



Owner Contracts: Current Trends & Owners' Continued Efforts to Shift the Risk to the A/E

Insurance companies' claims departments see thousands of contracts from design professional firms each year. Some of the contracts are great, while others have a lot to be desired. Sadly, a contract typically only finds its way into the hands of an insurance company's claims department when a claim is filed and that is certainly too late in the game for a design firm to realize the true importance of its contracts.

Surprisingly, many design professionals view the contract as merely a tool to set forth the scope of work and fee in order to get the project started. When faced with a professional liability claim, however, a firm's contract can "make or break" the case.



That is why, through continued education and counseling, many insurance providers try to impress upon their design professional clients the risk management benefits of a strict policy regarding contract review and negotiation prior to execution of a contract. From a claims standpoint, the firms that often get the best results are usually those firms that make contract review and negotiation a priority within their firms, and that are willing to walk away from a project if the contract terms are onerous and not negotiable.

COSTLY CLAIMS

To understand the need to be diligent in contract review and negotiation consider the following recent claim experience:

An architect (AR) was hired by a school district to design a new elementary school. The AR firm

executed a contract that allowed the district to recover consequential damages, including attorneys' fees, in the event of a claim or lawsuit. Additionally, the indemnification provision, which required the AR to indemnify for the consequential damages and attorneys' fees, did not limit the indemnity requirement to the AR's negligence; it was overbroad.

During the course of discovery, the claims department handling the resulting claim was able to develop very favorable facts, and initially viewed the matter as having only minimal liability exposure to the insured. However, when the claim went into mediation, the AR's insurance company was surprised to learn that the district's counsel had expended over \$400,000 in attorneys' fees. The district's counsel was billing at a rate of \$500/hour, so the fees and costs quickly mounted. Aside from the attorneys' fees being claimed, the district also presented a large number for consequential damages relating to delays.

Although the AR's insurance company may have received a possible defense verdict on the E/O claim, the case did present some trial risks. The insured did not want to go to trial because of the potential risks, even though there was a good chance for a defense verdict, and the defense attorney ultimately recommended settlement as the means for resolution. However, due to the poor contract terms relating primarily to indemnification and consequential damages, the insurance company was not able to negotiate a settlement that was proportionate to its minimal liability view of the case.

The case eventually settled for \$210,000. The original settlement recommendation, based purely on E/O considerations, was \$50,000 - \$75,000. The insurance company could not settle for something in that range due to the poor contract terms. During the claim process, the insured admitted that the particular contract was "just signed" so that they could get the job, and that attention was not given to the terms. When the claim closed, the insured advised that they would never take another job without first diligently reviewing the contract, and that they would walk away from contracts with onerous terms.

NEW TRENDS SPARK CONCERN

Owners' contracts that have crossed many claims adjusters' desks recently have terms that are sparking heightened concerns. It is evident that there is a continuing effort by owners to shift risk and exposure to the design professionals ("A/E") through owner-prepared contracts or through modifications to standard AIA contracts. Some of the recent trends and terms in owners contracts, which the owners have been refusing to strike or delete from their contracts, include:

1. **Language that heightens the A/E's duty of care.** An example would be a contract provision that requires "the highest degree of professional care. "A/E's are not held to a standard of perfection, and they are not held to the "highest degree of professional care." The A/E is held to the standard of other similarly skilled / educated A/E's in the community. A/E's should never agree to be bound by a heightened standard of care—as such a standard is contrary to the law.
2. **Consequential damages provisions.** Owners are forcing contract terms that allow for recovery of consequential damages. Consequential damages are economic damages such as delays, fines, attorney fees, lost business or lost income. Consequential damages are typically the "high-dollar" damages that drive claims and lawsuits. A/E's should try to have such terms stricken from the contracts and replaced with a consequential damages waiver.
3. **Indemnification clauses** that are overbroad and require the A/E to indemnify for not only their own negligence, but for the negligence of others, as well as for contractor claims. The A/E should agree to indemnify for only the damages that flow from the A/E's own negligence or from that of the A/E's subconsultants. By agreeing to indemnify for anything more, the A/E is increasing its exposure.
4. **Terms which require increased inspection and scheduling responsibility.** While owners want the A/E on site more frequently, they do not seem to want to pay for it. If the owner is requiring increased on-site activity by the A/E, then the A/E should be compensated. However, it is important to note that through such terms, owners are also trying to make the A/E more responsible for ensuring that the contractors are performing their work. A/E's need to closely read and monitor such terms to ensure their role is limited to observation, and that their scope is not expanded via contract, such that they become construction inspectors, which, also increases the A/E's liability along with increasing their scope. The A/E's contracts should clearly disclaim any responsibility or role related to "means and methods" or construction activities.
5. **Terms which make the A/E responsible for jobsite safety.** A/E's are historically not responsible for jobsite safety. Such responsibility lies with the general contractor and its subcontractors. A/E's should strike any contractual provisions that make them responsible for jobsite safety, as it expands their scope (relating to observation and the need to identify unsafe conditions), as well as their liability.
6. **Provisions that require the A/E to guarantee or certify their work and/or results,** or certify or guarantee results for a certain period of time. By definition, the words "certify," "warrant" or "guarantee" mean to assure the total accuracy of something or to confirm that a standard has been



met, absolutely. Such terms essentially require the A/E to confirm that they will not make any mistakes, which translates to an artificial standard of care.

7. Terms that require the A/E to pay the owners' attorney fees in the event of a claim or suit,

regardless of whether the A/E is found to be negligent or at fault. Most legal statutes and case law pertaining to negligence do not allow for the recovery of attorneys' fees. As such, if the A/E agrees to reimburse for such, they are assuming an obligation by virtue of the contract, for which they would not otherwise be responsible. All parties should agree to bear their own costs and fees in the event of a claim or lawsuit.

WALK AWAY

While not all firms will be able to negotiate a "perfect" contract, the key is for all firms to review contracts with their firm's "deal breakers" in mind. All firms should have a set policy regarding the contract terms that they will accept, as well as which terms are "deal breakers." (To read more about this topic visit xldp.com/primer to access the *Deal Makers and Deal Breakers chapter of Professional Services Agreements: A Primer.*)

During contract review, some firms may find themselves wise to recall the lyrics to the old song "Just Walk Away, Renee." Too many firms do not have internal policies regarding contract "deal breakers," and they do not know when they should walk away from a contract / project or why. Not only do the terms outlined above result in increased liability and exposure to policyholders, but most of

the terms would also present coverage concerns because, if agreed to in a contract, some of the terms result in the policyholder assuming liability by contract, which may not be covered under their professional liability insurance policy.

Unfortunately, some lessons are learned the hard way. Careful contract review and diligent negotiations procedures can help design professionals steer clear of the hard lessons and keep their firms on a safer, more profitable road.

The information in this article is the product of over 30 years of front-line claims experience and is part of the educational service provided to the design industry by the Design Professional group of the XL Insurance companies. For more information, other loss prevention resources and to find an agent in your area, visit xldp.com or phone 800-227-8533 ext.2102508.

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