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AE RESOURCES WEBINAR

Claims Against Design Professionals

Economic Loss / Independent Duty Doctrine Limitations of Liability

Presented by:
David K. Eckberg
skellengerbender
deckberg@skellengerbender.com
206-623-6501

Introduction

- **Economic Loss Doctrine (ELD)**
  - Defined
  - Current State of Law
- **Limitation of Liability (LOL)**
  - Concept Defined
  - Recent Developments
- **ELD and LOL Bibliographies**

Economic Loss Doctrine

- **What is ELD?**
  - A legal doctrine created by courts.
  - ELD reflects the difference between duties owed in common law versus those owed by contract.
  - The doctrine addresses a limited class of damages which are "purely economic" in nature.

Economic Loss Doctrine

- **What is ELD? (cont.)**
  - What are "purely economic" damages?
  - Damages where there is no injury to person or other property.
  - Instead, damages pertain only to the thing itself, the subject of the contract.
  - For example: lost profits, cost overruns, project delays, or repair cost for physical damage to a constructed project.

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Economic Loss Doctrine

- **What is ELD? (cont.)**
  - ELD originated in consumer product safety cases.
  - Later adapted to other discrete areas of law.
  - In modern era, ELD has evolved to be applied specifically to the construction industry.

Case Law

- Damages for delay, remediation, repair and diminution in value are economic losses. *East River Steamship Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 870 (1986) (economic losses include* lost profits, repair costs and decreased value).
- Tort law traditionally redressed injuries properly classified as physical harm.
- *Berschauer/Phillips Contr. Co. v. Seattle School Dist. No. 1, 124* Wn.2d 816, 881 P.2d 986 (1994) held that tort claim by contractor vs. design professional is barred when damages claimed are purely economic.
- *Griffith v. Centex Real Estate Corp., 93 Wn. App. 202, (1998) held* that tort claims are not available to any party, including owners in contractual privity with the design professional, when the only loss sustained is economic in nature.

Case Law

- Exception to ELD: when the plaintiff has suffered economic damage caused by a "sudden and dangerous" event as described in *Touchet Valley Grain Growers, Inc. v. Opp & Seibold Constr., Inc. 119 Wn.2d 334 (1992)*
- The *Touchet court held that in cases in which the harm arises out of* a "sudden and dangerous" or "calamitous" event, a plaintiff will be allowed to seek damages in tort for damages otherwise defined as economic losses.
- *Touchet rationale: "sudden and dangerous" events are most likely to* result in bodily injury and property damage, and that the availability of a tort remedy, even when the plaintiff has only suffered economic losses, provides an important incentive for defendants to exercise reasonable care whenever there is potential for this kind of damage.

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Justification

- **Why?** Shouldn't design professionals be accountable to whomever they may injure?
- **Policy rationale:** The economic expectations of sophisticated parties to construction contracts are presumed to represent a negotiated allocation of risk commensurate with the risk/reward business calculation each party has performed and agreed to.

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Justification

The Court in *Berschauer put it well:*

"We hold parties to their contracts. If tort and contract remedies were allowed to overlap, certainty and predictability in allocating risk would decrease and impede future business activity. The construction industry in particular would suffer, for it is in this industry that we see most clearly the importance of the precise allocation of risk as secured by contract. The fees charged by architects, engineers… and so on are founded on their expected liability exposure as bargained and provided for in the contract."

Berschauer (cont.):

"A bright line distinction between the remedies offered in contract and tort with respect to economic damages also encourages parties to negotiate toward the risk distribution that is desired or customary. We preserve the incentive to adequately self-protect during the bargaining process…If we held to the contrary, a party could bring a cause of action in tort to recover benefits they were unable to obtain in contractual negotiations."

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Introduction of the Independent Duty Concept

- ***Eastwood v. Horse Harbor Foundation, Inc., et al (2010)***
  – Claim for statutory "waste", gross negligence and breach of lease.
- ***Affiliated FM Insurance Co. v. LTK Consulting Services, Inc. (2010)***
  – Claim for negligence through subrogee insurance company.

Independent Duty

- ***Eastwood:***
  - Leased horse ranch allowed to fall into substantial disrepair.
  - Owner sued for damages – repair to the ranch, including claim
  - for statutory "waste", as well as breach of lease.
  - Court of Appeals, on its own, raised ELD to dismiss tort of "waste".

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Independent Duty

- ***Affliated FM:***
  - City hired vendor to operate monorail.
  - Engineer (LTK) hired by City to design improvements to the monorail.
  - Fire on monorail resulted in near catastrophe, but no injuries and only damage to monorail car itself.
  - Lawsuit in Federal court – question "certified" to WA Supreme Court, re effect of ELD.

Independent

- In ***Eastwood****, two of the plurality opinions endorsed a* fundamental change for Washington: abandon the analysis of ELD in favor of analysis called the "independent duty rule" (IDR). These opinions:
  - Reject ELD analysis, which they argue is rooted in whether the character of damages is purely economic or not.
  - On a policy basis, make vehement arguments against limiting claims to purely contractual remedies.

Independent Duty

- The emphasis of these two plurality opinions in *Eastwood is* instead about the perceived "duty" owed by a party who is alleged to be at fault for some injury.
- Per IDR, courts are supposed to consider whether "the duty sought to be enforced is a duty essentially assumed by agreement or a duty imposed by law." (J. Chambers)

Other States

- Over 25 different states have some form of protection for claims against design professionals based on economic loss doctrine
- At least 10 states do not allow ELD to bar claims against design professionals
  - Florida
  - Georgia

Recommendations

- It important to review insurance policies with your carrier to ensure that design professionals understand effect and reach of policies for new potential claims. *A discussion with your carrier about these changes is advised.*
- Consideration for seeking "additional insured" status on owners' CGL policies is warranted. This may be a critical negotiation for new projects – discussing with your clients your own new exposure risk.

Recommendations

- Pay attention to builder's risk policies – per *Affiliated FM,* subrogated insurers may prosecute claims against design professionals.
- Pay attention to indemnity clauses and to limitation of liability clauses.
- Strict attention to QA/QC practices will be the best prevention of claims and provide the best defense for claims when they occur.
- Include clauses addressing economic loss

Limitation of Liability Clauses in Design Professional Contracts

Limitation of Liability Defined

- A contractual agreement between parties to limit the monetary liability of one party to the other
- It's really a limitation on remedies, like a waiver of consequential damages

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Typical LoL Clause

- Engineer's total liability to the Client for any claim, loss, expense, or damage arising out Engineer's services or this agreement, shall not exceed $50,000, or the amount of Engineer's fee, whichever is greater.

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Recent Challenges to LOL Clauses

- The LoL Clause violates state anti-indemnity statutes
- The LoL Clause violates state licensing statutes
- The LoL Clause did not expressly cover claims against individual engineers

Anti-Indemnity Statutes

Typical Anti-Indemnity Statute

- Any clause in a contract collateral to construction that purports to indemnify a party from liability for claims of bodily injury or property damage resulting from the sole negligence of that party is against the public policy of this state and is void.

Heron Ridge Case

Partnership wanted to build luxury homes on this steep slope overlooking Puget Sound.

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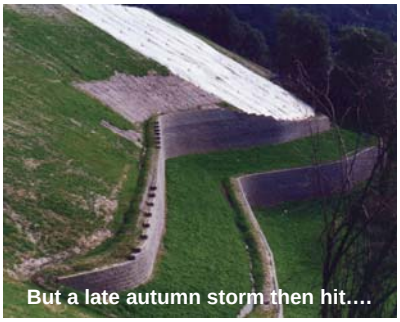
Engineer performs soils studies to determine slide risks. No deep-seated slide zone detected.



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Engineer's contract had a Limitation of Liability Clause capping exposure to Partnership at $50,000.

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Partnership argued that the LoL clause was not enforceable under Washington anti-indemnity statute

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Court Ruling

- **Anti-Indemnity statute prohibits "exculpatory" clauses – provisions shifting ALL liability to another party.**
- **LoL clauses are not exculpatory clauses because they do not preclude recovery – they merely limit what client can recover (i.e., a "limitation of remedy").**

North Carolina and Arizona

- ***Blaylock Grading Company, LLP v. Smith*, 658 S.E.2d 680 (N.C. App. 2008) (limitation of liability clause is not an indemnity clause)**
- ***1800 Ocotillo, LLC v. WLB Group, Inc., 196* P.3d 222, 225 (Ariz. 2008) (limitation of liability clause does not completely insulate surveyor from liability, as would an indemnity provision)**

Georgia

- *Lanier at McEver, L.P. v. Planners and Engineers Collaborative, Inc., 663* S.E.2d 240 (Ga. 2008):
  - **Supreme Court ruled that the LoL Clause violated Georgia's antiindemnity statute**

Why?

The LoL Clause in Lanier

Client agrees … to limit the liability of Engineer to Client and to all construction contractors and subcontractors on the project or any third parties for any and all claims, losses, costs, damages of any
nature whatsoever… to Engineer's fee.

Lanier Holding Limited

- **Two Georgia appeals courts have held that *Lanier only bars limitation of liability clauses* when they seek to limit liability to third parties**
- **Precision Planning, Inc. v. Richmark Communities, 679 S.E.2d 43 (Ga. App. 2009)**
- **RSN Properties, Inc. v. Engineering Consulting Services, Ltd., 686 S.E.2d 853 (Ga. App. 2009)**

Nebraska and Alaska

- ***Omaha Cold Storage Terminals, Inc. v. The Hartford Insurance Co., 2006 WL* 695456 (D. Neb Mar. 17, 2006) (unpublished) (LoL not valid)**
- ***City of Dillingham v. CH2M Hill Northwest, Inc. 873 P.2d 1271 (Alaska* 1994) (same holding)**

Lessons

When indemnification concepts are combined with LoLs, courts confuse the two.

Limiting liability to third parties does not work.

$$ amount must be reasonable

Extension of Liability Limit to Individual Engineers

Mallard Cove Base

Challenging site:

Moderate slope down to large urban lake
Abundant evidence of past earth movement
Concerned, well-heeled houseboat community down-slope

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"Client expressly agrees that … its maximum aggregate recovery for claims against Engineering Firm concerning Engineering Firm's professional services, including negligence or breach of this Agreement shall be $50,000."

LoL Clause Held Legally Enforceable BUT

The court ruled that the LOL clause did NOT limit liability of the individual engineers.

Why?

Because the clause only limited the liability Of the “Engineering Firm” – and not its employees.

Professional Licensing Statutes and Individual Liability

Florida

- ***Gerhardt M. Witt v. La Gorce Country Club, Inc., (Fla. Ct. App.*** **June 10, 2009)**

Key Facts

- Country Club retained Witt's engineering firm, GMWA, to provide consulting during construction of reverse osmosis water treatment system for the golf course irrigation system.
- System did not work – and club sued both Witt individually and his firm for $4 million.
- Contract with the engineering firm had LoL clause

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LoL Clause in Engineering Contract

Client agrees … to limit the liability of GMWA to the total dollar amount of the approved scope of work for any and all claims so that the total aggregate liability of GMWA shall not exceed the total dollar amount of the approved scope of work or GMWA's total fee for services rendered on this project, whichever is greater.

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Court's Ruling

- The contract did not limit Mr. Witt's liability – only the corporation's liability.
- Limitation of liability clauses are unenforceable as to individual professionals
- Licensing statute: "The fact that a licensed Court's Ruling professional geologist practices through a corporation or partnership shall not relieve the registrant from personal liability for negligence,…."

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New Virginia Licensing Statute

- **Va. Code §54.1-411 (effective March 9, 2010)**
- **Stricken: "No such organization shall limit the liability of any licensee … for damages arising from his acts or limit such corporation… from liability for acts of its employees."**
- **Inserted: "No individual practicing architecture, engineering, land surveying, landscape architecture … shall be relieved of responsibility that may exist for services performed by reason of his employment …."**

Among the States

Only three states clearly unenforceable:

- Alaska
- Florida
- Georgia

Remaining states have some support for Enforcement of LoLs

Lessons

If the LoL does not expressly cover claims against employees, it may be of limited practical use.

Licensing laws may bar individual registrants from limiting their liability

LoL Drafting Recommendations

LoL Drafting Recommendations

- Check your state's anti-indemnity laws
- Call it a "Limitation of Remedies" or
- Call it "Allocation of Risks"
- Keep the LoL clause separate from the indemnification clause
- Have client acknowledge that LoL clause is <u>not</u> exculpatory clause

LoL Drafting Recommendations

- Cover all your employees
- Check your state's licensing laws to make sure it's permissible
- Cover all possible claims that client can assert – whether negligence or breach of contract
- Do not try to limit liability to third parties
- Provide a mechanism in agreement for the client to purchase an increase in the LoL

Questions & Answers

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