



# a/e RISK REVIEW

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## Avoiding the profit squeeze

**Y**ou are nearing project completion. Overall, it's been a pretty successful and trouble-free venture, but it hasn't been perfect. Your client hit you with a few surprise project add-ons that resulted in a bit of scope creep. You've had to put in a few extra hours and pay overtime to both your staff and your subconsultants. Plus, your costs for fuel, equipment and supplies are turning out to be more than you anticipated.

Suddenly it hits you. The extra time and money you've put into this project have taken a sizable bite out of your projected profits. Any more surprises and you may not make a profit at all. You went into the work with a pretty tight margin because you really wanted to work with this new client, hoping for more lucrative work in the future. Now your rather low bid isn't looking like such a smart idea. There's a possibility you may lose money on this deal.

So what do you do? Do you start taking shortcuts to salvage as much profit out of the project as possible? If you avoid any glaring errors or omis-

sions the client may not notice that a little quality control is being sacrificed.

Do you, instead, ask your client for an increase in fees due to the scope creep that occurred during the project? The client may understand, or they may consider such a move highly unprofessional. Or, do you simply bite

“ A C O M P R E H E N S I V E  
S C O P E A L L O W S  
Y O U T O B U D G E T T I M E  
F O R Y O U R S E R V I C E S  
M O R E E F F E C T I V E L Y  
A N D ... Q U O T E A  
M O R E A C C U R A T E  
A N D A D E Q U A T E F E E . ”

the bullet? Do you continue to perform all services asked for and sacrifice rightfully earned profit to keep your client happy?

None of these three options is ideal. The best option is to avoid this predicament in the first place. Here are a few tips to help you end up with a satisfied client and an adequate profit at project completion.

### Develop a full scope of services

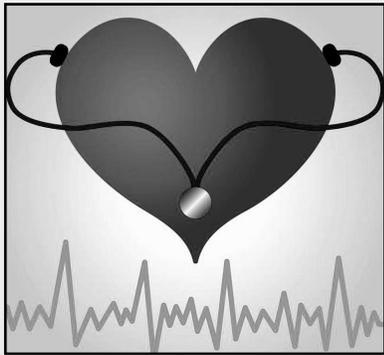
Developing a comprehensive scope of services is an essential first step to project and budget management. The scope should identify exactly what you are being paid to do as a consultant and, equally important, what you are not being paid to do. A comprehensive scope allows you to budget time for your services more effectively and, as a consequence, quote a more accurate and adequate fee.

Discuss your scope of services with your client. Clearly explain the full scope of services you feel is necessary for a successful project. If the client chooses to forego recommended services, document your client's decision in writing and explain that you offered and recommended those services. If the client asks for extended services, this gives you ammunition for establishing an adequate and itemized budget.

Do not let your client forego services that you feel are critical to a successful project. In the event of a future claim, a judge or jury is likely to believe a plaintiff's argument that you, as an experienced professional, were in a far better position to know what

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was and was not needed for successful project completion.

Accordingly, you could be found negligent because you did not insist upon performing a critical service and this omission feasibly allowed a problem to occur. Never mind that you told the client that the service was needed. Never mind that the client expressly said the service would be unnecessary or performed by others. You will likely be held liable.

**Charge an adequate fee**

Don't undersell your services. You may be tempted to shave a few dollars off of your bid in order to increase your chances of getting the job. But do you really want a client who is looking for the lowest bid?

Keep abreast of prevailing fees in your industry and locale. Is your fee structure in line considering your

areas of expertise and years in service? When was the last time you increased your fees? Have your costs increased for subconsultants, overhead and other expenses? Balance these factors with what you think the market will bear.

Similarly, if you are asked to provide cost estimates in your bid, be as realistic and thorough as possible. Make sure you are using up-to-date figures for materials, systems, etc. Present these figures as "opinions of probable costs." Let your client know these are not guarantees and that actual costs may differ.

**Document all changes in scope**

Consider this scenario: The project's design phase is complete and you present the client with an unanticipated, several-thousand-dollar bill for a wide

“ W H E N T H E C L I E N T  
A U T H O R I Z E S Y O U T O G O  
B E Y O N D T H E O R I G I N A L S C O P E ,  
P R E P A R E A W R I T T E N  
C H A N G E O R D E R . ”

array of changes you did not take the time to document at the time each was performed. Some of these changes are the result of add-on requests from the client once the work began. Others are the result of your own oversights that didn't become apparent until your work commenced.

How do you suppose your client reacts to these added charges? Does he say, "No problem. Let me authorize that payment right away?" or "What's this? Had I known this work

involved an extra fee, I never would have authorized it!"

**T**oo often the latter attitude prevails, creating the seed from which claims and lawsuits emerge. The client can refuse to pay, and you could wind up having to sue the client for payment of additional services. The client's likely response would be to sue you for negligence. Alternately, to keep the client happy, you could simply eat the extras and hope for a break-even project when all your unbudgeted bills are paid.

To avoid this problem, it is critical to document every change in scope, including its cost. When the client authorizes you to go beyond the original scope, prepare a written change order or memo of acknowledgment indicating what the extra work involves and how much it will cost to perform.

Be sure that your form or memo references the basic contract so all its terms and conditions apply.

Obtain the client's acceptance of the change order in writing. By presenting your overall change budget buttressed by individual, signed change orders, your client will be more willing to pay the extra cost and far less likely to sue you for negligence. Better yet, submit your change order bills on a regular basis so you can avoid the presentation of a mountain of additional charges created from multiple changes over the life of the project.

**Ask for a contingency fund**

Relatively few projects evolve exactly as originally planned. Educate your client about the possibility of having to pay for a certain threshold percentage

of project omissions or errors, and encourage the client to plan for the resulting extra costs by setting up a contingency fund.

A contingency fund establishes a certain percentage of the project budget to cover the normal “extra” costs that pop up in almost every project despite your best efforts to provide an accurate budget and perform to the prevailing standard of care. The percentage set aside in the fund should take into account the size, complexity and duration of the project. A contingency fund of 5–10% is not unusual for a standard project while a larger fund may be necessary for a highly innovative project with more unknowns. Also, try to negotiate a

clause in your contract which states that your client will not sue you for extra costs that are within reasonable range of the contingency amount.

All changes paid for by the contingency fund need to be documented. To an extent, these added fees will fall into the category of “known unknowns,” and because they have been budgeted, they should create little cause for concern.

**When necessary, bite the bullet**

Biting the bullet means providing everything the client expects or has been led to expect (via the scope of services) at the agreed-to fee. The logic for biting the bullet is basic: It is better to keep your client happy than to make your client unhappy, thereby risking loss of a client along with client referrals. More to the point, the dollars spent on performing professionally, i.e. applying the appropriate amount of quality control, are a prudent investment in risk management, especially given the dispute costs associated with litigation.

But biting the bullet should not be your first choice. Many clients have been in similar financial situations themselves and will be sympathetic for pragmatic reasons. They understand that firms performing services at a loss are probably not going to perform those services as well as they otherwise could, to the client’s ultimate detriment.

In short, your first choice should be speaking with your client to obtain the amount to which you believe you are entitled. In many cases, clients are willing to pay the additional amount in full or at least in part. In some cases,

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they pay nothing at all, but even then quality control should not be sacrificed. Professional performance is your top priority. By taking this approach, you should avoid problems, retain a client for the future and learn an important lesson.

**Can we be of assistance?**

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