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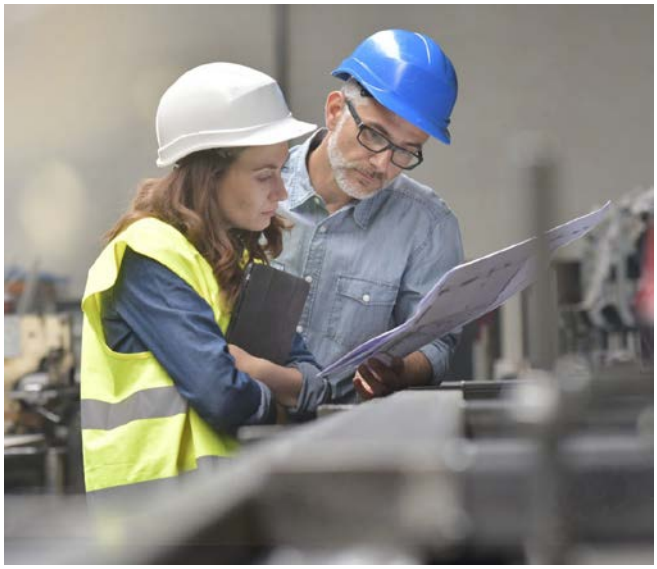
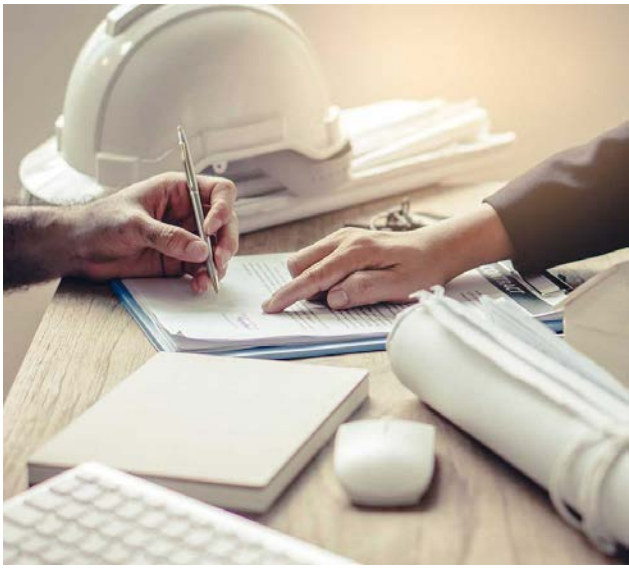
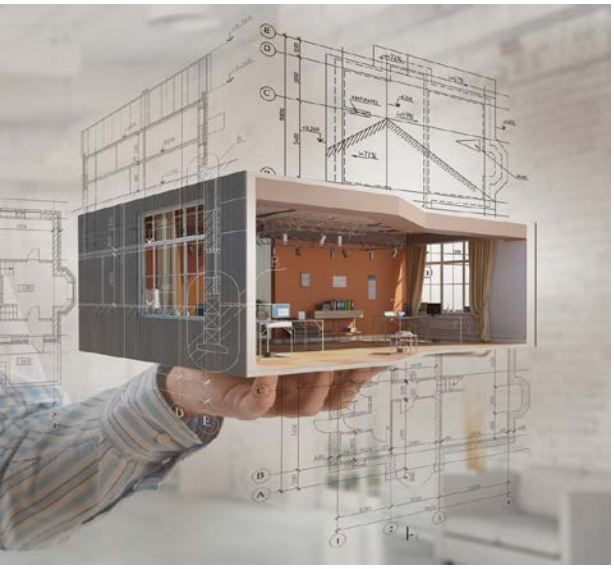
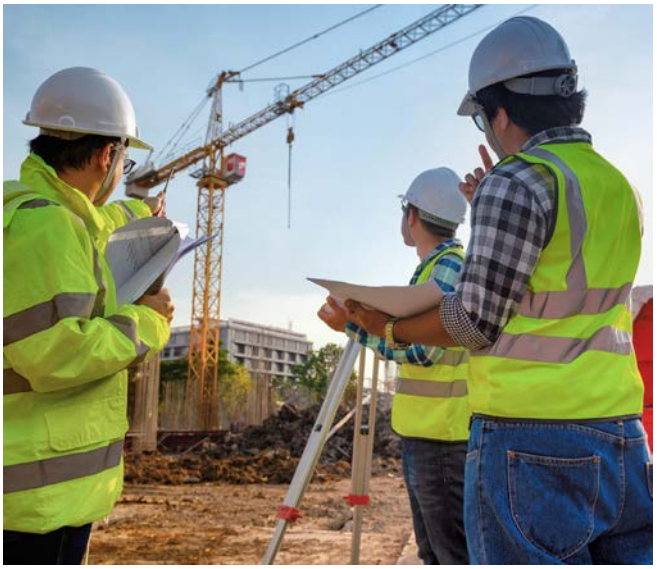


Contract Guide

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Contract Guide

Contracts are important in any business and any significant business transaction. The agreement establishes the obligations and the rights/entitlements. By its classic definition, a valid contract is to reflect and confirm "a meeting of the minds." That meeting of the minds is especially critical in the world of design and construction professionals where the projects, the project delivery system, and the services can vary so widely. It is the single best opportunity to educate and shape expectations, establish appropriate boundaries, and create the basis and ground rules for mutual accountability.

The design professional service agreement is literally the "recipe book" or "play book" for project success (or failure). In that regard, each clause can and does matter. However, not all clauses carry equal impact and some will have a far greater impact on the professional and financial success of a design professional firm and its projects as well as its client relationships. The goal below is to identify those "impact" clauses (good and bad) and to build a strategy to successfully navigate those clauses. For shorthand, we call them "the great eight".

The Professional Standard of Care

It is a professional service agreement. Accordingly its great starting point is what "professional service" actually means and what it doesn't. It is key both as a part of education and expectations. The AIA B101 appropriate defines the professional care as:

> *Services, skill and care ordinarily provided by architects practicing in the same or similar locality under the same or similar circumstances. [§2.2]*

It is a good starting point for any design or construction professional. It is also consistent with prevailing legal standards and therefore applicable professional liability insurance coverage. Such insurance coverage is frequently threatened when clients (or even the construction professional themselves) seek to elevate the "ordinary" language to a higher standard. "Best", "highest", and "first class" are common and potentially problematic superlatives. They should be avoided. If alternative language is required, experience based qualifications such as "experienced" or "specialized" standards are preferred—so long as they are accurate.

Equally important is to be clear what the standard of care is not. It is not a standard of perfection or an equivalent warranty or guarantee. Accordingly, design and construction professionals should scrutinize the scope of work and other provisions to remove or limit such perfection commitments or standards and should even consider an affirmatively disclaimer. Such a disclaimer is often ideally placed as an add-on to the standard of care clause as a means to further establish appropriate expectations. Such an add-on might provide:

> *Such standard of care is not a warranty or guarantee and consultant shall have no such obligation. Accordingly, client shall provide appropriate contingencies in both schedule and cost.*

The only three elements appropriate for warranty in a design or construction professional agreement are: 1) licensing; 2) contract compliance; and 3) compliance with the professional standard of care.

As a final consideration and enhancement, the typical standard of care clause may sometimes be viewed as a "floor" or "minimum" with other clauses, scopes, or related documents arguably elevated that standard as a whole or in part. To avoid that elevation, the standard of care clause may be elevated to status as a limitation by beginning with:

> *Consultant's services shall be provided consistent with and limited to the professional standard of care.*

Taking all the foregoing three elements together, an appropriate and desired standard of care clause may be based on the following:

> *Consultant's services shall be provided consistent with and limited to the professional standard of care which is the skill and care ordinarily provided by similarly situated professionals practicing in the same or similar locality under the same or similar circumstances. Such standard of care is not a warranty or guarantee and consultant shall have no such obligation. Accordingly, client shall provide appropriate contingencies in both schedule and cost*

Scope of Work

It the standard of care is the foundation of a professional service agreement, the scope of work is the structure. The scope of work should define not only what service it to be provided, but how and when it will be provided. Accordingly, it should be as detailed as possible and particularly with respect to:

1. Process
2. Sequencing and schedule
3. Quantity of activities.

The purpose of such detail is to make clear what is and what is not within the scope of work. Open-ended and ambiguous scopes of work both impair project completion and severely undermine the design or construction professional's right to additional service compensation. To close that exposure, the scope of work should either open or close with:

> *Consultant shall have no other duties or responsibilities except those set forth above/below except as agreed to in writing.*

Of course, that protection is only is good as the subsequent discipline in adhering to these principles.

Extended Relationships

A professional services agreement is about a relationship between the design or construction professional, and its client. In the context of a subconsultant, it may (but need not) extend one layer further to the ultimate project developer or owner. The challenge and problem is that any project will necessarily include many other participants who are not part of the contractually committed relationship. However, even though they are "outside" of the contract, the interaction with, reliance on, and accountability to and for others is a critical and multifaceted element of a quality professional service agreement and the delivery of the related services.

Before moving on to external concerns, it is first critical to affirm and commit to the core relationship. That process begins with an "intended beneficiary clause which both affirms the core relationship and disclaims others. It may provide:

> *This Agreement and the deliverables, obligations, and rights herein are intended for the sole use and benefit of the Parties and are not intended to create any third party rights or benefits.*

Consistent with such an intentional and committed relationship, it should not be unilaterally transferrable. Such a restriction might provide:

> *This Agreement and the design may not be transferred or assigned by either Party without written consent.*

If necessary, this may be qualified by the tag clauses, "which shall not be unreasonably withheld". There also may be some limited and inevitable exceptions to this approach (i.e. lenders), but that should be very limited and include a right to additional services consistent with that change and a different client.

Even with such clear and worthy clauses, there will still be bilateral interface with others and their respective information and performance. That involves elements of both reliance and potential accountability. There are two appropriate contractual responses:

1. To identify those areas of "reliance" such as owner or third party information, other design professionals or contractor design-assist or design-build elements. Ideally any obligations to call out deficiencies in such third party information will be limited to actual knowledge as opposed to a subjective "should" standard.

2. To make clear that other project participants are solely and independently accountable for their respective roles and does not overlap such that the design professional does not have any role in or responsibility for that portion of the project. The classic example would be construction means, methods, sequencing,

   and safety, but it can easily extend to other areas as well. To make clear the separation the professional service agreement may either disclaim responsibility or expressly assign the complete role to others with words such as "sole" or "exclusive". It may also be appropriate to expressly limit the design professional's responsibility and role to its licensing and scope of work

As a final, clear and definitive declaration of separation, the professional services agreement may and should provide:

> *Consultant shall not be responsible for the statements, performance, acts, errors, or omissions of any person or entity not under its direct control*

Ownership of Design Documents

With the ever increasing evolution and expansion of electronic design "documents" with their corresponding, ease of transfer and replication, true control over design documents has become increasingly elusive. At the same time, owners increasingly start with the contractual premise that they own all of the design documents prepared for their project. This runs contrary to both default legal principles and historical and present contract models which would have the design professional retain and control the copyright in its design.

The traditional approach continues to make sense. The AIA B101 is a good model for these purposes. Under that approach, the design professional retains all ownership of its design and the client received a license to use the design for construction of the subject project. The latter is further contingent on the client's payment of all fees and costs due under the agreement. A consolidated version of the key AIA clauses would provide:

> *Consultant shall be deemed the owner of its Instruments of Service, including the Plans, Drawings and Specifications, and shall retain all common law, statutory and other reserved rights, including copyrights. Consultant grants to the Client a nonexclusive license to use the Instruments of Service solely and exclusively for purposes of constructing, using, maintaining, altering and adding to the Project, provided that the Client substantially performs its obligations under this Agreement, including prompt payment of all sums due hereunder. [Based on §7.2 & 7.3]*

Where there must be transfer of ownership of the final design documents due to client demands or other requirements, it should still be subject to much of the foregoing and a little more.
Specifically:

1. Any acquired rights should be limited to use for the specific project;
2. It should be expressly contingent on payment of all fees and expenses;
3. It should release, indemnify, and hold harmless the design professional for any unauthorized use; and it should retain the design professional's right to continued use of the component elements (i.e. details, specifications, etc.) as a part of its ongoing practice.

The last element is the most unique and most seldom included element of these four objectives. Such a clause might provide:

> *Notwithstanding any other provision, Consultant shall retain all rights of ownership and use of its skills, knowledge and experience that have a general applicability, including such skills, knowledge or experience gained by Consultant in connection with performing services for the Project. Such knowledge and experience includes, but is not limited to standard arrangements and configurations, individual standard features, details, and design elements, specifications, general notes, and design templates.*

Such a preservation of intellectual capital is critical to the ongoing evolution and progress of any design practice.

Payment

The design and construction professional's goal is not only to design and build great projects, but also to get paid for those services. All too often, there is a disconnect in the professional service agreement as the scope of work and retention is driven by the design professional while the financial terms are delegated to the accounting side – or worse - overlooked. Fees are the true life blood of the firm.

As with all other relationship issues, smooth payment procedures are best established up front, want positive collaboration, and consensus are at their greatest. A quality set of payment provisions will provide:

1. The timing and frequency of invoices;
2. The expected content of such invoices. Often this element and the ultimate processing is enhanced by including a draft invoice template as an exhibit to the agreement;
3. A prompt deadline for the client to review the invoice and identify any deficiencies or disagreements in conjunction with an continuing obligation to pay all undisputed portions;
4. A deadline for prompt payment which should be before the next invoice is scheduled to be issued; and
5. Consequences for the failure to pay which should include both interest payments and the right to suspend or terminate services.

Finally, many contracts and statutes will provide that the client may withhold payments to cover potential claims or losses. Such withholds can have a crippling impact on design and construction professionals and the life blood of their cash flow. Moreover, the intended "source" for such claims should the applicable insurance and not the professional fees. Accordingly, the right to withhold should be limited to those fees associated directly with services deficiently performed and not the fee as a whole.

Indemnity

When problems arise, the first and core issue involves accountability. Who will be accountable to who and for what? The allocation of that accountability is most prominently established in the indemnity clause. For that reason and because such clauses may often "over-shift" the financial and legal accountability even to the point of being uninsured, no clause typically draws more attention or has greater implications for financial accountability.

An indemnity clause or an indemnity claim seeks to redistribute the financial loss by one party to another. Specifically, indemnity makes the "indemnitor" liable to the "indemnitee" for liability they incur to another party or even for their own damages. Where that obligation arises out of legal fault such as negligence, it seems fair and is not generally a problem. However, many indemnity clauses go far beyond an equitable sharing of financial accountability based on legal fault and seek to both make disproportionate allocations or responsibility and/or link that indemnity obligation to other extended obligations such as defense cost and attorneys' fees. For example, it is common for such clauses to obligate one party to "indemnify, defend, and hold harmless" the other "except in the cased of the other party's "sole responsibility." Such extended clauses are potentially both unfair and uninsured.

Because of the far reaching implications of such indemnity and defense clauses, the first preference for design and construction professional service agreements is simply not to have an indemnity clause. The absence of such a clause would simply defer the obligation to the common law which essentially would follow the contract and a fault based allocation. If that is not possible, the next best option is to make all indemnity clauses mutual as mutual clauses both promote better fairness and equity and can blunt the most onerous implications of the typical clauses.

Whether mutual or unilateral, the goal for any indemnity (and defense) clause should be to make it as fair and balanced as possible based on conduct and legal responsibility and to promote its consistency with applicable insurance coverage. The keys to such a clause are to tie it directly to legal fault and to make it proportionate to such fault. The words to do so are "to the extent caused by Consultant's actual negligence." The additional key is to limit the potentially uninsured obligation to defend or cover other extraneous costs or damages. Finally, the obligation should be limited to appropriate parties without ambiguous extensions. On that basis, the template for a "fair and reasonable" indemnity clause might provide:

> *Consultant and Client shall each defend to the extent covered by applicable insurance and indemnify the other for third party claims, damages, or liabilities to the extent actually caused by the other party's negligence, willful misconduct, or breach of this Agreement.*

The reference to "applicable insurance" serves multiple objectives. In addition to being more palatable than the other option which is to expressly exclude any defense obligation, there are situations where such coverage is available and can be a great protection. For example, a contractor or design-builder's general liability insurer may cover certain claims and by the foregoing language as well as a requirement that the design or construction professional be included as an "additional insured" under such policies, there may be a defense to such claims and such claims may be generally discouraged.

Dispute Resolution

Unfortunately, disputes, disagreements, and claims are not uncommon in design and construction projects. When they do, emotions can be at an "elevated" level and even communication can be strained. Accordingly, it is critical to essentially and require and facilitate solution and resolution oriented communications as a part of the contractual commitments before proceeding to the more extreme processes of litigation or arbitration. For that reason, design professional organizations such as the AIA and professional liability insurers have long promoted early communication and dispute resolution through mediation.

Whether by independent and direct communication or by more formal mediation, it is always better for both the project and the relationship to discuss such claims early and before further "damage" impact. In fact, implicating both direct communication and more formal mediation has historically proven to be most effective. Such an abbreviated clause might provide:

> *In the event of any dispute or disagreement, upon the written request of either Party, the official representatives of both parties shall meet in person in a good faith attempt to resolve such dispute or disagreement within fifteen days. If such dispute or disagreement has not been resolved by such meeting and negotiations within thirty days of the initial request, prior to taking any other action, the dispute or disagreement shall be subjected to mediation within sixty days of such request using <insert service name> or such other neutral and experienced third party as agreed by the Parties. The only exception to the foregoing would be any necessary filing to preserve lien rights or to avoid impacts of any statute of limitation.*

If the foregoing does not resolve the dispute or disagreement, the next step would be either litigation or arbitration. If there is no such selection, the default would be litigation in a public court. Each approach has its respective pros and cons and should be carefully selected based on the unique elements of the particular project, the client, and the legal venue or forum. Above all, any such selection should be implemented for the project and project team as a whole to avoid incomplete resolutions, or worse, simultaneous litigation and arbitration with different parties.

The unfortunate reality of any such dispute resolution process is that it can be expensive. Accordingly, many parties will seek to shift the cost of such a process by a "prevailing party attorneys' fees clause." Even design and construction professionals often favor such clauses as the only economically effective means to pursue unpaid fees. However, such clauses are also often outside professional liability coverage and can create a significant financial exposure to the design and construction professional. Such clauses can also reduce the litigation "advantage" often held by design and construction professionals where their insurance will cover legal fees while their adversaries are left to "self-funding." Accordingly, such prevailing party clauses should be avoided/deleted or should be limited to dollar amounts that could be managed on and uninsured basis.

Limitations

Finally, given the disproportionate financial incentives and benefits of most projects as between the ultimate client and the design or construction professional, it has long made sense to limit the liabilities and exposures consistent with such realities. The most commonly implemented clause would limit the design or construction professional to its fee or a set dollar amount. In fact, where they are prominently set forth and negotiated, such clauses have been favored and approved by many courts. Such a clause might provide:

> *Consultant's liability to client for any claim or cause of action based on negligence, breach of contract, indemnity or any other theory of liability shall be limited to $_or the fee received for Consultant's services, whichever is greater.*

Alternatively, such a clause might substitute “available insurance” in lieu of the dollar or fee limitation.

Such “traditional” limitations of liability are not the only tool for limiting or closing off liability. In fact, there are at least three other options:

1. Disclaimer of any “personal” liability which can often be promoted and “sold” on a mutual basis. Such a clause might provide:

> *Client expressly agrees that any liability arising out of this project shall be limited to the Consultant and its applicable insurance and shall not be the basis of personal liability as to Consultant’s owners, officers, directors, or employees.*

2. Disclaimer of categories of damages such as consequential damages. Such disclaimers are common to both the standard AIA and AGC contract documents. Such a disclaimer, waiver, or limitation may provide:

> *The Parties waive claims against each other for consequential damages arising out of or relating to this Agreement, whether arising in contract, warranty, tort (including negligence), strict liability, or otherwise, including but not limited to losses of use, profits, income, rent, overhead, business, reputation, or financing.*

3. A time limit for any claims which may be even shorter than the statutory time limits of applicable statutes of limitation or repose. Such a clause might provide:

> *Any claim in litigation between these Parties must be filed not later than the earlier of the expiration of the applicable statute of limitation or four (4) years from either substantial completion or Consultant’s last services on the Project.*

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