

March 22, 2018

Client-Authored Contracts for Architectural Services

Risk Transfer Concerns with Insurance Implications

The following draws on material originally developed by Pro-Demnity and its legal counsel, to assist the RAIC respond to questions arising from a presentation to a Senate Committee. The response to the RAIC captured many of the common concerns of architects related to Risk Transfer arising from client-authored contract provisions. It is repeated here for the benefit of Ontario architects insured by Pro-Demnity. The content may assist an architect explain to a client why such a client-authored contract provision is inappropriate and unwise for either client or architect.

Some of the content and layout has been amended since original provided to the RAIC to provide further clarification and ease of reading. *Professional Advice vs. Delivery of Construction* is an addition to the original list that was overlooked at the time.

Reference to LawPRO, the mandatory provider of professional liability insurance to Ontario lawyers, was included in recognition that some of the original readers would have a stronger connection with the practice of law than with architecture.

Context

In recent years a number of institutions, some municipalities, and some government entities or corporations have begun to amend their basic contracts for design and construction projects to include much broader indemnities than they had previously sought from consultants and contractors.

With respect to architects, professional insurance is available and is provided to deal with issues arising out of errors and omissions on the part of architects in the provision of services. That, of course, is nothing new, and in Ontario we have had mandatory insurance for Architects since 1987. That insurance was statutorily enshrined in the *Architects Act* and Regulation 27 thereunder, and since that time professional liability insurance has been provided to Ontario architects under a mandatory program provided by Pro-Demnity Insurance Company.

Accordingly, every architect in Ontario holding a Certificate of Practice issued by the Ontario Association of Architects has a policy of professional liability insurance with Pro-Demnity Insurance Company for at least the minimum required limits as described in the Regulation.

The arrangement is similar to the mandatory professional liability insurance program provided to Ontario lawyers through LawPRO.

The policy limits maintained by an architectural practice vary depending on the regulatory requirements as well as by decisions taken by the architect related to the needs of practice, the type of work done and services provided by the particular architect. Many practices maintain higher than the minimum limits, either through increased limits with Pro-Demnity or excess insurance purchased from other insurers.

Any professional, including an architect, has an obligation to indemnify a client respecting certain damages and costs arising from errors, omissions or negligence in the provision of services. This obligation is imposed by existing law rather than through a contract provision. However, some clients have insisted on including contractual language to address the indemnity. Where that language is coextensive with existing law, the architect has no problem since it has not taken on additional liability contractually that its insurance would not address.

However, of growing concern is contractual language promoted by some clients that has included a number of elements which exceed the architect's existing liability at law and hence its insurance coverage; in effect transferring client or owner's risk onto the architect. These include:

- Express Warranties, Guarantees, Indemnities or Penalty Clauses
- Inflation of Duty of Care beyond the Client
- Indemnity for Client's Defence and Legal Costs

- Right of “Set-off” by Client
- Dispute Resolution or Settlement Provisions in Contract
- Clients Abdicating Responsibility
- Contractual Liability for Specialists advising a Client
- Professional Advice vs. Delivery of Construction
- Contract Terms in an RFP that are “Non-Negotiable”

Each of these is discussed below.

Express Warranties, Guarantees, Indemnities or Penalty Clauses

Many client authored indemnity or warranty provisions expose the architect to obligations and liabilities that will exceed what are already the architect’s at law. These sorts of promises of perfection or obligations to indemnify a client do not reflect the professional’s obligations at common law, **and are excluded from professional liability insurance coverage** to the extent the obligations placed on the architect exceed what would already be its obligations at law in the absence of the provision.

Inflation of the Duty of Care beyond the Client

Inflation of the duty of care of the professional to parties outside of the client itself, including as an example a diverse group such as “*agents, directors & officers, shareholders, volunteers, contractors, employees, students and parents*” is unfair and unreasonable.

Agreeing to such a broad additional group of indemnitees would lead to gaps in coverage provided by the professional liability insurance available to architects.

Taking “*contractors*” as an example, an insurer would simply not accept that an architect who owes a duty to an owner with whom he is contracting should in all circumstances extend his liability to a contractor who is also providing services on the same project. That contractor owes its own duty to the owner and presumably carries its own form of contractor appropriate insurance.

Indemnity for Client’s Defence & Legal Costs

Many client-authored indemnity provisions include the obligation for the architect to provide a defence to any or all of the indemnitees at the architect’s cost, without limits on the obligation. This is not a reasonable expectation under our legal system.

There will be no professional liability insurance coverage for such an obligation assumed by the architect in a contract with a client.

In addition, promises to indemnify the owner for legal costs incurred on a “substantial indemnity” basis are not covered by professional liability insurance. While most policies of professional E & O insurance cover the insured for costs payable as ordered by a court or arbitrator it is well known that the norm of costs ordered are on the basis of “party and party” and not of “substantial indemnity.” In these clauses the owner is insisting that the indemnity from the architect provide in all cases for “substantial indemnity” costs, or even “all” costs to be paid whenever costs are payable. The difference between “party and party” costs which might be covered by the insurer and “substantial indemnity” costs, or even “all” costs of the owner as agreed to contractually could run into the hundreds of thousands if not millions of dollars in a serious case.

Right of “Set-off” by Client

Historically, indemnities have been based upon the party seeking compensation to establish its entitlement and the indemnity need not be fulfilled pending settlement or court order. In recent years some clients are insisting on obtaining fulfillment of indemnity prior to judgment based on the exercise of “set-off” against funds due the architect, at the sole discretion of the client. In so doing, clients are seeking to appoint themselves as “prosecutor, judge, jury, and executioner” and are insisting on withholding or offsetting fees until such time as the professional in effect proves his innocence. The clients have reversed the burden of proof. A client who exacts this sort of execution before judgment compromises the ability of the architect to continue to pay downstream fees to other consultants not to mention the compromise to the architect’s own business by its inability to pay its staff for the work it is doing on the job.

If the exercise of a set-off by the client is presented as agreement by the architect to accept such as settlement of a claim by the client, the architect may forfeit its professional liability insurance coverage for what could otherwise have qualified as an insured “Claim” under its insurance policy.

A settlement reached by client and architect without the insurer’s express approval is excluded from coverage.

Dispute Resolution or Settlement Provisions in Contract

Dispute resolution or settlement provisions included in a client / architect contract may negate the architects’ insurance coverage. Owners are frequently requiring architects to agree to dispute resolution provisions which require the architect to participate in any arbitration between the owner and any other

party. In agreeing to such a provision the architect is in breach of its duty to permit the insurer to control the course of litigation on its behalf.

Such a provision may well void or limit coverage.

Clients Abdicating Responsibility

In any professional / client relationship, the client properly has responsibilities that it must fulfill as a prerequisite for the professional to provide its own services. An obvious example is the obligation for a client to provide essential information about its requirements and the property it owns as a starting point for an architect to deliver its services. Recently, some clients have attempted to avoid their responsibility to provide essential information, transferring the owner's risk and responsibility onto the architect.

An example would be an RFP requiring the architect to retain certain specialists required for a client to meet its obligation to provide an architect with essential information about the existing state of its property. Common examples are specialists required to provide surveys, geotechnical and soils information, and information about toxic or hazardous materials on the property or in an existing building. Until quite recently, clients/owners retained these specialists to provide required information without question; however, a growing number of clients are attempting to shift the burden onto the architect.

In addition to the transfer of client's obligations onto the architect, **professional liability policies may include specific exclusions for claims related to some of these services.** Most architects and professional literature consider retention of these specialists to fall outside the "usual or customary" services of an architect, and **there is a risk that as such, they are not covered by an architect's professional liability insurance.** Further, if the architect retains any of these specialists instead of the client or property owner, it may assume contractual liability for the errors or negligence of the specialists, in contrast to being entitled to rely upon information that has been previously accepted as a client responsibility.

Contractual Liability for Specialists Advising a Client

Additional risk transfer concerns with insurance implications include expansion of the scope of services demanded of the architect by a client, often as a convenience to a client or its procurement group who prefer "one-stop shopping" to meeting the client's own obligations in the client /architect relationship. To that end, some clients are issuing RFPs that require an

architect to act as a procurement service to retain a broad array of specialists whose services and advice the client requires for the project.

Professional liability insurance policies afford coverage respecting the "usual or customary" services of the professional being insured.

Acting as a procurement service for specialists that are unrelated to or only distantly related to the recognized professional role of an architect may expose the architect to uninsured liability.

A common circumstance is a procurement policy of the client/owner that requires a "bid" process for every purchase – a policy that may be overridden by passing the retention of the specialists onto an architect. Many of these specialists can have little or nothing to do with the architect's own services on the project.

A few examples include Information Technology consultants advising a client directly, Security consultants whose advice may qualify as confidential from even the design consultants, Archaeologist assessing the site for the presence of historical artifacts or a Moving consultant (moving company) retained to assist the client plan for its relocation. The architect may assume contractual liability for these consultants but has no input into the work or the recommendations made to a client by the specialists.

The number of the possible "specialists" that clients' purchasing groups may require an architect to retain on their behalf is extraordinary...80 plus based on a recent research project. Some of these are not recognized professionals and will not carry professional liability insurance, leaving the architect and its insurance as the "default" insurer.

There is no assurance that a client's opinion respecting what might be "usual or customary" services of an architect would carry the day in the event of a coverage dispute, leaving the architect uninsured but possibly contractually liable.

Professional Advice vs. Delivery of Construction

An architect may advise a client about the work being constructed; however, the architect's professional liability insurance coverage will specifically exclude claims related to the delivery of the construction itself.

A construction contract between an architect's client and a contractor will commonly include specialist testing of specific aspects of the work as it is being undertaken or at completion, prior to being covered up by other work. Examples include compaction of soils or fill materials, concrete testing, roofing etc.

The testing during construction provides assurance to owner and contractor that the work meets the required specifications or standards included in the construction contract documents or are referenced in the Building Code.

Traditionally, a construction contract includes an allowance from which the contractor pays for the required testing, specialist inspections or additional supervision. The client pays for the services through the construction contract with the contractor. The contractor manages the testing and inspections in accordance with the construction contract.

Recently some clients have attempted to include retention and management of the construction testing services in the architect's contract instead of in the construction contract. Absent any specific indemnification from the client, the arrangement would have the architect assume contractual liability for these construction delivery testing and inspection services.

As part of the delivery of construction, these construction related testing and inspection services will be excluded from an architect's (or other design professional's) insurance coverage.

Contract Terms in an RFP are "Non-Negotiable"

These sorts of problems are exacerbated in cases where the project includes an RFP with a provision to the effect that the contract's indemnity clause or other problematic provisions are non-negotiable. In such cases, the owner runs the risk of losing viable and strong contending bidders who bow out rather than expose themselves to significant uninsured liability. A more sensible strategy for owners is to avoid deliberately exposing consultants to uninsurable risk.

For additional information, refer to the Pro-Demnity Insurance Company website: www.prodemnity.com

Material of particular relevance to this bulletin includes:

- *Architects Insuring Architects...The Ontario Architects Professional Liability Insurance Program*, a booklet explaining the Pro-Demnity professional liability insurance program for architects and clients.
- Pro-Demnity Insurance Company Policy Wordings and Standard Endorsements
- Bulletin dated November, 2017: **WARNING: Infrastructure Ontario Supplementary Conditions to OAA Document 600-2013**. This Bulletin explains the legal and insurance consequences of agreeing to a particular Indemnity Clause wording in considerable detail.

Other information available on the Pro-Demnity website includes:

- Current and back issues of the Pro-Demnity newsletter: *The Straight Line*
- *Claims*, Issues No. 18, 19 & 20
- Index and link to Pro-Demnity Bulletins and Notices available on the OAA website:
www.oaa.on.ca/the+oaa/allied+organizations/prodemnity+insurance+company+bulletins
OAA member log-in is required.

Important Notes

1. Readers are reminded that Pro-Demnity Insurance Company cannot and does not provide legal advice, nor does it represent, warrant, undertake or guarantee that any information in this document, howsoever used, will lead to any particular outcome or result.
2. Pro-Demnity will not be liable for any loss, damage, cost or expense arising by reason of any person using or relying upon information in this Bulletin.
3. Coverage decisions can only be taken by an insurer at the time a Claim arises based upon the policy wordings, the allegations made and the circumstances then known.
4. It is strongly recommended that any architect faced with changes to a standard form of Client / Architect Agreement or any alternate form of agreement refer the entire contract, the comments in this Bulletin and any proposed amendments to their own lawyer for review and advice.