Professional service pitfalls

Even minor changes in contract language can create major liability and insurance issues for design firms, so be aware of what's out there and act accordingly.

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GUEST SPEAKER

Today's contracts involving design firms and owners, project managers, and other participants, are increasingly subject to the dynamics of how projects are run; in particular, more owners now realize that "minor" changes in contract language may significantly shift risk allocation.

In this context, let's examine some emerging situations and contract language that may create expanded liability and potential insurance issues for design firms. Identifying these issues is the first step; offering your clients possible alternative language is the second step. The third? A successful, profitable project!

MUNICIPAL ADVISOR AND SCOPE OF WORK. Engineers are excluded from the SEC's definition of municipal advisor "to the extent that the engineer is providing engineering advice." The provision of engineering feasibility studies that include certain projections – such as output capacity, utility project rates, project market demand, or revenues based on engineering aspects of a project – generally fall under this exception.

Even so, the exemption may not encompass situations where engineers provide advice to a municipal entity pertinent to financial products or the issuance of municipal securities. This raises not only the issue of whether the engineering firm should be registered as a "municipal advisor," but also if "standard" professional liability insurance policies actually will cover any related claims.

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For example, an engineer's insurance company denied a recent claim involving the firm and a municipality, deeming the engineer's deficient

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services to be "… outside the definition of professional services … i.e., financial impact and revenue estimating services."

In such instances, design firms should ask their legal counsel whether they need to register as a "municipal advisor;" similarly, they should check with their insurance advisors on if their professional liability insurance policy needs to be amended. In its standard Owner-Engineer agreement, one firm uses language disclaiming any municipal advisor status, defining such services as "engineering related analysis."

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"Owner's" consultants. Owners traditionally hire an architect or a prime engineer to design their project; this firm then hires subconsultants covering various service disciplines. However, some services typically retained by the owner, such as geotechnical engineering and environmental investigations, are outside the prime designer's responsibilities. Many owners now seek to have the prime consultant retain all subconsultants on the project, shifting all related risk to the prime designer. Here are changes to watch for:

1) **Direct hire.** As noted, owners often hired certain consulting firms and then forwarded any resultant reports, etc. to the architect or engineering firm. An example is the owner's retention of the geotechnical engineer. More contracts now require the prime engineer to retain these consultants, shifting the liability for their work product to the engineer/architect.
2) **Designated by owner.** The owner requires its prime design firm to hire certain subconsultants named by the owner.
3) **Hired by owner, which "designates" responsibility to the design firm.** The owner retains certain specialty consultants, but the prime design contract stipulates the architect or engineer assumes responsibility for their work product (and, often, for processing their invoices on a "pass-through" basis at no mark-up).

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There's a fourth "category" in which the scope of work involves a sort of "mini-design/build" arrangement. An example – during a project an underground storage tank is discovered or a sewer line needs to be moved. The owner then "asks" the prime design firm to hire a contractor for the removal or installation work.

Each situation expands the design firm's potential liability and should involve a careful review of the contract and any potential insurance restrictions or limitations. While not likely deal-breakers, each situation should be reviewed and discussed with your client. Keep in mind, these additional fees are now part of your revenues and risk profile; you pay additional insurance for them and should be allowed some contractual accommodation for a reasonable mark-up.

RELIANCE BY LENDERS/THIRD PARTIES – WORK PRODUCT. These situations can be problematic for design firms. Consider the following clause: "Professional agrees that Developer and any Lender who makes a loan to Developer shall be entitled to rely upon the Services, including without limitation any Opinion Letters, Plans, Reports, Inspection Letters, etc. …."

If your agreement includes this language, there may be no limitation on the lender's right to rely, which incidentally is "automatic." Essentially, the right to rely equates to the right to sue you. So, it's important to determine whether this right is subject to your agreement's stated "obligations/limitations," including limitation on liability, reasonable standard of care, and scope of services. Additionally, design firms should delete the automatic right to rely, and make any such right by third parties subject to your approval.

A related issue involves the owner's right to assign its rights under the prime agreement to any successor, related company or third party (i.e., an unrelated developer). Many claims stem from a lack of understanding of the design firm's scope of services, exacerbated by insufficient communication during the course of design and construction.

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These issues are magnified by assignments to third parties. To keep this process in check insist on language that you be notified and allowed to approve any assignment; although you may rarely object to such assignments (for pragmatic reasons), being involved beforehand lets you engage your "new" client from the outset.

In each situation, use common sense in negotiating with clients. No single issue is a "walk away" red-flag; thus, you can compromise on several points and focus on any that create greater risks for your firm. Another point to track: Is the language really helpful to the owner and are there any unintended consequences? For example, giving you upfront notice of a proposed assignment can actually help facilitate the transition; making a smoother overall project for owners who are selling out, but may want to do "another" deal with their successor. Lastly, keep in mind, you don't have to win on every word; a good working relationship is often built on compromise.

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