PROFESSIONAL LIABILITY UPDATE

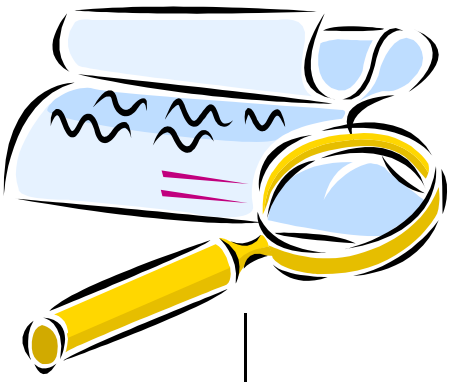
A Loss Prevention Newsletter for the Design Profession

MSP PL 03/2005: "Contract FAQs" March, 2005

Contract FAQs

1. What Is the Primary Purpose of a Contract with a Client?

The purpose of a client contract – or Professional Services Agreement – is to carefully define and document the intent of the involved parties. Professional service agreements require great certainty, especially regarding the precise obligations and responsibilities of the design firm.



Ambiguities typically work against the designer since they allow clients or others to allege that the professional should have taken on additional obligations, performed additional services, or otherwise been responsible for matters that the designer never intended to undertake.

2. How Aggressively Should I Negotiate My Contracts?

The best advice is to be diligent, but choose your battles carefully. Successful negotiation requires that the design professional be knowledgeable in good loss prevention practices. But he or she must also be able to recognize which concerns are of critical importance and which provisions might be acceptable depending on the circumstances.

For instance, some high-risk projects will mandate close adherence to all general loss prevention principles and – possibly – require additional affirmative protections in favor of the design firm. Other average-risk projects will require adherence to the important basic principles of loss prevention but may allow for flexibility in other concerns.

Sometimes design firms may decide that certain types of low-risk work (studies, for example) may allow for much greater flexibility. The key is to recognize when the project, client, service

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type and other subjective factors associated with the project allow for flexibility and when stricter adherence to general principles is necessary.

3. What's the Most Important Part of a Contract?

It's difficult to choose just one provision, because at least two come to mind. The first is a careful description of the scope of professional services, and the second is the Indemnity Agreement. Great care should be taken in drafting descriptions of exactly what services the design professional will and – equally important – will not perform.

- **Scope of Services**

  A careful description of the architect or engineer's scope of services during the construction phase is especially critical. This is a gray area where the contractor has primary responsibility for executing the design, but the designer has a secondary responsibility to help to see that the contractor's performance produces an appropriate final result.

  No professional services agreement that includes construction phase services should be signed without carefully prepared language limiting the designer's responsibility for activities of the contractor, especially construction site safety responsibilities.

- **What Is an Indemnity Provision?**

  To "indemnify" means to *"pay on behalf of."* The indemnitor agrees to pay the indemnitee's financial obligation. The most common contract of indemnity is an insurance policy. If certain circumstances occur – for example, the insured's building is destroyed by fire – the insurance company agrees to pay for the loss.

  When clients ask design firms to indemnify them through a contractual provision, they are, in effect, asking the design firm to act as their insurance company. From a professional liability standpoint, indemnity provisions that require the design professional to be financially responsible for losses other than those caused by the designer's negligence are not insurable. Any agreement to indemnify the client should be limited to the extent that the liability is caused by the negligent acts, errors or omissions of the designer. Take special note of indemnity provisions where your obligation is triggered by a mere allegation or claim of negligence. This type of "assumption of risk" is not insurable either.

4. What Contract Provisions Can Most Increase My Risks?

In addition to onerous indemnity provisions, watch out for clauses that amend your standard of care – i.e., raise the level of performance you as a design professional are legally required to achieve. Warranties, guarantees and certifications, for example, all have common-law implications. The services that you warrant, guarantee or certify in a contract will not be judged by the prevailing standard of care applied to your peers, but will absolutely require a positive result. (In California, there are special statutory exemptions of such liability arising out of certifications for professional engineers and land surveyors only.)

Worse yet, liability arising out of a contractual provision is not insurable if it exceeds the level of liability imposed by the prevailing standard of care. Such contract provisions give rise to "strict liability," that is, liability imposed without a showing of fault, but rather only a showing of a causal result. Producers of products, in contrast to providers of professional services, are typically held strictly liable by law. Insurance is available to cover their responsibilities. Such insurance is not available when those same responsibilities are voluntarily undertaken contractually by design professionals.

5. What Contractual Provisions Offer Me the Most Protection?

Again, there are no absolute answers here. However, a number of contractual provisions can provide important protection for design firms without asking clients to accept unreasonable liability. Among them are:

- **Limitation of Liability Provisions** – Limiting one's liability means that all of the assets of the design firm and the individual licensed professionals are not at risk for each and every project.

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Other industries commonly employing limitation of liability include shipping and transportation, air travel, computer equipment and services and other areas where the potential risk of loss greatly outweighs the maximum potential reward available to the service provider. Courts have upheld the legality of such provisions for design firms as well, including the landmark Markborough decision in California.

- **No Consequential Damage Provisions —** Oftentimes, the liability created by an architect or engineer includes consequential damages – such as loss of use, delays, etc. – far in excess of hard physical losses. A contract provision that prohibits either party to the agreement from claiming such damages against the other can provide significant protection to the designer.

- **Indemnity Provisions —** Indemnities in the designer's favor can also be used to protect the firm. Such provisions are seen by many designers to be a mandatory requirement before undertaking certain high-risk types of work.

6. What About My Contracts with Subconsultants?

Good question! Careful attention must also be paid to subcontracts when you are either a prime with subconsultants or when acting as a subconsultant to another entity.

Typically, a subcontract should reference the prime agreement and require that the subconsultant perform its services in the same manner and to the same extent as is required by the prime agreement. When you are the prime, it is imperative to bind subconsultants to the prime agreement so that they are required to perform their services in a way that will result in you meeting your obligations to the client. When you are the subconsultant, you must pay careful attention to any prime agreement or other contract documents referenced by the subcontract.

Be cautious, however, of overreaching provisions regarding the incorporation of the prime agreement into subcontracts. Provisions that seek to make the subconsultant responsible for all of the prime consultant's obligations to the client – rather than only requiring that the subconsultant's services comply with the requirements of the prime contract – can be a problem.

7. Should I Require My Subcontractors to Carry Insurance?

Yes, as the prime, you should make sure that your subconsultants are adequately insured. In fact, the prime contract may require that, at a minimum, any of your subconsultants carry the same insurance as is required of you as the prime. However, this is only a minimum and – if the client's requirements are inadequate – you should require appropriate coverage and limits.

8. Are there Special Contractual Issues Involved with Design/ Build Projects?

When providing design services as part of or as a consultant to a design-build entity, such entities are oftentimes contractors or developers. These parties may not be familiar with the liability concerns of architects and engineers. It is important that the

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design-build entity's agreement with the client differentiate between the responsibilities to design the project and to construct it.

Problems arise when the design-builder contracts to provide both construction and design services in a manner appropriate to contractors but not appropriate to design professionals. For example, contractors commonly guarantee their work. If the design-builder's guarantee also includes the design services, this creates an uninsurable problem for the designer. Design-builders, therefore, must be educated before they close their deal with the client.

Fortunately, the Engineer's Joint Contract Documents Committee has prepared standard agreement forms addressing the special concerns associated with design-build. These documents clearly differentiate the design and construction obligations. Use of appropriate design-build contacts is critical.

9. Similarly, What about Contracts for Joint-Venture Deals?

When a design firm is asked to enter into a joint venture with a contractor, the designer now undertakes responsibility for construction as well as design. This creates additional insurability concerns. Further, firms going this route need to make sure that their contractor partner is financially responsible and technically capable, and that the design firm itself can meet its additional obligations.

Summary

Someone once defined the word "contract" as *"a piece of paper that marries two business parties together by explicitly anticipating every eventuality of their divorce."*

In the event of litigation on a project, the first thing the lawyers will look at is the contract. It is imperative that your contracts be equitable and clearly spell out who is responsible for what. Negotiating a reasonable contract up front is a worthwhile investment.

Disclaimer: *This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.*

Cavignac Supports Upcoming MS Walk

More than twenty Cavignac & Associates team members will walk on April 10, 2005 to raise money to benefit ongoing research into the causes and cure for Multiple Sclerosis. So far the Cavignac Team has raised over $4,000.

If you'd like to sign up for the MS Walk, or pledge your support to our Team, please visit **www.MS Walk.com**.

Health Tips

from Cavignac & Associates' Employee Benefits Department

If the average American would burn at least an additional 150 calories per day, we would see a significant reduction in the occurrence of heart disease, high blood pressure, diabetes, colon cancer, anxiety, and depression.

Below are a few examples of how easy it can be to burn 150 calories.

Activity	Time (# of minutes)
Volleyball	45
Gardening	30-45
Walking	35
Basketball	30
Bicycling 5 miles	30
Stair climbing	15

Eating well and exercising can help you feel better, think more clearly, and live a longer, healthier life. Living a healthy lifestyle will also aid in preventing life-threatening and costly diseases. And, exercise can even be fun!

Remember, you're never too old or too young to become physically and nutritionally fit.