Contract Issues: a look at risky provisions

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OH DEAR DID WE NEGLECT TO READ THE CONTRACT THOROUGHLY?
On average, each year, roughly 25 A/E firms out of every 100 experience a professional liability claim...
Learning Objectives:

- Identify key contract provisions that are not insurable OR present a heightened level of risk
- Review claims examples that illustrate the problems with agreeing to “bad” contract provisions
- Explore sample alternative wording to help make provisions more insurance friendly
Issue 1: Standard of Care

“you don’t legally have to be perfect”
Standard of Care: defined

- Tort Law: ...the design professional is held to use the same degree of care as is ordinarily practiced by other similarly situated design professionals in that discipline.

- Contractual Agreement: The standard you agreed to Contractually

- Was there negligence???

- Perfection is not legally required
Standard of Care: another definition

M Civ JI 25.31 Negligent Design

The defendant had a duty to use reasonable care at the time of design of xxxx so as to eliminate unreasonable risks of harm or injury that were reasonably foreseeable.

Reasonable care means that degree of care that a reasonably prudent designer would exercise under the circumstances that you find existed in this case. It is for you to decide, based on the evidence, what a reasonably prudent designer would do or would not do under those circumstances.

A failure to fulfill the duty to use reasonable care is negligence...
Standard of Care: claim example

A construction manager (CM) provided services for a school renovation project. The CM’s contract with the school district required him to perform to the “highest professional standards.” The project fell behind schedule almost immediately with the discovery of an old septic field under the proposed bus lot. Further delays occurred when an underground water tank was found in the location for footings of a new gym. The electrical subcontractor filed a $600,000 change order request for extras due to delays allegedly caused by design errors, unanticipated conditions, and the non-performance of the general contractor. The request was denied and the contractor walked off the project. The school district hired a replacement contractor. The original contractor filed suit for unpaid fees, causing the school district to counter-claim against the contractor. Soon numerous parties were involved in the school district’s $1.8 million claim. The allegations against the CM were failure to adequately monitor and supervise construction, failure to coordinate the work, failure to exercise the highest professional standard of care, and breach of contract. The CM had significant exposure not only from the contractual obligation to perform to the “highest standards,” but also because a lack of adequate file documentation made it impossible to determine how well the CM did or did not perform his duties. The claim settled for $400,000, which included a $100,000 contribution from the CM. The CM also paid $155,000 in expenses. **NOTE: THE CM Paid 100K in damages and 155K in expenses out of pocket since they agreed to a higher standard of care.**
Standard of Care: sample UNINSURABLE clause

“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: sample INSURABLE clause

“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.”  ~AIA
Issue 2: Warranties and Guarantees

“Excluded in the Professional Policy”
Warranties and Guarantees: excluded in the policy

Sample Professional Liability Exclusion:

“h. Express Warranties or Guarantees

based upon or arising out of any express warranties or guarantees. However, this Exclusion does not apply to a warranty or guarantee by the Insured that the Insured’s Professional Services are in conformity with the standard of care applicable to that Professional Service.”
A large architecture firm designed a fountain in a city park. The design involved cutting-edge technology. The architect entered into a written contract with the city that contained a warranty stating that the design would meet specific criteria and guaranteed that the city would not be responsible for additional costs to accomplish the promised result. After completion, the fountain did not perform to the city’s satisfaction. When the fountain projected water 200-400 feet, it turned into mist. In certain weather conditions the fountain could not be used. The architect offered to replace several nozzles at a cost of $50,000, but the city wanted $500,000 to repair the fountain. The architect’s expert determined that the nozzles used in the design did not perform to the standards established in the manufacturer’s literature. Nevertheless, the city refused to involve the manufacturer, stating that they had relied on the architect’s expertise and promises. The city took the position that the architect should have considered the impact of average wind conditions and should not have relied on the manufacturer’s representations. The claim settled for $2,000,000, and expenses were more than $1,000,000.
Warranties and Guarantees: sample UNINSURABLE clause

“Design Professional warrants that its Services shall result in a design that will allow for the successful operation of the Facility, including the suitability of the Project for the use for which the Project is intended.”

Warranties and Guarantees: sample INSURABLE clause

“Consultant makes no warranties or guarantees, express or implied, under this Agreement or otherwise in connection with Consultant's services.” ~Berkley
Issue 3: Compliance with Laws
Compliance with Laws: a guarantee (excluded)

• What is required by laws, ordinances, codes etc. can be subjective (interpreted by a government agency employee)
• Laws can change during a project
• Tie compliance to standard of care
Compliance with Laws: claim example

An Architect is contracted to perform design services for a high school renovation. After the design was completed and construction began, the school board concluded that the design was not code compliant regarding fire safety, specifically that the code required a third floor balcony to have an emergency exit in case of a fire. While the project was being designed a peer reviewer contended that an emergency exit was required. The architect disagreed and suggested an alternative solution to meet the fire code standards. The design was finalized as the architect proposed, with what the architect thought was approved by the building code official “based on oral statements made by the official during a meeting.” After construction commenced, the official concluded that the design plans were not code compliant. This resulted in paying more for the renovation because the contractor’s bid did not contemplate the construction of a staircase. The architects defense was that it met the standard of care. The architect signed a contract that stated the architect would comply with the “customary professional standards currently practiced by firms in Florida AND in compliance with any and all applicable codes, laws, ordinances, etc.” The courts found that the even though the architect may have met the standard of care, the contractual obligation for code compliance was a separate requirement that the designer agreed to without any limitation.

Compliance with Laws: sample UNINSURABLE clause

“The Architect shall review laws, codes, and regulations applicable to the Architect’s services. Architect shall cause all drawings, specifications, documents and other Work required to be performed by Architect to be prepared in accordance with all federal, state, and local statutes and regulations governing the Project and the Work, it being specifically understood that Architect shall be responsible for interpreting applicable regulations so that all aspects of the facility may be utilized for the purposes intended. Should Architect fail to comply with Legal Requirements, or produce a design that complies with Legal Requirements, Architect hereby agrees to bear all resulting costs.”

Compliance with Laws: sample INSURABLE clause

“DP will apply the reasonable standard of care to comply with applicable laws in effect at the time the services are performed hereunder, which to the best of its knowledge, information and belief, apply to its obligations under this Agreement.” ~Construction Risk LLC

OR

“DP shall exercise usual and customary professional care in its efforts to comply with codes, regulations, laws, rules, ordinances, and such other requirements in effect as of the date of the execution of this Agreement.” ~Navigators
Issue 4: Time is of the Essence
Time is of the Essence:

• They suggest absolute guarantee of completion by a specific date.
• This clause fails to allow for unforeseen circumstances or for situations where the exercise of an appropriate standard of care may require additional time for performance.
• Potential uninsurable loss.
Time is of the Essence: claim example

An architect agreed to design a restaurant for a “partnership” between a celebrity chef and a father and his son. The architect contractually agreed to a “time is of the essence clause” and to turn over a fully completed restaurant within 15 weeks at a cost of no more than $1 million for design and construction. After the project was underway, the chef demanded a new “state of the art” kitchen. He also demanded that his office, originally located in the kitchen, be enlarged and relocated. These changes took seven seats from the restaurant and delayed the opening by a month. It also increased the cost to $1.7 million. The father/son partnership filed suit against the architect for $2 million, claiming lost profits from the delay, future lost profits from the lost seating, cost overruns, delays, and defective design. The father and son made the claim difficult to settle in mediation. Although it was felt that the architect had minimal liability, his greatest exposure was due to his contractual guarantee that the restaurant would be completed within a certain time and budget. In addition, the architect’s file documentation was poor, making it impossible to prove what the father and son knew and when. There was concern that if the claim went to litigation, an award might be rendered that exceeded the architect’s remaining policy limits. The claim finally settled for $400,000, with the remaining $600,000 in policy limits spent on expenses.
Time is of the Essence: sample UNINSURABLE clause

“Time is of the essence in performance of the Services described in this Agreement. Unless extended by mutual written agreement of the Parties, Consultant’s obligation to perform the Services to be provided under the terms of this Agreement shall commence on the Effective Date and be completed on or before the scheduled termination date.”

Time is of the Essence: sample INSURABLE clause

“The Architect shall perform its services as expeditiously as is consistent with such professional skill and care and the orderly progress of the Project.” ~B101-2007 AIA

Or

Consider revising to state: “time is of critical importance…” ~Construction Risk LLC

Or

“Neither party shall be deemed in default of this Agreement to the extent that any delay or failure in the performance of its obligations results from any cause beyond its reasonable control and without its negligence.” ~Schinnerer
Issue 5: Prevailing Party

“how do we know who that is?”
Prevailing Party: generally uninsurable

- An attorney fee clause providing that the “prevailing party” has the right to collect the money it spends on attorneys from the other party of the contract.
- What it means to prevail is not defined.
- Can encourage litigation
- Generally excluded under the contractual liability exclusion
Prevailing Party: claim example

A developer retained an architect to design a small condominium project. In an effort to save money, the developer terminated the architect’s services prior to construction. When problems arose on the project, the developer blamed the architect. The developer’s $400,000 claim related primarily to the design of the bathrooms. The architect’s defense was that these problems would have been noticed and resolved during construction had the architect still been involved with the project. After an unsuccessful mediation, the claim went to arbitration as stipulated in the written agreement. The arbitrator found that the design did not meet the standard of care because the design was not code compliant. The arbitrator awarded damages of $101,000. In addition, because the professional services agreement contained a “prevailing party” provision, the arbitrator declared the developer as the prevailing party and awarded attorneys’ fees of $85,000. The architect had been advised since the beginning of the claim that a contractual agreement to pay attorneys’ fees was not covered by the professional liability insurance policy. The insurance company paid the $101,000 judgment and the architect paid the $85,000 for attorneys’ fees.
"The prevailing party in any arbitration, or any other final, binding dispute proceeding upon which the parties may agree, shall be entitled to recover from the other party attorney’s fees and expenses incurred by the prevailing party."

None, but if you cannot take it out, consider limiting it or defining what prevailing means:

"Prevailing party is the party who recovers at least 67% of its total claims in the action or who is required to pay no more than 32% 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." ~Construction Risk LLC
Issue 6: Dispute Resolution

“pick mediation”
Dispute Resolution: mediation then litigation

• Mediation First
• Litigation if Mediation fails
• No arbitration-strike arbitration clauses
“In January 2015, I successfully defended an Architect and his Firm in arbitration. The claimant was a wealthy residential homeowner who alleged claims of water damage to the home’s structure due to the Architect’s negligent failure to detect construction deviations by the General Contractor resulting in over $700,000.00 in damages. Construction was completed in 2001. The Demand for Arbitration was filed in late 2013. Although this was an arbitration matter, it provides an example of why design professionals are generally better off in litigation for ultimate dispute resolution. While we successfully achieved a decision in the Architect’s favor after the hearings, it took significant time and legal fees to prepare for and defend the client at the arbitration hearings. In a litigation forum, the Architect would have had a straightforward Statute of Limitations/Statute of Repose winning defense. The Architect could have won the case prior to trial on a Motion for Summary Judgment. Instead, the Architect had to endure three intense and stressful weeks of preparation and hearings. Finally, the Architect incurred significant legal fees which he probably would not have incurred if we were in litigation.” ~Kent Holland, Construction Risk LLC
Dispute Resolution: sample UNINSURABLE clause

“Any dispute between Contractor and Subcontractor or claim related to, or arising out of, this Agreement, shall be submitted to a senior officer of Contractor and Subcontractor to resolve through deliberations conducted in good faith. If no resolution is achieved within sixty (60) days, the dispute shall be resolved utilizing final and binding arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association. Any arbitration shall be brought in Clay County, Missouri, before an arbitrator, retired judge, or an individual acceptable to Contractor and Supplier. If Contractor and/or Subcontractor do not wish to arbitrate such a dispute, it shall be litigated in the same venue as arbitration would have been conducted.”

Dispute Resolution: sample INSURABLE clause

“The Company and the Design Professional agree to submit all claims and disputes arising out of this Agreement to non-binding mediation prior to the initiation of legal proceedings. This provision shall survive the completion or termination of this Agreement; however, neither party shall seek mediation of any claim or dispute arising out of this Agreement beyond the period of time that would bar the initiation of legal proceedings to litigate such claim or dispute under the applicable law.” ~Navigators
Issue 7: Indemnification Clauses
Indemnification Clauses: things to beware of

• #1-Tie to Negligence first
• Indemnify your client-strike out agents, representatives, construction managers, consultants and even the owner unless that is your client.
• “Arising out of” vs “to the extent caused by”
• Don’t let a higher standard of care creep back in
• Don’t agree to indemnify for breach of contract
• Strike out a duty to defend
• Remember the provisions mentioned earlier
Indemnification Clauses: claim example

On a County highway, a car is stopped due to traffic. A semi truck doesn’t stop in time and rear ends the car in front of him, killing all the people in the vehicle. The Estate of the deceased persons sue the County, Lead Engineering Firm, and the sub-consulting engineering firms involved in the design of the highway project. Some of the sub-consultants were required to sign a contract with a “Duty to Defend” the County. No negligence has been found, but the county has sued a sub-consultant for breach of contract and demanded defense coverage per the terms of the contract. The engineering firm’s professional liability company has denied coverage for the duty to defend demand under the “contractual liability exclusion” and the general liability company has denied coverage under the “professional services exclusion”. The engineering firm will be responsible for paying the expenses and legal fees of the county out of their own pocket. Out of pocket expenses has not yet been determined as this is a current open claim.
A girl gets hurt in a park and the mom sues the owner of the park (client) for damages.

Client: Defend me per the contract.

Design Professional:
- General Liability Insurance Policy
- No coverage: You are a professional. Call your professional liability company.
- Professional Liability Insurance Policy
- No coverage. Contractual Liability Exclusion. You are on your own!

Out of Pocket:
- I don't have enough money. I didn't do anything wrong. I have to file for Bankruptcy.

Contractor:
- General Liability Insurance Policy
- No problem. Insurance will pay.

The proposed changes will NOT effect this.

Current Anti-Indemnification Statute in Indiana
A girl gets hurt in a park and the mom sues the owner of the park (client) for damages.

Client: Indemnify me. You messed up.

Design Professional: The insurance company pays damages as a result of my negligence.

Client: Out of Pocket. My Deductible. I can afford that. I can stay in business and my client gets indemnified.

Contractor: Defend me per the contract.

General Liability Insurance Policy:
No coverage: You are a professional. Call your professional liability company.

Professional Liability Insurance Policy:
My Deductible. I can afford that. I can stay in business and my client gets indemnified.

No Changes.
Indemnification Clauses: practice

Mark up the following clause...

To the fullest extent permitted by law, the Consultant shall defend (at Consultant’s expense and with counsel acceptable to Contractor), indemnify and hold harmless the Owner, Contractor and all its agents and employees from and against all claims, damages, losses or expenses, including attorney's fees arising out of, resulting from, or connected with the Consultant’s performance or failure of performance under this Agreement, but only to the extent caused by the acts or omissions of the Consultant, its laborers, employees, Consultants, suppliers or anyone for whose acts they may be liable, including, but not limited to, those that are: (1) attributable to bodily injury, sickness, disease, death or injury to or destruction of tangible property including the Work itself and/or the loss of use resulting there from; and/or (2) caused in whole or in part by negligent acts or omissions of Consultant or any of its Consultants, anyone directly or indirectly employed by any of them or for anyone for whose acts any of them may be liable, regardless of whether such is caused in part or in full by a party indemnified hereunder. This indemnity clause specifically applies to negligence claims and indemnifies the Contractor even for the Contractor’s own negligence unless the claim, damage, loss or expense arises solely and only from conduct or negligence by the Contractor.
Indemnification Clauses: marked up version

To the fullest extent permitted by law, the Consultant shall defend (at Consultant’s expense and with counsel acceptable to Contractor), indemnify and hold harmless the Owner, Contractor and all its agents and employees from and against all claims, damages, losses or expenses, including reasonable attorney's fees arising out of, resulting from, or connected with to the extent caused by the Consultant’s negligent performance or failure of performance under this Agreement, but only to the extent caused by the negligent acts or omissions of the Consultant, its laborers, employees, Consultants, suppliers or anyone for whose acts they may be legally liable, including, but not limited to, those that are: (1) attributable to bodily injury, sickness, disease, death or injury to or destruction of tangible property including the Work itself and/or the loss of use resulting there from; and/or (2) caused in whole or in part by negligent acts or omissions of Consultant or any of its Consultants, anyone directly or indirectly employed by any of them or for anyone for whose acts any of them may be legally liable, regardless of whether such is caused in part or in full by a party indemnified hereunder. This indemnity clause specifically applies to negligence claims and indemnifies the Contractor even for the Contractor’s own negligence unless the claim, damage, loss or expense arises solely and only from conduct or negligence by the Contractor.
Can you do another draft of this? There's still a couple of sentences people might actually understand...
Questions???

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Thanks to our insurance company partners and other professional partners for some of the data included in this presentation:
CNA/Schinnerer, Travelers, Berkley, Navigators, Kent Holland with Construction Risk LLC.