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New TxDOT Consultants Errors & Omissions Procedures: Design Professionals and Insurers Beware!

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In December 2006, the Texas Department of Transportation (TxDOT) issued new procedures to be applied in engineering, architectural and surveying contracts. These are called "Consultant Errors & Omissions Correction and Collection Procedures." These procedures appear to create significant uninsurable risks for consultants and will deprive consultants of due process to challenge determinations by TxDOT concerning responsibility for errors and omissions.

TxDOT Procedures based on Fundamental Misunderstanding of Common Law. The problems begin with the following statement that appears at page one of the Procedures: "During and after construction, errors and omissions can result in additional costs that TxDOT would not have incurred if the construction plans has been correct. Under contract law, the resulting additional costs are considered damages that TxDOT is entitled to collect." This inaccurate description of the law is the foundation for the Procedures that follow in which TxDOT states that it can assert that all errors and omissions that cause extra contractor costs (change orders) are per se the responsibility of the consultant and that TxDOT will issue a demand letter to collect such extra costs without regard to whether it can demonstrate that the consultant was negligent.

Presumption of Liability, and Deprivation of Due Process. The structure of the Procedures, and the hearings provided for by the Procedures and the Texas Administrative Code, are not intended to address whether the consultant was negligent. Instead, there is a presumption built into the Procedures that any change order costs arising out of errors and omissions are the responsibility of the consultant without regard to whether the consultant's errors and omissions were made within the standard of care. There appears to be no way to challenge that determination within the administrative process.

At common law, the project owner is deemed to have given an implied warranty of specifications to the construction contractor, but the consultant does not give the same warranty to the project owner. This means that it is entirely possible that the project owner may be required to pay a construction contractor change order costs resulting from changes necessitated by errors and omissions in the drawings and specifications, but be unable to recover those same costs from the consultant that was responsible for the drawings and specifications. In the absence of these peculiar Procedures, in order to recover from the consultant, TxDOT would have to present expert testimony in court to prove the standard of care and to prove that the consultant failed to meet the standard of care, i.e., that the designer was negligent.

If I am reading the Texas Administrative Code correctly, the consultant and its insurance carrier will never have a day in court in which to have the opportunity to argue that whatever errors and omissions may be alleged, they are not negligent ones. Since the decision of the TxDOT can only be reversed on appeal if the Administrative Law Judge finds fraud or abuse of discretion by the TxDOT officials in reaching their decision, the actual merits of the underlying case may never get litigated.



CONTRACT CONCERNS

Manipulating the Claims Process. The effect of these Procedures is that every construction change order will become a potential claim by TxDOT against the consultant. In what may appear to be an effort to capture as much insurance coverage as possible for these "claims," the Procedures state that TxDOT will cooperate with the Consultant whose *"consideration of a deductible and number of occurrences per year may affect their preference for combining or staging payments related to one project. One total payment versus two or more separate payments may be preferred."* (Section 7.0)

Insureds must keep in mind that each change order that arises out of a unique negligent act, error or omission will be considered a separate "claim." Separate claims cannot be combined as suggested by TxDOT into a single claim to avoid the deductible applicable to each claim. Moreover, the consultant would be required to report each individual claim arising out of a change order promptly as it becomes aware of it. It is not permitted by the policy to withhold notice until it has combined a number of change order claims into one single large claim.

Requiring Pre-payment of Change Order Costs before Administrative Review. Another problem with the Procedures is that they appear to require the Consultant to pay change order costs demanded by TxDOT before an Administrative Review may be requested. In my view, this is a rather stunning deprivation of due process, particularly in view of the fact that most consultants do not have large assets and will not be able to pre-pay a "claim before defending against it.

Contractual Liability Exclusion. The insured consultant, and its insurance broker, should keep in mind that pursuant to the terms of the professional liability policy, coverage is only provided for claims arising out of the Consultant's negligent performance of professional services. Not all errors and omissions are deemed negligent at common law and consequently, at common law, a consultant is not deemed liable for costs or damages arising out of every error or omission. To the extent that the Consultant, by virtue of entering into a contract with TxDOT, becomes contractually liable for change order costs resulting from all errors and omissions instead of only negligent errors and omissions, coverage could be barred pursuant to the contractual liability exclusion of the professional liability policy.

Warranty Exclusion. It would appear that committing to these TxDOT Procedures could constitute a warranty of perfect, error-free services. Coverage for claims arising out of such a warranty may be excluded pursuant to the warranty exclusion of the policy.

Unauthorized Compromise and Settlement. In addition to the exclusions of the policy that make risks assumed by consultants under the new TxDOT procedures uninsurable, the Consultant should keep in mind that the Claims procedure of the policy establish a duty of the Consultant to cooperate with the insurance carrier and to not take any action that would compromise or settle any claim without prior notice to the insurance carrier.

By agreeing to the TxDOT Procedures, the consultant would appear to be forfeiting its rights to ordinary due process, thereby prejudicing the ability of the insurance carrier to adequately defend a claim, present expert testimony, and otherwise assert typical defenses showing it complied with the generally accepted standard of care. Such prejudice to the claims process set forth in the policy may be a basis for denying coverage under the policy.

CONTRACT CONCERNS

Material Change in Risk Presented by Insured Consultant. The insurance carrier will also be concerned that if a consultant must pay large change order costs to TxDOT, this may impact the financial ability of that consultant and thereby adversely affect its ability to satisfactorily perform services on other private projects on which insurance coverage is applicable.

A consultant's uninsured claims on TxDOT projects could materially change the risk that the consultant poses to the insurance carrier—even on projects not related to the TxDOT project. Such a material change may influence the carrier's underwriting decisions, including the decision to terminate or non-renew consultants that perform services for TxDOT under the new Procedures—or at a minimum, significantly increase the insurance premium to cover the increased risk exposure.

Additional Comments on Specific Language Include the Following:

2.0 Error and Omission Correction. *"Consultants are responsible for promptly correcting errors and omissions without compensation...."*

On projects in most states (including Texas as far as I know), the question of whether or not a consultant will be compensated for correcting errors and omissions without compensation depends on the nature of the error and omission. When performing additional services as a result of errors and omissions in their initial drawings and specifications, consultants are often compensated for their time and effort – provided that their errors and omissions aren't deemed to have been negligent. There is no blanket rule depriving a consultant of such compensation. In fact, a project owner may deem it more cost-effective to pay for some redesign services along the way rather than attempt to design perfection up front and pay significant additional up-front design fees for having the consultant attempt to create the perfect, error-free design in the first instance.

2.1. (last sentence) "TxDOT Design PM should be able to clearly differentiate among routine mark-ups, design changes identified at TxDOT's request/preference, and errors and omissions in the form of an incorrect design or unacceptable plan sheet preparation."

Comment: From the above statement, it might appear that TxDOT recognizes that not all errors and omissions rise to the level of consultant responsibility. But if this is a recognition that only negligent acts, errors and omissions are the responsibility of the consultant, it does not clearly so state. Moreover, even if that were the intent, it is difficult to understand how a "PM should be able to clearly" decide that the errors and omissions are negligent ones. In court, an expert witness is required to testify before that determination can be made. In court there would also be an opportunity for opposing experts to counter that testimony. How is that accommodated in this procedure? It is not.

4.0 When to Finalize Additional Costs (2nd paragraph)

"Within a reasonable time after execution of each change order [involving consultant errors and omissions], the TxDOT Construction PM should coordinate with the consultant to verify and finalize the additional cost to be recovered and complete any necessary documentation."

Comment: This paragraph reiterates that TxDOT expects a project manager to make a decision on each change order as to whether to demand that the consultant pay the costs of the change. This has the affect of turning each and every change order into a claim against the consultant. Later in the procedures (7.0), TxDOT recognizes that this might create an insurance problem and thus suggests that the consultant (with

CONTRACT CONCERNS

TxDOT consent) might want to aggregate the change orders into a single claim—apparently so as to meet deductible requirements. See my comments on that at section 7.0 below.

4.1 Project Completion. This section states that upon completion of the project, TxDOT is to review change orders and notify the consultant of the additional costs to be paid by the consultant. The consultant is given 30 days to request a meeting in response to that letter/notice. If the consultant fails to request a meeting, TxDOT proceeds to cost recovery procedures set forth in section 7.0 "Cost Recovery Procedures" and section 10 "Debt Collection."

Comment: There is never an opportunity in this process for the consultant or its insurance carrier to have due process and an opportunity to legally challenge its responsibility. There is a presumption of negligence and the consultant has no opportunity under this procedure to disprove that presumption.

5.0 Contractor Claims Following Construction. This section creates all the same issues as identified in paragraph 4, but is for a different point in time—contractor claims after construction has been completed instead of during construction.

7.0 Cost Recovery Procedures (2nd paragraph)

"The consultant may disagree with the determination of responsibility at the time of change order, at project completion, or during the processing of a contractor claim after construction. If there is a genuine disagreement, TxDOT should look for a way to resolve the disagreement through negotiation and compromise prior to initiating cost recovery procedures. The consultant cannot request Administrative Review [see 8.0] of the disagreement until after the initial notification letter [see 7.1]."

"The involvement of an insurance company is the consultant's decision, but the consideration of a deductible and number of occurrences per year may affect their preference for combining or staging payments related to one project. One total payment versus two or more separate payments may be preferred. Within reason, TxDOT should be flexible in considering options, if requested."

Comment: Pursuant to the Claims provisions of the insurance policy, the consultant must not settle or compromise any claim without prior notice to the carrier. If the TxDOT determination of consultant responsibility for costs on a change order is considered a dispositive decision of error and omission, it would appear that every change order must be treated as a claim since it automatically results in a determination of responsibility by TxDOT.

This section is also troublesome because it appears to suggest that TxDOT and the consultant may cooperate to combine multiple claims arising out of multiple change orders into just one or two claims so as to avoid multiple deductibles. One can only imagine the arguments over whether these multiple change order occurrences—each with its own deductible since it is an individual claim—can be reduced to a single large claim as suggested by TxDOT with only a single deductible. Unless the change orders arise out of the same error and omission, there would be not basis for combining them into a single claim. The consultant and insurance carrier would instead have to address each as a separate claim as it occurs.

7.1. Initial Notification Letter

CONTRACT CONCERNS

"The initial notification letter serves as the first formal request for payment indicating the consultant's liability for the identified debt."

"The letter should also indicate the following:

- Within 30 days of the date of the letter a response is required with:
 - payment or
 - intent to pay with explanation of when the payment will be submitted or
 - written explanation of disagreement with request for Administrative Review
- Payment is required in order to file a contract claim...
- If payment is not received, TxDOT will proceed to collect the debt according to 43 TAC 5.10 Collection of Debts.
- Specific Instructions on how to remit payment."

Comment: This "notification letter," being what the TxDOT calls the "first formal request for payment" might reasonably be deemed the "Claim" that the insured must provide to the carrier and that would require a response under the insurance policy. Failure of the consultant to submit within 30 days a "written explanation" and a "request for Administrative Review" could be deemed a breach of the duty to cooperate with the insurance carrier in defending a claim, and could cause forfeiture of the consultant's potential coverage under the policy.

This section is confusing in that it contains a bullet stating that "Payment is required in order to file a contract claim. The Texas Administrative Code defines a "Claim" as any "dispute" and not just as an affirmative demand by the consultant for compensation from the Department. Even if the language is to be restricted to apply only to affirmative consultant claims, however, the consultant is put at a major disadvantage if it has to first pay contractor's change order costs before it can recover its own final payment for professional fees.

8.0 Administrative Review

This section, when read in conjunction with section 7.1.2, provides that the consultant may seek review of the initial notice letter by the "Assistant Executive Director of Engineering Operations."

Comment: It is not at all clear how the process works, but it appears that the request for review goes to the district office of TxDOT and that this office then involves the Design Division—Consultant Contract Office (DES-CCO). After the Assistant Executive Director makes a decision, the DES-CCO prepares a letter and sends it to the consultant. The procedures do not state whether the letter will contain any fact finding or legal opinions—but presumably not.

The letter issued by TxDOT gives the consultant only two options in the event that the decision is adverse to the consultant. The first option is to make payment immediately, and the second option is to respond with an intent to make payment on a payment plan. The section states "Payment is required in order to file a contract claim. Upon payment, a claim can be submitted to the TxDOT Contract Claim Committee according to the procedures set forth at 43 TAC 9.2 Contract Claim Procedure.

This language about making payment prior to being permitted to file a claim is the same as found at 7.1 "Initial Notification Letter" and remains confusing as to whether it means that the consultant cannot



CONTRACT CONCERNS

challenge the administrative decision that was issued by the AED without first paying the amount that the decision stated was due. See also 9.0 below.

9.0 TxDOT Contract Claim Committee

"In order to file a contract claim, the consultant must first pay the amount requested and proceed with submitting a claim to TxDOT.... Without payment, there can be no claim."

Comment: See my previous comment concerning this matter where it also appears at section 7.1 and 8.0.

10.0 Collection of Debt

This lengthy section of the procedures addresses how TxDOT is to prepare and send certified letters to the consultant, and initiate collection of the amount previously determined due, in the event that the consultant fails to pay the amount demanded.

Comment: Although the consultant could litigate to contest the debt collection, there appears to be no way to litigate the basic issue of whether the consultant's alleged acts, errors and omissions giving rise to the change order were negligent.

The pertinent section of the Texas Administrative Code, Title 43, Part 1, chapter 9 that is referenced in this procedure is located at:

[Title 43, Part 1, chapter 9](#)

The procedures for a having a contested case heard by an Administrative Law Judge in Texas are set forth in Title 43, Part I, Chapter 1, Subchapter E, Rule 1.21, et seq. See:

[Title 43, Part I, Chapter 1, Subchapter E, Rule 1.21, et seq.](#)

It appears that the party bringing the contract claim (i.e., the consultant) has the burden of proof to prove that the department decision was not only incorrect but was "based on fraud, misconduct, or such gross mistake as would imply bad faith or failure to exercise an honest judgment."

This is an extraordinarily high standard. It is essentially the same standard of review that a party must meet in order to get a court to overturn a decision by an arbitrator. What this means is that the consultant never has an opportunity to get a decision on the merits concerning whether it performed its services within the standard of care and therefore was not negligent. This also means that the E & O carriers never gets an opportunity to have a court determine whether the alleged act, error or omission was negligent and therefore covered under the professional liability policy. In the absence of such a determination, I do not understand how coverage for claims on TxDOT projects can be resolved.

Conclusion: For the reasons explained above, consultants need to understand that they may incur significant uninsured risks when performing professional services for TxDOT under the new Procedures. Insurance carriers that insure consultants performing services for TxDOT will need to be aware of the problems that they and their insureds may experience as a result of these new Procedures.



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CONTRACT CONCERNS

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