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LESSONS FROM THE WAR ROOM: KEY CONTRACTUAL CONCERNS FOR ENGINEERING SERVICE AGREEMENTS

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Engineers are typically required by statute to execute a written contract *before* beginning services. (California Business & Professions Code Section 6749) However, a written agreement is important even where not required by statute. Such agreements provide the structure and road map for a successful, profitable project. Therefore, regardless if required by statute, a well-reasoned and well-drafted contract is **always** a good idea.

The negotiation of the agreement is the first step in providing quality professional services. Communications regarding the terms of the agreement lay the foundation for everything which is to follow. The importance of a well-reasoned, well-drafted, detailed agreement cannot be overstated. Accordingly, the agreement should always be completed and signed prior to, *not after*, beginning the project services. In those *rare* instances where circumstances require that work proceed in advance of the written agreement, a letter of intent should be issued and the completion of the agreement should be pursued with all the zeal of the project delivery itself.

The essence of a contract is risk allocation. By defining the rights and responsibilities of the parties, a contract determines who will bear what risks and what the resulting consequences

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** *Severson & Werson has provided legal services throughout California and the country for more than fifty years. The firm provides counseling and litigation support to all members of the construction process, including design professionals, construction managers, environmental professionals, owners, contractors, and insurance carriers.*

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will be. Particular attention should therefore be focused on identifying the various risks and determining which party, if any, is in a position to control those risks. In general, **the party with the greatest ability to control a risk should bear that risk.** Parties should exercise extreme caution in accepting *any* risks which are outside their exclusive control. By allocating those risks up front, engineers can anticipate and develop project delivery strategies to manage those risks they have assumed.

Of course, each contract should be created based on the unique demands of each particular project. Nevertheless, there are some key contractual issues which apply to virtually any engineering service agreement. Some of the most important issues are discussed below.

PREPARATION FOR THE CONTRACT

Frequently, the key to a successful contract negotiation and execution is the preparation for that process. As stated above, the essence of a contract is risk allocation. To properly anticipate and address the unique risks of a particular project, the engineer should prepare for the contract by investigating the nature of the project and the players. Such an investigation is key to identifying the risks and issues which should be addressed and clarified during the negotiation process.

The next step in the preparation of a good contract follows directly from the first. That is, by definition a contract is to reflect a "meeting of the minds". Accordingly, the parties should meet or otherwise exchange the relevant information as to the project, including information as to the issues of concern identified through the initial investigation. Many form agreements, such as the AIA Owner/Architect Agreement, now require parties to exchange much of this information in order to complete the agreement. However, any good checklist of information to discuss in advance of preparing the agreement would include many or all of the following:

1. **Client identification:**
 - a. Sophistication/Experience.
 - b. Solvency/Longevity.
 - c. History/Reputation.
 - d. Cost versus Quality Emphasis.

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2. Project description:

- a. Project objectives, including the anticipated uses or goals;
- b. Physical parameters of the project;
- c. Owner's program for the manner in which the project will be developed;
- d. Legal description of the project; and
- e. Financial criteria for the project:
 1. Design budget;
 2. Construction budget; and
 3. Funding plan and source.
- f. Schedule including milestones, dates, durations, fast tracking, permitting;
- g. Procurement or project delivery method (*e.g.*, competitive bid, negotiated contract, construction manager, design-build, fast-track, etc.); and
- h. Other.

3. Project Team:

- a. Owner's representative and authority;
- b. Other owner representatives with design input;
- c. Owner's consultants and contractors; and
- d. Design team members, roles, and relationships.

Such discussions and communications should be documented. However, they by themselves are not enough. In order to be relevant and binding, such information should be included in the actual agreement itself. Absent express incorporation into the agreement itself,

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such discussions will be considered “parole evidence” and not a part of the contractual commitments.

SPECIFIC CONTRACT PROVISIONS

While each project and related agreement will have its own requirements, the following provisions should at least be considered in preparing any engineering services agreement.

Scope of Work. The single most important provision of any services agreement is the scope of work. More than any other provision, the scope of work statement defines the parties’ expectations and establishes the parameters of the services to be provided. Accordingly, the scope of work should be as complete and detailed as possible. Ambiguity and open ended descriptions should be avoided wherever possible.

To preserve the benefits of a properly drafted scope of work statement, the agreement should also provide that no additional services will be required absent a written amendment to the agreement signed by both parties. Such a provision avoids claims that additional services were promised, but not delivered. However, such a provision requires diligence on the part of the engineer to make certain that any additional services are documented by a written amendment. Absent such a written amendment, the engineer may face claims that it is not entitled to payment for the services regardless of whether they were actually provided.

At the same time, if the Agreement is favorable to the engineer (*e.g.*, a limitation of liability clause), it should also provide that all project-related services are covered by the Agreement. This avoids claims that services were “extra-contractual” and not subject to the contract protections.

Change In/Additional Services. A necessary corollary to defining the scope of services is defining when, how, and why the scope of services will change. In this regard, it is very important to provide as detailed a list as possible of those services which are not included in the basic agreement, as well as those services which will be treated as “additional”. Such lists should be preceded by the words “including, but not limited to” as a means of making the list non-exclusive. Such changes are usually committed to writing. However, the problem arises when the project timing or owner delay does not allow for this process. Accordingly, additional services provisions should include a self-executing mechanism to avoid unnecessary delay. For example, the owner or prime consultant may be given a certain time period in which to object to additional services proposed by the engineer. If the owner does not respond, the owner will be deemed to have agreed to the change.

Owner Rights & Responsibilities. Generally, a services agreement focuses on the obligations of the engineer. Often, the only obligation of the owner or prime consultant defined in the contract is the duty to pay for the services. However, depending on the nature of the project, other rights and responsibilities of the owner or prime consultant should be identified. For example, what information is the owner or prime consultant expected to provide, and what right does the engineer have to rely on that information? Similarly, what is the extent of the owner's project input and authority, and when is that input to be provided? Consideration of these issues can be invaluable in clarifying the expectations of the parties and can greatly assist the engineer in providing a quality, cost-effective service. Where information is provided by the client or others, the engineer's right to rely on it should be expressly stated in the Agreement.

Parties to the Agreement. Although it seems obvious, the agreement should also carefully define the parties to the agreement. Such provisions are necessary to determine who is entitled to modify or control the terms of the agreement, who is obligated to make payment under the agreement, and who is entitled to claim the benefits of the services. Ideally, the agreement will also provide that it is for the sole benefit of the prime consultant and owner, and not of any third party. (See below.)

Assignability. Provisions regarding each party's right to assign the agreement may seem inconsequential, but may have significant ramifications for the engineer. For example, if the engineer structures its fee and approach to the project based on the assumption that it is dealing with a sophisticated and cooperative client, and the client later assigns the contract to a less sophisticated/cooperative party, the engineer may be left in a difficult position. Accordingly, the agreement should provide that the agreement is not assignable. If that approach is not workable, the agreement should provide that any assignment constitutes a change in scope with an appropriate change in compensation.

Standard of Care. Absent implied or express provisions to the contrary, engineers are required only to provide their services with the degree of skill and care ordinarily exercised by reputable practitioners of the profession practicing in the same locality under similar circumstances. Perfection is not typically required. However, engineers often expressly or impliedly increase the applicable standard of care by agreement, statements, or conduct. Frequently, clients attempt to include contractual language indicating that the services will be provided "in accordance with the highest professional skill and care" or some similar language. While it is difficult to tell a client that such a provision is unacceptable, the engineer must recognize that such a provision may raise the standard of care to a level of near perfection.

Such elevated standards of care may also create potential insurance coverage with respect to any liability arising out of the elevated standard of care.

In addition to express contractual language, the standard of care may be elevated by implication. In pursuing the project, the engineers and others will frequently describe outstanding qualifications to provide the services. Some clients would argue that such overtures elevate the engineer's obligations beyond the ordinary standard of care. Such implications can be avoided by including an integration clause in the agreement providing that all representations and obligations are set forth in the written agreement. In order to make such an integration clause effective, the proposal including the extraordinary representations should not be included in or incorporated by reference into the agreement.

Finally, engineers should approach contractual obligations to comply with "all applicable laws and codes" with great caution. Ideally, the specific code should be identified with the qualification that it is subject to the interpretation and authority of the applicable building official. Furthermore, engineers in California can now seize upon the Engineer's Code of Conduct as issued by the State which provides, in part:

"A licensee may obtain and rely upon the advice of other professionals (e.g., architects, attorneys, professional engineers, professional land surveyors, and other qualified persons) as to the intent and meaning of such laws, codes, and regulations."

Ownership of Documents. Ownership of the design documents has become an increasing point of controversy. Such concerns are increased by the proliferation of electronic design mediums and owners' frequent requests to receive and own electronic design documents. (See related paper on *Towards the Paperless Project: Risks, Rewards, and Safeguards*.) Whenever possible, the engineer should retain all ownership of its design documents and simply grant the owner a limited license for use solely with respect to the project which is the subject of the contract. If the owner insists on ownership of the documents, the right to use those documents should be narrowly defined such that the documents may not be misused to the engineer's jeopardy. The agreement should also provide that any electronic design documents are provided solely as a courtesy with a disclaimer as to their future usefulness. Finally, any client rights in the engineer's work product should be expressly contingent on payment of all fees and costs under the agreement.

Electronic Communications. Electronic communication has also substantially affected the way that project participants communicate. Although often treated in a casual way, an e-mail message becomes a "written direction" with the click of a button. Accordingly, the agreement should specifically identify the anticipated electronic communications, and specifically identify

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the reliability and authority of such communications. This is particularly true if the project includes a project website.¹

Warranties & Guarantees. A warranty is an express or implied promise or guarantee that services or a product will satisfy certain criteria. Express warranties and guarantees can arise in various forms. In addition to express warranties clearly set forth in the agreement, express warranties may also arise from a number of other sources including the description of the scope of work, site observations, review of shop drawings and as-built drawings provided by the contractor, and certifications of contract compliance and payment requests. Similarly, management of a project with a guaranteed maximum price may create an implied warranty that the price will not be exceeded. Accordingly, the agreement should state that the only warranties and/or guarantees established by the agreement are those expressly set forth and identified as such in the agreement.

Limitation of Liability. Limitation of liability provisions seek to limit the engineer's potential liability to some finite amount proportionate to the benefit of the project. Although such provisions have been repeatedly attacked in the courts, the current law recognizes them as valid tools of risk allocation. To promote the effectiveness of limitation of liability clauses, they should be prominently set forth in the agreement such that the client can not claim surprise, mistake, or duress. Ideally, a limitation of liability clause limits the engineer's liability not just to the prime consultant and owner, but also to any contractors, suppliers, or other third parties. The limitation of liability should also exclude liability for consequential damages such as lost profits and loss of use.

Indemnity. Indemnity is the companion to limitation of liability. An indemnity provision seeks to have one party indemnify the other for claims of liability asserted against the party to be indemnified. Often, clients will seek to have engineers indemnify them from all claims except those caused solely by the client. Obviously, such indemnity provisions carry tremendous risk in that they expose the engineer to substantial exposures beyond the risks the engineer can control. The preferable approach is a mutual indemnity provision requiring each party to indemnify the other to the extent they are negligent and thereby responsible for the subject matter of the claim. The indemnity provision should also clearly define who is covered by the indemnity provision.

Insurance. Indemnity obligations are only as useful as the resources available to back them up. Accordingly, the architect and engineer should recommend and require that **all** project participants have and maintain adequate insurance coverage. Furthermore, the engineer should seek to be included as an additional insured on all contractor insurance policies.

¹ See "E-Mail as Project Communication Tool: Loose Fingers Sink Ships" by David A. Ericksen.

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Dispute Resolution Provisions. Of course, no one ever enters into a contract expecting it to result in litigation. However, the original contract is the best opportunity to create a mechanism to cost-effectively resolve any eventual claims. Mediation and arbitration are the two alternative dispute resolution provisions most often used to manage claims. Of course, the effective use of either approach depends on the project, the parties, and the type of claim. For example, an engineer should seek to avoid becoming involved in a larger dispute which only remotely or tangentially relates to their services or to any dispute resolution forum which would not resolve all claims involving the engineer in a single action.

Limitation of Third-Party Reliance. Recently, one of the greatest sources of claims against engineers and other design professionals has come from third-party strangers to the contract. Typically, such claims arise either from a party who has received a copy of the project documents and somehow come to rely on them, or from a party who believes they were an intended beneficiary of the services. To prevent and/or defeat such claims, the agreement should expressly identify the intended beneficiaries of the services and provide that the services are not to be used or relied upon by any other party without the express written consent of the affected engineer.

Payment Terms. Engineering service agreements often provide that the engineer is to be paid after the architect has been paid by the owner. Such a provision puts an engineer in a helpless secondary position without ordinary tools of recourse for payment. Such provisions may also often be unenforceable in California. A preferable approach is to provide that payment is due upon receipt of the invoice, but not late until after the architect has been paid by the owner. This approach will generally preserve the engineer's lien rights and other collection remedies.

Attorneys' Fees. Many embrace attorneys' fees clauses so they can recover their costs if they have to sue for collection. However, by language and the law of reciprocity, they are seldom limited to that context, and the financial exposure in a larger project claim for errors and omissions can be devastating. Even worse, such attorney fee exposure is seldom covered by insurance. As a result, an attorneys' fee clause should either be deleted or modified to limit the financial exposure. For example, it could be limited to a lesser dollar amount which would be both contained and consistent with the expenses of a collection action.

Consistency with Other Agreements. Finally, once the engineer has negotiated an appropriate agreement, the engineer should make certain that contractual obligations of other project participants are consistent with that agreement. This concern really proceeds in two directions. First, the engineer should make certain that any obligation or risk it has undertaken is appropriately allocated or transferred to any subconsultants or subcontractors retained by the engineer. Predictably, architects retaining engineers will do the same. Accordingly, engineers

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should be wary when incorporating the terms of a prime consultant into their own subconsulting agreement. Before doing so, the prime agreement should be reviewed in detail to make certain that it does not establish any unanticipated and/or unacceptable risks. Second, the obligations should be consistent with other project participants such as owner-retained consultants, contractors, and suppliers.

CONCLUSION

The execution of the contract is not the end of the story. Few contracts are perfect and there will always be risks. With the contract in place, the real key to risk management success is to develop project delivery and documentation strategies to contain and manage the remaining risks.