A/E RISK REVIEW

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Seven Crucial Client Contract Clauses: Part 2

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. We would like to thank the Design Professional unit of XL Catlin for their contribution of sample contract language which was excerpted from their eGuide resource.

In Part 1 of the two-part report, we examined four of the seven critical clauses affecting liability and insurability that you and your attorney should consider when drafting your client contracts. Those clauses included:

1. Scope of Services
2. Standard of Care
3. Certifications, Guarantees and Warranties
4. Third-Party Beneficiaries

Now let's discuss the final three crucial clauses.

5) Indemnities

Perhaps no contract clause is more troublesome and confusing for design firms than indemnity agreements. Put simply, an indemnity agreement is a contract clause that takes liability that traditionally belongs to one party to the project and transfers it to another party. For instance, a project owner may ask for an indemnity that makes the lead designer responsible for the owner's negligence. Or, an indemnity may seek to make the designer at least partially responsible for construction means and methods.

The obvious disadvantage of these indemnities is that they increase the design firm's liability. Making matters worse, these contractually-assumed liabilities are likely *not* insurable under the designer's professional liability (PL) policy. When an insurance company sets its premium rates, it does so based on the prevailing laws and practices regarding the distribution of liabilities. The insurer does not agree to provide coverage for any additional liabilities the design firm might voluntarily assume -- a liability that traditionally and rightfully belongs to another. In fact, the policy may specifically state that contractually assumed liabilities that the designer would not be liable for absent the contract are not covered by the PL policy.

Your primary objective is to get your client to remove any onerous indemnities from your contract. Often, a discussion of traditional liability assignments, where the party with the greatest control over the liability assumes that risk, is enough to change an owner's mind. Bringing up the fact that any liability you assume via an indemnity agreement will be uninsured may also sway the owner to drop the contract clause.

Still, some owners and their attorneys will press for indemnity language in all of their contracts, believing it is a reasonable way to limit their liabilities. They may argue that since a contractor will accept indemnity language that frees the owner of responsibility for jobsite safety (a common practice), the lead design should likewise accept an indemnity agreement.

Know that it is acceptable to include an indemnity agreement in the client contract, as long as the indemnity is mutual and does not transfer uninsurable liabilities that rightfully belong with the owner or others. Here is a sample mutual indemnity agreement provided by XL Catlin you should discuss with your attorney:

INDEMNIFICATION

The Consultant agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Client, its officers, directors and employees (collectively, Client) against all damages, liabilities and costs, including reasonable attorneys' fees and defense costs, to the extend caused by the Consultant's negligent performance of professional services under this Agreement and that of its subconsultants or anyone for whom the Consultant is legally liable.

The Client agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Consultant, its officers, directors, employees and subconsultants (collectively Consultant) against all damages, liabilities and costs, including reasonable attorneys' fees and defense costs, to the extent caused by the Client's negligent acts in connection with the Project and the acts of its contractors, subcontractors or consultants or anyone for whom the Client is legally liable.

Neither the Client nor the Consultant shall be obligated to indemnify the other party in any manner whatsoever for the other party's own negligence or for the negligence of others.

Note that, in some jurisdictions, the contractually-assumed obligation to pay attorneys fees and defense costs may not be covered by your PL policy. Also realize that in some jurisdictions the contractual duty to indemnify includes the duty to defend the client, even when no negligence on your part is shown. In these instances, you and your attorney should consider the following revised language:

The Consultant agrees to indemnify and hold harmless the Client, it's officers, directors and employees against all damages arising directly from the Consultant's negligent performance of the services under this Agreement. Notwithstanding the foregoing agreement to indemnify and hold harmless, the parties expressly agree that the Consultant has no duty to defend the Client from and against any claims, causes of action, or proceedings of any kind.

Finally, if your client refuses to enter into a mutual indemnity agreement, you may find a unilateral clause acceptable if it ties your liability to your own negligence and includes the concept of "comparative negligence"; that is, you are only liable for that portion of the damages for which you were personally responsible. Review this language with your attorney:

The Consultant agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Client against damages, liabilities and costs arising from the negligent acts of the Consultant in the performance of professional services under this Agreement, to the extent that the Consultant is responsible for such damages, liabilities and costs on a comparative basis of fault between the Consultant and the Client. The Consultant shall not be obligated to indemnify the Client for the Client's own negligence or for the negligence of others.

6) Insurance Requirements

The sixth contract clause we'll examine is that which sets the insurance requirements for the project. A client asking that its contractors, subcontractors, consultants and subconsultants carry adequate insurance is not only acceptable, it's preferable for all parties involved. However, the amount of insurance a client may require and the stipulations on that coverage cannot only be unreasonable, they can be unattainable.

Let's look at the one type of insurance most owners ask their design consultants to carry: professional liability (PL) insurance. First, realize that you cannot guarantee to a client you can obtain or maintain PL coverage now or in the future. Therefore, you should only commit to making a reasonable effort to obtain such coverage.

Also, you may not be able to obtain (or reasonably afford to maintain) a practice PL policy at the levels of coverage your client wants. For instance, a new client who wants you to design a simple commercial warehouse building might request $5 million in PL coverage when you only currently have a $1 million practice policy. As your insurance partner, we might be able to help convince your client that $5 million limits are excessive for the type of project being designed. Or, if your client is insistent, we might be able to help you obtain a project-specific or client-specific excess policy rider that will be less expensive than raising your limits on your practice policy.

Here is sample language regarding PL insurance, provided by XL Catlin, that you and your attorney might propose to your client.

PROFESSIONAL LIABILITY INSURANCE

The Consultant agrees to attempt to maintain professional liability coverage in the amount of $____ per claim and $____ in the annual aggregate for the period of design and construction of the Project and for a period of ___ years following substantial completion, if such coverage is reasonably available at commercially affordable premiums. For the purpose of this Agreement, "reasonably available" shall mean that the Consultant can secure at least three premium quotes for comparable coverage by admitted, A.M. Best Co. A-rated carriers. "Commercially affordable" shall mean the rate per $1,000 of fees is no more than a multiple of three times the rate being paid for comparable coverage in place when this agreement is executed.

Chances are, your client will require additional types of coverage, including commercial general liability, workers compensation, employers liability, and commercial automobile liability. We are here to help you obtain such insurance and assist your legal counsel by suggesting appropriate contract language regarding these coverages.

6) Dispute Resolution

When a dispute with the project owner arises, the most important question becomes: How do we resolve it?" In most cases, design firms face one of three forms of dispute resolution.
The first is a claim that is taken to litigation. The two parties duke it out in public court, with the whole world watching. A judge or jury of varying degrees or knowledge about the design and construction process, makes its determination and you live with it, fair or not.

The second option is to take the dispute to arbitration. Here, a third-party is selected to listen to both sides of the dispute and renders a binding decision. The selected arbitrator is likely knowledgeable of the design and construction industry, but has his or her own read on liability issues.

The third and our preferred dispute resolution technique is mediation. Here, a third-party mediator experienced in resolving design and construction disputes works with both parties to find a mutually acceptable solution. The mediator does not impose a binding decision. Instead it helps both parties examine the situation and seek common ground and an agreeable compromise. Major advantages include:

- It is nonbinding and consensual. Both parties must agree to any settlement reached.
- It facilitates communication. Dialogue and negotiation is the key, not fault-finding and blame-laying.
- It is private and confidential. All information discovered and exchanged remains behind closed doors.
- It's controllable. The two parties to the dispute make all decisions. You are not at the mercy of an arbiter, judge or jury.
- It seeks consensus. The objective is to reach a win-win resolution, not find a winner and a loser.
- It is forward-looking. The focus is to solve the problem and get the project on track, not place blame for past mistakes.

Mediation has proven to be the most amicable and least costly form of dispute resolution. It has been so successful that many insurance companies provide monetary incentives to their insureds if their contracts with their clients stipulate that mediation will be the first dispute resolution method used to try to resolve project problems.

The time to establish mediation as your choice of dispute resolution is upfront when drafting your contract, not after a dispute has risen and one or both parties are upset and feeling wronged. Here is some sample language from XL Catlin to establish mediation as your dispute resolution of choice:

MEDIATION

In an effort to resolve any conflicts that arise during the design and construction of the Project or following the completion of the Project, the Client and the Consultant agree that all disputes between them arising out of or relating to this Agreement or the Project shall be submitted to nonbinding mediation.

The Client and the Consultant further agree to include a similar mediation provision in all agreements with independent contractors and consultants retained on the Project and to require all independent contractors and consultants also to include a similar mediation provision in all agreements with subcontractors, subconsultants, suppliers and fabricators, thereby providing for mediation as the primary method for dispute resolution among the parties to all those agreements.

These seven crucial contract clauses can go a long way toward limiting your liability and providing legal protection should a project upset occur.

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.