Contract Review for Design Professionals

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RLI Design Professionals
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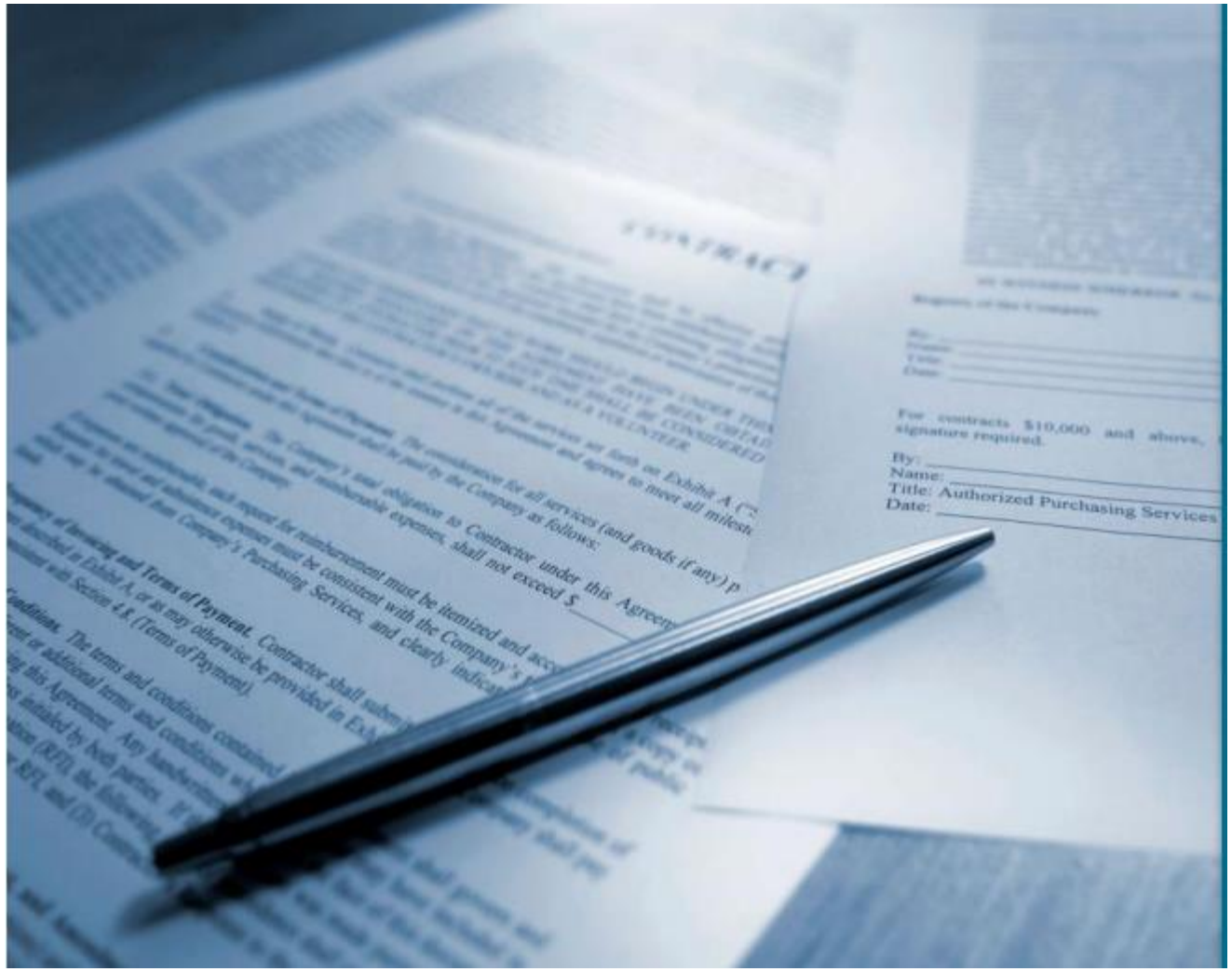
Course Description



- ✓ Importance of contracts
- ✓ Implications of exposures and court decisions
- ✓ Understand and negotiate

Learning Objectives

Participants in this session will:

UNDERSTAND THE IMPACT OF RISK ALLOCATION ON INSURABILITY

LEARN FROM COURT DECISIONS HOW CONTRACTS ARE INTERPRETED AND APPLIED

LEARN TO IDENTIFY AND REVISE KEY RISK ALLOCATION CLAUSES

LEARN NEGOTIATING IDEAS FOR REVISING CONTRACTS

Some Key Clauses to Review

- Standard of Care
- Indemnification
- Limitation of Liability
- Waiver of Consequential Damages
- Any warranties
- Time of the essence
- Ownership and copyright of instruments of service
- Site Safety
- Cost overruns/cost estimates
- Compliance with laws
- Site visits/inspections
- Certifications
- Payment provisions
- Incorporation by reference
- Dispute resolution
- Prevailing party attorneys fees

Incorporation by Reference

- Be sure to obtain and read the “prime agreement” that is incorporated.
- Determine that the incorporated terms and conditions don’t create greater responsibility than the t’s and c’s in your subcontract.
- At the end of the incorporation by reference sentence, insert the following:
  - “… provided however that the Standard of Care and the Indemnification provisions set forth in the Professional Services Agreement take precedence over the Contract between Prime and its Client.”

Standard of Care (problem)

The following clause in an owner-generated contract requires greater than the generally accepted standard.

- "DP represents that its services will be performed in a manner consistent with the highest standards of care, diligence and skill exercised by nationally recognized consulting firms for similar services."

Standard of Care (solution)

AIA B101-2017, Section 2.2 reads as follows:

- “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. The Architect shall perform its services as expeditiously as is consistent with such professional skill and care and the orderly progress of the Project.”

Standard of Care (solution 2)

If the contract seems to contain language that might be interpreted as warranties and guarantees, consider adding a catch-all sentence to the “Standard of Care” section stating something like this:

- “No warranty or guarantee, either express or implied, is made or intended by this Agreement.”

Designer Not Liable for Implied Warranty of Habitability of Condo

- Condo association filed suit against designer of condo complex, alleging breach of implied warranty of habitability resulting in air and water infiltration.

- Court held Designer not subject to liability – citing the principle that an architect does not warrant or guarantee perfection in his or her plans and specifications is long standing.

Board of Managers of Park Point at Wheeling Condominium Ass'n v. Park Point at Wheeling, LLC, 2015 IL App (1st) 123452

See next slide

Designers are Not “Workmen”

- Court rejected condo association's argument that DPs have an implied obligation to perform their tasks in a “workmanlike” manner.

- Citing to Black's Law Dictionary, the court noted a “workman” is a person who is “employed in manual labor, skilled or unskilled."

  - “Thus the term “workmen” does not include professional persons such as design professionals, and design professionals are not obligated to perform their professional services in a workmanlike manner.”

- **Contract Lesson**: Architects and engineers should be careful not to agree to contract provisions that require them to perform their services in a "good and workmanlike manner." While the phrase is seemingly innocuous, a court could find that it imposes a higher standard than the professional standard of care.

Engineer Can be Sued for Breach of Warranty of Professional Services

- Pulte Homes sued A/E that performed engineering and testing services for it. After resolving defects asserted by the homeowner through arbitration proceedings, Pulte sued A/E to recover damages paid homeowner.
- The theories of recovery included a claim based on breach of express or implied warranties.
- Pulte alleged that "S&ME expressly or impliedly warranted to Pulte that all work performed by them would be performed in a careful, diligent and workmanlike manner, and that any materials and/or services designed, supplied or sold by them for use on the project would be merchantable and fit for their intended or specific purpose."
- In reviewing the contract language, the court agreed that it "includes language arguably in the nature of an express warranty."

Pulte Home Corp. v. S &ME, Inc., 2013 WL 4875077 (U.S. District Court, South Carolina, 2013).

Certification (problem)

Beware of language requiring certification of contractor's compliance with all plans and specs. E.g.,

- *"Upon completion of the construction, the DP shall certify that the work was completed in accordance with the plans, specifications, and drawings."*

Certification (AIA solution – knowledge within contract scope)

Set limits on signing certificates:

- "The Architect shall not be required to execute certificates or consents that would require knowledge, services, or responsibilities beyond the scope of this Agreement." AIA B101-2017, §10.4.

- Instead of making certificate an absolute certainty of fact, condition it on "the best of knowledge, information and belief."

Compliance with Law

Typical clause creates liability if non-compliance with law was not intentional or negligent. SOLUTION: Insert standard of care wording shown in red letters.

- "DP shall exercise the Standard of Care to comply with all laws, ordinances and codes."
- *"The DP shall indemnify and hold harmless the owner against any claims, damages and losses of any kind caused by, arising out of, or related to failure to comply with any laws, ordinances or regulations to the extent caused by failure to meet the Standard of Care."*

Who is Indemnified?

Don’t agree to indemnify agents and representatives

- Prime contractor had to indemnify the Architect per indemnity clause requiring it to indemnify the Owner’s “representatives” against claims arising out of contractor’s work.

- Court said Architect fell in category of “**representative**” of Owner.

Valdez v. Turner Construction & Skidmore Owings Merrill (SOM), 171 A.D. 3d. 836 (NY 2019)

Indemnification (problem 1)

- Uninsurable “contractual liability” when DP agrees to indemnify for anything other than damages to the extent caused by DP’s negligence.
  - No professional coverage for specific terms of “indemnity” clauses. Only covered if liability would have existed at common law – in the absence of the clause.
- Indemnity provisions are being written so broadly as to apply to:
  - First party breach of contract claims;
  - All errors and omissions even if not negligent;
  - All damages so long as DP is a little bit responsible

Indemnification – Be sure the word “negligence” modifies everything

- Poor wording may shift risk to DP for damages not caused by its own negligence. E.g.,
  - *“DP shall indemnify the Client for all claims, damages and expenses arising out of acts, omissions, errors or negligence of the DP.”*
- The word “negligence” is in the wrong place. It fails to modify “acts, omissions and errors.” Thus, the indemnity applies to everything.

Indemnification – Could Increase Standard of Care

- Indemnification clauses that are not limited to negligence conflict with the normal Standard of Care.
- DP might be held to a perfection standard by the indemnification provision so it is liable despite having met the standard of care, i.e., it was not negligent.
- So a bad indemnity clause can trump a good standard of care provision in the contract.

Indemnification (the uninsurable Duty to Defend)

Don’t agree to defend an Indemnitee against Professional Liability claims. No common law duty requires a DP to defend its client against third party actions.

- “Contractual liability exclusion” applies.
  Professional policy will not provide defense of the Indemnitee.

- A contractually agreed upon duty to defend is triggered as soon as the claim is made because it is a separate duty from the duty to indemnify.

- At least that is how most courts will interpret it. For example – California.

Revising the Duty to Defend

Alternatives:

(1) Delete the duty to defend entirely by striking out the word “defend” where it appears in the clause; .

(2) Don’t delete the word “defend,” but add a parenthetical like this: “indemnify, defend (except against professional liability claims) and hold harmless….”

- The benefit of this alternative is it is more acceptable to Owner because general liability claims to be defended. Owner is often an additional insured under the CGL policy.

Indemnification (problem of 1st party claims)

- Indemnity should only apply to damages arising out of third party tort claims against the client.
- Some courts allow clients to use the clause to recover their own first party damages, losses and costs even where no 3rd party claim was made against the client.
- It is best to add wording to the clause clarifying that only damages from 3rd party claims are covered.

New York: Indemnification for 1st Party Claims

- Plaintiff can recover its own damages and losses even if no 3rd party claim;
- Court stated: "It is a familiar principle that a cause of action for *common-law* indemnification must be based upon a defendant's breach of duty to a **third party**."
- This case, however, didn't involve common-law indemnification. "Instead, the scope of defendant's obligation is governed by the parties' intent as revealed by the plain language of the indemnification provision that they agreed upon."
- *WSA Group v. DKI Engineering, 178 A.D. 3d 1320 (NY 2019)*

Indemnification Only for 3rd Party Claims

- After contractor (Kr) was awarded GMP it subcontracted engineering firm to provide balance of design services.
- Later, Kr claims A/E designs were flawed, and it had to make midstream corrections to comply with various code requirements, and thereby incurred unexpected costs.
- Made claim against A/E under indemnity clause.
- Court held against the indemnity claim

  Suit based on indemnification could only seek damages resulting from 3rd party claims against the Indemnitee (KR). The indemnity clause could not be basis for 1st first party KR claims to recover its financial losses.

  Hensel Phelps Construction v. Cooper Carry, Inc., 2016 WL 5415621 (U. S. District Ct., District of Columbia, 2016).

  (See next slide)

Indemnification Only for 3rd Party Claims – Cont'd

The clause in Hensel Phelps:

"indemnify, defend and hold … harmless" [the contractor] from any claim, judgment, lawsuit, damages, liability, and costs and expenses, including reasonable attorneys' fees, as a result of, in connection with, or as a consequence of [engineer's] performance of the Services under this Agreement…."

Court says, engineer, "naturally, argues that his clauses refers only to liabilities that [contractor] would face from third parties, not to [contractor's] own "damage" and "costs and expenses" from contract breaches."

According to the court, "The words "damage" and "costs and expenses" in the indemnification clause are listed along with other words that clearly anticipate the problem of third-party litigation against [contractor] for problems that [engineer created…. [ ] Reading the indemnification clause in the most obvious way, it required [engineer] to cover [contractor]s] liabilities when and if a third party sues over problems caused by the [engineer's] fault."

Engineer Required to Defend Client against Routine Contractor Claim

Trial court held A/E owed its client, the town, a defense against a contractor suit that alleged that the plans and specifications prepared by the engineer and provided by the town to the contractor for bidding and construction were defective.

It was a routine contractor claim against the project owner, but the court concluded engineer's indemnity agreement was so broad it had to defend the town against the contractor's claim.

Penta Corporation v. Town of Newport v. AECOM Technical Services, Inc., No. 212-2015-CV-00-011 (Merrimack, New Hampshire Superior Court, 2016).

Penta Corp. (2)

- Contractor claimed its construction met engineer's plans and specs that called for a specific brand of disc filters for a wastewater treatment facility.
- Upon receipt of the suit, the town sent the engineer a demand for a defense against the contractor's suit pursuant to the terms of the indemnification clause in the contract between the engineer and the town and the engineer. The engineer responded to the town's demand, stating it would not defend (or indemnify) the town because the allegations of the contractor were not directed at the engineer.

Indemnity Wording (Penta 3)

"shall indemnify, exonerate, protect, **defend (with counsel acceptable to the Town . . .)**, hold harmless and reimburse the Town . . . **from and against any and all** damages (including without limitation, bodily injury, illness or death or property damage), losses, liabilities, obligations, penalties, **claims (including without limitation, claims predicated upon theories of negligence, fault, breach of warranty, products liability or strict liability), litigation**, demands, defenses, judgments, **suits**, proceedings, costs disbursements, or expenses of any kind or nature whatsoever, including without limitation, attorneys' and experts' fees, investigative and discovery costs and court costs, **which may at any time be** imposed upon, incurred by, **asserted against**, or awarded against **the Town** . . . **which are in any way related to the Engineer's performance under this Agreement** but only to the extent arising from (i) any negligent act, omission or strict liability of Engineer, Engineer's licenses, agents, servants or employees of any third party, (ii) any default by the Engineer under any of the terms or covenants of this Agreement, or (iii) any warranty given by or required to be given by Engineer relating to the performance of Engineer under this Agreement."

Duty to Defend Applied to “ALL” Claims – Not Just Tort Claims (Penta 4)

- The court noted that the duty to defend applies to “claims,” “litigation,” and “suits” that are “asserted against” the town and related to the engineer’s negligent contract performance.
- Significantly, the court concluded, “This language anticipates unproven allegations, meaning the duty to defend would necessarily arise prior to any factual finding as to [the engineer’s] negligence or breach.”
- The court said, “If [the engineer’s] duty to defend only required it to reimburse the Town for the cost of a defense following adjudication of [the engineer’s] negligence or breach, then the Town would necessarily have to choose its own counsel, thus rendering the [choice of counsel language in the clause] meaningless.”

“Arising Out Of” is Broad Term (Penta 5)

- A/E argued that language of the clause reading “but only to the extent arising from” served as a strict limitation on the engineer’s responsibility.
- The court rejected that argument, stating, “The phrase ‘arising out of’ has been construed as a ‘very broad, general and comprehensive term’ meaning ‘originating from or growing out of or flowing from’.”
- The phrase, according to the court, “indicates intent ‘to enter into a comprehensive risk allocation scheme.’ ‘Arising out of’ does not mean that any losses or claims must have been caused by [the engineer’s] negligence or breach. Nor does it necessarily require an action for negligence or breach. A claim merely has to involve an alleged negligent act or omission in the performance of the contract.”
- Thus, the court concluded that the engineer’s assertion that adding the words “to the extent” in front of “arising from” did not alter the broad intent of the words “arising from.”

Reasonable Indemnification Clause Example

"**Indemnification.** Consultant shall indemnify, defend (except against professional liability claims) and hold harmless the Client, its officers, directors, and employees from and against third party tort claims, causes of action and demands ("Claims") and the damages and costs arising from such Claims to the extent caused by the wrongful misconduct or negligent act, error or omission of the Consultant or anyone for whom the Consultant is legally responsible, subject to any limitations of liability contained in this Agreement."

Site Visits – Inspection (the problem)

An example of a problematic clause is the following:

- *"DP shall make visits to the site to inspect the progress and quality of the executed work of the Contractor and its Subcontractors, and to determine if such work is proceeding in accordance with the Contract Documents. . . . DP shall keep the Owner informed of the progress and quality of the work and shall exercise the utmost care and diligence in discovering and promptly reporting to the Owner any defects or deficiencies."*

Site Visits (reasonable clause)

- On the basis of the site visits, the Consultant shall keep the Owner reasonably informed about the progress and quality of the portion of the Work completed, and report to the Owner (1) known deviations from the Contract Documents and from the most recent construction schedule submitted by the Contractor, and (2) defects and deficiencies observed in the Work.

- NOTE: This wording is similar to AIA B 101- 3.6.2.1

Schedule (timeliness of performance)

- Revise “time of the essence” clauses. They suggest absolute guarantee of completion by a specific date.
  - Consider revising to state: “Time is of utmost importance….”
- AIA B101-2017, at §2.2, addresses time for performance as follows:
  - “The Architect shall perform its services as expeditiously as is consistent with such professional skill and care and the orderly progress of the Project.”

Cost Estimates Exceeded – (a reasonable clause)

- Notwithstanding any other term of this Agreement, if Consultant has any duty to design the Project within a Construction Budget, its duty shall be limited to responsibilities that are reasonably within its direct control, thereby excluding matters that are beyond the control of Consultant including, but not limited to, unanticipated rises in the cost of labor, materials or equipment, changes in market or negotiating conditions, and errors or omissions in cost estimates prepared by others. Therefore, any such redesign effort required of Consultant necessary to maintain the project within the Construction Budget that is not due specifically to the negligent act error, omission, or willful misconduct on the part of Consultant shall require an increase to the compensation of Consultant.

Ownership and Copyright

(1) **How to handle our own proprietary pre-existing documents**.
Client expressly acknowledges and agrees that the documents and data to be provided by Consultant under the Agreement may contain certain design details, features and concepts from Consultant's own practice detail library, which collectively may form portions of the design for the Project, but which separately, are, and shall remain, the sole and exclusive property of Consultant. Nothing herein shall be construed as a limitation on Consultant's right to re-use such component design details, features and concepts on other projects, in other contexts or for other clients.

(2) **Get Indemnity if Client Reuses Documents without us**.

"Client agrees to indemnify, defend and hold the Consultant harmless from and against any claims or damages that may result from the subsequent use, reuse, transfer or modification of Consultant's drawings and specifications, except on projects where the Consultant has been retrained to provided services."

Pay if Paid / Pay When Paid

Payment from the Client can be an issue both when we are the Prime Consultant and when we are the subconsultant.

- When we are the Prime Consultant, we want to make payment to our subconsultants contingent on receiving payment from our Client.

The courts in different states have interpreted the words *"pay if paid"* and *"pay when paid"* differently, sometimes deciding they just mean "pay within a reasonable amount of time".

- Including the words *"payment from the Client is a condition precedent to payment"* can add weight to the argument that the subconsultant will not be paid until we have been paid

Pay if Paid / Pay When Paid

If we are a subconsultant and our contract has a pay-if-paid or pay-when-paid clause, we need to be able to suspend services if we are not being paid.

Add a provision such as:

If Consultant fails to receive payment within forty-five (45) days of submitting a properly formatted invoice, Consultant may suspend its services, without liability for any damages or delays, after providing seven (7) days written notice and an opportunity to make payment. Before resuming services, Consultant shall be paid all sums due prior to the suspension and any expenses unavoidably incurred in suspending and resuming its services. Following the resumption of services, time schedules and Consultant's fee for the remaining services shall be equitably adjusted.

Site Safety: Responsibility and Liability

Scaffolding Collapse: Engineer, Architect, Project Owner Not Liable for Injuries

- Summary judgment for architect and an engineer, against employees of a contractor that were injured when scaffolding failed under the weight of a concrete slab that was being poured.
- No basis for claim against firms that designed and observed the project because they were not involved in actual supervision and control of the contractors work.
- Citing the AIA B141 agreement, the court found the engineer "was not obligated to inspect the scaffolding to ensure that it was in compliance" with the plans and specifications.

*McKean v. Yates Engineering Co*rp., 2015 WL 5118062 (Mississippi 2015).

See discussion Next Slide

Engineer Had No Duty to Warn

- Court stated only limited circumstances where engineer has duty to warn employees of the contractor or subcontractor of hazardous conditions.
- Engineer had one initial site visit and then a visit after the collapse.
- Court considered factors to determine if supervisory powers went beyond provisions of contract:
- (1) actual supervision and control of the work; (2) retention of the right to supervise and control; (3) constant participation in ongoing activities at the construction site; (4) supervision and coordination of subcontractors; (5) assumption of responsibilities for safety practices; (6) authority to issue change orders; and (7) the right to stop the work.

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Engineer Had No Duty to Warn - Continued

- Court said: “the scaffolding was a means to build the project's second-story floor”, and “nothing in the contract made the architect responsible for ensuring that the engineer’s scaffolding design was adequate.”

- Court found no contractual duty to inspect the scaffolding before the concrete was poured. Quoted the contract that stated the DP “shall visit the site at intervals appropriate … to determine that the Work when completed will be in accordance with the Contract Documents.”

- General authority to “reject” non-conforming work did not create a special duty, because the architect “had no authority to stop the work. Only [the owner] had the authority to *stop* work on the project.”

Dispute Resolution (prefer litigation)

- DP's generally prefer litigation over arbitration.

- The language with the AIA check-box in B101 - 8.2.4 states:

  – "If the Owner and Architect do not select a method of binding dispute resolution below, or do not subsequently agree in writing to a binding dispute resolution method other than litigation, the dispute will be resolved in a court of competent jurisdiction."

Dispute Resolution (prevailing party attorney's fees)

"Recovery of Litigation Costs. In the event that legal action is brought by either party against the other in the Courts (including action to enforce or interpret any aspect of this agreement), the prevailing party shall be reimbursed by the other for the prevailing party's legal costs, in addition to whatever other judgments or settlement sums, if any, may be due. Such legal costs shall include, but not be limited to, reasonable attorney's fees, court costs, expert witness fees, and other documented expenses, in addition to any other relief to which it may be entitled."

– NOTE: Delete this uninsurable liability. If can't do so, then define the term to reduce risk. See **next slide**.

Define “Prevailing Party”

“Prevailing party is the party who recovers greater than 67% of its total claims in the action or who is required to pay no more than 33% of the other party’s total claims in the action when considered in the totality of claims and counterclaims, if any. In claims for monetary damages, the total amount of recoverable attorney’s fees and costs shall not exceed the net monetary award of the Prevailing Party.”

Mutual Waiver of Consequential Damages

- Include Waiver of Consequential Damages Clause:

- *"Consultant and Client waive all consequential or special damages, including, but not limited to, loss of use, profits, revenue, business opportunity, or production, for claims, disputes, or other matters arising out of or relating to the Contract or the services provided by Consultant, regardless of whether such claim or dispute is based upon breach of contract, willful misconduct or negligent act or omission of either of them or their employees, agents, subconsultants, or other legal theory, even if the affected party has knowledge of the possibility of such damages. This mutual waiver shall survive termination or completion of this Contract."*

Limitation of Liability (good example)

"Limitation of Liability: To the fullest extent permitted by law, the total liability, in the aggregate, of DP, DP's officers, directors, partners, employees, agents, and subconsultants, to Client, and anyone claiming by, through, or under Client for any claims, losses, costs, or damages whatsoever arising out of, resulting from or in any way related to this Project or Agreement from any cause or causes, including but not limited to negligence, professional errors and omissions, strict liability, breach of contract, or breach of warranty, shall not exceed the total compensation received by DP or $50,000 whichever is greater. The Client may negotiate a higher limitation of liability for a reasonable additional fee, which is necessary to compensate for the greater risk assumed by DP."

Thank you for your time – Questions?

This concludes The American Institute of Architects Continuing Education Systems Program

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