

Focus on risk management...

## When does a notice from a client become a claim that must be reported to your insurance carrier?



*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.*

Where a project developer sued its engineer that was responsible for the site and grading plan, the engineer's carrier refused to defend the suit because it asserted the engineer had not provided notice of the claim within the time permitted for reporting under the policy. The developer wrote a letter to the engineer in March stating that the engineer's slope design failed to follow the recommendations of a geotechnical report and therefore resulted in the parking not draining. The letter concluded by directing the engineer to "develop a plan to correct the drainage problem." The engineer did not give notify its insurance carrier of this letter as a "claim" against it but instead responded by letter to the developer with an explanation that the problems were caused by defective construction rather than defective design. After follow-up meetings with the developer at which the causes for the problem were reviewed, the engineer sent another letter reiterating that the problem was caused by construction defects. After receiving that letter the developer sent a second letter or e-mail to the engineer in the month of May specifically accusing the engineer of design error and chastising it for failure to "accept responsibility." Three months later (August), the engineer advised its carrier that this May correspondence by the developer constituted a "claim" against him. Subsequently, the developer filed suit against the engineer as well

as the architect and contractor, and the engineer's carrier refused to defend the suit because the engineer didn't give timely notice of the claim as required by the policy.

The engineer filed suit against the carrier in a separate action for alleged breach of duty to defend it in the underlying litigation. The court in this case (*Matkin-Hoover Engineering, Inc. v. Everest National Insurance Company*, 2009 WL 1457669 (W.D. Tex., 2009)) denied the insurance carrier's motion for summary judgment – meaning that the case will go forward on its merits to determine whether the carrier properly declined to defend the engineer.

The issue of what communication from the developer to the engineer first constituted a "claim" that the engineer must report to its carrier was carefully analyzed by the court, but it seems to this author that the decision failed to address a critical point and that if this case goes forward on the merits the carrier may yet prove that it owed no duty to defend the engineer in view of exclusions that may potentially apply. (*See Comments at the conclusion of this case note.*)

Policies were issued by Everest Insurance to the engineer for the time period of April 15, 2005 to April 15, 2006, and a renewal policy covered the following twelve month period of April 15, 2006 to April 15, 2007. When the engineer gave Everest notice of what it deemed to be developer's claim in August 2006, the second Everest policy was in effect. Since the developer's March 2006 letter was written during the first policy period, Everest argued

that the claim occurred during that policy and must be reported within 60 days of the end of that policy period. This is the claim event that the carrier asserted the engineer was required to report during the first policy period pursuant to the requirement that for coverage to be triggered, “the claim arising out of the wrongful acts is first made against any Insured during the policy period” and the “the claim is reported in writing to [Everest] no later than 60 days, after the end of the policy period.

The engineer argued that it was not until receipt of a May 19, 2006 letter from the developer demanding that it pay to correct the defects in the parking lot that it was clear that the Owner was making a claim against him.

“Claim” was defined in the policy as follows:

“**Claim**” means a demand for money or **professional services** received by the Insured for damages, including but not limited to, the service of a lawsuit or the institution of arbitration proceedings or other alternative dispute resolution proceedings, alleging a **wrongful act** arising out of the performance of **professional services**.”

The court explained that it found nothing about this definition to be ambiguous. According to the court,

[W]hether a claim has been made on an insured doesn’t depend on whether a demand is formal or informal—it depends on whether the communication ‘demand[s] . . . money or professional services . . . for damages . . . [and] allege[es] a wrongful act arising out of the performance of professional services.

As further stated by the court, “The definition anticipates that communications other than ‘the service of a lawsuit or the institution of arbitration proceedings or other alternative dispute resolution proceedings’—whether formal or informal—may implicate the duty to defend. . . .” The absence of words in the definition stating that that a “claim” applies to informal proceedings is not a latent ambiguity, says the court.

Having determined that the language of the policy was not ambiguous, the judge continued to evaluate the letter from the developer to determine whether it fit within the definition of a “claim.” In this regard, the court stated that this determination requires a fact-specific analysis to be conducted on a case-by-case basis. The inquiry “asks when circumstances known to the insured would have suggested to a reasonable person the possibility of [a] claim.”

In this case, the court considered the insurance company argument that a reasonable person should have understood the letter to constitute a claim because, according to the carrier, it demanded performance of professional services to repair the drainage problem and alleged a wrongful act arising out of the engineer’s performance of professional services. In rejecting the carrier’s argument, the court found that this characterization of the letter was overstated and that “considering the circumstances known to the insured, the letter did not necessarily suggest to a reasonable person the possibility of a claim.” There were several communications between the parties after receipt of the March 2006 letter, culminating in a letter from the engineer to the developer dated May 18, 2006 reporting the results of a “comprehensive as-built survey” showing how the road as built by the contractor did not meet the engineer’s plans and specifications. Upon receipt of that letter, the developer responded by letter dated May 19, stating, “Your letter contains suggestions to

correct the problem but you did not discuss the costs, [make] any attempt to determine the costs, or how to pay for the costs. You simply dumped your suggestions on my laps [sic], which I interpret to mean that you have refused to accept responsibility for your design error. Do I read you correctly?

Until receipt of this letter, the court stated “a reasonable person could have believed that [the developer] had not decided who caused the drainage problem. . . I agree with [Engineer’s] position that the [first letter] ‘could be reasonably regarded not as a demand but as a request for additional engineering services to help correct a construction defect for which [the engineer] was not responsible and for which it thought, at the time, it would be paid.’” The fact that the developer eventually sued everybody (including the engineer, architect and contractor) supports the engineer’s argument that the developer was uncertain about who was responsible for the problem.

The final focus of the court’s discussion addressed whether the fact that the first letter from the developer demanded professional services constituted a “claim” since the definition refers to a demand for professional services as being a possible claim. Although the letter demanded professional services, the court found “the letter did not demand professional services for damages as the definition of ‘claim’ requires.” This is the important distinction that the entire decision rests upon. The court summed up as follows:

The [developer] letter does not suggest that [Developer] expected [Engineer] to pay an amount which [Engineer] was legally obligated to pay for a covered claim. A reasonable person may likely have viewed the [Developer] letter as [Engineer] says it did—as a request for additional engineering services to fix the drainage problem for which it would be paid. Because a reasonable person may not have

viewed the letter as a demand for professional services for damages, a question of fact exists, precluding summary judgment.”

**Comment:** It is not uncommon for problems to arise on a project where there is uncertainty or dispute over who is responsible for defects in the project as constructed. The construction contractor might not have met the plans and specifications. Or the architect or engineer may not have met the standard of care in drafting the plans and specifications. Or there could be shared responsibility for the problem if it is determined that the problem was caused by a combination of defective plans and specifications as well as defective construction work. The claim notice issue that confronts design professionals is when does it become necessary to report a matter as a claim if the professional believes the problem is created solely by defective construction work, and that the contractor is inappropriately asserting that the design professional is at fault. This can be a difficult judgment call. Design professionals may not want to report every contractor change order demand as a claim under their professional liability policy merely because the contractor has alleged a basket or reasons for entitlement, including some tenuous argument of design error. On the other hand, what happens if a party with standing to make a claim (such as the project owner/client) eventually makes a written demand or files a suit against the design professional? Will the claim be denied by the insurance carrier as untimely because it was not reported when the design professional first became aware of the issue?

To reduce the risk design professionals have in missing deadlines for reporting claims, professional liability carriers generally include language in their policies permitting what is known as “circumstance” reporting. This permits the insured to report any incident that it reasonably believes may become a claim against it. The policy in effect when the “circumstance”

is reported to the carrier is the one that will ultimately be responsible for responding to a “claim” if such claim eventually results from that “circumstance.” In the case reported in this article, if circumstance reporting was permitted, then even if the engineer had not recognized the letter from its client as a claim, it could have reported it to its carrier as a “circumstance” and thereby preserved coverage under the 2005-2006 year policy even though the law suit was not filed until a subsequent year’s policy was in effect.

Recognizing claims, and timely reporting them to the carrier, is important as demonstrated by this case. It can become even more of an issue if the policy was not renewed with the same carrier but was instead replaced with a different insurance company’s policy. The application for insurance requires the applicant to identify any known claims or known situations that could reasonably become claims. If a few months after changing carriers an Insured gives its new carrier a claim to defend, that carrier is going to want to know when the Insured first knew the

circumstances giving rise to that claim – and may deny the claim if it determines that knowledge of the claim pre-existed the issuance of the new policy. If that happens, the Insured could be stuck in the middle—with no coverage under either its old policy or the new policy—since it didn’t report the matter to the old carrier within the required time frame permitted for filing claims under that policy.

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