BluePrint

For Design Professionals

The Ten Commandments of Design Professionals' Contracts (Vol.1)

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The last two-plus decades have seen a massive rise in the importance of contracts in the construction industry—whether for design professionals, owners, contractors, lenders, suppliers, or the building trades. Contracts have increasingly been enforced as "meaning what they say and saying what they mean." The developing law in many states has encouraged parties to allocate risk through their business agreements. In support of this, courts have increasingly prohibited parties from bringing claims for purely economic losses against each other unless they have a direct contractual relationship. This, in turn, emphasizes the importance of negotiating specific terms when parties get into business with one another.

This context of modern business relationships elevates the importance of negotiating key terms when parties enter into agreements for design or construction services. This paper will serve as the first in a series of discussions about essential clauses that are worthy of strong focus when allocating risk between the parties to a construction project.

Thou Shalt Get It in Writing

It is absolutely essential to state up front that EVERY PROJECT DESERVES ITS OWN CONTRACT. Simply reusing a prior form without tuning it up and making it applicable to the project at hand can yield disastrous results. And failing to get all parties to an agreement to sign the contract opens the door to the dreaded "swearing match" over what the actual terms were, because the lack of a

fully executed agreement allows a later adversary to argue the terms of an oral contract. These dangers can be addressed with a purposeful, high-energy approach to the opening stages of a contract, when relationships are likely at their best. The following terms are among the most important that parties can secure for themselves in protecting against risk if things later go wrong on the project.

Thou Shalt Obtain a Limitation-of-Liability Clause

This is arguably the most important contractual clause that an engineer or architect can obtain when negotiating the terms of a professional services contract. In a typical best-case scenario, the design professional strictly limits liability to the amount of the professional fees *actually paid* to the architect or engineer (though in massive projects commanding very high design fees, this type of clause might not be as helpful). There are arguable exceptions for intentional torts such as fraud, and for situations involving gross negligence, since courts may refuse to apply limitations of liability when a defendant has deliberately done wrong. Since those situations are few and far between, however, the overwhelming majority of claims and disputes can be tamed in advance through the use of this type of clause.

Thou Shalt Waive of Consequential Damages

Litigation adversaries have fought for decades over what the proper measure of damages should be under a claim. Does it include the owner's lost rents or lost profits in general? What about a failure to bring the project "to market" at an ideal economic moment, when the owner/developer could have made unprecedented profits by striking at the perfect time? Should a design professional be expected to pay the additional interest on a construction loan because the final financing terms were delayed? Who should be responsible for the contractor's extended general conditions in the event of a delay? There is no limit to the creativity and possible overreach that some claimants' lawyers may bring to bear—and without robust contract language to push back against it, it may be very difficult to resist claims for "what could have been."

Thou Shalt Watch the Schedule (Or…Time: Is It "Of the Essence"?)

"Do not cavalierly sign on to a dated and/or unrealistic schedule for the performance of your work."

Under the law of some states, agreeing to a certain schedule and then failing to meet that schedule (without a viable excuse) could open the door for a categorical finding that you have breached the contract. The danger on this front becomes very high if you agree in writing that "time is of the essence"—in which case the question of whether you breached the contract might not even reach a jury. The threat becomes that much more toxic if negotiations run long and parties neglect to update the project milestones at the end of the discussion. Do not cavalierly sign on to a dated and/or unrealistic schedule for the performance of your work.

Thou Shalt Accept No Damages for Delay

The construction industry is not known for its punctuality, but rather suffers from the typical delays that arise from complicated design and construction issues. These complexities and resulting delays are not surprising, but rather come with the nature of the work itself—and many project delays have nothing whatsoever to do with the design of a project. Right in line with the waiver of consequential damages, a party should strongly consider contract language that will categorically eliminate claims that arise from delays in the project.

Thou Shalt Obtain a Waiver of Subrogation

Subrogation is a legal principle that allows an insurance carrier to pay out a claim under a property loss or other property, and then go seek out the parties who are allegedly responsible for the loss and pursue them through litigation. Essentially, this puts parties in nearly the same position as if there had never been an insurance policy at all, since the carrier has a strong motivation to chase the project team to claw back previous outlays. A waiver of subrogation between you and your contracting counterpart helps leave the risk where parties traditionally expect it to be—with the carrier who issued the policy. Some of the AIA form contracts contain helpful language for this purpose. It is important to consult a legal professional, however, to make sure that the language in question is enforceable where you are doing business.

Thou Shalt Paper Up the File

This sounds precisely like what a lawyer would say—but design professionals unfortunately operate with too much optimism and expect clients, contractors, and others to "do the right thing" and accept responsibility under difficult circumstances. Regrettably, self-protection impulses can lead parties to engage in revisionist history, or to refuse to take ownership of problems that belong to them. This danger is magnified during white-hot economic times, when clients are pushing for design and construction to be completed in record time. Too often, owners propose—and architects and engineers often agree—to "park" a difficult issue and agree to sort it out later. Whether intentional or not, this poses a massive threat for all sorts of later issues that might develop. The most important terms—payment, limitation of available damages, the professional standard of care, the schedule, and responsibility (if any) for delay damages—become subject to a "swearing match" if both parties don't sign the contract and don't record the project's history as it develops. For these reasons, it is essential to make a contemporaneous record of what is happening at key points in the project.

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Thou Shalt Define the Scope of Work--*AND* What's Not Included

Many construction-industry disputes arise over parties' disagreements about who was to perform how much work, in what location, and for how much money. Epic battles have been fought over whether one party or the other should have obtained a builder's risk policy, or other insurance coverage, and whether one party or the other was responsible for hiring a building envelope specialist, a geotechnical engineer, or some other kind of consultant. Abundant other examples exist as to misunderstandings that could have been avoided if only the parties had detailed the various responsibilities under the contract. The contract is the single best place—and arguably the only place—to set forth each party's obligations. If the original business participants leave the company or otherwise become detached from the project, you must have the protection of a fully executed contract that outlines precisely what you were supposed to do on a project, and what was specifically excluded. Some of the longer AIA form contracts contain a grid of responsibilities for certain aspects of the work. This can be hugely helpful in forcing the parties to confront exactly what is included (and just as crucially, what *is not* included) in the contractual undertaking.

Conclusion

In closing, it is important to note that ***THIS IS NOT LEGAL ADVICE.*** The circumstances of any given project are highly detailed and operate within the framework of many relationships and contracts governing them. Further, the law of any given jurisdiction may strongly affect the language that must be used to make contract provisions enforceable—and in some areas, there are statutory and court-mandated prohibitions on certain contract language. It is absolutely essential to consult with a lawyer who has experience in construction law, and with the law of the jurisdiction that will govern. And remember: ***Each project deserves its own contract.***

"Better living through better contracts" is a credo that can lead to less conflict, more predictable behavior, and less opportunism on any given project. The early investment of energy at the outset can serve as a bulwark against later disputes by insisting on specific terms and an allocation of duties from the very start of a project. Above all, please remember: **GET THE CONTRACT SIGNED,** and prepare to negotiate good and realistic terms—and then live by them.

Matthew Ryan has extensive experience with construction disputes, including serving as lead counsel and appearing in federal court, as well as arbitration, administrative proceedings, and extensive mediation experience. He regularly represents design professionals in disciplinary and registration proceedings at the Texas Board of Architectural Examiners and Texas Board of Professional Engineers, and he lectures and focuses extensively on lien and bond claims, AIA form contracts, design professional disciplinary actions, and claims before the Texas Department of Transportation and the State Office of Administrative Hearings. In addition, Mr. Ryan's experience includes construction claims, contract drafting and negotiations, and other areas of commercial and civil law, focusing on helping his clients build and maintain strong foundations for their businesses.

Coverage Corner: Additional Insured

In our last *BluePrint*, we published an article discussing the *"Pitfalls of Adding Clients or Other Design Professionals as Additional Insureds"*. We frequently receive requests by our Insureds to add clients or project owners as additional insureds under their professional liability policy. For the reasons stated in the article, we would like to stress the fact that Navigators does not add unrelated entities as additional insureds to our professional liability policies.

Professional liability policies provide coverage for claims arising from a wrongful act or pollution incident in the performance of professional services by a design professional. Professional services are generally defined as the services the Insured performs for others in the practice of an architect, engineer, land surveyor, landscape architect, construction manager, interior designer, technical consultant, etc. By this definition project owners would not be afforded any coverage under the policy as they are typically are not providing these professional services.

The design professional's client may be under the impression that inclusion as an additional insured will provide coverage for claims arising from the design professional's services. However, the typical design professional liability policy pays on behalf of the Insured to the injured party. This means that if the client is named as an additional insured, it would no longer be able to collect against the policy should they face damages related to a covered wrongful act from the Insured.

As you can see there are many reasons why adding clients, owners and other unrelated entities as additional insureds would not be in your or their best interest. We hope this clarifies some of the information previously presented and if you should have any further questions or concerns please contact Roseanne DeBellis at rdebellis@navg.com.