Legal Liability of Design Professionals

Studying this module should enable you to:

1. Define "professional liability."
2. Identify and distinguish between the two theories of liability most applicable to design professionals.
3. Understand the roles of contracts in professional practice.
4. Describe the elements of a valid contract.
5. Explain what it means to breach a contract.
6. Define the professional standard of care.
7. List the elements of the tort of negligence, and define each in the context of professional practice.
8. Name and describe three types of intentional torts.
9. Define strict liability, and describe a situation where it might be applied to a design professional.
10. List the persons to whom a design professional might be liable in contract and in tort.
11. List the persons for whose actions a design professional might be liable.
12. Describe the three basic categories of legal damages.
13. Describe five common defenses to professional liability claims against design professionals.
14. Identify the basic types of firm organization, and explain the liability implications of each.

Professional liability consists of those obligations that are or will be legally enforceable, and that arise out of the performance of, or failure to perform, professional services by the design professional.

There is no single definition of "legal liability" that is satisfactory for all circumstances. By one definition, legal liabilities are those obligations that are enforceable under the law. According to *Black's Law Dictionary*, when one has a "liability," that person or entity is legally responsible for a possible or actual loss, expense, or burden. *Black's* also says that one who is liable is "exposed or subject to a given contingency, risk, or casualty, which is more or less probable." For our purposes here, we will combine some frequently used concepts of liability into an informal working definition:

> Professional liability consists of those obligations that are or will be legally enforceable and that arise out of the performance of, or failure to perform, professional services by the design professional.

This module will provide an overview of the legal principles underlying professional liability. However, it is not intended to serve as a substitute for the advice of an attorney in any specific situation. Rather, this module is intended to help design professionals recognize the implications of situations they encounter and get legal assistance when needed.

Theories of Liability

Law schools teach their students to recognize all potential legal theories of liability that might apply to a specific situation. Experience teaches, however, that legal claims against design professionals are usually based in the law of *contracts* or the law of *torts*. Nearly everyone has some experience with contracts. For now, it is sufficient to know that a tort is a civil wrong, which is violation of a private right, as distinguished from a criminal wrong, which is violation of a public right.

Contract Liability

It is important for design professionals to understand what is required to make a contract and what liabilities can be created, allocated, mitigated, or avoided by the terms of a contract. The information in this module covers the basic aspects and elements of contracts and the liabilities that arise

☞ **For a breakdown of claims involving contracts, please see *From Risk to Profit: Benchmarking and Claims Studies* at www.Schinnerer.com/risk-mgmt/Pages/Claim-studies.aspx.**

by contract. Other aspects of professional service contracts, particularly contract types and specific contract terms and conditions, are addressed in Module 2-1, "Contracts for Professional Services."

In general, design professionals operate their practices to perform services in accordance with contracts they sign with their clients. Detailed, written contracts for services are more prevalent between design professionals and their clients than is the case with practically any other profession, such as medicine, law, or public accounting. The content of these contracts ☞ is often closely negotiated between the parties and is intended to record their expectations and to constitute the ground rules for the professional relationship on a specific project.

☞ **Use of a written contract is the baseline criterion needed to qualify for Schinnerer and CNA's risk mitigation credit for eligible firms. Go to www.Schinnerer.com/risk-mgmt/Pages/Tools-understanding-insurance.aspx for details.**

Contracts can help parties communicate. Through a contract, parties can state the goals and expectations they have of each other and of third parties. They can allocate rights and responsibilities, ☞ risks and rewards. Contracts can also help parties deal with future changes. Even though it may not be possible to determine exactly what those changes might be, it is usually possible to establish a process and some procedures for dealing with change. Also, contracts can help prevent disputes and help resolve those that do occur.

☞ **For guidance in evaluating or drafting equitable contract provisions, use the following resources from Schinnerer:**

- ***Terms and Conditions Review Guide***
- ***Managing Risk Through Contract Language***
- ***Tips for Reviewing a Contract***

Go to www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx.

There are four principal elements that are required for a contract to be legally valid. Remember that the parties are generally trying to create and record a set of promises that the law will enforce. The required elements of a contract are: 1) mutual assent, 2) consideration, 3) legal capacity, and 4) a legally permissible objective.

Mutual assent is present when two or more parties have agreed to something. This usually happens when one party makes an offer that is accepted by the other party. In the construction industry, a clear example of offer and acceptance is when a client accepts a bid made by a construction contractor (the offer), normally when a contract is awarded to the bidder (offeror) that made the lowest responsive bid. Similarly, a design professional's proposal, submitted in response to a

client's request for proposal (RFP), is usually an offer that the client may accept to bind the professional. In legal terms, an offer creates the power in the offeree (i.e., the one to whom the offer was made) to form a contract by accepting the offer.

Consideration is that goal, motive, or benefit that leads the parties to enter into the contract. It involves a bargained-for exchange of something of legal value. For the design professional, consideration is usually money. A promise to give a gift, however, is generally unenforceable because the term implies that there is no exchange of something of legal value.

Legal value is not necessarily the same as commercial value. One party could agree to pay one dollar for a residence that had been appraised at $300,000. The single dollar would be valid consideration for the contract because it has legal value, even though the commercial value of the house is much greater. Alternatively, parties can supply the necessary consideration to a contract by performing some act that they are under no legal obligation to perform, or by ceasing some activity in which they are legally entitled to engage. Promises are also good consideration. A contract whereby one party promised to perform services in exchange for the other party's promise to pay would be supported by valid consideration.

Each party to a contract must have the *legal capacity to contract*. Generally, that means that the parties must be of legal age (i.e., either 18 or 21 years old, depending on the state) and reasonably able to understand the nature of what they are doing (i.e., not intoxicated or mentally incapacitated). Legal capacity is not often a problem area with design and construction contracts. To the extent that it is, the problem is usually one of determining whether a corporation was authorized to enter into a contract for the purposes involved, or whether the corporate officer signing is one who is properly empowered to sign such a contract on behalf of the corporation.

Since all states require that architects, engineers, and many other design professionals be licensed in the state before practicing there, a design professional who is not properly

licensed may be denied access to the courts in the state to enforce a contract if that should ever be necessary. Therefore, to the extent that an unenforceable contract is no contract at all, proper state licensure is also a component of a party's legal capacity to contract.

A *legally permissible objective* is anything that is not contrary to a statute, i.e., those laws enacted by local, state, or federal governments, or the common law, i.e., the general law derived from the law of England and developed over the years through court decisions. A contract that requires either party to perform an illegal act is unenforceable.

Once made, a valid contract can be categorized simply as either *express* or *implied*. Express contracts arise when the parties write or speak the elements to which they have mutually assented. Contracts in the design and construction industry are usually express contracts. Not all express contracts are in writing, however. Oral contracts are express contracts and are legally enforceable. The problem with oral contracts is that their existence and terms are difficult to prove. Even when parties have the best of intentions, people move on to other assignments, and memories often fade. If the existence and terms of an oral contract can be proven, however, the law will enforce such a contract, with only a few exceptions.

Some contracts must be in writing to be enforceable. The laws that impose such a requirement are commonly referred to as statutes of frauds. In the context of the design and construction industry, only four types of contracts are normally required to be in writing. They are:

1. those in which one party agrees to assume responsibility for the debts of another party;

2. those in which an executor (i.e., one charged with carrying out the last will and testament of another) promises to pay the deceased's debts out of his own (i.e., the executor's own) funds;

3. those for the sale of land or any interest in land; and

4. those that cannot be performed (as opposed to those that are not intended to be performed) within one year.

Regardless of whether or not a contract is required to be in writing to be enforceable, executing written agreements is good policy.

Implied contracts arise when a promise can be inferred from the conduct of the parties as opposed to their express words. For example, assume that one party says to another, "Please design a new deck for my home by next week, and I will pay you $1,000." Then assume that the second party says nothing, but produces the deck design within the allowed time. The law would infer from the action of the second party an acceptance of the offer, and a contract would exist. The first party would be obligated to pay the $1,000. Similarly, if a client failed to execute and return a proposed agreement to a design professional, but subsequently made one or more progress payments due the design professional in accordance with the terms of the agreement, the law would infer acceptance of the agreement from the client's payment.

Warranties, guarantees, ☞ and certifications can be considered, for practical purposes, to be types of contracts as well. Simply put, a *warranty* is a legally enforceable assurance of the truth of a statement. Warranties often describe the quality or performance of a product or service. Everyone has seen warranties for products that promise that the product will be free of faults and defects for a specific period of time. *Guarantees* are similar, so much so that "guarantee" and "warranty" are often used interchangeably in normal conversation. Legally, warranties are made with respect to the speaker's own product or service, while guarantees are made with respect to the products or services of another. A guarantee would exist, for example, when one company promises to be responsible if another company's product or service fails to act as promised. Similarly, *certifications* commonly contain affirmations of the truth of some premise. For example, design professionals are often asked to certify that the design is in compliance with applicable codes. In each case, a party makes

☞ **Read our *Management Advisory*, "Express Warranties," under the "Contracts" subhead at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

a statement whose truth is important to another party who relies on that statement and acts accordingly.

The common thread in all of the foregoing is that promises are made, and there are legal consequences if those promises are not kept. When a valid contract is not performed substantially according to its terms, it is said to have been breached. Note that the failure must be substantial. Not every minor or merely technical deviation from the terms of a contract is considered to be a breach of contract. If there is a substantial, unexcused deviation or failure to perform according to the terms of the contract, however, the breaching party will be liable under the law for that breach. The party or parties to whom the breaching party is liable and the types of damages or losses for which they are liable are discussed below.

Tort Liability

Torts are civil wrongs, i.e., violations of the personal, business, or property interests of private citizens. When the interests of individuals or business entities are violated, they may sue the responsible party in court to remedy the injury. Torts are similar to criminal acts. When the interests of the general public are violated or the peace is disturbed by an individual or business entity, the actions are usually criminal and are prosecuted by the state. Frequently, the same actions constitute both torts and crimes. Tort law concepts are extremely important to design professionals concerned with professional liability risk management.

There are three basic types of torts: 1) negligence, 2) intentional, and 3) strict liability. If an individual or business entity fails to exercise the degree of care that society reasonably expects of a prudent and careful person or entity under similar circumstances, it is likely that such an individual or entity will be considered negligent. For design professionals, this means that they must act as prudently and carefully as other reasonable design professionals would have acted under the same or substantially similar circumstances. This test or standard is often referred to as the *professional standard of care*, or the standard of due care and diligence.

☞ **Read our *Management Advisory*, "Standard of Care: Avoiding an Unattainable Obligation," under the "Legal" subhead at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

Negligence

There are four elements that must exist to comprise the tort of negligence: 1) the existence of a duty, 2) breach or violation of that duty, 3) evidence that the breach was the proximate cause of the alleged injury, and 4) measurable damages.

First, there must be a *duty* owed by one person or entity to another. A duty is an obligation to do something or refrain from doing something, and duties arise in many ways. The contract that a design professional makes with a client or consultant is the principal source of the duties that the design professional owes in a given situation. Other sources of duties include codes, standards, and professional registration laws. Parties may even establish duties by their conduct with respect to each other. For example, a client and design professional that have worked together on a number of projects may have established a course of conduct—a way of working together. Such conduct may create duties between the parties on future projects or in other circumstances. In each case, duties of varied scope and type are created.

☞ **To read more about this, see our *Management Advisory,* "Codes and Standards," under the "Legal" subhead at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

According to common law, a professional is required to act as competently as could reasonably be expected of other professionals practicing under substantially similar circumstances in substantially similar communities. The law does not require perfection, merely reasonably careful and skillful performance of the duties undertaken by the professional. Consider that medical patients may die despite good care by a physician, and that one lawyer in every trial loses the case. Fortunately, perfection is not required as long as a design professional does not specifically promise perfection.

Second, *breach* of a duty is proven by the testimony of other professionals (i.e., expert witnesses) who help to educate the court or the jury on that level of skill and care that is common and appropriate in a given situation. With rare exceptions, a design professional cannot be held liable for negligence without expert testimony describing the expected standard of performance and how the questioned performance was

substandard. Note that expert testimony is not always required in breach of contract cases because a jury may be capable of understanding the terms of a contract and deciding on whether they were substantially met without any explanation or assistance from an expert.

The third element is *causation*. There must be a sufficient causal connection between the breach and the injury that is being claimed. There must be both actual and legal causation. Actual causation is determined by asking: "But for the breach, would the injury have occurred?" For example, if an engineer errs in the calculations and a beam collapses, one can ask, "But for the incorrect calculations, would the beam have collapsed?" The concept of legal or proximate cause is intended to assure that the breach or substandard performance is closely related to the injury and not merely linked by a long chain of intervening events and occurrences. Evaluation of legal cause requires a consideration of the foreseeability of the damages. One must ask, "How reasonable is it to expect that this injury would occur if proper skill and care are not applied to the calculations?"

The fourth legal element is *damages*. There must have been some injury that the law can remedy. Not all injuries can be remedied by a court. A court cannot effectively order two people to be friends or to trust one another again after a business deal or professional relationship sours. It can, however, order one party to pay for the destruction of another's property caused by the first party's negligence. Basketball fans may find it helpful to remember this element by recalling the credo of "no harm, no foul."

Another element, anger, is not legally required, but is very important as a practical matter. All other elements of negligence may exist, but there will be no lawsuit or claim against the design professional unless someone is angry enough to take action. Frequently, claims are made or lawsuits are filed when few legal elements of negligence exist. Often, all it takes is sufficient anger. Such cases are rarely won; they simply cost the design professional time and money to provide

a defense. A good relationship with clients and others in the industry can help to preclude or mitigate such anger when something does not go as planned.

Intentional Torts

Intentional torts are different from negligence. They involve breaches of duty committed on purpose by an individual or business entity. There are a number of intentional torts, but three in particular are pertinent to design professionals: 1) intentional misrepresentation, 2) defamation, and 3) intentional interference with contractual or business relationships.

Intentional misrepresentation occurs when someone states something as a fact, not as an opinion, that is known to be false, to induce another person or entity to rely on that false statement, and the other party does so to its detriment. For example, assume that an engineer intentionally provides a client with incorrect data about the projected performance of a new design for a processing facility so that the engineer will be awarded the commission. That engineer will be liable for intentional misrepresentation if the client relies on this material fact when selecting the engineer and then suffers damages because of the inadequate design. If the representation is not made knowingly, but is incorrect because the engineer did not reasonably investigate to determine its truth, that would not be intentional misrepresentation, but could be negligent misrepresentation.

Defamation occurs when, through written or spoken words, a person or business entity is held up to scorn or ridicule in the eyes of respectable members of the community. If the defamatory statement is written, it is referred to as *libel*; if spoken, it is referred to as *slander*. In both cases, the statements must be communicated as statements of fact, not merely someone's opinion. Whenever a design professional publishes a statement (i.e., sends or communicates a statement about one party to a third party), there is a risk of suit for defamation. For example, uncomplimentary comments made by an architect to a newspaper about a construction

contractor's performance or quality of work may be libelous. Fortunately, truth is usually a complete defense to defamation claims. Nonetheless, design professionals should always be circumspect in the comments they make about others in business and professional life.

Also, it is possible to intentionally interfere with an existing contractual relationship between two other parties, or interfere with an advantageous business relationship even where there is no actual contract involved. Sometimes this activity is perilously close to what would be considered aggressive marketing. While it is perfectly appropriate for a firm to promote itself for consideration by a client on future projects, it would be inappropriate for that firm to try to obtain a commission by suggesting that a client breach or terminate an existing contract with another design professional. Over the years, the professional societies have had ethical rules that have addressed similar situations.

Strict Liability

As noted in Module 1-1, strict liability is liability without fault or negligence. To date, strict liability concepts have generally only been applied to manufacturers of products and to those who engage in activities that are considered to be inherently dangerous, such as blasting or transporting hazardous waste (as defined in legislation such as "Superfund"). Most activities of design professionals are not of a nature that makes them susceptible to application of strict liability principles. One way to preserve the distinction is to be clear that design professionals generally provide services and do not sell products or perform work.

To Whom Are Design Professionals Liable?

The foregoing sections in this module discuss the legal theories of liability most applicable to design professionals—contract and tort liability. This section identifies those parties to whom the design professional may be liable under each of the theories.

Liability in Contract

Because contracts are basically promises that the law will enforce, it follows that the person or business entity to which the promise was made will be entitled to enforce the promise. In other words, design professionals will be liable to the parties with whom they contract if they fail substantially to do what they promised in contract. Most frequently, it is clients that sue design professionals for breach of contract. Other design professionals that have been hired as consultants to the prime professionals could also sue on this theory.

☞ See benchmarking information on client claims at www.Schinnerer.com/risk-mgmt/Pages/Claim-studies.aspx.

Sometimes, it is even possible for someone who was not a party to a contract with a design professional to sue for breach of that contract. This can happen when a contract was specifically intended to benefit a third party. Accordingly, those parties are called *third-party beneficiaries* and may have rights to sue under the contract. There have been instances where a construction contractor has sued a design professional claiming to be a third-party beneficiary of the design professional's agreement with the client, particularly with respect to construction contract administration services. A professional can only serve one master, so a situation wherein the design professional has to worry about serving the client's interests and the contractor's interests would be unworkable. The standard forms published by The American Institute of Architects (AIA) and the Engineers Joint Contract Documents Committee (EJCDC) both disclaim any intention to create such a relationship. (See AIA Document B101-2007, ¶ 10.5 and EJCDC Document No. E-500, 2008 Edition, ¶ 6.07.C.)

Liability in Tort

Unlike contracts, where the parties to the contract are known, the number of people and entities to whom design professionals may be liable in tort is of indefinite length. Design professionals can expect to be liable under tort law to anyone to whom they owed a duty to act with reasonable professional skill and care. Clearly, this is a standard that can expand and contract depending on situations that come before the courts. Courts look to the terms of contracts, statutes, codes, standards, and other sources to determine whether the

design professional assumed such a duty. They also consider whether or not the specific circumstances suggest that it was reasonably foreseeable that a given claimant would be injured if the design professional did not act with due skill and care. If a court is convinced that the design professional should have been able to foresee that specific persons or classes of persons would be injured if there were substandard performance of professional services, then the design professional will probably be liable to those persons if such harm occurs.

When the criteria mentioned above are applied in actual situations, clients, members of the public who use or come in contact with construction projects, contractors, subcontractors, construction laborers, lenders, insurers, sureties, and others may be included in the list. Design professionals must develop the ability to assess the likelihood that someone could be harmed by their actions or inaction, and should take steps to prevent or mitigate potential harm.

Note that insurers were named above as possible claimants. This is because of subrogation.☞ *Subrogation* is a concept that allows an insurer who has paid a claim to its insured or to someone else on behalf of its insured to, in effect, step into the shoes of that party. In other words, the insurer can act on the right of the injured party to sue the person or entity that actually caused the harm.

☞ **Read more about subrogation in our *Management Advisory,* "Waiver of Subrogation," under the "Insurance" subhead at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

For example, suppose that an architect negligently specifies a method of attachment for a roofing membrane that results in water damage to property inside a building. The property insurer who pays the claim on the damaged property may want to sue the architect whose negligence was the source of the problem. If the insurer could do so under the concept of subrogation, there would be litigation where none would otherwise be necessary. If a party pays insurance premiums and then recovers for an insured loss, one might question why the insurer should be allowed to sue to recover what was paid. Wasn't that why the insurer charged premiums? To minimize such litigation, the standard form documents published by the

EJCDC and AIA require a waiver of subrogation for damages covered by property insurance applicable to the construction work. (See EJCDC Document C-700, 2007 Edition, ¶ 5.07 and AIA Document A201-2007, ¶ 11.3.7.)

For Whom Are Design Professionals Liable?

Design professionals are, of course, liable for their own personal actions. They are also liable for the actions of others under specific circumstances. Those professionals who are employers are liable for the actions or failures to act of their employees if such activity was within the normal course of the employee's duties on behalf of the firm. This kind of vicarious liability (i.e., liability incurred via another person) is imposed due to the doctrine of *respondeat superior*. Loosely translated from the Latin, this means that the master should respond for the actions of the servants. This concept can sometimes apply in situations that might be unexpected. For example, if an employee is moonlighting (i.e., doing projects for a personal account) and makes a negligent error or omission, the employer could be liable. (The employer's knowledge of the moonlighting may determine liability.) Although it appears that the activities are not within the scope of employment, they can be so considered if the employee uses the employer's equipment or takes moonlighting calls at the office.

To read more about vicarious liability, see the following *Management Advisories* under the "Legal" subhead at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx:

- **"Negligence of Others"**
- **"Vicarious Liability"**

Design professionals are also liable for the professional acts and omissions of the consultants that they hire or those for whom the design professional takes responsibility by contract. The design professional who contracts with the client is called the prime professional. The prime normally contracts to provide a certain scope of services, some of which are then subcontracted to independent consultants. If these consultants breach their contracts, that failure might cause the prime to be in breach of contract and become liable to the client. Similarly, actions of the consultants may injure others to whom the prime might also be liable.

Finally, design professionals are liable for the acts and omissions of their partners and joint venturers. A joint venture

is essentially a partnership, but only for a specific, and usually limited, purpose. Although partnership agreements and joint venture agreements usually allocate responsibility and liability between the parties (e.g., it may be 50/50, 60/40, or some other combination), that allocation is internal only. To the rest of the world, the partners or joint venturers are "jointly and severally" liable. That means that an injured party may recover the full scope of damages awarded by the trier of fact (i.e., court, arbitration panel) from either party or from both parties in any combination. For example, if an injured party recovers the full award of damages from Partner A in a case where Partner A and Partner B had agreed to be 50/50 partners, Partner A can require Partner B to reimburse Partner A for its 50 percent share. The risk that Partner B will be able to do so, however, is totally on Partner A. The originally injured party is entitled to the full amount of damages awarded, whether collected all from Partner A, all from Partner B, or in any ratio. Therefore, it is critical to be comfortable with your co-venturer's financial ability to respond in the event of a claim.

For What Damages Are Design Professionals Liable?

There are essentially three categories of damages for which design professionals may be liable: 1) direct damages, 2) consequential damages, and 3) statutory damages. Direct damages generally either consist of bodily injury to, or wrongful death of, a person or damage to property. The damages must be a direct result of the proscribed actions or a failure to act. Consequential damages☞ do not directly or immediately result from particular actions or a failure to act—they depend on intervening circumstances. Nevertheless, they must be a reasonably foreseeable result of an activity. They can include economic losses, such as lost profit. Direct damages and consequential damages, together referred to as compensatory or actual damages, are intended to fully compensate an injured party for the injury sustained. They are not intended to compensate an injured party for more than its actual loss. Statutory damages are those that are prescribed by language in a statute. Statutory damages may be awarded regardless of whether a party actually suffers damages.

☞ **Read more about consequential damages in *Managing Risk Through Contract Language* at www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx.**

The damages for which an injured party can recover depend on the theory of liability on which the claim is based. Obviously, statutory damages are created by specific laws. For example, it is possible to recover statutory damages for violating the copyright of another person or business entity. If copyrighted material is improperly copied, the author will often be able to recover damages specified by law whether or not there were any actual, provable damages caused by the copying.

Consequential damages are most closely associated with tort law. The public policy behind much of tort law is to emphasize safety and to allocate the costs of physical injuries and property damage among the parties who cause the damages. As mentioned earlier, the range of potential consequences of actions that the courts have deemed to be reasonably foreseeable has grown significantly in the last 30 to 35 years.

When a negligent action or failure to act by a design professional results in the bodily injury or death of a person, the law is clear that victims may sue the design professional whether or not there was a contract between them. Until approximately 35 years ago, the general rule was that one party could not sue another unless the two were parties to a contract (i.e., in "privity of contract"). Today, with some significant exceptions, privity of contract is not required for a person or business entity to sue a design professional for negligence. The same is true if the design professional's negligence causes damages to the property of a person or business entity. Whether or not the parties had a contractual relationship, the design professional will be liable under tort law for such damages if found to be responsible.

Contract law, on the other hand, has as a policy the promotion of commercial market efficiency. That is done in part by assuring parties that the risks and rewards, benefits and burdens that they negotiate in contracts will be respected and enforced. In other words, the parties allocate risks and rewards in their contracts, and the courts should protect their economic expectations. One manifestation of this policy is that consequential damages are not usually available for breach of

contract. For a party to recover such damages for breach of contract, the wronged party would have to prove that the breaching party actually knew that such damages would occur as a result of a breach of contract.

The law of torts and the law of contracts, and the public policies underlying them, potentially overlap when so-called economic losses occur. Some courts have adopted an economic loss rule to preserve the distinctions between contract and tort remedies. In short, this rule provides that a party may not sue in tort for economic losses unless it has a contractual relationship with the party being sued. For example, a contractor who believes that an architect under contract to the client performed construction contract administration services negligently and thereby put the contractor through unnecessary expense may want to sue the architect for alleged losses. In states with the economic loss rule, the contractor would not be permitted to do so. That is because the contractor has no contractual relationship with the architect, and there is no bodily injury or property damage involved, only loss of money, i.e., an economic loss. If the contractor were allowed to sue the architect in tort for such damages, it would disrupt the allocation of risk that the client, architect, and contractor had negotiated in their agreements and could allow the contractor to achieve a better result than it had otherwise been able to negotiate. States that have adopted the economic loss rule have decided that it is important to preserve the sanctity of contractual negotiations and agreements.

Read about an important case in Pennsylvania that could seriously impact cases involving the economic loss doctrine in "What's Left After *Bilt-Rite?*," available at www.Schinnerer.com/risk-mgmt/Pages/AMIA-past-meetings.aspx.

Defenses to Liability Claims

A number of defenses are available to design professionals faced with professional liability claims, one or all of which may be applicable in any given case. A brief discussion of several of the more common defenses follows.

Statutes of limitations and *statutes of repose* have been enacted in most states. A statute of limitations generally provides that once a legal claim accrues to a party, that party has only a specific period of time to sue. Accrual of a claim is usually that point where a party has reasonable notice of the

NSPE annually publishes *NSPE's State-by-State Summary of Liability Laws Affecting the Practice of Engineering*. You can download a copy through NSPE's website at www.nspe.org.

facts that would justify legal action against someone for damages. It can be difficult to determine exactly when the period begins to run, and the number of years allowed varies from state to state and from legal theory to legal theory. For example, in many states a breach of contract claim must be made within six years of the date of the breach. A claim for negligence, however, may only be available for three years from the date of discovery.

A statute of repose is similar to a statute of limitations, but its time period begins to run upon the occurrence of some event, not necessarily a party's notice of the facts constituting a claim. For example, it is possible that all claims for negligence in the design and construction of an improvement to real property must be made within six years of the date the improvement was placed into service (i.e., the date of substantial completion), regardless of when such negligence was first discovered. A number of states have enacted statutes specifically aimed at the design and construction industry, as just described. Once a project has been completed for a certain span of years, factors such as maintenance, control by others, lack of access by the design professional and the contractor, and other reasons suggest that it is unfair to continue to subject design and construction entities to claims for problems with the facility.

Some standard forms of agreement attempt to add some certainty to this area of the law by providing a positive trigger to the running of the statutory period, whatever it might be. (See AIA Document A201-2007, ¶ 13.7 and EJCDC E-500, 2008 Edition, ¶ 6.11.E.) Additionally, within reason, parties to a contract can negotiate a shorter or longer period for making claims than provided in the law. For example, a client and design professional could agree that all claims by either party against the other must be made within three years from the date of substantial completion of the project. Statistically, the majority of claims are filed within such a period, and almost all claims are filed within six years of substantial completion of a facility.

Comparative negligence is an alternative, in some respects, to the idea of joint and several liability that was discussed earlier. For those states that use comparative negligence, the relative amount of each party's negligence is measured as a percentage of the damages incurred by the injured party. For example, if both the construction contractor and the design professional jointly cause an injury to the client or a third party, they could be held jointly and severally liable. That means that the design professional might have to pay all of the injured party's damages even if he is only one percent at fault. In states that use comparative negligence concepts, if the design professional is found to be only one percent liable, then he or she would only have to pay one percent of the damages, regardless of whether or not the injured party could recover the other 99 percent from the contractor. Clearly, this is a more equitable situation from the perspective of the design professional. One of the major objectives of current efforts for legal or tort reform is the elimination of joint and several liability.

Contributory negligence occurs when the party making the claim is partly responsible for its own injury or damages. When this concept applies, the damages that the injured party can recover are reduced by the percentage of that party's own negligence. If the injured party's contributory negligence is substantial, recovery may be barred entirely. For example, in some states that use contributory negligence, injured parties must be less than 50 percent negligent or they cannot recover at all. Because of the potential harshness of such a result, the majority of states have replaced contributory negligence acts or doctrines with comparative negligence.

Betterment☞ occurs when an injured party is compensated for more than its loss. Although it may be appropriate for a design professional to be financially responsible for damages caused by its negligent acts or omissions, that does not extend to improving the project or the client's economic position compared to what it would have been if no such error or omission had occurred. For example, assume that an architect negligently omitted a requirement for railings in a stairwell of a

☞ **Read more about betterment and its use as a defense in, "Betterment or Added Value? The Defense with an Identity Crisis," at www.Schinnerer.com/risk-mgmt/Pages/AMIA-past-meetings.aspx.**

public building. Accordingly, they were not part of the contractor's construction price. When the omission is discovered, assume that the contractor will be given a change order for the cost of adding the missing handrails. If the client could recover from the architect for the full cost of the handrails, there would be a betterment. The client would have received for free what it would have had to pay for if no error had been made. On the other hand, if the cost of the railings and associated labor increased from what they were at the time of bidding, or if remedial work was required in connection with the installation of the handrails, then it would be appropriate for the architect to be responsible for such additional costs since the client would never have incurred the costs but for the negligent error or omission.

A design professional may enjoy limited *immunity* or protection from claims under a number of circumstances. For example, it is common for a design professional acting as the decider of disputes between the client and construction contractor during the construction phase of a project to be immune from suit for the results of decisions rendered in good faith. This immunity is specifically provided for the design professional in standard form agreements of the AIA and EJCDC. It is also called for in the Construction Industry Rules of the American Arbitration Association with respect to its construction arbitrators. Immunity of this nature is necessary if the design professional is to perform its services properly without fear of suit for defamation or interference with business relationships, as mentioned earlier in this module.

Waiver is the voluntary and intentional giving up of a known right. For example, if a client knowingly agrees to accept less than full performance from a contractor, that would be a waiver of the right to enforce full compliance. That waiver might be made expressly in words or in writing, or it might be implied from the circumstances. Often, waivers are the result of negotiations in the settlement of claims.

Finally, *estoppel* is similar to waiver, but with the following principal difference: waiver only requires action by one party

while *estoppel* requires action by both parties. In essence, *estoppel* operates to stop someone from doing something that they would otherwise have the right to do. The reason both parties must be involved is that it requires the first party to take action on which the second party relies to his detriment. For example, if a client tells an engineer that he need not visit the site on a particular day, which the engineer would have otherwise done, the client will be estopped from suing the engineer for not observing construction activity that would otherwise have been observed. Estoppel is based on equity or fairness principles and can be a valuable defense in a number of situations.

Effect of Form of Practice on Liability

Design professionals organize their practices in a variety of different legal forms, including sole proprietorships, partnerships, corporations, and limited liability companies or limited liability partnerships. Each has somewhat different implications for professional liability risk management.

Sole proprietorships are those businesses owned by one person. There may or may not be any employees (i.e., there may be just a sole practitioner). There is no legal distinction between the business and personal assets of the sole proprietor. If the proprietor becomes liable for damages due to either business or professional activities, all of the proprietor's personal assets are potentially available to satisfy the judgment. Note that only the assets of the proprietor are so available. If assets are placed in trust for the benefit of children, for example, or are titled in the spouse's name, then they usually are not the proprietor's property and are not available to creditors. Such transfers should be made as an integral part of long-range estate planning, with appropriate advice of an attorney experienced in estate planning and succession issues.

Partnerships are formed when two or more people agree together to undertake business activities. All partners are jointly and severally liable for obligations of the partnership. Generally, all personal property of the partners is potentially available to satisfy judgments against the partnership. In that

sense, the situation is similar to that faced by sole proprietors. The main difference is that not only can one's own acts or failures to act place all personal assets at risk, but one's partner's acts conducted in furtherance of the partnership business can also do so. A joint venture is a form of partnership, and the liability of joint venturers is the same as for partners in a typical partnership.

Corporations are legal entities in and of themselves. That means that they are legally distinct from the people who own and run them. Two typical types of corporations are professional corporations and business corporations. Professional corporations (sometimes called professional associations) are those in which all shares of ownership (or a minimum percentage) in the corporation must be held by licensed professionals in the appropriate profession. For example, generally, in a professional architectural corporation, all shares of stock must be owned by licensed architects. Some states require the use of this type of corporation for those that provide professional services to the public.

On the other hand, a business corporation can be owned by non-licensed persons. General business corporations are not allowed by all states to provide professional services. Even when they are so permitted, there is usually a requirement that at least a majority of the shares of ownership be owned by licensed design professionals. Both professional corporations and business corporations can be either "C" or "S"corporations. These designations are from the Internal Revenue Code and have principally to do with the tax status of the corporation and the shareholders. They have no effect on the liability exposure of the corporation.

In general, the owners of corporations are not personally liable for acts or failures to act by the corporation. They only stand to lose the value of the stock that they own in the corporation if a large claim or liability affects its worth. If the insurance and assets of the corporation are not adequate to satisfy its obligations, claimants generally have no right to pursue the personal assets of the individual shareholders.

This shield from personal liability is only available for general business liabilities, however, not for professional liability. Since only individuals are tested and licensed to practice as design professionals, those licensed individuals cannot escape liability for their personal actions or failures to act. A corporation may provide some increased protection compared to a partnership, however, because the actions of one shareholder do not place the personal assets of other, uninvolved, shareholders at risk the way that they would be if the practice were a partnership.

Limited liability companies and *limited liability partnerships* are fairly recent statutory creations in which the personal liability of the members or partners can be reduced while still maintaining some of the advantages of a general partnership, such as flow-through tax treatment.

A limited liability company (LLC) is a business entity that provides all members with protection from personal liability for company debts while allowing them to participate in management and control of the company. The personal liability shield of an LLC is broad, but as is the case with a corporate entity, an LLC will not shield individuals from liability caused by their own tortious action (e.g., negligence, professional malpractice). An LLC will, however, protect the other members of the LLC from liabilities caused by another member's tortious actions.

A limited liability partnership (LLP) is a general partnership in which partners are afforded protection from certain types of partnership liabilities. The types of liabilities from which an LLP partner is protected vary greatly from state to state, but generally LLP partners are not liable for the tortious actions (e.g., negligence, professional malpractice) of other partners. An LLP partner is not, however, protected from his own tortious actions or from other types of partnership liabilities. Unlike an LLC, an LLP may not protect a partner from personal liability for some debts of the partnership, such as those caused by a breach of contract.

Summary of Points

1. Professional liability consists of those obligations that are or will be legally enforceable and that arise out of the performance of or failure to perform professional services by the design professional.

2. Professional services contracts allow the parties to state their goals and expectations; anticipate future changes; allocate rights and responsibilities, risks and rewards; prevent disputes; and resolve disputes that do occur.

3. Elements of a legally enforceable contract are: 1) mutual assent, 2) consideration, 3) legal capacity, and 4) a legally permissible objective.

4. Valid contracts are either express or implied. When parties speak or write the elements to which they have assented, the contract is express. When the conduct of the parties demonstrates their promises, a contract is implied.

5. Breach of contract occurs when there is a substantial, unexcused deviation or failure to perform according to the terms of the contract.

6. Torts are civil wrongs involving violations of the personal, business, or property interests of private citizens. They are similar to criminal actions, which violate interests of the general public.

7. Four legally required elements comprise the tort of negligence: 1) duty, 2) breach, 3) causation, and 4) damages. Though not legally required, a fifth element—anger—is often crucial in bringing about a claim or lawsuit.

8. A design professional is negligent when he fails to act as prudently and carefully as other reasonable design professionals would have acted under the same or substantially similar circumstances. This is the professional standard of care.

9. Professional duties may arise out of contractual agreement, codes and standards, professional registration laws, and the conduct of the parties.

10. Expert testimony by a qualified, (usually) licensed, design professional is necessary to establish that substandard performance occurred in each specific case.

11. Intentional torts involve actions committed on purpose by an individual or firm. Those pertinent to design professionals are: 1) intentional misrepresentation, 2) defamation, and 3) intentional interference with contractual or business relationships.

12. Expressions of professional opinion are not misrepresentations and are not torts. Nevertheless, design professionals should be circumspect in voicing opinions about the qualifications and performance of contractors and others.

13. Strict liability is liability without fault. It is not generally applicable to design professionals who provide services and do not do construction work, conduct ultra-hazardous activities, or sell products.

14. Design professionals may be liable to parties with whom they have contracts as well as to those that are intended beneficiaries of such contracts.

15. Design professionals may also be liable under tort law to anyone who it was reasonable to foresee would be injured if the design professional did not exercise due care and diligence in performing professional services.

16. Subrogation is a concept that allows an insurer who has paid a claim to step figuratively into the shoes of the originally injured party to recover from the party who caused the damages. A waiver of subrogation eliminates that right and can minimize consequent litigation.

17. Design professionals are vicariously liable for the actions of their employees (within the scope of their employment), as well as for the actions of their partners and co-venturers in joint venture arrangements.

18. When two or more firms or individuals are jointly and severally liable to an injured party, that party can recover

the full amount of allowable damages from any of those found liable, or from all of them, in whatever proportion is possible. Arrangements between the liable parties to share potential liability in some ratio are not binding on the injured party.

19. Design professionals may be liable for: 1) direct damages, 2) consequential damages, and 3) statutory damages. Damages that are recoverable in any specific case depend on the applicable legal theory of liability. Consequential damages are most often associated with tort law.

20. Statutes of limitations and statutes of repose provide defenses to professional liability claims. Statutes of limitations preclude filing of claims beyond some number of years after the claim accrues. Statutes of repose do the same based upon passage of time after a specific event, such as substantial completion of a project.

21. In most states, the defense of contributory negligence has been replaced by comparative negligence. If principles of comparative negligence apply, a party will only be liable for that percentage of the total allowable damages that is equivalent to its portion of liability compared to that of other parties.

22. Design professionals are not responsible for "betterment" of a project. When a client is damaged as a result of a design professional's error or omission, the client's economic position or the project should not be improved beyond what it would have been if no error or omission had occurred.

23. Design professionals are often granted immunity from the consequences of their good faith actions in deciding disputes between the client and the contractor. This immunity may be established by law or by contract.

24. Waiver is the voluntary and intentional giving up of a known right whereas *estoppel* prevents a party, as a consequence of his own acts or conduct, from asserting a right against another party who relied on the conduct of the estopped party.

25. Different forms of business organization affect the liability exposure of design professionals. Professional liability is always personal, and there is no shield to liability for personal professional negligence. Nor is there any shield from business or professional liability for sole proprietors and partners in a partnership for damages that result from business and professional activities. In corporations, stockholders may have a shield to liability that results from another stockholder's actions or failures to act that do not involve them personally.

26. Limited liability companies (LLCs) and limited liability partnerships (LLPs) are fairly recent statutory creations in which the personal liability of the members or partners can be reduced while still maintaining some of the advantages of a general partnership.

Further Reading

Acret, James, *Architects & Engineers: Their Professional Responsibilities*, Third Edition, Shepard's, Inc. Division of McGraw-Hill, Colorado Springs, 1993.

Bockrath, Joseph T., *Contracts and the Legal Environment for Engineers and Architects*, McGraw-Hill, New York, 1999.

Croessmann, Philip R., "Firm Legal Structure," Chapter 6.7 in *The Architect's Handbook of Professional Practice*, Thirteenth Edition, edited by Joseph A. Demkin, John Wiley & Sons, Inc., New York, 2001.

Cushman, Robert F. and G. Christian Hedeman, eds., *Architect and Engineer Liability: Claims Against Design Professionals,* Aspen Publishers, Inc., New York, supplemented 2002.

Jones, Joseph H., Jr., "Legal Dimensions of Practice," Chapter 15.1 in *The Architect's Handbook of Professional Practice*, Thirteenth Edition, edited by Joseph A. Demkin, John Wiley & Sons, Inc., New York, 2001.

Schoumacher, Bruce H., *Engineers and the Law: An Overview*, Van Nostrand Reinhold Company, Inc., New York, 1997.

Spevacek, Charles E., "Betterment and Added Value Defenses in Design Cases," *Guidelines for Improving Practice*, Volume XXII, No. 1, Victor O. Schinnerer & Company, Inc., Chevy Chase, MD, 1992.

Sweet, Justin, *Legal Aspects of Architecture, Engineering, and the Construction Process*, Fifth Edition, West Publishing Company, St. Paul, 1999.