Direct Damages, Consequential Damages & Liquidated Damages: A Brief Review
by Robert Gavin

We often are asked “What is the difference between direct and consequential damages?,” “What are liquidated damages,” “Is this covered under our Professional Liability policy?”

Let’s use a claim example to demonstrate: a relatively simple project; a manufacturing facility for small garden implements such as small tractors and tillers. The manufacturer is a small, family owned business that has teamed up with a local university to develop, manufacture, and sell more fuel efficient garden equipment that also produce much less harmful emissions. They believe there would be great demand for these eco-friendly implements. ACME A&E Associates are very happy to design a new, large manufacturing facility. Due to some internal staffing issues and some issues with the building department, ACME is a bit late with their construction documents but the facility is designed and built. Tractors and tillers are produced, sales are better than expected and everyone is happy…. until the day heavy snows lead to a catastrophic roof collapse that flattens the plant. Investigation reveals poor design is the sole cause of the collapse. The manufacturer client makes a claim for substantial damages.

It’s fairly easy to determine the direct damages the manufacturer sustained: the structure needed to be demolished and replaced, all the manufacturing equipment needs to be replaced; conveyor systems, fork lifts, parts and supplies need to be replaced. There was little inside the building that wasn’t left damaged or destroyed. Those damages are fairly easy to quantify and calculate and most people can understand those damages directly related to the design defect.

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But let’s look at some other damages claimed by the manufacturer. The manufacturer client makes a claim for liquidated damages. ACME was aware of the clause that called for $1,000 per day in liquidated damages against ACME for every day they are late in providing final construction drawings. They downplayed that risk when negotiating the contract, believing it would never be an issue. But it did create an additional $27,000 claim. Much to the chagrin of ACME, their insurance carrier advises them the policy specifically exclude coverage for liquidated damage claims as they are penalties.

While liquidated damage clauses are quite common in construction agreements, we rarely see them in professional service agreements. In the event such clauses are proposed by your client they should be rejected as there are far too many issues outside of your control that may impact your ability to meet a deadline. The lawsuit also alleged “consequential damages,” which are a “consequence” of the damage. Eco-friendly garden implements were a new concept in the market place and sales had been very good. Now other competitors who had witnessed their success were able to break into the market with their own eco-friendly implements. The initial competitive advantage the manufacturer had has now been lost. The manufacturer claims it has lost a good deal of business since its retail customers have turned to competitors. It also claims it had several lucrative deals in the works with large warehouse clubs that have now gone to competitors. It claims their reputation as a reliable garden implement manufacturer/supplier has been severely damaged in the marketplace.

These other damages claimed by the manufacturer are hard to quantify with any accuracy. How does one put a dollar value on lost reputation or foregone business deals? These types of damages are a more indirect nature rather than direct damages like destroyed equipment discussed earlier.

Consequential damages are a big concern because they include items that one might not ordinarily contemplate when providing design services. Furthermore they are often highly speculative and can give rise to claims for dollar amounts far beyond what a design professional ever imagined.

These types of claims do happen on a regular basis and why we recommend a waiver of consequential damages clauses such as:

Notwithstanding any provision to the contrary, and to the fullest extent permitted by law, neither the Client nor the Design Professional shall be liable to the other for any incidental, indirect or consequential damages arising out of or connected in any way to the Project or this Agreement. This mutual waiver of consequential damages shall include, but not be limited to, loss of use, loss of profit, loss of business or income or any other consequential damages that either party may have incurred from any cause of action whatsoever.

We strongly encourage you to include such a clause in all of your standard agreements with your clients and as always we welcome your feedback or any questions you may have.
Welcome to Oswald Tim!

Oswald Companies is pleased to announce the appointment of Tim Walsh to the position of Director of Construction Practice in the Property & Casualty Division.

Tim joins Oswald with more than 28 years of industry experience, most recently serving as Executive Vice President, Managing National Director of Project Solutions at Aon. Before that, Tim spent five years working at Travelers. Because of the many changes to the design and construction industry, Tim will be a valuable resource to our clients who are involved or want to be involved in construction.

Welcome to Oswald Tim!
Are you a Risk Terminator?

20 Questions to Test your Liability IQ

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

So, how good of a risk manager are you? Are you a risk terminator or a risk inciter? Here are 20 true/false questions you can use to measure your Risk Management IQ:

The Questions

1. When including a mediation clause in your client contract, it is nearly always best for you and your client to mutually agree upon a specific mediator before the contract is signed.  T   F

2. A specific-job-excess professional liability policy can be a good choice when entering into a joint venture with another design firm where the client demands high limits.  T   F

3. Adding your client as a named insured on your professional liability policy is an inexpensive way to increase protection for your client.  T   F

4. In light of the passage of the Frank-Dodd Act and the potential liability of being sued for providing services as a municipal advisor, it’s a good idea to increase your limits on your professional liability policy.  T   F

5. Most PL insurance companies have changed their tune and now advise against including "prevailing party" clauses (losing party pays both sides' legal fees) in client contracts.  T   F

6. At the first sign that a contractor is not complying with your design intent, you should immediately ask him or her to stop work on the project and bring the issue to the client’s attention.  T   F

7. A split-limits PL policy is an affordable way for two design firms to share the same insurance policy limits.  T   F

8. Broad-form indemnities in a client’s contract should be avoided at all costs.  T   F
9. It is currently illegal for architects and engineers to use drones (unmanned aircraft) for commercial purposes. T F

10. Cyber liability insurance not only covers damages to third parties due to compromised identity or financial information, privacy leaks, and transmission of computer viruses, it can help cover the costs for public relations work incurred to help restore your reputation. T F

11. When working overseas in countries like France and Egypt that impose decennial liability, it is crucial to have a clause in your client contract that clearly states you are not liable for this exposure. T F

12. Poor communications is the #1 nontechnical cause of claims. T F

13. Multiple prime projects create a hornet's nest of liabilities and should be avoided at all costs. T F

14. If your professional liability insurance policy lapsed in 2013, but you purchased a new policy in 2015, a new claim against design services you provided in 2012 may not be covered by your new policy. T F

15. Always wait until a formal claim is filed against your firm before reporting a problem to your insurance company. Otherwise, your premiums may go up. T F

16. Employee Practice Liability Insurance only covers claims against your firm by current and former employees. T F

17. It is advisable to have a contract clause stating you do not owe a fiduciary duty to your client. T F

18. One of the best ways to reduce the risk of a fast-track project is to get your client to lower its expectations. T F

19. Threatening to sue a client for late payment of services is one of the most effective ways to ensure you get paid on time in the future. T F

20. When drafting your scope of services, you should only list those specific services you have agreed to perform for a fee. T F
The Answers

1. **False.** It is generally recommended that the mediator be selected only after a dispute arises. This allows you to select a mediator that has expertise in the subject of the specific dispute at hand.

2. **True.** With specific-job excess coverage, each party to the joint venture could maintain its current limits on their practice PL policy while purchasing an endorsement that provides a separate higher limit to cover the joint venture project.

3. **False.** If your client were added as an additional insured on your PL policy it could jeopardize their coverage since, in the event it filed a claim, it would be suing itself.

4. **False.** The 2013 ACEC Survey of Carriers indicated nearly all PL carriers have no intention of covering municipal advisory services as defined by Dodd-Frank under their policies.

5. **True.** Since you would not normally be liable for another party's legal expenses in absence of a prevailing party contract clause, those costs might not be covered unless specifically stipulated in your policy.

6. **False.** In no instance should a project representative demand a contractor to stop work unless it is an issue of imminent danger to the safety or lives of people on the site. A stop work order can be interpreted as taking control of construction means and methods and greatly expand the design firm's liabilities.

7. **False.** With a split-limits policy, a design firm has an annual policy limit for a single claim and a higher aggregate limit that covers all claims in the policy year. For instance you may have a $2 million annual limit per claim, but an annual aggregate limit of $5 million.

8. **True.** Broad-form indemnities can make a design firm responsible for almost any problem that befalls its client during the project, whether or not the designer was negligent.

9. **False.** As of the writing of this test, businesses are generally prohibited from using drones for commercial purposes. However, under Section 333 of the FAA Modernization and Reform Act of 2012, architects, engineers, and others can file for an exemption from current federal regulations on a case-by-case basis and, if granted the exemption, use drones for commercial purposes.

10. **True.** While cyber liability policies differ from insurer to insurer, many do cover public relations expenses incurred to mitigate negative publicity.
11. **False.** You can’t eliminate decennial liability through contracts with either the owner or your subconsultants. If you perform work in a country where decennial liability is in effect, you are exposed to this form of strict, joint-and-several liability.

12. **True.** A study of more than 17,000 closed claims published by insurer XL Catlin showed that communication failures were a contributing factor in nearly a third of all claims, making it #1 on the list.

13. **False.** While it is true that multi-prime projects can cause overlapping responsibilities and liabilities if poorly managed, they can be a viable delivery method for complex or multi-stage projects. This is especially true when the client has extensive experience managing multiple primes and/or contractors or hires a professional project coordinator.

14. **True.** To keep your retroactive date in force and have prior acts coverage, you normally must maintain continuous coverage. If you go uninsured for a period of time and then get a new PL policy, you could lose coverage for your acts prior to the new policy’s inception date. Be aware, however, that you may be able to purchase prior acts or "tail" coverage.

15. **False.** Most insurance companies do not consider an incident report as a claim unless a formal demand for money or services is made. Smart insurance carriers understand it is in their best interest to encourage early reporting and don't "ding" you for reporting an incident that never becomes a claim.

16. **False.** EPLI provides protection against claims made by current employees, former employees, and potential employees. It covers claims based on discrimination, wrongful termination, sexual harassment, and other employment-related allegations.

17. **True.** Have your attorney draft language in your contract that confirms neither you nor any of your subconsultants have offered any fiduciary service to the client and no fiduciary responsibility shall be owed to the client as a consequence of entering into an agreement to provide design services.

18. **True.** Educate your clients on the risks of fast-tracking a project and bring expectations in line with reality. There should be an understanding that some changes, delays, modifications, reconstructions and extra costs are the norm, not the exception, with fast-track.

19. **False.** Sue a client for fees and you’ll likely face a countersuit from your client for errors or omissions in your services, whether warranted or not. A better way to ensure timely payment for your services is contract language that allows you to suspend your services after a specified period of non-payment for undisputed fees.
20. **False.** In addition to listing the services you will perform for an agreed to fee, it is generally recom-
mended that you list additional services that you can perform for an additional fee, recommended services 
you will not perform per the client's refusal and required design services that will be performed by a third 
party, such as a subconsultant.

So, how did you do? If you missed three or fewer questions, consider yourself a risk terminator. If you 
missed more than five, you might need some refresher work on professional liability issues. Ask us about 
the in-person and online education opportunities available in the area of risk and practice management.

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**Can We Be of Assistance?**

*We may be able to help you by providing referrals to consultants, and by providing guidance relative to 
insurance issues, and even to certain preventives, from construction observation through the development 
and application of sound human resources management policies and procedures. Please call on us for 
assistance. We’re a member of the Professional Liability Agents Network (PLAN). We’re here to help.*

*Contact Paula Selvaggio with questions: 216.839.2801 or Toll Free: 800.367.8787*