Dealey, Renton & Associates, *Insurance Brokers*

VOLUME 15 NUMBER 5

a/e RISK REVIEW

A PUBLICATION OF THE PROFESSIONAL LIABILITY AGENTS NETWORK

A prudent approach to project selection

An architectural firm in a small Midwest town was celebrating a new project. It was a condo conversion involving a historic hotel. Sure, the client had a history of being litigious, but he was so nice and very enthusiastic about the innovative design. That enthusiasm was pretty remarkable, considering the architectural firm had never done a condo conversion or historic restoration before.

The project budget was rather tight, but there were a few shortcuts the architect could take to save on expenses. Plus, the contractor was selected on a low-bid basis, so money was being saved there as well. It's a fast-track project and the scope of services is limited, so the architect won't have a lot of long-term overhead expenses either.

It sounded like a quick, slam-dunk project with high visibility in the community. The firm's principal thought it might be the perfect project to get his new architectural firm on the map. Right? Wrong!

Obviously the above scenario is far from ideal. Still, in the real world, it isn't always easy to pick and choose among potential projects. Sometimes, any project can look good. Yet careful project selection is essential because accepting the wrong project almost guarantees professional liability claims.

Let's look at several factors that must be weighed when selecting projects.

> "Even a less risky type of project can become high risk if the other parties involved in it are litigious or prone to errors and omissions."

Type of project

Some types of projects are so litigation-prone that only the most qualified consultant—or the most foolhardy—would accept them. Condominiums, for example, are so high-risk that most insurance companies are hesitant to insure firms that design them. Historic renovations are also high risk due to the chance of hidden problems such as asbestos, lead paint and other hazardous conditions.

According to insurance industry studies, residential custom homes, schools (K-12), high rises, hotels, residential subdivisions, airports, bridges/trestles, and wastewater/sewage plants are examples of project types that can present higher than average risks. Lower-risk projects include malls/retail and commercial industrial buildings of nine or fewer stories.

This is not to say that you should never take a higher-risk project. However, you should approach these types of projects cautiously, make sure you are qualified to do them, set your fees to reflect the higher risk and insist on protective contract language.

Project delivery method

These days, more and more design and construction projects vary from the traditional design-bid-build delivery method. It is important to realize that each alternative delivery project involves specific risks and requires a different allocation of responsibilities for those risks.

For example, your risk on a design-build project varies depending on the role and contractual relationships you undertake. If you lead a design-build project, you become responsible for

Continued

risks traditionally associated with contractors and not normally assumed by architects, engineers or environmental consultants. On the other hand, with a contractor-led design-build project, your risk may be little different from that of the traditional delivery method.

The same holds true for firms that provide construction management services. Your risk as a construction manager depends on which role you play on the project and what contractual obligations and relationships you undertake.

Project delivery methods also include fast-track projects. These "ready, shoot, aim" projects often involve substantial modifications to plans and thus big change-order expenses. Unsophisticated clients may not expect change orders or understand the need to have sufficient contingency reserves set aside in their project budgets.

Other parties involved

Even a less risky type of project can become high risk if the other parties involved in it are litigious or prone to errors and omissions. Indeed, your client may be the greatest risk factor associated with your project. A client with a history of litigation against professional consultants, contractors and others should be a red flag when considering a project. So is a client who does not recognize the value of a firm's construction-phase services.

Likewise, the contractor assigned to a project is a significant risk factor. This is particularly the case when the contractor has been selected on a low-bid basis. It is always wise to investigate the history of the contractor as part of the project selection process. Subcontractors and subconsultants (or the prime if you are a subconsultant) should be scrutinized as well.

Level of experience and knowledge

Take a hard look at the capabilities of your own firm when selecting projects. How much experience do you have with this type of project? Who on your staff has the necessary professional ability? Have you worked with the owner or contractor before?

Consider your projected workload and the mix of other projects you will be working on concurrently. If you will need additional personnel to take on a new project, are those professionals available? Taking on a project that stretches your available staff and skills can be a recipe for trouble.

"...ON A HIGH-RISK PROJECT, THE RISK SHOULD BE BORNE BY THE PARTY BEST ABLE TO CONTROL IT."

Project funding

An underfunded project is a high-risk project. Clients with insufficient capital often look to skimp on quality and encourage their consultants and contractor to do the same. They may even delay payment for services or file trumped-up claims as a ploy to avoid payment altogether.

If a project appears to be underfunded, be sure to conduct a financial check of your client. Don't let the client reduce your scope of services to the point where you cannot adequately control your risks. Also make sure you have a suspension of services clause in your contract that gives you a way to pull out of the project in the event funding problems result in project delays, slow payment or other breaches of your contract.

Scope of services and fees

Even when overall project funding seems adequate, avoid projects for which you are offered a severely limited scope of services and/or inadequate fees. Projects that omit your construction observation services, for example, are more prone to errors since you are not available to provide guidance in the execution of your plans.

Contractual provisions

Beware of the "contractually hazardous" project. This could be any type of project—even a simple, single-story commercial building—for which the client issues a contract containing such unfair or onerous provisions that you could wind up accepting most or all of the client's liability.

An unsophisticated client may attempt to issue a purchase order or similar contract form which is inappropriate for engaging a professional consultant's services. Some might argue that such a project is among the riskiest of all because you have none of the standard contractual provisions professionals need for protection.

Alternately, strong contractual language can make an otherwise risky project palatable. Contractual limitations on your liabilities could be a make-or-break negotiating point.

A project evaluation checklist

Project selection is rarely a cut-and-dried, yes-or-no decision. Projects usually contain a number of risk factors that might be acceptable when considered separately, but together can add up to a liability headache.

Take for example, a well-financed client who wants to build an apartment complex as a speculative project and then sell it to the highest bidder. You might be able to negotiate a solid contract. But can you protect yourself from the subsequent purchaser of the complex? What could you do to mitigate risks if the apartment complex sells and goes condo in a few years and the complex suddenly has 300 new owners?

Your best course during project selection is to strive to identify all of the potential risks, then make a calculated decision based on a combination of factors. Some firms use a Project Evaluation Checklist to evaluate projects before submitting a proposal or negotiating an agreement. This can save a lot of time and money spent chasing projects you really shouldn't accept.

Your Project Evaluation Checklist should cover issues such as:

❑ Is the project type one that is inherently risky?

❑ Does the project team, including the owner, the prime consultant, subconsultants and the contractor, have experience with this type of project?

❑ Is the project adequately financed?

❑ Does the project owner or contractor have a litigious history?

❑ Does the project include an adequate scope of services?

❑ Are you receiving an adequate fee?

❑ Is the project schedule realistic?

❑ Are there any unusual features, such as unfamiliar code requirements, new technologies, hazardous waste or unstable geological conditions?

❑ Can mitigating factors be offset with contractual protection, such as a limitation of liability clause or indemnity provisions?

Add your own checklist items based on the unique characteristics of your firm.

Once you've analyzed the risks of a potential project, determine how the risks you've identified might be managed. You can minimize some risk

Continued

Dealey, Renton & Associates
www.dealeyrenton.com
• 66 Franklin Street, Suite 210
Oakland, California 94607
510.465.3090
Fax 510.452.2193
info@insdra.com
MAILING ADDRESS:
P.O. Box 12675
Oakland, CA 94604-2675

• 199 S. Los Robles Ave., Suite 540
Pasadena, California 91101
626.844.3070
Fax 626.844.3074

• 3 Imperial Promenade, Suite 440
Santa Ana, California 92707
714.427.6810
Fax 714.427.6818
MAILING ADDRESS:
P.O. Box 10550
Santa Ana, CA 92711-0550

An ESOP Company · License No. 0020739

by educating your clients, providing more comprehensive services and insisting on qualification-based selection of a competent contractor. You can also reduce your risk by developing a contract that is fair and precise, that accurately defines the intent of both parties—and that includes reasonable indemnities and a limitation of liability clause. And, of course, you can limit your risks by purchasing adequate professional liability insurance.

It is in everyone's best interest for you and your client to take a good, hard look at the risks you cannot prevent or control. Understand that on a high-risk project, the risk should be borne by the party best able to control it. If no one can control the risk, then it rightly remains with the project or property owner, who has the most to gain from the project. If the owner refuses to shoulder his or her share of the risk, you should probably decline the project.

The risks that remain on your plate—those that rightly belong to you and cannot be otherwise transferred or managed—will require a hard-nosed business decision. Is the fee or other incentive sufficiently attractive that you can afford to accept the risk? Making that determination may be the toughest decision you make on the project.

Can we be of assistance?

If you have questions about this article, please call on us for assistance. DRA is a member of the Professional Liability Agents Network (PLAN).

We're here to help.

Visit our website at www.dealeyrenton.com

Dealey, Renton & Associates
Insurance Brokers

P.O. Box 12675
Oakland, CA 94604-2675