



Fédération Internationale des Ingénieurs-Conseils
International Federation of Consulting Engineers
Internationale Vereinigung Beratender Ingenieure
Federación Internacional de Ingenieros Consultores



EUROPEAN FEDERATION OF
ENGINEERING CONSULTANCY ASSOCIATIONS

Policy Statement on Limitation of Liability

1. The Objective

- 1.1 The provision of professional services has as its core objective appropriate consultant performance as a means to achieve the client's requirements. In every consultant's appointment it is in both the client and consultant's interest to agree mutually acceptable terms, a fair fee and a clear definition of the services required by the client so as to realise the project.
- 1.2 This policy statement promotes professional excellence, successful project delivery and, in particular, the importance of the parties agreeing to practical and sensible contract terms and to appropriate management of risk.

2. The Issue

- 2.1 In many parts of the world (including both developed and developing economies) consulting engineers are exposed both to the imposition of unreasonable and onerous contract terms, and to unrealistically high (or unlimited) liability in the event of negligent default by the consultant.
- 2.2 Construction projects are complex. They involve a multitude of professionals, contractors, subcontractors, specialists and suppliers, all of whom are required to interact and work together to deliver the finished project. To meet this obligation, a consultant's terms of appointment and conditions of engagement must be commensurate and proportionate with his/her particular role and his/her ability to control both project risks and those activities he/she is responsible for.
- 2.3 FIDIC's policy is that all consultant engagements should be subject to a limit of liability commensurate with the role of the consultant and the risks that the consultant can effectively manage and mitigate. This is expressed in the FIDIC client/consultant model services agreement (the White Book) and other standard forms of appointment promoted by FIDIC Member Associations which provide for such a limitation by the client and consultant agreeing the maximum compensation payable in respect of liability arising under the appointment.

3. The Reality

- 3.1 Unfortunately, and notwithstanding the unanimous guidance of learned legal and engineering professionals (by way of numerous industry standard Forms of Contract providing for caps of liability), many clients and their advisors mistakenly believe that they can adequately manage design risk simply by transferring all risk to design professionals. They seek to do this by the inequitable imposition of unreasonably high or unlimited liability.
- 3.2 For the most part, professional design firms are not asset rich and are not able to get unlimited PI insurance cover. This means that the client's assumption of risk mitigation is based on a false premise.
- 3.3 In addition, the request for unreasonable levels of liability is often coupled with requirements for indemnities, warranties and excluded risks, many of which can effectively cause the consultant to be un-insured and at risk of being liable for uninsured losses for which there will be no recovery by the client.
- 3.4 Imposing contract terms which create unrealistic and/or uninsurable risk put both the client and consultant to be at serious financial risk. The reality is that failure to agree a fair, reasonable and insurable financial cap creates serious risk to:
 - the consultant's business
 - the success of the project
 - the client's potential for financial recompense in the event that the consultant's services fall below the required standard and results in a loss.

4.0 The Solution

- 4.1 Respected and forward looking businesses are identifiable by their keenness to promote and embrace corporate integrity, ethics and fair play. This is true for clients, consultants and contractors. Most well run businesses also seek long term stakeholder relationships with their advisors, professionals and suppliers. These core ideals will only be achieved with fair and equitable relationships/contracts between clients and consultants.
- 4.2 In practice all professional service providers (including lawyers, accountants, etc) require that the liabilities and obligations specified, or implied, in their conditions of engagement (or service contracts), to be commensurate with the services provided and the ability of that professional to manage and control the financial consequences of every risk that might arise as a consequence of those services.
- 4.3 It is not in the interest of the project (or client) for consultants to be contractually obliged to be responsible for risks that they have no control over, or to be liable for losses which they will not be able to meet. A realistic and sensibly derived financial cap, backed up with an appropriate level of Professional Indemnity Insurance [PI], will provide a client with certainty that would otherwise not exist.
- 4.4 In reality, professional services firms have very little asset value and PI cover is the only practical way of ensuring that a claim for damages can be met. Most importantly, a claim that is, in effect, not insured, or exceeds the level of insurance cover, will leave clients without the protection that they have assumed. Unlimited liability is not insurable and, in addition, many onerous contract conditions imposed

by clients, or their advisors, have the effect of voiding insurance cover, i.e. they are not insurable.

4.5 Just as the magnitude of the consultant's fee is normally referenced to the size and complexity of the project, together with the scope of services that the consultant will provide, so too can a reasonable assessment be made of likely losses resulting from negligent default and thus of a reasonable level of liability. Such an assessment can be, and is frequently made by reference to:

4.5.1 a multiple of the consultants fee (a multiplier of between 1 and 5 is frequently used), or

4.5.2 a proportion of the project budget, or

4.5.3 a separate assessment of the damages that might flow from default, or

4.5.4 a local industry standard lump sum

4.6 FIDIC, through its member associations, monitors major client groups and promoters of projects to assist in ensuring its members are aligned with a client's reasonable needs and objectives. FIDIC undertakes to work with all clients and promoters to achieve continual improvement in the delivery of services and client financial security. FIDIC encourages its members to raise any concerns with their member associations.

4.7 FIDIC recommends the following as best practice:

- The use of reasonable and equitable Conditions of Engagement/Contracts
- All contracts should contain a Limit of Liability for the Consultant
- Consultants should carry sufficient PI cover to meet their limit of liability
- The maximum value for the Limit of Liability should be commensurate with the value of the service, the risk of failure and the operating environment (statutory/cultural)
- All consultants and sub-consultants working on a project should be required to carry PI insurance.

Why Clients Should Limit the Liability of their Consulting Engineer

Clients engage Consulting Engineers to provide engineering and related professional services. Based on their consultants' advice, clients may invest in a project, the cost of which may be in the range of 10 to 1000 times greater than the consultant's fee.

In the unlikely event that the engineer is negligent in that advice, the cost of rectifying the error may be several times greater than the original fee. This constitutes a risk to the client. How best to manage and mitigate this risk is the subject of this and subsequent bulletins.

An initial reaction by some clients is to attempt to transfer all risk to the Consultant by requiring high, or even unlimited liability. This provides neither surety of risk mitigation nor the most cost effective way of managing such risk. Unreasonably high or unlimited liability is not supported by insurance and so, when faced with requests for onerous liability, the consultant is faced with some or all of the following unsatisfactory options:

- Risk their business viability (and the client's ability of redress) by working with potential liability greater than their PI insurance cover and the value of their company. This usually means not offering some services or offering services with conditions;
- Limiting their work to conservative design and advice with little or no innovation (this can have a significantly detrimental financial impact on the success of the project);
- Strip their company of assets such that a claim above the insured sum will not be worthwhile to the claimant;
- Decline to provide services to clients who insist on unlimited or unreasonable liability.

Each of these options leads to a non-productive and unsustainable consulting sector and will generally result in increased construction costs and a reduction in quality.

The appropriate methods to mitigate risk include:

- Preparing a brief with the consultant's scope of work and services well defined;
- Making consultant selections on the basis of quality rather than price;
- Client and consultant working proactively together to identify and mitigate risk;
- Investing appropriately on site investigation and other pre-design studies;
- When appropriate, arranging for peer reviews of the consultant's work;
- Setting an appropriate and commercially viable limit of liability;
- Requiring the consultant to maintain Professional Indemnity (PI) insurance to match the agreed limit of liability.

The "liability" of the consultant is only a safeguard for the client if it is backed up by PI insurance. Professional Indemnity premiums are expensive and increasing. Insurance providers worldwide are limiting the size and types of risk that they will cover. In some locations and for some services, PI cover is no longer available, as a result of inappropriate risk management. In addition insurers will exclude cover for inappropriate liability!

A commercial balance is required to provide clients with security, and consultants with viability, backed by insurance. A general rule of thumb that has developed over time, in some countries, is that the limit of liability should be about three to five times the fee. This level:

- Has substance in the event of negligence by the consultant;
- Covers virtually all legitimate claims that arise;
- Is commercially equitable for both the client and consultant;
- Is significantly higher than accepted practice in other professional service sectors.