PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 05/2007: "First Line of Defense Against Third Party Claims" May, 2007

First Line of Defense Against Third-Party Claims

Article courtesy of Professional Liability Agents Network (PLAN)

Here's a chilling fact: clients file up to two-thirds of all professional liability claims against architects and engineers. Given this, it's obvious that design firms need to be diligent when it comes to client selection.

Equally important is the drafting of client contracts that fairly and equitably allocate liability to the party that has the greatest degree of control over the various risks. These liability issues between design firms and clients are regular topics of discussion in our newsletters.

But what about the ***other*** one-third of liability claims – those filed by third parties not subject to the conditions of the designer-client contract? What many design professionals do not realize is how effectively the designer-client contract – and the discussions that the negotiation process generates – can be used to reduce third-party claims. For example, contractors file about half of these third-party claims, and designers can have substantial influence regarding the contractual issues between the client and contractor.

To help reduce the likelihood of third-party claims, you need to discuss with the client how a number of contract provisions can lower **both** of your exposures to third-party liability. Explaining to clients how equitable contracts with your design firm and with third parties can lower exposures is key to reducing the chances of claims associated with your project.

Following is a list of contractual issues that can help lower liabilities from third-party claims. Discuss these with your legal counsel in advance of negotiating with your next client.

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Including a Third-Party Exclusion

Third parties sometime file claims because they think the contract provisions between you and your client cover them. For that reason, it can be beneficial to include 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 it far more difficult for third parties to take a claim forward, and even tougher for them to win.

Prohibit Third-Party Reliance

Third-party reliance on a research report prepared for a client is a well-known liability problem in the environmental field. It can also be a problem for design professionals.

For example, you may evaluate the structural integrity of a building for a client, only to have the client sell the property, using your report as part of the sales proposal. For that reason, your client contract should include a third-party reliance provision that forbids any party other than the client to rely on 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 for a client.

To reduce your risk further, include a copy of your contract with your client as an appendix to any research report you produce. This will indicate specifically the scope of services you were hired to provide and the nature of the agreement between your firm and the client for whom the service was performed. Any limitations as to your liability for your work that are included in the client contract (such as the third-party-reliance provision) will then be made known to the third parties.

Watch Out For Contractor Claims

Third-party claims brought against design consultants and their clients are frequently filed by contractors or other parties damaged by contractor error. You can help prevent claims of this nature by offering a variety of services as part of your scope of services. For example:

- **Contractor pre-qualification** helps ensure that the selected contractor has the experience and credentials required to perform the required services. That alone can help prevent problems. Moreover, should a problem arise, a reputable contractor will be more likely to seek a quick and equitable resolution.

  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 negligence claims.

- **Pre-bid meetings** can help ensure contractors' questions are answered before work begins. You are in the best position to answer questions about your portion of the work.

- **Pre-construction meetings** can further contribute to clear understanding between the contractors and design professionals involved in the project.

- **Construction observation services** are essential to minimizing problems. The designer can spot problems that contractors, subcontractors and other third parties do not see and can deal with them at the "molehill stage." The documentation that results can also help discourage a contractor from filing a suit for damages due to design firm negligence or omissions.

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If an owner refuses your construction observation services, work with legal counsel to obtain contractual protection for claims that arise due to the lack of coordination or the lack of professional interpretation of the construction documents during the construction phase.

- **Hold Harmless Agreement** – You should call for the owner's agreement with the contractor to include a provision requiring the contractor to hold you and the owner harmless for jobsite safety issues. The same provision could call for the contractor to make you and the owner additional insureds on the contractor's general liability insurance.

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 design consultants with shop drawings, causing a sharp slowdown in the review process. Other problems can arise when shop drawings differ significantly from what was originally 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, thus gaining client support in developing effective shop drawing review procedures. In essence, you identify which shop drawings you want to see, requiring the contractor to review and approve each drawing before you see it and to call to your attention any that would represent a design change. By adhering to these 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 relative to conditions surveys of any type. When your client is considering the subject property for purchase, your finding of a latent problem would cause the property to lose value or delay the transaction. When you seek protection for this third-party exposure in your contract, typically 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 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.

Certifications

Various documents, such as those required by lenders, may require design professionals to certify that certain conditions have been met. It is impossible to certify conditions as fact, but a design professional can give an opinion regarding conditions, e.g., that a building was constructed in compliance with drawings, specifications, and applicable codes and standards.

The word "certify" can easily be taken to mean "guarantee," and to guarantee the existence of

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conditions whose existence cannot be verified is foolhardy. Making it even more dangerous is the fact that most professional liability insurance policies today do not cover any losses resulting from such guarantees. Your client should care about certifications you are required to make because, if you lose your coverage, the claimant will likely 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, you can encourage the client to explain the situation to third parties who seek certification.

Site Safety

Claims filed against you by injured contractors' employees are among the most common of those not filed by clients or contractors. They arise because design professionals are among the few parties available to sue, given that 1) under workers compensation laws, employees generally cannot sue their employer for workplace accidents, and 2) owners typically have nothing to do with what happens at a site.

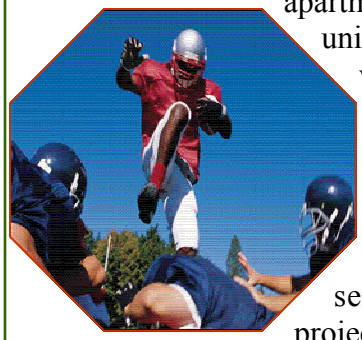
In order to forestall such site safety suits – and to permit you to reduce or eliminate any contingency allowance you might require in contemplation of the risk – the client needs to make it clear in your agreement that you are not responsible for site safety, or the means, methods, sequences and operations of construction. These functions are vested solely in the contractor or, where applicable, the construction manager. In those states where design professionals are protected by workers compensation "wrap-up" provisions, having such contract language is essential to obtain the protection.

Beware Condominium Conversions

Generally, only the owner of an apartment building you designed would be in a position to instigate a claim on the ground 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. In fact, condominiums are among the riskiest projects a design firm can get involved with, in terms of both claim frequency and severity.

While conventional contract protections, such as limitation of liability provisions, remain 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. (Generally, you are liable only to those parties who might foreseeably be damaged by your negligent acts, errors or omissions.)

Condominium developers also are 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 because the condominium managers have not effectively maintained the building and its equipment. You can therefore help your client by including a provision in your agreement requiring the client to include a maintenance requirement in the condominium's bylaws, causing the condominium owners to waive any claims against the developer, consultants and contractors for failure of equipment or materials that are not properly maintained.

Client and Contractor Insurance Provisions

As we pointed out in an earlier issue, the risks of claims increase to you and your client if the contractor – and construction manager – do not have the requisite insurance and indemnity provisions. Be diligent about making sure the owner properly incorporates the necessary wording!

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.*

California's AB573

What Does It Do for Design Professionals?

By Jeffrey W. Cavignac, CPCU, RPLU, CRIS

AB 573 (the Legislative Digest and the law itself follow this article) was a law advocated by design professionals – primarily CELSOC – to achieve equitable indemnities between municipalities in the State of California and design professionals. Interestingly, the State of California is exempted from this law. The opinions in this article are mine, and do not constitute a legal review.

In a nutshell, I believe the intent of AB573 was to make it illegal for a municipality to require a design professional to indemnify the municipality for anything other than the design professional's negligence. To quote from a memorandum authored by James P. Corn of Stoel Rives LLP:

> *"The applicable public agencies can no longer require an indemnity promise any broader than a promise that requires the design professional to indemnify for its own negligence, recklessness or willful misconduct."*

Here is where the confusion comes in. If you read the law itself (see pages six and seven), it says (I'll paraphrase and quote):

> *A design professional will not be required to indemnify a municipality* ***"except for claims that arise out of, pertain to, or relate to the negligence, recklessness or willful misconduct of the design professional."***

The new law merely states that the design professional can only be required to indemnify a municipality for damages arising out or pertaining to or relating to the design professional's negligence. The bill does not tie the design professionals' responsibility to the percentage of their negligence

For example, if the design professional is 50% at fault and the municipality is 50% at fault, the claim is certainly *"related to"* the negligence of the design professional. The law fails to specify whether the design professional would be held responsible for only 50% of the damages, or for the entire 100%. I believe the intent of the law was to make design professionals responsible for their own negligence (50%) – but that's where the confusion lies.

Some municipalities are treating the law as if nothing has changed. They still require design professionals to not only be responsible for their own negligence, but also for any negligence of the municipality except for *"liabilities caused in part by their sole negligence, active negligence or willful misconduct."*

Although this may or may not be legal under the new law, professional liability policies only cover the negligence of the design professional. Coverage is not provided for contractual assumptions of risk that go beyond the design professional's negligence. In this example, the design professional could be assuming responsibility for the municipality's passive negligence, which is not insurable.

When this law was passed and became part of the California Civil Code (Section 2782), it was hailed as a well-deserved victory for design professionals. Based on how the law is interpreted, however, it remains to be seen if it will actually change design professionals' exposures. Ultimately, judicial determination will have to clarify the intent of the law.

Play It Safe in the Sun

Article Courtesy of the Employee Benefits Department

Pool parties, cook outs, just hanging out – kids are glad it's summer. But it's important to shield their skin from the damaging effects of the sun. No matter what they're doing, if they're outside, they need to be protected.

Build safe sun habits into your family's daily routine. Lead by example – children will respond better when they see you protecting your skin. For example, use the American Cancer Society's ***Slip! Slop! Slap!***® safe sun basics to teach your kids healthy sun habits. Remind them to:

- **Slip!** on a shirt – always wear protective clothing when out in the sun.
- **Slop!** on the sunscreen – use one wit h an SPF of 15 or higher.
- **Slap!** on a hat that shades your face, neck, and ears.

Just a few serious sunburns can increase your child's risk of skin cancer later in life, so help your children stay safe in the sun by protecting their skin.

California
Assembly Bill AB573

LEGISLATIVE COUNSEL'S DIGEST

AB 573, Wolk. Design professionals: indemnity.

Passed the Assembly August 22, 2006

_____
Chief Clerk of the Assembly

Passed the Senate August 10, 2006

_____
Secretary of the Senate

This bill was received by the Governor this day of , 2006, at o'clock m.

_____
Private Secretary of the Governor

CHAPTER _____

An act to add Section 2782.8 to the Civil Code, relating to indemnity.

Existing law provides that agreements contained in or affecting any construction contract that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage, or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants, or independent contractors who are directly responsible to the promisee, or for defects in design furnished by those persons, are against public policy and are void and unenforceable, except as specified. Existing law also provides that provisions, clauses, covenants, or agreements relating to construction contracts with a public agency that purport to impose on the contractor, or relieve the public agency from liability for the active negligence of the public agency, are void and unenforceable.

This bill would provide, for all contracts, and amendments thereto, entered into on or after January 1, 2007, with a public agency for design professional services, that all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any such contract, and amendments thereto, that purport to indemnify, including the cost to defend, the public agency by a design professional against liability for claims against the public agency, are unenforceable, except for claims that arise out of or relate to the negligence, recklessness, or willful misconduct of the design professional.

ASSEMBLY BILL NO. 573

The people of the State of California do enact as follows:

SECTION 1. Section 2782.8 is added to the Civil Code, to read:

2782.8. (a) For all contracts, and amendments thereto, entered into on or after January 1, 2007, with a public agency for design professional services, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any such contract, and amendments thereto, that purport to indemnify, including the cost to defend, the public agency by a design professional against liability for claims against the public agency, are unenforceable, except for claims that arise out of, pertain to, or relate to the negligence, recklessness, or willful

AB573 *(continued on page 7)*

AB573 *(continued from page 6)*

misconduct of the design professional. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties.

(b) For purposes of this section, the following definitions apply:

(1) 'Public agency' includes any county, city, city and county, district, school district, public authority, municipal corporation, or other political subdivision, joint powers authority, or public corporation in the state. Public agency does not include the State of California.

(2) 'Design professional' includes all of the following:

(A) An individual licensed as an architect pursuant to Chapter 3 (commencing with Section 5500) of Division 3 of the Business and Professions Code, and a business entity offering architectural services in accordance with that chapter.

(B) An individual licensed as a landscape architect pursuant to Chapter 3.5 (commencing with Section 5615) of Division 3 of the Business and Professions Code, and a business entity offering landscape architectural services in accordance with that chapter.

(C) An individual registered as a professional engineer pursuant to Chapter 7 (commencing with Section 6700) of Division 3 of the Business and Professions Code, and a business entity offering professional engineering services in accordance with that chapter.

(D) An individual licensed as a professional land surveyor pursuant to Chapter 15 (commencing with Section 8700) of Division 3 of the Business and Professions Code, and a business entity offering professional land surveying services in accordance with that chapter.

(c) This section shall only apply to a professional service contract, or any amendment thereto, entered into on or after January 1, 2007.

Approved _____, 2006

_____

Governor

8 Principles
of a Safe Workplace

By Stuart Nakutin, CSM, ASP, AIC, HMR, WCCR, CPDM
Director of Loss Control Services

1. **Safety Is an Ethical Responsibility** – At its core, ethics hold up a positive vision of what is right and what is good. It defines what is "worth" pursuing as guidance for our decisions and actions. Workplace injuries and deaths are too often seen in the abstract as statistics. But when it happens to someone we love, we suddenly see the reality of the horrible pain and suffering and its widespread effect.

   It is our ethical responsibility to do what is necessary to protect employees from death, injury, and illness in the workplace. This is the only foundation upon which a true safety culture can be established in any workplace.

2. **Safety Is a Culture, Not a Program** – The combined commitment and participation of the entire organization is necessary to create and maintain an effective safety culture. Every person in the organization, from the top management of the corporation to the newest employee, is responsible and accountable for preventing injuries.

3. **Management Is Responsible** – Management's responsibility is to lead the safety effort in a sustained and consistent way, establishing safety goals, demanding accountability for safety performance, and providing the resources necessary for a safe workplace. Managing safety is the responsibility of every supervisor, from the first line supervisor to the Chairman of the Board.

4. **Employees Must Be Trained to Work Safely** – Awareness of safety does not come naturally. We all need to be trained to work safely. Effective training programs both teach and motivate employees to be a productive part of the safety culture.

5. **Safety Is a Condition of Employment** – The employer must exhaust every reasonable means to lead, motivate, train and provision employees to maintain a safe workplace.

   But, in the event the employee refuses to take the actions required to work safely, the employer must utilize a system of progressive discipline to enforce safety requirements and ensure the cooperation of the employee, or the removal of the employee from the workplace, in order to protect the employee and his/her co-workers.

6. **All Injuries Are Preventable** – Sometimes accidents occur without the apparent indication of fault or blame. But there is always some chain of events that occurred leading up to the accident that, had we recognized the eventual outcome, changes could have been made. The fundamental belief that injuries are, by their nature, preventable is a catalyst that encourages us to prevent injuries.

7. **Safety Programs Must Be Site-Specific with Recurring Audits of the Workplace and Prompt Corrective Action** – The purpose of the workplace audit is to discover and remedy the actual hazards of the site before they can injure workers. Recurring hazard analyses, comprehensive inspections, and aggressive investigation of accidents or near misses discover potential workplace hazards and identify weaknesses in safety plans, programs, policies and procedures.

   Safety regulations and generic safety programs are not sufficient means to discover hazards, because they are not specific to the individual workplace. A safety audit program is site-specific. Whenever a safety deficiency is found, prompt action is required both to overcome the hazard and to reinforce the message that safety is a priority.

8. **Safety Is Good Business** – Reducing workplace injuries and illnesses reduces the costs of workers compensation, medical expenses, potential government fines, and the expenses of litigation. Effective workplace safety is not an expense – it is an asset.

A properly managed safety culture based on these eight principles of workplace safety will produce employees who participate actively in training, identify and alert one another and management to potential hazards, and feel a responsibility for their safety and the safety of others. Accepting safety as an ethical responsibility demonstrates a sincere concern for each employee, which establishes the foundation for an effective safety culture.