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Developments impacting claims involving design professionals, architects & engineers

Our Professional Liability team in San Francisco have compiled a summary of trends, issues and developments impacting claims involving design professionals, architects and engineers. The team regularly advises on claims around the world involving US-based design firms, and have set out below some of the global factors, industry trends, coverage issues, dispute resolution trends and developing theories of liability in this area.

Global factors impacting claims involving design professionals, architects & engineers

- Falling commodity prices on resource projects: Recent decreases in global commodity and energy prices have rendered projects focused on the extraction of these materials less profitable. We see large claims in which owners are asserting claims against engineering firms that designed these projects to recoup their investment.
- Strength of United States Dollar: For policies denominated in United States Dollars in which the defense fees and costs and indemnity payments are paid in other currencies, the strength of the United States Dollar is a boon to Underwriters. If the US dollar remains strong and projects for US-based firms are in other foreign jurisdictions, we expect this trend to continue.
- Uncertainty for infrastructure spending: As momentum in China slows, the credit and infrastructure-spending-fed growth may prove unsustainable. Since the United States Presidential election in November, government is attempting to reduce regulations on energy and authorize carbon-intensive projects (e.g., approving Keystone XL). This political change will impact spending on infrastructure projects.

Industry trends

- Increased M&A activity: Over the past 18-24 months, we have continued to see consolidation in the sector. AECOM's $6-billion acquisition of URS was completed in October 2014, further solidifying AECOM's status as the world's largest engineering firm. Merger activity can create unique risks. For example, in March 2015, URS lost out on a $63 million contract post-merger with AECOM because of a conflict in their roles on the same project. In May 2015, CH2 (a leader in infrastructure and natural resource projects with annual gross revenues of $5.5 billion) agreed to partner with an affiliate of Apollo Global Management, LLC (an alternative-investment manager) in exchange for a $300 million investment. August 2015, WSP Global enhanced its presence in Canada by acquiring MMM Group Limited for an aggregate purchase price of $425 million. Another example is Thornton Tomasetti's, which already was the third largest architectural/engineering firm, merger with Weidlinger in September 2015 to create a combined firm with projected revenue of $240 million.
- Locations of largest projects/claims: As noted above, many of the largest projects/claims are in jurisdictions other than the United States, which tracks expectations based on the location of

infrastructure spending. Based on current spending trends, we expect that the largest claims will be in Australia, Brazil, Canada, and Qatar.

- Changing project-delivery methods: Project-delivery methods continue to evolve beyond the traditional "design-bid-build." We see an increased use of alternative project-delivery methods, including public-private partnerships (e.g., a toll road), design-build (single entity responsible for delivering the project, design and construction), design-build-finance (single entity responsible for design, construction, and financing), construction manager at risk (builder is hired before the design phase is complete and engages a separately-hired design firm to provide input on construction), fast-track (design and construction occur simultaneously), and guaranteed-maximum price contracts.

Insurance-coverage issues

- "Soft Market" perception? New entrants and increased competition in the Architects & Engineers insurance market may lead to further bargaining for more favorable terms. In speaking with general counsel at large architecture and engineering firms, there is a perception that the market is "soft" and that firms are looking at other players within the market— insurers that may have indicated a willingness to accept lower premiums (often as a way to break into the market) while at the same time, offering to broaden coverage (see below for further detail).
- Addition of favorable policy provisions: Insureds have been successful in negotiating "Forgiveness of Charges," "Mitigation of Loss," and "Rectification" provisions, which provide supplemental coverage that extends to the insured's own costs, not just those paid to defense counsel and indemnity payments. Insureds are increasingly resolving matters through mitigation efforts and waiver of fees to avoid a formal claim.
- New case law in related claims: The issue of whether two claims are "related" for purposes of determining whether one or multiple limits/policies apply continues to be one of the most significant coverage issues in the A/E professional liability area. Because projects—especially large ones spanning several years—potentially give rise to claims and/or circumstances that could implicate a wide range of issues and disciplines, insurers should be aware of the criteria under which courts have evaluated whether claims are related. Depending on the jurisdiction, the criteria and test for determining coverage could be very different.

  For example, in California, courts look to whether the claims are causally or logically related, and this broad standard recently has been endorsed by the unpublished Court of Appeal decision, *Flowers v. Camico Mutual Insurance Company*, 2013 WL 2571271 (Cal.App. 1 Dist., 2013). The *Flowers* court held that multiple instances of misconduct serving the same client, and based on a retained services agreement, is enough for one claim under a policy even if arising from advice covering various features of the professional relationship.

  By contrast, New York courts have analyzed various, factually-driven factors. *Dormitory Authority v. Continental Casualty Company* (DASNY) 756 F.3d 166 (2d Cir. NY 2014) recently held that two design-related issues—a “steel girt tolerance issue” and an "ice control issue"—were not related, resulting in coverage under two policies. The court held that the two issues arise from two unrelated wrongful acts. "One has to do with the structural integrity of the building; the other, with its aesthetic design." (Id. at 170.) The court went on to find that the two issues involved different design systems, "each with its own distinct engineering considerations," "different design teams," and "separate sets of contractors." (Id.) The court further found that "the problems ultimately manifested themselves at different times and resulted in different types of damage." (Id.) Finally, the court considered that "the solutions to each issue were wholly different." (Id.) The court held "That both may have resulted from the generalized negligence of the Architects is an insufficient degree of relatedness." (Id.)

- Hybrid actions including insured's fee recovery efforts: When an insured pursues a client to recover its fees, and there is no cross-action for negligence, the costs to prosecute the insured's fee claim are not covered damages or fees under professional liability policies. The coverage question becomes more challenging when the insured's fee recovery claim also involves a claim against the insured for professional negligence. If an insurer is presented with such a hybrid action, best practice is for the insurer to request that the insured and outside counsel separately track expenses incurred for fee recovery as compared to expenses incurred in defense of the professional negligence claim asserted against the insured.

Trends in dispute resolution

- Summary adjudication in key markets: Summary adjudication continues to be difficult to obtain, particularly in the context of arbitration. Defense counsel retained in one of our matters recently explained that, practically speaking, the standard of review for a dispositive motion before an arbitration panel likely is higher than the standard of review before most trial courts. Arbitration panels, obviously, do not want to have their decisions reversed by a court of law. The need for arbitration panels to avoid reversals likely is amplified by the fact that a court's reversal of an arbitrator's decision possibly will impact the arbitrator's ability to be selected by other parties as an arbitrator for future panels. The resulting practical effect of summary adjudication in the context of alternative dispute resolution remains incredibly difficult to obtain. We are monitoring the impact of the Supreme Court of Canada's 2014 holding in *Hyrniak v. Mauldin*, [2014] 1 SCR 87, 2014 SCC 7 (CanLII). The *Hyrniak* decision granted trial courts more latitude to develop procedures to resolve disputes before trial through motions for summary adjudication.
- Arbitration centers around the world: As the use of arbitration centers around the world becomes more prevalent, we anticipate that we likely will see an increase of parties using 28 U.S.C. § 1782 to obtain discovery for the international arbitration within the United States. 28 U.S.C. § 1782 is the statute which allows a United States district court to order a person (or legal entity) to provide testimony or produce documents for use in a proceeding for a foreign or international tribunal.

  Currently, District courts and United States circuit courts are divided as to whether 28 U.S.C. § 1782 can be used to compel testimony or production in a private commercial arbitration as it is unclear whether a private arbitration constitutes a "tribunal." Some factors courts have considered in determining whether a private commercial arbitration panel is a "tribunal" include: (1) whether the panel acts as a first-instance decision maker; (2) whether the panel permits the gathering and submission of evidence; (3) whether the panel resolves the dispute; (4) whether the panel issues a binding order; and (5) whether the panel's order is subject to judicial review. See *Consorcio Ecuatoriano de Telecomunicacaiones S.A. v. JAS Forwarding (USA), Inc.*, 747 F.3d 1262, 1270 n. 4 (11th Cir. 2014) citing *Intel Corp. v. Advanced Micro Devices, Inc.*, 542 U.S. 241 (2004).

Unique cyber risks for design professionals

- Cyber risks represent an emerging area of risk for the construction industry which we believe is underpublicized. One trade publication (Engineering News-Record) reported an unnamed source claiming that Chinese hackers had accessed the computers of an Australian prime contractor and stolen floor plans, communications-cable layouts, server locations, and security system designs for the Australian Secret Intelligence Organization's (ASIO) new headquarters, which was still under construction. Certain best practices in the industry are costly and difficult to implement. In the ASIO example, sanitized government-issued

computers, a cellphone ban on the construction site, and hard copy plans (which were not allowed to leave the site) did not prevent the breach. We view higher risk for sensitive projects like government projects, energy production and distribution. But even for less sensitive projects, all entities (including design professionals) in possession of project documents may be seen as weak access points. There remains a risk that design professionals, who are not experts in cyber security, are not adequately prepared to defend against cyberattacks. United States officials are taking steps to revise compliance and reporting standards in the construction industry.

Developing theories of liability

- Intentional/negligent misrepresentation: In the past year we have seen two very significant claims premised on allegations that the insured intentionally or negligently made misrepresentations in order to induce the claimant to hire the insured for a project. We also have seen allegations of string-along-fraud in which it is alleged that the insured continued making misrepresentations throughout the course of a project in order to prevent the project owner from terminating the insured's involvement in the project or even terminating the project altogether. An obvious implication concerning allegations of intentional or negligent misrepresentations is the resulting interplay with policy exclusions for fraud and intentional acts (which must be evaluated on a case-by-case basis).
- Misleading or deceptive conduct under Australia's Competition and Consumer Act: Australia's Competition and Consumer Act of 2010 (previously known as the Trade Practices Act) prohibits conduct by corporations in trade or commerce that is misleading or deceptive or likely to mislead or deceive. With respect to predictions about future matters, such predictions are determined to be misleading or deceptive if they are not based upon reasonable grounds. There is no requirement under the Act that the conduct at issue be intentionally misleading. Therefore, as long as a claimant relied on the misleading or deceptive conduct, a respondent may be found liable under the Act even if they believe the representations to be true. This generally makes it difficult to assert a viable coverage defense based on any intentional acts exclusion in the insured's policy. Significantly, disclaimers and contractual protections (such as limitation-of-liability caps) are not effective under the Act.
- Green techniques/standards: Architects and engineers continue to implement new technology in their projects (e.g., green technology, LEED certification). With new and evolving technology, comes a heightened risk for potential exposure as techniques are untested and project goals, such as efficiency/energy standards and life-cycle cost savings, if not realized, become potential areas of exposure.
- Crawford and CH2M Hill: In favorable news, the negative impacts of the decisions in *Crawford v. Weather Shield Mfg., Inc.* (2008) 44 Cal.4th 541 and *UDC-Universal Development, L.P. v. CH2M Hill* (2010) 181 Cal.App.4th 10 appear to be diminishing. *Crawford* holds that unless an agreement expressly provides otherwise, upon receipt of tender, a contractual indemnitor has an immediate duty to assume the indemnitee's active defense against claims encompassed by the indemnity provision. In our discussions with various design professionals, *Crawford* continues to be applied broadly by California courts. In *CH2MHill*, the court held that a design professional's defense obligation was not conditioned on a determination of its negligence but arose simply when any claim "implicated" the design professional's scope of services on the project. Questions have arisen whether these "contractually-assumed liabilities," including a contractual duty to defend in the absence of fault, would be covered under commercial or professional liability policies.

Overall, we are seeing fewer claims asserted against design professionals under this case law. We believe that the effects have diminished, in part, as the relevant contracts increasingly were executed after the dates of these court decisions. We frequently see tenders and demands for indemnification largely ignored by design professionals.

- Recent case barring equitable indemnity claim against design professional where only economic damages are involved: A California court of appeal recently held that the economic loss doctrine bars cross-claims for equitable indemnity against a design professional. In *State Ready Mix, Inc. v. Moffatt & Nichol*, 232 Cal.App. 4th 1227 (2015), a pier construction contractor brought an action against a concrete subcontractor for breach of contract and breach of warranty after the concrete failed to meet the project owner's compressive strength requirements. The concrete subcontractor brought a cross-claim for equitable indemnity and contribution against a civil engineer. The court held that the engineer did not owe the concrete subcontractor a duty of care and that the engineer did not have a continuing duty to ensure that the subcontractor followed the concrete mix specifications. Thus, the subcontractor could not seek equitable indemnity based on the theory that the engineer negligently performed its contract with the project manager; the engineer has no contract with the subcontractor or the general contractor. Moreover, the concrete did not injure any person or damage any property. Thus, under California law, where the damages are purely economic, an equitable indemnity claim against a design professional appears to be barred.

Largest/most significant claims

- In our experience, the largest claims involve the following types of projects: jail/prisons, condominiums, roadways (including traffic forecasting), mines, refineries, stadiums/arenas, and railways. Additionally, catastrophic-injury cases involving multiple plaintiffs result in the largest exposures to professional-liability insurers.

Lingering impact of global financial crisis

- The financial crisis of 2007-08 continues to reverberate in claims. We actively are working on many matters that arose from design services that originated during the global financial crisis (GFC) and the immediate aftermath. Even when an insured survived the GFC, claimants continue to look to the remaining entities to recover their losses and may tailor their claims to target these entities. In the years following the GFC, aggressive bidding and value-engineering featured prominently in projects with reduced profit margins for the entities involved. We anticipate that the effect of the financial crisis will diminish as the global construction climate continues to improve.

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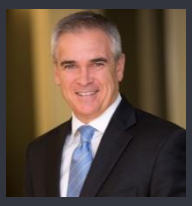

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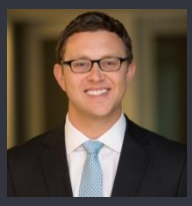

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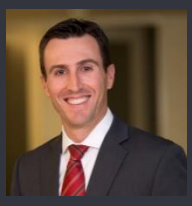

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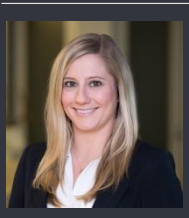

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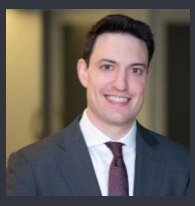

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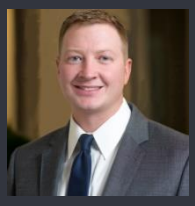

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