

# Consultants Corner

Engineering for the future



## Third Party Reliance: What Does It Mean and Why Do We Care?

**R**equests for third party reliance on geoprofessional, environmental and civil engineering reports have become more commonplace in today's engineering consulting marketplace. Requests for grants of third party reliance have traditionally been limited to the environmental field, particularly on due diligence projects, such as Phase I Environmental Site Assessments and Limited Site Assessments. Parties seeking reliance are often lenders, banks and other investors in the subject property.

Requests for reliance letters have not been typical in the geoprofessional and civil engineering practice until recently. Geoprofessional and civil engineering consultants now receive requests for grants of third party reliance on documents such as geotechnical and construction materials engineering and testing (CoMET) reports. What does this "third party reliance" mean to the professional consultants and why do we care? Many consultants and their clients do not understand the potential impact of granting reliance to a third party.

To understand "reliance," it is important to first understand the legal principle of privity, which generally protected a consultant from claims by third parties. Under this legal theory, when a consultant performed services for its client pursuant to a contract, the consultant would not be responsible to

a third party because the consultant had no contractual obligations to perform for the benefit of such third party in the first place. Without privity between the consultant and the third party, claims by the third party were barred.

In our litigious society, however, the concept of privity is constantly under attack and is now almost obsolete, resulting in a lack of clarity in the law. To address this lack of certainty, financial institutions (lenders) seeking to invest in their clients' projects developed third party reliance letters as another mechanism to minimize their investment risks to the greatest extent possible.

Simply put, a grant of "reliance" to a third party on a report is a grant of the legal right to sue the consultant (and potentially its client) if the relying party is somehow damaged due to its reliance on the report. Usually under the contractual terms between the client and its consultant, the right to "rely" on the information conveyed in a report must be specifically granted by the consultant, otherwise known as a grant of third party reliance. In most states, the third party would not

have legal recourse (the right to sue) against the consultant without such a grant of reliance.

Using our lender example, to be in privity with the consultant, the lender will seek a letter from the consultant stating that the lender has the right to rely on and use the information conveyed in the report. The lender would then have legal recourse against the consultant in the event that the lender believed that it was damaged

by such reliance and use. Therefore, the ultimate impact of a grant of the right of reliance to a third party is the expansion of the right to sue the consultant to additional parties.

Why do we care? Geoprofessional, civil and environmental consultants typically negotiate a scope of services and terms for service with a client tailored for the client's specific project needs. It is not unusual to negotiate specific items to include or exclude from the scope of services, or to negotiate an allocation of risk or limitation of liability acceptable to both parties. As a consequence, the lender may be relying on a report for a use that was not contemplated by the consultant in negotiating



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# Third Party Reliance...

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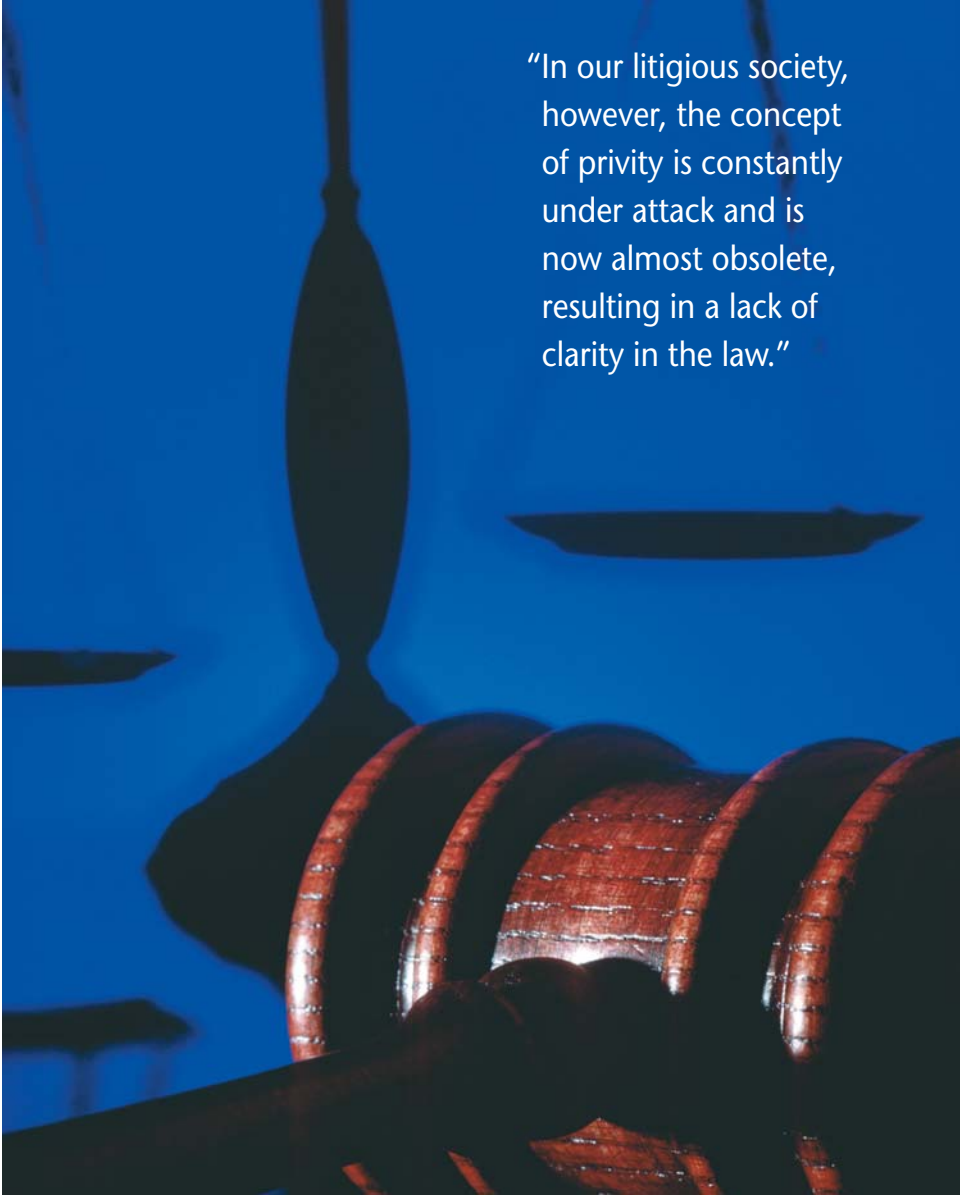
the scope of services with the client.

In addition, the lender generally will not pay for the privilege of receiving the grant to rely on the report, or agree to the terms negotiated with the client, and usually refuses to agree to any caveats regarding their ability to rely on the report. Often the lender will require specific obligations from the consultant in the reliance letter that are non-negotiable and contrary to the acceptable and reasonable risk management practices of the consultant and its profession.

Without appropriate terms in the reliance letter, the consultant and its client could be exposed, whereby the consultant would be liable for certain acts that may, in fact, not be negligent or even necessarily culpable, and would not be insured or insurable. Assuming such an uninsurable risk is not in the best interest of any party.

The grant of a right of reliance (the right to sue) is a significant expansion of the potential liability of the firm issuing the report. Therefore, consultants must take a careful and reasoned approach to grants of reliance, both in terms of whom a firm will allow to be a relying party and under what terms reliance will be issued.

*—Ji Shin, JD and  
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