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ENCON Group Inc.
Telephone 613-786-2000
Facsimile 613-786-2001
Toll Free 800-267-6684
www.encon.ca

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Gimme Shelter — Personal Liability Shifts to Employees

by David E.Waterhouse, LL.B.
Chiarelli, Cramer, Witteveen

No words strike more fear in the ears of brave design professionals than "personal liability." Until now, however, architects and engineers and those who have incorporated their practices have felt fairly safe behind what they thought were sure defences.

Personal liability for the design consultant can arise from non-compliance with a contract, but it can also be through tort law, usually through the law of negligence.

For decades, lawyers have offered their clients two strategies to avoid the unpleasantness of being found personally liable for the business activities of their firms. Those consultants who, for tax or some other purpose, wished to carry on business as a sole proprietorship or partnership were advised to transfer their assets to their spouses. Generally, this was good advice as long as the spouses were getting along.

The other strategy was for the consultant to incorporate his or her business. It was widely accepted that this approach would ensure that only the assets of the corporation were available if the firm was found to have fallen short in performing its professional services which resulted in a financial loss to another party.

The situation has always been different where the negligent work resulted in personal injury or property damage to something other than the subject matter of the professional service contract. If, for example, an engineer's negligence results in the collapse of a structure and an individual suffers a personal injury, the law has always been such that both the firm and the individual would be liable. Similarly, if part of the collapsed structure falls on someone's car, the firm and the individual are both liable to the car owner for the damage to it.

The cost of redesigning and remedying the damaged structure covered by the contract has been treated somewhat differently. The courts have labelled this as "pure economic loss" as it affects the owner's pocketbook only. With some exceptions, the courts historically have held that only the firm is liable for that loss. Most often, the exceptions arose where there was an individual at a firm who had a particular expertise which the client was contracting for, and there was an element of reliance on that individual to provide that expertise. In those situations, the courts have been prepared to find that the individual as well as the firm was liable.

But aside from third party claims and in the absence of special circumstances, the courts have generally respected the notion that only the firm is liable for the negligent acts of employees and that operating a limited company provides protection.

Defences Down

A couple of recent court cases concerning engineers, however, suggest that the situation has changed. In British Columbia three employees of an engineering firm were sued, along with their employer, for alleged negligence in the production of a building condition survey. An application was made on behalf of the employees on the basis that the building owner's contract was with the firm, rather than with the

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individuals. It was suggested that the individuals, as individuals, owed no separate duty of care to the owner. The court dismissed the application and reached a remarkably far-reaching conclusion.

The court stated that: "It cannot be plausibly argued that a limited company purporting to offer professional services of 'consulting engineers' and indicating that its employees have special skill and experience is not inducing its clients to rely on those individuals' expertise. It is immaterial whether the client can identify that expertise with individual employees of the firm."

The court further held that: "Employees who exercise professional functions on behalf of corporations must realize that it is their skill and experience that clients are engaging and will rely upon. Accordingly a duty of care arises in favour of those clients and those employees are potentially liable in tort if they fail to meet that duty."

From this broad language, it seems there is little scope for a design professional to protect his or her personal assets simply by incorporating a design practice. Nor can the design professional take much comfort in the fact that his or her employer's business is incorporated.

Don't think design professionals are being singled out. They are only one of the groups upon which the courts have so ruled.

For Argument's Sake

The first indication that the principle of personal liability would be applied generally came in a decision of the Supreme Court of Canada in 1992. In that case, two forklift drivers had negligently dropped a transformer, causing about $40,000 in damages. The owner of the transformer couldn't take action against the forklift drivers' employer because of a clause in their contract which limited liability to $40. So, the owner decided that it would sue the drivers personally to recover the full amount of the damages.

In deciding the case, the court held that there was no reason in principle why the drivers could not be sued personally. Happily for the drivers, however, the court also held that in this case the limitation of liability clause that protected the company was broad enough to protect the individuals as well.

Is this principle of personal liability fair? Probably not. In analyzing these situations at the policy level, the courts sometimes refer to various theories. One is the so-called "enterprise theory" which suggests that the entity which created and stands to profit from the risk should bear the risk of loss. The engineering company not the individual would bear the risk. Under another theory, the party best able to manage the risk should bear it. Again, that would be the employer or the client.

A third analysis suggests that in a planned transaction where the allocation of risk between the parties to a contract is negotiated, and the pricing and structure of the transaction reflects, at least in part, this allocation, it makes no sense to have an individual who is not party to the agreement bear any of the risk. The individual is not being compensated to bear the risk and his or her ability to manage it may be compromised by budgetary or other constraints imposed by either the employer or the client. Nor would it be fair for clients to argue that they reasonably expected at the outset that the individual's personal assets would be available to compensate them in the event that the work was not performed satisfactorily. The outcome of this imposition of personal liability would be to allow clients to lessen their risk of loss at no cost. In a very real way, they would get a "free ride" on the tort system in that the allocation of risk would be an improvement upon that which they contracted for.

Insured Anyway?

So, "Who cares?" you ask. My company has professional liability insurance, or my employer's company has insurance and as an individual I have coverage under the policy. The insurer will cover that exposure.

But what if the policy limits are relatively small and the damages are large? Or, what if the limits were adequate at the time that the policy was purchased but have been eroded through other claims? You may now have a significant uninsured exposure. Is there anything that can be done to protect you? Happily, there is. In recent years, the Supreme Court of Canada has addressed the limitation of liability through the use of appropriate contract language. It seems to be a concept which judges enthusiastically endorse.

What it means is that you should ensure that there is a properly drafted limitation of liability clause in your firm's consulting services agreement with its client. It should speak specifically about your personal liability. The following is a sample that you may wish to consider in your firm's next contract:

> For the purposes of the limitation of liability provisions contained in the Agreement of the parties herein, the Client expressly agrees that it has entered into this Agreement with the Consultant, both on its own behalf and as agent on behalf of its employees and principals.
>
> The Client expressly agrees that the Consultant's employees and principals shall have no personal liability to the Client in respect of a claim, whether in contract, tort and/or any other cause of action in law. Accordingly, the Client expressly agrees that it will bring no proceedings and take no action in any court of law against any of the Consultant's employees or principals in their personal capacity.

You or your employer should consult with your insurance broker to make sure that your insurance coverage is adequate and with your lawyer over the contract wording. We all work too hard and too long only to have our personal assets seized.

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