Part III – Pre-Contract
Risk Management
3.1 Introduction

Most design professionals will acknowledge that they have never produced a perfect set of construction documents. Simply put, it is impossible to anticipate every condition or contingency. This accounts for the changes clause in construction industry contracts and the need for contract modifications or change orders to respond equitably to changed conditions. Beyond the need for contractual mechanisms to accommodate change, the design professional, design professional’s client, and other project participants must have the capacity and willingness to work together to find timely solutions.

A continuous process of collaborative problem solving has, historically, characterized the most successful projects. Accordingly, it is no surprise that design professionals with a reputation within their peer and client communities for the quality of their services and for their collaborative problem solving skills are most sought after by sophisticated clients undertaking complex or high-profile projects.

The overall purpose of pre-contract risk management is to determine whether the risks associated with the client, project, and project contract are reasonable and controllable. At a minimum, this should be a structured “consciousness-raising” exercise. The general categories presented below should be considered when evaluating the sources of risk that may be associated with a given project. Since no two projects are alike, these general categories should be adapted to project-specific requirements. To facilitate this process, Schinnerer’s Pre-Contract Risk Management Checklist, is included as Appendix A to this publication. For ease of adaptation to practice and project-specific requirements, this checklist is also available as a download from Schinnerer’s website at www.Schinnerer.com/risk-mgmt/Pages/Contract-review.aspx.

3.2 Evaluation of the Prospective Client

Risk is generated or influenced by the interplay of a variety of client, design professional, and project characteristics, as well as the environment in which the services will be performed. Because clients can become claimants and plaintiffs, a design professional must be prepared to turn down the project based upon an objective evaluation of the client.

When evaluating a potential client, the design professional should consider the following:

- Financial capability;
- Risk aversion;
- Composition of the client group;
- Expectations;
- Parties relying on the design professional’s services;
- Understanding of uncertainties; and
- Prior client experience.

3.2.1 Financial Capability

In addition to the basic business risk of not being paid, an underfinanced client presents other kinds of risk to the design professional. In commercial transactions, credit checks and financial
investigations in conjunction with sales are commonplace. After all, in most cases, design professionals effectively extend credit to clients when they begin to perform services. Factors to be considered when evaluating the financial capability of the potential client include:

- Does the prospective client have sufficient resources to undertake the proposed project and stand behind its contractual obligations?
- Is the prospective client prepared to support a quality design in terms of engineering and construction, or is it looking for a quick and dirty solution?
- Does the prospective client appear to have a well-established or growing and prosperous business that suggests it will survive far into the future?

### 3.2.2 Risk Aversion of the Prospective Client

A risk-averse client may attempt to unfairly shift the risk of financial loss and liability to other project participants, including the design professional. Also, some clients are more litigious than others. It is possible for design professionals to investigate the court records in their area or in the client’s home area to determine the incidence of litigation to which the potential client was a party. When evaluating the prospective client’s risk aversion, consider factors such as:

- Does the prospective client understand that some sources of risk are appropriately borne by the client?
- Has the client proposed harsh contractual liability provisions (indemnity, warranty, other) that are “non-negotiable”?
- What is the prospective client’s claims history?

### 3.2.3 Composition of the Client

It is not uncommon for the client on a project to be a committee or group. To better evaluate the risk a prospective client poses, it is important that the design professional know exactly the composition of the client group. A so-called “committee” client can have several competing or ever-changing agendas, leading to conflicts and potential claims. Factors to be considered include:

- What are the interests of each party?
- Is the group a legal entity with competence and authority to contract, and be sued, if necessary?
- Is there a clear leader and duly authorized representative of the group?
- Is each member jointly and severally liable for the obligations of the group?
- Does the client group have internal conflicts or competing interests?

### 3.2.4 Client Expectations

How a prospective client expresses its desired result may indicate how reasonable it may be during the project. Unrealistic expectations often form the basis for dissatisfaction with the project end result, which may very well lead to claims and liabilities.

The more a prospective client understands the uncertainty associated with design and
construction, the lower the likelihood of client claims. Some clients are unlikely to be technically knowledgeable about the design and construction process. The critical risk management issue, however, is whether the client can understand or is willing to recognize uncertainty as a source of risk and is willing to commit the resources necessary to manage the risk.

Issues to consider include:

- Are the prospective client’s budget expectations reasonable given the desired time and performance goals?
- Does the prospective client understand that cost uncertainty, to varying degrees, is inherent in all design and construction projects?
- Are the client’s schedule expectations reasonable given the nature of the project?
- Does the prospective client understand that schedule delays, varying with project complexities and uncertainties, are inherent in design and construction projects?
- Are the prospective client’s expectations as to results reasonable given the desired time and cost goals?
- Does the prospective client understand that the design professional cannot effectively warrant or otherwise guarantee project outcomes?

If the answer to one or more of these questions is “no,” the design professional should determine whether the prospective client’s expectations can be made more realistic through education and discussion. If not, the client should probably be avoided. Unfulfilled expectations are the major cause of claims against design professionals and contractors.

3.2.5 Third Parties Relying on the Services

Although the design professional may be retained by an individual client, other parties, such as the client’s lender or prospective tenants, may rely on the design professional’s services. Such reliance may give rise to claims on the project. It is therefore critical that all parties that may be relying on the services be identified. Important issues to be evaluated include:

- Can these parties be identified?
- Can their interests be identified?
- Can their interests be addressed properly within the scope of services and budget proposed?
- Will the client assign its contractual rights in the design professional agreement to a lender?
- Will the lender require any additional contract terms or certifications? If so, what are they, and are they acceptable?
- What is the lender’s reputation for dealing with design professionals and other construction professionals?

3.2.6 Prior Experience with the Prospective Client

As a final issue, it is important to consider any previous experience the design professional has had with the prospective client, keeping in mind that the client’s staff, objectives, and attitude toward risk may have evolved over time. Factors to consider include:
What was the quality of the professional relationship with the client?
Did the client make timely decisions?
Were bills paid in a timely manner?
Were necessary additional services authorized in a timely manner?

The issues mentioned above are not exclusive. When evaluating a potential client, the design professional should obtain and consider as much relevant information as possible. Every piece of information gathered might expose sources of risk that must be addressed. Judgments about these factors are subjective, and the design professional should consider what levels of risk are appropriate and at what point it should refuse the project. In some areas it may be necessary to employ the services of an attorney to assist in identifying, evaluating, and appropriately responding to potential sources of risk.

3.3 Evaluation of the Prospective Project

The following general categories should be considered when evaluating sources of risk that may be associated with a given project.

3.3.1 Project Characteristics

The quantity and quality of information available will vary from project to project, and any conclusion will probably be subjective. The risk of inaccurate information provided by the prospective client should be allocated appropriately in the contract. While it may not be possible to obtain all relevant information due to schedule constraints, the design professional should attempt to investigate the following factors:

- Is the project program, budget, and schedule adequately defined?
- Is the project type “high risk” (e.g., residential or mixed use condominiums, complex renovations, large public use centers)?
- Does the project involve highly complex or innovative design elements?
- Are complex or innovative methods or sequences of construction necessary due to complex design elements, fast-track or phased delivery requirements, or occupancy of the facility during construction?
- Are there scheduling issues that may result in liability exposures to third parties, such as meeting a sale or leasing deadline?
- Have the appropriateness and availability of special technologies or products proposed for the project been adequately researched and tested?

3.3.2 Site-Specific Issues

- Are there geographic considerations or site constraints that may limit the availability, access, or staging of labor or materials?
- Are there known or suspected environmental issues on or adjacent to the site that may increase risk?
- Is there any perceived community opposition to the project?
3.3.3  Services to Be Performed or Furnished

Once the parameters of a project have been determined, the required services and risks associated with those services should be analyzed. Effective risk management requires a realistic assessment of the skills and abilities available to the design professional. If the required experience and skill sets are unavailable to the design professional (either internally or through consultants), it is wise for the project to be refused. Factors to consider include:

- What types of service are needed—project planning, design, project/program management, permitting, scheduling, inspection/evaluation of the work, submittal review/coordination, expert witness testimony, or others?
- What are the sources of risk associated with the types of services needed?
- Is the client asking about green design alternatives?
- Are there any habitational design factors to consider?
- Is the design professional being hired to perform design without construction phase services?
- Do any of the intended service outcomes (e.g., financing, permitting, or scheduled completion) involve high uncertainty?

3.4  Evaluation of the Prospective Contract

As previously discussed, contracts allocate rights and responsibilities, risks and rewards. A well-drafted, equitable contract can help prevent disputes and establish a framework for the fair resolution of those that do occur. Accordingly, when evaluating the contract, factors to consider include the following.

3.4.1  Basic Contract Issues

- Are the parties (client and design professional) clearly identified with their legal entity names?
- Is the project clearly defined?
- Is the design professional’s “part of the project” clearly defined?
- Does the design professional’s scope of services not only describe what is included but what is not included?
- Are the expectations of the parties clearly articulated and reasonably integrated (scope, budget, schedule)?
- Is the design professional required to warrant or guarantee any deliverable or any project outcome?
- Does the contract require the design professional to “verify” client-furnished information or services?
- Is the design professional’s role during construction (if applicable) limited or non-existent?
- Is the design professional’s role during the bidding or negotiation phase and during the construction phase coordinated with the bidding documents and the conditions of the contract for construction?
● Does the contract include mechanisms to accommodate change (scope, budget, and schedule) equitably during the course of project delivery?
● Does the design professional have the right to suspend services in the event of the client’s failure to make timely payments?
● Are the roles of key third parties (e.g., contractor, construction manager, separate design consultants, etc.) clearly defined?
● Is each risk allocated to the party in the best position to manage or control that risk?
● Is the same responsibility assigned to more than one party?
● Does the client solely control the method or substantive procedures for the resolution of disputes?

3.4.2 Third-Party Risk Transfer/Insurance

● Are the insurance coverages required of the design professional reasonable and commercially available?
● Will available insurance cover the indemnity obligations imposed on the design professional?
● Will the client and any key third parties (e.g., contractor, construction manager, separate design professional) be appropriately insured?
● Will the design professional be named as an additional insured under the client’s and contractor’s commercial general liability insurance (CGL) policies?
● Will the design professional be named as an additional insured under the client’s or contractor’s builder’s risk policy?
● Do the applicable project contracts include mutual waivers of subrogation?
● Is bonding required of the contractor?

3.4.3 Subcontract Issues

● Are pertinent portions of the applicable prime contract incorporated into the subcontract?
● Are project budget provisions coordinated with subcontract budget provisions?
● Are the subcontract terms of payment coordinated with the timing and method of payment under the prime contract?
● Are the dispute resolution provisions of the subcontract coordinated with those of the prime contract?
● Are the indemnity obligations of the subcontract coordinated with the prime contract?
● Is the termination provision contained in the subcontract keyed to the subconsultant’s performance and coordinated with the termination provision contained in the prime agreement?
● Are the insurance requirements of the subcontract coordinated with those of the prime contract and otherwise appropriate with the liability exposures reflected in the subconsultant’s scope of services?
● Are the ownership/use of documents provisions contained in the subcontract coordinated with those contained in the prime contract?
● Are any limitation of liability provisions coordinated with those contained in the prime agreement?
While there is no formula by which to quantify the aggregate risk indicated by answers to the above questions, the experienced practitioner should develop a sense of the total risk exposure sufficient to make a “go/no go” decision.

3.5 **Contract Negotiation**

Risk, the probability of an unfavorable outcome, attends the undertaking of any project for any client. Once the design professional has evaluated the potential sources of risk associated with the client, the project, and any proposed contract terms and conditions, the design professional can make an informed decision as to how and if to negotiate a contract for professional services.

3.5.1 **Proposal-Phase Communications**

A proposal to provide professional services is many things, not the least of which is a road map for the project to come. The development of the proposal provides an opportunity to think about the project and how, when, and under what circumstances services will be performed. It is also the opening stage of contract negotiations. Therefore, it is an opportunity to address any known client terms and conditions that are objectionable. (As discussed above, the design professional will have a fairly well-developed sense of client, project, and contract-specific sources of risk as a result of the pre-contract evaluation of the project and the prospective client.) If accepted by the client, the proposal may be considered the basis of the contract between the parties, and clients sometimes require the design professional’s proposal to be incorporated by reference or physically attached to and made a part of the contract.

Accordingly, the design professional should be careful not to oversell the firm, the quality of services to be performed, or the results to be obtained from those services. The desire to distinguish one’s firm from the others competing for a project may result in promises that cannot be met and expectations that cannot be fulfilled. Whether or not these promises are made a part of the contract, clients tend to remember what they are promised and are disappointed when the promises are unmet. It is generally better that proposals begin to foster in the client a realistic sense of what is possible and begin the ongoing task of managing and fulfilling the client’s expectations.

3.5.2 **Preparation for Negotiation**

*Webster’s Collegiate Dictionary* defines negotiation as the process of “confer[ring] with another so as to arrive at the settlement of some matter.” Negotiation, however, is not a purely standardized process, and it is often hard to know when and how to get started. The use of a conceptual road map, such as provided in the book *Getting to Yes* (discussed below), can help to structure and guide the process. However the design professional chooses to proceed, three salient characteristics of successful negotiations must be recognized and accommodated. First, negotiation is a consensual process. Success is dependent upon voluntary, good-faith efforts by all parties to reach a negotiated agreement. Second, negotiation involves some adjustment in the desires of the parties that effectively addresses the issues in question. In the design and construction project arena, this involves balancing the client’s program aspirations against budget and schedule realities. Finally, the new relationship must represent an overall bettering of the
position of each party given their respective bargaining positions, i.e., each party must perceive that they are better off with the deal than without it.

3.5.3 The Negotiation Process

There are two general approaches to negotiation. Often, these two approaches are both used in a particular negotiation; however, one or the other usually predominates. The first and perhaps most traditional approach is referred to as “positional bargaining” and is characterized by parties exaggerating their respective positions in order to meet somewhere in between. Generally, positional bargaining favors the party with superior leverage, whether that is based on time, money, or some psychological or other advantage, regardless of the relative merits of the parties’ positions. In some instances, one party exaggerates its position solely to frustrate the negotiation process and stall for a time when its leverage will have increased.

The alternative to positional bargaining is “interest-based bargaining,” which is also commonly referred to as “principled negotiation.” This approach is described in a short, influential book by Roger Fisher, William Ury, and Bruce Patton of the Harvard Negotiation Project titled, Getting to Yes: Negotiating Agreement Without Giving In. The authors suggest that parties not bargain over positions, but pursue four strategies that are applicable to nearly every situation:

- “Separate the people from the problem.”
- “Focus on interests, not positions.”
- “Generate a variety of possibilities before deciding what to do.”
- “Insist that the result be based on some objective standard.”

The first strategy is designed to help the participants think about the problem objectively rather than reacting to it in an overly personal and emotional way. Often, the problem in the minds of the participants becomes identified with the other party rather than with the situation at hand. Participants should be encouraged to see themselves as working together toward a solution.

The second strategy is to understand and focus on the interests that are the basis of the participants’ stated positions rather than the positions themselves. Simply coming up with a compromise between stated positions is unlikely to meet the requirements of the participants.

The third strategy deals with the process of actually devising a solution under difficult circumstances. One should not look for the one correct course of action. That is most likely to lead to a mental road block. Instead of evaluating and discarding options one by one, a more productive and creative approach is to “brainstorm” or encourage a fairly free flow of ideas for a certain period of time. Developing a number of widely divergent possible solutions means that you have a better chance of finding one that will suit all the parties.

The fourth strategy is to insist on objective criteria. This is especially important when the parties seem to have opposing interests. An objective standard means that parties do not win or lose by insisting on a particular position, but they both accede to an accepted way of determining a fair solution. (Fisher, Ury, and Patton, 10-12)

Principled negotiation clearly requires more effort and creativity than positional bargaining,
but the results are far more satisfying to the parties and more often reinforce, rather than undermine, ongoing relationships.

3.6 Summary

Contract negotiation, supported by an objective evaluation of the client and the project, is the prime opportunity to communicate with the client. That communication should include a discussion of guiding principles in establishing contract language that appropriately allocates risk and reward between the contracting parties.

Standard contract forms—such as the documents published by the AIA and EJCDC—attempt to establish contractual liability within common law standards of professional care, skill, and diligence. Unique or custom-drafted agreements may greatly enlarge the design professional’s liability exposure through the inclusion of contract provisions that exceed normal duties and responsibilities. Although there are an ever increasing number of AIA and EJCDC documents that address specific project delivery methods, no AIA, EJCDC, or other standard form document should be seen as suitable “off the shelf.” All standard form documents need to be tailored to the needs of each project.