



Look before you leap

A/E firms with new projects should carefully examine their contracts, or risk expanding overall exposure and adding potentially significant uninsured liabilities.



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**GUEST
SPEAKER**

Before inking a deal on a new project, architects and engineers should conduct a thorough review of the contract. These days, the use of onerous contractual wording has become widespread. It can greatly expand the design professional's overall exposure and add potentially significant uninsured liabilities.

To put contractual reviews in context, it helps to understand what an A/E firm's professional liability policy will and will not cover. Specifically, these policies are intended to cover claims arising from professional negligence or malpractice. They address claims for bodily injury and property damage, in addition to economic loss.

On the other hand, underwriters of this insurance want to avoid covering certain types of risks, such as contractual liability, so they inserted exclusions to limit coverage.

Thus, if you sign a contract shifting a financial obligation to your firm that would not otherwise exist under common law or statute, then your professional liability insurer may deny coverage.

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Accordingly, as part of any contract review, pay close attention to indemnification clauses.

Often, project owners seek indemnity from design professionals for claims and expenses in

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connection with their professional services. However, a design professional's potential liability under an indemnification clause can be much broader and involve liabilities that would not otherwise exist to clients and other project participants. They include:

- **Duty to defend.** In an indemnity agreement, strike any obligations to "defend" a client from claims made by third parties. This can include reimbursement of attorney's fees and other litigation expenses incurred by the client in resisting a third-party claim. If the client will not agree to this, then try limiting any defense obligation to reimburse defense costs that would be recoverable under common law. Insert the qualifying phrase, "where recoverable under law" after "reasonable attorney's fees" in an indemnity provision.
- **Tied to negligence.** Most professional liability policies provide coverage for the design professional's negligent acts, errors or omissions. Thus, the indemnification clause might be worded to provide for indemnity "arising out of" the performance of professional services, "but only to the extent caused by" negligent acts, errors or omissions.
- **Indemnifying entities related to the owner.** Often, clients insert language requiring design professionals to indemnify numerous entities that may or may not be related to the client, such as agents, representatives, subsidiaries, affiliated companies, and lenders, among others. This creates insurability and risk management issues for design professionals as they do not typically owe a duty of care under common law to these entities. Try to remove any references to parties or agents beyond your client, its officers and employees.
- **Flow-down clauses.** Some contracts contain clauses obligating the parties to requirements in other contracts, such as the prime agreement. If your firm agrees to an indemnity clause, check if there is a flow down; if so, review the prime contract and make sure you are compliant.

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Besides indemnification clauses, design firms should watch for other potential contractual issues, including the following:

- **Standard of care.** When defined in the contract, the standard of care should require the design professional to "... perform its services within the degree of skill and care ordinarily exercised by other members of the profession in the same locality and under similar circumstances as of the time services were rendered." A design professional's contract should never promise perfection or total accuracy in its professional services. Try to remove such clauses and any language that

"insures" or "ensures" a specific result. Modify any stated absolute result or performance level by insert wording, such as: "... to the best of our professional opinion, knowledge, and belief"

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- **Limitation of liability.** This restricts the design professional's financial exposure in the event liability is established. Many design firms actively negotiate an enforceable limit of liability. The clauses typically only protect design professionals from their client's direct claims and not those brought by third parties. They should be discussed with legal counsel.
- **Waiver of consequential damages.** These damages involve indirect economic expenses, such as lost profits, some elements of delay damages or diminution in value. Although insured, they represent a disproportionate risk to the compensation provided the professional under the contract. Reject language holding your firm responsible for consequential damages. Be aware: if the contract is silent on the issue, A/E firms likely will face this risk.
- **Site safety.** Contracts should include a clause that makes jobsite safety the contractor's sole responsibility and excludes the A/E firm from any related obligation. Further, by written agreement, the project owner should require the contractor to name the design professional as an additional insured under the contractor's commercial general liability and auto policies.
- **Prevailing party attorney's fees.** Some agreements contain provisions that shift the cost of the prevailing party's legal expenses to other litigant(s). These fees would likely be considered a liability assumed under contract by your professional liability carrier, so A/E firms should negotiate to have them removed.
- **Ownership of documents.** Some clients may insert contract language granting them ownership of the A/E firm's instruments of professional service to have an unlimited license to use them. Strike any contractual language that purports to offer a client unlimited license; instead, only provide a limited license for the client's specific project needs. These agreements should be reviewed with legal counsel.

Equitable contracts that do not create uninsurable risks for design professionals are essential to a productive relationship on any project. Design professionals need to understand risks inherent in poorly drafted contracts and work with their legal counsel to modify them. ▀

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