

A/E RISK REVIEW

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Minimizing Risks of 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.

Underfunded projects are a major cause of professional liability claims and losses. When clients are strapped for capital, they look for ways to reduce costs. They may take shortcuts and skimp on details and quality control. They often encourage their design firms and contractors to do the same. In such cases, errors and omissions become more prevalent, leaving disputes and legal wrangling in their wake.

Capital-strapped projects can also result in slow payment for design services. Desperate clients may even file trumped-up negligence claims 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 for all parties involved.

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 can play a significant role in professional liability losses, design professionals should do whatever it takes to avoid financial entanglements in the first place. But architects and 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 clients have already provided this same financial information to a number of other parties to obtain credit and project approval. In most cases, they hardly blink an eye 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 your background check shows that a potential client has a less than perfect credit history. Does that mean you should automatically reject this client? Of course not. It is simply an 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 form of solid contractual language. But combine that spotty credit record with a trail of litigation and you might make the best business decision of your life by avoiding this firm.

Secure an Adequate Scope of Services

Should your credit check of a potential client reveal the potential for project underfunding, an adequate scope of services becomes critical. Your services should include pre- and post-design activity designed to enhance quality control and lower risk exposures. Services you should attempt to negotiate in your scope may include:

- **Pre-qualification of contractors.** Help your client assure that all contractors invited to bid are reputable, experienced, bondable and otherwise qualified to perform the work.

- **Pre-selection conference.** Host a conference where pre-qualified contractors are invited to address any questions they may have about the project and to learn the project ground rules from you and the client's representatives.
- **Plan and specification review.** As part of the selection process, have pre-qualified contractors review the constructability of plans and identify potential errors, omissions, ambiguities or inconsistencies.
- **Pre-construction meeting.** Meet with the selected contractor and client representative to review schedules, establish lines of communication and otherwise solidify understandings regarding key project components
- **Full construction observation services.** This should be a deal-breaker for any project that will be completed on a tight budget.

Getting a cash-strapped client to agree for you to perform these services for a fee may be difficult. Nonetheless, the need for performing them should be addressed with the client. If the client summarily dismisses your suggestions and demonstrates a desire to proceed with the project in the least expensive way possible, you will be given a clear insight into the client's priorities. The question you then must ask yourself is: Do I really want to work for this client?

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

Suspension of Services

Failure by a client to pay you according to the terms of your agreement is considered a breach of a material term of the contract and therefore a cause for termination. However, you may not want to use the ultimate hammer of termination as your first action in the event of late payment. Rather, you may want to

temporarily withhold your services in hopes of forcing the client to cure the breach while keeping the contract in force.

Seek the right, therefore, to suspend your services without breaching your contract or incurring liability for delay. Granted, if the nonpayment continues for a sufficient time, you may ultimately wish to terminate. But in the meantime, you at least want to avoid increasing your receivables while you seek payment for services rendered.

Try to negotiate a contractual provision that stipulates conditions under which you or your client could suspend the contract for a relatively short period of time without additional cost to either party. For a longer suspension, however, 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.

Specifically, seek the right to suspend your services without 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 the Design Professional group of the XL Insurance 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.**

You may wish to insert different time frames that are acceptable to you and your client. Be 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 the Design Professional group of the XL Insurance Companies, allows your client to terminate the contract with or without cause. However, the client is held responsible for any costs you incur associated with stopping the project. It also gives you the right to terminate the agreement for specified causes and offers you protection should 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 strict provisions concerning ownership of instruments of service in the event they are terminated early. This can help prevent clients from walking off with complete or near-complete construction documents and forgoing construction administration services.

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.

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