



Tips for Reviewing a Contract

A resource especially for policyholders in Schinnerer and CNA's Small Firm Program

Manage Risk Through Your Contracts

For a design professional to be held negligent, a plaintiff must prove that the design professional had a duty, and that the design professional breached that duty, which in turn was the proximate cause of the plaintiff's harm. The three most common sources of duty can be found in common law—the professional standard of care—statutory law, and contract law.

The contract negotiation process provides an opportunity to set the client-design professional relationship on a firm and productive course. Both parties must have a full appreciation of the issues involved in the negotiation process, their interrelationships, and relative importance to the end result, the project.

Step 1 - Determine the Type of Contract

Design professionals typically encounter five generic types of professional services contracts: oral agreements, letter agreements, purchase orders, standard form agreements (often with extensive modifications), and custom agreements.

Custom agreements drafted by the prospective client and negotiated with the design professional present the greatest danger. While such agreements are often developed because of the unique nature of a project or because of events that occur in the normal course of dealing with the client, the use of custom contracts may be driven by the client's intent to establish an unbalanced contractual relationship.

It is important that design professionals keep sight of the need to include certain project-specific and general condition terms in their agreements and strive to limit onerous, unrealistic, or ambiguous terms. In this effort, it is often useful to start by comparing the proposed agreement with the standard documents of The American Institute of Architects (AIA) or the Engineers Joint Contract Documents Committee (EJCDC). For more information on these documents, go to www.aia.org or www.nspe.org.

Key Elements of a Contract

- Clearly defined scope of services
- Method for determining compensation
- Adequate time for delivery of professional services
- Risk allocated to party in best position to control that risk
- Appropriate authority is given with each responsibility
- Each responsibility is given to only one party

Step 2 - Ask Yourself These Questions

From a risk management perspective, the outcome of the contract negotiation process can be considered successful if our policyholders can answer yes to each of these questions.

- Are the expectations of the parties clearly articulated and reasonably integrated?
- Are the rights and obligations of the parties clearly expressed?
- Are the risks and rewards fairly allocated?
- Is each source of risk allocated to the party in the best position to control or otherwise manage that risk?
- Is insurance available to support any common law or contractual indemnity obligation?
- Do mechanisms exist to accommodate changes during the course of the project?
- Is the mutual understanding of the parties confirmed in writing?

Step 3 - Check the Establishment of Scope, Time and Compensation

Perhaps the two most important aspects of an agreement are the description of the scope of services to be provided and the method for determining the design professional's compensation for performing those services. A third, and increasingly important, aspect is the time allocated for the delivery of services.

- **The design professional's scope of services should be defined with reasonable precision within the contract.** An ambiguous or unspecified definition of scope may lead to an obligation to perform more services than contemplated or to a dispute with the client.
- **The agreement should specify the time expectations for the rendering of services and the submission of deliverables.** Time parameters, however, cannot be stated as absolute; milestones or deadlines must be adjusted when delays are caused by factors beyond the control of the design professional.
- **Professional services agreements should provide for the prompt payment for services.** Prevention of unreasonable withholding of fees, and requirements for the equitable adjustment or renegotiation of fees for delayed or terminated projects are important parts of the professional services agreement.

Step 4 - Check that the Professional Services and Construction Contracts are Coordinated

One of the most common oversights design professionals make is the failure to check that the professional services and construction contracts general conditions are coordinated. Often, the contract for design services is executed months before the construction contract and general conditions are developed, and the design professional has not had an opportunity to check for conflicts between the two agreements.

If the design professional is to perform construction phase services, the construction contract and general conditions must specify the design professional's role. Provisions that should be carefully checked include:

- Evaluation of construction,
- Certificates of payment to contractor,
- Submittal review,
- Change orders, and
- Project completion and closeout.

Since the AIA and EJCDC publish families of documents, coordination is less of an issue. However, if the design and construction contracts are custom agreements, or if one agreement is standard and the other is custom, care should be taken to make sure the agreements are coordinated.

Step 5 - Use These Resources from Schinnerer

Use the contract review checklist below and the *Terms and Conditions Review Guide*, attached, for contract negotiation advice. Schinnerer's risk management website, www.PlanetRiskManagement.com, also contains valuable resources that can assist you in reviewing your professional services agreements.

Contract Review Checklist

Following is a brief checklist of items to consider when reviewing your agreements with your clients. It should not be considered a complete or exhaustive list. Where noted, please refer to your copy of *Managing Risk Through Contract Language (MRTCL)* or the attached *Terms and Conditions Review Guide (T&CRG)* for further discussion.

General Considerations

- Risks are allocated to the **party in the best position** to manage those risks. *See page 48 of MRTCL*
- Responsibilities are accompanied with the **appropriate authority**. *See page 48 of MRTCL*
- Responsibilities are **assigned to only one party**. *See page 48 of MRTCL*
- Client's **insurance requirements** are available and subsequently met. *See page 43 of MRTCL*
- Mechanisms exist to **accommodate changes** during the course of the project. *See page 50 of MRTCL*
- Mutual understanding** of the parties is confirmed in writing. *See page 8 of MRTCL*

Scope of Services and Time

- Scope of services** is clearly articulated. *See page 33 of MRTCL*
- Expectations** are clearly articulated and are reasonable. *See page 51 of MRTCL*
- The agreement clearly articulates **time requirements** for the rendering of services. *See page 35 of MRTCL*

Terms and Conditions

- Compensation** terms have been clearly defined in the agreement. *See T&CRG*
- If applicable, the agreement articulates that the design professional's **construction phase services** do not include responsibility for construction means, methods, techniques, sequences, and procedures or construction site safety. *See T&CRG*
- The agreement includes a provision for **dispute resolution**. *See T&CRG*
- If an **indemnity** clause is included, indemnity is limited to the damages caused by the design professional's negligence. *See T&CRG*
- If applicable, **opinions of cost** are limited to a representation of the design professional's judgment and are not a guarantee of actual construction costs. *See T&CRG*
- The design professional retains the **ownership and copyrights** of the instruments of service but grants the client a limited license for a stated purpose. *See T&CRG*
- The **standard of care** does not exceed the common law standard. *See T&CRG*
- A provision is included to facilitate the **termination** of the agreement by either party. *See T&CRG*
- For **electronic transfer of information**, the agreement clearly articulates that a printed copy has control over any variances in information that has been transferred electronically. *See T&CRG*

Miscellaneous Clauses

- Warranties and guarantees** are not included in the professional services agreement. *See page 37 of MRTCL*
- Code compliance** is limited to those codes applicable to the professional services. *See page 37 of MRTCL*
- The choice of law provision identifies the **governing law** for the agreement. *See page 46 of MRTCL*
- Professional services agreement is coordinated** with applicable construction contracts and general conditions. *See page 25 of MRTCL*

Terms and Conditions Review Guide

The *Terms and Conditions Review Guide* is not a model contract. The commentary and model provisions are based on Schinnerer's experience in loss prevention and on the general scope of insurance coverage offered under the CNA policy. The information presented here is for professional liability risk management guidance. It is designed to inform design professionals about some of the terms and conditions to consider when reviewing or negotiating professional services agreements; it is not intended as legal or insurance advice applicable to specific circumstances. Consultation with local legal and insurance counsel is recommended before applying or acting on anything contained or suggested by this material. Copyright 2009 by Victor O. Schinnerer & Company, Inc.

Compensation

A schedule of compensation due the design professional should always be expressly addressed to avoid potential disputes.

Sample provision: For the scope of services stated in Attachment ____, Client agrees to pay Consultant the compensation stated in Attachment ____ to this Agreement. Consultant agrees to submit invoices monthly for services rendered in the manner and format stated in Attachment ____.

Construction Phase Services

If the agreement provides for any construction phase services by the design professional, the agreement should include express language that the contractor is solely responsible for site safety and the means, methods, techniques, sequences and procedures of construction that are used to perform the work.

Sample provision: If this Agreement provides for any construction phase services by Consultant, it is understood that the Contractor, not Consultant, is responsible for the construction of the project, and that Consultant is not responsible for the acts or omissions of any contractor, subcontractor or material supplier; for safety precautions, programs or enforcement; or for construction means, methods, techniques, sequences and procedures employed by the Contractor.

Dispute Resolution

Clients and design professionals should anticipate the possibility of disputes or claims and include some provision for dispute resolution in their agreements. Alternative dispute resolution through mediation is a non-binding process in which an impartial mediator actively assists the parties in identifying and clarifying issues in dispute, and in designing and agreeing to solutions.

Sample provision: Client and Consultant agree that they shall first submit any and all unsettled claims, counterclaims, disputes and other matters in question between them arising out of or relating to this Agreement to mediation in accordance with the Construction Industry Mediation Rules of the American Arbitration Association, effective as of the date of this Agreement.

Force Majeure

Circumstances or events may occur that are outside the control of either party. This provision states that neither party shall be liable for losses arising out of any cause beyond its reasonable control.

Sample provision: Neither party shall be deemed in default of this Agreement to the extent that any delay or failure in the performance of its obligations results from any cause beyond its reasonable control and without its negligence.

Hazardous Environmental Conditions

If the design professional is not engaged to perform services related to hazardous environmental conditions, affirmative language should be included in the contract to exclude such services and exposures.

Sample provision: It is acknowledged by both parties that Consultant's scope of services does not include any services related to the presence at the site of asbestos, PCBs, petroleum, hazardous waste or radioactive materials. Client acknowledges that Consultant is performing professional services for Client and Consultant is not and shall not be required to become an "arranger," "operator," "generator" or "transporter" of hazardous substances, as defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1990 (CERCLA).

Indemnity

Indemnity provisions allocate risk and liability among parties. In the context of professional services agreements, each party should be willing to be responsible for losses and claims arising out of its own negligence.

Sample provision: To the fullest extent permitted by law, Client and Consultant each agree to indemnify the other party and the other party's officers, directors, partners, employees, and representatives, from and against losses, damages, and judgments arising from claims by third parties, including reasonable attorneys' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error, or omission of the indemnifying party or any of the indemnifying party's officers, directors, members, partners, agents, employees, or subconsultants in the performance of services under this Agreement. If claims, losses, damages, and judgments are found to be caused by the joint or concurrent negligence of Client and Consultant, they shall be borne by each party in proportion to its negligence.

Terms and Conditions Review Guide

Opinions of Cost

It is important to qualify that the design professional's opinions or estimates of cost are based upon experience and qualifications and represent the design professional's best judgment, not a guarantee.

Sample provision: When included in Consultant's scope of services, opinions or estimates of probable construction cost are prepared on the basis of Consultant's experience and qualifications and represent Consultant's judgment as a professional generally familiar with the industry. However, since Consultant has no control over the cost of labor, materials, equipment or services furnished by others, over contractor's methods of determining prices, or over competitive bidding or market conditions, Consultant cannot and does not guarantee that proposals, bids, or the actual construction cost will not vary from Consultant's opinions or estimates of probable construction cost.

Ownership and Copyright of Documents

Drawings, specifications, reports and other documents produced by design professionals are instruments of their professional service, not products. Sometimes clients may insist on owning or having an unlimited license to use the instruments of service. If the design professional can identify the client's specific needs for the instruments of service (e.g., construction, occupancy or maintenance), a limited license can be granted by the design professional to satisfy those needs. However, if the client insists on owning or having an unlimited license, and the design professional is willing to acquiesce to this demand, the client should be required to hold harmless and indemnify the design professional for all liability, costs and expenses incurred as a result of any modification or use of the instruments of service without the design professional's written authorization.

Sample provision: All documents prepared or furnished by Consultant pursuant to this Agreement are instruments of Consultant's professional service, and Consultant shall retain an ownership and property interest therein, including all copyrights. Consultant grants Client a license to use instruments of Consultant's professional service for the purpose of constructing, occupying or maintaining the project. Reuse or modification of any such documents by Client, without Consultant's written permission, shall be at Client's sole risk, and Client agrees to indemnify and hold Consultant harmless from all claims, damages and expenses, including attorneys' fees, arising out of such reuse by Client or by others acting through Client.

Standard of Care

According to common law, a professional is required to act as competently as could reasonably be expected of other professionals practicing under substantially similar circumstances. The law does not require perfection, merely reasonable skill and care.

Sample provision: The standard of care for all professional services performed or furnished by Consultant under this Agreement will be the skill and care used by members of Consultant's profession practicing under similar circumstances at the same time and in the same locality. Consultant makes no warranties, express or implied, under this Agreement or otherwise, in connection with Consultant's services.

Termination of Contract

The rights and obligations of the parties should be clearly expressed, including the right to terminate the contract.

Sample provision: Client may terminate this Agreement with seven days' prior written notice to Consultant for convenience or cause. Consultant may terminate this Agreement for cause with seven days' prior written notice to Client. Failure of Client to make payments when due shall be cause for suspension of services or, ultimately, termination, unless and until Consultant has been paid in full all amounts due for services, expenses and other related charges.

Use of Electronic Media

The transfer of information by electronic media is inherently risky. One way to reduce this risk is to state that a hard copy has control over any variances or changes that might be introduced by electronic means.

Sample provision: Copies of documents that may be relied upon by Client are limited to the printed copies (also known as hard copies) that are signed or sealed by Consultant. Files in electronic formats, or other types of information furnished by Consultant to Client such as text, data or graphics, are only for convenience of Client. Any conclusion or information obtained or derived from such electronic files will be at the user's sole risk. When transferring documents in electronic formats, Consultant makes no representations as to long-term compatibility, usability, or readability of documents resulting from the use of software application packages, operating systems or computer hardware differing from those in use by Consultant at the beginning of this project.

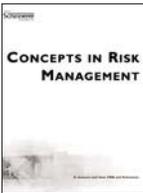
Additional Resources from Schinnerer

The Schinnerer program website contains risk management and contract negotiation resources for all policyholders. Following are a few examples of the resources you'll find at Schinnerer's risk management section, www.PlanetRiskManagement.com:



Managing Risk Through Contract Language helps policyholders understand underlying legal and practice management concerns and aids in developing a communication strategy for contract negotiations. The web address is www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx.

Management Advisories provide users with short, subject-specific articles about insurance and risk management issues affecting design professionals. The web address is www.Schinnerer.com/risk-mgmt/Pages/Management-advisories.aspx.



Concepts in Risk Management includes commentaries on risk-intensive issues, a risk management matrix, and the *Terms and Conditions Review Guide*. The web address is www.Schinnerer.com/risk-mgmt/Pages/Practice-management.aspx.

The **Small Firms Risk Kit** contains information on better practice tips and industry news. The web address is www.Schinnerer.com/risk-mgmt/Pages/Risk-kit-small-firms.aspx.



Guidelines for Improving Practice, your bi-monthly policyholder newsletter, contains valuable information to help you negotiate your agreements with your clients and benchmark your practice. Mailed bi-monthly to insureds, past issues can be found at www.Schinnerer.com/risk-mgmt/GdIns/Pages/Guideline.aspx.

The American Institute of Architects (AIA) and the Engineers Joint Contracts Documents Committee (EJCDC) publish standard short form and small project agreements for your use or for comparison with custom contracts. Please visit their websites at www.aia.org or www.nspe.org.

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