Managing Risk Through Contract Language

A Resource Tool from Schinnerer and CNA

Victor O. Schinnerer & Company, Inc.

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Preface

This latest edition of Schinnerer's *Managing Risk Through Contract Language* has been designed to serve as an essential risk management guide to the contracting process for design professionals.

Design and construction projects involve a high degree of contracting (i.e., outsourcing) under conditions of high uncertainty. The result is often a complex and confusing web of business and legal relationships among a cast of project players that includes project owners, developers, design professionals, contractors, subcontractors, and material and equipment suppliers, along with a supporting cast of lenders, insurance companies, and lawyers.

All of these relationships create the need to sort out and allocate the respective roles and responsibilities of all of the participants in a coordinated and effective fashion while somehow addressing the uncertainties inherent in the design and construction process. Failure in this regard is a significant source of friction, disputes, and ultimately the use of some outside entity to resolve problems—often at great expense to the various parties.

Notwithstanding the availability of well-drafted families of coordinated standard contract forms, such as those published by The American Institute of Architects (AIA) and the Engineers Joint Contract Documents Committee (EJCDC), many of the parties' contracts are poorly coordinated, not only one to another but internally as well. Nevertheless, their contracts are promises that the law will enforce.

Of course, a further complication to the contracting and project delivery process is the fact that the opinions, reports, and construction documents prepared by design professionals can never include all information, specify all details, or anticipate all contingencies. As a consequence, effective pre-contract risk management must not only evaluate the pros and cons of specific contract forms or contract terms but also the capacity and willingness of the various parties to work together, collaboratively and in good faith, to bring about a satisfactory project outcome.

Accordingly, this edition of *Managing Risk Through Contract Language* has been divided into three parts to provide design professionals with a reasonably comprehensive but practical understanding of contract law, professional liability, contract types, contract terms, and pre-contract risk management.

Part I—Contract Law and Professional Liability

Provides an overview of contract terminology and contract law, a discussion of how liability arises in contract and in tort, a discussion of some common defenses to professional liability claims, and a summary of the implications of a design professional's or client's form of business organization on liability exposure.

Part II—The Professional Services Contract

Provides an overview and discussion of the various types of contracts and contract terms, project-specific and general, commonly used in professional services contracts.

Part III—Pre-Contract Risk Management

Addresses and categorizes the various issues that determine whether the risk associated with the client, project, and project contract is reasonable and controllable.

Throughout the presentation of this material, where appropriate, reference is made to provisions contained in the standard agreement forms published by the EJCDC and AIA. In particular, the following documents are extensively cited:

- AIA Document B101-2007, *Standard Form of Agreement Between Owner and Architect* (formerly B151-1997)
- EJCDC E-500, *Standard Form of Agreement Between Owner and Engineer for Professional Services*, 2008 Edition

The reader is encouraged to become familiar with these industry standard forms and review them in conjunction with the use of this publication.

Finally, a note is appropriate on the need to obtain appropriate professional advice when negotiating a professional services contract. Lawyers and insurance professionals are not qualified to provide design services. Equally, design professionals should not assume that they can provide legal or insurance advice either for their own use or for that of their client. Therefore, we strongly recommend that appropriate legal and insurance advice be obtained when negotiating any binding document, including your professional services contract.

Appendix A—Pre-Contract Risk Management Checklist

Appendix B—Terms and Conditions Review Guide

Part I – Contract Law and Professional Liability

1.1 Introduction

Contract law is the legal framework within which parties may create their own rights and duties by agreement. This framework affords significant freedom to the contracting parties to determine the terms of their agreement and provides the parties with legal remedies for breach of their agreement so that the commercial efficiency of contracting is enhanced.

A contract is an agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law. Accordingly, the content of contracts between design professionals and their clients is often closely negotiated and is intended to record their expectations and constitute the ground rules for their relationship until each party's contractual undertaking is discharged. The contracting process, therefore, can be viewed as the first phase of project delivery and the resulting contract can be viewed as the foundation for each phase of service that follows.

This section provides a broad overview of the principles of contract law and professional liability. While general in nature, the information provided will help the design professional understand the importance of contracts in structuring commercial relationships and in providing remedies when contracting parties fail to fulfill their obligations to one another or when others are injured as a consequence of their acts or failures to act.

1.2 Essential Elements of a Contract

There are four essential elements that are required for a contract to be legally valid: mutual assent, consideration, legal capacity to contract, and a legally permissible objective. Each of these is briefly described in the following sections.

1.2.1 Mutual Assent

Mutual assent is present when two or more parties have agreed to something. This usually happens when one party makes an offer that is accepted by the other party. For example, a design professional's proposal, submitted in response to a client's request for proposal (RFP), is usually an offer that the client may accept to bind the professional. In legal terms, an offer creates the power in the offeree (the one to whom the offer was made) to form a contract by accepting the offer.

Usually, an offer must be accepted exactly as offered. A response, therefore, is often either a complete acceptance or a complete rejection of the offer. Frequently, however, a "rejection" may simply contain differing terms from the offer. In that case, the response is called a counteroffer. The party who originally made the offer has the power to accept or reject the counteroffer. Obviously, this dialogue frequently occurs in contract negotiations.

As a rule, an offer may be withdrawn at any time prior to acceptance by the other party. Sometimes offers are withdrawn according to their own terms (e.g., they are stated to be open for only 30 days) or simply due to the passage of a "reasonable" amount of time. This is to prevent old offers that were never formally rejected from being accepted at an inappropriate time. To avoid uncertainty, it is generally a good policy to place a time limit for acceptance of the offer in the offer itself.

1.2.2 Consideration

Consideration is that goal, motive, or benefit that leads the parties to enter into the contract. It involves a bargained-for exchange of something of legal value. For the design professional, consideration is usually money. A promise to give a gift, however, is generally unenforceable because the term "gift" implies that there is no exchange of something of legal value. One party gives, the other receives, and no exchange is involved.

Legal value, however, is not necessarily the same as commercial value. One party could agree to pay one dollar for a residence that had been appraised at $300,000. The single dollar would be valid consideration for the contract because it has legal value, even though the commercial value of the house is much greater.

Alternatively, parties can supply the necessary consideration to a contract by performing some act that they are under no legal obligation to perform or by ceasing some activity in which they are legally entitled to engage. Promises are also good consideration. A contract in which one party promises to perform services in exchange for the other party's promise to pay is supported by valid consideration.

1.2.3 Legal Capacity to Contract

Each party to a contract must have the legal capacity to contract. Generally, that means that the parties must be of legal age (which varies from state to state) and reasonably able to understand the nature of what they are doing (e.g., not intoxicated or mentally incapacitated).

Legal capacity is not often a problem area with design and construction contracts. When it is an issue, the problem is usually to determine whether an individual or corporation was authorized to perform the services covered by the contract or whether the corporate officer or representative signing was properly empowered to sign such a contract on behalf of the corporation.

Since all states require that architects, engineers, and many other design professionals be licensed in the state before practicing there, a design professional who is not properly licensed may be denied access to the courts in the state to enforce a contract if that should ever be necessary. Therefore, to the extent that an unenforceable contract is no contract at all, proper state licensure is also a component of a party's legal capacity to contract.

1.2.4 Legally Permitted Objective

A legally permissible objective is anything that is not contrary to a statute; that is, those laws enacted by local, state, or federal governments, or the common law, which is the general law developed over the years through court decisions. A contract that requires either party to perform an illegal act is unenforceable.

1.3 Express and Implied Contracts

Once made, a valid contract can be categorized as either express or implied. A contract is implied when a promise can be inferred from the conduct of the parties rather than from their express words. For example, if a client failed to execute and return a proposed contract to a design professional, but subsequently made one or more progress payments that were due to

the design professional in accordance with the terms of the contract, the law would probably infer the existence of a contract.

Express contracts arise when the parties write or speak the elements to which they have mutually assented. Contracts in the design and construction industry are usually express contracts. Not all express contracts are in writing, however. Oral contracts are express contracts and are, generally, legally enforceable. Some contracts, however, must be in writing to be enforceable. The laws that impose such a requirement are commonly referred to as "statutes of frauds." Four types of contracts are generally required to be in writing. They include:

- Those in which one party agrees to assume responsibility for the debts of another party;
- Those in which an executor (one charged with carrying out the last will and testament of another) promises to pay the deceased's debts out of his own (the executor's own) funds;
- Those for the sale of land or any interest in land; and
- Those that cannot be performed within one year.

In addition to the above requirements, at least one state (California) requires that all contracts for architectural services or engineering services be in writing. In the absence of such requirements, however, there are no business or risk management advantages to oral contracts. An obvious problem with oral contracts is that their existence and terms are difficult to prove. Although parties may have the best of intentions, people move on to other assignments, and memories often fade. Even though a contract need not be in writing to be enforceable, executing written contracts is good policy and offers many benefits. A written contract provides objective, documented evidence of the agreement, unlike an oral contract, in which the terms are left to the subjective and possibly biased recollection of each party. Having contracts in writing provides an opportunity for each party to review those terms and make certain they are comfortable with their undertakings and obligations. In the event that a dispute cannot be resolved directly between the parties, a written contract provides a basis upon which some third party (e.g., judge or arbitrator) may resolve the dispute.

1.4 Prime Contracts and Subcontracts

Design and construction projects typically involve one or more tiers or hierarchies of contracts and contracting parties. For example, the contract between the project owner and design professional or project owner and contractor is referred to as a prime contract. The design professional may then be referred to as a prime design professional and the contractor as a prime contractor (or general contractor).

These "primes" may then subcontract certain portions of the services or work through subcontracts to independent consultants or subcontractors. The "subs" may, in turn, further subcontract the services or work to sub-subcontractors and so forth. While project owners typically seek to avoid contractual relationships with the prime professional's consultants and prime contractor's subcontractors, the prime contracts often include flow-down provisions designed to incorporate the terms and conditions of the prime contract into the terms and conditions of the lower tier subcontracts.

Due to the potential for conflicts over inconsistencies between prime contracts and

subcontracts, one prominent author has referred to subcontracting as the "Achilles' heel" of the design and construction process (see *Sweet on Construction Law*, 1997, 346). This potential for conflict points to the need for a comprehensive set of coordinated project contracts, such as the standard forms published by the AIA and EJCDC. These and other families of standard industry agreement forms are further described in Part II and many of the provisions contained in the AIA and EJCDC agreement forms are cited throughout this publication.

1.5 Contract Terms

In general, a contract term is any provision forming a part of the contract. Not all contract terms, however, are stated expressly. Terms that are not expressly stated by the parties, but are assumed to exist by the courts, are referred to as implied terms. For example, the law generally assumes a duty among parties to a contract to act in good faith and perform the contract fairly. This so-called "covenant of good faith and fair dealing" is viewed as so fundamental to the parties' contractual undertaking that it need not be negotiated or expressed in the contract. Similarly, if not otherwise expressed, additional terms typically implied in a contract for design professional services include the design professional's obligation to: (1) perform services with reasonable skill, care, and diligence; (2) perform services in accordance with applicable law; and (3) perform services in a reasonable time.

Other terms may be made a part of the parties' contractual obligations through incorporation by reference provisions. As discussed above, the terms of a prime contract may be incorporated by reference and thus flowed-down into a subcontract agreement. Similarly, regulations, statutes, schedules, insurance, and other requirements may be incorporated by reference into a prime contract or subcontract. To avoid ambiguity, however, it is often preferable to incorporate the specific provisions that the parties intend to govern in the event of a dispute rather than to simply reference an entire prime contract or other lengthy document for incorporation.

1.6 Contract Interpretation

Contract interpretation is the process by which the courts or others determine what terms are implied in order to fill gaps or resolve conflicts in incomplete or imperfectly coordinated contracts. Courts will not look outside the contract to deliver terms of an agreement unless there is a gap or ambiguity in the contract itself. In interpreting the contract, courts (or, in some instances, arbitrators or design professionals acting as initial interpreters) try to respond to a gap by filling it with an objectively reasonable term or with their best understanding as to what the parties would have wished had they negotiated the term and expressed it in the contract. In other circumstances, rules of precedence reflecting industry practice are applied. The following are some of the basic rules used to aid in interpretation:

- The contract should be interpreted as a whole in order to give reasonable, lawful, and effective meaning to all of the terms.

- In the event of a conflict, negotiated terms take precedence over standard terms or "boilerplate" language.
- Specific terms govern over general terms. (For example, unless the contract provides otherwise: special conditions take precedence over general conditions; specifications take precedence over drawings; and large-scale details take precedence over smaller-scale drawings.)
- Unless a different intention is expressed, general words are given their commonly accepted meaning and technical terms are given their normal technical meaning.
- Express terms, course of dealings, and trade usage are weighted in that order.
- Ambiguous terms (i.e., those susceptible to more than one reasonable meaning) are generally interpreted against the interests of the drafter.

1.7 Waiver

In some instances, one or both of the parties to a contract will waive a right that would otherwise be assumed to exist and that would be an implied term of the parties' contract. Waiver is defined as a party's voluntary relinquishment of a known right and may be express (in writing or orally) or, in some instances, inferred from circumstances.

Written contracts frequently include express waiver provisions such as those waiving the right to file a mechanic's lien, waiving the right to a jury trial, or waiving the right to consequential damages. (See, AIA Document B101-2007, § 8.1.3 and EJCDC E-500, 2008 Edition, § 6.10.E.) Such waivers are part of the parties' contractual exchange and, unless contrary to law, are enforceable.

Similarly, written contracts frequently include express "no waiver" provisions. These essentially state that the failure of either party to insist on the performance of the other party in a given instance will not be construed as a waiver with respect to any future performance. (See, EJCDC E-500, 2008 Edition, § 6.11.D.)

1.8 Contract Modification

A contract modification is any change that adds or deletes elements to the contract but leaves the general purpose intact. As a general rule, once made, a contract can be modified or changed orally or in writing. To avoid the problems associated with oral contracts as described in 1.3, most written contracts contain a provision prohibiting oral modification such as, "This agreement may be amended only by written instrument executed by both parties." (See, also, AIA Document B101-2007, § 13.1 and EJCDC E-500, 2008 Edition, § 8.02.A.)

There are essentially two types of contract modifications or changes: a bilateral modification and a unilateral modification. As the names suggest, a bilateral modification is agreed to by both parties, whereas a unilateral modification may be ordered at the discretion of one of the parties.

An unusual feature of construction contracts is that they typically afford the project owner the right to unilaterally change the contract, provided that the change does not constitute a cardinal change (a change so substantial that the contractor's performance constitutes a new undertaking). The project owner's insistence on such a change would be a breach of the original contract.

1.9 Contract Discharge

Contract discharge means that the legal duty of one or both of the parties has been terminated. Most contracts are discharged when each party has performed to the satisfaction of the other party. Of course, a contract may be discharged, modified, or replaced if the parties so agree. A contract may also be discharged if it becomes impossible to perform due to circumstances or events beyond the control of the parties (e.g., the death or incapacity of one of the parties) or by operation of law (e.g., the bankruptcy of one of the parties).

Finally, in the event of a material breach of the contract by one party, the non-breaching party is generally excused from performing and can sue to recover damages. Not every material breach, however, results in immediate contract termination. Many contracts include an "opportunity to cure" provision providing the defaulting party with an opportunity to cure or correct the default within a certain amount of time following the other party's written notice to cure. (See, EJCDC E-500, 2008 Edition, § 6.05.B.1.c.)

1.10 Professional Liability

According to *Black's Law Dictionary* (Abridged Sixth Edition, 1991), when one has a liability, that person or entity is legally "responsible for a possible or actual loss, penalty, evil, expense, or burden." Black's also says that one who is liable is "bound in law and justice to do something which may be enforced by action." For our purposes here, we will combine some frequently used concepts of liability into an informal working definition:

> Professional liability consists of those obligations that are or will be legally enforceable and that arise out of the design professional's performance of, or failure to perform, professional services.

Experience teaches that professional liability claims against design professionals are usually based in contract or in tort. The following sections briefly explore those sources of liability and how they potentially overlap.

1.10.1 Liability in Contract

Because contracts are promises that the law will enforce, it follows that the person or business entity to which the promise was made will be entitled to enforce the promise. When a valid contract is not performed substantially according to its terms, it is said to have been breached. Note that the failure must be substantial. Not every minor or merely technical deviation from the terms of a contract is considered to be a breach of contract. But if there is a substantial, unexcused deviation or failure to perform according to the terms of the contract, the breaching party will be liable under the law for that breach.

Sometimes, it is possible for someone who is not a party to a contract to sue for breach of that contract. This can happen when a contract was specifically intended to benefit a third party. Accordingly, those parties are called third-party beneficiaries and may have rights to sue under the contract. To avoid claims by third parties who are not specifically intended to

benefit from the contract, contracting parties often include a "no third-party beneficiaries" provision in their contracts. (See, AIA Document B101-2007, § 10.5 and EJCDC E-500, 2008 Edition, § 6.07.C.)

Finally, a party may be subrogated to the position of a contracting party, such as an insurer who has paid a claim or loss under its insurance policy. Unless the policy or contract of insurance provides for the waiver of this right, the concept of subrogation allows the insurer to "stand in the shoes" of its insured in pursuing recovery against responsible third parties. (See, *Professional Liability and Pollution Incident Liability Insurance Policy*, Member Companies of CNA Insurance, 2005, § VI.D, Subrogation, which reads, in part, "We hereby waive subrogation rights against your client to the extent that you had a written agreement to waive such rights prior to a claim or circumstance.") In response to the likelihood of subrogation actions by insurers, many design and construction contracts include "waiver of subrogation" provisions. (See, AIA Document B101-2007, § 8.1.2 and EJCDC E-500, 2008 Edition, § 6.04.E.)

Third-party plaintiffs or claimants who are not third-party beneficiaries of the contract or who are not subrogated to the position of a contracting party are generally left to remedies available in tort.

1.10.2 Liability in Tort

Torts are civil wrongs, i.e., violations of the personal, business, or property interests of private citizens. When the interests of individuals or business entities are violated, they may sue the responsible party in court to remedy the injury.

Unlike contracts, where the parties to the contract are known, the number of people and entities to whom design professionals may be liable in tort is indefinite. Design professionals can expect to be liable under tort law to anyone to whom they owed a duty to act with reasonable professional skill and care, that is, non-negligently. This standard is referred to as the negligence standard or, alternatively, the professional standard of care.

Clearly, this standard can expand the express obligations assumed under a particular contract. Courts look to the terms of the contract as well as statutes, codes, standards, and other sources to determine the scope of the design professional's undertaking. They also consider whether the specific circumstances of that undertaking suggest that it was reasonably foreseeable that a given claimant would be injured if the design professional did not act with due skill and care. If a court is convinced that the design professional should have been able to foresee that specific persons or classes of persons would be injured if there was substandard performance of professional services, then the design professional will probably be liable to those persons if such harm occurs.

When the criteria mentioned above are applied in actual situations, clients, members of the public who use or come in contact with construction projects, contractors, subcontractors, construction laborers, lenders, insurers, sureties, and others may be included in the list of those to whom the design professional might be liable. As a consequence, design professionals must develop the ability to assess the likelihood that someone could be harmed by their actions or inaction and should take steps to prevent or mitigate potential harm.

1.10.3 Misrepresentation

In recent years, misrepresentation, "an untrue statement of fact…or false representation" (*Black's Law Dictionary*, Abridged Sixth Edition, 1991) has become an increasingly important

source of liability for design professionals. In contract law, a misrepresentation is any erroneous statement of fact made by one party that has the effect of inducing the other party into the contract. Generally, the effect of such misrepresentation is to make the contract voidable at the election of the representee, i.e., the party who relied on the representation. (See, also, 2.2.2 for a brief discussion on the "language of representation.")

Similarly, the tort of negligent misrepresentation would be a viable claim for a third-party plaintiff who relied, to its detriment, on erroneous information or a misrepresentation provided by a design professional in association with the services performed on behalf of the client. An example would be the claim of a lender who, in extending a loan to the design professional's client, relied to its detriment on erroneous information provided by the design professional.

To mitigate exposure to claims of negligent misrepresentation, design professionals are urged to describe any representation as a professional opinion limited to and based upon the design professional's scope of services. Also, while a statement of opinion will generally not be construed as a statement of fact, a court is more likely to construe such an opinion as a statement of fact if the representor claims special knowledge or expertise. Accordingly, design professionals should not only qualify representations as professional opinions, but they should avoid any characterization of their professional opinions as "expert opinions" unless the opinion is based on facts within the professional's knowledge and control.

1.11 Liability for Employees, Consultants, and Joint Venturers

Design professionals are, of course, liable for their own personal actions. They are also liable for the actions of others under specific circumstances. Those professionals who are employers are liable for the actions or failures to act of their employees, if such activity was within the normal course of the employee's duties on behalf of the firm. This kind of vicarious liability (liability incurred via another person) is imposed due to the doctrine of *respondeat superior*. Loosely translated from the Latin, this means that the "master" should respond for the actions of the "servants."

Design professionals are also liable for the professional acts and omissions of the consultants that they hire or those for whom the design professional takes responsibility by contract. As discussed in 1.4, the prime design professional normally contracts to provide a certain scope of services, some of which are then subcontracted to independent consultants. If these consultants breach their contracts, that failure might cause the prime to be in breach of the prime contract and become liable to the client. Similarly, actions of the consultants may injure others to whom the prime might also be liable.

Finally, design professionals are liable for the acts and omissions of their partners and joint venturers. A joint venture is essentially a partnership, but only for a specific, and usually limited, purpose. Although partnership agreements and joint venture agreements usually allocate responsibility and liability between the parties (it may be 50/50, 60/40, or some other combination), that allocation is internal only. To the rest of the world, the partners or joint venturers are, in essence, co-promisers and are "jointly and severally" liable. That means an injured party may recover the full scope of damages awarded by the trier of fact (e.g., court, arbitration panel) from either party or from both parties in any combination.

1.12 Types of Damages

There are essentially three categories of damages for which design professionals may be liable: 1) direct damages; 2) consequential damages; and 3) statutory damages.

Direct damages generally consist either of bodily injury to, or wrongful death of, a person or damage to property. The damages must be a direct result of the proscribed actions or a failure to act. Consequential damages do not directly or immediately result from particular actions or a failure to act—they depend on intervening circumstances. Nevertheless, they must be a reasonably foreseeable result of an activity. They can include economic losses, such as lost profit. Direct damages and consequential damages, together referred to as compensatory or actual damages, are intended to fully compensate an injured party for the injury sustained. They are not intended to compensate an injured party for more than its actual loss. Statutory damages are those that are prescribed by language in a statute. Statutory damages may be awarded regardless of whether a party actually suffers damages.

The damages for which an injured party can recover depend on the theory of liability on which the claim is based. Obviously, statutory damages are created by specific laws. For example, it is possible to recover statutory damages for violating the copyright of another person or business entity. If copyrighted material is improperly copied, the author will often be able to recover damages specified by law, whether or not there were any actual, provable damages caused by the copying.

Consequential damages are most closely associated with tort law. The public policy objective behind much of tort law is to promote public safety and to allocate fairly the costs of physical injuries and property damage among the parties who caused the damages.

When a negligent action or failure to act by a design professional results in the bodily injury or death of a person, the law is clear that victims may sue the design professional, regardless of whether there was a contract between them. Until approximately 40 years ago, the general rule under the economic loss doctrine was that one party could not sue another unless the two were parties to a contract (called privity of contract). Today, with some significant exceptions, privity of contract is not required for a person or business entity to sue a design professional for negligence. The same is true if the design professional's negligence causes damages to the property of a person or business entity. Regardless of whether the parties had a contractual relationship, the design professional will be liable under tort law for such damages if found to be responsible.

The goal of contract law, on the other hand, is to promote commercial market efficiency. That is done in part by assuring parties that the risks and rewards, benefits and burdens that they negotiate in contracts will be respected and enforced. In other words, the parties allocate risks and rewards in their contracts, and the courts should protect their economic expectations. One manifestation of this policy is that consequential damages are not usually available for breach of contract. For a party to recover such damages for breach of contract, the wronged party would have to prove that the breaching party actually knew that such damages would occur as a result of the breach of contract.

The law of torts and the law of contracts, and the public policies underlying them, potentially overlap when so-called economic losses occur. Some courts have adopted an economic loss rule to preserve the distinctions between contract and tort remedies. Generally, this rule provides that a

party may not sue in tort for economic losses unless it has a contractual relationship with the party being sued.

For example, a contractor who believes that a design professional under contract to the client performed construction contract administration services negligently and thereby put the contractor through unnecessary expense may want to sue the design professional for alleged losses. In states with the economic loss rule, the contractor would not be permitted to do so. That is because the contractor has no contractual relationship with the design professional and there is no bodily injury or property damage involved, only loss of money, i.e., an economic loss. If the contractor were allowed to sue the design professional in tort for such damages, it would disrupt the allocation of risk that the client, design professional, and contractor had negotiated in their contracts and could allow the contractor to achieve a better result than it had otherwise been able to negotiate.

1.13 Defenses to Liability Claims

A number of defenses are available to design professionals faced with professional liability claims, one or all of which may be applicable in any given case. A brief discussion of several of the more common defenses follows.

1.13.1 Statutes of Limitations and Statutes of Repose

Statutes of limitations and statutes of repose have been enacted in most states. A statute of limitations generally provides that once a legal claim accrues to a party, that party has a specific period of time in which to sue. Accrual of a claim is usually that point where a party has reasonable notice of the facts that would justify legal action against someone for damages. It can be difficult to determine exactly when the period begins to run, and the number of years allowed varies from state to state and from legal theory to legal theory. For example, in many states a breach of contract claim must be made within six years of the date of the breach. A claim for negligence, however, may only be available for three years from the date of discovery.

A statute of repose is similar to a statute of limitations, but its time period begins to run upon the occurrence of some event, not necessarily a party's notice of the facts constituting a claim. Generally, under a statute of repose, all claims for negligence in the design and construction of an improvement to real property must be made within a specified period of years following the date the improvement was placed into service (the date of substantial completion), regardless of when such negligence was first discovered. Such statutes recognize that once a project has been completed for a certain span of years, factors such as maintenance, occupancy and usage, and other reasons suggest that it is unfair to continue to subject design and construction entities to claims for problems with the facility. (For state-specific statutes, see NSPE's *State-By-State Summary of Liability Laws Affecting the Practice of Engineering*, National Society of Professional Engineers, 2008, **www.nspe.org**.)

Some standard agreement forms attempt to add some certainty to this area of the law by providing a positive trigger to the running of the statutory period, whatever it might be. (See, EJCDC E-500, 2008 Edition, § 6.11.E.) Alternatively, they may impose a limit on its duration. (See, AIA Document B101-2007, § 8.1.1.) Parties to a contract can, within reason, negotiate

a shorter or longer period for making claims than provided in the law. For example, a client and design professional could agree that all claims by either party against the other must be made within three years from the date of substantial completion of the project. (Statistically, following substantial completion of a facility or other improvement to real estate, the majority of any claims filed against design professionals occur within three years, and almost all such claims are filed within six years.)

1.13.2 Comparative Negligence and Contributory Negligence

Comparative negligence is an alternative, in some respects, to the idea of joint and several liability among joint tortfeasors (two or more parties liable in tort for the same injury). For those states that use comparative negligence, the relative amount of each party's negligence is measured as a percentage of the damages incurred by the injured party. For example, if both the construction contractor and the design professional jointly cause an injury to the project owner or a third party, they could be held jointly and severally liable. That means that the design professional might have to pay all of the injured party's damages even if only one percent at fault. In states that use comparative negligence concepts, if the design professional is found to be only one percent liable, then he or she would only have to pay one percent of the damages, regardless of whether or not the injured party could recover the other 99 percent from the contractor. Clearly, this is a more equitable result from the perspective of the design professional.

Contributory negligence occurs when the party making the claim is partly responsible for its own injury or damages. When this concept applies, the damages that the injured party can recover are reduced by the percentage of that party's own negligence. If the injured party's contributory negligence is substantial, recovery may be barred entirely. For example, in some states that use contributory negligence, injured parties must be less than 50 percent negligent or they cannot recover at all. Because of the potential harshness of such a result, the majority of states have replaced contributory negligence acts or doctrines with comparative negligence.

1.13.3 Immunity

A design professional may enjoy immunity or be protected from claims under certain circumstances. When the design professional acts as an agent of the client, effectively acting as the client, there is often immunity from claims. The basis of this immunity is that the design professional is a substitute for the client and any liability is the client's and not that of the design professional. An example of this would be a situation where the design professional acts on behalf of a client during the bidding period and causes one of the bidders to be improperly precluded or puts them to unjustified expense. If the bidder recovers from the client (the principal), the design professional (the agent) will generally be immune from a separate suit from the bidder.

Another situation in which a design professional may be immune from suit is when the design professional renders a decision in good faith when acting as an arbitrator or decider of disputes between the project owner and contractor. This immunity is specifically provided for in the standard form agreements of the AIA and EJCDC. It is also called for in the Construction Industry Rules of the American Arbitration Association with respect to its construction arbitrators. Immunity of this nature, often referred to as quasi-judicial immunity, is necessary if the design professional is to perform services properly without fear of suit for defamation or interference with business relationships.

1.13.4 Betterment

Betterment occurs when an injured party is compensated for more than its loss. Although it may be appropriate for a design professional to be financially responsible for damages caused by its negligent acts or omissions, the responsibility does not extend to improving the project or the client's economic position compared to what it would have been if no such error or omission had occurred. For example, assume that an architect negligently omitted a requirement for railings in a stairwell of a public building. Accordingly, they were not part of the contractor's construction price. When the omission is discovered, assume that the contractor will be given a change order for the cost of adding the missing handrails. If the client could recover from the architect for the full cost of the handrails, there would be betterment. The client would have received for free what it would have had to pay for if no error had been made. On the other hand, if the cost of the railings and associated labor increased from what they were at the time of bidding, or if remedial work was required in connection with the installation of the handrails, then it would be appropriate for the architect to be responsible for such additional costs since the client would never have incurred the costs but for the negligent error or omission.

1.13.5 Waiver and Estoppel

Waiver, as described in 1.7, is the voluntary and intentional giving up of a known right. For example, if a client knowingly agrees to accept less than full performance from a contractor, that would be a waiver of the right to enforce full compliance. That waiver might be made expressly in words or in writing, or it might be implied from the circumstances. Often, waivers are the result of negotiations in the settlement of claims.

Estoppel is similar to waiver, but with the following principal difference: waiver only requires action by one party while estoppel requires action by both parties. In essence, estoppel operates to stop someone from doing something that they would otherwise have the right to do. The reason both parties must be involved is that it requires the first party to take action on which the second party relies to its detriment. For example, if an engineer's client tells the engineer that he need not visit the site on a particular day, which the engineer would have otherwise done, the client will be estopped from suing the engineer for not observing construction activity that would otherwise have been observed. Estoppel is based on equity and fairness principles and can be a valuable defense in a number of situations.

1.14 Effect of Form of Business Entity on Liability

Design professionals and their clients organize their businesses in a variety of different legal forms, including sole proprietorships, partnerships, corporations, and limited liability companies or limited liability partnerships. Each form has somewhat different implications for general business liability and professional liability risk management. Design professionals should consider these implications when establishing their practices and when contracting with their clients.

A note on pre-contract risk management is appropriate before proceeding further. Regardless of the form of a client's business organization, the design professional should

recognize that professional services contracting results in a commercial transaction in which the design professional effectively extends credit to the client for periods often exceeding 90 days. Accordingly, credit checks of the client should be considered. Alternatively, if the client is a governmental entity, the design professional should verify that money has been appropriated to pay for the contemplated professional services.

1.14.1 Sole Proprietorships

Sole proprietorships are businesses owned by one person. There may or may not be any employees (there may be just a sole practitioner). There is no legal distinction between the business and personal assets of the sole proprietor. If the proprietor becomes liable for damages due to either business or professional activities, all of the proprietor's personal assets are potentially available to satisfy the judgment. Note that only the assets of the proprietor are available. If assets are placed in trust for the benefit of children, for example, or are titled in the spouse's name, then they usually are not the proprietor's property and are not available to creditors. Such transfers should be made as an integral part of long-range estate planning, with appropriate advice of an attorney experienced in estate planning and succession issues.

1.14.2 Partnerships and Joint Ventures

Partnerships are formed when two or more people agree to undertake business activities together. All partners are jointly and severally liable for obligations of the partnership. Generally, all personal property of the partners is potentially available to satisfy judgments against the partnership. In that sense, the situation is similar to that faced by sole proprietors. The main difference is that not only can one's own acts or failures to act place all personal assets at risk, but one's partner's acts conducted in furtherance of the partnership business can also do so.

As noted in 1.11, a joint venture is a form of partnership which is created for a single purpose. For example, two unrelated design professional firms who wish to form a partnership to perform services on a particular project would traditionally form a joint venture. Similarly, a design professional firm and a contractor could form a joint venture in connection with a design-build project. As with a general partnership, however, each party is fully liable for the joint venture and the other's acts and omissions. The control of the joint venture and allocation of risk and reward is usually addressed in a joint venture agreement. Both the AIA and EJCDC publish standard form joint venture agreements. (See, AIA C801-1993 and EJCDC E-580, 2005 Edition.) A limited liability partnership (LLP), as discussed below, is a recent alternative to a joint venture.

1.14.3 Corporations

Corporations are legal entities in and of themselves. That means that they are legally distinct from the people who own and run them. Two typical types of corporations are professional corporations and business corporations. Professional corporations (sometimes called professional associations) are those in which all shares of ownership (or a minimum percentage) in the corporation must be held by licensed professionals in the appropriate profession. For example, generally, in a professional architectural corporation, all shares of stock must be owned by licensed architects. Some states require the use of this type of corporation for those that provide professional services to the public.

On the other hand, a business corporation can be owned by non-licensed persons. General business corporations are not allowed by all states to provide professional services. Even when they are so permitted, there is usually a requirement that at least a majority of the shares of ownership be owned by licensed design professionals. Both professional corporations and business corporations can be either "C" or "S" corporations. These designations are from the Internal Revenue Code and have principally to do with the tax status of the corporation and the shareholders. They have no effect on the liability exposure of the corporation.

In general, the owners of corporations are not personally liable for acts or failures to act by the corporation. They only stand to lose the value of the stock that they own in the corporation if a large claim or liability affects its worth. If the insurance and assets of the corporation are not adequate to satisfy its obligations, claimants generally have no right to pursue the personal assets of the individual shareholders.

This shield from personal liability is only available for general business liabilities, however, not for professional liability. Since only individuals are tested and licensed to practice as design professionals, those licensed individuals cannot escape liability for their personal actions or failures to act. A corporation may provide some increased protection compared to a partnership, however, because the actions of one shareholder do not place the personal assets of other, non-involved, shareholders at risk, as is the case with a partnership.

1.14.4 Limited Liability Companies and Limited Liability Partnerships

Limited liability companies and limited liability partnerships are fairly recent statutory creations in which the personal liability of the members or partners can be reduced while still maintaining some of the advantages of a general partnership, such as flow-through tax treatment.

A limited liability company (LLC) is a business entity that provides all members with protection from personal liability for company debts while allowing them to participate in management and control of the company. The personal liability shield of an LLC is broad, but as is the case with a corporate entity, an LLC will not shield individuals from liability caused by their own tortious action (negligence, professional malpractice). An LLC will, however, protect the other members of the LLC from liabilities caused by another member's tortious actions.

A limited liability partnership (LLP) is a general partnership in which partners are afforded protection from certain types of partnership liabilities. The types of liabilities from which an LLP partner is protected vary greatly from state to state, but generally LLP partners are not liable for the tortious actions (negligence, professional malpractice) of other partners. An LLP partner is not, however, protected from his own tortious actions or from other types of partnership liabilities. Unlike an LLC, an LLP may not protect a partner from personal liability for some debts of the partnership, such as those caused by a breach of contract.

1.15 Summary

To summarize the foregoing, design professionals should understand the following:

- Contract law allows contracting parties to create their own rights and duties by agreement and affords the parties legal remedies for breach. The essential elements of a valid contract are: (1) mutual assent; (2) consideration; (3) legal capacity to contract; and (4) legally permitted objective.
- Legally enforceable contracts may be written or oral, although it is always a good policy to execute a written agreement. Both written and oral contracts are called express contracts. When a contract can be inferred from the conduct of the parties, it is called an implied contract. Contract terms can also be express or implied. Implied contract terms are assumed to exist under the law, even though they are not spelled out within the contract.
- Contract modifications or changes usually require the consent of both parties. An unusual feature of construction contracts, however, is that they often allow the project owner to change the contract unilaterally, provided that the change is not a cardinal change, i.e., one so substantial as to constitute a new undertaking.
- Design professionals typically face two types of liability—liability in contract and liability in tort. When a party substantially fails to perform a contractual obligation, that party is considered to be in breach of the contract and will be liable for that breach. In contrast, torts are civil wrongs—that is, they involve violations of the personal, business, or property interests of private citizens. Thus, liability in tort is much more open-ended than liability in contract. Design professionals are liable not only for their own actions, but under some circumstances for those of their employees, consultants, and joint venturers.
- Design professionals may be held liable for three different types of damages: (1) direct damages; (2) consequential damages; and (3) statutory damages. Consequential damages are most often associated with tort law. Some states have adopted the economic loss rule, which does not allow a party to sue in tort for economic losses unless it has a contractual relationship with the party being sued. The purpose is to preserve the sanctity of contractual negotiations and agreements.
- Common defenses to liability claims against design professionals include statutes of limitations and statutes of repose, comparative negligence and contributory negligence, immunity, betterment, waiver, and estoppel.
- Different forms of business organization affect the liability exposure of design professionals and their clients. Professional liability is always personal, and there is no shield to liability for personal professional negligence. Nor is there any shield from business or professional liability for sole proprietors and partners in a partnership for damages that result from business and professional activities. In corporations, stockholders may have a shield to liability that results from another stockholder's actions or failures to act that do not involve them personally. Limited liability companies (LLCs) and limited liability partnerships (LLPs) are fairly recent statutory creations in which the personal liability of the members or partners can be reduced while still maintaining some of the advantages of a general partnership.

Part II – The Professional Services Contract

2.1 Introduction

It is often helpful to think of the professional services contract as an inventory and explanation of rights, responsibilities, and procedures. Through their contract, the parties can state the goals and expectations they have of each other and of third parties. They can allocate rights and responsibilities, risk and reward. They can establish procedures for dealing with conditions that may change during the performance of their contractual duties. And, they can mitigate the impact of disputes by establishing dispute resolution provisions that are both timely and fair. Such a contract can allow performance to unfold over time without placing either party at the whims of the other.

This section discusses the contracting practices, contract types, and contract terms commonly used in the procurement of design professional services. A broad familiarity with contracting practices and language is often critical to the design professional's ability to negotiate a fair and equitable contract that is consistent with project requirements and available compensation. That familiarity, along with an understanding of the coverage afforded by the design professional's professional liability insurance policy, is crucial to identifying inappropriate and uninsurable contract terms, such as express warranties and broad indemnity obligations.

While referencing the project-specific and general condition terms of the standard form agreements published by The American Institute of Architects (AIA) and the Engineers Joint Contract Documents Committee (EJCDC), this section also includes numerous sample contract provisions that design professionals will find useful in two respects:

For comparing the proposed language submitted by prospective clients to what we consider to be generally equitable language presented in these sample provisions.

For developing terms and conditions to incorporate into professional services agreements, particularly letter agreements incorporating terms and conditions documents.

Many of these sample provisions are included in Schinnerer's *Terms and Conditions Review Guide*, attached to this publication as Appendix B and available as a download from Schinnerer's website at **www.PlanetRiskManagement.com**.

2.2 Content of Professional Services Contracts

Experience suggests that written contracts include certain basic elements. These are described below. The similar elements reflected in so-called letter agreements are addressed in 2.3.1.

2.2.1 Introductory Provisions

The introductory provisions typically include the title of the contract (e.g., "AGREEMENT BETWEEN OWNER AND CONSULTANT") and an introductory clause that identifies the date of the agreement, the parties to the agreement, the project name and location, and, in some instances, a brief project description. Some contracts also include one or more recitals (often beginning with the word "Whereas") following the introductory clause.

As a general rule, the date in the introductory clause should be the only date given in the contract so there is no confusion as to when the contract takes effect. This assures a clear baseline against which to identify any subsequent changes in the project's requirements.

Also, the identification of the parties in the introductory clause should include each party's full legal-entity name, its jurisdiction of organization, and define the entity type. The identification of each party and the project is usually followed by a shortened name for each, in parentheses, making each shortened name a defined term. A sample introductory clause follows:

> This Agreement is dated August 4, 2008 ("Effective Date"), and is between SKY-MART STORES, INC., a Delaware corporation ("Owner"), and RISK READY DESIGN LLC, a Florida limited liability company ("Consultant") for Parking Lot Renovations and Expansion, Store #47, Gainesville, Florida ("Project").

When recitals are included as part of the introductory provisions, they often describe the purpose of the contract and provide background information that helps to introduce the specific provisions that the parties are agreeing to. Sometimes the project is identified and defined in the recitals. If the contract is a subcontract, a recital may be used to identify the prime contract, the parties to the prime contract, and date of the prime contract. The last recital is typically used to introduce the body of the contract (e.g., "The parties therefore agree as follows").

While courts generally regard any recitals as subordinate to the body of the contract, they do consider recitals when interpreting the contract and determining the intent of the parties. Thus, recitals should be carefully reviewed for both accuracy and relevance to the parties' agreement.

2.2.2 The Body

The body of the contract addresses what the parties are specifically agreeing to. It may include a list of definitions, project-specific terms, and general condition terms, the latter often referred to as "boilerplate."

Defined terms that occur throughout the contract are often placed in a definition section at the beginning or end of the body of the contract so that they do not clutter up the text. (See, e.g., EJCDC E-500, 2008 Edition, Article 7.) While many of the terms delineated in the definition section may be generally familiar, the specific definitions may have an important effect on the parties' undertakings and obligations. Design and construction projects typically involve a complex system of individual contracts—design and construction, prime, and sub. From a practical standpoint, the terms of each contract must take account of the terms of the other contracts since the efforts of the various project participants are generally interdependent.

Accordingly, defined terms should be thoroughly coordinated across all project contracts. To facilitate this effort, both the AIA and EJCDC owner-design professional agreement forms specify that the general conditions documents to be used as a part of any construction contracts shall be the respective AIA or EJCDC standard general conditions form. (See, e.g., AIA Document B101-2007, § 3.6.1.1 and EJCDC E-500, 2008 Edition, § 6.01.G.) In addition and as further described in 2.6, the AIA and EJCDC publish design professional–consultant contract forms that are coordinated with their respective owner–design professional forms as well as their respective general conditions documents.

The contracting issues commonly addressed in project-specific and general condition terms are discussed in 2.4 through 2.6. In addition to those contracting issues, however, design professionals should become attuned to the specific categories of language employed in contracts and their implications to the performance and undertakings of the contracting parties. Categories of language used in contracts are comprehensively addressed in *A Manual of Style for Contract Drafting*, by Kenneth A. Adams (American Bar Association, 2004, Chapter 3). The principal categories of language addressed by Mr. Adams include the following:

Language of Representation. A representation is an express or implied statement of fact by one party to induce or otherwise influence the other party to enter into the contract. In many contracts, a list of such statements—covering existing or future circumstances or events—comes under the heading "Representations and Warranties." Warranties, like representations, are assurances of some fact upon which the other party may rely. In general, any statement of fact not within the knowledge or control of the representing party should be avoided. Moreover, virtually all professional liability insurance policies specifically exclude express warranties, however labeled, from coverage. (See 1.10.3 for a brief discussion on the related topic of "misrepresentation.")

Language of Performance. This type of language indicates that the actions described are taking place at the time of the signing of the contract; consequently, language of performance is in the present tense. This type of language should not employ the passive voice as it is important to be unequivocal about who is taking the action. The word "hereby" is often used in the language of performance to indicate that the action takes place by virtue of that provision. The following is an example of language of performance: "Owner hereby retains and engages Consultant to perform the services described in this Agreement."

Language of Obligation. This type of language is used to state the obligations of the parties to the agreement. In legal language, the word "shall" is used to indicate "has a duty to," while the word "will" is usually reserved to indicate future actions. Sometimes the word "must" is substituted for "shall," however, "must" means "is required to," which does not always express that the subject has a duty.

Language of Discretion. In contrast to language of obligation, this type of language indicates that the party can decide whether or not to take the action; that is, the action is within the party's discretion. The most commonly used word to express discretion is "may." In legal terms, it is sometimes said that "shall" is mandatory and "may" is permissive. Also, the word "may" can be used to indicate that some action is possible. Generally, the difference in meaning is obvious from the context. The following is an example of language of discretion within a contract: "Either party may terminate this agreement upon thirty days' prior written notice to the other party."

Sometimes the word "may" is used with the word "only" to limit the actions over which the subject has discretion. For example, the above statement could be changed to read: "Either party may only terminate this agreement upon thirty days' prior written notice to the other party." This makes it clear that the discretion is limited to this particular circumstance.

Language of Condition. The language of condition is used in contracts to express a duty that is triggered by the occurrence of an uncertain future event. Until that event happens, the duty does not exist. So if the event does not occur, the obligator is not in breach of contract because there is no duty until that event happens. Conditions agreed to by the parties are called express. Sometimes the court will fill in a condition, in which case it is said to be implied.

The language used to express condition is familiar to all of us. Generally, it takes the form of a

subordinate clause that begins with "if," "when," "on condition that," "subject to" or other such words. This part of the statement contains the condition that, when fulfilled, will cause the duty to exist. The second part of the sentence, sometimes called the consequent, contains the duty itself. Often the consequent contains the verb "must." An example of the language of condition is found in the Section VI, Conditions, Paragraph B.1 of the CNA *Professional Liability and Pollution Incident Liability Insurance Policy* (2005) as follows:

> If there is a Claim, you must…promptly notify us in writing. This notice must be given to us within the policy year in which the claim was made or within 60 days after its expiration or termination.

In most cases, the antecedent or subordinate clause will precede the main clause, although this is not always the case. Often the words "provided that" or "as long as" are used to express conditions when the subordinate clause comes at the end of a sentence.

Sometimes the word "unless" is used as a sort of double-negative to express condition. For example, "no payment shall be made, unless the design professional submits written proof of substantial completion of services described in this contract."

Nearly any event can be a condition as long as it occurs before the existence of the contract and is not a certain event (such as the passage of time). When we speak of conditions here, we are talking about what is sometimes called a "condition precedent" as opposed to a "condition subsequent." While a condition precedent triggers a duty, a condition subsequent terminates a duty that already exists.

The event upon which the duty is conditioned may be one that is within the control of the obligator (services completed to satisfaction of the client), the obligee (furnishing proof of loss), a third party (financing), or no one at all (damages as the result of a fire).

Language of Prohibition. This type of language indicates that the parties are prohibited from taking some particular action. "Shall not" and "must not" are the usual ways of indicating prohibition. "Shall not" means "has a duty not to," while "must not" means "is required not to."

Using "may not" is not a good choice since it could have several different meanings and thus is ambiguous. Sometimes a prohibition is indicated by an exception to the language of discretion; for example, the example used above could be changed to read: "Either party may terminate this agreement; except that neither party shall do so without giving thirty days' prior written notice to the other party."

2.2.3 Concluding Clause and Attachments

The body of the contract is followed by a concluding clause, signature spaces, and any attached exhibits or schedules that are referenced in the body of the contract. A concluding clause consistent with the sample introductory clause provided in 2.2.1 would read as follows:

The parties have signed this Agreement on the date first stated above.

SKY-MART STORES, INC.
By: _____
Name:

Title:
RISK READY DESIGN, LLC

By: _____
Name:
Title:

In general, exhibits are stand-alone documents (e.g., the client's program, the design professional's proposal, or a copy of the prime agreement). Exhibits can be numbered (1, 2, 3) or lettered (A, B, C) consecutively.

Schedules typically consist of information that is part of the agreement but has been located separately for convenience (e.g., hourly pay rates for various classes of employees). Schedules can be numbered or lettered consecutively or identified by the contract section to which they relate (e.g., 2.2.3 Schedule).

2.3 Types of Professional Services Contracts

Written professional services agreements generally fall into one of the following categories: letter agreements, purchase orders, standard form agreements, modified standard form agreements, or custom agreements.

2.3.1 Letter Agreements

Some clients and design professionals prefer to use letter-form agreements rather than more formal types. Letter-form agreements are often suitable when the project is small with a well-defined, relatively routine scope of services.

Letter agreements typically include the following elements: the sender's address, the recipient's address, the date, the salutation, an introductory sentence, the substantive terms (project-specific and general conditions), a closing sentence, the sender's signature, and the recipient's signature. Like any other written agreement, the letter agreement should be signed by both parties to show mutual assent to the terms stated in the letter.

The letter itself should address project-specific information and terms, such as the specific scope of services, client obligations, and compensation—including amount, basis, and schedule of payment. It should also include an identification of additional services offered to the client and any provisions relating to schedule or time for performance of services.

2.3.2 Purchase Orders

Some clients use purchase orders to procure all goods and services. In these cases, a client may enter into a base agreement with the design professional that generally defines the standard terms of the agreement and then issue purchase orders to the design professional for project-specific assignments. If the client uses the same purchase-order forms for all procurements (for example, hiring a construction contractor, retaining a design professional, or purchasing goods or equipment), the form will probably contain provisions that are not appropriate for use in the procurement of design professional services.

Sometimes clients are inflexible about changing or deleting these inappropriate provisions. Ideally, these provisions should be addressed in the contracting process, and modifications should be made to reflect the procurement that is the subject of the agreement. For example, in the procurement of goods or construction work, it is customary and generally appropriate for a client to require express warranties and performance guarantees. The same is not true for professional services, which are usually governed by a professional standard of care or negligence standard, rather than an express warranty or product liability standard.

Also, when a client uses purchase orders in conjunction with a base agreement to procure project-specific services, care must be taken to make certain that the purchase order contains accurate, complete project-specific information, including scope of services, terms, as well as the method, amount, and timing of payment.

2.3.3 Standard Form Agreements

Various construction industry associations have developed standard forms of agreement for adaptation and use as professional services contracts. Associations publishing extensive families of documents that address various methods of project delivery include the AIA, the EJCDC, and, most recently, ConsensusDOCS, a coalition of approximately 20 trade organizations led by the Associated General Contractors of America (AGC). Other associations publish documents applicable to specific methods of project delivery including the Construction Management Association of America (CMAA) and the Design-Build Institute of America (DBIA). Still other associations publish discipline-specific contract forms such as the Council of American Structural Engineers (CASE) and the American Society of Landscape Architects (ASLA). Some of the common characteristics of these industry standard form agreements follow:

- Generally reflect prevailing customs, practice and experience.
- Provide a framework for the agreement between the parties.
- Drafted for broad applicability—must be adapted to project-specific circumstances and requirements.
- Internally coordinated and consistent.
- Periodically updated.
- Reflect the perspective of the drafting organization.
- Influence the drafting of custom agreements.

As noted in the preface to this publication, whenever appropriate to the presentation of the

material, reference is made primarily to provisions contained in the standard documents published by the AIA and EJCDC. We focus on the AIA and EJCDC documents because they are the industry's principal design professional-driven contract document programs.

The AIA Documents Program. The AIA was founded in 1857 and is the nation's leading membership association for architects. It began publishing contract documents in 1888. Today, the AIA documents program has expanded to include over 100 contract and administrative forms covering various methods of project delivery. AIA documents are used on a broad range of building projects, ranging from modest residential construction to major commercial, governmental, and institutional work. It is likely that well over half of all design and construction projects in the United States utilize a slightly or substantially modified form of an AIA document.

The most important AIA form, for the purposes of this publication, is AIA Document B101-2007, *Standard Form of Agreement Between Owner and Architect* (referred to herein as AIA B101-2007). This is the AIA's "flagship" owner-architect agreement. Extensive information concerning the AIA documents program, including form descriptions, purchasing information, and commentaries on individual AIA documents is available at **www.aia.org**.

The EJCDC Documents Program. EJCDC was founded in 1975 as a successor to a documents program founded by the Professional Engineers in Private Practice division of the National Society of Professional Engineers (NSPE/PEPP) in 1963. EJCDC is now a joint venture of NSPE, the American Council of Engineering Companies (ACEC), the American Society of Civil Engineers (ASCE), and the Associated General Contractors of America (AGC). EJCDC documents are used on various engineered projects such as roads, bridges, airports, industrial plants, and water, wastewater, and solid waste facilities.

The most important EJCDC form—for the purposes of this publication—is EJCDC E-500, *Standard Form of Agreement Between Owner and Engineer for Professional Services*, 2008 Edition (referred to herein as EJCDC E-500, 2008 Edition). This is EJCDC's principal owner-engineer agreement form. Document descriptions, commentaries and purchasing information are available at **www.ejcdc.org** and at the websites of each EJCDC sponsor organization.

At scheduled intervals or in response to industry needs, the AIA and EJCDC standard form documents are amended through an extensive review process, and new editions are published. According to the "drafting principles" published by the AIA (2005), standard contract documents should strive for balance and fairness by:

- Conforming to common law and statutory precepts adopted in the majority of jurisdictions;
- Seeking industry consensus among all parties whose interests may be significantly impacted by individual documents; and
- Allocating risks and responsibilities to:
  - The party best able to control them;
  - To the party best able to protect against unexpected cost, or
  - To the client, when no other party can control the risk or prevent the loss.

Due to their widespread use, many of the more important provisions of the AIA and EJCDC documents have been interpreted by courts, and much of the court precedent reflecting those interpretations has been published. This establishes a level of confidence that these provisions have a settled meaning and application.

2.3.4 Modified Standard Agreement Forms

Often, the client or the design professional will require amendments or addenda to standard form agreements. Generally, these changes are intended to address project-specific issues and may also address issues that may not be included in standard form agreements. In preparing these amendments or addenda, it is important to use terms and phraseology consistent with the terms of the standard form agreements. A particularly helpful guide to the amendment process is AIA Document B503-2007, *Guide for Amendments to AIA Architect Agreements*.

It is also important to recognize that the scope of modifications to some standard agreement forms is often so extensive that the resulting form has few of the positive characteristics ascribed to standard agreement forms above, in 2.3.3. Accordingly, from a risk management perspective, a line-by-line review is generally appropriate.

2.3.5 Custom Agreements

Some projects or clients may require the preparation and use of custom or so-called "manuscript agreements" because of the unique nature of the project. More often, custom documents are proposed because they are specifically designed with the purpose of favoring the interests of the drafting party. No matter what considerations drive the development and use of a custom agreement, it is important that the design professional not lose sight of the need to include certain project-specific and general-condition terms in those agreements (see discussion below). In reviewing a custom agreement, it is often useful to start by comparing the proposed agreement against the standard AIA or EJCDC agreement forms referenced above.

As a general matter, design professionals should avoid the temptation to develop and propose the use of agreements that are particularly one-sided to the design professional or that unfairly allocate risk or shift responsibility away from the design professional. These attempts to shift risk unfairly are likely to prompt a like response from the design professional's client, that is, the proposal of an equally one-sided contract from the standpoint of the client.

2.4 Project-Specific Terms

As the name suggests, project-specific terms are those terms that pertain to the project that is the subject of the agreement. These include terms that describe: the project, the design professional's scope of services, the schedule and time for performance, and the terms and timing of payment. Each of these project-specific terms are described in more detail below.

2.4.1 Project Description/Definition

Design and construction projects are complex endeavors. Technically, the client's objectives and priorities must be defined and clearly articulated within the context and constraints of the project environment. The EJCDC and AIA have long attempted to address the need to define the project and the project environment by including provisions in their standard contract forms that require the client to provide "full information," i.e., a program, schedule, budget,

procurement or delivery method, and other information necessary to proceed with the project. (See, e.g., AIA B101-2007, *Exhibit—Initial Information*.)

In addition, under the AIA and EJCDC documents, the design professional has a duty to respond to the initial information provided and advise the client of apparent conflicts or the need for additional information or consultant services (see AIA B101-2007, § 3.2.2 and EJCDC E-500, 2008 Edition, Exhibit A, §§ A1.01.A.1 and A1.01A.2). A provision contained in AIA B101-2007 requires that the architect's preliminary evaluation of the client's program, schedule, and budget shall include a discussion of "the feasibility of incorporating environmentally responsive design approaches" (§ 3.2.3).

Summarized below are some of the categories of requirements and information that should be evaluated by the design professional in defining the project.

Owner's Program, Schedule, and Budget. The term program is commonly used to describe the client's qualitative and quantitative requirements for the project. Specifically, AIA B101-2007 describes the program as "the Owner's objectives, schedule, constraints and criteria, including space requirements and relationships, flexibility, expandability, special equipment, systems and site requirements" (§ 5.1). Similarly, EJCDC E-500, 2008 Edition, describes the program as the "Owner's requirements for the Project, including design objectives and constraints, space, capacity and performance requirements, flexibility, and expandability, and any budgetary limitations..." (Exhibit B, § B2.01.A). Accordingly, the program should be composed with sufficient detail to afford effective decision support throughout the planning and design process. If circumstances change or refinements are made, the program should be revised accordingly, again with the client's written approval.

Information on Existing Conditions. Information provided by surveyors, geotechnical engineers, and others forms what is essentially a database for the design professional to use in planning and designing the project. A high-quality database can significantly reduce the level of uncertainty and variability associated with the project's cost and schedule. A low-quality database will have the opposite effect. Under the EJCDC and AIA standard agreement forms, the services of surveyors, geotechnical engineers, and other specialists reasonably needed for the project are to be provided by the client, and the design professional has the right to rely on the resulting information. Of course, if the design professional firm possesses the in-house expertise to perform some or all of the necessary specialty services, the AIA or EJCDC agreement forms can be modified to include those as services of the design professional.

Applicable Laws and Regulations. Design professionals are required to identify, become familiar with, and design in accordance with those laws, statutes, codes, ordinances, and regulations that are applicable to the project. (See, e.g., AIA B101-2007, § 3.2.1 and EJCDC E-500, 2008 Edition, §§ 6.01E and 7.01.A.16.)

Client's Design Criteria and Standards. Many clients with ongoing construction programs have developed design criteria that must be used by the design professionals they hire when designing new facilities or improvements. Some clients also insist on their own standard design details and specifications in the design and construction of their facilities. In many cases, these design criteria and standards exceed the minimum requirements of the applicable codes and regulations. Nevertheless, the design professional should inquire early about the existence of such design criteria and standards so they can be smoothly integrated into the planning and design of the project. The design professional is not, however, relieved of his normal duties of skill and care

simply because a client provides, or even insists on, the use of specific details, design standards, or criteria.

2.4.2 Scope of Services

A primary purpose of the professional services contract is to clearly delineate the scope of services undertaken. In doing so, the contract defines the relationship between the design professional and the client as well as each party's relationship to other project stakeholders, such as contractors, permitting agencies, and insurance companies. And, as discussed in 1.10.2, the scope of services is relevant to actions in contract and tort between the parties as well as to third parties. Accordingly, great care should be taken in delineating the scope of services. A good approach is to divide the services into four categories:

- Basic services—those that are included.
- Additional services—those that will be provided at additional cost when authorized.
- Expressly disclaimed services—those that are not included and for which responsibility is expressly disclaimed.
- Client responsibilities—those that will be provided by the client at no cost to the design professional and upon which the design professional can reasonably rely.

Basic Services. From a business and risk management perspective, the design professional's basic scope of services should be defined with reasonable precision within the contract. A well-defined scope provides the first or primary line of defense to certain client and third-party claims. Conversely, a poorly or inadequately drafted service scope may significantly impair the defensibility of these claims or, at a minimum, render the defense of the claims significantly more problematic and costly. Also, a clear, precise definition of scope is essential for business and payment purposes. An ambiguous or non-specific definition may lead to an obligation to perform more services than contemplated or to a dispute with the client.

One way to organize and clarify basic service obligations is by grouping them according to specific phases of project delivery. For example, Article 3 of AIA B101-2007 defines the architect's basic services under the following phases of service: schematic design, design development, construction documents, bidding or negotiation, and construction. Similarly, EJCDC E-500, 2008 Edition, Exhibit A, Part 1, defines the engineer's basic services under the following phases of service: study and report, preliminary design, final design, bidding or negotiation, and construction. Each AIA and EJCDC phase of service is then further broken down into phase-specific tasks.

When using a standard form that contains a detailed description of the basic service obligations by phase or type of service, the design professional should make sure that any services the parties have agreed to delete are stricken and that their deletion has been documented.

Additional Services. Often, it is advisable to list, in the contract, those additional services that are not included in the scope of basic services, but which the design professional is willing to perform for additional compensation. (See, e.g., AIA B101-2007, Article 4 and EJCDC E-500, 2008 Edition, Exhibit A, Part 2.) The list, at a minimum, clarifies the basic services definition by specifying what is not included, thereby reducing the risk of disputes

with clients over the nature or extent of the basic services obligations. If a design professional recommends that any of the additional services be performed, the recommendation should be made in writing. Authorization to perform these services should be obtained in writing and signed by an authorized representative of the client. The authorization should include the terms of compensation if they are generally undefined in the agreement.

Expressly Disclaimed Services. Design professionals should be particularly careful to contractually limit their services and responsibilities in connection with the construction means, methods, techniques, and safety provisions of the contractor. (See, e.g., AIA B101-2007, § 3.6.1.2 and EJCDC E-500, 2008 Edition, § 6.01.H. and Exhibit A, Part 1, § A.1.05.A.7.b.)

> Sample provision: If this Agreement provides for any construction phase services by Consultant, it is understood that the Contractor, not Consultant, is responsible for the construction of the project, and that Consultant is not responsible for the acts or omissions of any contractor, subcontractor, or material supplier; for safety precautions, programs, or enforcement; or for construction means, methods, techniques, sequences, and procedures employed by the Contractor.

Another common example of expressly disclaimed services concerns services and responsibilities related to hazardous materials or toxic substances. (See, e.g., AIA B101-2007, § 10.6 and EJCDC E-500, 2008 Edition, § 6.09.D.)

> Sample provision: It is acknowledged by both parties that Consultant's scope of services does not include any services related to the presence at the site of asbestos, PCBs, petroleum, hazardous waste, or radioactive materials. Client acknowledges that Consultant is performing professional services for Client and Consultant is not and shall not be required to become an "arranger," "operator," "generator," or "transporter" of hazardous substances, as defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1990 (CERCLA).

Finally, it is common for clients to request the assistance of the design professional in obtaining permits and approvals for their projects. However, in the professional services contract it is important to distinguish between assisting the client in meeting its obligation to obtain permits and approvals, and committing to actually obtain such permits and approvals. (See, e.g., AIA B101-2007, § 3.1.6 and EJCDC E-500, 2008 Edition, Exhibit A, Part 1, § A.1.03.A.2.) The following sample provision addresses the need to clarify these responsibilities:

> Sample provision: Consultant shall provide technical criteria, written descriptions, and design data for Client's use in filing applications for permits from or approvals of governmental authorities having jurisdiction to review or approve the final design of the Project and assist Client in consultations with appropriate authorities.

Client's Responsibilities. Certainly, one of the most important client responsibilities is the obligation to compensate the design professional in a timely manner for the performance of the

design professional's services. Clients have many other important obligations, however. These obligations should generally include the following:

- Providing complete information regarding the project requirements and program;
- Establishing and periodically updating an overall budget for the project;
- Designating a client representative authorized to act on the client's behalf;
- Furnishing survey and site information;
- Filing applications for permits from or approvals of governmental authorities having jurisdiction;
- Engaging certain specialized consulting, testing, legal, accounting, and insurance consulting services; and
- Timely payment for services rendered and reimbursable expenses incurred.

The scope and nature of a client's responsibilities may vary according to the requirements of a particular project. Any such project-specific obligation should be spelled out clearly in the contract. (See, e.g., AIA B101-2007, Article 5 and EJCDC E-500, 2008 Edition, Article 2 and Exhibit B.) A provision that may be appropriate for inclusion in a terms-and-conditions document attached to a letter agreement follows:

> Sample provision: Client shall designate in writing a person to act as its representative with respect to Consultant's services; provide all criteria and full information as to Client's requirements for the Project; place at Consultant's disposal all available information pertinent to the Project and Project site; provide or arrange for legal access and make all provisions for Consultant to enter any site where services are to be performed; and give prompt written notice to Consultant whenever Client observes or otherwise becomes aware of any development that affects the scope or timing of Consultant's services. Consultant shall be entitled to rely upon the information, services, and instructions provided by Client and Client's representative.

2.4.3 Schedule and Time for Performance

Project requirements regarding the schedule or time for performance of services are also project-specific. In the absence of a specific schedule or time requirements, courts usually find that the contract implies a "reasonable" period of time. (See, e.g., AIA B101-2007, § 2.2 and EJCDC E-500, 2008 Edition, § 3.02.)

Before making a commitment to perform services in accordance with a specific schedule or other time requirements, the design professional should be satisfied that any requirements are reasonable and grant the design professional the ability to control and achieve compliance with them. For example, the design professional's ability to meet a schedule may depend on the performance of review by the client, a governmental agency, or a third party, none of which are within the exclusive control of the design professional. In these cases, the design professional should qualify any specific schedule obligations accordingly.

The client needs to understand that the design professional should not be held

accountable for damages caused by delays that arise from circumstances or events beyond the design professional's reasonable control. Such circumstances are normally addressed by including a force majeure provision in the professional services contract. Force majeure means a superior or irresistible force. A narrow force majeure provision limited only to named events (i.e., acts of God, war, strikes) should be avoided. An example of a force majeure provision appropriate to a professional services contract follows:

> Sample provision: Consultant shall not be deemed in default of this Agreement to the extent that any delay or failure in the performance of Consultant's obligations results from any cause beyond its reasonable control and without its negligence.

Many clients attempt to force specific time limitations on design professionals or to impose late-performance penalties. Of course, timing issues are very important to clients, but schedules must be reasonable and adjustable to account for events beyond the design professional's control. Arbitrary attention to interim deadlines may only translate into increased adjustments later, and "time is of the essence" clauses could convert any delay into a material breach of contract that might justify termination by the client. Clients should understand the necessary balance between a schedule and the exercise of sound professional judgment.

2.4.4 Terms and Timing of Payment

The design professional's compensation, of course, should be set forth in the contract. The AIA and EJCDC contract forms each provide for various methods of compensation—cost plus a fixed fee, lump sum, and fixed billing rates—and provide for reimbursable expenses. (See, e.g., AIA B101-2007, Article 11 and EJCDC E-500, 2008 Edition, § 2.01.B and Exhibit C.) Lump sum design professional contracts are often based on a percentage of construction costs. From a risk management perspective, because of the uncertainty associated with the performance of design professional services, lump sum contracts are quite risky. It is important to include an adequate contingency allowance in lump sum contracts.

> Sample provision: Unless otherwise provided for in writing, Consultant shall be compensated for its services at its standard rates and shall be reimbursed for costs and expenses (at a multiplier of ____) reasonably incurred in the performance of services. Consultant shall submit monthly invoices that are due and payable upon receipt. On amounts not paid within 30 days of invoice date, Client shall pay interest from invoice date until payment is received at a rate of __% per month. If Client disagrees with any portion of an invoice, it shall notify Consultant within 21 days of receipt of the invoice, and shall pay the portion not in dispute.

2.5 General Condition Terms

A number of general condition provisions are typically included in agreements between the design professional and client, irrespective of project-specific requirements. The following are particularly important from a risk management perspective:

2.5.1 Standard of Care

The term "standard of care" refers to the standard against which the design professional's performance of services will be measured. There are a number of different standards that may be applicable: the common law or professional negligence standard, breach of contract, and strict liability or liability without fault.

Common Law Standard of Care. Generally, under the common law, the standard of care for a professional consists of the duty to use the same degree of skill and care as other similarly situated professionals under the same or similar circumstances.

Contractual Standard of Care. The standard of care applicable to the design professional may also be defined by the express terms of the contract. (See, e.g., AIA B101-2007, § 2.2 and EJCDC E-500, 2008 Edition, § 6.01.A.) In cases involving negligent performance of a contract, under either a claim of negligence or of breach of contract, the duties of the design professional are primarily defined by the written contract between the design professional and the client. An appropriate standard of care provision follows:

> Sample provision: The standard of care for all professional services performed or furnished by Consultant under this Agreement will be the care and skill used by members of Consultant's profession practicing under similar circumstances at the same time and in the same locality. Consultant makes no warranties, express or implied, under this Agreement or otherwise, in connection with Consultant's services.

In some instances, clients may want to impose a higher standard of care through express provisions in the contract. Professional liability insurance policies, however, usually provide coverage solely for claims arising out of negligent acts, errors, or omissions in the performance of professional services. These policies generally exclude coverage for claims based upon express warranties or guarantees, or other contractual provisions that impose a standard of care that exceeds the common law negligence standard, e.g., performance in accordance with "highest" professional standards.

Strict Liability. Strict liability is liability without fault. To date, strict liability concepts have generally only been applied to manufacturers of products and to those who engage in activities considered inherently dangerous, such as transporting hazardous materials. Design professionals, however, should be particularly wary of using or accepting terms such as "representation" or "warranty" or "guarantee" in contracts or other documents upon which a client or third party could claim reliance. These terms do not merely raise the standard of care to a higher level, they may effectively impose strict liability (see also 1.10.3 and 2.2.2).

2.5.2 Compliance with Laws

As discussed in 2.4.1, design professionals are required to identify, become familiar with, and design in accordance with the laws, statutes, codes, ordinances, and regulations applicable to the project. The standard for compliance with laws, however, is another instance where the usual standard of care is frequently modified. For example, some clients propose contract language similar to the following:

Sample unreasonable provision: The Plans and Specifications will comply with all applicable federal, state, and municipal laws, rules, regulations and ordinances of every nature and description, including without limitation, zoning, building, disabled access, fire, health and sanitary codes and ordinances, and subdivision control and environmental laws, rules and regulations, including without limitation, the Federal Clean Air Act, as amended, and the Federal Clean Water Act, as amended and state laws and regulations consistent with the requirements of such Acts, and the Project, if constructed in accordance with the said Plans and Specifications, will likewise comply.

On the face of it, this may not seem to be objectionable since design professionals are required to design in accordance with applicable law. This provision, however, requires uninsurable perfection, and does not recognize that many of the items referred to are or may be internally inconsistent, contradict one another, or be so arcane that the typical design professional would not, in the exercise of reasonable skill and care know how to comply. Further, all such rules and regulations are subject to the interpretation and discretion of local enforcement officials, among others. As a practical matter, nothing on this topic needs to be said in the professional services contract since the common law demands non-negligent performance, i.e., that the design professional shall use due care, skill, and diligence to comply with applicable codes and standards.

2.5.3 Schedules, Budgets, and Estimates or Opinions of Cost

While a client may have specific schedule and budget objectives and a concept for the project when the client-design professional agreement is signed, it is likely that many program aspirations will be balanced with program, budget, and schedule realities after the agreement is signed. Because the design professional's design will be based upon his understanding of these requirements, the program, schedule, and budget should be memorialized in writing. In that regard, the program should be spelled out in sufficient detail to afford effective decision support throughout the planning and design process. If circumstances change or refinements are made, the program should be revised accordingly, again with the client's written approval.

The client's budget for the cost of the work is a particularly important parameter in AIA B101-2007 (and many custom agreements) because, implicitly, it is a fixed construction cost limit that the design professional must design to (§ 6.1 and Exhibit A—Initial Information, § A.1.3). If the client's budget for the cost of the work is exceeded by the lowest bona fide bid or negotiated proposal, and if required by the client, the architect is obligated to modify the documents to bring the cost of the work within the client's budget. This redesign effort is at no additional cost to the client (§ 6.7). Under EJCDC E-500, 2008 Edition, Exhibit F, if a construction cost limit has been established and is then exceeded, the engineer is also obligated to modify the documents to bring the construction cost within the agreed-to limits. The engineer, however, is compensated at cost without profit. Under both agreement forms, the design professional's modification of the documents, under the terms provided, is the client's sole remedy against the design professional.

As a practical matter, it is important for the client to understand that cost estimates are only as accurate as the information on which they are based, and the design professional should make clear to the client the limitations of his estimates. (See, e.g., AIA B101-2007, § 6.2 and EJCDC E-500, 2008 Edition, § 5.01.) The "preliminary estimates" or "opinions of probable cost"

prepared by design professionals under the AIA and EJCDC agreement forms, respectively, are generally predicated on conceptual estimating techniques, not detailed quantitative techniques. If detailed estimates are desired, the design professional can be engaged to provide them, with the assistance of a cost consultant if the design professional is not otherwise qualified. Alternatively, the client can engage an independent cost consultant directly. (See, e.g., AIA B101-2007, § 4.1.11 and EJCDC E-500, 2008 Edition, Exhibit B, § B2.01.K.)

The bottom line is that schedules, budgets, and estimates or opinions of probable cost reflect the design professional's professional judgment, based on available information. They should not be construed as warranties or guarantees. The following sample provision reflects this reality:

> Sample provision: Any schedules or completion dates, budgets, or estimates of cost prepared by Consultant represent Consultant's professional judgment based on its experience and available information. Since neither Consultant nor Client has control over the cost of labor, materials, or equipment, or contractor's methods of determining prices, or over competitive bidding or market conditions, Consultant cannot and does not warrant or represent that actual schedules, budgets or completion dates or actual costs will not vary from schedules or completion dates, budgets, or estimates of cost prepared by Consultant or proposed, established, or approved by Client.

2.5.4 Intellectual Property

Transfer of the ownership or licensing the use of physical objects does not automatically transfer the copyright in the design professional's documents or instruments of service. The design professional should not, however, transfer the copyright because that may severely restrict future use of details, specifications, and other aspects of the instruments of service. A good solution, which balances the interests of the client and design professional, is for the design professional to retain the copyright and to license the client to make use of the instruments of service in specific ways that satisfy the client's needs without prejudice to the interests of the design professional. (See, e.g., AIA B101-2007, Article 7 and EJCDC E-500, 2008 Edition, § 6.03.)

> Sample provision: All documents prepared or furnished by Consultant pursuant to this Agreement are instruments of Consultant's professional service, and Consultant shall retain an ownership and property interest therein. Consultant grants Client a license to use instruments of Consultant's professional services for the purpose of constructing, occupying, and maintaining the Project. Reuse or modification of any such documents by Client, without Consultant's written permission, shall be at Client's sole risk and Client agrees to indemnify and hold Consultant harmless from all claims, damages, and expenses, including attorney's fees, arising out of such reuse by Client or by others acting through Client.

2.5.5 Confidentiality

From their clients, design professionals frequently receive confidential information necessary to perform their services. Sometimes, information of this nature may constitute a "trade secret." In most states, the common law protects clients from the disclosure of designated "trade secrets," "confidential information," or "proprietary information." In addition, clients will often require that an express confidentiality provision be included in the professional services contract or, alternatively, will request that the design professional sign a separate confidentiality agreement. Clients have many reasons for this desired confidentiality. Disclosure of the information could adversely affect the proposed acquisition or sale of property, place the client at a competitive disadvantage to its competitors, or subject the client to various statutory or common law liabilities for site cleanup or personal injury.

Design professionals, however, may be required by law or professional responsibility rules to disclose certain information to regulatory authorities. For example, while performing services, the design professional may learn that a soil sample indicates that a site contains hazardous waste. A licensed professional's public health and safety obligation generally requires that this information be disclosed to protect innocent third parties from potential injury or to comply with federal and state statutory and regulatory reporting requirements.

Accordingly, confidentiality provisions in contracts should include exceptions for disclosure required by legal or ethical obligations. An example of a provision that recognizes the client's rights to confidentiality while acknowledging the design professional's disclosure responsibilities follows:

> Sample provision: Consultant shall maintain the confidentiality of the Project information including but not limited to the nature of the Project, the location of any sites under consideration or selected sites, together with any other information supplied to Consultant by Client and designated by Client to be confidential or proprietary, except (1) when such confidential information becomes generally known to the public through no fault of Consultant or (2) when disclosure is required pursuant to applicable governmental regulations or with an order of a court of competent jurisdiction.

If the client requests the execution of a separate confidentiality agreement, the above-referenced exceptions for disclosure should be included. In addition, the design professional should take care to be sure that the separate confidentiality contract is coordinated with the terms of the professional services contract and does not include conflicting terms. In particular, the design professional should be certain that the separate confidentiality agreement does not include express warranties or guaranties or alter the ownership and use-of-documents provision or choice-of-laws provision contained in the professional services contract.

2.5.6 Indemnity Provisions

Indemnity provisions are intended to allocate risk or liability among parties. Typically, that allocation is designed to shift liability to the party who is thought to be more actively involved in activities or events giving rise to liability. In the context of client-design professional agreements, a client may seek indemnity from a design professional for liability or risk resulting from the

negligence or other wrongdoing of the design professional in the performance or furnishing of services.

Client-proposed indemnity provisions, however, often demand more of the design professional than the law would otherwise require. As a basic proposition, design professionals should not accept risk unfairly allocated to them, that is, risk that they are unable to control. Ideally, indemnity obligations should be restricted to the adjudicated negligence of the design professional and should be drafted in a manner consistent with the coverage afforded under the design professional's professional liability insurance policy. A sample indemnity provision consistent with this proposition follows:

> Sample provision: To the fullest extent permitted by law, Consultant shall indemnify Client, its officers, directors, partners, employees, and representatives, from and against losses, damages, and judgments arising from claims by third parties, including reasonable attorneys' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error, or omission of Consultant or Consultant's officers, directors, members, partners, agents, employees, or subconsultants in the performance of services under this Agreement.

Clients rarely propose mutual or cross indemnity provisions wherein the design professional indemnifies the client and the client indemnifies the design professional. The general rationale for clients insisting on a unilateral contractual indemnity provision is that the design professional (or contractor) is directly involved in the activity of design (or the activity of construction) and should take responsibility for claims and shield those whose involvement is passive. In addition, many municipalities and governmental entities are barred from assuming contractual indemnity obligations as a matter of law or policy. Nevertheless, mutual indemnity provisions are often viewed by design professionals as more reasonable than a unilateral indemnity provision in favor of the client (or in favor of the prime professional under a subcontract). A sample mutual indemnity provision consistent with common law principles follows:

> Sample provision: To the fullest extent permitted by law, Client and Consultant each agree to indemnify the other party and the other party's officers, directors, partners, employees, and representatives, from and against losses, damages, and judgments arising from claims by third parties, including reasonable attorneys' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error, or omission of the indemnifying party or any of the indemnifying party's officers, directors, members, partners, agents, employees, or subconsultants in the performance of services under this Agreement. If claims, losses, damages, and judgments are found to be caused by the joint or concurrent negligence of Client and Consultant, they shall be borne by each party in proportion to its negligence.

The interpretation and enforceability of indemnity provisions depends upon the jurisdiction, statutes, and case law. There are significant differences on how different jurisdictions interpret and enforce indemnity provisions. Accordingly, when reviewing or drafting indemnity provisions, consultation with knowledgeable legal counsel is essential.

Finally, even if an indemnification provision is enforceable in a particular jurisdiction, the indemnification is only as valuable as the worth of the indemnitor. As discussed in Part III of this publication, the design professional should determine, prior to entering into a contract, whether the indemnitor is capable of actually indemnifying the design professional if necessary.

2.5.7 Limitations of Liability

A limitation of liability (LOL) provision is one under which a design professional and a client contractually agree to limit the liability exposure of the design professional to: (1) a specified dollar amount; (2) available insurance proceeds; or (3) direct damages, typically through a waiver of consequential damages. Probably the most "saleable" LOL provision is one based upon available insurance proceeds. (See, e.g., the above alternatives as styled in EJCDC E-500, 2008 Edition, Exhibit I.)

Courts have held that the intent to limit the liability must be clearly spelled out in the contract and must be "clear" and "unambiguous." To determine whether a limitation of liability provision should be enforced, the courts may examine the contract for such factors as the clearness of the language, the intent of the parties, equality of bargaining power and ability to negotiate between the parties, and the conspicuousness and potential unconscionability (i.e., unreasonably detrimental to the interest of a contracting party) of the provision.

Moreover, a limitation of liability provision is not a "silver bullet." First, the provision will not generally protect the design professional from liability arising out of intentional, reckless, or grossly negligent conduct. Second, the provision is only effective against the client, not third parties. Third, some states look at limitation of liability provisions as another form of indemnification for negligence and will not enforce them. A sample limitation of liability clause follows:

> Sample provision: To the fullest extent permitted by law, Client agrees that the total liability, in the aggregate, of Consultant and Consultant's officers, directors, members, partners, agents, employees, and subconsultants, to the Client, its subsidiary and/or affiliated companies and their respective officers, directors, employees, agents and anyone claiming by, through, or under Client for any and all injuries, claims, losses, expenses, damages whatsoever arising out of, resulting from or in any way relating to Consultant's services, this Agreement or any Addenda, from any cause or causes, shall be limited to [the available proceeds of insurance coverage] [$_____ or the total amount of compensation received by Consultant, whichever is greater].

The design professional should consult with an attorney about the validity and enforceability of a limitation of liability provision in the applicable jurisdiction. Proper terminology and adequate documentation of contract negotiations may be critical to the enforceability of the provision.

2.5.8 Insurance Requirements

Professional services contracts typically include an insurance section that defines requirements for various types of insurance including commercial general liability, workers' compensation and employer's liability, automobile liability, and professional liability. (See, e.g., AIA B101-2007, § 2.5 and EJCDC E-500, 2008 Edition, § 6.04 and Exhibit G, § G.6.04.)

Certificates of insurance, evidencing the existence and terms of coverage, are usually required prior to the commencement of services under a professional services contract. Waiver of subrogation provisions are also commonly included in professional services contracts. In general, the purpose of these provisions is to waive claims among the client, design professional, contractor, and their respective insurers in a subrogated capacity to the extent that the loss or damage forming the basis of those claims has been compensated by insurance. Waiver of subrogation provisions, therefore, serve the valuable purpose of ensuring finality for claims compensated by insurance, at least between certain project participants.

When drafting or modifying contractual insurance requirements, the advice of insurance counsel or a broker familiar with design professional services and available coverages should be obtained so that the insurance requirements will be consistent with industry terminology and uninsured sources of risk can be identified for contractual assignment to or management by one of the parties. A sample provision addressing professional liability coverage follows:

> Sample provision: Consultant shall obtain and maintain a policy of professional liability insurance (with prior acts coverage sufficient to cover the services performed under this Agreement) with policy limits in an amount of not less than $_____ per claim/$_____ aggregate. Such insurance will be renewed so as to provide continuous coverage during the term of this Agreement and for a period of at least twelve (12) months following the completion of Consultant's professional services under the Agreement. Coverage shall not be canceled or reduced in limits by endorsement until at least 30 days prior written notice is given to Client or cancelled for nonpayment of premium until at least 10 days prior written notice is given to Client.

2.5.9 Suspension and Termination of Services for Non-Payment

If the client fails to make timely payments for services, the design professional may have the right to suspend performance of services or to pursue the legal remedy of termination of the contract. Termination is a drastic step that has important legal consequences and potential liability associated with it, and should be pursued only after careful consideration and discussion with legal counsel. In no event, however, should a design professional terminate his agreement without first providing at least the contractually mandated advanced written notice to the client so that the client has a reasonable opportunity to avert the impending termination by curing the default within the notice period.

Suspension of services performance for nonpayment is a less drastic step than termination. As distinct from termination, suspension of services merely stops the performance of services

while the nonpayment or other default that forms the basis of the suspension continues. As with termination, suspension should be preceded by at least the contractually mandated advance written notice to allow the client an opportunity to cure the default. Professional services contracts should clearly deal with the parties' rights to suspend or terminate the contract. (See, e.g., AIA B101-2007, Article 9 and EJCDC E-500, 2008 Edition, § 6.05.)

> Sample provision: Client may terminate this Agreement with seven (7) days' prior written notice to Consultant for convenience or cause. Consultant may terminate this Agreement for cause with seven (7) days' prior written notice to Client. Failure of Client to make payments when due shall be cause for termination or, at the option of Consultant, suspension of services under this Agreement until Consultant has been paid all amounts due.

2.5.10 Dispute Resolution

Contracting parties normally anticipate the possibility of disputes or claims and include in their agreement some provision for dispute resolution, often involving several steps. For example, if direct negotiation between the parties fails to resolve a dispute, the agreement may provide for mediation or an alternative nonbinding "jobsite" process, such as standing neutral or dispute review board. If these nonbinding processes fail to resolve the dispute, the contract will designate one of two adjudicative dispute resolution processes—arbitration or litigation. Generally, if the contract is silent or fails to designate arbitration, litigation will be the default dispute resolution process. (See, e.g., AIA B101-2007, § 2.2 and EJCDC E-500, 2008 Edition, § 3.02.)

Mediation is a non-binding process in which an impartial mediator actively assists the parties in identifying and clarifying issues of concern and in designing and agreeing to solutions for those issues. Mediation is a condition precedent to arbitration or litigation under AIA B101-2007, § 8.2.1 and is an option for selection under the 2008 Edition of EJCDC E-500, Exhibit H, § H.6.08. In recent years, mediation has become the predominant method of dispute resolution for design professionals because it is generally cost effective and, perhaps equally important, is generally far less destructive to the design professional's business relationships than arbitration or litigation. The following sample language is intended to make mediation a condition precedent to arbitration or litigation:

> Sample provision: Client and Consultant agree that they shall first submit any and all unsettled claims, counterclaims, disputes, and other matters in question between them, arising out of or relating to this Agreement to mediation in accordance with the Construction Industry Mediation Rules of the American Arbitration Association effective as of the date of this agreement.

Unlike mediation, which is a consensual dispute-resolution process, both arbitration and litigation are adjudicative dispute-resolution processes designed to result in a final and binding determination of the dispute. Generally, in the absence of a specific agreement to arbitrate, litigation will be the final and binding dispute-resolution mechanism.

The perceived advantages of arbitration include less formality, less legal expense, and more expeditious resolution. Arbitration, however, lacks some of the procedural and legal safeguards afforded by litigation. Thus, substituting arbitration for litigation involves trade-offs. For this reason, some design professionals who include an arbitration provision in their agreements place a dollar limitation on the size of claims subject to arbitration. (See, e.g., AIA B503-2007, 9—Dollar Limitation on Arbitration and EJCDC E-500, 2008 Edition, Exhibit H, § H.6.08.C.2.)

2.5.11 No Third-Party Beneficiaries

Obviously, a disappointed client can sue the design professional with whom it has a contract. However, suits have been brought by contractors or other third parties not in contractual privity with the design professional. Such a third-party may contend that it has a "third-party beneficiary" right in the contract as discussed in 1.10.1. These third parties will claim to have relied upon the design professional's services (e.g., opinions, reports, surveys, plans and specifications). For example:

- A contractor may claim additional costs and/or delays due to alleged errors and omissions in the plan/specifications/reports prepared by the design professional.
- Another consultant or the client's lender may claim damages because it relied upon statements, opinions, drawings, or reports in its performance of services or in advancing loan monies.
- A future purchaser of the property may claim damages resulting from reliance upon information contained in the design professional's opinions or reports in deciding to purchase the property.
- Employees of a contractor, subcontractor, or even the government may claim that they have been injured as a result of the design professional's services. Worker's compensation laws limit recovery by employees from their employer. Thus, individual employees often seek damages against the design professional based on the theory that the design professional negligently breached its duty to provide jobsite safety services or alert workers to potential dangers. A citizen may bring a claim upon the same theory.

To mitigate this exposure, contracts typically include "no third-party beneficiary" provisions. (See, e.g., AIA Document B101-2007, § 10.5 and EJCDC E-500, 2008 Edition, § 6.07.C.) A sample provision follows:

> Sample provision: Nothing contained in this Agreement shall be construed to create, impose, or give rise to any duty owed by Client or Consultant to any other individual or entity. Consultant's services under this Agreement are for the sole use and benefit of Client and may not be used or relied upon by any other individual or entity without the express written approval of Client and Consultant.

2.5.12 Severability

Depending on the facts or the provisions involved (e.g., the indemnification and limitation of liability clauses), courts in various jurisdictions may find some clauses to be in violation of public policy or otherwise void and unenforceable. To protect the remaining contract, however, the design professional should include a severability clause. Then, even if a contract provision is considered unenforceable, the remaining provisions remain in effect. An example of a severability clause follows:

> Sample provision: If any of the provisions of this Agreement shall be finally determined to be invalid or unenforceable in whole or in part, the remaining provisions hereof shall remain in full force and effect, and be binding upon the parties hereto. The parties agree to reform this Agreement to replace any such invalid or unenforceable provision with a valid and enforceable provision that comes as close as possible to the intention of the stricken provision.

The second sentence of the clause, in which the parties agree to reform the contract, protects the bargain or compromise that may have contributed to certain clauses. For example, if the design professional lowers the fee in exchange for inclusion of a provision that is subsequently determined to be unenforceable, he will still want something in return for the reduced compensation. Thus, the replacement of the provision with another similar provision is important to fill that gap.

2.5.13 Survival

It is important to ensure that the protective provisions (i.e., the limitation of liability, the indemnification, dispute resolution, and the scope of services) remain in effect even after the contract is completed or terminated. This may be accomplished by using a survival clause such as the following:

> Sample provision: Articles ____ , ____ , and ____ shall survive the completion of the services under this Agreement and the termination of this Agreement for any cause.

2.5.14 Applicable Law

The design professional may negotiate with the client to determine what jurisdiction applies in the event of a dispute. Though the design professional may want to choose the law of a state that is favorable or convenient to the design professional, such action alone can lead to a dispute. Sometimes choice-of-law clauses are not upheld by the courts. The best practice, generally, is to state that the law of the place of the project is controlling. (See e.g., AIA B101-2007, § 10.1 and EJCDC E-500, 2008 Edition, § 6.06.)

2.6 Coordination of Prime Contracts and Subcontracts

The agreements between the prime professional and each of his independent professional consultants should describe, in detail, the duties and responsibilities of the prime professional and independent consultant. Because virtually all design and construction projects involve multiple contracts they should be similarly constructed to avoid conflict and ambiguities. The EJCDC and AIA both publish families of documents that are integrated and coordinated. Thus AIA's client-architect agreement form, AIA B101-2007, is coordinated with its architect-consultant agreement form, AIA Document C401-2007. Likewise, EJCDC E-500, 2008 Edition is coordinated with EJCDC E-570, 2007 Edition.

Generally, these agreements require that the consultant provide services to the prime professional in the same manner as the prime professional is bound by the prime agreement to provide such services to the client. Also, a copy of the prime agreement (less compensation amounts) is usually attached and made a part of the agreement.

Among many points of coordination, the following are often not given sufficient attention:

- Design criteria and standards, drawing or CADD file format requirements, etc.
- Schedule requirements.
- Budget requirements and any contractually established construction cost limitations.
- The terms and timing of payment.
- Submittal review and jobsite visits.
- Use and ownership of documents.
- Terms and provisions for termination.
- Dispute resolution provisions.
- Professional liability and other insurance requirements, including the furnishing of certificates evidencing such coverage.
- Limitation of liability provisions. (Generally, a prime should not accept an LOL provision proposed by a consultant unless the client similarly limits the prime's liability.)

2.7 Summary

Clear and concise contract terms can substantially reduce design professional's exposure to disputes, claims, and liability. Moreover, contracts are excellent devices for facilitating communication and defining appropriate expectations among contracting parties.

During the development and negotiation of specific contract provisions, design professionals should recognize the need for certain essential terms and conditions, as well as the need to avoid certain other provisions, such as warranties and broad indemnity obligations. Such provisions result in unreasonable and uninsurable exposures to liability. We address problematic provisions commonly encountered in the contracting process in, "Some Risk-Intensive Contracting Issues," an online supplement to this edition of *Managing Risk Through Contract Language*, which can be found at **www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx**.

While contracts for specific projects may vary considerably, the following general principles for structuring reasonable professional services agreements serve as a reliable guide:

- Determine who is in the best position to carry out responsibilities and assign responsibilities accordingly. Shifting risk to a party incapable of managing the risk is both unreasonable and unproductive.
- Assign responsibilities to those with the authority to fulfill them. Having the authority to do what is necessary to satisfy a contractual obligation is a basic principle of contract formation.
- Assign each responsibility to only one party. Co-responsibility creates a situation in which neither party is fully responsible or accountable.
- Use provisions that create reasonable and realistic expectations. The use of absolute language or superlatives in describing the performance of professional services enhances the probability of disappointed expectations, disputes, and liability.

Part III – Pre-Contract Risk Management

3.1 Introduction

Most design professionals will acknowledge that they have never produced a perfect set of construction documents. Simply put, it is impossible to anticipate every condition or contingency. This accounts for the changes clause in construction industry contracts and the need for contract modifications or change orders to respond equitably to changed conditions. Beyond the need for contractual mechanisms to accommodate change, the design professional, design professional's client, and other project participants must have the capacity and willingness to work together to find timely solutions.

A continuous process of collaborative problem solving has, historically, characterized the most successful projects. Accordingly, it is no surprise that design professionals with a reputation within their peer and client communities for the quality of their services and for their collaborative problem solving skills are most sought after by sophisticated clients undertaking complex or high-profile projects.

The overall purpose of pre-contract risk management is to determine whether the risks associated with the client, project, and project contract are reasonable and controllable. At a minimum, this should be a structured "consciousness-raising" exercise. The general categories presented below should be considered when evaluating the sources of risk that may be associated with a given project. Since no two projects are alike, these general categories should be adapted to project-specific requirements. To facilitate this process, Schinnerer's *Pre-Contract Risk Management Checklist*, is included as Appendix A to this publication. For ease of adaptation to practice and project-specific requirements, this checklist is also available as a download from Schinnerer's website at **www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx**.

3.2 Evaluation of the Prospective Client

Risk is generated or influenced by the interplay of a variety of client, design professional, and project characteristics, as well as the environment in which the services will be performed. Because clients can become claimants and plaintiffs, a design professional must be prepared to turn down the project based upon an objective evaluation of the client.

When evaluating a potential client, the design professional should consider the following:

- Financial capability;
- Risk aversion;
- Composition of the client group;
- Expectations;
- Parties relying on the design professional's services;
- Understanding of uncertainties; and
- Prior client experience.

3.2.1 Financial Capability

In addition to the basic business risk of not being paid, an underfinanced client presents other kinds of risk to the design professional. In commercial transactions, credit checks and financial

investigations in conjunction with sales are commonplace. After all, in most cases, design professionals effectively extend credit to clients when they begin to perform services. Factors to be considered when evaluating the financial capability of the potential client include:

- Does the prospective client have sufficient resources to undertake the proposed project and stand behind its contractual obligations?
- Is the prospective client prepared to support a quality design in terms of engineering and construction, or is it looking for a quick and dirty solution?
- Does the prospective client appear to have a well-established or growing and prosperous business that suggests it will survive far into the future?

3.2.2 Risk Aversion of the Prospective Client

A risk-averse client may attempt to unfairly shift the risk of financial loss and liability to other project participants, including the design professional. Also, some clients are more litigious than others. It is possible for design professionals to investigate the court records in their area or in the client's home area to determine the incidence of litigation to which the potential client was a party. When evaluating the prospective client's risk aversion, consider factors such as:

- Does the prospective client understand that some sources of risk are appropriately borne by the client?
- Has the client proposed harsh contractual liability provisions (indemnity, warranty, other) that are "non-negotiable"?
- What is the prospective client's claims history?

3.2.3 Composition of the Client

It is not uncommon for the client on a project to be a committee or group. To better evaluate the risk a prospective client poses, it is important that the design professional know exactly the composition of the client group. A so-called "committee" client can have several competing or ever-changing agendas, leading to conflicts and potential claims. Factors to be considered include:

- What are the interests of each party?
- Is the group a legal entity with competence and authority to contract, and be sued, if necessary?
- Is there a clear leader and duly authorized representative of the group?
- Is each member jointly and severally liable for the obligations of the group?
- Does the client group have internal conflicts or competing interests?

3.2.4 Client Expectations

How a prospective client expresses its desired result may indicate how reasonable it may be during the project. Unrealistic expectations often form the basis for dissatisfaction with the project end result, which may very well lead to claims and liabilities.

The more a prospective client understands the uncertainty associated with design and

construction, the lower the likelihood of client claims. Some clients are unlikely to be technically knowledgeable about the design and construction process. The critical risk management issue, however, is whether the client can understand or is willing to recognize uncertainty as a source of risk and is willing to commit the resources necessary to manage the risk.

Issues to consider include:

- Are the prospective client's budget expectations reasonable given the desired time and performance goals?
- Does the prospective client understand that cost uncertainty, to varying degrees, is inherent in all design and construction projects?
- Are the client's schedule expectations reasonable given the nature of the project?
- Does the prospective client understand that schedule delays, varying with project complexities and uncertainties, are inherent in design and construction projects?
- Are the prospective client's expectations as to results reasonable given the desired time and cost goals?
- Does the prospective client understand that the design professional cannot effectively warrant or otherwise guarantee project outcomes?

If the answer to one or more of these questions is "no," the design professional should determine whether the prospective client's expectations can be made more realistic through education and discussion. If not, the client should probably be avoided. Unfulfilled expectations are the major cause of claims against design professionals and contractors.

3.2.5 Third Parties Relying on the Services

Although the design professional may be retained by an individual client, other parties, such as the client's lender or prospective tenants, may rely on the design professional's services. Such reliance may give rise to claims on the project. It is therefore critical that all parties that may be relying on the services be identified. Important issues to be evaluated include:

- Can these parties be identified?
- Can their interests be identified?
- Can their interests be addressed properly within the scope of services and budget proposed?
- Will the client assign its contractual rights in the design professional agreement to a lender?
- Will the lender require any additional contract terms or certifications? If so, what are they, and are they acceptable?
- What is the lender's reputation for dealing with design professionals and other construction professionals?

3.2.6 Prior Experience with the Prospective Client

As a final issue, it is important to consider any previous experience the design professional has had with the prospective client, keeping in mind that the client's staff, objectives, and attitude toward risk may have evolved over time. Factors to consider include:

- What was the quality of the professional relationship with the client?
- Did the client make timely decisions?
- Were bills paid in a timely manner?
- Were necessary additional services authorized in a timely manner?

The issues mentioned above are not exclusive. When evaluating a potential client, the design professional should obtain and consider as much relevant information as possible. Every piece of information gathered might expose sources of risk that must be addressed. Judgments about these factors are subjective, and the design professional should consider what levels of risk are appropriate and at what point it should refuse the project. In some areas it may be necessary to employ the services of an attorney to assist in identifying, evaluating, and appropriately responding to potential sources of risk.

3.3 Evaluation of the Prospective Project

The following general categories should be considered when evaluating sources of risk that may be associated with a given project.

3.3.1 Project Characteristics

The quantity and quality of information available will vary from project to project, and any conclusion will probably be subjective. The risk of inaccurate information provided by the prospective client should be allocated appropriately in the contract. While it may not be possible to obtain all relevant information due to schedule constraints, the design professional should attempt to investigate the following factors:

- Is the project program, budget, and schedule adequately defined?
- Is the project type "high risk" (e.g., residential or mixed use condominiums, complex renovations, large public use centers)?
- Does the project involve highly complex or innovative design elements?
- Are complex or innovative methods or sequences of construction necessary due to complex design elements, fast-track or phased delivery requirements, or occupancy of the facility during construction?
- Are there scheduling issues that may result in liability exposures to third parties, such as meeting a sale or leasing deadline?
- Have the appropriateness and availability of special technologies or products proposed for the project been adequately researched and tested?

3.3.2 Site-Specific Issues

- Are there geographic considerations or site constraints that may limit the availability, access, or staging of labor or materials?
- Are there known or suspected environmental issues on or adjacent to the site that may increase risk?
- Is there any perceived community opposition to the project?

3.3.3 Services to Be Performed or Furnished

Once the parameters of a project have been determined, the required services and risks associated with those services should be analyzed. Effective risk management requires a realistic assessment of the skills and abilities available to the design professional. If the required experience and skill sets are unavailable to the design professional (either internally or through consultants), it is wise for the project to be refused. Factors to consider include:

- What types of service are needed—project planning, design, project/program management, permitting, scheduling, inspection/evaluation of the work, submittal review/coordination, expert witness testimony, or others?
- What are the sources of risk associated with the types of services needed?
- Is the client asking about green design alternatives?
- Are there any habitational design factors to consider?
- Is the design professional being hired to perform design without construction phase services?
- Do any of the intended service outcomes (e.g., financing, permitting, or scheduled completion) involve high uncertainty?

3.4 Evaluation of the Prospective Contract

As previously discussed, contracts allocate rights and responsibilities, risks and rewards. A well-drafted, equitable contract can help prevent disputes and establish a framework for the fair resolution of those that do occur. Accordingly, when evaluating the contract, factors to consider include the following.

3.4.1 Basic Contract Issues

- Are the parties (client and design professional) clearly identified with their legal entity names?
- Is the project clearly defined?
- Is the design professional's "part of the project" clearly defined?
- Does the design professional's scope of services not only describe what is included but what is not included?
- Are the expectations of the parties clearly articulated and reasonably integrated (scope, budget, schedule)?
- Is the design professional required to warrant or guarantee any deliverable or any project outcome?
- Does the contract require the design professional to "verify" client-furnished information or services?
- Is the design professional's role during construction (if applicable) limited or non-existent?
- Is the design professional's role during the bidding or negotiation phase and during the construction phase coordinated with the bidding documents and the conditions of the contract for construction?

- Does the contract include mechanisms to accommodate change (scope, budget, and schedule) equitably during the course of project delivery?
- Does the design professional have the right to suspend services in the event of the client's failure to make timely payments?
- Are the roles of key third parties (e.g., contractor, construction manager, separate design consultants, etc.) clearly defined?
- Is each risk allocated to the party in the best position to manage or control that risk?
- Is the same responsibility assigned to more than one party?
- Does the client solely control the method or substantive procedures for the resolution of disputes?

3.4.2 Third-Party Risk Transfer/Insurance

- Are the insurance coverages required of the design professional reasonable and commercially available?
- Will available insurance cover the indemnity obligations imposed on the design professional?
- Will the client and any key third parties (e.g., contractor, construction manager, separate design professional) be appropriately insured?
- Will the design professional be named as an additional insured under the client's and contractor's commercial general liability insurance (CGL) policies?
- Will the design professional be named as an additional insured under the client's or contractor's builder's risk policy?
- Do the applicable project contracts include mutual waivers of subrogation?
- Is bonding required of the contractor?

3.4.3 Subcontract Issues

- Are pertinent portions of the applicable prime contract incorporated into the subcontract?
- Are project budget provisions coordinated with subcontract budget provisions?
- Are the subcontract terms of payment coordinated with the timing and method of payment under the prime contract?
- Are the dispute resolution provisions of the subcontract coordinated with those of the prime contract?
- Are the indemnity obligations of the subcontract coordinated with the prime contract?
- Is the termination provision contained in the subcontract keyed to the subconsultant's performance and coordinated with the termination provision contained in the prime agreement?
- Are the insurance requirements of the subcontract coordinated with those of the prime contract and otherwise appropriate with the liability exposures reflected in the subconsultant's scope of services?
- Are the ownership/use of documents provisions contained in the subcontract coordinated with those contained in the prime contract?
- Are any limitation of liability provisions coordinated with those contained in the prime agreement?

While there is no formula by which to quantify the aggregate risk indicated by answers to the above questions, the experienced practitioner should develop a sense of the total risk exposure sufficient to make a "go/no go" decision.

3.5 Contract Negotiation

Risk, the probability of an unfavorable outcome, attends the undertaking of any project for any client. Once the design professional has evaluated the potential sources of risk associated with the client, the project, and any proposed contract terms and conditions, the design professional can make an informed decision as to how and if to negotiate a contract for professional services.

3.5.1 Proposal-Phase Communications

A proposal to provide professional services is many things, not the least of which is a road map for the project to come. The development of the proposal provides an opportunity to think about the project and how, when, and under what circumstances services will be performed. It is also the opening stage of contract negotiations. Therefore, it is an opportunity to address any known client terms and conditions that are objectionable. (As discussed above, the design professional will have a fairly well-developed sense of client, project, and contract-specific sources of risk as a result of the pre-contract evaluation of the project and the prospective client.) If accepted by the client, the proposal may be considered the basis of the contract between the parties, and clients sometimes require the design professional's proposal to be incorporated by reference or physically attached to and made a part of the contract.

Accordingly, the design professional should be careful not to oversell the firm, the quality of services to be performed, or the results to be obtained from those services. The desire to distinguish one's firm from the others competing for a project may result in promises that cannot be met and expectations that cannot be fulfilled. Whether or not these promises are made a part of the contract, clients tend to remember what they are promised and are disappointed when the promises are unmet. It is generally better that proposals begin to foster in the client a realistic sense of what is possible and begin the ongoing task of managing and fulfilling the client's expectations.

3.5.2 Preparation for Negotiation

Webster's Collegiate Dictionary defines negotiation as the process of "confer[ring] with another so as to arrive at the settlement of some matter." Negotiation, however, is not a purely standardized process, and it is often hard to know when and how to get started. The use of a conceptual road map, such as provided in the book *Getting to Yes* (discussed below), can help to structure and guide the process. However the design professional chooses to proceed, three salient characteristics of successful negotiations must be recognized and accommodated. First, negotiation is a consensual process. Success is dependent upon voluntary, good-faith efforts by all parties to reach a negotiated agreement. Second, negotiation involves some adjustment in the desires of the parties that effectively addresses the issues in question. In the design and construction project arena, this involves balancing the client's program aspirations against budget and schedule realities. Finally, the new relationship must represent an overall bettering of the

position of each party given their respective bargaining positions, i.e., each party must perceive that they are better off with the deal than without it.

3.5.3 The Negotiation Process

There are two general approaches to negotiation. Often, these two approaches are both used in a particular negotiation; however, one or the other usually predominates. The first and perhaps most traditional approach is referred to as "positional bargaining" and is characterized by parties exaggerating their respective positions in order to meet somewhere in between. Generally, positional bargaining favors the party with superior leverage, whether that is based on time, money, or some psychological or other advantage, regardless of the relative merits of the parties' positions. In some instances, one party exaggerates its position solely to frustrate the negotiation process and stall for a time when its leverage will have increased.

The alternative to positional bargaining is "interest-based bargaining," which is also commonly referred to as "principled negotiation." This approach is described in a short, influential book by Roger Fisher, William Ury, and Bruce Patton of the Harvard Negotiation Project titled, *Getting to Yes: Negotiating Agreement Without Giving In*. The authors suggest that parties not bargain over positions, but pursue four strategies that are applicable to nearly every situation:

- "Separate the people from the problem."
- "Focus on interests, not positions."
- "Generate a variety of possibilities before deciding what to do."
- "Insist that the result be based on some objective standard."

The first strategy is designed to help the participants think about the problem objectively rather than reacting to it in an overly personal and emotional way. Often, the problem in the minds of the participants becomes identified with the other party rather than with the situation at hand. Participants should be encouraged to see themselves as working together toward a solution.

The second strategy is to understand and focus on the interests that are the basis of the participants' stated positions rather than the positions themselves. Simply coming up with a compromise between stated positions is unlikely to meet the requirements of the participants.

The third strategy deals with the process of actually devising a solution under difficult circumstances. One should not look for the one correct course of action. That is most likely to lead to a mental road block. Instead of evaluating and discarding options one by one, a more productive and creative approach is to "brainstorm" or encourage a fairly free flow of ideas for a certain period of time. Developing a number of widely divergent possible solutions means that you have a better chance of finding one that will suit all the parties.

The fourth strategy is to insist on objective criteria. This is especially important when the parties seem to have opposing interests. An objective standard means that parties do not win or lose by insisting on a particular position, but they both accede to an accepted way of determining a fair solution. (Fisher, Ury, and Patton, 10-12)

Principled negotiation clearly requires more effort and creativity than positional bargaining,

but the results are far more satisfying to the parties and more often reinforce, rather than undermine, ongoing relationships.

3.6 Summary

Contract negotiation, supported by an objective evaluation of the client and the project, is the prime opportunity to communicate with the client. That communication should include a discussion of guiding principles in establishing contract language that appropriately allocates risk and reward between the contracting parties.

Standard contract forms—such as the documents published by the AIA and EJCDC—attempt to establish contracted liability within common law standards of professional care, skill, and diligence. Unique or custom-drafted agreements may greatly enlarge the design professional's liability exposure through the inclusion of contract provisions that exceed normal duties and responsibilities. Although there are an ever increasing number of AIA and EJCDC documents that address specific project delivery methods, no AIA, EJCDC, or other standard form document should be seen as suitable "off the shelf." All standard form documents need to be tailored to the needs of each project.

Appendix A – Pre-Contract Risk Management Checklist

1. Basic Data

a. Project Name:
b. Project Location:
c. Nature of Services to Be Provided:
d. Prospective Client:
e. Client Contact:
f. Approximate Project Value in Billings:
g. Approximate Project Timeline:
h. Regulatory Agencies Involved:
i. Other Significant 3rd Party Involvement (if any):

2. Checklist Preparation/Review

a. Prepared By:
b. Date(s) of Preparation:
c. Individuals Contacted/Consulted:
d. Documents Received:
e. Reviewer(s):
f. Date of Review:
g. Review Comments (attach additional sheets as necessary):

3. Prospective Client

a. Is the client financially competent?
b. Does the client wish to unrealistically transfer risk?
c. Is the client a "committee" client?
d. Is the client a legal entity that is authorized to enter into contracts and that can be sued when it becomes necessary?
e. Are the client's expectations realistic?
f. Does the client understand the uncertainties of time, cost, and outcome?
g. Who besides the client may rely on the deliverables or services?
h. What is the client's principal objective in undertaking the project?
i. Have we worked with this client in the past and, if so, was the quality of our relationship satisfactory?

4. Prospective Project

a. Are the project program, budget, and schedule adequately defined?
b. Is the project type "high risk" (e.g., residential or mixed-use condominiums, complex renovations, large public use centers)?
c. Is the project complex from a design or construction perspective?
d. Does the project location present any special risks?
e. Is this a Superfund site?
f. Will we be required to arrange for, store, or provide transportation of hazardous substances?
g. Do we have the necessary skill sets to support the proposed project?
h. Have we selected qualified subconsultants?

5. Prospective Contract

a. Whose contract form is being used—client's or our's?

b. Are the parties (client and design professional) clearly identified with their legal entity names?

c. Are the following appropriately addressed?

(1) Standard of care	
(2) Scope of services	
(3) Client duty to cooperate	
(4) Permit responsibility	
(5) Design professional's role during construction (no responsibility for means and methods or safety programs and procedures)	
(6) Unilateral or mutual indemnity for negligence	
(7) Limitation of liability	
(8) Force majeure	
(9) Insurance	
(10) Compensation method	
(11) Right to suspend services in the event of non-payment	
(12) Prompt non-binding dispute resolution	
(13) No third-party beneficiaries	
(14) Severability	
(15) Survival	
(16) Applicable law	

d. Are the following high-risk issues avoided?

(1) Problematic indemnity and defense obligations	
(2) Representations, warranties, and guarantees	
(3) Unrealistic certification obligations	
(4) Obligations to "verify" client-furnished information or services	

6. Retained Risk

Risk ID	How will we manage it?

Appendix B – Terms and Conditions Review Guide

Using this Risk Management Tool

This *Terms and Conditions Review Guide* provides CNA policyholders with a comparison of acceptable language to assist them in reviewing language provided by a prospective client. The contractual provisions of the guide also serve as model provisions for policyholders that would like to incorporate clear, unambiguous language into their professional services agreements.

The *Terms and Conditions Review Guide* is not a model contract. The commentary and model provisions are based on Schinnerer's experience in loss prevention and on the general scope of insurance coverage offered under the CNA policy. The information is offered for professional liability risk management guidance. It is designed to inform design professionals about some of the terms and conditions issues to be considered when reviewing or negotiating professional service agreements; it is not intended as legal or insurance advice applicable to specific circumstances.

These model provisions do not replace the need for you to rely on local counsel for a legal review of the terms and conditions of contracts that you negotiate with your prospective clients. The independent insurance broker who represents you can also provide advice on the applicability of professional liability insurance to the exposures you negotiate when crafting a professional services agreement.

Please feel free to photocopy Schinnerer's *Terms and Conditions Review Guide* for use in your office. Policyholders in the Schinnerer and CNA programs are granted a nonexclusive license to reproduce this publication in whole or in part for any internal educational purpose.

1. Standard of Care

According to common law, a professional is required to act as competently as could reasonably be expected of other professionals practicing under substantially similar circumstances. The law does not require perfection, merely reasonable skill and care.

> Sample provision: The standard of care for all professional services performed or furnished by Consultant under this Agreement will be the skill and care used by members of Consultant's profession practicing under similar circumstances at the same time and in the same locality. Consultant makes no warranties, express or implied, under this Agreement or otherwise, in connection with Consultant's services.

2. Compensation

A schedule of compensation due the design professional should always be expressly addressed to avoid potential disputes.

> Sample provision: For the scope of services stated in Attachment ____, Client agrees to pay Consultant the compensation stated in Attachment ____ to this Agreement. Consultant agrees to submit invoices monthly for services rendered in the manner and format stated in Attachment ____.

3. Indemnification

Indemnification provisions allocate risk and liability among parties. Typically, that allocation is designed to shift liability to the party who is thought to be more actively involved in activities or events giving rise to liability. In the context of professional service agreements, each party should be willing to be responsible for losses and claims arising out of its negligence.

> Sample provision: To the fullest extent permitted by law, Consultant shall indemnify Client, its officers, directors, partners, employees, and representatives, from and against losses, damages, and judgments arising from claims by third parties, including reasonable attorneys' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error, or omission of Consultant or Consultant's officers, directors, members, partners, agents, employees, or subconsultants in the performance of services under this Agreement.

When a firm reviews a contractual indemnity provision it should consider making the obligation reciprocal. Mutual indemnity provisions are often viewed by design professionals as more reasonable than a unilateral indemnity provision in favor of the client (or in favor of the prime professional under a subcontract). A sample mutual indemnity provision consistent with common law principles follows:

> Sample provision: To the fullest extent permitted by law, Client and Consultant each agree to indemnify the other party and the other party's officers, directors, partners, employees, and representatives, from and against losses, damages, and judgments arising from claims by third parties, including reasonable attorneys' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error, or omission of the indemnifying party or any of the indemnifying party's officers, directors, members, partners, agents, employees, or subconsultants in the performance of services under this Agreement. If claims, losses, damages, and judgments are found to be caused by the joint or concurrent negligence of Client and Consultant, they shall be borne by each party in proportion to its negligence.

4. Force Majeure

Circumstances or events may occur that are outside the control of either party. This provision states that neither party shall be liable for loss arising from any cause beyond its reasonable control.

> Sample provision: Neither party shall be deemed in default of this Agreement to the extent that any delay or failure in the performance of its obligations results from any cause beyond its reasonable control and without its negligence.

5. Dispute Resolution

Clients and design professionals should anticipate the possibility of disputes or claims and include in their agreements some provision for dispute resolution. Alternative dispute resolution through mediation is a non-binding process in which an impartial mediator actively assists the parties in identifying and clarifying issues in dispute, and in designing and agreeing to solutions.

> Sample provision: Client and Consultant agree that they shall first submit any and all unsettled claims, counterclaims, disputes, and other matters in question between them arising out of or relating to this Agreement to mediation in accordance with the Construction Industry Mediation Rules of the American Arbitration Association, effective as of the date of this agreement.

6. Termination of Contract

The rights and obligations of the parties should be clearly expressed, including the right to terminate the contract.

> Sample provision: Client may terminate this Agreement with seven days prior written notice to Consultant for convenience or cause. Consultant may terminate this Agreement for cause with seven days prior written notice to Client. Failure of Client to make payments when due shall be cause for suspension of services or, ultimately, termination, unless and until Consultant has been paid in full all amounts due for services, expenses and other related charges.

7. Hazardous Environmental Conditions

If the design professional is not being engaged to perform services related to hazardous environmental conditions, affirmative language should be included in the contract to exclude such services and exposures.

> Sample provision: It is acknowledged by both parties that Consultant's scope of services does not include any services related to the presence at the site of asbestos, PCBs, petroleum, hazardous waste or radioactive materials. Client acknowledges that Consultant is performing professional services for Client and Consultant is not and shall not be required to become an "arranger," "operator," "generator" or "transporter" of hazardous substances, as defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1990 (CERCLA).

8. Ownership of Documents

Drawings, specifications, reports and other documents produced by design professionals are instruments of their professional service, not products. Sometimes a client may insist on owning or having an unlimited license to use the instruments of service. If the design professional can

identify the client's specific needs for the instruments of service (e.g., construction, occupancy and maintenance), a limited license can be granted by the design professional to satisfy those needs. However, if the client insists on owning or having an unlimited license, and the design professional is willing to acquiesce to this demand, the client should be required to hold harmless and indemnify the design professional for all liability, cost, and expenses incurred as a result of any modification or use of the instruments of service without the design professional's written authorization.

> Sample provision: All documents prepared or furnished by Consultant pursuant to this Agreement are instruments of Consultant's professional service, and Consultant shall retain an ownership and property interest therein. Consultant grants Client a license to use instruments of Consultant's professional service for the purpose of constructing, occupying and maintaining the Project. Reuse or modification of any such documents by Client, without Consultant's written permission, shall be at Client's sole risk, and Client agrees to indemnify and hold Consultant harmless from all claims, damages and expenses, including attorneys' fees, arising out of such reuse by Client or by others acting through Client.

9. Use of Electronic Media

Transferring information by electronic media is inherently risky. One way to reduce this risk is to state that a hard copy has control over any variances or changes that might be introduced.

> Sample provision: Copies of documents that may be relied upon by Client are limited to the printed copies (also known as hard copies) that are signed or sealed by Consultant. Files in electronic media format or text, data, graphic or other types that are furnished by Consultant to Client are only for convenience of Client. Any conclusion or information obtained or derived from such electronic files will be at the user's sole risk. When transferring documents in electronic media format, Consultant makes no representations as to long-term compatibility, usability, or readability of documents resulting from the use of software application packages, operating systems or computer hardware differing from those in use by Consultant at the beginning of this assignment.

10. Construction Phase Services

If the agreement provides for any construction phase services by the design professional, the agreement should include express language that the contractor is solely responsible for the construction site and construction means, methods, techniques, sequences, and procedures that it uses to perform the work.

> Sample provision: If this Agreement provides for any construction phase services by Consultant, it is understood that the Contractor, not Consultant, is responsible for

the construction of the project, and that Consultant is not responsible for the acts or omissions of any contractor, subcontractor or material supplier; for safety precautions, programs or enforcement; or for construction means, methods, techniques, sequences and procedures employed by the Contractor.

11. Opinions of Cost

It's important to qualify the design professional's opinions or estimates of cost as being based on experience and qualifications that represent the design professional's best judgment, not a guarantee.

Sample provision: When included in Consultant's scope of services, opinions or estimates of probable construction cost are prepared on the basis of Consultant's experience and qualifications and represent Consultant's judgment as a professional generally familiar with the industry. However, since Consultant has no control over the cost of labor, materials, equipment or services furnished by others, over contractor's methods of determining prices, or over competitive bidding or market conditions, Consultant cannot and does not guarantee that proposals, bids, or actual construction cost will not vary from Consultant's opinions or estimates of probable construction cost.

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