Legal Risk Management Services

Case Study

Water supply project in a rural area, to be constructed under the Municipal Infrastructure Grant (MIG) scheme

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Background

A consulting engineer was appointed by a municipality to undertake the design and construction contract administration of the first phase of a new water supply scheme in a rural area. Being for an initial phase of the project, the comprehensive appointment included a preliminary design for approval before proceeding further, compliance with environmental legislation, undertaking topographical surveys, preparation of construction contracts and construction monitoring, including in the latter function acting as the client's agent in compliance with the Occupational Health and Safety Act and construction regulations.

Difficulties were encountered during the construction stage of the project, with disputes between the contractor and employer, represented by the consulting engineer. On two occasions, an adjudicator appointed to resolve disputes found in favour of the contractor, which brought the liability of the consulting engineer into question. The consulting engineer prudently informed his insurers of a possible claim. This manifested itself some time later in a summons from the municipality, claiming damages of R6.6 million. The inclusion of a "limitation of liability" clause in the consulting engineer's agreement, saw the claim reduced to R2.7 million and the consulting engineer's professional liability insurers settled the matter for this amount. The settlement process is however often not straightforward and the condition of limited liability needs to be carefully worded.

The Problem

The summons was served by the attorneys acting for the municipality nearly six years after the consulting engineer had been appointed to undertake the assignment. The project had been completed in this period. The summons alleged in strong terms the failure of the consulting engineer to exercise "reasonable professional skill, care and diligence" in performing his services, which clearly breached the terms of the consulting engineer's agreement with the municipality (which was a standard agreement issued by the then South African Association of Consulting Engineers, now CESA).

In justifying its claim in the summons, the municipality listed a number of actions (or lack thereof) by the consulting engineer, supporting its allegations above. These included inadequate designs and /or specifications preventing the stipulated delivery rate of water from being achieved; failure to conduct sufficient quality control tests resulting in faulty construction; allowing operation of the system to commence causing damage to the works and various detail faults relating to water pipelines and their interfaces with structures.

These shortcomings caused the municipality as employer in the construction contract to incur additional costs of R2.6 million for remedial work by the contractor, plus R4 million to deliver water by tanker due to delay in completion of the works. The total sum claimed thus amounted to R6.6 million.

In terms of the client/ consulting engineer agreement, the municipality had paid the consulting engineer's Fees totalling R1.35 million and conceded in its claim that the consulting engineer's liability- was limited to twice the fees, i.e. R2.70 million.

The consulting engineer did not deny his client's allegations of malperformance (noting that two adjudication decisions during the contract had gone against him). In accepting liability, he maintained his liability was limited as per the agreement. He accordingly registered a claim under his professional indemnity insurance policy in the sum of R2.70 million.

This was paid to the Municipality by the insurers to settle the claim, with the consulting engineer paying the excess of R50 000 under the PI policy.

Lessons to be learned

1. The value of a limitation of liability provision in the consulting engineer's agreement with his client cannot be understated. In the case above the claim on the consulting engineer was reduced from R6.6 to R2.7 million, i.e. to a value less than half of the claim intended by the client, which otherwise would probably have been successful.

2. This provision makes sound business sense. A consulting engineer's fees are often of the order of 5% of the cost of the project. Costs of restitution arising from a consulting engineer's proven malperformance can involve a substantial part of the 95% portion of project cost. Considering the relationship between fees and project cost, this places an unreasonable business risk on the consulting engineer and a limitation of liability provision becomes essential.

3. While the limitation may be essential, the level of limitation requires it to be reasonable. This is generally best expressed as a multiple of the consulting engineer's fees. A factor of two (twice the value of the fees) is frequently used, some client bodies require a higher factor, but this should not exceed three.

4. It is also important that the limitation of liability be clearly expressed in the consulting engineer's agreement with his client, bearing in mind his PI insurance may need to defend a claim having a far higher value.

5. Typical clauses dealing with limitation of liability which should appear i n the consulting engineer's agreement are given below:

    a) "The maximum amount of compensation by either party to the other in respect of liability under this agreement is limited to an amount equal to twice the amount of fees payable to the consulting engineer under this agreement, excluding reimbursements and expenses unless otherwise stated"

    b) "Each party agrees to waive all claims against the other insofar as the aggregate of compensation which might otherwise be payable exceeds the aforesaid maxim um amount payable"

    c) "If either party makes a claim for compensation against the other party and this is not established, the claimant shall reimburse the other party for his reasonable costs incurred as a result of the claim, or if proceedings are initiated in terms of the Settlement of Disputes clauses for such costs as may be awarded"

    d) "The client shall indemnify the consulting engineer against all claims by third parties which arise out of or in connection with the rendition of the services save to the extent that such claims do not in the aggregate exceed the limit of compensation stated above, or are covered by the insurances arranged under the terms of the Insurance for Liability and Indemnity clause of this agreement"

    e) "Notwithstanding the terms of the Prescription Act No. 68 of 1969 (as amended) or any other statute of limitation neither the client nor the consulting engineer shall be held liable for any loss or damage resulting from any occurrence unless a claim is made in terms of the Settlement of Disputes clauses within the period stated herein, or where no such period is stated, within a period of three years from the date of termination or completion of this agreement"

6. The Consulting Engineer should consult with his P.I. insurers to ensure the above wording is appropriately included in his agreement.

7. It should be noted that insurers do incentivise consulting engineers to limit their liability in their professional services agreement by affording them a 50% discount in the deductible payable in the event of a claim being settled.

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