PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 01/99: "Third-Party Liability" January, 1999

Third-Party Liability

As you probably are aware, as many as 60-65% of all professional liability claims against architects and engineers are filed by clients. The obvious costs of these claims is significant. But the not-so-obvious costs, including the value of the billable time spent, and the loss of what could have been a client for life, can be larger still.

Given clients' propensity for filing claims, you need to be diligent when it comes to client selection. Invest the time and energy required to educate clients and thereby earn their trust and respect. Client trust and respect can be gained, in large part, through an effective contract formation process.

Third-parties account for the remaining 35-40% of professional liability claims (about half of which are filed by contractors). Once again, an effective contract can significantly reduce the likelihood of a problem.

To attain an agreement that can effectively reduce the likelihood of third-party claims, you need to meet with the client and explain how a number of contract provisions can lower your third-party liability exposure as well as the client's**.**

Reports and Studies

When you have been engaged to conduct research and issue a report or study, be it a soils report, evaluation of an existing building or structure, etc., third-parties are likely to rely on what you provide. In some cases, you won't know they have done so until after the fact, when damages are alleged and a source of recovery is sought.

To reduce your exposure (and your client's), you could physically include a copy of your contract with the owner as an appendix to the report to indicate specifically the scope of services involved and the nature of your agreement with the client for whom the service was performed.

Third-Party Exclusion

Third-parties sometimes file a claim because, somehow, they think they are beneficiaries of the contract between you and your client. For that reason it can be beneficial to include a third-party exclusion in your general conditions.

This provision states that the agreement does not create any right or benefits for parties other than the consultant and the client. While the provision cannot prevent third-party claims, it makes them far more difficult to take forward, and

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Published by

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even tougher to win.

Third-Party Reliance

Third-party reliance on a report is a well-known problem in the environmental field. It can also be a problem for design professionals if, for example, you evaluate the structural integrity of a building or some other structure, only to have your client sell the property and use your report as part of the sales package. The scope of service you implemented on your client's behalf may not have been the scope that a third-party would have preferred.

To reduce its liability, your client needs to communicate to a prospective purchaser the importance of conducting its own study. For that reason, your agreement should include a third-party reliance provision that forbids any party other than the client to rely upon your report unless you give explicit permission for it to do so.

Wording about third-party reliance should be included in any report you develop, and as noted above, it may be wise to include your agreement as an appendix.

Condominium Claims

- Conversion – While you owe a duty of care to residents of any apartment communities you design, the duty of care you owe to owners of condominium units is far broader. Only the owner of the apartment building would be in a position to instigate a claim on the grounds that an error or omission on your part led to an unanticipated expense.

  By contrast, each and every owner of a condominium unit could file such a claim against you, and generally speaking, unit owners are far more sensitive to construction defects, far quicker to rely on litigation, and in a far better position to win at trial.

  While conventional contract protections, such as a limitation of liability provision, still would be appropriate in your contract with the owner/developer of an apartment project, recognize that unit owners – not your client – would be the most likely claimants if that apartment building were converted to condominium ownership.

  Accordingly, if you are engaged to provide services on an apartment project, consider including a condominium conversion clause that states that your client does not foresee conversion of the building to condominium ownership.

  That provision itself might be sufficient to block a suit against you in the event that the building is converted to condominium ownership at some later date. (You are liable only to those parties who might *foreseeably* be damaged by your negligent acts, errors or omissions.) Such a provision can be found in the DPIC Companies' ***Contract Guide.***

- Maintenance – Condominium developers are also at risk of lawsuits filed by unit owners who face unanticipated costs. In many cases these costs occur not because of inadequate design or construction, but solely because condominium management has not effectively maintained the building and its equipment.

  You can therefore help the client by including a provision in your agreement requiring your client to include a maintenance requirement in the condominium's by-laws, causing the condominium to waive any claims against the developer, consultants, and contractors for failure of equipment or materials that are not properly maintained.

Contractor Claims

Claims brought against owners and their design consultants are frequently filed by contractors, or they are filed by third-parties whose damages were caused by contractor error. You can help prevent claims of this nature by offering a variety of services that should be included in your agreement's scope of services. Because these services are likely to increase your client's short-term expense, you have to educate your client about the long-term savings that might be involved.

- Contractor pre-qualification helps ensure that the contractor that is selected has the experience and reputation required to perform well. That in itself can help prevent problems, and you are likely to have the kind of relationship

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with such contractors that will make it relatively easy to work out problems that do arise.

Contractors that obtain work on an open bidding basis are sometimes unfamiliar with local conditions or the full scope of services that may be required, or they may be buying into a contract in hopes of making a profit through change orders and/or well-documented negligence claims.

- Pre-bid meetings can help ensure contractors' questions are answered and help remove some of the gamesmanship that can otherwise occur. Only you are in the best position to answer questions about your portion of the work.
- Pre-construction meetings can help ensure solid understandings between the contractors and design professionals involved, so people know when they will be needed and why.
- Construction observation – not just occasional visits to the site – are essential, because a construction observer can spot problems that others do not see, or can at least deal with problems while they are still in their "molehill" stage. The documentation that results can also help discourage a contractor from filing a suit, if only because it would create a no-win situation.

Shop Drawing Review

In many states, third-parties cannot successfully file a negligence claim when the losses are purely monetary (e.g., as a consequence of delays). In other states, where third-parties can sue for purely monetary losses, delay claims by contractors are becoming more common. A typical method used by unscrupulous contractors is to inundate consultants with shop drawings, causing a slow-down in the review process.

Other problems can arise when shop drawings differ significantly from what was called for, but such differences are not called to your attention.

You can use a contract provision to bring this problem to your client's attention, to help ensure client support in developing effective shop drawing review procedures. In essence, you should identify specifically which shop drawings you want to see, require the contractor to review and approve each before you see it and to call to your attention any that would represent a change.

By adhering to requirements, you can help prevent shop drawing review from becoming a profit center for those who intend to misuse the process.

Diminution of Value

Diminution of value can be a serious problem to conditions surveys of any type. When the subject property is being considered for purchase by your client, your finding of a hitherto latent problem would cause the property to lose value.

When you seek the protection for this third-party exposure in your agreement, as through an indemnification provided by your client, you can bring the issue to the surface. Your client can then seek protection from the property owner, requiring the latter to agree to waive any claim brought about by a finding that makes a property less valuable.

Right of Entry

When it comes to conditions surveys or forensic work, you need to ensure that you have a legal right to enter onto property not owned by your client. Otherwise, you could be faced with trespassing charges or worse, such as a claim that your forensic evidence was gained through unlawful means.

Be certain that the necessary permission is obtained, and that (when appropriate) the property owner is advised that the work you do may involve some property damage. The client should be responsible for this activity.

Limitation of Liability

Limitation of liability provisions can be written in such a way that the claims filed by a client **and the client's contractors** may not exceed a certain fixed amount. In fact, this type of language was in common use during the 1970s and much of the 1980s. As design professionals pointed out to their clients, contractors who were aware that such a limitation was in place were far less likely to attempt project buy-in with the idea of filing claims later in order to make a profit.

Certification

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Various documents, such as those used by lenders, require design professionals to certify that certain conditions have been met. Unfortunately, the word "certify" can be taken to mean "guarantee," and to guarantee the existence of conditions whose existence cannot be verified is dangerous. Making it even more dangerous is the fact that problems resulting from certified conditions not actually existing have nothing to do with negligence. As such, your professional liability insurance may not cover you for any such losses.

Your client should care because, if you lose your deep pockets, chances are the claimant will come after the client, the party that caused you to sign a document that resulted in your loss of insurance. By calling the issue to the client's attention by means of a contract provision, the client should be far more anxious to explain the situation to third-parties who seek a certification, since your signing one could increase the client's risk.

Site Safety

Claims filed against you by injured contractors' employees are among the most common third-party claims. They arise because design professionals are among the few parties available to sue, given that workers compensation laws shield contractors, and owners typically have nothing to do with what happens at a site.

In order to forestall such suits, and to permit you to reduce or eliminate any contingency allowance, you should make it clear in your agreement that you have nothing to do with the means, methods, sequence, procedures, techniques or scheduling of construction. Point out that these functions are vested solely in the contractor.

Ideally, the contractor agrees to hold you harmless unless and include an indemnity provision in the agreement between the owner and the contractor. You should be included as an additional insured on the contractor's policy.

For Assistance

While it may be somewhat of a surprise to you that an effective contract can be of such value in reducing your third-party exposures, recognize that you will be in a position to obtain such an effective agreement only if you have a good relationship with your client – the same kind of relationship that can encourage your client to work out problems, rather than resorting to litigation or arbitration.

Recognize, too, that good relationships with contractors in your area can also be a major deterrent to litigation and arbitration. ✧

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