Talk to Me About A&E: Episode 3 — Dealbreakers

DOUG PALANDECH: Talk to your owner. You don't want this language. This is language that you do not want because you want to protect the insurance policy as your most vital asset in the case something does go wrong.

SPEAKER 1: Welcome to Talk to Me About A&E, a podcast series focused on risk management for architects and engineers. Host, Dan Buelow, managing director of Willis A&E, will engage experts across the A&E spectrum on topics ranging from contract details to the broadest trends impacting design professionals in North America.

DAN BUELOW: Well, hello, and welcome back to our Willis A&E podcast series Talk to Me About A&E. And with me here is DOUG PALANDECH, the lawyer from Chicago that we have been talking to for the last two series on contracts here. Doug, how are you doing?

DOUG PALANDECH: Good morning, Dan. I'm doing well. Thanks for having me.

DAN BUELOW: Well, thank you. So the last Doug and I were talking about, we were talking about dealmakers and dealbreakers. And we went through the list of dealmakers. And that list included mediation, hazardous materials, job site safety, limitation liability and ownership of instruments service, termination and getting named on a contractor's deal. And this chapter here, this segment, we're going to be talking about seven specific dealbreakers.

And dealbreakers as defined by the DPIC contract guide, a dealbreaker is a client-written clause that is so burdensome and onerous that you must insist it be deleted from any agreement. If your client refuses to delete or substantially modify such a clause, you'll need to seriously consider refusing the project. And so the seven dealbreakers we're going to talk to Doug about include the following-- assignment, certifications guarantee and warranties, insurance requirements, job site safety, liquidated damages, stop work authority, and indemnities.

And so Doug, what I want to start off then is to get right into this with you here on this list here. Let's talk about assignment. And I will say that this is one of those clauses back-- with the last economic downturn, it seemed like one that a lot of attention wasn't really placed on it. But when we suddenly saw a bunch of projects go bankrupt or owners go bankrupt, or projects mothballed, some suddenly this became a very relevant clause.

DOUG PALANDECH: It always is going to be relevant even-- because who are you contracting with? You are contracting with someone that you know. And I'm sure you've done your search for liquidity, and I'm sure everyone's done their research to make sure that they're a viable business partner. But what does assignment mean? It means that the owner has a right to give it to a third-party and now you have to be looking for payment from someone you have absolutely no understanding with and no bargain with. So that assignment clause is valid.

Again, Dan, you talked earlier about the validity of these provisions. Every court will enforce it. Likewise a non-assignment is also valid so that once you have separated ownership and payment to a second party that you have no contractual relationship with, you have introduced profound risk hence a dealbreaker.

DAN BUELOW: So to modify this then you would want it to add wording so as to allow you to buy consent as I would assume.
DOUG PALANDECH: Consent is mandatory. The best thing is not a sign of consent--
DAN BUELOW: Not to have it in there at all. But if you have it, have consent in there. I mean, again, to your point, and we've seen this, is suddenly you're working with somebody that you may not want to be working for and you also have to spend a lot of time and resources to get them up to speed on the project which you're not going to be compensated for. So it is a real possible mess you could find yourselves in if you're stuck with this clause.
DOUG PALANDECH: Absolutely.
DAN BUELOW: So thanks. And then so the next one on the list here is certification guarantees and warranties. You have virtually anything. And our first podcast we did with you, Doug, on these critical issues here, we talked about how important these words are and the standard of care. Maybe talk a little more about that and why this is a problem in these owner-drafted agreements.
DOUG PALANDECH: Yeah, again, we're borrowing language that's really contractor language, not design professional language. And we talked about insurability and we talked about standard of care. When we have design professionals warranting and certifying things, liability without fault. Liability without fault is again, outside of the coverage that you have under your insurance policy.
So when we see these words-- certify, warrant, those understandings and those undertakings are legal. No question about it. But they're taking you in a risk category that is uninsured. And you and I talked about this on day one, talk to your owner. You don't want this language. This is language that you do not want because you want to protect the insurance policy as your most vital asset in the case something does go wrong.
DAN BUELOW: So again, the standard of care is so important to understand this alignment of between the standard of care and your insurance policy. Your professional liability insurance policy are closely aligned. So your professional liability policy will cover you for everything you do as a design professional. However, if you take on some of these words that would arguably take you over and above that standard of care, you could find yourself in a potentially uninsurable position. But at the very least, you might be taking on performance-based exposures that are significant and unfair and could cost you a great deal.
DOUG PALANDECH: Dan, you mentioned it in one of our earlier broadcasts, contractual liability. You just bought it. You bought contractual liability but it's uninsured.
DAN BUELOW: Yeah. All right, so the next on here is insurance containing unattainable requirements. And this is a pretty-- I'll feel this and see what Doug has to add to this. But we always encourage our Willis A&E clients to send us any insurance requirements and certainly anything that's unfamiliar so that we can ensure that they can meet those requirements in order to be able to issue a certificate. It's again, a lot easier to deal and address this up front at this stage when you're negotiating this contract and then later on when you cannot get a certificate.
And we're going to have another program and really drill down on some of these issues when it comes to some of the insurance requirements. But it could be all sorts of things, including material change and certain things that your carrier won't offer. Doug, anything that you would add to that?
DOUG PALANDECH: Dan, here are the two flash points that I have seen-- owners insisting that they be named as an additional insured on your PL policy. No matter how many times we've seen this, we go

back and say, this is an impossibility. You cannot be an AI. Number two, we've seen so many times where owner insists that the consultants secure the same limits and same coverages as the prime. Well, that's impossible. If you're an architect and you got a major project and you have a $5 million limit, you may well have an interior architect or a civil that's nowhere close to being able to secure that kind of coverage. And again, the only time you can talk about it, Dan, is formation because if it's in the contract, it's going to be enforced. So no, you cannot be an AI, and no, we're not going to be able to get some consultants to our limits.

DAN BUELOW: Yeah, there great points. OK, so this next on the list here is job site safety here. And job site safety was on also the dealmakers. We talked about this earlier, Doug, but go into this a little bit about how important it is to make sure that it's in writing and in your contract that you're not taking responsibility for job site safety as a design profession.

DOUG PALANDECH: This goes back to our formation session, which is will the court enforce a provision that is negating responsibility for job site safety? They will. So from the standpoint of writing the language, we can get summary judgment. We can get the design professional out of the litigation, and these tend to go on forever.

As a matter of law, judge look at the contractile. Our client never assumed a duty for job site safety. See if there's an exclusion here. At that point the court will say, you know what, you're right. There is no duty. There is no liability. Judgment is a matter of law. Again, vital to have it. And if there's any hint in the contract that there is a supervision or responsibility of the contractor or operation, bad for you. That's a dealbreaker.

DAN BUELOW: And we talked about earlier too, is how important it is to educate the staff as to their responsibilities on the site, because even if you have this wording which you should have in your agreement, again, if your staff goes out there and starts taking control of the job site in any way, it really doesn't matter what's in this contract.

DOUG PALANDECH: It is a liability assumed by conducting, and you're exactly correct. And that's where the staff responsibility is. You do not take responsibility for the contractor operations.

DAN BUELOW: All right, so-- and again, we have an on-demand program on job site safety. We can and we do spend an hour and a half talking about it. It's that important because it all really goes into this construction administration and the documentation responsibility around that, which is so important. Another clause here that we'll see that owners will try to put in their agreements often is around liquidated damages. And this is something, again, that we would want to strike because it's uninsurable. Why is this an issue, Doug, and why does it not belong in a professional agreement?

DOUG PALANDECH: It is, again, a liquidated damage provision is most commonly associated with public utilities so that when you deal with public utilities, you want to get power or you want to get energy to the public. In a private engagement in which you are providing the service, a design service, the concept of time so that, in other words, if we exceed this time limit, then all of a sudden I've exposed myself to a fixed damage.

Again, the court then is going to award damages. If the expectation or the contract says that the design shall be completed on day x and for each day there'll be a liquidated damage of $10,000 per day, the courts are going to enforce it. What does that mean? They don't belong in a professional service agreement. And again, we want to make sure that you're not going to be responsible if anything comes up

in the course of design that elongates the design effort. That is not part of the risk that should ever be assumed in a professional contract.
DAN BUELOW: And again, all your professional liability insurance policies will include this clause where it's going to exclude contractual liability.
DOUG PALANDECH: That's all it is.
DAN BUELOW: You just bought this as you would say if you took on this exposure because in many situations, you may not have insurance for liquidated damages. OK, so after liquidated damages on this list, we have stop work authority. So a client will add to their contract that they want to give the design professional the authority to stop the work. I would say it's OK to reject the work. What's wrong with stopping the work?
DOUG PALANDECH: That is not a function of a design professional. And so here is what the exposure is going to be and it's going to actually tie in to our last discussion. There is something at the project that is cause for the design professional to be concerned about its progress.
And let me give you an anecdote. What if the general contractor has not provided you with enough definition regarding structural steel connection? You then have a concern that the building is not sound. So you go to the owner and say we're not authorized to stop work, that's not our prerogative, but we want to tell you our concern. The stop work directive comes from the owner.
If you have that stop work authority, then you're now responsible for the delay of the project, have you now bought unliquidated damage or a perhaps consequential loss. So it is not an architect function or design professional function to stop work. You confer with your owner. It is an owner prerogative, not a design professional prerogative.
DAN BUELOW: And we have seen claims, again, where the design professional may not have this wording in their contract, however, they have staff out on the site that stops the work. And then in comes OSHA and they determine that they've taken control of the job site and there can be some real problems with that. So again, there's a situation as we talked earlier about your actions can certainly take precedent over whatever is in your agreement.
DOUG PALANDECH: Correct, and again, that is what you want to avoid. Again, you don't have management of the job site. The performance is a contractor issue. Management and decision making is an owner issue.
DAN BUELOW: All right, so the last on the list is the biggie for us and the one we'll spend a little more time on here is around indemnities. And so arguably, you really don't need an indemnification agreement or clause in your agreement. But at the same time, we know these owner attorneys love to have these in there. In fact, they like them so much. They might have a half dozen or so of these clauses woven throughout the agreement.
The purpose of an indemnity agreement right is to transfer risk from one party to another. So if you've got a bunch of them in there, that's not a good thing, is it? And so talk to us a little bit about the indemnity agreement, and why this is such a problem for design firms and what they need to watch out for.
DOUG PALANDECH: Dan, when you started, I think, our first session, you talked about over lawyering and about why do people use or why do lawyers make things harder than they need to be. That was one of your first observations. I want the audience to consider what you just said.
What is the purpose of an indemnity? It's to take responsibility away from the owner who acquired it passively or by status and place it where it belongs. So the concept is a very simple one-- a third-party

has been injured. The owner is liable to that party by virtue of operation of law but that liability is vicarious. That liability is passive. The indemnity vehicle takes that liability and passes it to where it belongs. How simple.

However, what have we seen in practice? I have seen more butchering, four or five different indemnities in the same form, all of which are a little different, some of which try to pass on the liability of others who are fault, which you can't do because liability, it belongs to the party who caused it. So this has been a source of mischief in our industry literally for decades.

Should there be an indemnity? Like you said before, you don't need one. But if you do have an indemnity, make it simple. Make it simply say to the extent that the owner is subject to a third-party liability by virtue of our error, our fault, our failure to adhere to standard of care, we will assume that risk. It's fair, it's simple, and a judge is not going to have trouble understanding it.

This is the most overlawyered, the most confusing, and the most prolific area of contract formation. Great to have silence. But if you must have an indemnity, put it in English.

DAN BUELOW: Yeah, and this is one clause you really do want to get a legal opinion on to make sure that you're not taking on exposure that is really uninsurable. Let me read to you-- let's dissect a bad indemnity clause. And this happens to be a pretty short one because, again, we've seen these run pages. Here, let me read this to you. Consultant shall defend the company from any and all suits claims and demands seeking to recover damages on account of any injury, either bodily or personal, death or any property damage or destruction caused, or alleged to have been caused by the negligence or other breach of legal duty on the part of the consultant, even if such suit is groundless, false, or fraudulent. And so this again is a real co-owner drafted agreement.

And it's just chock-full in that little bit. Let's take this one at a time here. And one word I didn't see in here, which will often see and I want to talk to you about is arising out of versus to the extent caused by. I think it's very important language. But the defend obligation-- they want this owner-drafted agreements it seems they want in every one of these agreements. And so at the end of the day, we're telling you to strike this defend obligation because it's uninsurable. Well, talk to us a bit about, Doug, what's the problem with that?

DOUG PALANDECH: You're absolutely correct. The defense obligation is in fact uninsurable. It's liability assumed by contract. It's exactly what you've done.

And the distinction that you've drawn is excellent. Arising out of opens the door to everything. Caused by closes the door and ties you back default. That's why the indemnity obligation should be, we will indemnify you by virtue of what we did that was caused by our error, our negligence, our failure to perform the standard of care. That is critical. Because arising out of means it's an allegation. Well, now all of a sudden, you're on the hook for defending an allegation.

DAN BUELOW: And they'll often have in there, and not in this one example I gave you, but they'll often list all these different indemnities. They want you to identify all these different parties. Talk to us a little bit about that. I mean, it seems like at the end of the day, this is too broad, and don't I only want to deal with that party I'm having a-- agreeing to with this agreement?

DOUG PALANDECH: You're absolutely correct. And it's almost a common sense notion. You've made a deal with this party and this is the party with whom you're willing to extend that indemnity. So that is a narrow audience. You're exactly right. What about my cousin? What about my lender? What about my party's that I'm privy with on the contractor side?

Has nothing to do with the concept. So the indemnity obligation only recognizes the business partner who is exposed to a liability. You're willing to do that but you're not going to be indemnified in the world.
DAN BUELOW: And I would also add, you've got to be careful when they say, well, let's make this indemnity mutual. Well, that's not often a great deal for the design professional, is it?
DOUG PALANDECH: No, there's very rarely a situation where the design professional is going to be facing a direct liability by virtue of something that the owner did. It doesn't exist. It's a theoretical construct but not a real one.
DAN BUELOW: So Doug, that concludes our list of these dealmakers, dealbreakers, this being on the dealbreaker side. Maybe sum up just what your just thoughts are, tying this all together about these dealmakers, dealbreakers, and just the importance of the design professional to negotiate these clauses to make sure that they're not hanging out there, if you will.
And back to the earlier point, I just want to stress again, and we kept talking about this is, is using this as a vehicle as an opportunity to establish and manage expectations because that's where a lot of these claims are coming from. But these are some real clauses that can hang you up in a bad way if you sign them or if you don't modify them.
DOUG PALANDECH: Here's what I would say, Dan. There's a gut instinct all of us have. So in some of the client relationships I've had I've always said, if you see something that troubles you, trust your gut. Call your counsel. Call your carrier. Call Dan Buelow. Call Bob Stanton. Call Doug Palandech.
And looking at indemnity, I haven't seen this before and it doesn't sit right. You know what, you're right. Your instinct is correct. Don't blindly sign something where you see that seven sins those seven dealbreakers get counseled.
DAN BUELOW: All right, well, thanks, Doug. And that concludes our Willis A&E podcast-- Talk to Me About A&E. Be sure to listen to our next podcast that will be coming out soon here. I want to thank our special guests Mr. Doug Palandech for sharing his time and expertise with us. Thanks, Doug.
DOUG PALANDECH: Thank you very much, Dan. And I love you and you're from Minnesota,but go White Sox.
DAN BUELOW: All right, and thank you for joining us for our Willis A&E podcast-- Talk to Me About A&E.
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