



Claims Study

Small Firms Claims

This claims study focuses on three claims that were made against firms in our small firms program. This program admits firms with annual billings of less than \$500,000. Almost all of the claims made against small firms derive from either delays and extras or property damage. From 1999 to 2008, 47% of the claims made against firms (frequency) in the small firms program involved allegations of delays and extras. Delays and extras claims accounted for 44% of the dollars CNA spent (severity) on small firms claims. Property damage claims accounted for 41% of the frequency and 41% of the severity.

The following three claims were chosen because they represent instances when something really went wrong for a small firm, resulting in CNA paying extremely large amounts for indemnity and claim expenses. These claims help illustrate the fact that even small firms run the risk of being subjected to enormous claims.

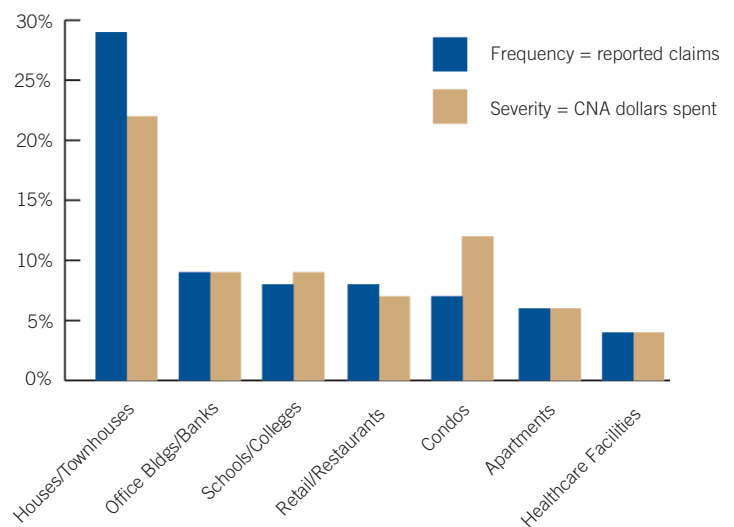
Case Study #1

An engineer provided structural engineering services for additions and renovations to an airport parking garage. The engineer wrote the performance specification for the concrete mix. The contractor had trouble achieving the specification, claiming that it took over seven months to achieve the proper mix. The contractor submitted a claim against the client for delays and extras. The contractor settled the claim with the client, who assigned to the contractor its rights for claims against the engineer and architect. The contractor's allegation was that the engineer did not provide accurate and achievable specifications.

CNA retained experts who felt very strongly that there was no liability on the part of the engineer. The concrete specifications were eventually met, and the garage was built with the specified concrete. However, there was inherent risk in this claim because the contractor claimed in excess of \$11 million in damages. The engineer had \$5 million in coverage.

This case went to trial because defense counsel could not secure a reasonable settlement. During the trial, the court seemed to have concerns over some of the engineer's actions. One concern focused on why the engineer was not as restrictive on some parts of the specifications and not others; another focused on why the engineer did not perform calculations that may have eliminated some of the delay. The judge eventually found the engineer to be partially liable. CNA paid \$1,960,000 in indemnity and \$1,490,000 in expenses.

Claims by Project Type
(1999 - 2008)





Case Study #2

An architect was hired to provide architectural services for a new high school. The architect was also to provide value analysis and contract administration services. The preparation of the construction documents was the responsibility of a consultant, and the architect was responsible for signing and sealing the original drawings. In the agreement, the architect assumed responsibility for all errors, omissions, or negligence in these documents, including the work done by the consultant.

After construction, the architect inspected the school and saw that there was a complete lack of maintenance for the HVAC units. There were also roof units without fan belts, roof leakage, and minor mold issues in the interior. The school board had been advised from the onset that a certain type of HVAC system would not be as efficient and durable, but due to budget constraints, this was the only type of system they could afford.

The school district submitted a claim against multiple defendants, including the architect. The school's main allegations included property damage caused by water infiltration and problems with the HVAC system involving mold. Due to the nature of this case, a trial was considered risky. There were several reasons to settle this claim. The school district had already spent more than \$15 million to upgrade its HVAC system and remediate property damage caused by water infiltration and mold. The architect's design arguably contained some water-infiltration errors, and the architect was also vicariously responsible for the alleged under-sizing of the HVAC system. Also, the jurisdiction where the case was pending has a reputation for being difficult for defendants. The claim was settled for \$2,245,000, with \$135,000 paid in expenses.

Case Study #3

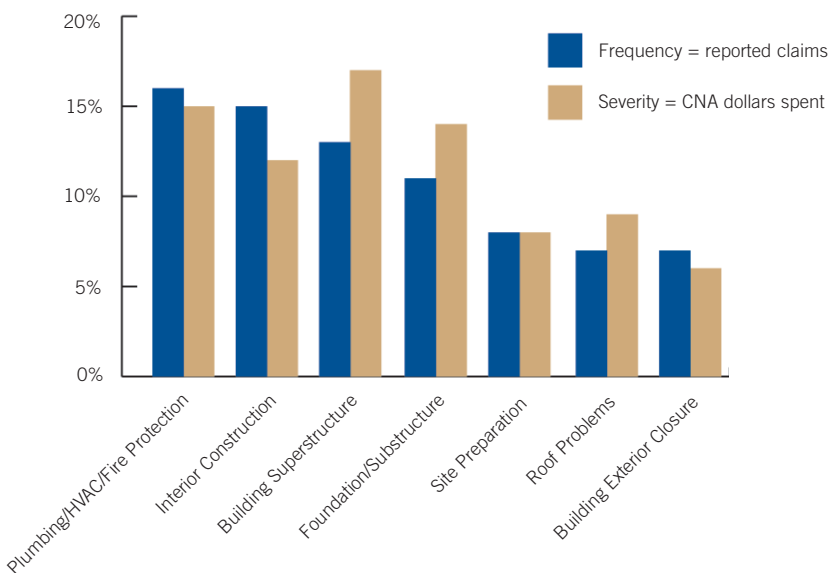
An architect was retained to provide architectural services in connection with the renovation of a church. The project included interior alterations to the existing second floor, construction of two new floors, and construction of a new sanctuary, cafeteria, kitchen, office space, and a third-floor mezzanine. The architect's responsibilities included preparation of all plans and specifications, site visits, reviewing and approving change order requests, and payment requisitions.

The community protested this project as it displaced a number of business owners who had been renting the affected space. A gunman later entered one of the commercially-leased space, which was part of the church, and

shot several people. The gunman locked the front metal gate to prevent anyone from getting out and set the building on fire. Some of the people were able to make it to the basement, only to find that there was no way to exit to the street. The store and the church had shared a common basement but were now separated by a brick wall that was allegedly constructed as part of the renovations. This resulted in leaving the store's basement without the code-required means of egress. In addition, the renovation allegedly necessitated the disconnection of the sprinkler system. Seven of the store's employees perished in the fire.

Multiple plaintiffs filed suit against multiple defendants that were involved with the project, including the architect. The plaintiffs' claim

Claims by Problem Area (1999 - 2008)





involved the fatalities arising out of the fire and the shooting, property damages, and compensatory damages due to loss of services.

It was determined that the lack of enough exits was not due to the insured architect's design, but was in fact the responsibility of the store's own architect. The insured architect's testimony was consistent in that it was not contractually obligated to do any work in the store's basement. The store had retained its own architect to prepare designs for work performed in the store's space.

Despite the fact that the insured architect was not responsible for the lack of exits in the store basement, settlement was preferable to trial. If this case had gone to trial, the architect's exposure likely would have been considerable due to the multiple fatalities. With policy limits dwindling due to defense costs, an offer of the remaining policy limits was made to the plaintiffs; the offer was accepted. \$520,000 was paid in indemnity and \$480,000 was paid in expenses. The total amount paid was around \$12 million combined from all defendants.

Managing the risks of small firm claims

- Smaller design firms often think that because of their lesser fees on "smaller" scope projects, they are immune to major claims. A significant amount of the highest paid claims in the CNA program were made on behalf of firms in our small firm program.
- The contract negotiation process provides an opportunity to set the client/design professional relationship on a firm and productive course. It is critical that professional services agreements contain: a clearly defined scope of services; method for determining compensation; adequate time for delivery of professional services; risks allocated to the party in the best position to control that risk; appropriate authority given with each responsibility; and responsibility given to only one party.
- Be proactive on maintenance issues. Try to convince the client to establish a contingency fund for testing, maintenance, and repairs. Arrange to be put on retainer to work with the client, and offer to prepare a maintenance manual as part of your scope of services.
- As with all projects, pay appropriate attention to the quality of the design, continuously manage the expectations of your clients through timely and consistent communication, and have a systematic, objective documentation process in place to document all relevant activity.

© 2009, Victor O. Schinnerer & Company, Inc. Schinnerer's risk management resources have been prepared solely for the purpose of sharing general information regarding insurance and practice management issues and are not intended to constitute legal advice or a determination on issues of coverage. Victor O. Schinnerer & Company, Inc. makes no representations about the accuracy, completeness, or relevance of this information.

Schinnerer and CNA policyholders have a non-exclusive, revocable license to reproduce this information for in-firm and client educational purposes. No other republication or redistribution of this material is allowed without the approval of Victor O. Schinnerer & Company, Inc.

For more information on practice management, please visit our website at www.Schinnerer.com or www.PlanetRiskManagement.com. You can reach our Risk Management Department at 301/951-9753, fax at 301/951-5496, or email at vos.RMeducation@Schinnerer.com.

Victor O. Schinnerer & Company, Inc.
Two Wisconsin Circle
Chevy Chase, Maryland 20815
301/961-9800

