XL Insurance

8 Key Contract Provisions

And how to make them work for your firm

Jake Winkler
Account Executive, PC
Holmes Murphy & Associates

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Workshop Learning Objectives

1. This program will provide attendees with a foundation to understand the significance of written contracts and how the law operates to interpret and enforce contracts.
2. At the conclusion of this session participants will have a greater appreciation for how a written contract forms the building blocks of a firm's risk management program as key risk transfer mechanisms and protections are considered in light of a variety of risk factors beyond the contract.
3. This program provides attendees with a deeper understanding of the pitfalls of key contractual risk transfer mechanisms and strategies firms can employ to mitigate the negative impacts.
4. After completing this program attendees will have better understanding of how professional liability insurance works, and how insurable contract terms can help manage a firm's liability risk exposure.

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Agenda

✓ Why contracts matter

✓ The provisions that matter most

✓ Putting it all together

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Why contracts matter

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Importance of contracts

Foundation of your risk management program

1. Memorializes the parties agreement and supports successful project delivery
   - Who does what, when, how and for what price
   - What will you not do
   - What you will do for additional fee
2. A document you can always refer to
3. Says what happens if there is a dispute
4. Dictates how we respond to and ultimately resolve a claim

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Negotiation & Contracts

The cost of poor agreements

Unclear and inappropriate scope of services	56.3%
Lack of mediation clause in agreement	8.3%
Construction phase services not in contract	8.3%
Other	8.3%

$135,500

Average Claim Size

Negotiation & Contracts

Almost 1/3rd of these claims is over $100K

When there is a claim and ***no contract in place when work began***

60%

of the time it costs

$100K or more

Only 1 other risk driver has a claim cost of $100K or more

$544,000

Average claim size when it's >$100K

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The provisions that matter most

How do you address these provisions?

- Certifications, guarantees and warranties
- Indemnity
- Limitation of Liability
- Mediation
- Prevailing party fee clause
- Standard of care
- Waiver of consequential damages
- Waiver of subrogation

Indemnity: What it does

Indemnity is a risk transfer mechanism

- Determines upfront who is responsible for a loss
- Often includes who pays a third party's defense
- Under the common law you are always responsible for your own mistakes (whether you have an indemnity or not)
- Those who are in the best position to control a risk should be responsible for it
- Is this covered by insurance?

Indemnity: What it should look like

From the *Contract Guide* Indemnity chapter

The Consultant agrees to indemnify and hold harmless **the Client, its 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.

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Indemnity: When it is a problem

- Uninsured defense obligation
- Broad scope of indemnitees
- More than damages
- Less than a negligence standard

- Consultant agrees to defend, indemnify and hold harmless…
- Client, its officers, directors, employees, agents, lawyers, consultants, contractors…
- from and against any and all claims, demands, causes of action, injunctive relief…
- …arising out of or relating to work on the project

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Negotiation talking points

- I am willing to be responsible for my own negligence and those of my subconsultants.
- My insurance covers me for damages you incur caused by my negligent performance of professional services. My insurance does not cover the duty to defend.
- My insurance will reimburse you your reasonable defense costs caused by my negligence and awarded by a court or arbitrator.
- The more insurable my contract is, the better chance will you get paid if something goes wrong.
- I don't know who your agents and assigns are, and I cannot agree to indemnify unknown entities.
- I cannot put your interest before public health, safety and welfare (when the client is trying to make you a **fiduciary**).

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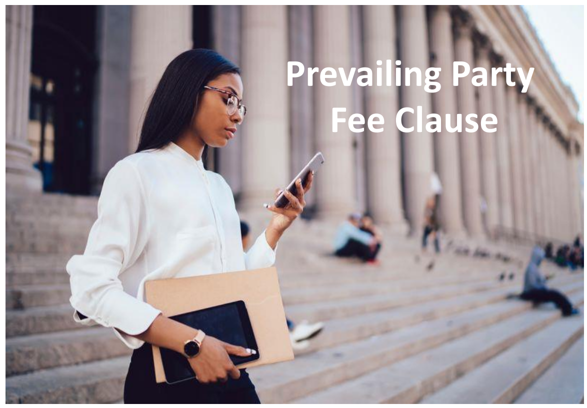

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Prevailing Party Fees: What it does

The losing party to a dispute has to pay the prevailing party its lawyers' fees and costs

- Acts as a form of indemnity to reimburse legal fees and costs in a dispute with the client
- Can act as a disincentive to settle by creating an unrealistic expectation that if you win you will get all of your fees and costs

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Prevailing Party Fees: What it should look like

1. **Delete Prevailing Party Fee clauses**

~~The Parties agree that in the event of a claim or dispute, the prevailing Party will be entitled to recover all of its legal fees and costs from the other Party.~~

2. **Or add under Dispute Resolution**

In the event of a claim or dispute, the Parties agree to bear their own legal fees and costs

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Prevailing Party Fees: When it is a problem

1. This is not appropriate for design professional contracts where there is a great disparity of obligations
2. Can undercut a well-negotiated indemnity provision
3. Can be triggered in the absence of a third-party dispute unrelated to design professional services which can create an uninsured exposure
4. The term “Prevail” is rarely defined causing confusion over whether it is a dollar amount or a percentage recovery
5. Can trigger the contractual liability exclusion and compromise insurance coverage
6. Extremely dangerous when used with an elevated standard of care

Negotiation talking points

- My insurance may not be able to pay these costs.
- Striking this clause will help both of us settle any dispute we might have by forgoing the expectation that we will get our attorneys’ fees and costs from each other.
- It is not clear what it means to prevail.
- This clause is not fair because the contract obligates me to do much more than what you are obligated to do.

Standard of Care: What it does

Sets forth the standard of your performance

- Determines the level of skill required to perform your professional services
- Absent a higher agreed upon standard, you will be judged according to what another design professional would do at the same time and in the same locality; i.e., common law negligence
- If there is a claim, an expert can offer evidence in support of your conduct that you did what another prudent design professional would do

Standard of Care: What it should look like

From the *Contract Guide* Standard of Care

In providing services under this Agreement, the Consultant shall perform in a manner consistent with and limited to that degree of care and skill ordinarily exercised by members of the **same profession** currently practicing under **similar circumstances** at the **same time** and in the **same or similar locality**. The Consultant makes no warranty, express or implied, as to its professional services rendered under this Agreement.

Standard of Care: When it is a problem

1. When the standard of care is elevated beyond common law negligence creating a potentially uninsured exposure and a standard that is easy to violate
2. Agreeing to perform to a level of perfection, making no mistakes, performing to the client’s satisfaction, guaranteeing the contractor’s work, or acting as a fiduciary will cause you to lose a dispute every time and can trigger the contractual liability exclusion
3. An elevated standard of care means no expert opinion to support you
4. Very dangerous when an elevated standard of care is used in conjunction with an onerous indemnity or prevailing party fee clause

Negotiation talking points

- My professional liability insurance will pay for damages caused by my negligence arising out of my professional services, but insurance will not cover me if I agree to a level of perfection.
- I cannot owe you a fiduciary duty because putting your interests first would violate my professional duty to public health, safety and welfare.
- No set of plans is perfect and no project is perfect. The design and construction process involves working through challenges that arise during the process.
- I can't guarantee the work of contractors or other third parties, because I have no control over their means and methods and cannot supervise them constantly.

Certifications, Guarantees & Warranties: What it does

Guarantees an outcome or level of performance

- An assurance as to the accuracy of something or compliance with a standard
- Used to guarantee construction is perfect or in 100% conformance with the plans and specifications
- Shows up in client-drafted contracts, pay app approvals, lender certifications and email correspondence

Certifications, Guarantees & Warranties: What it should look like

From the *Contract Guide* Certifications, Guarantees & Warranties

CONSULTANT'S CERTIFICATION OPINION

I hereby certify that I am a licensed architect/engineer in the State of ___________ . ~~I further certify~~ To the best of my knowledge, information and belief, the building was constructed in ~~strict~~ general conformance to the plans and specifications and, in my professional opinion, is in compliance with ~~all~~ applicable laws, codes and ordinances.

CERTIFICATIONS, GUARANTEES AND WARRANTIES

The Consultant shall not be required to sign any documents, no matter by whom requested, that would result in the Consultant's having to certify, guarantee or warrant the existence of conditions whose existence the Consultant cannot ascertain. The Client also agrees not to make resolution of any dispute with the Consultant or payment of any amount due to the Consultant in any way contingent upon the Consultant's signing any such certification.

Certifications, Guarantees & Warranties: When it is a problem

1. You don't have personal knowledge; e.g., certifying that the construction is in strict conformance with the plans and specifications or that a project is LEED Silver or ADA compliant
2. You certify a level of perfection or construction means and methods that take you out of coverage due to the contractual liability exclusion and the fact that your professional liability insurance does not cover construction activities
3. Lender certifications and consents to assignments that alter your duties and obligations under your existing contract with your client
4. You certify compliance with all laws and codes

Negotiation talking points

- I cannot guarantee or certify what the contractor did because I didn't stand over his/her shoulder and observe every aspect of construction (and you didn't want to pay me to do that either).
- The law doesn't require that I guarantee any outcomes on the project.
- No set of plans is perfect.
- My insurance does not cover me when I guarantee someone else's work; i.e., construction is not a professional service and any standard less than negligence is not covered by insurance.
- For lender certifications and consents to assignment: We already have a contract. I'm not changing the terms now.

Limitation of Liability: What it does

Limits your liability to a set amount

- ➢ Used to allocate a project's risk in some reasonable proportion to the profits and other benefits to be derived by each party
- ➢ Limits liability only to your client and does not protect against third-party claims; e.g., an injured construction worker
- ➢ Can mitigate an onerous indemnity or elevated standard of care clause

Limitation of Liability: What it should look like

From the *Contract Guide* Limitation of Liability chapter

IN RECOGNITION OF THE RELATIVE RISKS AND BENEFITS OF THE PROJECT TO BOTH THE CLIENT AND THE CONSULTANT, THE RISKS HAVE BEEN ALLOCATED SUCH THAT THE CLIENT AGREES, TO THE FULLEST EXTENT PERMITTED BY LAW, TO LIMIT THE LIABILITY OF THE CONSULTANT AND CONSULTANT'S OFFICERS, DIRECTORS, PARTNERS, EMPLOYEES, SHAREHOLDERS, OWNERS AND SUBCONSULTANTS FOR ANY AND ALL CLAIMS, LOSSES, COSTS, DAMAGES OF ANY NATURE WHATSOEVER OR CLAIMS EXPENSES FROM ANY CAUSE OR CAUSES, INCLUDING ATTORNEYS' FEES AND COSTS AND EXPERT-WITNESS FEES AND COSTS, SO THAT THE TOTAL AGGREGATE LIABILITY OF THE CONSULTANT AND CONSULTANTS OFFICERS, DIRECTORS, PARTNERS, EMPLOYEES, SHAREHOLDERS, OWNERS AND SUBCONSULTANTS SHALL NOT EXCEED $______, OR THE CONSULTANT'S TOTAL FEE FOR SERVICES RENDERED ON THIS PROJECT, WHICHEVER IS GREATER. IT IS INTENDED THAT THIS LIMITATION APPLY TO ANY AND ALL LIABILITY OR CAUSE OF ACTION, INCLUDING WITHOUT LIMITATION ACTIVE AND PASSIVE NEGLIGENCE, HOWEVER ALLEGED OR ARISING, UNLESS OTHERWISE PROHIBITED BY LAW. IN NO EVENT SHALL CONSULTANT'S LIABILITY EXCEED THE AMOUNT OF AVAILABLE INSURANCE PROCEEDS.

Limitation of Liability: When it is a problem

1. The limitation amount is extremely low; e.g., $100 and is unenforceable
2. The clause was not fairly negotiated and was buried in the fine print and is unenforceable
3. The limitation does not apply to all claims
4. You fail to include in your limitation of liability the subconsultants for whom you are contractually liable
5. The client refuses to limit your liability and insists on an onerous indemnity and standard of care clause
6. Some states do not allow these provisions or construe them very strictly to ensure that they were fairly negotiated

Negotiation talking points

- This project is too risky for me given the limited amount of scope / fee that I have relative to the benefit you and others will derive in the long run. (I'm happy to reconsider for an additional fee)
- You have required that I hire your consultants under my contract, and I don't have a comfort level or history of working with them. If we proceed, I need to limit my liability.
- The conditions at the site present added challenges, and I cannot be responsible if our reasonable efforts fail.
- Have you considered insurance products like an owner's protective policy?

Waiver of Consequential Damages: What it does

Precludes liability for indirect damages

- Used to protect against claims for lost profits, loss of use, delays and other economic loss
- Consequential damages can be excessive for certain project types like retail, high-end hospitality, hospitals, stadiums and schools
- Difficult to calculate
- Can be used with a Limitation of Liability

Waiver of Consequential Damages: What it should look like

From the Consequential Damages chapter in the *Contract Guide*

Notwithstanding any other provision of this Agreement, and to the fullest extent permitted by law, neither the Client nor the Consultant, their respective officers, directors, partners, employees, contractors or subconsultants shall be liable to the other or shall make any claim for any incidental, indirect or consequential damages arising out of or connected in any way to the Project or to this Agreement. This mutual waiver of consequential damages shall include, but is not limited to, loss of use, loss of profit, loss of business, loss of income, loss of reputation and any other consequential damages that either party may have incurred from any cause of action including negligence, strict liability, breach of contract and breach of strict or implied warranty. Both the Client and the Consultant shall require similar waivers of consequential damages protecting all the entities or persons named herein in all contracts and subcontracts with others involved in this project.

Waiver of Consequential Damages: When it is a problem

1. A client won't waive consequential damages and…
   - you have an onerous indemnity or an elevated standard of care
   - you have an inexperienced contractor or are required by the client to hire additional consultants under your contract
   - the potential of huge economic damages exists if there is a minor delay; e.g., stadiums, hospitals, schools and retail
2. The design and construction schedule is unrealistic

Negotiation talking points

- The risk associated with a late project is out of proportion to my fee. There are too many factors outside of my control. I'm willing to be responsible for direct damages caused by my negligence but not remote indirect damages.
- I have concerns about the contractor, schedule and/or delivery method that if something goes wrong the resulting indirect damages could be disproportionate to my fee.
- The mutual waiver of consequential damages will help us both focus on delivering a successful project instead of focusing on defending a large claim.
- If you won't agree to a waiver of consequential damages then you need to purchase a performance bond for the contractor.

Waiver of Subrogation: What it does

Prevents an insurance company from seeking reimbursement from you for money that it paid for a loss

- Subrogation is when an insurance company "steps into the shoes" of an insured and sues other potentially responsible parties to recover money that it paid for a loss
- A policyholder can waive the insurance company's right to seek reimbursement after a loss
- Owners often ask project participants to agree to waive subrogation in an effort to keep projects from being delayed when parties litigate over liability and damages

Waiver of Subrogation: What it should look like

From the *Contract Guide* Waiver of Subrogation chapter

The Owner and the Consultant agree, to the fullest extent permitted by law, to waive any and all rights against each other and any of their contractors, subcontractors, consultants, subconsultants, construction managers, owner's representatives, employees, directors, officers, agents and assigns for any and all damages, including without limitation bodily injury, death, damage to real and personal property, and all consequential damages including delay and lost profits (collectively "Damages") covered by any insurance applicable to the Project or the site upon which the Project is located.

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What it should look like (continued)

From the *Contract Guide* Waiver of Subrogation

The Owner and the Consultant hereby warrant and represent that they will require all of their contractors, subcontractors, consultants, subconsultants, construction managers, owner's representatives, employees, directors, officers, agents and assigns to waive subrogation against each other, the Owner and the Consultant and any of their contractors, subcontractors, consultants, subconsultants, construction managers, owner's representatives, employees, directors, officers, agents and assigns for any and all Damages covered by any insurance applicable to the Project or the site upon which the Project is located. The provisions of this waiver apply regardless of whether the loss occurs or the damages are sustained during construction or after the project is completed. The intent of this provision is to obtain the broadest waiver of subrogation possible.

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Waiver of Subrogation: When it is a problem

1. The waiver only applies to you but not others (meaning you can still get sued)
2. Project participants have different waivers meaning that one insurance company can sue for a certain loss but not others
3. The waiver is limited to property damage (meaning you are exposed to bodily injury and delay claims)
4. All parties have the same waiver of subrogation and your insurance company pays a loss for which you may not be entirely responsible; e.g., your subconsultant won't contribute. This means you pay your deductible and your loss history is adversely affected.

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Negotiation talking points

- If everyone has the same waiver of subrogation, we can make sure that if anything goes wrong, insurance will pay for it and we can focus on delivering a successful project.
- Waiving subrogation as to all kinds of damages covered by insurance (and not just property losses) regardless of when the loss occurs will help us achieve a successful project by eliminating future litigation.

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Mediation: What it does

A form of Alternative Dispute Resolution

- A typically non-binding and confidential way to resolve disputes using a neutral third-party
- 98% of cases resolve by utilizing mediation
- Mediation results in significant cost savings by guiding the parties in evaluating their exposure and settling their differences short extended litigation resulting in an uncertain outcome at trial or arbitration
- You qualify for a mediation credit that reduces your deductible obligation up to 75% not to exceed $25,000 (**do not share this with your client**)

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Mediation: What it should look like

From the Dispute Resolution chapter in the *Contract Guide*

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

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Mediation: When it is a problem

1. When a client refuses to agree to mediation during contract negotiations thereby demonstrating an unwillingness to cooperate during a future claim when none of the facts are currently known
2. When a client refuses to engage in constructive talks to resolve a dispute that will save everyone time and money
3. Refusal to mediate coupled with a prevailing party fee clause, an elevated standard of care, or an onerous indemnity is extremely dangerous; i.e., you have significant risk and someone is going to exploit that

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Negotiation talking points

- It makes sense to have a framework in place to resolve disputes before they happen – something that will help us save time and money.
- **Do not mention the mediation credit to your client. If you do, any settlement of a dispute will likely increase by the amount of the credit since it won't be perceived as your money.**
- Consider a stair-stepped jobsite dispute resolution process in addition to mediation; e.g., resolve disputes first in the field, then principal to principal. (see the *Contract Guide*)

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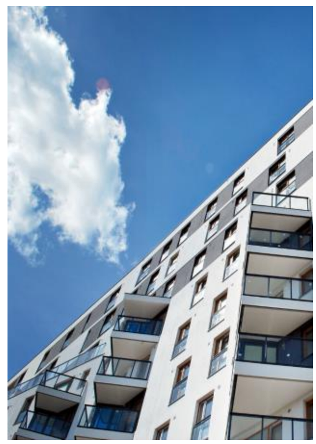
Session Recap

- ✓ Contract related claims are costly
- ✓ A few provisions make a big impact
- ✓ Know what is important
- ✓ "No thanks"



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