains.

4 See also Mighty Midgets, Inc. v. Centennial Insurance Company, 47 N.Y.2d 12 (N.Y. 1979).

Insurance Panel Covers Hurricanes, Condos, and K-12 Projects

The 2005 Annual Joint Session on Current Insurance Issues affecting the design professional industry convened on November 3rd in New York City. The event was sponsored by Zetlin & De Chiara LLP (Z&D), as well as the New York Chapters of the American Council of Engineering Companies and the American Institute of Architects. Michael K. De Chiara, Esq., founding partner of Z&D, moderated a panel of senior executives from the country’s top insurance companies serving the architectural and engineering communities.

The panel included David J. Bresnahan, Sr. VP of Lexington Insurance; Dana Brown, RPLU, A&E Specialty Lines Underwriter of Beazley USA; Kevin J. Collins, RPLU, Sr. VP & Sr. Manager of Victor O. Schinnerer & Co.; Michael A. Davis, RPLU, Professional Liability Product Line Manager of Zurich NA; Paul C. Dietrich, ARM, VP & Mid-Atlantic Regional Manager of ACE USA; Lee Genecki, Managing Director of St. Paul Travelers; and Daniel J. Kumpf, CPCU, RPLU, VP of XL Design Professional.

Given the critical impact insurance has on the management of a design practice, this open forum between insurance companies and the design professionals they serve was formatted in Q&A-style, addressing current issues faced by the architectural and engineering industry that may affect insurance carriers and their ability to underwrite certain projects. Topics discussed include the impact of the devastating 2005 hurricane season, challenges in the condominium and K-12 markets, and developments concerning mold and silica.

The program began with a discussion about the direction of insurance premiums over the next few years. The majority of the panelists agreed that industry-wide premiums will likely remain flat, although there is the possibility of a positive increase on an individual carrier basis during 2006 and beyond. The primary stimulus for any increase would be a consequence of Hurricanes Katrina, Rita and Wilma. Rate increases will be determined by the amount reinsurance companies absorb in Hurricane Katrina-related claims. When reinsurance capacity is greatly reduced, primary insurance rates increase and coverage terms are restricted because primary insurers have less underwriting capacity and increased reinsurance premiums.1 Higher premiums must be passed on and will likely impact casualty lines into which (design) professional liability falls.

The panel agreed that the losses resulting from damages sustained during the hurricanes, particularly Katrina, will take a considerable bite out of the industry’s cash flow. Specifically, the estimated dollar impact will range between $40 billion and $60 billion dollars. Relative to the industry’s $90 billion cash flow, if Katrina costs $60 billion, approximately 15% of the industry’s surplus will be depleted. However, this loss may not result in a huge impact on the industry—as long as the loss is distributed evenly.

Although initial reports indicate that Katrina will affect primarily the property, marine and energy lines of the insurance industry, the tri-state area will also feel the impact of inflation and cost increases resulting from the hurricanes’ devastation. Specifically, the tri-state area will see an increase in steel and transportation costs and a labor shortage because of the increased need for construction and related services in the Southern region.

According to the panel, since Katrina hit the Southeast, the rating agencies have put 24 insurance companies on watch in connection with their financial strength. They have also put eight companies on watch for credit risk. Further, the rating agencies downgraded four companies which, according to one panel member, might sound the death knell for those particular companies.2 These actions are all in response to the insurance companies own announced losses. Interestingly enough, those reporting companies account only for approximately half of the $40 billion dollar-estimated loss.
Continued from pg. 9

to be sustained by the insurance industry.

Condominium development projects continue to be considered the riskiest by the insurance industry.

Historically, condominium projects have and continue to present a high propensity for litigation. This leads to significant pay-outs and increases in professional liability rates. Since there are multiple units and owners, if there is a construction or design flaw, that flaw is likely to be repeated throughout all units, thus multiplying the potential damages. The fact that residential condominiums provide a higher risk of exposure because of the 24-7 occupancy by owners is also a contributing factor. Further, claimants can file a class action suit and split the legal bill, which leads to an increased frequency of claims being brought against design professionals.

Moreover, the nature of condominium projects allows many developers without ties to a community to come into an area for a “quick build.” These developers build cheaply and disappear after the project is completed. When problems arise, unit owners often have little recourse except against the local design professional. Ofttimes, the design professional is not contracted to provide construction phase services and is not on-site during the building phase to insure that the contractor builds according to design specifications. An insurer’s best approach to a proposed condominium project is to determine whether the client firm has been involved previously with a successful condominium development. Positive indicators include a design professional’s early partnership with the contractor and/or an owner/developer who works on multiple condominium projects. According to Michael De Chiara, the AIA/ACEC Contracts Committee is developing contract forms that include limitations of liability for and preclusions to lawsuits against the design professional. The intention of the Committee is to incorporate limitation provisions in contracts between the developer and the sponsors, and between the sponsors and the individual shareholder/unit owners. Mr. De Chiara also sought the support and participation of the insurance industry in creating contract language that would provide some protection for design professionals from owners.

Don’t miss the Annual Joint Session on Current Insurance Issues for Design Professionals

Date: December 6, 2006

Participating Companies
• ARCH Insurance
• ACE Insurance
• Beazley Group
• Lexington Insurance Company
• The St. Paul Travelers
• Victor O. Shinnerer & Co., CNA
• XL Design Professional
• Zurich North America

It was suggested that owners and developers secure their own insurance separate and apart from design professionals on these types of projects. Owner and developer premiums would be based on their previous involvement with condominium development, as well as the overall financial viability of the proposed condominium project. Another type of construction project that concerns the insurance industry is “K-12” school projects. These projects are ripe for litigation due to delay claims and cost overruns. The major issue with these types of projects is that they are budgetarily restricted, highly politicized and managed by revolving school boards. Therefore, these projects are usually fast-tracked in order to complete the job before it can be debated and delayed. Indeed, according to one panelist, large design firms engaged in K-12 school projects experience the highest frequency and severity of losses due to claims in the New York and New Jersey area.

Educational projects will remain a problem for the insurance industry because of the project owners and environmental concerns, such as mold and HVAC issues, which pose a direct health threat to young students. However, insurers “overlay” these concerns by evaluating the underwriting strength of educational projects based on the volume of work in a given project type relative to claims. Condominium projects have a $4 to $1 ratio for the amount of claims paid out relative to the consulting revenue received, but school projects have a $1 to $1 ratio.

The panel also addressed specific issues presently covered by underwriters that pose a concern for insurance carriers regarding coverage, including silica and mold. Silica (a dust similar to asbestos which arises from earthwork, sandblasting and bridgework and is thus more of a construction and contractor liability issue) has been a difficult issue for the insurance industry to sort through, but will be watched carefully in 2006. While mold appears to be well-contained as an insurable and underwritable risk as it applies to a design professional, it is still a concern in terms of claims against a contractor. To what extent a contractor will look to transfer its mold exposure to a design professional is also of concern. No insurance carrier on the panel currently has a mold or silica exclusion in their policies and none have immediate plans to exclude mold or silica-attributed claims as they apply to water intrusion and/or construction defect claims. However, mold is seen as an additional claim in connection with water intrusion or a construction design defect claim.

The 2005 Annual Joint Session on Current Insurance Issues was attended by over 350 architects, engineers, lawyers and insurance representatives.

---

4 Id.
Bonding the Construction Project

Continued from pg. 3

Perform the project, either itself or through independent contractors;

Secure a replacement contractor approved by owner, with equivalent payment and Performance Bonds; or

Waive its right to perform and either (a) pay owner its damages or (b) deny liability on the bond. The denial must be supported by a statement of reasons for the denial.

If the surety fails to do one of these things, the owner must give the surety a final notice and demand for performance, at which point the owner is free to hold the surety in default and proceed to enforcement.

Performance Bonds should be distinguished from Completion Bonds. Completion Bonds are conditioned on the lien-free completion of the project, and they are not defeated by an Owner Default. In fact, a Completion Bond is triggered by an Owner Default. Essentially, a Completion Bond is a Performance Bond with the additional proviso that it covers Owner Default as well as Contractor Default.

Payment Bonds are encountered about as frequently as Performance Bonds. Indeed, the AIA A312-1984 form includes both payment and Performance Bonds in a single electronic file, and the bonds are almost always underwritten together. The Payment Bond is conditioned on the payment of all sums that the principal may be obligated to pay for labor, equipment and materials used in the construction project.

Payment Bonds are especially significant in public contracting, because contractors, subcontractors, material suppliers and other parties that are normally protected through the right to file a lien are usually precluded from asserting liens on public property. Even states that, like New York, permit the filing of a “public improvement lien” generally provide that the real estate affected by the project remains unlienable. The Miller Act, 40 U.S.C. §§ 3131 – 3134, mandates the furnishing of a Payment Bond for all projects that affect real property of the United States. Many states have parallel provisions—known colloquially as “Little Miller Acts.” A gap in coverage sometimes occurs when a privately-funded project is being erected on public property. For example, a private user (an airline or rental car company) might wish to have improvements erected on public land, such as an airport. In the case of a public project in New York, the lien law grants subcontractors and material suppliers a lien on the public funds that are earmarked to pay for the project. When the project is being funded by a private user, there is no public fund, so the subcontractors and material suppliers cannot file liens. A recent amendment to §5 of the New York Lien Law provides that when there is no public fund, the private entity for whom the work is being done must file a Payment Bond for the full amount of the contract sum.

Payment Bonds for private projects must be filed with the County Clerk whenever the contract sum exceeds $100,000. This duty is prescribed by statute, and a failure to comply renders the owner answerable for reasonable attorneys’ fees incurred by any party that successfully brings an action or proceeding on the bond.

Lien Bonds

The New York Lien Law contains several distinct provisions concerning bonds. In any of these situations, the principal on the bond is not home free until the bond has been exonerated, and that can be a very time-consuming and daunting task.

One of these is §19 of the Lien Law, which provides for the discharge of a private improvement lien by filing a bond with the clerk of the county where the project is located for 110% of the amount of the claimed lien. The filing of the bond discharges the lien as an encumbrance on the real estate, and the lien thereafter attaches to the bond.

Section 21 of the Lien Law provides for a similar bond to discharge public improvement liens. Such bonds are filed, not with the county clerk but with the State or the public agency holding the funds to pay for the project.

A third bonding provision is rarely invoked, but it has its place in some projects. Section 37 of the Lien Law provides for a “bond to discharge all liens.” This bond is filed in advance of liens being claimed. The amount of the bond must be set by court order; once it is filed, no mechanic’s lien will attach to the property.

Bonds and the A201

The AIA standard form of general conditions (A201) contains many provisions pertaining to bonding. These clauses often require careful attention to their modification. The primary bond clause, paragraph 11.5, provides that Payment and Performance Bonds may be required by the contract documents, but it defers to other contract documents to supply the operative language that would require and govern the furnishing of bonds.

Subparagraph 5.4.1 provides that the contingent assignment of subcontracts to the owner is subject to the rights of the surety on payment and Performance Bonds.

Subparagraph 7.3.6 makes it clear that adjustments in the premium payable for a bond are a component in pricing change orders if the job is bonded.

Subparagraph 9.6.7 provides that payments received by a contractor for work performed by subcontractors are received in trust unless a Payment Bond is in effect. This is not consistent with the Trust Fund provisions of the Lien Law, which govern all payments received by a contractor for the work, irrespective of whether a Payment Bond has or has not been obtained.

Subparagraph 9.10.2 provides that the consent of the surety is always required before making the final payment. The making of final payment without securing that consent would discharge the bond. It also provides that a bond may be used as a substitute if a subcontractor refuses to deliver a final lien waiver at the time of closeout. Because obtaining a bond does not actually affect the legal status of a lienor’s rights, this clause is one that often requires careful modification.

Subparagraph 9.10.3 provides that when retainage is being reduced or released due to delays in achieving final completion that are not chargeable to the contractor, the consent of the surety is a condition precedent to the payment.

Subparagraph 11.4.9 permits any contractor or subcontractor to require the owner to give a bond with respect to its handling of property insurance proceeds that will be used to pay the cost of the repairs. The cost of the required bonds is chargeable against the insurance proceeds received as fiduciary.

Surety Bonds and Change Orders

Every participant in the construction industry learns at an early stage that change is the only constant in construction. The interaction between the change order process and

Continued on pg. 12
Continued from pg. 11

surety bonds is complex but critically important. The AIA form of Payment and Performance Bond, A312-1984, is quite open-ended about changes in the work. Section 8 of the Performance Bond, and Section 10 of the Payment Bond, both provide:

The Surety hereby waives notice of any change, including changes of time, to the Construction Contract or to related subcontracts, purchase orders and other obligations.

Moreover, having agreed that it is liable for the performance of the Construction Contract and the payment of all sums required to be made under the Construction Contract by the Contractor, the Performance Bond defines “Construction Contract” to mean

§12.2 Construction Contract: The agreement between the Owner and the Contractor identified on the signature page, including all Contract Documents and changes thereto. [Emphasis supplied.]

Section 15.2 of the Payment Bond contains the same language. This remarkable language appears to give the owner and contractor the power to change the obligations of the contract dramatically—and thereby the obligations of the surety on the bond—without so much as notification to the surety. There was a time when even a minuscule change in the bonded contract would discharge the surety unless it consented to the change. That rule has largely gone by the wayside when a compensated corporate surety is involved.

However, a question remains as to whether there are any limits to the change order power. To state an extreme example, suppose the original contract called for a subcontractor to install windows in a single-family residence, and the “change order” required that subcontractor to handle the entire curtain wall system for a $100 Million luxury condominium. In such an extreme case, it seems accurate to say that the old contract has been wholly supplanted by a new contract for a dramatically different scope of work, and the new contract is not bonded.

Some guidance on this issue can be found in Success Construction v. Superintendent of Insurance, 220 A.D.2d 339, 632 N.Y.S.2d 788 (1st Dept. 1995). In that case, a bond had been written to cover a $195,000 subcontract that expressly excluded stonework in the lobby and atrium from the scope of work. A change order was issued that added stonework in the lobby and atrium, with a price increase of $350,000.

The court held that the surety was discharged by the change order.

Under construction contracts specifically making allowances for alterations during the course of the work, changes not fairly within the contemplation of the parties at the time the original contract was made, constituting a material departure from the original undertaking, will therefore release a nonconsenting surety from obligations under its bond.

Los Angeles Office Opens

The firm recently opened a Los Angeles office and named Robert H. Shaffer, Jr. as resident partner. Mr. Shaffer, formerly of Wickwire Gavin LLP, specializes in construction claims; construction contract drafting and negotiation; construction-related insurance coverage; and prosecution and defense of surety claims. “We are thrilled to have Rob on board. He is the perfect person to have at the helm of our new West Coast venture,” said Michael S. Zetlin.

Shaffer, pictured right, has over 14 years of legal experience in the construction industry. His resume includes such successes as arbitrating extra work/delay claims for a geotechnical contractor; and defending a residential developer/general contractor against a multi-million dollar claim for defects and earthquake damage. He received his law degree from Pepperdine University School of Law and holds an undergraduate degree in economics and political science from Pepperdine University.

“Zetlin & De Chiara’s expansion into the California market was meticulously planned and required the leadership of someone we felt had the integrity and experience to mirror our firm’s culture,” said Michael K. De Chiara.