

# A/E RISK REVIEW

A PUBLICATION OF THE PROFESSIONAL LIABILITY INSURANCE NETWORK



**FINANCE INSURANCE, LTD.**  
Quality Service For Your Insurance Needs

VOLUME 36, 2002

For More Information Contact:

Mary Yoshimoto

Tel: 522-2095

Fax: 522-2082

email: [myoshimo@financeinsurance.com](mailto:myoshimo@financeinsurance.com)

## Dealing with An Underfunded Project

*The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.*

A review of loss prevention case files reveals that underfunded projects are a major cause of professional liability claims and losses. This problem becomes more prevalent during times of economic slowdown, with clients strapped for capital looking for ways to reduce costs. Design professionals may be encouraged to reduce costs by taking shortcuts and skimping on details or quality control; contractors may be encouraged to do the same. In such cases, errors and omissions become more prevalent, leaving argument and legal wrangling in their wake.

Capital-strapped projects can also result in slow payment as well as trumped-up negligence claims filed as a ploy to avoid payment altogether. Should the funding problem reach crisis stage, the project itself comes into jeopardy. Delays, work stoppages and project termination can lead to a legal quagmire and professional nightmare.

Fortunately, there are preventive steps design firms can take to avoid or at least minimize the headaches and heartbreaks of an underfunded project.

### Conduct A Financial Check of Your Client

Because inadequate funding plays such a huge role in professional liability losses, design professionals should

do what it takes to help avoid these entanglements in the first place. For whatever reason, however, architects and consulting engineers are often reluctant to perform financial background checks on their clients. They feel they will insult, embarrass or otherwise alienate their clients.

Yet the fact of the matter is that most of these clients have already willingly provided this same financial information to a number of other business associates in order to obtain credit and project approval. In most cases, they would hardly blink at providing the same information to their prospective design firms. And if a prospective client is reluctant to share its financial records, maybe that's just the type of client you might choose to avoid.

Assume the background check shows that the client has a less than perfect credit history. Does that mean you should automatically reject this client? Of course not. It is simply one important piece of information to consider. If the firm or individual has an otherwise clean record as a reasonable, non-litigious client, you can certainly move forward with the project, taking necessary precautions in the forms of solid contractual language. But combine that spotty credit record with a trail of litigation and/or a history of selecting low-bid contractors, and you might make the best business decision of your life by avoiding this client.

### Secure an Adequate Scope of Services

Securing an adequate scope of services is always recommended to avoid risk and liability. When your credit check of the client reveals the potential for underfunding, an adequate scope becomes critical. The scope of services should include pre- and post-design activity designed to enhance quality control and lower risk exposures. It might even be worthwhile for you to

offer these services at a lower-than-usual profit margin, given the risks that might otherwise exist.

Services you should consider include, among others:

- **Pre-qualification of contractors**, to help assure that all invited to bid are reputable, experienced, bondable and otherwise qualified to do the work
- **Management of a pre-selection conference**, where pre-qualified contractors are invited to address any questions they may have and to learn the "rules of the game" from you, other design professionals and the owner's representatives
- **Plan and specification review** by contractors as part of the selection process, to help assure the constructability of plans and to identify potential errors, omissions, ambiguities, or inconsistencies before work begins
- **Hosting a pre-construction meeting**, where schedules are reviewed, understandings are solidified and put in writing, and project principals get to establish lines of communication that can be used once the project is under way
- **Full-time construction observation** by qualified and experienced field personnel.

Obtaining a cash-strapped client's agreement for you to perform these services for a fee may be difficult. Nonetheless, the need for performing them should be addressed to the client. If the client summarily dismisses your suggestions and demonstrates a desire to do this work the cheapest possible way, you will be given a clear insight into the client's mindset. The question you then must ask yourself is, "Do I really want to work for this client?" Many architects and consulting engineers will respond, "No" because the risk of loss is so substantial.

Should you decide to accept an assignment from a financially troubled firm, it is prudent to draft contract language that provides you an "out" should the project turn sour. Insist on language that provides you the right to suspend services or terminate the agreement if the client reneges on its contractual obligations or financial commitments.

### **Suspension of Services**

Failure by a client to pay you is considered a breach of a material term and therefore a cause for you to

terminate. But you may not want to use the ultimate hammer of termination; you may want to be able to suspend and withhold your services in hopes of forcing the client to cure the breach but keep the contract in force. You need the right, therefore, to suspend your services without breaching your contract yourself or incurring liability for delay. Granted, if the nonpayment continues for a sufficient time after you have made demand and given proper notice of the breach, you may ultimately wish to terminate. But in the meantime, you at least want to avoid increasing your receivables.

One solution is a contractual provision that allows you or your client to suspend the contract for a defined but relatively short period of time without additional cost. For a longer suspension, you should be compensated for the expenses of interrupting and resuming your services. And, for an excessive period of client-ordered suspension, you need the option to terminate the agreement; you may need to step back and renegotiate the entire deal.

Give yourself the right to suspend your services without risk or liability for delay in the event of nonpayment of your fees, or for any other breach by your client of terms you consider critical to the progress of your services. Here is a sample service suspension provision provided by DPIC Companies to discuss with your attorney:

### ***Suspension of Services***

***If the Project or the Consultant's services are suspended by the Client for more than thirty (30) calendar days, consecutive or in the aggregate, over the term of this Agreement, the Consultant shall be compensated for all services performed and reimbursable expenses incurred prior to the receipt of notice of suspension. In addition, upon resumption of services, the Client shall compensate the Consultant for expenses incurred as a result of the suspension and resumption of its services, and the Consultant's schedule and fees for the remainder of the Project shall be equitably adjusted.***

If the Consultant's services are suspended for more than ninety (90) days, consecutive or in the aggregate, the Consultant may terminate this Agreement upon giving not less than five (5) calendar days' written notice to the Client.

***If the Client is in breach of the payment terms or otherwise is in material breach of this Agreement, the Consultant may suspend performance of services upon five (5) calendar days' notice to the Client. The Consultant shall have no liability to the Client, and the Client agrees to make no claim for any delay or damage as a result of such suspension caused by any breach of this Agreement by the Client. Upon receipt of payment in full of all outstanding sums due from the Client, or curing of such other breach that caused the Consultant to suspend services, the Consultant shall resume services and there shall be an equitable adjustment to the remaining project schedule and fees as a result of the suspension.***

We have chosen 30, 90 and five days as examples of time periods for this provision. You may wish to insert different times that are acceptable to you and your client, being sure to coordinate your Suspension of Services clause with your Billing and Payment, Retainers, Changed Conditions and Termination provisions in your agreement.

#### **Termination Clause**

The following sample clause provided by DPIC Companies for discussion with your attorney allows your client to terminate with or without cause, but to be held responsible for any costs you incur associated with stopping the project. It gives you the right to terminate for specified causes and offers you protection when you quit for justifiable cause.

#### ***Termination***

***In the event of termination of this Agreement by either party, the Client shall within fifteen (15) calendar days of termination pay the Consultant for all services rendered and all reimbursable costs incurred by the Consultant up to the date of termination, in accordance with the payment provisions of this Agreement.***

The Client may terminate this Agreement for the Client's convenience and without cause upon giving the Consultant not less than seven (7) calendar days' written notice.

***Either party may terminate this Agreement for cause upon giving the other party not less than seven (7)***

***calendar days' written notice for any of the following reasons:***

***Substantial failure by the other party to perform in accordance with the terms of this Agreement and through no fault of the terminating party***  
***Assignment of this Agreement or transfer of the Project by either party to any other entity without the prior written consent of the other party***  
***Suspension of the Project or the Consultant's services by the Client for more than ninety (90) calendar days, consecutive or in the aggregate***  
***Material changes in the conditions under which this Agreement was entered into, the Scope of Services or the nature of the Project, and the failure of the parties to reach agreement on the compensation and schedule adjustments necessitated by such changes.***

***In the event of any termination that is not the fault of the Consultant, the Client shall pay the Consultant, in addition to payment for services rendered and reimbursable costs incurred, for all expenses reasonably incurred by the Consultant in connection with the orderly termination of this Agreement, including but not limited to demobilization, reassignment of personnel, associated overhead costs and all other expenses directly resulting from the termination.***

Some consultants also include stricter provisions concerning ownership of instruments of service in the event they are terminated early, in order to prevent clients from walking off with complete or near-complete construction documents and forgoing construction administration services. Negotiate for explicit and reasonable termination rights that work for both you and your client.

#### **Can We Be of Assistance?**

***We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.***