A/E RISK REVIEW

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Make a Resolution: Only Use Written Contracts!

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.

New Year's resolutions are a time-honored tradition. When the calendar flips over, it's a great time to commit to breaking bad habits or starting good ones.

For design professionals, one New Year's resolution that can pay big dividends if kept and not broken is: ***Don't accept any project lacking a written contract between client and designer.*** Having a written document that spells out roles, responsibilities and liabilities is perhaps the best way to avoid major project disputes.

Verbal Agreements Not Enough

It's been said that a verbal agreement isn't worth the paper it's written on. Many interpret that to mean verbal agreements are not binding, that parties to an agreement cannot be held to their commitments unless they are in writing. But this is simply not the case.

Verbal agreements, no matter how brief, can be binding. If you and your client agree verbally to produce a project that, for example, includes a specific scope of work for a specific price, to be completed by a specific deadline, those commitments are likely binding.

The problem with verbal contracts is that the parties to the agreement rarely agree as to what they have agreed to. If a project dispute occurs, chances are each party has its own remembrance of the contents of the agreement. And lacking a written document or other record of the agreement, there is no way to settle that dispute short of going to a trier of fact such as a judge, mediator, arbitrator or jury.

And would you trust a jury or other trier of fact to determine what commitments the verbal agreement actually contained? Not hearing the actual conversation, how would a mediator, arbitrator, jury or judge know whether either version of the understanding of the agreement is correct?

There is one important exception where verbal agreements are not binding. This is when the two parties also enter into a written contract. When the parties agree to a signed written contract regarding the project, any verbal agreement also reached is no longer binding. The written contract supersedes any verbal agreement.

Types of Written Agreements

There are a variety of short form written agreements between project owners and design consultants. While virtually all of them are preferable to a verbal agreement, most do not provide adequate protection. As a rule, the more detailed the written agreement, the better.

Consider these short-form agreements:

A ***letter of proposal*** is a simple but formal document prepared by the design professional that covers the basics of the proposed project. The letter typically identifies the parties involved, provides the location of the project, and includes a brief description of the project, a basic scope of services to be delivered and a proposed fee.

While a letter of proposal is an effective tool to gain an initial basic agreement on a proposed project, it is inadequate as a final contract document. There is simply insufficient detail to effectively serve as a legally binding agreement. Also letters of proposal rarely include signatures of both parties.

A ***letter of intent*** is often used as a follow-up to a letter of proposal, once the two parties have acknowledged general agreement with the proposal. In the letter of intent, the designer adds greater detail to the project description and the scope of services to be delivered. It also adds basic terms and conditions regarding schedules, budgets, roles and responsibilities. It may include brief drawings, but not detailed plans. Basically, it spells out, in simple terms, how the designer intends to proceed with the project.

A letter of intent is effective in illustrating that the designer understands the owner's needs and goals. It is typically signed by the designer, though does not require the signature of the project owner. Again, it is inadequate as a final contractual document.

A ***letter of agreement*** is intended to demonstrate that the owner agrees with the designer's understanding of the intent of the project. It includes any revisions the owner might request after reviewing the letter of intent as well as additional terms, conditions and details regarding scheduling, budgeting, compensation and the like. Basic drawings or sketches may be included.

A letter of agreement is typically written by the lead designer and signed by both the designer and the owner. The signatures can make this a binding legal document. Still, its brevity (typically no more than a couple of pages) makes it inadequate as a final contractual document.

Short form agreements between project owners and architects have their place and can be quite useful when properly used. For instance, a short-form agreement can be helpful in emergency situations (e.g., a post-earthquake inspection of a building by a structural engineer) where neither party has the time to complete a lengthier contract before work begins. However, they are no substitute for a written detailed owner-designer contract.

An Effective Written Contract

Getting a client to agree to draft a written contract should not be difficult. Yes, there was a day when a hearty handshake and a slap on the back was considered a "gentleman's agreement," and asking for a written contract was considered an act of distrust. But those days are long gone for most firms.

A written contract between client and designer is a mutually beneficial tool. From your client's perspective, it's a commitment from the designer to complete a project that meets his or her stated requirements. True, there are no guarantees that all of the owner's objectives will be achieved. Nor should there be. But a written agreement can help avoid misunderstandings and unpleasant surprises. And, should a project dispute arise, a written contract provides a solid roadmap to get the problem identified and resolved in accordance with the stated intentions of both parties.

What type of written contract should you use? Generally it is preferable to have the contract drafted by the lead designer on the project and its legal counsel. The lead designer is in the best position to spell out the general terms and conditions that will govern the design of the project. The lead designer can also help establish the roles and responsibilities of each party and set reasonable schedules for project completion and payment for services rendered.

The designer's contract should be based on industry norms governing such documents. A good starting point is to use recommended language that has been developed by experts in the field. Design professional associations such as the American Institute of Architects (AIA) have developed contract documents that are widely used and generally considered unbiased and equitable for both designer and client. Professional liability insurance carriers have also developed recommended contract language for their insureds. These documents put a heavy emphasis on risk management and insurability.

Regardless of which standard contract documents you choose to use, these should only be your starting points. It is critical for you and your attorney to create customized language that fits your firm and the particular client and project.

What about clients who present their own contracts for you to sign? You certainly can't reject each and every client-drafted contract outright. But you and your attorney should certainly scrutinize the language and call in your professional liability agent to address any concerns regarding liabilities and insurability.

All contracts, whether client or designer drafted, will be negotiated. It's a give-and-take process reliant on open communications. In fact, some designers contend that the negotiation process is as valuable as the ultimate contract document that results. Contract negotiations will reveal the true colors of your clients and should help convince you whether this is a project you want to take on.

Recommended Contract Clauses

So what language should your contract contain in order to help achieve a successful project and avoid costly liabilities? That will depend on both the nature of your company and the specifics of the particular project. There is no "one size fits all" when it comes to contracts. But working with your attorney and armed with sample contract clauses provided by your industry associations and professional liability insurers, you should be able to craft solid contractual protection for each and every one of your projects.

Here are some contract clause that you'll want in virtually all of your contracts, whether drafted by you or your client:

Scope of services. The contract should include a detailed description of the services you are agreeing to supply for a stated fee, a list of additional services you can provide for an additional fee, and services you recommended to be performed but the client has refused. Without a clearly defined scope of services, you will be subject to "scope creep," with clients expecting you to perform additional services without an additional fee.

Standard of care. Some clients will expect perfection in the services you deliver. The contract should state that you are only obligated to perform up to the prevailing standard of care: performing your services with the same degree of skill and care ordinarily exercised by members of your profession under similar circumstances.

Certifications, guarantees and warranties. To be consistent with your standard of care clause, you will want to make sure you state that you are not making any certifications, guarantees or warranties regarding your services or any materials, machinery or systems you specify in your contract. Again, you and your work are not expected to be perfect.

Consequential damages. Seek a contract clause that provides a waiver for liability for consequential (i.e., indirect) losses incurred by the client. An example of consequential damages is a client's lost profit due to a delay in completing the project.

Billing and payment. Your contract should specify your total fees, how you will bill your client for services delivered and when the client is obligated to make payments. The billing and payment clause should also specify the penalties for late payment and your rights in the event of nonpayment.

Jobsite safety. Make it clear in your client contract that the contractor is solely responsible for jobsite safety. The contractor is responsible for construction means and methods as well as the construction workers on the site. Directing construction workers, ensuring jobsite safety and having the authority to stop work are not part of your duties -- and your contract should specifically say so.

Limitation of liability. Strive to obtain a limitation of liability (LOL) clause that puts a dollar cap on your maximum liability to your client. The LOL should be tied to a factor such as your total fees or available limits of professional liability insurance, and should reflect an equitable risk versus reward ratio considering potential profits and losses for your firm.

Mediation. Your client contract should specify mediation as the first resolution technique to be applied to any dispute between client and designer. This is a non-binding process that helps the disputing parties reach a mutually acceptable solution, quickly and inexpensively.

Termination. A termination clause defines the actions or inactions of the parties that may lead to one party putting a halt to the project and terminating the contractual agreement. Nonpayment of fees should be listed as a potential cause of termination by the designer.

Be Resolute with Your Contract Demands

Demand written contracts, signed by you and your client, as part of any future project. Likewise, you should insist on written and signed contracts with all of the subconsultants that you bring to the project. Make sure these subconsultant agreements are consistent with the owner contract in terms of flow-down provisions. Spelling out your roles, responsibilities and limited liabilities *in writing* can go a long way to making your firm healthy, wealthy and wise in the year ahead.

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.