Risk Management for Geotechnical Professionals

Lessons Learned from Litigation and Case Studies

GeoVirginia 2019

September 23-25, 2019

Presentation by:

Kent Holland
Construction*Risk* Counsel, PLLC

Kent@ConstructionRisk.com

703-623-1932

ConstructionRisk.com

Topics Covered

- Standard of Care
- Incorporation by Reference (prime agreement)
- Indemnification
- Limitation of Liability
- Ownership and Copyright of Documents
- Third Party Beneficiaries
- Case Studies of Settled Claims

A Professional Doesn't Warrant Perfection

- Court cited the principle that a design professional does not warrant or guarantee perfection in his or her plans and specifications.

- Court found implied warranty should be limited to subcontractors who were involved with the physical construction or the construction-sale of the property.

- *Board of Managers of Park Point at Wheeling Condominium Ass'n v. Park Point at Wheeling, LLC, 2015 IL App (1st) 123452*
- **See next slide**

Standard of Care & Warranties

Designers are not “workmen”

- Court rejected a condo association's argument that DPs have an implied obligation to perform their tasks in a “workmanlike” manner.

- Citing to Black's Law Dictionary, the court noted a “workman” is a person who is “employed in manual labor, skilled or unskilled."

  - “Thus the term ‘workmen’ does not include professional persons such as design professionals, and design professionals are not obligated to perform their professional services in a workmanlike manner.”

- **Contract Lesson**: DPs should be careful not to agree to contract provisions that require them to perform their services in a "good and workmanlike manner." While the phrase is seemingly innocuous, a court could find that it imposes a higher standard than the professional standard of care.

Engineer Can be Sued for Breach of Warranty of Professional Services

- Pulte Homes sued A/E that performed engineering and testing services for it. After resolving defects asserted by the homeowner through arbitration proceedings, Pulte sued A/E to recover damages paid homeowner.
- The theories of recovery included a claim based on breach of express or implied warranties.
- Pulte alleged that "S&ME expressly or impliedly warranted to Pulte that all work performed by them would be performed in a careful, diligent and workmanlike manner, and that any materials and/or services designed, supplied or sold by them for use on the project would be merchantable and fit for their intended or specific purpose."
- In reviewing the contract language, the court agreed that it "includes language arguably in the nature of an express warranty."

Pulte Home Corp. v. S &ME, Inc., 2013 WL 4875077 (U.S. District Court, South Carolina, 2013).

What is Incorporated by Reference from Prime Agreement to Subcontract?

DP indemnity should not be as broad as the D-B indemnity to project owner

- Contractor will typically agree to indemnify its client for more liability than the A/E can agree to under its subcontract.

- In the subcontract the DP can put limits on what terms and conditions will flow down to the DP. In particular, limit the standard of care and the indemnification obligations to make them insurable to the extent possible.

Protect against Incorporation by Reference

- "provided however, that notwithstanding any clause in the Prime Contract or this Agreement to the contrary, Subconsultant expressly disclaims all express or implied warranties and guarantees with respect to the performance of professional services, and it is agreed that the quality of such services shall be judged solely as to whether Subconsultant performed its services consistent with the professional skill and care ordinarily provided by firms practicing in the same or similar locality under the same or similar circumstances ("Standard of Care"), and provided further that Subconsultant shall not provide indemnification of any indemnitee other than to the extent damages arise out of third party claims against the indemnitee and to the extent caused by Subconsultant's willful misconduct or negligence, and provided further that Subconsultant shall not defend any indemnitee against professional liability claims."

Indemnification

Indemnitee for 3rd Party Claims Only

- Florida court holds indemnity clause in contract applies only to damages for claims brought by 3rd parties and not to 1st party damages and claims between the parties.
- To make indemnity apply to 1st party damages and claims the contract would have to expressly state that intent.
- The clause in question:
- Indemnification. To the fullest extent permitted by law, [Subcontractor] shall indemnify and hold harmless [Contractor], its officers, directors or employees and the Owner, from and against all claims, damage, losses and expenses (including, but not limited to attorney's fees) arising out of, in connection with or resulting from the performance of Work under this Subcontract Agreement ....
- *Int. Fidelity Ins. Co. v. Americaribe*, 906 F.3d 1329 (11th Cir. U.S., 2018)

District of Columbia Case
Contractor 1st Party Indemnity Claim against Engineer Dismissed

- Hensel Phelps ("Contractor") was awarded a Guaranteed Maximum Price (GMP) contract.
- In preparing its GMP proposal, the contractor relied upon an engineer's "Preliminary Design Documents."
- After completing certain work, contractor states it determined designs were flawed, and it had to make corrections for code compliance – causing increased costs.

- *Hensel Phelps Construction v. Cooper Carry, Inc.*, 2016 WL 5415621 (U. S. District Ct., District of Columbia, 2016).
- (*Continued on next slide)*

Contractor Indemnity against Engineer (continued)

- Contractor made claim against engineer under the indemnification clause to recover its damages and attorney's fees.
- Summary judgment granted to engineer because:
  - A suit based on the indemnification clause of the contract could only seek damages if they resulted from 3rd party claims against the contractor.
  - The indemnity clause could not be used to make 1st party claims by the contractor to recover its own financial losses.

Sample Indemnification Clause

- “Consultant shall indemnify and hold harmless the Client, its officers, directors, and employees ("Indemnitees") from and against those damages and costs (including reasonable attorneys fees and cost of defense) that Indemnitee incurs as a result of third party tort claims to the extent caused by the willful misconduct or negligent act, error or omission of the Consultant or anyone for whom the Consultant is legally responsible, subject to any limitations of liability contained in this Agreement.”

Limitation of Liability

$50,000 LoL Clause Enforced for Designer under Design-Build Contract

- $50,000 limitation of liability (LoL) clause was only eight (8) percent of DP's $665,000 fee.
- LoL clause capped damages without exempting or exculpating the designer from **all** liability – so did not violate the state law.
- **Facts**: Contractor sued design professional (DP) claiming that designer's negligence caused contractor to incur $1,218,197.93 resolving problems caused by the designer's design plans.
- The court well explains the principal of freedom of contract and importance of honoring mutually agreed upon terms of contract even if terms turn out to be burdensome or one sided.
  - *Zirkelbach Construction, Inc. v. DOWL, LLC*, 389 Mont. 8 (Montana 2017).
- *See next slide*

$50,000 LoL continued:
Affirming Freedom of Contract

With regard to the issue of freedom of contract the court quoted from a number of earlier court opinions as follows:

- "The fundamental tenet of modern contract law is freedom of contract; parties are free to mutually agree to terms governing their private conduct as long as those terms do not conflict with public laws." (citation omitted). "This tenet presumes that parties are in the best position to make decisions in their own interest." (citation omitted). "A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contract, so far as the same is ascertainable and lawful."

- "To permit the avoidance of a written contract because the terms of the contract now appear burdensome or unreasonable would defeat the very purpose of placing a contract into writing."

$9.5 Million Jury Verdict Knocked Down to $550,00 due to LoL

Housing developer won jury verdict for $9.5 million against a geotechnical engineer.

LoL clause limited liability to $550,000.

Developer attempted to avoid the LoL by arguing that geotech's conduct was willful and wanton misconduct.

Trial court allowed evidence in that regard, but the jury found the conduct was not willful and wanton.

Therefore, the LoL clause withstood the challenge.

Taylor Morrison of Colorado, Inc. v. Terracon Consultants, Inc., 2017 WL 2180518, 2017 COA 64 (2017).

LoL Drafting Tips

- The LoL clause should be comprehensive. Consider one I like to use:

- **Sample LoL Clause**
- To the fullest extent permitted by law, the total liability, in the aggregate, of Consultant and its officers, directors, partners, employees, agents, and subconsultants, to Client, and anyone claiming through or under Client, for any claims, losses, costs, or damages whatsoever arising out of, resulting from or in any way relating to this Project or Contract, from any cause or causes, including but not limited to tort (including negligence and professional errors and omissions), strict liability, breach of contract, or breach of warranty, shall not exceed the total compensation received by Consultant or $100,000, whichever is greater. The Client may negotiate a higher limitation of liability for an additional fee, which is necessary to compensate for the greater risk assumed by Consultant.

Arbitrator Ignores LoL Clause in Awarding Damages and Attorneys Fees

- Contractor filed arbitration claim for $500K in unpaid fees. Owner counterclaimed for $2.3 million.
- Contract had LoL clause, but also had prevailing party attorneys fees clause.
- Arbitrator awarded Owner damages and prejudgment interest totaling $699K (the amount of the LoL cap)
- Almost $1 million attorneys fees awarded by arbitrator.
  - Exceeded LoL clause cap.
  - Arbitrator found attorneys fees were not a “loss” or “damages” subject to LoL clause.
- Court refused to set aside decision as arbitrary and contrary to law.
  Beumer Corp. v. ProEnergy Services, LLC, No. 17-2862 (8th Cir. Aug. 9, 2018)

Include Waiver of Consequential Damages Clause – separate from LoL

- **Sample Mutual Waiver of Consequential Damages**:

"Consultant and Client waive all consequential or special damages, including, but not limited to, loss of use, profits, revenue, business opportunity, or production, for claims, disputes, or other matters arising out of or relating to the Contract or the services provided by Consultant, regardless of whether such claim or dispute is based upon breach of contract, willful misconduct or negligent act or omission of either of them or their employees, agents, subconsultants, or other legal theory, even if the affected party has knowledge of the possibility of such damages. This mutual waiver shall survive termination or completion of this Contract."

Ownership & Copyright of Design Documents

Ownership & Copyright of Documents

- Standard form contracts say the DP owns the copyright to the instruments of service and the client has a license to use them for the project.

- More often, however, we see client generated contract forms that require the DP to give copyright ownership to the client.
  - How to address this if your client is the project owner.
    - Release and indemnity for use of documents on other projects without DP's participation.
  - How to address if your client is a design professional or contractor.
    - Resist giving copyright to anyone other than the project owner.

Project Owner May Lose Right to A/E's Documents Due to Failure to Pay Invoices

- When a project owner failed to pay its architect, the architect terminated its contract for default and terminated the owner's nonexclusive license to use the architect's documents.
- The owner and its new architect and contractors continued to use the documents over the protest of the architect.
- In response to the architect's suit, the defendants moved to dismiss the complaint based on the argument that the payment requirement of the contract was a mere "covenant" upon which the architect could sue for damages, but was not a "condition precedent to the existence of the nonexclusive license."
- The court concluded that this was indeed the law of the state, but it was the wrong argument to raise in this case. WHY?
- (next slide)

Ownership & Copyright (continued)

- It is the wrong argument because, although the nonexclusive license came into existence "upon execution" of the Agreement before payment was due, the contract expressly provided for "termination" of the license for subsequent non-payment.
- The more important point was that the architect had been prudent enough to include language in its contract stating that even if a license was granted at the outset of a project, the license would automatically terminate upon failure of the client to pay the architect's invoices.
- *Eberhard Architect's v. Bogart Architecture, Inc. et al.,* 314 F.R.D. 567 (U.S. District Court, N.D Ohio)

Third Party Beneficiary Claims against Design Professionals

Owner on Design-Build Project Can't Sue the Subcontracted DP

- Owner on design-build project sued design-builder as well as subcontracted DP firm and two of its employees.
- Summary Judgment for engineers because lack of privity of contract with the owner.
- Affirmed on appeal because no contract between engineers and Owner, and no "functional equivalent to privity" of contract.
  - because no evidence of "linking conduct" by DP – such as "words or actions that link the professional the professional to the non-client."
- *Stapleton v. Barrett Crane Design & Engineering. United States Court of Appeals, Second Circuit (2018)*

3rd Party Beneficiary of DP Contract?

- New York City claimed it was intended 3rd party beneficiary of engineer's contract with NY Dormitory Authority.

- Court held summary judgment must be granted to DP because City failed to demonstrate it could be found to be 3rd beneficiary.

  - "We have generally required express contractual language stating that the contracting parties intended to benefit a third party by permitting that third party 'to enforce [a promisee's] contract with another.'"
  - "In the absence of express language, '[s]uch third parties are generally considered mere incidental beneficiaries'.

- *Dormitory Auth. of the State of N.Y. v Samson Constr. Co. 2018 NY Slip Op 01115 Decided on February 15, 2018*
- *(Next slide)*

3rd Party Beneficiary case (continued)

- "[A] third party may sue as a beneficiary on a contract made for [its] benefit. However, an intent to benefit the third party must be shown, and, absent such intent, the third party is merely an incidental beneficiary with no right to enforce the particular contracts"
- "We have previously sanctioned a third party's right to enforce a contract in two situations: when the third party is the only one who could recover for the breach of contract or when it is otherwise clear from the language of the contract that there was "an intent to permit enforcement by the third party".

Case Studies of Settled Claims

Risks from Software Programs

- Claims based on failure of data in a software package to convert correctly when transferred into a different software program.
  - Storm water drainage planning. "Infoworks" used by City to mode storm water.
    - Converted by designer into SWMM (Storm Water Management Model).
    - Inaccurate conversion
    - Highway design based on SWMM relied on undersized trunk sewer.
    - Costly remedy to build underground holding tanks to hold water for later discharge.

Soil Compaction & Settlement Problems

- Litigation regarding foundations not holding up buildings as planned.
  - Potential issues include:
    - Vibratory sheet installation and removal affecting or disturbing compacted soil and foundations.
    - Soil not supporting as well as reasonably anticipated – thus requiring piling down to rock.
    - Adequate number, location and depth of soil boring samples

Slope Design Problems

- Litigation concerning design and construction of steep slope stabilization
  - Geoprofessional engineer relied upon a manufacturer's slope stabilization drainage product that was advertised as capable of handling storm water drainage from a steep slope.
    - System failed. Arguments over causation, fault and responsibility followed.
      - Manufacturer liability? Warranty?
      - Prime designer liability for specifying the system?
      - Construction failure?

More detailed articles and case notes on the cases presented in this program are available at:

www.Construction*Risk*.com

Use the "Search" bar for these and more case notes, articles and papers on relevant topics

J. Kent Holland, J.D.
Construction*Risk* Counsel, PLLC

1950 Old Gallows Rd.
Suite 750
Tysons Corner, VA 22182

703-623-1932
Kent@Construction*Risk*.com

ConstructionRisk.com

Disclaimer

Disclaimer: This information is not legal advice and cannot be relied upon as such. Any suggested changes in wording of contract clauses, and any other information provided herein is for general educational purposes to assist in identifying potential issues concerning the insurability of certain identified risks that may result from the allocation of risks under the contractual agreement and to identify potential contract language that could minimize overall risk. Advice from legal counsel familiar with the laws of the state applicable to the contract should be sought for crafting final contract language. This is not intended to provide an exhaustive review of risk and insurance issues, and does not in any way affect, change or alter the coverage provided under any insurance policy.