Construction Law in NC

7 CRITICAL MISTAKES

ENGINEERS & ARCHITECTS

make during project negotiation & execution that sabotage their projects & invite litigation

Melissa Dewey Brumback, J.D., LEED Green Associate
Ragsdale Liggett PLLC
Editor, Construction Law in North Carolina

PO Box 31507
Raleigh, NC 27622

Ph: 919-881-2214 (direct)
Fax: 919-783-8991

Email: mbrumback@rl-law.com
Blog: www.constructionlawNC.com

7 CRITICAL MISTAKES
ENGINEERS & ARCHITECTS MAKE DURING PROJECT NEGOTIATION AND EXECUTION THAT SABOTAGE THEIR PROJECTS & INVITE LITIGATION

The typical commercial construction lawsuit can cost an architecture or engineering firm well over $100,000 to resolve. It is not unheard of for some construction lawsuits to rise into the multiple hundreds of thousands of dollars, and, in some cases, for damages to reach into the millions. You might believe that because you are a small firm, performing routine, limited work, you are safe from such large claims. However, no matter how small your role on a construction project, you can still be sued for any amount of damages. One geotechnical engineer we defended, who performed only 5 site sample borings, was later sued for over $200,000 on a $1,000 contract. No one who works in the construction field is immune from large claims.

Even firms that are fully insured with large Errors & Omissions (E&O) policies run the risk of spending hundreds of man-hours in meetings with lawyers, mediation, and court—hours that directly affect your bottom line. This white paper is intended to address the common, but critical, mistakes of design professionals, so that you can avoid (or minimize) liability on your construction projects.[1] While you can never eliminate every possible avenue for claims, this paper will provide guidance on *7 specific mistakes* which you can correct to dramatically lower your chances of being sued.

Mistake #1: Not Treating The Contract Seriously

This mistake can be made in several ways—either by not having a written contract at all, not reviewing the contract terms, or allowing inconsistent provisions between the contract and your proposal.

The contract rules the parties. It is the blueprint, if you will, that says what you can be sued for, when you can sue the other party, and what your damages will be. If you do not have any written contract, the law presumes certain things that you may not want it to presume.

[1] **Legal Disclaimer**: This white paper is intended for general informational purposes only and does not provide any legal advice nor create any attorney-client relationship. Statutes and case law vary from jurisdiction to jurisdiction. Information presented here may not be applicable to any individual situation. You should consult a licensed attorney in your jurisdiction for legal advice relating to your specific situation.

The most frequent way this mistake is made is in not having a written contract at all. Every project should have a written contract.

The second way this mistake is made is to sign the contract presented, without reading it or attempting to negotiate any of the terms. In this bad economy, you may think that you can not afford to make trouble. However, almost all owners are willing to negotiate, at least to some extent. If you run into an owner who will not budge even an inch on the contract when the parties are all working well together, it does not bode well for the relationship down the road. Some projects you are simply better off not getting.

Simply stated, you *must* have a written contract, and you *must* look at that contract before you sign it. Standard contracts (that is, those produced by the Architect Institute of America (AIA), the Engineering Joint Contracts Document Committee (EJCDC), or ConsensusDocs) are the norm for larger projects. There is some built in level of projection if you use one of these standard form contracts. Even so, however, you need to look at the contract closely, particularly those changes and modifications to the default terms. Standard terms can cause problems if they will not work for your project and circumstances.

If your contract is not a standard contract, which is typical and appropriate for smaller projects, you must examine the proposed contract even more closely. Contracts drafted by one party can often be extremely one-sided. You must carefully read the contract from top to bottom to make sure everything discussed is accounted for in the document.

Another way you can make the mistake of not taking the contract seriously is by not dealing with the inevitable discrepancies between your proposal and the contract. Undoubtedly, there are things that differ between the two. Most contracts have a provision that is called a "merger clause," which means that all former agreements are gone. The legal fiction is that all agreements have been merged into the contract itself; in actuality it may mean you will lose key terms if they are not stated within the final, executed contract. Thus, if your proposal has a limitation of liability clause, but the contract does not, the contract will prevail. You might think that, if the contract does not address an issue, but your proposal does, the proposal term can still apply. Unfortunately, you would be wrong. The merger clause typically makes any side or prior agreement null and void. This is another reason to treat the contract seriously, and to make any changes necessary so the contract reflects the important points of your proposal.

Mistake #2: Allowing Unfair Or One-Sided Contract Terms To Persist

Avoiding this mistake is part of reviewing your contract well, but certain contract provisions are so unfair or one-sided that they deserve special attention during negotiations. Three of the biggest unfair provisions you may encounter are indemnity, duty to defend, and consequential damages.

a. Indemnity

Indemnity is the agreement, in advance, of a party to assume the liability of another party. Project owners sometimes have one-sided indemnity clauses in their contracts stating that your firm will indemnify them from any claims. Some of these provisions state that you are even required to indemnify the owner from the owner's own negligence. In North Carolina and other states, such a provision purporting to give someone else liability for your own negligence is void as against public policy. If an indemnity provision is properly worded, however, it can still be valid. There are pros and cons to indemnity, and the area is fraught with legal issues. For example, most E&O policies do not provide coverage for assumed contractual liabilities such as indemnity clauses.

If there is to be indemnity in the contract, the least you should do is to push for a mutual indemnity provision, where each side agrees to indemnify the other, and *only to the extent the claim is based on that party's negligence*.

b. Duty to defend

The duty to defend can exist in a contract even if the indemnity clause is stricken. If a duty to defend is stated, that requires you to pay for the owner's defense of the specified types of claims, whether or not your firm is negligent or even named as a defendant. Usually, the duty to defend is tied to the indemnity provision, but it does not have to be. In addition to insurance coverage issues here, there is the likelihood that the owner will pick a law firm that is top of the line, leaving you no say, yet stuck with the legal bill. At the minimum, if a duty to defend clause cannot be stricken, you should attempt to insert clauses to modify it by including language to allow your firm to hire, direct, or be consulted on the litigation defense.

c. Consequential damages

Consequential damages is another area where you need to pay careful attention. Consequential damages include everything that is not a direct damage. These are indirect sources of loss, such as loss of use, loss of profit, or even loss of bonding capacity. The standard construction agreements by AIA, EJCDC, and ConsensusDocs all have at least a partial mutual waiver of consequential damages. However, if this provision is modified, it should be done with full knowledge of the increased risk. Non-standard, owner-written contracts sometimes provide for consequential damages for the owner, but not for the design professional. Again, if the provision is included, it must be mutual.

Mistake #3: Not Choosing The Proper Dispute Resolution Method

Generally, there are a few distinct options if you do need to fight about a construction dispute: arbitration or trial. The arbitration can be voluntary, or it can be mandatory. The trial can be a bench trial or a jury trial. Which is best? Ask 10 lawyers and you will get 11 opinions. This is something you should discuss with your lawyer prior to signing on the dotted line. The default is litigation before a jury. However, many standard forms default to arbitration, usually American Arbitration Association (AAA) arbitration. There are pros and cons to both, depending on where the case would be heard, the amount of damages in dispute, and how, whether, or not, the underlying claim is complex.

Many lawyers are reluctant to trust a jury with a construction case, although the vast majority of them settle prior to ever getting to a jury because the stakes are so high. However, juries generally take their job very seriously and can often be a good dispute resolution method, depending on the facts and the venue.

If you decide to forego a trial and contract for arbitration, you must decide whether it will be private arbitration or arbitration through one of the major arbitration organizations (e.g., the AAA). If you opt for private arbitration, you also need to decide whether it will be single or three-panel arbitration. A single arbitrator is usually faster and definitely cheaper; however, you run a greater risk of unintentionally using a poor arbitrator. In a three-person panel, even if one is poor, there usually are fail-safes represented by the other two panel members.

These discussions are not easy, and there is no one-size-fits-all solution. Still, the main mistake made here is in not thinking about the dispute method up front. What may be the preferred method in one type of project may not be best for a different type of project. Do not just assume the default; have the discussion up front.

Mistake #4: Failing To Have Good Change Order And/Or RFI Management Processes

As a design professional, you are well aware of the often voluminous Requests for Information (RFIs) or proposed Change Orders submitted by contractors. Many of these are simply the result of the contractor not wanting to look at the design documents; many others are the result of unscrupulous contractors or subcontractors attempting to "change order" the project to death to make up for profit they may have conceded earlier to get the project. Regardless, all change orders and RFIs need to be appropriately managed to avoid litigation. You should review the contract requirements on how quickly you are required to turn around these documents and strive to stick to that schedule. If the parties agree to hold off on a change order while additional data or pricing is obtained, that should be documented in the change order file. The thing that you do not want to do is to be casual with such requests since, if litigation ensues, the first thing the contractor or owner's attorney will consider is how responsive you were to the change orders and

RFIs. If delays in response are appropriately documented at that time, you will have created a very nice business record and trial exhibit to explain to a jury why it appears you sometimes did not follow the contract requirements.

You also may believe that, if you receive an RFI for something that should be obvious, you do not need to respond, but you do. Do not give anyone a chance to say you were anything but thorough. You may verbally respond to a written RFI while in the field. That is fine, but be sure to document the verbal response once you return to the office.

Mistake #5: Failing To Have A Quality Document Retention System

Related to the change order and RFI process, your firm should have a quality document retention system in place for every project. This should include keeping uniform procedures for storing documents, deciding whether or not electronic documents are printed, determining where on the hard drive documents will be saved, and requiring timely filing of all incoming documents. First, such a system will help your entire team be more productive and efficient, and it will help prevent anything from falling through the cracks. Second, if you get sued, it will be much easier for your lawyer to find the pertinent key project documents. If you save documents one way and your project superintendant another way, confusion is created. If a project employee only saves documents to his personal laptop and he subsequently leaves your employment, that data may be lost forever. A good document retention system can save you many hours of headache in the event of a lawsuit.

Mistake #6: Failing To Respond Properly To Claims Of Errors & Omission

Like the contractor who misuses the RFI process to document a claim of design errors, some contractors and owners tend to write letters and emails complaining of issues during the project. Often the issue complained of is minor. Sometimes the issue has already been resolved. It does not matter; if you get a letter that states that your firm did something wrong, respond and respond in kind. Specifically, do not call to dispute allegations made in a letter; respond with your own letter. For every letter stating your firm did something wrong, there should be a corresponding letter from you explaining why the facts support your position. Sometimes clients complain that letter-writing wars are pointless, and they may very well be, at times. However, if you do not respond (even to simply say you disagree with the opposing party's statements), it will be that much harder to explain yourself to a jury after the fact. The jury will wonder why you did not respond, or respond in writing, during the project.

Mistake #7: Failing To Involve Insurance Company & Lawyer At First Time Of Trouble

No one likes to face the reality of a possible professional negligence claim. However, you must report any such claim as soon as you become aware of it. This is for two reasons. First, if you do not report it right away, you run the risk of the insurance carrier later denying the claim. Second, most E&O carriers have experienced lawyers on staff who can help you minimize potential claims if you contact them immediately. At times, the E&O carrier will even hire an attorney on your behalf to assist you behind the scenes, helping to respond to letters claiming design error and the like. This is called "loss prevention," and it is usually free for your firm for being a client of the insurance company. It is generally not considered a claim (since no lawsuit has yet been filed), you usually do not have to pay your deductible, and you get free, and often critical, assistance to stop a claim before it becomes unstoppable.

If you do not have insurance (although really, you should), you *still* should consider having a lawyer assist you behind the scenes to clear up potential problems before they become exacerbated.

Conclusion

While no single white paper, seminar, or procedure can prevent every lawsuit, of course, if you take these 7 mistakes to heart, you can dramatically lower the risk for your firm. "An ounce of prevention is worth a pound of cure," as Ben Franklin so famously wrote. Take some time now to implement some good policies and procedures, and it can pay multiple dividends later.
