Contracts for Professional Services

Clear, concise contract terms substantially reduce the risk of business and financial disputes, as well as the risk of professional liability problems with clients.

Studying this module should enable you to:

1. Identify various factors that should be considered when selecting contract type and content.
2. Describe five basic types of contracts.
3. Understand why a written agreement for professional services is preferable to an oral agreement.
4. Identify the appropriate elements of a letter agreement.
5. Describe the benefits of using the standard form agreements published by The American Institute of Architects (AIA) and the Engineers Joint Contract Documents Committee (EJCDC).
6. Distinguish between project-specific terms and general-condition terms.
7. Identify and describe the key types of project-specific terms.
8. Identify and describe the key types of general-condition terms.
9. List six indicators of success in the contracting process.

Contracts have long been recognized as essential risk management tools. Clear, concise contract terms substantially reduce the risk of business and financial disputes, as well as the risk of professional liability problems with clients and other project stakeholders. In contrast, an oral or poorly drafted contract is more likely to result in confusion, leading to conflict, leading to litigation.

This module provides an overview and discussion of the types of contracts and contract terms, both project-specific and general, commonly used in the procurement of design professional services. Throughout the presentation of this material, where appropriate, reference is made to provisions contained in the standard form agreements ☞ published by The American Institute of Architects (AIA) and the Engineers Joint Contract Documents Committee (EJCDC). The reader is encouraged to review the referenced AIA or EJCDC language in conjunction with studying this module.

☞ **For more information on standard contracts published by the AIA and EJCDC, go to www.aia.org or www.ejcdc.org.**

Factors to Consider in the Contracting Process

The choice of contract type and content is not always within the control of the design professional. In many instances, private as well as public-sector clients demand that their own standard contracts be used. In some of these instances, the contract is so poorly drafted or the contract terms are so one-sided that, in the absence of a reasonable opportunity to negotiate mutually acceptable terms, the project must be avoided.

When the design professional has the opportunity to influence the selection of contract type and content, ☞ factors such as the following should be considered for specific response during the contracting process (see also Module 1-4, "Evaluation of Projects and Clients"):

- Client's sophistication and capabilities;
- Proposed method of project delivery;
- Size and complexity of the project;
- Duration of the project;
- Nature of the services to be performed;

☞ **For a breakdown of claims involving contracts, please see *From Risk to Profit: Benchmarking and Claims Studies* at www.Schinnerer.com/risk-mgmt/Pages/Claim-studies.aspx.**

- Prior experience or relationship of the design professional and client;
- Level of pre-project planning, if any;
- Time allowed for the contract negotiation process;
- Bargaining position of the design professional;
- Contracting constraints of the client;
- General and project-specific risk management concerns or considerations; and
- Third-party requirements, such as those of public or private sources of project funding.

Types of Professional Services Agreements

Design professionals typically encounter five generic types of contracts: oral agreements, letter agreements, purchase orders, standard form agreements, and custom agreements. These are described and discussed in the following paragraphs.

Oral Agreements

As noted in Module 1-2, "Legal Liability of Design Professionals," an agreement need not be in writing to be enforceable. However, there are *no* business or risk management advantages to oral agreements.☞ Some relatively small or unsophisticated clients may be reluctant to execute a written contract, causing the design professional to agree to dispense with the formality of one. This could be a perilous course since a client's unwillingness to sign a written agreement may indicate reservations about making a formal commitment to the project, to payment, or to other commitments to the design professional. Even if the design professional has worked for the client in the past without a written contract and has not had a problem being paid, there are still many reasons to conclude a written agreement. Beyond the payment obligation, there are many other important aspects of a professional relationship and the respective obligations of the design professional and client that should be understood and confirmed in writing. The advantages of a written agreement include the following:

☞ **Read about the risks of using oral agreements under the "Contracts" subhead at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

First, a written contract provides objective, documented evidence of the agreement as distinct from an oral agreement,

the terms of which are left to the subjective, often biased recollection of each party. By definition, an agreement is intended to reflect the mutual assent of the parties regarding the subject of the contract and the respective obligations of the parties. Having agreements in writing allows each party to review those terms and make certain that it is comfortable with its obligations.

Also, putting pen to paper encourages, if not compels, the parties to be more conscientious about addressing and memorializing the complete terms of their agreement and provides an opportunity for careful selection of the language to reflect those terms. The absence of agreement or mutual assent on a material term may lead to the legal conclusion that no agreement existed. The absence of other contract terms may lead a court to infer terms that do not necessarily reflect the intention of the contracting parties.

In the event that a contractual dispute between the design professional and client cannot be resolved directly, a written agreement provides an objective basis upon which some third party (for example, a judge, jury, or arbitrator) may resolve the dispute. Without the written agreement, the third party inevitably will be required to resolve credibility issues based upon conflicting testimony from the parties regarding their subjective and biased recollection of the terms of the agreement.

Another advantage of the written agreement is that its negotiation provides a unique opportunity early in the professional relationship to evaluate the responsiveness and reasonableness of the client toward risk allocation and other liability-related concerns.

The uses of a written agreement ☞ also go beyond the immediate project under consideration. A well-drafted written agreement may be used by the management of the design professional firm as a basis for reviewing the firm's progress in satisfying project commitments, as well as for determining whether principals or employees of the firm are entering into agreements whose terms are consistent with firm policy and reflect sound business and risk management judgments.

☞ **Use of a written contract is the baseline criterion needed to qualify for Schinnerer and CNA's risk mitigation credit for eligible firms. Go to www.Schinnerer.com/risk-mgmt/Pages/Tools-understanding-insurance.aspx for details.**

Letter Agreements

Some clients or 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. 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; compensation, including amount and basis of payment, and payment schedule; provisions relating to schedule or time for performance of services; and identification of additional services offered to the client.

Using specific names or descriptions to aid identification, the letter should explicitly reference terms and conditions that are incorporated as an essential part of the agreement. The terms and conditions should be attached to the letter, initialed, and dated by the client at the same time that the client signs the letter agreement. The terms and conditions should address more general (i.e., less project-specific) topics, such as standard of care, indemnification, dispute resolution, waiver of subrogation, construction observation services, review of shop drawings and submittals, ownership and use of documents, and construction-cost estimates.

Some design professional firms may develop specific terms and conditions ☞ for particular types of projects, such as land surveying, interior design, and environmental services. A firm's terms and conditions should be amended over time to reflect evolving risk and practice management considerations. Firms should maintain a record of all editions or versions of the terms and conditions that they have used as part of the contracting process.

☞ **See our discipline-specific terms and conditions review guides:**

- ***Architects and Engineers*** **(www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx)**
- ***Surveyors*** **(www.Schinnerer.com/risk-mgmt/Pages/Surveyors-risk-mgmt.aspx)**
- ***Landscape Architects*** **(www.Schinnerer.com/risk-mgmt/Pages/Landscape-arch-risk-mgmt.aspx)**
- ***Construction Managers*** **(www.Schinnerer.com/risk-mgmt/Pages/Construction-managers.aspx)**
- ***Environmental Practitioners*** **(www.Schinnerer.com/risk-mgmt/Pages/Environmental.aspx)**

Purchase Orders

Some clients use purchase orders to procure all goods and services. In such cases, the 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 many provisions that are not appropriate for use in the procurement of design professional services.

For more information on the inappropriate use of purchase orders for professional services, go to www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

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 particular 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 typically are governed by a professional standard of care (see Module 1-2) or negligence standard, rather than an express warranty.

For help in educating clients about inappropriate provisions and professional liability insurance in general, go to www.Schinnerer.com/risk-mgmt/Pages/Tools-understanding-insurance.aspx.

See our *Management Advisory* on "Standard of Care" at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

Also, in those circumstances in which 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 and terms, and the method, amount, and timing of payment.

Standard Form Agreements

The Engineers Joint Contract Documents Committee (EJCDC) and The American Institute of Architects (AIA) publish standard form agreements, such as client-engineer and client-architect agreements, architect-consultant agreements, and general conditions of the contract for construction. These organizations obtain input from clients, contractors, and other groups with an interest in the construction process in order to produce a set of standard agreement forms that are fair and balanced in approach, reflect industry customs and terms, and are easily understood and, therefore, more likely to be accepted and used by clients, as well as by design professionals. At scheduled intervals or in response to industry

needs, these standard form documents are amended through an extensive review process, and new editions are published.

To some extent, the prevalent use of AIA and EJCDC standard form documents gives the parties a level of confidence in those documents and the expectation that the terms represent a fair, balanced approach to the major issues involved in the client-design professional engagement. In addition, many of the more important provisions of the standard form agreements have been interpreted by courts, and much of the court precedent reflecting those interpretations is published. This provides yet another level of confidence that these provisions have a settled meaning and application. Standard form agreements promote a reasonable amount of certainty and clarity about the nature and scope of commitments, the primary goals of the contracting process.

Standard form agreements are also available for the engagement of subconsultants (see AIA Document C401 and EJCDC E-568 or E-570). As a matter of practice, it is strongly recommended from the perspective of both the prime and subconsultant that written agreements be executed that include such terms as definition of scope, compensation, risk allocation, and insurance requirements.

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 specific general-condition topics, such as indemnification and dispute resolution, that may not be included in standard form agreements. In preparing these amendments or addenda, it is important to select terms and phraseology consistent with the terms of the standard form agreements. If appropriate, indicate how the text of the standard form agreement is affected, if at all, by the amendment or addenda, such as by the deletion or modification of certain standard terms.

In some instances, the design professional may assist the client in preparing general, supplementary, or special conditions of the construction contract, collectively called the

construction contract conditions. In other instances, the design professional has little or no role in the preparation of the construction contract conditions. Although the design professional is not a party to the construction contract, it is important that the provisions in the construction contract that describe his role and responsibility, particularly during the construction contract administration phase, be consistent with the terms of his agreement with the client. For that reason, design professionals should request, at a minimum, an opportunity to review the construction contract conditions prior to bidding or negotiation of the construction contract.

In addition, the construction contract conditions typically contain provisions that relate to the allocation of risk between client and contractor, for example, an indemnification provision or a no-damages-for-delay provision. If the design professional has an opportunity to review the construction general conditions and provide input, it may be possible to expand the scope of these provisions to provide appropriate protection to the design professional as well as to the client. Similarly, some clients may wish to transfer risks associated with unforeseen conditions entirely to the construction contractor through the omission of a differing-site-condition clause or by a broad disclaimer of the accuracy or completeness of geotechnical information. Deprived of any avenue of time or cost relief from the client, a contractor may assert or create claims against the design professionals involved in the project. If a design professional is provided an opportunity to review the construction contract general conditions, he may be in a position to influence the client to include provisions that allocate risk fairly between the client and the contractor. As a general rule, risk should be allocated to the party best positioned to control the risk. Allocation of risk on the basis of disparate bargaining power rarely results in effective control of the risk allocated.

Custom Agreements

Some projects or clients may require the preparation and use of custom agreements, because of the unique or special nature of the project or the course of dealing with the client. No

matter what considerations are driving 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 a standard AIA or EJCDC agreement.

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.

For guidance in evaluating or drafting equitable contract provisions, use the following resources from Schinnerer:

- ***Terms and Conditions Review Guide***
- ***Managing Risk Through Contract Language***
- ***Tips for Reviewing a Contract***

Go to www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx.

Content of Professional Services Agreements

The content of professional services agreements may be broadly divided into two general categories: 1) project-specific terms, and 2) general-condition terms. Within each of these categories, further classifications may include business and legal or risk management terms. However, it is important to appreciate that these two broad classifications are not mutually exclusive. Good business judgment often reflects sound risk management judgment, and sound risk management considerations often result in profitable business transactions. In general, business terms include the scope, nature, compensation, and payment for basic services and additional services, as well as the definition of and compensation and payment for reimbursable expenses. Although our focus here is on risk management, it is important to recognize that the negotiation of appropriate business terms is of *primary* importance to the success of the project and the financial viability of the design professional. When the design professional's compensation is inadequate to fund the scope of services expected by the client, the outcome is rarely favorable for either party.

Project-Specific Terms

Project-specific terms include, as the name suggests, those terms that pertain to the project that is the subject of the particular agreement. These include terms that cover the specific scope of basic services, changes in services or additional services, time for the performance of services, terms and timing of compensation, schedule for service performance, project personnel, information regarding channels of project communication, and specific client obligations and responsibilities (beyond payment).

Design Professional Responsibilities. From a business and risk management perspective, the design professional's scope of services should be defined with reasonable precision within the contract. Specifically, a well-defined scope of services often 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 their defense significantly more problematic and costly. Also, a clear, precise definition of service scope is essential for business and payment purposes. An ambiguous or unspecific definition may lead to an obligation to perform more services than contemplated or to a dispute with the client.

One way to clarify basic service obligations is by grouping them according to specific phases of the design and construction process. For example, EJCDC E-500, 2008 Edition, Exhibit A defines the engineer's basic services under the following phases of service: study and report, preliminary design, final design, bidding or negotiating, construction, and post-construction.

Another way to clarify basic service obligations is by categorizing them by type of service. For example, AIA Document B101-2007 subdivides the architect's services into the following phases: schematic design phase; design development phase; construction documents phase; bidding or negotiation phase; and construction phase.

When using a standard form that contains a detailed

description of the basic service obligations by particular phases or types of services, the design professional should make sure that any services that the parties have agreed to delete are stricken and that a note is added stating that they are not included in the agreement. Again, it is important that the design professional's services during the construction phase as described in the agreement conform to those defined in the construction contract general conditions.

In some instances, the design professional has developed a detailed definition of the basic-service scope in a proposal submitted to the client early in the professional relationship. Generally, the design professional should emphasize that the agreement, and not prior proposals or correspondence or other pre-agreement documentation, reflects the final and full expression of the contract between the parties. (See EJCDC E-500, 2008 Edition, ¶ 8.02 and AIA Document B101-2007, ¶ 13.1.) On the other hand, if the design professional intends to rely on the pre-agreement proposal or any information in it to define the basic-service obligations, the pertinent information in the proposal should either be explicitly incorporated into the text of the agreement or included by reference, with the proposal attached as an exhibit to the agreement.

Some clients wish to severely limit or, in some cases, totally eliminate any role for the design professional during the construction phase. This approach is unfortunate and should be discouraged. As the representative of the client during the construction phase, the design professional provides valuable support to the client and the construction process through observation of the construction, review of shop drawings and related submittals, review of contractor payment requisitions, interpretation of the contract documents, and resolution of disputes between the client and contractor. Generally, providing the design professional with an opportunity to observe or evaluate the work for conformance with the contract documents gives the client greater confidence that the project will be constructed in accordance with those documents. In addition, the design professional's continuous project role from

design through the construction phase gives him an opportunity to detect errors or omissions in the construction documents and avert, or at a minimum mitigate, any adverse impact they might have. The more limited the role of the design professional during the construction phase, the less protection afforded to the client and the higher the professional liability risk for the design professional.

In defining the scope of his basic-service obligations, the design professional should identify those consultants that he expects to retain (for example, see AIA Document B101-2007, Exhibit A, Initial Information ¶ A.2.5). A listing of those consultants by discipline preceded by language such as "including" or "without limitation" leaves open-ended the consultants that the prime design professional may be obligated to retain.

On certain types of projects, a particular engineering consultant's role may be as dominant as the role of the traditional prime design professional (for example, a hospital renovation project in which the mechanical/electrical/plumbing role may be as dominant as that of the architect). In these cases, the client may chose to retain both the traditional prime professional and the engineering consultant directly as separate prime professionals.☞ Care should be taken to define and allocate design coordination and other responsibilities (such as coordination or review of shop drawings and review of contractor payment requisitions) between the separate prime professionals. (See EJCDC E-500, 2008 Edition, Exhibit B, ¶ B2.01.N and EJCDC No. 1910-30A-B, 1993 Edition.)

☞ **To read more about client-selected consultants, see Schinnerer's *Management Advisory* on this topic at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

Often, it is also advisable to include in the agreement a list of those additional services that (a) are not included in the scope of basic services, and (b) the design professional is willing to perform for additional compensation. 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-service 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 not generally defined in the agreement.

Client Responsibilities. Certainly, one of the more explicit client responsibilities is the obligation to compensate the design professional in a timely manner for the performance of his services. However, in addition to the payment obligation, clients have many other equally important obligations. (See EJCDC E-500, 2008 Edition, Exhibit B and AIA Document B101-2007, Article 5.) These obligations generally include 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, and engaging certain specialized consulting, testing, legal, accounting, and insurance consulting services. The scope and nature of a client's responsibilities may vary according to the requirements of a particular project. Any such project-specific obligations should be spelled out in the agreement. For example, on a particular project, the client may be responsible for obtaining zoning approvals, specialized permits, or environmental site assessments.

Schedule and Time for Performance. Particular 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, design professionals are required to perform their services "as expeditiously as is consistent with professional skill and care and the orderly progress of the Project" (AIA Document B101-2007, ¶ 2.2). Before making a commitment to perform services in accordance with a specific schedule or other time requirements, the design professional should be satisfied that these requirements are reasonable and that he has the ability to control and achieve compliance with them. For example, sometimes 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 his obligations accordingly.

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 often particularly important from a risk management perspective:

Guarantee/Warranty/Certification Provisions. A client may request that the design professional warrant or guarantee a certain level of performance or a specific result, for example, that the design professional will meet all client project requirements and perform in all respects in a superior manner. Alternatively, a client may request that the design professional certify that certain conditions exist or will exist upon completion of construction.

Read more about express warranties and guarantees at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

In general, warranties and guarantees pose a substantial risk of uninsured liability should the design professional be found liable on the basis that the warranty or guarantee was unfulfilled. In addition, breach-of-warranty claims typically are not subject to the protection generally afforded by statutes of repose that have been enacted in certain jurisdictions and that bar third-party claims against design professionals after a specific period of time has elapsed following substantial completion of the project.

Design professionals should be extremely reluctant to provide any form of guarantee, warranty, or certification. With respect to certifications, design professionals should make certain that they are qualified to make the certification, that is, that it falls within the scope of services provided by the design professional. Then he should appropriately qualify the certification, using introductory language such as “In my professional opinion” or “To the best of my knowledge, information, and belief.” Since unqualified commitments are tantamount to signing a blank check, a design professional should not commit to signing any certifications that the client

or others, such as the construction lender, may require without first having the opportunity to review and comment on them. (See EJCDC E-500, 2008 Edition, ¶ 6.01.F and AIA Document B101-2007, ¶ 10.4.)

☞ You can read about intellectual property rights and risks in our *Management Advisory*, "Intellectual Property Risks," www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

Ownership and Use of Documents. ☜ Drawings, specifications, reports, and other documentation produced by design professionals should be acknowledged as instruments of their professional service and not regarded as products. As instruments of service, they should remain the property of the design professional. Sometimes a client will insist on owning or having an unlimited license to use the instruments of service produced by the design professional. If the design professional is willing to acquiesce to this demand, he should require the client to hold harmless and indemnify him for all liabilities, costs, and expenses that he might incur as a result of any modification of the instruments of service without his written authorization. (See AIA Document B101-2007, Article 7 and EJCDC E-500, 2008 Edition, ¶ 6.03.)

In some instances, a client may wish to distribute a report prepared by the design professional to third parties. This could lead to third-party claims against the design professional for negligent misrepresentation (see Module 1-2) if the third party were to rely on inaccurate information or statements contained in the report. Design professionals should try to control distribution of reports to third parties and include in their reports appropriate qualifications and limitations on opinions and information contained therein.

☞ Read more about lender requirements at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

Consent to Assignment of Agreement to Lender ☜ **or Other Entities.** Clients sometimes request that a design professional agree to the collateral assignment of the client-design professional agreement to some third party, typically the construction lender. In the context of such a request, there are several considerations to bear in mind:

- The design professional and legal counsel should be given a reasonable opportunity to review and comment on the terms of the assignment.
- The assignment should not alter the substantive and

material terms of the client-design professional agreement, such as payment obligations and ownership and use of documents.

- The design professional should not be required to accept the assignment unless all of the client's obligations have been fulfilled as of the date of the assignment.
- The assignee agrees to accept all of the past, present, and future obligations of the client as defined in the client-design professional agreement, including curing of any then-existing client defaults, such as nonpayment.

In some circumstances, a design professional may be required to give up ownership of document rights as a condition of the assignment. The design professional should not accept such a condition unless appropriate hold harmless and indemnification protection is afforded to the design professional for any liability arising from changes or modifications in the documents made without his written authorization.

Suspension and Termination of Services for Nonpayment. 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 client-design professional agreement. 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 seven days advance written notice so that the client has a reasonable opportunity to avert the impending termination by curing the default within the notice period.

Suspension of services 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 seven days written notice to allow the

☞ **Read more about fee collection as a risk management practice at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.**

Also, proper payment terms and invoicing procedures are one of the six "best practices" criteria (three out of six are required) needed to qualify for Schinnerer and CNA's risk mitigation credit for eligible firms. Go to www.Schinnerer.com/risk-mgmt/Pages/Tools-understanding-insurance.aspx for details.

In addition, read our *Management Advisory* on "Termination, Suspension and Abandonment" at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

client an opportunity to cure the default. (See EJCDC E-500, 2008 Edition, ¶ 4.02.B and AIA Document B101-2007, ¶ 9.1.)

Indemnification Provisions. Indemnification provisions are intended to allocate risk or liability between parties. In the context of client-design professional agreements, a client may seek indemnification from a design professional for liability or risk resulting from the negligence or other wrongdoing of the design professional. In turn, the design professional may seek similar indemnification from the client for liabilities or risks resulting from matters within the client's control or responsibility.

To read more about indemnification, see the following *Management Advisories* at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx:

- "Defending and Indemnifying a Client"
- "Indemnification: General Issues"
- "Indemnification: Subconsultants"

You can also read "Contractual Limitations of Liability: Worth The Paper They Are Written On?" from the Annual Meeting of Invited Attorneys at www.Schinnerer.com/risk-mgmt/Pages/49thAMIA.aspx.

As noted in Module 1-4, indemnification provisions 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, i.e., risks that they are unable to control. Ideally, indemnification 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. (See EJCDC E-500, 2008 Edition, ¶ 6.10.A.)

NSPE annually publishes *NSPE's State-by-State Summary of Liability Laws Affecting the Practice of Engineering*. You can download a copy through NSPE's website at www.nspe.org.

The enforceability of indemnification provisions depends upon the jurisdiction, and the statutes and case law differ significantly in this regard. For example, some states have enacted so-called anti-indemnification statutes that preclude or restrict an indemnitee's ability to obtain indemnification for its own negligence or other wrongdoing. Consultation with knowledgeable legal counsel is essential in this area. In addition, design professionals practicing in several jurisdictions need to be aware of the variations in laws regarding indemnification in those jurisdictions in order to allocate risk effectively. Finally, the prime design professional should be mindful of the need to include appropriate indemnification provisions in agreements with consultants.

Limitation of Liability Provisions. A limitation of liability 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, 3) particular types of damages, or 4) change-order costs. Exhibit I of EJCDC E-500, 2008 Edition, contains model provisions for each of these forms of limitation of liability. In general, limitation of liability clauses are enforceable and provide an effective limitation on liability exposure, particularly if properly drafted to encompass a broad range of claims, for example, negligence, breach of warranty, strict liability, violation of statutory obligations, and breach of contract. In some states, the enforceability of limitation of liability clauses may be questionable, particularly in states with strong anti-indemnification legislation and public policy.

Unlike a release, a limitation of liability clause does not extinguish all liability, rather it merely limits the amount or extent of liability exposure. In the event that the design professional or the client wishes to establish the liability limit in the amount of insurance, it is important that this intention be expressed through specific language such as: "Liability, in the aggregate, shall be limited to the amount of any insurance proceeds which may be available to satisfy any claim." Absent this language, a contract that contains a limitation of liability provision for $1 million may not necessarily accomplish the intention of limiting liability to the amount of insurance even though the design professional holds a professional liability policy in that aggregate amount. Because of other claims, $1 million may not be available at the time the claim is made. In addition, at the time of the claim, a $1 million policy limit may no longer be in effect.

Limitation of liability clauses should be drafted by legal counsel in the design professional's jurisdiction with experience in this area. The phraseology of such clauses may be critical not only to their effectiveness and scope, but also to the enforceability of the clause itself. In addition, to enhance enforceability of such a clause, the design professional should draw the client's attention to the clause, engage in negotiation with the client concerning the clause, and maintain documentation and evidence of that negotiation process.

To read more about limitations of liability, see the following *Management Advisories* at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx:

- **"Limitation of Liability"**
- **"Limitation of Liability: Subconsultants"**

You can also read "How Safe Is the Harbor? Limited Liability Provisions in the Design Professional Agreement" from the Annual Meeting of Invited Attorneys at www.Schinnerer.com/risk-mgmt/Pages/AMIA-past-meetings.aspx.

☞ Read more about subrogation at www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.

Waiver of Subrogation. ☞ A waiver of subrogation provision is often included in client-design professional agreements (see AIA Document B101-2007, ¶ 8.1.2 and EJCDC E-500, 2008 Edition, ¶ 6.10.E) and in the construction contract general conditions (see AIA Document A201-2007, ¶ 11.3.7 and EJCDC C-700, 2007 Edition, ¶ 5.07). In general, the purpose of these provisions is to waive claims among the client, design professional, and 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. For example, if a sprinkler pipe bursts during construction resulting in damage to the structure, and that damage is compensated by insurance, neither the client, design professional, contractor, nor their respective insurers would have the right to assert claims against each other to the extent that the damage has been compensated by insurance. Waiver of subrogation provisions, therefore, serve the salutary purpose of ensuring finality for claims compensated by insurance, at least between certain project participants.

☞ More about additional insureds at:

- "Additional Insureds" *Management Advisory* (www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx)
- *Intro to Professional Liability Insurance* (www.Schinnerer.com/risk-mgmt/Pages/Tools-understanding-insurance.aspx)

Additional Insured Provisions. ☞ In some situations, the design professional may be named as an additional insured on insurance policies obtained by other participants in the construction process. For example, a design professional may be named as an additional insured on a builder's risk insurance policy or on a commercial general liability insurance policy. In most states, the additional insured status will preclude the insurer from asserting subrogation claims against the design professional.

☞ Download a copy of our dispute resolution primer at www.Schinnerer.com/risk-mgmt/Pages/Practice-management.aspx.

Dispute Resolution. ☞ Many times, clients and design professionals anticipate the possibility of disputes or claims and include in their agreement some provision for dispute resolution. For example, in the event that direct negotiations between the parties fail to resolve a dispute, the agreement may provide for mediation, arbitration, litigation, or some combination of those types of dispute resolution. (See EJCDC E-500, 2008 Edition, ¶ 6.08 and AIA Document B101-2007, ¶¶ 8.2 and 8.3.)

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. The 2007 editions of AIA Document A201 and AIA Document B101 require mediation as a condition precedent to arbitration or litigation. Mediation is optional under EJCDC documents C-700 (2007 edition) and E-500 (2008 edition).

Unlike mediation, which is a consensual dispute resolution process, both arbitration and litigation are adjudicative dispute resolution processes that are designed to result in a final and binding determination of the dispute. In the absence of a specific agreement to arbitrate, litigation will be the final and binding dispute resolution mechanism. Both the EJCDC and AIA documents provide for arbitration as an option that can be selected for a binding dispute resolution mechanism.

The perceived advantages of arbitration include less formality, less legal expense, and more expeditious resolution. However, arbitration lacks some of the procedural and legal safeguards afforded by litigation. Therefore, substituting arbitration for litigation involves trade-offs. For this reason, some design professionals who include an arbitration provision in their agreements include a dollar limitation on the size of claims subject to arbitration. (For more detailed discussions of non-adjudicative and adjudicative methods for dispute resolution, see Modules 2-4 and 2-5, respectively.)

Contractual Limitation Periods for Assertion of Claims. Most states allow parties to an agreement to include a provision that specifically defines both the time within which the client may assert a claim against the design professional, and the start or trigger date for the running of that contractual limitation period. The trigger date should be defined by reference to an objectively ascertainable date or occurrence, such as the date of substantial completion of the project, rather than a subjective or less clearly discernible or provable event, such as the date that the complainant actually discovered the basis for a claim against the design professional. As to the length of the

limitation period itself, the laws of some states require that the period not be unreasonably short. In establishing a specific contractual limitation period, the design professional should consult with knowledgeable counsel in his jurisdiction. (See AIA Document B101-2007, ¶ 8.1.1 and EJCDC E-500, 2008 Edition, Exhibit H, ¶ H6.08.A.1.)

Indicators of Success in the Contracting Process

As noted at the beginning of this module, contracts are essential risk management tools. From that perspective, the outcome of the contracting process can be considered successful if it results in a contract that satisfies the following key criteria:

- The expectations of the parties are clearly articulated and reasonably integrated.
- The rights and obligations of the parties are clearly expressed.
- Risks and rewards are clearly addressed and fairly allocated, with each source of risk allocated to the party in the best position to control or otherwise manage it.
- Insurance is available to support any indemnity obligations.
- Mechanisms exist to reasonably accommodate changes during the course of the project.
- The parties' mutual understanding is confirmed in writing.

Summary of Points

1. Clear and concise contract terms substantially reduce the risk of business and financial disputes as well as the risk of professional liability problems with clients and other project stakeholders.

2. There are five basic types of professional services agreements: oral agreements; letter agreements; purchase orders; standard form agreements; and custom agreements.

3. There are five major reasons why written agreements are preferable to oral agreements: a) a written agreement

provides objective, documented evidence of the intent of the parties; b) putting pen to paper encourages reflection about specific terms; c) a written agreement provides a stronger basis for dispute resolution by a third party such as a judge, jury, or arbitrator; d) the process of negotiating a written agreement provides an opportunity to evaluate the client; and e) a written agreement may be used by the design professional to help assess whether it is meeting its project commitments.

4. Letter agreements may be appropriate for use on small projects with well-defined and relatively routine services. In addition to project-specific information and terms such as the scope of services and compensation/payment terms, a letter agreement should explicitly reference general-condition terms incorporated as part of the agreement. Letter agreements should be signed by both parties.

5. Purchase order forms will probably contain provisions that are not appropriate for use in procurement of design professional services and should be modified appropriately.

6. The Engineers Joint Contract Documents Committee (EJCDC) and The American Institute of Architects (AIA) publish standard forms of agreement and general conditions for use in various projects.

7. Some projects or clients may require the preparation and use of custom agreements.

8. Professional services agreements contain two broad categories of terms and conditions: a) project-specific terms; and b) general-condition terms.

9. Project-specific terms include the design professional's responsibilities, the client's responsibilities, and terms related to the schedule and time for performance.

10. General-condition terms are often particularly important from a risk management perspective.

11. In general, warranties and guarantees pose a substantial risk of uninsured liability.

12. Design professionals should not commit to sign any certification without first examining a copy of the proposed form of certification.

13. Drawings, specifications, reports, and other documentation produced by the design professional are instruments of service and should preferably remain the property of the design professional.

14. Design professionals should carefully monitor and control the use and distribution of reports to third parties and include appropriate qualifications on opinions and information contained therein.

15. Assignments should not alter the material terms of the client-design professional agreement.

16. Suspension of services may be used as an alternative to termination in the event of nonpayment by the client.

17. The enforceability and interpretation of indemnification provisions vary depending on jurisdiction, statutes, and case law.

18. A limitation of liability clause does not extinguish all liability, rather it merely limits the amount or extent of liability exposure.

19. Waiver of subrogation provisions serve the purpose of ensuring finality for claims made by certain project participants that are compensated by insurance.

20. A design professional may be named as an additional insured on a builder's risk policy or a commercial general liability policy that has been obtained by other participants in the construction process.

21. Anticipating the possibility of disputes or claims, an agreement may provide for mediation, arbitration, litigation, or some combination of those types of dispute resolution.

22. Contractual limitation periods for assertion of claims are allowed in most states as long as the period is not unreasonably short.

Further Reading

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Bockrath, Joseph T., *Contracts and the Legal Environment for Engineers and Architects*, McGraw-Hill, New York, 1999.

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Ellickson, Dale R., "The AIA Documents," Chapter 11.4 in *The Architect's Handbook of Professional Practice,* Thirteenth Edition*,* edited by Joseph A. Demkin, John Wiley & Sons, Inc., New York, 2001.

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