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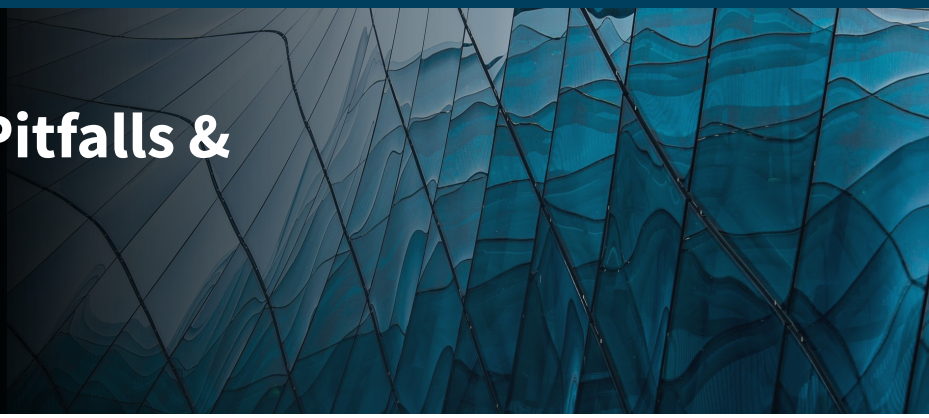

3 Common Contract Pitfalls & How to Avoid Them

by Kelly Long Jackson

In the construction industry, design services and consulting involves significant risks. Many projects are governed by lengthy and complex contracts, and legal terms often exacerbate risks.

Signing a contract without a formal, professional review exposes a design firm to inappropriate risks, making the firm vulnerable to uninsured losses. The only safeguard is a sound, rational, and business-minded professional review and negotiation of every contract. This proactively protects your firm should a claim arise, as an insurance carrier could deny a claim if a contract contains terms that jeopardize an A/E firm's liability coverage.

A well-structured contract can serve as an essential risk management tool for the firm and provide a key foundation for a successful project. Doing your due diligence ensures fair contractual conditions that are in both parties' best interests and further prevents an A/E firm from committing to onerous contractual terms exceeding industry standards.

3 Common Pitfalls to Avoid in Your Contracts

Contracts must be insurable to avoid claim processing delays or denials. Consider these three common contractual pitfalls:

1. Overpromising

Architects, engineers, and consulting professionals are legally expected to follow a professional standard of care. Issues easily arise when a contract does not include the appropriate standard.

Did you know that you can contractually heighten the standard of care you agree to comply with? Seemingly harmless phrases in a contract can create a contractual obligation that design professionals would otherwise not be obligated to meet. Examples include:

- Guaranteeing that your work will be "free from defect"
- Warranting your services will result in a project "fit for its intended purpose"
- Stating the services will meet a specific deadline without delays.

Elevating the standard of care could jeopardize or even negate your professional liability insurance coverage. The cost of defending a claim or lawsuit could then fall on your firm – without the benefit of insurance coverage — thereby impacting profitability or putting you and your firm at risk of a major financial loss.

Take Action: Watch out for language in a contract that is inconsistent with the common law standard of care and that demands performance beyond the baseline. Avoid phrasing such as "highest," "world-class," or wording that implies a design will meet every requirement or intention of the project owner. Be aware that even marketing materials may overpromise. Seek out customized contract reviews to this type of uninsurable contractual liability.

2. Agreeing to an Immediate Duty to Defend

Another common contractual liability to avoid is the "duty to defend" in indemnification clauses. This obligates a firm to defend another party immediately upon notice or tender of a claim, regardless of who may be at fault.

The word "defend" raises significant insurability issues — regardless of the insurance company involved — because it is broader than the duty to indemnify. An A/E firm may be required to defend a claim based upon a mere allegation of negligence, whereas a duty to indemnify is triggered by a finding or agreement of actual negligence.

The high costs of defending a claim may not be insurable until a final determination of fault, leaving your firm paying out of company coffers, possibly for years. Professional liability coverage is triggered by negligence in the performance of your services, so avoid agreeing to this defense obligation in your contracts.

Take Action: Avoid agreeing to "defend" in an indemnity clause because a contractor-oriented contract is proposed or because other parties and their lawyers are focused on Commercial General Liability coverage and not Professional Liability.

3. Proportionate Causation of Negligence

Indemnification is a contractual obligation that deals with tort liability. It is one party agreeing to be responsible for a lawsuit or damages directed against the other party.

Indemnity clauses in contracts often include many things that can "trigger" an obligation to indemnify. For an A/E firm to have an indemnity obligation that is insurable under its professional liability policy, such triggers need to be restricted or tied back to a finding of the firm's proportionate negligence.

Including a wide range of damages and losses potentially arising from the project — such as, "any and all claims whatsoever" — under an indemnity provision might seem like covering all bases. However, the broader an indemnification agreement is, the less coverage you may have in the event of a claim.

Take Action: Include the phrase "to the extent caused by" in your indemnity clause. Avoid broader, open-ended phrases like "arising out of or related to," which are more common in construction contracts rather than professional services agreements. If the indemnity terms go beyond this, you put yourself at risk for uncovered losses or damages as AE firms are only covered for your own specific liability to the extent damages are caused by negligence.

Being Proactive Reduces Risk

Contract review and negotiation are essential steps in managing your firm's inherent risk. Putting in the time and effort to thoroughly review contracts and amend the language to better protect your firm can prevent costly claims and avoid uninsurable liability. Be proactive and make sure your contracts contain fair mitigation of risk, rather than waiting until a claim arises and facing potentially uninsured damages after the fact.

Let's Talk

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