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ProNetwork News

Risk Management Tools for the Design Professional

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The AIA Northeast Illinois Chapter awarded her their 2000 Service Award for Outstanding Affiliate Member, and her recent articles, *The Big Switch – Look Before You Leap When Changing Insurance Companies* and *Reporting Claims and Potential Claims Under Professional Liability Insurance Policies*, were published by AIArchitect and are included in the AIA's Best Practice feature.

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Architects Step Into Contractors Liability, Size XXL

By Melissa Roberts, Euclid Insurance Agencies and Eric Singer, Ice Miller LLP

If you have ever gone car or shoe shopping with and for someone else (teenagers and significant others, in particular), you know the difficulty and frustration that usually follows efforts to fit and style those with strong opinions and feelings on the subject. Such shopping is more an effort in very personal comfort, feel and perception than utility. The same can be true for design professionals' scope of services. The most recent economy has left design professionals to suffer earliest, longest and hardest, particularly those that rely on residential development. To keep busy, some A/Es are marketing a broader scope of services, including services historically reserved for construction contractors. The comfort, feel and perception of such expanded scopes of services are highly personal but come with distinct and practical liabilities and risks. Like finding the right shoe size or vehicle type, A/Es can manage expanded risks with properly fitting contracts, insurance and professional structure.

SUV v. Sedan and Dress Shoe v. Cleats

In annual magazine reviews, sedans are compared to sedans and SUVs are compared to SUVs. The same is true of legal standards by which different roles are judged. A/Es provide a professional service and are compared to other A/Es by a standard of care – what others in the same profession are doing or would have done for a similar project. A/E contracts typically take care to adhere to recitations of the baseline standard of care and avoid or disclaim responsibility for means and methods, safety, warranties and the contractor's timely or proper performance.

Contractors provide a finished product which is judged by a good and workmanlike standard: a warranty of quality, timeliness and, usually, safe performance of the work. Contractor agreements therefore give the contractor control over and responsibility for means and methods, safety, warranties, schedule and performance.

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Crossovers and Hybrids.

There is a line between trucks and cars, but there are luxury SUVs and crossovers to blur the line and offer compromises of varying degree. The line between A/E services and contractor services has become equally fuzzy. Try to explain in words the difference between the scope of services of a Construction Manager/Advisor, a Program Manager and an Owner's Representative. For example: The label is less important than the intended division of responsibility, control and money, and how that is expressed in a contract.

Sometimes these services are combined with the marriage of more than one firm or entity. Joint ventures are just like partnerships. Two firms combine efforts for a project, usually with a contract that marries the two firms for that project and defines who does and pays for what. Like a marriage with joint credit accounts, each of the married firms is responsible for the charges and actions of the other. Sometimes such a marriage means a new entity – a corporation or LLC, owned by the constituent firms. There, too, is a contract in the form of a shareholder or operating agreement dividing up responsibilities and dollars. With any of these arrangements, the contracts must address who will do what in the relationship – who will carry insurance, contract with the trades, be responsible for cost and time, and how will liabilities be divided.

Gym class needs gym shoes.

For any expanded scope or combination arrangement, it is important to recognize the rules of the game. Like grade school, you need gym shoes for gym class, regardless of what you wear the rest of the day. In construction relationships, legal and insurance requirements can drive the structure and counsel in favor of a particular arrangement.

Licensing. If the combined services will include design, the parties must be careful to comply with state licensing requirements in each state where services are performed (and they will differ state to state). This sometimes means that the combined entity itself must be registered as a licensed design firm and comply with the requirements necessary to do so.

Insurance. With some exceptions, a contractor cannot purchase professional liability insurance to cover the contractor's unlicensed design. In addition, an A/E's professional liability insurance policy typically excludes performance of physical construction. While both A/Es and contractors carry Workers Compensation and General Liability insurance, the risks for A/E's are markedly different. Contractors have responsibility for worker safety for their own employees and for those on the construction site. For this reason, Workers Compensation and GL are much more expensive for contractors and depend greatly on experience ratings. Each trade contractor should name the A/E and the contractor as additional insured in a primary and non-contributory basis.

Eric Singer

Eric Singer is a partner at Ice Miller, LLP. He concentrates his practice in construction law, with emphasis on the representation of architects, engineers, contractors, owners, and lenders as well as other professionals, in litigation and alternative dispute resolution of design and construction issues.

Mr. Singer, who was awarded his J.D by the University of Chicago Law School, is a former Professional Affiliate Director of the American Institute of Architects of Chicago and is a member of multiple bar associations and design professional groups. Recently ranked as AV ® Preeminent™ by Martindale-Hubbell and listed in The Best Lawyers of America ®, Construction Law, by those peer-review organizations, Eric is an active speaker and prolific author on the subject of construction litigation and the liability of the design professional.

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Directors and officers liability insurance can be important for contractors or developers of multifamily projects governed by homeowners associations. There is typically a period of early sales during which the developer/builder operates or manages the association. After turning over the association to a board made up of homeowners, deferred or costly maintenance or the need to make repairs might be discovered. The new board might then go looking for a deep pocket.

It is also important to remember that many significant contractor risks are not insurable. Bad work or slow work may cause or incur significant damages but are generally not covered by insurance without bodily injury or property damage. The cost of repair or replacement under warranty, for example, is on the contractor's dime. Payment liabilities also can be significant but not insured. Paying a soon-to-be-bankrupt subcontractor without securing appropriate waivers from material suppliers, for example, can force a general contractor to pay twice.

OSHA and Labor. Construction methods must comply with federal and state worker safety regulations, and the penalties for failing to do so can be severe. While A/Es can incur OSHA violation liability, it is relatively rare. As an A/E firm venturing into construction management, be aware that OSHA will look at you like a contractor. In the event of an inspection or an accident, you will need to be able to produce documentation to show you have sufficient training and safety compliance procedures. There are statutory and legal restrictions on the ability to recover OSHA fines and related penalties from subcontractors. Like the mythical "get out of jail free" card, it is generally against public policy to be rendered free of responsibility for worker safety. Labor union relationships in your project's town can be challenging as well. If you retain a non-union subcontractor or one not paying the required wage rates under State or Federal law, you may be responsible for the consequences, including differential wage rates and labor union injunctions stopping your project.

Bonds. Some projects require payment and performance bonds backed by a commercial surety to secure completion of the work and payment to the subcontractors. Surety bonds are indemnity contracts, not insurance. To get a surety bond, a contractor pays a premium but also pledges an indemnity, usually along with accounts receivable, a personal guarantee, a house and everything in it. The surety monitors the progress and payments and even restricts how much bonded work a contractor can bid or undertake at any time – like a credit limit. If the contractor defaults by failing to pay a sub or finish a project and the surety has to step in to pay up or finish up, the surety then collects what it spent from the contractor's accounts, personal assets and house. Before stepping into bonded construction, consider who will procure the bonds and, most important, who will personally guarantee them.

All of these considerations counsel strongly in favor of having written contracts among the participants in a combined venture and with the owner, carefully detailing included and excluded services. Labels like CM or Owner's Rep will be meaningless if the contracts are unclear. If you will be loaning or sharing employees or expenses, consider the corporate structure of the venture and, in particular, whether creation of a new entity offers some insulation from liability.

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Return Policy.

Having subcontractors is similar to having subconsultants, at least contractually, though contractors are typically better at forcing terms on their trades. Many construction subcontract forms contain two key (and highly recommended) provisions – the flow down clause and the "pay when paid" clause. The flow down clause tells the subcontractor that the sub owes the general contractor all of the liability that the general contractor owes the owner, at least with respect to the sub's scope. It typically also promises to the sub only those obligations (and payments) that the owner promises to the general contractor. Similarly, the pay-when/if-paid clause promises to pay the subcontractor only when and if paid by the owner, leaving the subcontractor to its mechanics lien rights in the event of non-payment.

With respect to owners, it is similarly important to limit warranties and liabilities, some of which are implied by law and require magic language in order to properly disclaim. Contractors working in residential construction, for example, may promise to assign manufacturer warranties for appliances and roof shingles, without any further obligation, or to disclaim the implied warranty of habitability in favor of a one-year repair warranty.

Expanded scopes of services bring expanded liabilities, some of which are insurable and all of which must be governed by careful contracts. The design professional's scope of services is not one size fits all, and neither are contracts, liability insurance and professional structure.

Broker's Notes

a/e ProNet is an international organization of insurance agents who specialize in Design Professionals. Membership is by invitation only.

We are pleased to provide you with this newsletter. Professional Underwriters, Inc. is a member of a/e ProNet.

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