

A/E RISK REVIEW

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Actions that can Increase Revenues and Profits

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

In today's economy, where projects can be rare and budgets tight, it is critical that you achieve adequate fees for all of the valuable services you deliver. You also need to take steps to help ensure that the project is adequately funded so that you receive full payment for the services you have agreed to provide. Here are a few tips to help you ensure that you end up with a satisfied client and an adequate profit at project completion. Some of these tips can also reduce your professional liability risks at the same time!

Draft a Full Scope of Services

Developing a comprehensive scope of services is an essential first step to basic project and budget management. The scope should solidify in writing exactly what services you will be providing on the project and, equally important, what services you are *not* being paid to provide. A comprehensive scope allows you to effectively budget time and resources for delivering your services and, as a consequence, deliver a more accurate and adequate quote for the project.

Discuss your scope of services with your client at the early stages of negotiations. Explain clearly and in detail the full scope of services you feel is necessary for a successful project. If the client chooses to forgo any of your recommended services, document your client's decision in writing, explaining that those services were recommended and offered, but refused. If the client

agrees to your full scope of services, this gives you documentation for establishing an adequate and itemized budget.

From a risk management standpoint, you do not want to 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 design professional, were in a far better position to know what services were and were not needed for successful project completion. Accordingly, you could be found negligent because you did not insist upon performing a critical service whose 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 could still be held liable.

Charge an Adequate Fee

Don't undersell your services. Sure, there is always the temptation to shave off a few dollars here or there in order to increase your chances of getting the job. But do you really want a client who is looking for the lowest bid rather than the most qualified design professional and contractor?

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

Consider this scenario: Your client agreed to an adequate scope of services, although he did forego some of your recommendations. The project’s design phase is now complete. Over the course of the project there have been several add-on requests from the client. In addition, you have performed additional services due to your own oversights – the need for these services didn’t become apparent until your design work had commenced. Now you present the client with an unanticipated, several-thousand-dollar bill for a wide array of additional services you did not individually document and bring to his attention at the time each service was performed.

How do you suppose the client reacts to these added charges? Does he say, “No problem!” and merrily sign the invoice to authorize payment? Or does he say, “What’s this? Had I known this work involved this exorbitant fee, I never would have authorized it!”

Too often, the latter attitude prevails, creating the seed from which claims and lawsuits emerge. The client can refuse to pay, and you very well 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 of your unbudgeted bills are paid.

To avoid this problem and maximize your revenues and profits, 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 acknowledgement indicating what the extra comprises and how much it will cost to perform. Have the client review and approve change orders in writing. Be sure that your change orders reference the basic contract and specify that all its terms and conditions apply.

By presenting your overall change budget buttressed by individual, signed change orders, your client will be far

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 (e.g., monthly), so you can avoid the one-time presentation of a mountain of additional charges created from multiple changes over the life of the project.

Ask For a Contingency Fund

Few, if any, projects evolve exactly as originally planned. Educate your client about the possibility that he or she will be required to pay for a certain threshold percentage of project additions, omissions and errors, as well as other unanticipated costs, and encourage the client to plan for the resultant extra costs by setting aside 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 5%-10% contingency fund is not unusual for a standard project while a larger fund may be necessary for a complex project or one with many unknowns. Also, try to negotiate a contract clause that states your client will not sue you for extra costs 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 will have been budgeted, they should create little cause for concern. Plus, this contingency fund increases the chance that money will be there to pay you for all of the extra services you provide.

Contractual Rights to be Paid

There are other contractual measures you can take to increase the chances of being paid and to help avoid the problem of a countersuit related to client nonpayment. Add language to your contract that spells out payment provisions for services rendered and your rights to remedies in the event you are not paid according to contract terms. The more precisely you define the details of these payment terms and your right to enforce them, the more likely you’ll receive prompt payment -- and the less likely your client will consider a

counterclaim. Work with your legal counsel to draft the following billing and payment terms:

Retainer. Require the client to make an initial payment upon execution of the agreement. Hold the retainer and apply it to the final invoice.

Payment terms. Specify the timing of your invoices, e.g., weekly, monthly or upon completion of project phases. Specify the period of time for payment (e.g., upon delivery, net 30) and when payment is considered past due. It is always advisable to specify that payment for services rendered shall be due regardless of any subsequent suspension or termination of the agreement by either party.

Interest. Establish interest due on late payments and how that interest rate is accrued. Also set how future payments are applied – e.g., first to accrued interest and then to the unpaid principal.

Collections. Address how any collection costs will be recovered. Contractual clauses often specify that the client agrees to pay for all collection costs incurred, including legal fees, collection agency fees, court costs, reasonable consultant staff costs and other expenses.

What If Profits Don't Materialize?

Sometimes, a design firm may get toward the end of a project and realize that unanticipated or underestimated costs in delivering contracted services will result in a project that barely breaks even or may even result in a net loss for the designer. At this point, it may be necessary to just bite the bullet.

Biting the bullet means providing everything the client has been led to expect via the scope of services at the agreed-to fee, even if it results in zero profit. The logic for biting the bullet is basic: It is likely better from a long-term monetary standpoint to keep the client happy than to make the client unhappy, thereby risking loss of the client as well as client referrals. Also, the dollar loss associated with performing professionally -- i.e., applying the appropriate amount of quality control -- is a prudent investment in risk management, especially given the costs associated with litigation.

But biting the bullet should not always be your first choice, especially with long-term clients with whom you enjoy a good working relationship. These clients

may be sympathetic and willing to pay an additional amount they feel is reasonable. Regardless, quality control should not be sacrificed. Professional performance is your top priority. By taking this approach, you can avoid problems, retain a client's business in the future, and learn an important lesson on profitability.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.