

Client Contracts: Business Risk, Professional Liability & Insurance Coverage

Many client-drafted contracts endeavor to transfer unreasonable risk to the design professional. Many of these risks create liability exposures that go far beyond what is expected of you as a design professional. To make the best management decisions, you need to know where professional liability insurance coverage stops and business risks start.

Here are 21 contractual issues that can have a significant impact on your professional liability exposure, your bottom line and your firm's reputation.

1. Scope of Services

The scope of services is the foundation of your professional services contracts and should always be developed in collaboration with the client. Agreeing on a scope of services starts with explaining to the client what you can and can't provide. Consider drafting the scope of services as an opportunity to both educate and learn, and always include your project managers in the process.

Your scope of services should be detailed and specific. Vaguely-defined scopes are hard to quantify and measure. Avoid words like "all", "comprehensive", "thorough" and "complete". Always include a list of exclusions for services that you are not going to provide.

2. Standard of Care

Standard of care provisions can raise the bar for design professionals putting your professional liability insurance coverage in danger. Words like highest, best and superior, when used to describe your professional responsibilities represent a contractually assumed duty not covered by professional liability insurance.

As a professional, the adequacy of your services are measured against the acceptable practices of other designers. The law does not require your services to be free of errors and omissions:

It is his further duty to use the care and skill ordinarily used in like cases by reputable members of his profession practicing in the same or similar locality under similar circumstances, and to use reasonable diligence and his best judgment in the exercise of his professional skill and in the application of his learning, in an effort to accomplish the purpose for which he was employed.

Clark v. City of Seward, 659 P.2d 1227 (Alaska 1983)

The American Institute of Architects provides this standard of care language:

§ 2.2 The Architect shall perform its services consistent with the professional skill and care ordinarily provided by architects practicing in the same or similar locality under the same or similar circumstances....

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Don't let a poorly drafted standard of care provision put your insurance coverage in question

3. Warranties, Guarantees, and Certification

Contract language that requires you to warrant, guarantee or certify your services or construction quality is a contractually assumed risk that is a specific exclusion in most professional liability insurance policies. Be on the alert for provisions that require you to certify that construction is in strict compliance with the plans and specifications. The contract may also require you to execute bank or other lender certifications attesting to the quality of the completed construction. Don't.

4. Job Site Safety

Client contracts may include language that can conceivably make you responsible for job site safety. Circumvent wording that makes you responsible for supervising construction or approving the contractor's safety program. Professional liability insurance does not provide coverage for liability arising out of the contractor's job site safety responsibilities.

5. Indemnities

Indemnity provisions are by far one of the most challenging issues inherent in client-drafted contracts. These contract clauses can transfer unreasonable and uninsurable risk to design professionals. Be wary of indemnity provisions that:

- Require you to "defend" the indemnified parties. Unlike general liability insurance, professional liability insurance does not provide for an immediate defense to indemnified parties.
- Make you responsible for indemnified parties' wrongful acts. Professional liability insurance coverage is limited to the design professional's negligent acts in the performance of their professional services.

Recent case law in California emphasizes the importance of carefully drafted indemnity provisions that limits your liability to professional negligence. With advice from legal counsel, indemnity language should be similar to this model provision:

Consultant agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Client,

its officers, directors and employees (collectively, Client) against all damages, liabilities or costs, including reasonable attorneys' fees and litigation costs, to the extent caused by the Consultant's negligent performance of professional services and that of its sub-consultants or anyone for whom the Design Consultant is legally liable under this Agreement, as determined by judicial or arbitration proceedings, excepting only those claims, damages, liabilities or costs caused by the negligent acts or negligent failure to act by the Client. Neither the Client nor the Consultant shall be obligated to defend or indemnify the other party in any manner whatsoever for the other party's own concurrent or sole negligence or alleged concurrent or sole negligence. Nothing herein is intended to create a duty to immediately defend the other party until and unless negligence is established by judicial proceedings or arbitration on the part of the party charged with a defense tender hereunder.

6. Estimates

Managing project costs during the design phase is critically important for project owners and highly risky for design professionals. Failing to keep project costs in check can put you on the "hook" for significant project delay costs. The American Institute of Architects attempts to limit this exposure by providing the owner five viable options:

§ 6.6 If the Owner's budget for the Cost of the Work at the conclusion of the Construction Documents Phase Services is exceeded by the lowest bona fide bid or negotiated proposal, the Owner shall:

- 1. give written approval of an increase in the budget for the Cost of the Work;*
- 2. authorize rebidding or renegotiating of the Project within a reasonable time;*
- 3. terminate in accordance with Section 9.5;*
- 4. in consultation with the Architect, revise the Project program, scope, or quality as required to reduce the Cost of the Work; or*
- 5. implement any other mutually acceptable alternative*

§ 6.7 If the Owner chooses to proceed under Section 6.6.4, the Architect, without additional

compensation, shall modify the Construction Documents as necessary to comply with the Owner's budget for the Cost of the Work at the conclusion of the Construction Document Phase Services, or the budget as adjusted under Section 6.6.1. The Architect's modification of the Construction Documents shall be the limit of the Architect's responsibilities under this Article 6.

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The "free redesign" addressed in § 6.6.4 and § 6.7 is a tradeoff for avoiding exposure to the Client's delay costs.

A better approach is to retain the services of a qualified cost estimating firm that is better suited to help the Client keep the project in budget during the design phase. In a perfect world, the client would contract directly with this construction cost professional.

7. Consequential Damages

Clients may ask you to assume the risks of consequential damages. These types of damages are very speculative and hard to quantify. To limit this far-reaching exposure, design professionals should negotiate a mutual waiver of consequential damages.

§8.1.3 The Architect and Owner waive consequential damages for claims, disputes or other matters in question arising out of or relating to this Agreement. This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination of this Agreement, except as specifically provided in Section 9.7.

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8. Code Compliance

Code compliance is a primary design accountability. Be careful, however, to avoid contract language that places unrealistic expectations on your design. Limit your duty for code compliance to applicable design codes and avoid language that requires "full" compliance with "all" codes. Such language can be construed as a guarantee that may not be covered by professional liability insurance.

The varying interpretations that can be applied to even the most longstanding, time-tested building

codes are equally problematic. Look at how often code issues impact the construction process. Despite all the code reviews and approvals leading up to the issuance of the building permit, there are almost always code issues identified during routine field code inspections. The American Institute of Architects attempts to address this issue in its 2007 Owner Architect Agreement:

§3.1.5 The Architect shall, at appropriate times, contact the governmental authorities required to approve the Construction Documents and the entities providing utility services to the Project. In designing the Project, the Architect shall respond to applicable design requirements imposed by such governmental authorities and by such entities providing utility services.

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9. Dispute Resolution

Mediation is recognized in the design/construction industry as the preferred approach to resolving claims. Question Clients that don't include contract provisions that provide for mediating disputes as the first course of action. Many professional liability insurance carriers provide policy deductible credits for disputes resolved through the mediation process.

10. Inspection

The word inspection implies an expectation that the design professional has a duty to assure that all the construction, when completed, is in full compliance with the contract documents. This is an unrealistic requirement, even if the design professional has a fulltime site presence during construction. Preferred language uses the word "observe" and limits the evaluation to the specific work observed:

9.02 Visits to Site

Engineer will make visits to the Site at intervals appropriate to the various stages of construction as Engineer deems necessary in order to observe as an experienced and qualified design professional the progress that has been made and the quality of the various aspects of contractor's executed Work. Based on information obtained during such visits and observations, Engineer, for the benefit of Owner, will determine, in general, if the Work

is proceeding in accordance with the Contract Documents. Engineer will not be required to make exhaustive or continuous inspections on the Site to check the quality or quantity of the Work. Engineer's efforts will be directed toward providing for Owner a greater degree of confidence that the completed Work will conform generally to the Contract Documents. On the basis of such visits and observations, Engineer will keep Owner informed of the progress of the Work and will endeavor to guard Owner against defective Work.

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11. Stop Work

Contract terms that place a duty on you to stop construction presents significant risks. First, stopping construction can expose you to contractor delay claims. Just as critical, stop work authority can make you liable for failing to take action to protect worker safety. The authority to stop work should rest with the project owner and not you.

12. Limited or No Construction Phase Services

When it comes to construction phase services, clients can be penny wise and pound foolish. Looking for ways to trim their project budgets, some clients view construction phase services as a "can do without" expense. As a design professional, you need to explain that your participation in the construction process is vital to overall project success.

If you fail to convince your client of the value of construction phase services, consider negotiating contract language that addresses your concerns:

The Client chooses not to retain the Consultant to perform construction phase services. The Client, therefore is responsible for, but not limited to the following:

- Site observations
- Contractor performance
- Submittal review and approval
- Contract document interpretation
- Site observations
- Change order review and approval

- Review and approval of contractor payment applications
- Certificates of substantial and final completion
- Preparation and disposition of punch lists
- Responding to contractor requests for information
- Administration of any operational and maintenance training including collection operational and training manuals

The Client shall assume full responsibility for any and all changes made to the Contract Documents during construction. The Client agrees to waive any claims against the Consultant arising in any way related to such changes.

13. Ownership of Documents

As hard as you try to retain ownership of your design documents, clients try even harder to secure the right to reuse your designs. The middle ground in this struggle is to grant the client a limited license to use your design. The license limits the use to constructing, using, maintaining and altering the Project.

You should also ask the client to provide protection should they reuse your design without your involvement:

9.02 Visits to Site

§7.3 Upon the execution of this Agreement, the Architect grants to the Owner a nonexclusive license to use the Architect's Instruments of Service solely and exclusively for the purposes of constructing, using, maintaining, altering and adding to the Project, provided that the Owner substantially performs its obligations, including prompt payment of all sums when due, under this Agreement. The Architect shall obtain similar nonexclusive licenses from the Architect's consultants consistent with this Agreement. The license granted under this section permits the Owner to authorize the Contractor, Subcontractors, Sub-subcontractors, and material or equipment suppliers, as well as the Owner's consultants and separate contractors, to reproduce applicable portions of the Instruments of Service solely and exclusively for use in performing services or construction for

the Project. If the Architect rightfully terminates this Agreement for cause as provided in Section 9.4, the license granted in this Section 7.3 shall terminate.

§7.3.1 In the event the Owner uses the Instruments of Services without retaining the author of the Instruments of Service, the Owner releases the Architect and Architect's consultant(s) from all claims and causes of action arising from such uses. The Owner, to the extent permitted by law, further agrees to indemnify and hold harmless the Architect, and its consultants from all costs and expenses, including the cost of defense, related to claims and causes of action asserted by any third person or entity to the extent such costs and expenses arise from the Owner's use of the Instruments of Service and this Section 7.3.1. The terms of this Section 7.3.1 shall not apply if the Owner rightfully terminates this Agreement for cause under Section 9.4.

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14. Hazardous Materials

Hazardous materials come with the project owner's site and the risks associated with their removal should stay with the project owner. You should avoid contract language that makes you responsible for identifying and removing hazardous materials. Clearly define what constitutes a hazardous material by referencing:

CFR Title 40:PART 261—Identification and Listing of Hazardous Waste

15. Prevailing Party Attorney's Fees

Prevailing party attorney fees are a contractually-assumed obligation that is not covered by professional liability insurance. Additionally, agreeing on who's the prevailing party can be questioned depending on the outcome of the legal proceedings. For example, is a client that sues for \$1,000,000 and gets a \$1,000 verdict the prevailing party?

16. Insurance Requirements

Clients often don't have a complete understanding of the insurance coverages appropriate for design professionals. They may simply apply contractor insurance requirements that really aren't applicable and sometimes not even available in the marketplace.

There are two common problems specific to professional liability insurance. First, professional liability insurance policies do not permit the client to be added as an additional insured. Secondly, professional liability insurance is most often offered on a claims-made basis, whereas client contracts may require you to have an occurrence-based policy.

17. Limitation of Liability

There are times where negotiating a limitation of liability provision may be both appropriate and justified. When project risks outweigh the potential rewards, limiting your liability is smart business and good risk management. Exposing your professional liability insurance limits and deductible on a difficult project where success is questionable should be counterbalanced with thoughtful consideration.

When a limitation of liability provision is the right course of action to pursue, you need to make sure that your proposed provision is more than a "cut and paste" from an online article, white paper or legal manuscript:

- Limitation of liability provisions need to be carefully drafted
- Dollar values should be reasonable
- Don't arbitrarily use insurance policy limits to define the limits of your liability
- Remember available insurance **proceeds** may be less than insurance policy **limits**
- Enforcement of limitation of liability provisions vary from state to state
- Seek guidance of legal counsel

18. Third-Party Action Over Provisions

Client contracts may include provisions that are commonly referred to as third-party action over indemnities. These provisions make you liable for the bodily injury of your employees beyond the benefits provided by workers' compensation insurance (WC). This is one example:

To the fullest extent permitted by law, Consultant's indemnification obligations shall not be limited in any way by any limitation on the amount or type of damages, compensation, or benefits payable under workers' compensation

acts, disability acts, or other employee benefits acts, and shall extend to and include any actions brought by, or in the name of, any employee of Consultant or others for whom the Consultant is legally liable.

As an illustration, let's assume that one of your employees gets injured on a construction site. The Injured employee sues the Project Owner. In turn, the Project Owner invokes the third-party action over Indemnity. This effectively voids your protection under WC which limits your employee's claim against you to WC benefits.

These third-party action over provisions constitute contractually-assumed liabilities that are not covered by professional liability insurance.

19. Site Inspections

Project Owners can shift unreasonable risks by drafting contract provisions that make you responsible for any and all problems with their building sites. These seemingly innocuous and boiler plate provisions often go unchallenged when negotiating client contracts. But as this provision demonstrates, site evaluation provisions can be just as problematic as any client-drafted provision:

A/E shall visit proposed project site, as required, to obtain total details of specifics required for renovation work, including but not limited to, demolition, architectural, structural, mechanical, electrical, etc., in order to fully complete drawings and specifications without omission. Such visit shall include thorough inspection of normally enclosed or inaccessible areas such as spaces above ceilings, within walls or chases, and in pipe crawl spaces under basement floors. Where necessary, A/E shall arrange to have walls or ceilings broken, or have excavations made to physically determine existing conditions.

You are better off if your contracts do not include a site inspection provision. But when faced with one, the first thing you want to do is change "inspection" to "evaluation" next, you want to be sure that you are not being asked to do the impossible. Limit your site evaluations to a **visual review** of existing site conditions. If the client wants more, address the options that

can be taken including selective demolition and destructive testing. Remember, however, that the client should always retain the risks associated with their sites. **DON'T GUARANTEE THAT ALL EXISTING SITE CONDITIONS WILL BE IDENTIFIED.**

20. Project Performance Warranties

When negotiating client contracts, you may be confronted with contract language similar to these two provision:

Consultant shall be responsible to see that the Project as designed can operate as a functional, efficient, high-quality facility.

and

Consultant warrants that its Services performed under this Agreement and the Contract will provide a proper design fit for its intended purpose

21. Flow-Down Provisions

Flow-down provisions are common in the design/construction industry. Prime consultants and surveyors often see language similar to this:

First Tier: Client-Prime Professional

The Contract Documents consist of (1) this Agreement; and (2) the Prime Contract, between the Owner and Contractor.

This flow-down provision provides for the terms and conditions of the owner prime professional contract to be passed down to the Prime professional's subconsultants:

Second Tier: Prime Professional–Consultant

Architect agrees to incorporate by reference into all contracts with its Project consultants and subconsultants this Agreement, requiring such consultants and subconsultants to acknowledge and be bound by its terms.

Flow-down provisions are problematic in that:

- They are often considered as unimportant fine print and therefore simply ignored
- They are confusing to interpret and apply
- They often transfer uninsurable risks to design and surveying professionals

- And they frequently don't establish any order of precedence between the documents incorporated via the flow-down provision

If at all possible, avoid flow-down provisions and when you can't, review all incorporated documents, **in detail**, seek clarification when faced with conflicting and ambiguous language and always have your contract take precedence over all contracts/documents that are incorporated via a flow-down provision.



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