

PROFESSIONAL PRACTICE 544

INSURANCE - LICENSING OF ARCHITECTS – FORMS OF ASSOCIATION

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INSURANCE

Insurance

▶ Professional Liability Insurance (Errors & Omissions)

- ▶ Coverage for claims of negligent errors or omissions by Architect
- ▶ Key terms and concepts
 - ▶ Coverage Limit - The maximum that the policy will pay on account of a claim
 - ▶ The policy pays any loss and pays an attorney to defend the Architect
 - ▶ E&O policies (and others) are “declining balance” policies, so costs paid for defense diminish the amount available to pay or settle a claim
 - ▶ Deductible - The amount that Architect must pay from its own pocket before the insurance proceeds apply
 - ▶ Retroactive Date – The earliest date of Architect's error or omission for which coverage will apply
 - ▶ Premium - Annual payment an Architect makes to the insurer to “buy” the policy

Insurance

▶ Professional Liability Insurance (errors & omissions)

- ▶ The policy is a “claims made” policy, which means that it covers all claims made within the policy year
 - ▶ Because a claim may be made after a project is completed, the insurance only provides protection if it is kept in place
 - ▶ Architects who are retiring or going out of business may purchase “tail policies” which protect against claims made arising out of prior projects even though no further insurance is being purchased
- ▶ Deductibles are quite large, particularly for Architects with large practices who have been in business for a long time
- ▶ Premium a function of coverage limits, deductible, and claims history – similar to how your auto policy may be figured

Insurance

▶ **Professional Liability Insurance**

- ▶ Claims must be reported promptly
 - ▶ Claims made to the insurance broker
 - ▶ Claims made to the carrier
- ▶ The lawyer hired by the insurance company to defend the claim owes his duties of loyalty to Architect, not the insurance company
 - ▶ The lawyer is probably retained frequently by the insurance company and will have strong business ties to it
 - ▶ If a conflict of interests with the insurance company, Architect may have two lawyers
 - ▶ One looks out for Architect's interests, while the other looking out for the insurer's interests

Insurance

▶ Professional Liability Insurance

▶ Practice v. project policies

- ▶ The typical professional liability insurance is a practice policy. It covers all claims for professional errors or omissions made against Architect during the course of the policy year arising out of Architect's practice
- ▶ Alternative insurance is a "project policy." This provides insurance for all professional liability claims against the design professional arising out of a particular project
- ▶ One reason for the popularity of project policies is that the premiums for them can often be directly passed through to Owner as a cost of the project
- ▶ Practice policy costs needs to be factored into the overhead numbers when bidding a project
- ▶ Contractors and their policies, including pass-through costs are a bit different

Insurance

▶ **Commercial General Liability Insurance - The Architect**

- ▶ When purchased by Architect, it covers claims of liability not arising out of professional services
 - ▶ These claims are rare on the typical construction project. Some examples might be:
 - ▶ A client trips and falls on a rug in Architect's office
 - ▶ Architect's construction site observer accidentally bumps into someone and injures him
 - ▶ Because this insurance responds to very few risks, it is not very expensive
 - ▶ It is written on an “occurrence” basis, rather than a “claims made” basis, so it covers all claims arising out of actions that occurred during the policy year

Insurance

▶ **Commercial General Liability Insurance - The Contractor**

- ▶ When purchased by contractor, it is the major source of protection against claims by injured workers or for calamitous property damage
 - ▶ The general contractor names Owner and Architect as additional insured parties under the insurance
 - ▶ This provides important coverage for Owner, but its coverage for Architect is illusory
 - ▶ When a claim for a construction worker injury or property damage is made against Architect, it is generally deemed to be a claim for professional liability
 - ▶ An exclusion exists in the commercial general liability policy for claims alleging professional liability, so Architect has no coverage under the policy
- ▶ Policies cover claims alleging sudden and dangerous occurrences resulting in property damage or bodily injuries, but not solely economic loss or repair/replacement costs due to bad workmanship

Insurance

▶ **Automobile Liability Insurance**

- ▶ Very similar to general liability policies except they cover accidents arising out of the use of a car
- ▶ These policies are simply commercial versions of the automobile insurance policies that virtually every individual has on his or her own automobile
- ▶ Anyone who drives to the construction site, including both Architect and Contractor, purchase these policies and keep them in place essentially constantly

Insurance

▶ **Builder's Risk Insurance**

- ▶ This is a policy that covers the actual construction work being performed on the site: The work in place, materials stored on site, etc.
- ▶ It may be purchased either by Owner or by Contractor, but the policy names both as insured parties
- ▶ Unlike the liability policies described above, builder's risk insurance is no-fault property damage insurance
 - ▶ Covers damage to the work in place regardless of whether anyone was at fault in causing it
- ▶ The danger to an Architect is that the builder's risk insurer may pay off a loss, and then turn around and sue Architect for having negligently contributed to the problem

Insurance

▶ **Builder's Risk Insurance**

- ▶ Danger to an Architect is that the builder's risk insurer may pay off a loss, and then turn around and sue Architect for having negligently contributed to the problem
 - ▶ The insurer is "subrogated" to Owner's (and possibly the contractor's) rights against Architect after paying a loss. Essentially, the courts deem that the insurer "steps into the shoes" of the insured parties to the extent of the payment
 - ▶ This appears to be fundamentally unfair, as the basis for calculating coverage costs is a "no-fault" assumption
 - ▶ Architect can ensure that the builder's risk insurer cannot sue Architect by being named as an additional insured party under the policy or else by having Owner (and possibly the contractor) waive their rights of subrogation in their contracts

Insurance

▶ Workers' Compensation Insurance

- ▶ Employers customarily purchase this insurance to protect against a bodily injury claim by the employer's own employees
- ▶ Several statutes passed by the state that require this insurance and that set minimum levels of coverage
- ▶ Worker's compensation laws are the exclusive remedy that an injured employee has against its own employer – but not against 3rd parties
 - ▶ Damages that an employee receives through this process is usually far smaller than what it would receive from a jury in court
 - ▶ Common for the employee to sue everyone for negligently causing the injury except his employer – as that is the workers' comp claim
 - ▶ Workers' compensation laws make it difficult for the parties who have been sued by the employee to bring the employer into court to bear its fair share of the loss

Insurance

▶ Certificates of Insurance

- ▶ To prove that the insurance policies were purchased and coverage is in place
- ▶ Prepared by insurance brokers describing the basic terms of the insurance coverage
- ▶ Often is Architect's responsibility to collect, examine, and forward the insurance certificates provided by the construction team
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- ▶ If complex issues regarding coverage arise, you must examine the actual policies



LICENSING OF ARCHITECTS

LICENSING OF ARCHITECTS

Purpose of Licensing Architects

- Public interest – to protect the public from incompetent design
- Business interest – to regulate competition

Illinois Department of Financial & Professional Regulation (IDFPR)

- Administrative agency over the profession
- Regulations – still has the force of law
- More specific than legislature

LICENSING OF ARCHITECTS

Sanctions for Violation of License Statutes

- Fines or penalties
- Denial of license upon subsequent application
- Inability to sue for fees or forfeiture of all fees
 - Issues/cases arise mostly in this area
 - Should the client avoid paying for fees simply because of no license?
 - Sole proprietor – individual architect example

LICENSING OF ARCHITECTS

Types of Licensing Statutes

- “Holding Out” Statutes
 - Simply requires the design professional to use a particular label
 - Does not regulate the work
 - Allows the public to know a licensed architect is competent, but nothing for the unlicensed
- “Practice” Statutes
 - Prohibits practice without a license
 - But what then is the definition of architectural services?
 - You simply cannot contract with an unlicensed architect (fees +/-)
- Illinois has a hybrid statute (both are required)
- Who should be able to decide about contracting parties?

LICENSING OF ARCHITECTS

Practicing Architecture without a Licensing

- Under a licensed architect's supervision
 - Content/participation versus the “fly-by” review
- Reciprocity for out-of-state architect
 - National Council of the Architectural Registration Boards (NCARB)
 - The rules and regulations still vary from state to state, and what is actually recognized
 - “Warm” versus “Cold” states

LICENSING OF ARCHITECTS

Questions re: Licensing and Registration

- If an architect can pass a competency exam (i.e., the AREs), why should the degree or experience matter?
- Does having a license prevent incompetence?
- What about licensing interior architects, landscape architects, contractors for design?
- What about insurance for licensed v. unlicensed architect?
- Why prohibit the recovery of fees for “practicing” without a license, especially if licensed elsewhere?



FORMS OF AGENCY

THE LAW OF AGENCY

Principal, Agent, and Third Party

- Agent – A person acting on behalf of another
 - Principal is the party for whom the agent is acting
 - The third party is the person with whom the agent is interacting on behalf of the principal

Examples of Common Agency Relationships

- Employer/employee
- Actor or athlete/agent
- Real estate broker/property owner
- Owner/architect (to a limited extent)

THE LAW OF AGENCY

Purpose and Theory – Why have an agent?

- Agents may have greater expertise than their principals
- Principals may need to delegate tasks
- Certain legal entities can only operate through agents

Effects of an Agency Relationship

- The agent may bind the principal to a contract
- Knowledge of the agent is attributed to the principal – even if the principal does not have such knowledge
- The agent's acts (and omissions) are attributable to the principal

THE LAW OF AGENCY

The Agent's Duties to the Principal (Fiduciary Duties)

- Loyalty
- Care (not being negligent)
- Obedience
- Notification (forwarding information)

THE LAW OF AGENCY

Source of the Agent's Authority

- Actual authority
 - Explicitly granted – communication from principal to agent
 - Written, oral, or implied
- Apparent authority
 - Authority the principal leads third parties to believe is granted to agent
 - Must be principal who creates – not the agent
- Ratification by the principal
 - Not all actions by agent are binding on principal
 - Principal may adopt/accept/ratify an act after-the-fact – even if unauthorized
 - May be express or implied

THE LAW OF AGENCY

Undisclosed principal

- An agent pretends to be acting on her own behalf, but really acting on behalf of an undisclosed principal
- An agent indicates there is a principal but fails/refuses to provide the identity of the principal
 - Third party may have a claim against both the agent and the principal
 - Third party has right to know with whom it is dealing

THE LAW OF AGENCY

Termination of the Agency Relationship

- Express or implied termination
- At the end of a given period of time, or when the purpose has been accomplished
- By principal at any time (but may be a breach if agency relationship results from a contract and specific period)
- The principal should advise all third parties of the termination (to avoid apparent authority)



FORMS OF ASSOCIATION

SOLE PROPRIETORSHIPS

Any individual who conducts business

No legal distinction between the business and the individual

- Income treated as personal income
- No special liability protections

May use an assumed name (d/b/a)

May have employees

- Employees can be agents within scope of their employment

PARTNERSHIPS

Similar to a sole proprietorship owned jointly by two or more people – combined into one partnership

Governed by state law

- Uniform Partnership Act (default agreements)
- Court created law
- Partnership agreement (contract between partners)

Debts and Taxes

- Individual partner are responsible for the debts of the entire partnership.
- Profits and losses are taxed pro rata to the partners' interests

PARTNERSHIPS (cont.)

Ownership division between partners

- Rights and duties may be divided in any agreed percentage
- One partner may have 75% of the profits and only 33% of the losses
- Partners are not guaranteed a salary; they share profits

Each partner is the agent of the others and of the partnership

- Full authority to act or bind the partnership
- All knowledge fully attributable to the partnership
- Partnership duties are similar to agency duties, but operate in a two-way direction

PARTNERSHIPS (cont.)

Effect of a partnership

- Income is treated as personal income
- No special liability protections

“Limited” partnership distinguished

- Primarily a financing mechanism
- Role of general partner – same as with a regular partnership
- Role of “limited” partners
 - No authority to manage or bind the partnership (not an agent)
 - Only liable to the extent of individual financial contribution

CORPORATIONS

Corporations are legal entities – just like people

Governed by state law

- Illinois Business Corporation Act
- Articles of Incorporation, by-laws
- Shareholder agreements in close corporations

Rights of the owners (shareholders) of the corporation

- Voting for directors
- Receiving dividends
- Liquidation rights upon corporate dissolution

CORPORATIONS (cont.)

The Corporate Hierarchy

- Shareholders (not agents)
- Directors (agents and owe fiduciary duties)
- Officers (agents and owe fiduciary duties)
- Employees (limited agents – depends on the scope of employment)

CORPORATIONS (cont.)

No personal liability for corporate malfeasance

- Shareholders, officers, directors, and employees are not liable for corporate acts
- Complex, restrictive tax, and accounting treatments (double taxation of dividends)
- Piercing the corporate veil – if sham, shell corp., not true

Professional corporations

- Set up to practice a particular licensed profession (law, architecture, etc.)
- Laws vary from state to state
- Generally obsolete in Illinois

LIMITED LIABILITY COMPANIES (LLC)

A hybrid between a corporation and a partnership

- A separate legal entity, like a corporation
- Tax and accounting treatment of a partnership
- Liability protections of a corporation

Also governed by state law

- Illinois Limited Liability Company Act
- Not as much court-created law as traditional corporation law
- Operating Agreement acts like corporate by-laws

LIMITED LIABILITY COMPANIES (“LLC”) (cont.)

Hierarchy similar to a corporation

- “Members” are owners/unit holders (like shareholders)
- “Managers” are like officers and directors
- May have employees just like any corporation

LLCs are usually the best vehicle for complex organizations

- Often seen as single-purpose entities in the construction world
- Good for joining unique business partners

SUMMARY OF RISKS

Type of Entity	Flexible Taxation and Accounting	Liability Shield (Separate Legal Entity)
Sole Proprietorship	✓	
Partnership	✓	
Corporation		✓
LLC	✓	✓



QUESTIONS