Contract Guide Course for Design Professionals:

Part II

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Learning Objectives

- Learn about key contract clauses creating risks;
- Learn to negotiate contract clauses to allocate risk more appropriately;
- Study and learn contractual risk transfer issues from case studies

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Incorporation by Reference

- Be sure to obtain and read the "prime agreement" that is incorporated.
- Determine that the incorporated t's and c's don't create greater responsibility than the t's and c's in your subcontract.
- Example clause is AIA C401-2007, 1.1 that provides:
  - "A copy of the Architect's agreement with the Owner, known as the Prime Agreement … is attached as Exhibit A and is made a part of this Agreement".
- As a subcontractor, DP should:
  - (1) amend the above clause by adding exceptions for specific, identified articles of subcontract, and

    (2) revise the Prime Agreement clauses as they will apply to you in the event they are unacceptable.

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Indemnification (problem 1)

- Uninsurable "contractual liability" when DP agrees to indemnify for anything other than damages caused by DP's negligence.

- Indemnity provisions are being written so broadly as to apply to:
  - First party breach of contract claims;
  - All errors and omissions even if not negligent;
  - All damages so long as DP is a little bit responsible
- No professional coverage specifically for the terms of "indemnity" clauses. Only covered if liability would have existed at common law.
  - So revise indemnity clause accordingly

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Indemnification (Example bad clause)

- Example of overbroad and uninsurable indemnity agreement:

  - *“DP shall indemnify and save harmless the Client, and its officers, directors, employees and agents, from and against all liability, loss, cost or expense (including attorney’s fees) by reason of liability imposed upon the Client, arising out of or related to DP's services, whether caused by or contributed to by the Client or any other party indemnified herein, unless caused by the sole negligence of the Client”*

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Indemnification – (problem - “In Whole or in Part”

- Beware of a clause stating DP will indemnify client for all damages caused “in whole or in part” by DP.
  - That language means DP will indemnify for ALL the damages even though caused only in small part by DP.
  - Insurance will only cover the damages to the extent caused by DP.
  - Reword a “in whole or in part” clause.

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Indemnification (problem of 1st party claims)

- Indemnity should only apply to damages arising out of third party claims against the client.
- Some courts are confusing indemnity and allowing clients to use the clause to recover breach of contract claims against the DP, and to include their attorneys fees as part of their recovery.
- See next slide for sample indemnity clause limited to third party claims.

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Indemnification (solution for third party claims)

- Example of reasonable indemnity clause:
- "**Indemnification.** Notwithstanding any clause or provision in this Agreement or any other applicable Agreement to the contrary, Consultant's only obligation with regard to indemnification shall be to indemnify and hold harmless (but not defend) the Client, its officers, directors, employees and agents from and against those damages and costs that Client is legally obligated to pay as a result of third party claims, including the death or bodily injury to any person or the destruction or damage to any property, to the extent caused by the negligent act, error or omission of the Consultant or anyone for whom the Consultant is legally responsible, subject to any limitations of liability contained in this Agreement.

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Indemnification: EJCDC solution

- ”*Indemnification by Engineer*: To the fullest extent permitted by law, Engineer shall indemnify and hold harmless Owner, and Owner’s officers, directors, members, partners, agents, Design Professionals, and employees from reasonable claims, costs, losses, and damages arising out of or relating to the Project, provided that any such claim, cost, loss, or damage is attributable to bodily injury, sickness, disease, or death, or to injury to or destruction of tangible property (other than the Work itself), including the loss of use resulting therefrom, but only to the extent caused by any negligent act or omission of Engineer or Engineer’s officers, directors, members, partners, agents, employees, or Design Professionals. This indemnification provision is subject to and limited by the provisions, if any, agreed to by Owner and Engineer in Exhibit I, “Limitations of Liability.” EJCDC E-500 (2008), §6.10.A.”
-

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Indemnification – Be sure the word "negligence" modifies everything.

- Poor wording may shift risk to DP for damages not caused by its own negligence. E.g.,
  - *"DP shall indemnify the Client for all claims, damages and expenses arising out of acts, omissions, errors or negligence of the DP."*
- Notice that "negligence" is in the wrong place and fails to modify "acts, omissions and errors." Thus, the indemnity applies to everything.

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Indemnification – Increasing the Standard of Care

- Indemnification clauses that are not limited to negligence conflict with the normal Standard of Care.
- DP might be held to a perfection standard by the indemnification provision so it is liable despite having met the standard of care, i.e., it was not negligent.
- So a bad indemnity clause can trump a good standard of care provision in the contract,

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Indemnification (the Uninsurable Duty to Defend

- DPs should not agree to defend their Clients. No common law duty requires a DP to defend its client against third party actions.
  - No insurance coverage for the defense costs that the consultant pays on behalf of its client. The "contractual liability exclusion" applies.
- A contractually agreed upon duty to defend is triggered as soon as the claim is made because it is a separate duty from the duty to indemnify.
  - At least that is how most courts will interpret it. For example – California.

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Inspection (the problem)

- An example of a problematic clause is the following:
  - *“DP shall make visits to the site to inspect the progress and quality of the executed work of the Contractor and its Subcontractors, and to determine if such work is proceeding in accordance with the Contract Documents. . . . DP shall keep the Owner informed of the progress and quality of the work and shall exercise the utmost care and diligence in discovering and promptly reporting to the Owner any defects or deficiencies.”*

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Inspection (Solution) –

- AIA B101-2007,§3.6.2.1, "The Architect shall visit the site at intervals appropriate to the stage of construction, or as otherwise required in Section 4.3.3, to become *generally familiar* with the progress and quality of the portion of the Work completed, and to *determine, in general*, if the Work observed is being performed in a manner indicating that the Work, when fully completed, will be in accordance with the Contract Documents. However, the Architect shall not be required to make exhaustive or continuous on-site inspections to check the quality or quantity of the Work. On the basis of the site visits, the Architect shall keep the Owner *reasonably informed* about the progress and quality of the portion of the Work completed, and report to the Owner (1*) known deviations* from the Contract Documents and from the most recent construction schedule submitted by the Contractor, and (2) defects and *deficiencies observed* in the Work.

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Inspection – (Sometimes it really is "inspection"

- If you the term "inspection", define it narrowly. E.g., AIA B101-2007, at §3.6.6 "Project Completion":
  - The Architect shall conduct inspections to determine the date or dates of Substantial Completion and the date of final completion; issue Certificates of Substantial Completion; receive from the Contractor and forward to the Owner, for the Owner's review and records, written warranties and related documents required by the Contract Documents and assembled by the Contractor; and issue a final Certificate for Payment based upon a final inspection indicating the Work complies with the requirements of the Contract Documents.

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Insurance (problem)

- Beware of contract like ConsensusDOCS 240 that requires DP to give copies of policies to the client.
  - Only certificates of insurance are typically required.
  - The terms and conditions (particularly endorsements) are often unique to the DP firm and not something to be shared with others..
  - Note also that DP might choose to reveal coverage of only what the contract calls for instead of the full amount of coverage carried by the DP.

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Insurance – (problem – no coverage specifically for indemnity)

- Owner-generated contracts sometimes state that the DP is to procure a professional liability policy with contractual liability coverage for the project owner. E.g.,
  - *“The Engineer’s contractual liability coverage must, at a minimum, protect the Owner to the extent of the following hold harmless agreement….”*
- Note that under the typical contractual liability exclusion, indemnity is not excluded from coverage so long as a court would have imposed the liability even in the absence of the indemnity provision. But insurance is not expressly written to cover indemnity clauses. So delete that language.

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Insurance (problem - Naming Owner as Additional Insured is not Possible)

- My recent Zurich a/e Briefings provides a full explanation for why project owners and other clients are not named as additional insureds on a DP's policy.
  - http://www.zurichna.com/internet/zna/sitecollectiondocuments/en/products/construction/designprofessional/aebriefings/aebriefing_2012_fall.pdf#page=1
- Just say NO when asked to name someone as an additional insured.

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Limitation of Liability (EJCDC)

- EJCDC Document E-500 (2008) at Exhibit I, 6.10.A.-1:
- *"Limitation of Engineer's Liability …* To the fullest extent permitted by law, and notwithstanding any other provision of this Agreement, the total liability, in the aggregate, of Engineer and Engineer's officers, directors, members, partners, agents, employees, and Design Professionals, to Owner and anyone claiming by, through, or under Owner for any and all claims, losses, costs, or damages whatsoever arising out of, resulting from, or in any way related to the Project or the Agreement from any cause or causes, including but not limited to the negligence, professional errors or omissions, strict liability, breach of contract, indemnity obligations, or warranty express or implied of Engineer or Engineer's officers, directors, members, partners, agents, employees, or Design Professionals shall not exceed the total compensation received by Engineer under this Agreement."

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Limitation of Liability (good example)

- *"Limitation of Liability:* To the fullest extent permitted by law, the total liability, in the aggregate, of DP, DP's officers, directors, partners, employees, agents, and subconsultants, to Client, and anyone claiming by, through, or under Client for any claims, losses, costs, or damages whatsoever arising out of, resulting from or in any way related to this Project or Agreement from any cause or causes, including but not limited to negligence, professional errors and omissions, strict liability, breach of contract, or breach of warranty, shall not exceed the total compensation received by DP or $50,000 whichever is greater. The Client may negotiate a higher limitation of liability for a reasonable additional fee, which is necessary to compensate for the greater risk assumed by DP.

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Limitation of Liability (ConsensusDOCS problem)

- Beware of ConsensusDOCS 240, which has a prohibition upon certain LoL clauses in DP contracts. Section 3.5 of that contract states that the Architect/Engineer is prohibited from entering into an agreement with a DP that includes any limitation of liability, at least without the prior written approval of the Owner.

- ConsensusDOCS 240 also provides that the Owner "*shall be considered the intended beneficiary of the performance*" of the DP's services, which could support a direct claim by the Owner against a DP (§3.6.12).

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Limitation of Liability (Waiver of Consequential Damages)

- **Waiver of Consequential Damages.** Notwithstanding anything in this Agreement to the Contrary, it is agreed that Consultant shall not be liable in any event for any special or consequential damages suffered by the client arising out of the services hereunder. Special or consequential damages as used herein shall include, but not be limited to, loss of capital, loss of product, loss us use on any system, or other property, or any other indirect, special or consequential damage, whether arising in contract, tort (including negligence), warranty or strict liability."

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Waiver of Consequential Damages AIA and EJCDC Approaches

- AIA B101-2007, §8.1.3 as follows:
  - "The Architect and Owner waive consequential damages for claims, disputes or other matters in question arising out of or relating to this Agreement. This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination of this Agreement, except as specifically provided in Section 9.7."

- Similarly, EJCDC E500 (2008), §6.10.E, provides "*Mutual Waiver*: To the fullest extent permitted by law, Owner and Engineer waive against each other, and the other's employees, officers, directors, members, agents, insurers, partners, and Design Professionals, any and all claims for or entitlement to special, incidental, indirect, or consequential damages arising out of, resulting from, or in any way related to the Project."

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Owner's Responsibilities (AIA)

- AIA B101, article 5, includes twelve paragraph description of duties assumed by the owner, including:
  - "Provide information regarding requirements for the Project, including a written program (§5.1); Periodically update the budget (§5.2); Render decisions and approve the Architect's submittals in a timely manner (§5.3); Furnish services of geotechnical engineers (§5.5); Coordinate the services of its own Design Professionals with those services provided by the Architect (§5.6); Furnish tests, inspections and reports required by law or the Contract Documents, such as structural, mechanical, and chemical tests, tests for air and water pollution, and tests for hazardous materials (§5.7)."

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Owner’s Responsibilities (EJCDC)

- The EJCDC E-500 (2008), Exhibit B,
  - “B2.01 In addition to other responsibilities of Owner as set forth in this Agreement, Owner shall at its expense:

A. Provide Engineer with all criteria and full information as to Owner’s requirements for the Project, including design objectives and constraints, space, capacity and performance requirements, flexibility, and expandability, and any budgetary limitations; and furnish copies of all design and construction standards which Owner will require to be included in the Drawings and Specifications; and furnish copies of Owner’s standard forms, conditions, and related documents for Engineer to include in the Bidding Documents, when applicable.”

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Owner Responsibilities (for Substitutions)

- One issue that gives design firms cause for concern is a decision by the Owner to accept substitution of equipment- such as “or equal” products instead of the brand name.

- AIA B101-2007, §3.1.4 addresses this issue by providing the architect some level of protection as follows:

  - “Owner Decisions

    “The Architect shall not be responsible for an Owner’s directive or substitution made without the Architect’s approval.”

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Ownership of Documents

- Contracts such as the AIA Document B101 - 2007, and EJCDC Document E-500 (2008), state that that Instruments of Service belong to the DP that created them.

- Owners are more frequently demanding that they be granted copyright ownership and that can can reuse documents at will for any purpose.
  - Creates potential additional liability risk for DP, not to mention the business risk.

- How to protect the DP against such risk. See next slides.

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Ownership of Documents (bad clause)

- An example of an unfortunate Owner contract clause requiring transfer of ownership follows:

  - *"All plans, drawings, tracings, specifications, programs, reports, models, mock-ups, designs, calculations, schedules, technical information, data, CADD documents and other material (collectively the "Documents") prepared, furnished, or obtained by Design Professional, or Design Professional's consultants under or for the Project, shall be the property of the Owner whether the Project is completed or not . . . . If this Agreement is terminated for any reason prior to Final Completion of the entire Project, the Documents may be used by Owner and its agents, employees, representatives and assigns, in whole or in part, or in modified form, for all purposes they may deem advisable in connection with completion and maintenance of, and additions to, the Project, without further employment of, or payment of any compensation to, Design Professional…"*

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Owner Reuse of Documents – (Solution Hold Harmless and Indemnify DP)

- If Owner insists on taking copyright ownership it should grant release from liability and also an indemnity to DP., E.g.,

- AIA B 101, §7.3.1
  - "In the event the Owner uses the Instruments of Service without retaining the author of the Instruments of Service, the Owner releases the Architect and Architect's Consultant(s) from all claims and causes of action arising from such uses. The Owner, to the extent permitted by law, further agrees to indemnify and hold harmless the Architect and its Consultants from all costs and expenses, including the cost of defense, related to claims and causes of action asserted by any third person or entity to the extent such costs and expenses arise from the Owner's use of the Instruments of Service under this Section 7.3.1…."

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Ownership of Documents (A/E Reuse After Transferring to Owner)

- ConsensusDOCS 240, §10.1.4
  - "Where the Architect/Engineer has transferred its copyright interest in the Documents under Subparagraph 10.1.1, the Architect/Engineer may reuse Documents prepared pursuant to this Agreement in its practice, but only in their separate constituent parts and not as a whole."

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Ownership of Documents (Protecting DP Rights to Its Design Details)

- When Owner is given copyright it should not get copyright to existing practice library details of the consultant.
  - “Client expressly acknowledges and agrees that the documents and data to be provided by Consultant under the Agreement may contain certain design details, features and concepts from Consultant’s own practice detail library, which collectively may form portions of the design for the Project, but which separately, are, and shall remain, the sole and exclusive property of Consultant. Nothing herein shall be construed as a limitation on Consultant’s right to re-use such component design details, features and concepts on other projects, in other contexts or for other clients.”

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Payment (problem - Withholding Fees)

- AIA B101-2007, §11.10.3 addresses withholding of fees as follows:

  - “The Owner shall not withhold amounts from the Architect’s compensation to impose a penalty or liquidated damages on the Architect, or to offset sums requested by or paid to contractors for the cost of changes in the Work unless the Architect agrees or has been found liable for the amounts in a binding dispute resolution proceeding.”

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Payment (problem - Withholding Fees)

- Use clause like this to prevent client from arbitrarily withholding fee. It provides that deductions in invoices may only be made by if it has been determined by a dispute resolution process that the client is entitled to do so.

  - *"Objections to Invoices/No Deductions*. It is important for the Consultant to be promptly informed of problems. If the Client objects to any portion of an invoice, the Client shall notify the Consultant in writing within twenty days of the invoice's receipt. The Client agrees to pay any undisputed portions of an invoice. No deductions shall be made from the Consultant's compensation on account of penalty, liquidated damages, or other sums withheld from payment to contractors, except as may be determined by mediation, arbitration, or other dispute resolution mechanism to which the Consultant is a party."

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Payment (What to do if Late)

- *“Payment.* Owner agrees to pay DP’s invoice within 30 days of receipt. For any payment not received within that time, Owner shall pay a service charge on the past due amount, including interest at the prevailing legal rate [or ____%], and reasonable attorneys fees and expenses if collected through an attorney or collection agency…”

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Permits (Problem clause)

- An example of a clause that may create extraordinary risk to the DP is as follows:
  - *"DP shall obtain all required permits, licenses, agency approvals, and other necessary documentation in order to complete the project."*

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Permits (Solution clause)

- DP may agree to assist the Owner in obtaining permits needed by the Owner to design and construct the project (without undertaking responsibility for obtaining the permits). An example follows:
  - *"Permits.* DP shall assist the Owner in connection with Owner's responsibility for applying for permits, licenses and approvals needed for the Project and in connection with filing documents required for the approval of governmental authorities having jurisdiction over the Project."

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Standard of Care (problem)

- Owners are sometimes including language in their contracts requiring the DP to perform to a standard greater than the generally accepted standard. For example, one such clause states:
  - *“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.”*

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Standard of Care (ConsensusDOCS problem)

- ConsensusDOCS 240 requires these Documents to "completely describe all work necessary to bid and construct the Project."
  - This is contrary to industry practice of what is actually expected of DP's when it comes to drafting plans and specifications.

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Standard of Care (solution)

- AIA B101, Sec. 2.2., states the standard of care to which the architect must perform as follows:
  - "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. The Architect shall perform its services as expeditiously as is consistent with such professional skill and care and the orderly progress of the Project."

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Standard of Care (solution 2)

- DP might also add at the end of the standard of care clause include a brief statement that the contract is not intended to create any guarantees or warranties on the part of the DP. An example is as follows:
  - “No warranty or guarantee, either express or implied, is made or intended by this Agreement.”

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Standard of Care (solution 3)

- If the Owner insists on a "highest standard of care" the DP might be able avoid warranty liability or other uninsurable contractual liability by clarifying the contractual intent as follows:
  - "The performance standard is not intended to create a warranty, guarantee or a strict liability standard, and it is expressly agreed that DP is agreeing only that its services will not be performed negligently or with willful or reckless misconduct."

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