Focus on risk management...

Project Evaluation More Important Than Ever

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As the economy dictates what has now become our ‘new normal’ design firms can feel compelled to compete for virtually every opportunity. Firm’s feel they can’t afford to be picky with the projects they pursue and aggressively go after RFPs they may have ignored in a better economy. When the bottom first dropped out of the economy, the largest change we saw were firms taking familiar project types, but in unfamiliar and far-away locales. The influx in RFP’s from out of town firms was unparalleled. As the coffers gradually dried, selection standards eventually dwindled, and once choosy firms were now considering once off-limits project types.

In such an environment, project evaluation can often take a back seat. Design firms are less concerned about project risks. Their number one priority is getting the work. Yet it is in tough times such as these that project evaluation becomes more critical than ever. A design firm that decides to take on a risky or unfamiliar project needs to know the potential perils and how to best mitigate them. When firms say “yes” to a project they’ve typically said “no” to, they should proceed with caution and have their risk management toolkit fully stocked and ready for application.

Let’s look at several factors that must be weighed when evaluating potentially risky projects.

**Type of Project**

Some types of projects are so litigation-prone that only the most qualified—or most desperate—architect or engineer would accept them. Condominiums, for example, have historically been so high-risk that professional liability 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 materials or conditions.

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

This is not to say that design firms should not take on condos, historic restorations or other types of higher-risk projects. They should, however, approach these types of projects cautiously, making sure they have qualified individuals to design them, set their fees to reflect the higher risk and are persistent in negotiating protective contract language. In certain circumstances firms who’ve shown a specialty of a project type (albeit high risk) can be more appealing to an insurance carrier vs. the firm that simply dabbles.
Location of Project
When the economy first went sour in late 2007, and most notably in third quarter 2008, firms quickly reacted by expanding their reach to new territories. Smaller firms were reaching out to Seattle from Portland and vice versa. Mid-size firms were responding to RFPs in Denver, California, and Washington D.C. Design firms of all sizes were now expanding their reach internationally in hopes of new work and revenue streams. At the same time, firms from all over the country were now competitors in our backyard.

When we engage in projects outside of our territory, issues can arise – even domestically. Local laws vary from state-to-state, and project oversight can be significantly diminished if travel limitations prevent us from getting onsite in an afternoon’s notice. Issues can spiral out of control, while you and your staff are thousands of miles away. When an issue does arise, will we be forced to travel hundreds or thousands of miles to resolve a dispute in unfamiliar territory? Who’s our attorney? Does this jurisdiction have a bias towards the local firm/project owner and their impact on their local economy? Does our staff have experience working with the municipalities like they do back home? All questions should be considered even if we’re just responding to an RFP in Boise. Just because we’ve worked on numerous projects like this one, doesn’t mean we should find complacency, and not treat it like our first rodeo.

Internationally, the issues become even more complex. Many countries don’t accept Professional Liability insurance issued in the US at face value. Furthermore, what we consider domestically to be a standard of care and finding of negligence to be legally liable simply isn’t recognized the same way outside of our borders.

So what can we do specific to project locales? To assist on a first party basis, we always have the ability to modify the governing law/venue clauses under contract to more familiar or favorable venues. Always check with your insurance broker and attorney about international projects, and their liability or insurance implications.

Is our Reputation at Risk?
Nearly every design firm we’ve ever worked with finds their reputation to be one of the most important aspects of their business. Often when ten years have passed after completion of a project, most parties involved in the construction have either folded, or closed their doors– except for the A/E firm. We’ve seen retroactive dates of current firms that date back prior to the incorporation of the borough or suburb they reside in.

One of the best stories we can tell about reputation was a mid-size firm who’d been engaged to design a restaurant. The owner had a great reputation, financing, and overall good contract. The project team in place was even better than most. However, the restaurant to be built was a national restaurant chain traditionally comprised of male only patrons who weren’t just dining for the wings and refreshments. The firm, in an effort to distance themselves from having to ‘claim’ the project as one of their own, created a dba (doing business as) to work solely on this particular restaurant project. We found this to be a creative way to retain the work, but keep this particular project out of the marketing brochure going forward.

Even in prosperous times, we should always consider the prospect of living with all our projects (both good and bad) for years to come. Megaprojects, high-rises, and publicly funded buildings all have the opportunity to place firms on the map, but what if there’s a huge claim and our name
is in the newspaper or the five o’clock news? Are we happy to market our involvement in this project? In the event we aren’t, what can we do?

**Project Delivery Method**

More and more projects vary from the traditional design-bid-build delivery method. In addition to the growth in design-build and fast-track projects, project delivery methods incorporating BIM, IPD and other hi-tech techniques are in increasing use. It is important to realize that each alternative project delivery method involves specific skills and risks and requires a different allocation of responsibilities for those risks.

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

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

The “ready, shoot, aim” nature of fast-track projects often involve substantial modifications to plans and thus big change-order expenses. Unsophisticated clients won’t expect change orders and, most likely, will not understand the need to have sufficient contingency reserves set aside in their project budgets.

BIM and IPD projects not only require a unique set of technology skills, they involve shared and often blurred roles and responsibilities. This is no time for on-the-job learning for lead designers.

**Other Parties Involved**

Client selection in of itself is a topic for an entire newsletter. Even the most plain-vanilla type of project can be high risk if the other parties involved in the project are litigious or prone to errors and omissions. A client with a history of litigation against design firms, contractors and others should be a huge red flag when evaluating a project.

Indeed, when budgets are extremely tight and profit margins thin, the client may be the greatest risk factor associated with a project. An underfunded project is a high-risk project. Clients with insufficient capital will look to skimp on quality and will encourage their design firm and contractor to do the same. They may try to save money by eliminating a design firm’s construction-phase services. Should financing begin to dry up, they may 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 you can’t 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.
Likewise, the contractor assigned to a project is a significant risk factor. This is particularly the case when a 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. Are they experienced in this type of project? Do they have a history of litigation? Can we or our attorney check Lexus Nexus, or local public records? Subcontractors and sub-consultants (or the prime if you are a sub-consultant) should be looked at as well.

**Level of Experience and Knowledge**
Take a hard look at the capabilities of your firm when evaluating projects. How much experience do you have with this type of project? Who on your staff has the necessary expertise? 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 have reduced your staff down to the bare bones, will you need additional personnel to take on this new project? Chances are there is a substantial pool of available designers that you can hire or subcontract to. Taking on a project that severely stretches your staff and skill set can be a recipe for disaster. Some of the largest claims examples come from very experienced and full capable PM’s eliciting the ‘sink or swim’ philosophy with the wet behind the ears staff.

**Scope of Services and Fees**
Even when overall project funding seems adequate, be wary of 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” projects that “take-it-or-leave-it” owners may present during hard economic times. 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.

Sometimes, an unsophisticated client with a small project may attempt to issue a purchase order, simple hand-shake, or similar contract form, which is thoroughly inappropriate for engaging a design professional’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 can offset a lot of project sins. You can often negotiate additional contract protection in exchange for a smaller design fee.

**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, considered separately, might be acceptable. But together, these risks could add up to a big liability headache.
Your best course during project evaluation is to strive to identify all of the potential risks of a prospective project and then make a calculated decision based on a combination of factors, including the current economic climate.

Some architects and engineers use a Project Evaluation Checklist to evaluate projects before submitting a proposal or negotiating an agreement. This checklist should cover issues such as:

- Is the project type one that is inherently risky, such as condominiums, amusement rides or renovations?
- Where is the project located?
- Does the project team, including the owner, the prime consultant, sub-consultants and the contractor, have experience with this type of project?
- Does your firm have the necessary skills and staffing for the project? If not, can you acquire it?
- 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 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 by educating your clients, providing more comprehensive services and assisting the owner with a qualification-based selection of a competent contractor. You can also reduce your risk by developing a contract that is fair and precise – and that includes reasonable mutual indemnities and a limitation of liability clause. If the project resides in unfamiliar territory, can we change the governing law or venue clause? And, of course, you can limit your financial 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 owner, who has the most to gain from the project. You may get a fee that (these days) pays your employees and keeps your lights on, whereas the owner gets a beautiful building that lasts for 30-50 years—or longer.

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 so attractive or necessary that you can accept the risk? Remember, if we’ve done our homework and issues do arise, no claim is smaller than the day its first noticed. Get the appropriate parties involved ASAP.

In the end, project evaluation and selection requires a business decision that only you can make. In tough economic times you may feel compelled to accept any and all project offers. Before accepting risky business, however, make sure you are well armed and educated to proceed in the safest way possible.

**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.*

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This article is provided by Risk Management Committee member Morgan West, Kibble & Prentice, a leading broker for the insurance needs of design professionals in the Northwest and specialists in risk management and loss prevention education services.