

SKATING ON THIN ICE: SURVIVING AND SUCCEEDING ON PROJECTS WITH PRECARIOUS CONTRACT TERMS

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January 2011

Just as perfection in design and construction is a rarity, so is the perfect design agreement. It is a human enterprise subject to competing positions, competing leverage, preconceived biases, and, ultimately, compromise. It is also rare that any agreement can fully anticipate all that can, and inevitably does, happen on any construction project. While insurance companies and attorneys extol a vast array of contractual advice favorable to the design professional, owners and contractors have their own attorneys and advisors promoting contractual provisions equally or more favorable to their constituents. As a result, nearly any design agreement is either going to include provisions adverse to the design professional or exclude other provisions which could not be resolved into an agreement. It is the simple reality of business today.

Given this reality, many (or most) design professionals take one of two dramatically different approaches once the agreement has been executed. Some deliver the contract to their accounting department or otherwise file it away in the hope that they will never actually have to confront those imperfect and uncomfortable positions. Others seek to strategically identify and manage the imperfect provisions and omissions with the hope that proactive management will lead to project success and client satisfaction, as opposed to any contentions and/or costly legal debate regarding the subject provisions. For obvious reasons, the latter approach is the preferred model.

Successfully managing such variables is greatly aided by doing so within the context of an operating model. For those purposes, the acronym IROPE has worked well as a guide. Broken into its sequential elements, IROPE is built from:

- **Issues:** Identify the issues of concern arising from both the undesirable clauses, as well as those omitted from the agreement.

- **Risks:** Identify the potential risks and, especially, the consequences arising from the issues identified in Step One.
- **Options:** List and map the potential options to manage and minimize the risks and consequences. Inevitably, some may be implemented in conjunction with one another, while others may be inconsistent and require an election.
- **Plan:** From the available options, establish a plan to proactively manage (or at least closely monitor) each issue.
- **Execute:** Implement and follow the plan consistently through the project with adaptation as possible and necessary to deal with the competing issues.

With this as a background, the remainder of this paper will analyze some of the most common adverse clauses and apply at least some of the potential solutions within the IROPE model. The clauses and analysis is simply an exemplar. There are many more issues, risks, and options that could be applied in particular circumstances.

INDEMNITY

***Sample Imperfect Clause:** Consultant shall defend, indemnify, and hold harmless Client (including its agents and representatives) from any and all claims which arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of Consultant or any person or entity for whom Consultant is responsible.*

- **Issues:**
 - Includes duty to defend.
 - Not proportionate.
 - Obligation not limited to client.
 - Responsibility extends beyond firm.
- **Risks:**
 - Duty to defend is not covered by insurance.
 - Duty to defend may begin upon allegation of negligence under statute or common law, regardless of actual negligence.

- “Hold harmless” may extend even beyond indemnity and defense.
- May be financially and legally responsible for others who do not or cannot respond effectively or adequately.

- **Options:**
 - Modify by broad standard of care provision which applies to and limits any and all obligations under the agreement or with respect to the project.
 - Limit the exposure by tying the obligation to issues, as opposed to parties.
 - Seek to establish anticipatory or contemporaneous joint defense arrangements.
 - Seek to limit responsibility for third parties by provisions limiting joint and several liabilities with others.
 - Seek broad insurance coverage with focus on defense obligations.
 - Require co-extensive indemnity and defense obligations from others.

- **Plan:**
 - Coordinate all indemnity obligations in agreements to be equal to or greater than these.
 - Seek indemnity protections from third parties through contracts or general conditions.
 - Clearly define and document divisions of responsibilities and inputs with third parties.
 - Respond promptly and proactively in the event of any claim or allegation.

- **Execute:**
 - Consistent documentation.

PREVAILING PARTY ATTORNEY FEES CLAUSES

***Sample Imperfect Clause:** In the event of any claim or litigation arising out of or related to this Agreement or this Project, the prevailing party shall be entitled to recovery of its attorneys’ fees and expenses incurred with respect to the claim or litigation.*

- **Issues:**
 - Not covered by insurance.
 - Mutual obligation.
 - Prevailing party not defined or limited.
 - No requirement of reasonable.

- **Risks:**
 - Significant expense risk outside of insurance coverage.
 - Disproportionate expenses when comparing collection actions versus allegations of negligence.
 - Escalating problem as claim or litigation proceeds.
 - Lack of control.

- **Options:**
 - Require mediation.
 - By agreement or by conduct, shift definition of prevailing party.
 - Cap fees.
 - Require reasonableness in both fees and negotiation.

- **Plan:**
 - Respond quickly to claims.
 - Require or promote alternative dispute resolution.
 - Assess realistically and act accordingly.

- **Execute:**
 - Monitor collections closely.
 - Examine risks before initiating claims.

GUARANTEED MAXIMUM PRICES

Sample Imperfect Clause: Owner will enter a Guaranteed Maximum Price (“GMP”) contract with the Contractor. Any and all design errors, omissions, and revisions which cause the GMP to be exceeded shall be the financial responsibility of Consultant.

- **Issues:**
 - No input into GMP.
 - No process to identify “design” relationship.
 - “Design revisions” overbroad.
 - Not linked to standard of care or negligence.

- **Risks:**
 - GMP uncertain and may be unrealistic.
 - No stated contingency.
 - May be uninsured.

- **Options:**
 - Establish process and basis for GMP.
 - Distinguish owner or contractor generated revisions.
 - Link obligations to standard of care.
 - Recommend or require appropriate contingencies.

- **Plan:**
 - Participate in and document process of creating GMP.
 - Require an appropriate contingency.
 - Become the record keeper (or require accuracy) in the identification of events potentially falling under this clause. Specifically distinguish non-covered issues such as owner changes, contractor changes, and unforeseen conditions.

- **Execute:**
 - Stay involved, communicate, and document.

GUARANTEED CONSTRUCTION “BUDGETS”

***Sample Imperfect Clause:** The Client, in its sole discretion, may modify the Budget or apply additive or deductive alternates on an ongoing basis . . . In the event that cost estimates at any point in the design or construction exceed the Budget, the Architect shall revise the design at no cost to the Client.*

- **Issues:**
 - Financial exposure for redesign based on changes of heart or market conditions.
- **Risks:**
 - Design costs.
 - Delays.
- **Options:**
 - Require realistic budgets.
 - Require client concurrence at key project milestones with provisions that subsequent modifications will lead to both schedule delays and additional fees and costs.
- **Plan:**
 - Document client commitments.
 - Promptly identify and document budget and program conflicts.
- **Execute:**
 - Refuse to postpone resolution of budget/scope conflicts on the “hope” that “it will all work out.”

CODE AND STATUTE COMPLIANCE

Sample Imperfect Clause: The Project shall comply with all applicable Codes, Statutes, and Regulations.

- **Issues:**
 - Strict liability standard.
 - Building officials delay and change their position.
 - Obligation is overbroad as it encompasses all statutes and regulations.

- **Risks:**
 - Even where Code and Statute issues are deferred or are the result of discretionary and varied interpretations, the design professional is always blamed.
 - Changes and modifications can be expensive.
 - Clients often choose to capitulate even where there is a basis to validate design.

- **Options:**
 - Establish the right to rely on others as provided in the California Engineers Code of Ethics.
 - Extend the right to rely to the advice of building officials.
 - Limit the obligation to Codes, Statutes, and regulations specifically applicable to your scope of work.

- **Plan:**
 - As appropriate, seek the counsel and input of other professionals.
 - Seek and document the early direction and concurrence of responsible officials.

- **Execute:**
 - Advise clients that decisions to submit to discretionary or erroneous interpretations are their own responsibility, that alternative approaches exist, and that the original approach was defensible.

LEED CERTIFICATION

***Sample Imperfect Clause:** Project Description: The Project shall be a LEED Certified Gold or better project qualifying for all applicable federal, state, and local tax credits, incentives, and rebates with approximately _____ square feet allocated between residential and commercial space with affiliated support facilities and infrastructure.*

- **Issues:**
 - LEED certification involves many factors.
 - LEED certification is ongoing and renewable.
 - Financial issues are typically beyond design professional expertise.

- **Risks:**
 - Guarantees are not insurable.
 - Ongoing obligation for continuing LEED certification.
 - Lack of control over all necessary elements.

- **Options:**
 - Establish multiple points of responsibility for LEED certification.
 - Establish that LEED is discretionary and ongoing.
 - Limit role to scope of work.
 - Establish LEED development process and distinction of responsibilities.

- **Plan:**
 - Clearly document uncertainties in LEED process.
 - Clearly document and respect responsibilities and roles of others.
 - Terminate project obligations before or at project completion to avoid ongoing issues.

- **Execute:**
 - Disclaim guarantees.
 - Limit obligations to standard of care.

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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.*