Should an owner limit the architect / engineer's liability?

26 MAY 2016
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Many owners and developers may be unaware that most standard form architectural and engineering agreements and proposals promulgated by design firms contain limitations of liability arising out of the architect or engineer’s negligence (often contained in the fine print “Terms and Conditions” at the end of the proposals). Some of these are absurdly low—often as low as US$ 25,000—while others are somewhat more forgiving and can be as high as US$ 1 million. These limits are generally enforceable in most states, and therefore must be squarely addressed by every owner or developer.

Clearly, the work product of architects, and structural, MEP (mechanical, electrical and plumbing services) and geotechnical engineers (among others) can result in enormous financial loss and damages for an owner if there are errors or omissions in that work product. These damages not only include the repair of defective design (and damage to the building resulting from that defective design), but also damages for delay in completion of a project, or lost rent while defective design issues are being repaired. For larger projects, the losses could be in the millions of dollars.

So what should an owner do? From a practical perspective, most architectural and engineering firms do not have very much capital or the ability to pay a large damages award against them arising out their negligence. The main hope for relief for an owner damaged by errors and omissions lies with the professional liability insurance carried by the architect or engineer. Therefore, it is absolutely critical that sufficient insurance limits for the size and complexity of the owner’s project are required of every architect or engineer. Assuming that sufficient limits of liability are required, one option is to cap the architect or engineer’s liability at the amount of professional liability insurance. In that way, the architect or engineer does not face the prospect of coming “out of pocket” for a claim and is likely to agree to a limit of liability tied to their insurance.

It is important to note, however, that unless the professional liability insurance is project specific (and most of the time that is not required), the limits can be eroded by claims on other projects of the architect or engineer. In addition, legal fees to fight a malpractice claim come “off the top” of the limits that are available to pay an owner’s damages. Therefore, it may be necessary to engage in a discussion with the architect or engineer as to whether the limit of liability is tied to “available insurance proceeds” or to the limits required in the contract. The latter approach is preferable for owners and developers as it provides an incentive for the design professional to “replenish” its insurance if it has been eroded by other claims, and keeps the design professional’s “skin in the game” to the extent of legal fees eroding the policy limits (thus promoting settlement of a claim).

Best Practice: Carefully examine the appropriate limit of liability if one is required by an architect or engineer, and make sure that such limit is reasonable for project size and complexity.
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