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Errors and Omissions Claims in Construction Projects – Understanding The Terms And Language You Can Use To Protect Your Clients

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Errors and Omissions Damage Claims

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Errors and omissions claims are specifically targeted against the designer of the project. In general, such a claim is based on the premise that the designer (architect or engineer, or as will be called here, the A/E) failed to fulfill its contractual requirements to the owner to provide a design that complies with the expectations of the owner, is constructible, biddable, and meets all appropriate standards and codes.

First let's discuss what are errors and omissions. It would seem to be a straight forward question but in practice some owners interpret the concepts differently. An error is an element incorporated into the design which does not serve the function it's intended to perform. A steel beam that is not adequate to support the anticipated weight of a rooftop equipment item or a drainage line too small to handle the volume of water are examples of possible errors. An omission is an element that is necessary for the function of the project but was not included in the project scope of work. Neglecting to include the support beam for a rooftop equipment item or failing to include the drainage pipe are examples of possible omission. Errors are generally considered to be a more serious deficiency in the design.

Some owners interpret the definition of an error to be any design element which is not correctly specified in the documents at the time of contract award. Others allow the A/E a second look allowing the A/E to correct errors and convert them to omissions as long as they are found prior to the installation of the work. By their definition, work has to be installed and then removed to be classified an error. Finding the problem before the work is installed is essentially considered omitting to do it right the first time. While this may seem to be a stretch of logic, it does allow recognition of the A/E for correcting the problem and mitigating the expense, if any, before it was installed.

Perhaps understanding what is an error or omission is easier by understanding what they are not. They are not changes required to accommodate field or changed conditions, owner requested additions (not necessary to achieve the function of the project), value engineering cost reduction changes, or changes that result in an improvement to the design or betterment to the owner as long as the as designed element would have provided the intended function. An exception to the above, however, might be a field condition case where a prudent engineer properly discharging his responsibilities should have discovered the condition. The existence of subsurface conditions or obstructions that could have been readily discovered through a reasonable program of investigation or through examination of readily available drawings may be a failure on the part of the A/E to meet the standard of care that the owner has a right to expect and the A/E an obligation to deliver. There are no clear cut answers to such issues. If on a given project the A/E failed to perform such reasonable investigation the A/E contract must be examined to determine its responsibility. Were they obligated to perform such investigations? Were they implied? Were they the responsibility of others? Or did the owner warrant and take responsibility for the site conditions?

The responsibility for the cost, the damage to the owner, of an omission or an error is often not clear. It is necessary to examine the contract between the A/E and the owner. Generally, some omissions should be expected and with this should come the owner's expectation to absorb some of the cost. However, lacking any defined method to quantify an acceptable amount of omission (and to a degree error) the A/E's cost responsibility becomes an issue of standard of care which is discussed further below. In some instances a particular owner's contract may make the A/E responsible for all omissions and errors. In other instances the A/E may become responsible for omissions or errors whose cumulative value exceeds a fixed percentage of the bid price. Owner's and their willingness to accept damage costs are typically more tolerant of omissions than they are of errors and thus the standard for errors is often more severe.

E&O claims are generally brought against the A/E by the project owner. Contractors may want to act against the A/E but usually their course of actions is against the owner. Generally the lack of a contractual relationship between the contractor and the A/E prevents a direct claim from the contractor against the A/E. A legal opinion considering the details of the contract provisions and the applicable laws governing the project would be required to determine if the contractor can claim directly against the A/E.

Typically then it is the owner who makes the claim. What are the owner's damages? Well if the owner has issued change orders to the contractor to correct the conditions, then the owner's damages are the increased cost of the work and any delays and their related costs. The owner may also seek to pass through to the A/E the construction management and/or administrative costs for resolving the damage claims. Again, a legal opinion is necessary to determine if this may de done. Further, sometimes the owner will bring the A/E into the process effectively making the A/E resolve the claims with the contractor with the A/E providing their agreement to the costs. The determination of the owner's total damages is necessary to evaluate the responsibility for those costs.

There are several questions that regularly occur relating to E&O issues. What is the A/E's responsibility for the contractor's and/or owner's damage relating to an error or an omission? Is there a premium cost for the corrective work when performed through a change order? And finally, is it reasonable to expect a perfect design?

The premium cost represents the difference between the cost of the corrective work and what the owner's cost would have been had the work been properly designed and included in the project scope at the time of the bid.

In the case of an error where deficient work must be removed and replaced, the owner's damages are relatively straightforward. The A/E would be responsible for the cost of removing the deficient work, the cost of any work that must be removed for access and then replaced, and then the cost of the deficient work. The properly designed element should have been included in the original contract and would have properly been a cost to the owner. The properly designed element effectively becomes an omission for the purpose of analysis of the cost responsibility. In the case of an omission, the A/E would be responsible for any access costs but the owner would be responsible for the work element since he would have properly paid for it if it were included under the original contract.

A complication to evaluating an omission is the case where the A/E was required to design to a budget. If the omitted work, when added to the contract price, causes the contract value to exceed the budget cap, then the contract remedies for exceeding the budget or other provisions as applicable may be invoked.

Under the case of either an error or omission, the question that remains is what was the premium cost associated with performing the work as a change order. Despite the wishes of many, there is no rule of thumb here to address that issue. Each change must be examined on its own merits. We can clarify it somewhat though. The difficult element is what would have been the difference in cost had the work been included under the original contract and thus competitively bid versus a non-competitive change order situation. First, however, there are elements that can be segregated. Any removals or removals/re-installations as described above are in effect premium costs. So too would costs that relate to the change such as now having to provide protection of installed work that would not have been necessary had the work been installed as a part of the original contract. All such costs must be segregated and considered as premium. The competitive premium applies to that element of the work that should have been included under the bid. While there is no conclusive study or data that supports it, those who regularly evaluate these premium costs place the premium as an additional cost of 10 percent to 20 percent of the value of the omitted work plus the premiums identified above.

What is reasonable to expect from a designer? Can a design be expected to be perfect? What is the standard of care that the client can reasonably expect from a competent professional performing a similar service? A legal definition of standard of care should be consulted but it is safe to say that perfection is not the standard. All the checking in the world will not prevent all errors and/or omissions. Excessive checking will produce a diminishing return with increased design costs exceeding the premiums associated with corrective work. A reasonable A/E working to a standard of care can be expected to have some omission. As discussed above, often the amount of the cost premiums that the owner will absorb before seeking compensation from the A/E is undefined. The other approach is to define the A/E's threshold of responsibility based on a fixed percentage of the bid price after which the standard of care is considered to have been breached.

It is important to note that an overly conservative design is not an error. For instance, professional opinions on a reasonable safety factor may differ. That does not make a conservative design an error. A conservative design

that will perform the intended purpose may not be the most economical design and may be cause for future clients to select other professionals but it is not an error.

Not all errors and omissions damage costs relate directly to a construction contract. An owner may experience additional costs due to delays by the A/E. Redesign or changing the design to meet a budget or make corrections may result in costs for re-bidding, escalation, or damages such as lost revenue or penalties to the owner.

Design professionals are expected if not required to carry errors and omissions (E&O) insurance. E&O insurance is, in a simplistic description, meant to insure that the A/E has protection from the costs of any change orders and/or damages because of an error or omission. The insurance also protects the owner in that the policy assures the owner that there is, at least, the policy limit available to pay for any costs or damages associated with a design error or omission. Each A/E does however have a deductible of some amount to satisfy before the insurance coverage applies. Unfortunately for owners and designers, the deductible and/or some portion of the coverage amount may be used to defend and/or refute the E&O claims. The E&O insurance is meant to provide a means to correct design deficiencies and is not a checkbook for the owner to make changes, improvements, or scope increases over and above what may be necessary to meet the design intent and serve the intended purpose.

A/E's who have design to budget requirements are faced with another facet of E&O, insuring that the design will not exceed a given dollar amount. Such requirements pose interesting questions including the measurement that defines when the budget is exceeded and what the cure is. In order to have a design to budget contractual arrangement, a well defined scope of the project is necessary. The design and the related cost should be based on that project scope. Any additions in scope by the owner during the design will affect the overall project cost. A methodology must be in place in the contract to evaluate the design change cost impacts and cause a corresponding increase in the budget to account for the increased scope of the work.

In general, in reviewing the damages associated with errors and omissions it is first necessary to verify that there was indeed an error or omission. Knowing the item of work in question then allows for an analysis of the corrective costs to determine which are due to errors, which are due to omissions, and what are the associated cost premiums. With an understanding of the nature and extent of the damages costs, the assignment of responsibility follows. A review of the contract between the A/E and the owner should be performed to determine if there is any predetermined methodology in place to evaluate such costs or any thresholds that when reached trigger a responsibility on the part of the A/E. In the case of no defined evaluation method, the responsibility for the costs and the owner's reasonable expectations for participation in such costs are then based on the standard of care that a competent professional in the area would normally provide. Other damages such as delay and escalation need to be evaluated to determine their cause. The responsibility for these damages is then based on their cause. In the case of a design to budget contract the A/E and owner must establish the methodology to measure the compliance of the A/E, determine the corrective measures, and have in place a methodology to adjust the budget to reflect changes in the scope of the design.

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