

For the Client

Assessing Risk

By Frank Musica

Victor O. Schinnerer & Company, Inc.

Your client wants your services for a project where any problem, including a negligent error or omission on your part, could result in significant damages to the client beyond those that are directly caused by you.

Sometimes a claimant asserts that the actions of a design professional caused consequential damages—those that go beyond direct losses. Consequential damages are usually defined by courts as those damages that are more remote and difficult to evaluate. They are abnormal, related to the particular transactions, and more subjective; they also could be of great significance to the client and catastrophic to the design professional. Lost profits caused by delay in completing the project is one example.

While it is common in commercial contracts to limit the amount that may be received due to consequential damages or other specific types of damage or to exclude such recovery entirely, many project owners see no reason to limit the risk of a design professional to direct losses caused by the design professional's negligence. Direct losses, which can occur in any design contract, are usually measured by conventional objective formulas. They include the cost to cure a problem caused by the party being held responsible. Direct losses could be the cost of repairing a negligently designed roof, the incremental construction cost of adding an element of a proj-

ect negligently omitted from the design, or the medical expenses of someone injured because of a design professional's negligence in design or contract administration.

The risk of being responsible for direct losses and the professional ethics of the design professional provide incentives for a design professional to perform services carefully. When a client obtains the services of a design professional, that client is providing the design professional with a limited scope of services and limited authority for what usually is a very limited fee. That client has a need and is willing to make an investment to address that need. There is an intrinsic risk in any investment. Providing professional services also gives rise to risk. Waiving consequential damages means that both parties to the agreement acknowledge known, and calculable, risks and recognize that any unclear, and incalculable, risks exist. A mutual waiver of consequential damages is not a totally exculpatory clause for either party but one that simply limits the liability of each party to a significant, but not catastrophic, amount. Such an apportionment of risk is fair and that will get the professional relationship off on a positive start.

The American Institute of Architects has included a mutual waiver of consequential damages in the 1997 edition of B141. A similar waiver is included in A201, the general conditions of the construction contract. The combination of these waiver provisions should make the risks to both the design professional and contractor more predictable, and therefore

more easily translated into the costs of providing the design and construction services. The Engineers Joint Contract Document Committee (EJCDC) language in Exhibit I of 1910-1 (1996) is an option that can be tailored to particular types of damages that may be applicable to the type of project or specific circumstances. The EJCDC "Exclusion of Special, Incidental, and Consequential Damages" option also can be converted to a limitation of the amount of such damages.

A design professional is potentially liable in both contract and tort to the client. The negligence of a design professional may entitle the client to sue either under a tort theory for negligence or a contract theory for breach of contract caused by the negligence. When a client proceeds under both tort and contract causes of action, each theory of liability has its own distinct damages and its own distinct statute of limitations. First, damages recovered under a contract theory are measured differently than damages recovered under a tort theory. In certain jurisdictions, this difference may make the tort remedy more advantageous to the client. Contract damages are generally limited to direct damages deemed to flow "naturally" from the breach, such as the direct costs of fixing a problem caused by design error. The recovery for additional damages, often referred to as "special" or "consequential" damages, is limited. Thus, damages such as lost profits resulting from the interruption of use of a facility are only awarded when such damages were in the reasonable contemplation of the parties at the time they made

(continued on page 2)



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the contract. By contrast, in an action in tort, the limitations of damages may only be tied to the idea of proximate causation and the general policy that denies recovery to certain types of interests.

Duties imposed by law are tort obligations. The ability of an owner to recover in an action in tort against a design professional when the damages sought are purely economic in character often depends on whether the breach of contract is considered a tort; in many cases a breach of contract is not considered a tort unless a legal duty independent of the contract itself has been violated. With design professionals, conduct constituting a breach of contract also may constitute a tort. A design professional has the legal duty to perform the duties of the contract according to the standards of the profession. In a breach of contract situation, the law does not charge a breaching party with all the losses caused by its breach. Usually the breaching party is not chargeable with all consequential or less direct damages. Yet, the foreseeability requirement—the standard used most frequently in determining whether consequential damages can be recovered—has been applied by modern courts in such a way as to diminish protection.

For that reason, the design professional should seek to exclude this liability for consequential damages in the contract. This can be done expressly or by limiting the responsibility of the design professional to correction of the work caused by defective design or, when that is not economically feasible, to the diminished value of the project. To further the

appropriate allocation of risk to that which is foreseeable, it may be in the interest of the client and the design professional to include a provision in the general conditions of the contract for construction that would equitably allocate risk and increase the efficiency of the project delivery system. Particularly in states where the economic loss doctrine is not observed, the client may want to include the design professional in the contractor's waiver of claims for consequential damages. Clauses limiting consequential damages are strictly construed by the courts and are subject to the same general rules with respect to enforceability as they apply to other limitation of liability clauses. As in all situations involving legal interpretations, local legal counsel should be consulted for an explanation of the distinctions between and among direct and consequential damages.

The PEPP Professional Liability Committee offers this commentary for a fuller understanding of issues that may arise between engineers and their clients.