

A/E RISK REVIEW

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Reducing the Chances of Third-Party Claims

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

According to leading professional liability insurance companies, clients file about two-thirds of all professional liability claims against design professionals. Given this, design firms need to be diligent when it comes to client selection. You want to avoid clients with a history of filing claims against their design consultants. Plus, you want a client who will agree to contracts that fairly and equitably allocate liability to the party that has the greatest degree of control over the various risks.

But what about the other one-third of liability claims – those filed by third parties not subject to the conditions of the consultant-client contract? The legal obligations that design firms have to third parties such as contractors, construction workers or building tenants can be difficult to ascertain.

Under the concept of “privity of contract,” design professionals owe a duty of care only to those with whom they have a contract. However, numerous court decisions have eroded this concept and today, you can be successfully sued by anyone who could be harmed as a result of your professional services whether you have a written contract with that party or not.

It Starts with Your Client Contract

So how can a design professional take actions to minimize third-party liabilities? What many architects and engineers don’t realize is how effectively the consultant-client contract – and the discussions that the negotiation process generates – can be used to reduce third-party claims.

For example, design firms can have substantial influence regarding the contractual language between their clients and their clients’ contractors – who happen to be the biggest source of third-party claims against design firms. You can discuss with your client how a number of contract provisions can lower exposures to contractor liability for the both of you. Explaining to clients how equitable contracts with your firm and with contractors and other third parties can lower exposures is a key to reducing the chances of claims associated with a project.

Following is a list of issues that should be addressed in order to lower liabilities from third-party claims. Discuss these with your legal counsel in advance of negotiating your next client contract.

Contractor Selection

When considering a new project, communicate to your client the importance of contractor selection. Offer your assistance in helping to select and educate the contractor in an effort to avoid project problems and disputes.

Contractor pre-qualification helps ensure that the selected contractor has the experience and credentials required to perform needed services for a particular project. Moreover, should a problem arise, a reputable contractor will be more likely to seek a quick and equitable resolution.

Pre-bid meetings can help ensure contractors' questions are answered before work begins. You – not your client -- are in the best position to answer questions about your designs. Pre-construction meetings can contribute to clear understanding between all contractors, subcontractors, consultants and subconsultants involved in the project.

Third-Party Exclusions

Third parties sometime file claims because they think the contract provisions between you and your client apply to them. For that reason, some attorneys say it can be beneficial to include a third-party exclusion in your client contract. This exclusion should state that nothing in your agreement with your client creates a contractual relationship with a third party. It should also state that your services are being performed solely for the client's benefit. It can be helpful to have similar language regarding your services included in the contracts between the client and its contractors, subcontractors, subconsultants, vendors and other parties to the project.

Note that a third-party exclusion cannot prohibit third-party claims. However, it can make it more difficult for third parties to take a claim forward and even tougher for them to win.

Third-Party Reliance

Third-party reliance on a research report prepared for a client is a well-known liability problem in the environmental field. It can also be a problem for design professionals. For example, you may evaluate the structural integrity of a building for a client, only to have the client sell the property using your report as part of the sales proposal. For that reason, your client contract should include a third-party-reliance provision that forbids any party other than the client to rely on your report, unless you give explicit permission for it to do so. Wording about third-party reliance should be included in any report you develop for a client.

To reduce your risk further, include a copy of your contract with your client as an appendix to any research report you produce. This will indicate specifically the scope of services you were hired to provide and the nature of the agreement between your firm and the client for whom the service was performed. Any limitations as to your liability for your work that are

included in the client contract (such as the third-party-reliance provision) will then be made known to the third parties.

Construction Observation

You can help prevent third-party claims by delivering a full scope of services to your client. For example, construction observation services can greatly minimize jobsite liabilities. You can spot problems that contractors, subcontractors and other third parties may not see, and can deal with those issues at the "molehill" stage. The documentation that results from construction observation can also help discourage a contractor from filing a suit for damages due to design firm negligence or omissions.

If a client refuses your construction observation services, work with legal counsel to obtain contractual protection for claims that arise due to the lack of coordination or the lack of professional interpretation of the construction documents during the construction phase.

Shop Drawing Review

Unscrupulous contractors have been known to inundate design consultants with shop drawings, causing a sharp slowdown in the review process and subsequent claims for delays. To avoid this, seek to limit your shop drawing responsibilities through appropriate contract language.

Identify shop drawings by type and define for the contractor exactly which ones you will review. Give the contractor a list of the submittals you will require prior to construction and have the contractor provide a schedule of submissions. Establish a logging, tracking and follow-up system for shop drawing and submittal processing. Insist on a clause in the general conditions of the construction contract that requires the contractor to provide you with written notice of any deviations from contract requirements. By following these steps, you can help prevent shop drawing review from becoming a profit center for those who intend to misuse the process.

Diminution of Value

Diminution of value can be a serious problem relative to conditions surveys of any type. When your client is considering property for purchase, your finding of a latent problem would cause the property to lose value or could delay the transaction.

Seek protection for this third-party exposure through an indemnification provided by your client. Your client can seek protection from the property owner by requiring the owner to agree to waive any claim brought about by a finding that makes the property less valuable.

Right of Entry

When your services include conditions surveys or forensic work, you need to ensure you have a legal right to enter onto property not owned by your client. Otherwise, you could be faced with trespassing charges or worse – such as a claim that your forensic evidence was gained through unlawful means. Be certain that the necessary permission is obtained, and that the property owner is advised that the work you do may result in property damage. The client should be responsible for liabilities associated with such activities.

Certifications

Various documents, such as those required by lenders, may ask design professionals to certify that certain conditions have been met. The word "certify" can easily be taken to mean guarantee – and to guarantee the existence of conditions whose existence cannot be verified is foolhardy. What's more, most professional liability insurance policies do not cover claims resulting from such guarantees.

While it is impossible to certify conditions as fact, a design professional can give an *opinion* regarding conditions, e.g., that a building was constructed in compliance with drawings, specifications and applicable codes. Make sure you use appropriate language when asked by third parties to give certifications, and encourage your client to explain this issue to third parties who seek such certification.

Site Safety

Claims against design firms filed by injured contractors' employees are among the most common of those claims not filed by clients or contractors. These

injury claims arise because design professionals are among the few parties available to sue, given that:

- 1) Under workers compensation laws, employees generally cannot sue their employer for workplace accidents, and
- 2) Project owners typically have nothing to do with what happens at a jobsite.

Make it clear in your contract with your client that you are not responsible for site safety, or the means, methods, sequences and operations of construction. These functions are vested solely in the contractor or, where applicable, the construction manager. Call for the client's agreement with the contractor to include a provision requiring the contractor to hold you and your client harmless for jobsite safety issues. The same provision could call for the contractor to make you and the owner additional insureds on the contractor's general liability insurance.

Equally important, do not take any actions on the jobsite that could be interpreted as taking responsibility for means and methods of construction. That includes never issuing a stop-work order except in extreme cases where a jobsite condition, such as a potential trench collapse, presents an immediate danger.

Condominiums

Condominiums are among the riskiest projects a design firm can get involved with, in terms of both claim frequency and severity. Third-party claims are especially prevalent. Each and every owner of a condominium unit – as well as the development's homeowners' association – can file a claim against you. Plaintiff attorneys are well aware of this fact and often seek out "wronged" condo associations as clients.

You can protect yourself by carefully scrutinizing the claims history of your client's previous condo projects. You should also include a provision in your client contract requiring the client to include a maintenance agreement in the condominium's bylaws. Such a clause would cause the condominium owners to waive any claims against the developer, consultants and contractors for failure of equipment or materials that are not properly maintained.

Client & Contractor Insurance Provisions

The risks of claims increase to you and your client if the contractor – and construction manager – do not have the requisite insurance and indemnity provisions. Be diligent about making sure your client requires that all parties to the construction project maintain adequate insurance. This can prevent you from becoming the targeted “deep pockets” in a third-party claim.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.