Blueprint

for Design Professionals

March 2011
Volume 2 Issue 1

Navigators
Insuring A World In Motion®

Welcome to our second edition of Blueprint For Design Professionals. This issue focuses on contracts – how they can help and hurt you. Let us know your thoughts as it helps us to deliver to you information relevant to your practice. Send us article ideas, risk management questions, and any other comments you might have to David Soltero at dsoltero@navg.com. While we may not be able to respond to you directly, we will do our best to incorporate the answers and ideas in future issues.

Inside This Issue

1 Three Killer Contract Clauses to Increase Your Profits

2 The Devil is in the Details

The first rule of contract negotiations is "everything is negotiable"

Three Killer Contract Clauses to Increase Your Profits

By James F. Lee, Jr. and Terrence M. McShane

As you know, in commercial transactions nothing is more valuable than a written contract. For design professionals, having a written contract that defines not only your scope of services and fees, but limits your risk and increases your profits can be critical to your future success.

The first rule of contract negotiations is "everything is negotiable." Therefore, in the world of commercial contracts, always remember that you can incorporate new clauses in your contracts that limit your risks and increase your profitability. Three options you may want to consider when negotiating your future design contracts are:

Please see Killer Contract Clauses on the next page

The Devil is in the Details

By Michael Stone

Design professionals are often so focused on getting interesting work that they neglect to analyze those aspects of contracts which address what happens if things go wrong. If problems arise during or following the completion of the work, and litigation is threatened or commenced, contracts among the owner, design professionals, contractors and subcontractors control the manner in which disputes may be resolved and the scope of claims which may be brought by and among the parties.

Please see The Devil is in the Details on page 4

Certificate of Merit

Over the past 20 years, 14 states have enacted "certificate of merit" statutes to try to insulate licensed professionals from frivolous lawsuits. Some of the statutes are more effective than others by creating more requirements for a potential plaintiff to satisfy in order to file a lawsuit against a design professional. They are a starting point, however, not the beginning or end. If you practice in a state with no certificate of merit statute, then don't just except the status quo. Instead, attempt to negotiate the inclusion of a certificate of merit clause in your contracts. Likewise, if you are in a state where a certificate of merit clause already exists, then review the statute and ask your attorney if it can be strengthened via contract. Some language we have suggested for local clients to consider is as follows:

> The Owner shall make no claim for professional negligence, either directly or in a third party claim, against Architect or Engineer unless the Owner has first provided the Architect or Engineer with an affidavit containing a written certification executed by an independent design professional currently practicing in the discipline of the alleged defective design and licensed in the jurisdiction of the Project. This certification shall: (a) contain the name and license number of the certifier; (b) specify each and every act or omission that the certifier contends is a violation of the standard of care expected of a design professional performing the allegedly defective professional services under similar circumstances; and (c) state in complete detail the basis for the certifier's opinion that each such act or omission constitutes such a violation.

As you may know, this type of clause can create a valuable defense and an obstacle to an owner or a third party asserting a lawsuit against a design professional without satisfying this contractual requirement. Whether you practice in a state with a certificate of merit statute or not, a strong certificate of merit contract clause can help provide a winning defense to an otherwise costly and time consuming claim.

Statute of Limitations

A viable statute of limitations defense is one of the few ways to have an unwanted lawsuit dismissed early in the legal process. However, the key to a successful statute of limitations defense is your contract. While all states have enacted various statute of limitations statutes, many of those statutes are perforated with holes where a skillful plaintiff's attorney can file a suit and avoid dismissal. This is particularly true when states allow claims for "latent defects" beyond the typical statute of limitations under the "discovery rule exception." In the State of Maryland, for example, a plaintiff can bring a claim years after the three year statute of limitations has expired if the claim arises from latent defects that were not "discovered" until after the statutory period of limitations had expired. Consequently, the effective date for the statute of limitations to expire can be extended for years when a claim arises in a jurisdiction with the "discovery rule."

Please see Three Killer Contract Clauses to Increase Your Profits on Page 3

Three Killer Contract Clauses to Increase your Profits from page 2

Therefore, if you practice in a state with the "discovery rule" or you want to strengthen your statute of limitations defense, you should consider language that appeared in the 1997 AIA B-141 Owner/Architect contract as follows:

> Article 1.3.7.3 – Causes of action between the parties to this Agreement pertaining to acts or failures to act shall be deemed to have accrued and the applicable statutes of limitations shall commence to run not later than either the date of Substantial Completion for acts or failures to act occurring prior to Substantial Completion or the date of issuance of the final Certificate for Payment for acts or failures to act occurring after Substantial Completion. In no event shall such statutes of limitations commence to run any later than the date when the Architect's services are substantially completed.

This contract language does not reappear in the 2007 AIA contracts. However, you can incorporate it in your contracts today. If you do, it can provide an argument to counter the "discovery rule" for latent defects and may help limit your future business risks.

Waiver of Subrogation

A waiver of subrogation defense is one of the most overlooked defense tactics an attorney can assert in large or small construction cases. In years past, we have taken advantage of this defense as a winning strategy to get multi-million dollar lawsuits dismissed for our design clients.

The 2007 AIA B101 Owner/Architect Agreement contains a waiver of subrogation clause as follows:

> Article 8.1.2 To the extent damages are covered by property insurance, the Owner and Architect waive all rights against each other and against the contractors, consultants, agents and employees of the other for damages, except such rights as they may have to the proceeds of such insurance as set forth in AIA Document A201-2007, General Conditions of the Contract for Construction. The Owner or the Architect, as appropriate, shall require of the contractors, consultants, agents and employees of any of them similar waivers in favor of the other parties enumerated herein.

The value of this defense cannot be overstated. Like the statute of limitations defense, a waiver of subrogation defense if applicable can provide a winning defense even if a design professional breached the standard of care and was negligent in rendering his or her services. Therefore, if you are using AIA contracts make sure they contain the clause above. If you are not using AIA contracts, then negotiate the inclusion of a waiver of subrogation clause in all of your future contracts. If you do, this clause may turn a sure loser on liability into a sure winner for you.

James F. Lee, Jr. and Terrence M. McShane are partners in the law firm of Lee & McShane, PC, based in Washington, DC. Lee & McShane has represented over 600 different A/E firms over the past 20 years. Please note it is important to confer with local counsel regarding your design contracts and any proposed clauses to make sure they comply with local, state and federal law.

The Devil is in the Details Continued from Page 1

There is often disparate bargaining power between the owner and the design professional, especially in the current economic climate. Contracts can be used as swords by the owners to shift their risks for the project onto the design professional. It is important for the design professional to carefully examine contracts to avoid uninsurable and potentially financially devastating contract language.

INDEMNIFICATION

The design professional can unwittingly find that it has contractually assumed obligations which may not be covered by the design professional's insurance. The most typical example is the inclusion of a "duty to defend" clause requiring the design professional to defend and indemnify the owner whether or not the conduct of the design professional was negligent or actually caused the problem. The following example is typical of an owner-friendly clause and should be the subject of careful scrutiny: "Architect agrees to save, defend and indemnify and hold harmless Owner from and against any and all claims of any kind . . . where such accident, damages or injury resulted or is claimed to have resulted from any act, omission or negligence on Architect's part." Here, the design professional's duty to defend and indemnify is triggered by a mere allegation that the claim is related to the professional's services. The cost of defending such claims can be very substantial and may not be covered by the design professional's professional liability insurance.

Contrast such language with the following: "To the fullest extent permitted by law, the architect shall indemnify and hold harmless the owner against claims . . . but only to the extent caused in whole or in part by the act, omission or negligence by the architect . . ." Here there is no duty imposed to defend the owner, and the professional's duty to indemnify is not triggered until there is a finding of and is limited to the design professional's negligence. This subtle difference in language can significantly impact the design professional's exposure.

As the legislation and court decisions vary from state to state, the design professional would be well served by being familiar with the manner in which the courts address indemnification obligations and should, of course, consult with counsel or its insurance agent to provide assistance and guidance in negotiating these terms.

LIMITATION OF LIABILITY PROVISIONS

Contract clauses can also be used as a shield by the design professional by including language that defines the extent of responsibility for monetary damages that may be caused by the actions of the design professional or its sub-consultants. One common clause limits damages to a fixed dollar amount or to received fees and is particularly important when the fees for services are dwarfed by the potential risks; to wit, "Notwithstanding any other provision . . . design professional's liability to owner . . . shall not exceed the total compensation received by design professional hereunder and owner releases design professional from any liability in excess of such amount."

Please see The Devil is in the Details on page 5

The Devil is in the Details continued from page 4

The majority of jurisdictions enforce such limitations as they permit commercial entities to identify potential risks and to negotiate financial terms prior to commencing work on a project. If a limitation of liability clause is to be contained within a contract with the owner, the design professional should be attentive to having consistent language in its contracts with its sub-consultants to avoid disparate limitations.

Owners do not look favorably upon limitations of liability. Nonetheless, such clauses can be worth the fight as they significantly reduce exposure to damages.

DISPUTE RESOLUTION

When disputes arise with respect to the design or construction of a project, there are generally three ways in which they can be addressed. The traditional method is litigation in state or federal courts which may be expensive, time consuming and intrusive to all parties involved.

Alternatively, some contracts contain clauses which require the parties to engage in "alternative dispute resolution," which may consist of mediation and/or arbitration. Mediation is a non-binding process where the parties present their positions to a neutral facilitator to assist in achieving a voluntarily negotiated resolution. Mediation is generally the least expensive way to resolve a dispute.

Arbitrations are binding proceedings conducted by one or more neutral arbitrators in a procedure that is similar to a court trial but is usually more informal. The process for selecting arbitrators can be dictated by the contract and may allow the parties to select arbitrators so that they are able to present technical matters to a person who has knowledge or experience in their field. The arbitrator(s) consider the evidence and arguments of the parties but are not governed by the same rules that apply to the courts. While arbitration may reduce legal fees and costs associated with dispute resolution, it also limits or eliminates some of the legal protections of court proceedings – paramount among these is that arbitration results in a binding decision that is not subject to appeal.

The paperwork is important. All the contracts on a project must be reviewed together for consistency as they can provide substantial protections (or burdens) in the event that a dispute arises.

MICHAEL J. STONE is a partner in the Boston law firm Peabody & Arnold, LLC where he concentrates in the defense of professionals, including architects and engineers. Mr. Stone received B.S and M.S degrees in engineering from Columbia University and was a practicing engineer and teacher of engineering prior to obtaining his J.D. from Northeastern University School of Law. If you would like more information with regard to this article, please do not hesitate to contact Michael Stone at mstone@peabodyarnold.com.