Risk Avoidance

How can engineering firm leaders reduce their risk and prosper in 2014? Here’s some advice from the pros.

BY DANIELLE BOYKIN
What’s on the horizon for the AEC industry for 2014? The outlook is positive, yet securing the next project while navigating the ins and outs of contracts and risk management will present challenges for almost any design firm leader. Three professional liability and risk management experts shared with PE magazine their take on the current trends and the do’s and don’ts that should be a priority for engineering professionals.

Kevin Collins
Senior Vice President, Victor O. Schinnerer & Co.

Now that the challenges left behind by the Great Recession are fading and revenues and opportunities are increasing, Kevin Collins, who leads Schinnerer’s Architects and Engineers program, sees increased optimism among his AEC clients. However, the environment remains competitive and firms will need to be proactive and innovative. Here is some of Collins’ advice on projects, risk, and talent management that firm leaders should pay close attention to, not only in 2014, but over the long term.

1. Focus on improving technology to meet internal and client needs
Focusing on improving and upgrading technology will go beyond internal business success for AEC firms. Every dollar invested will count toward a client’s benefit as well. Clients want more efficient projects, and technology will need to be used to meet these expectations. If firms are focused only on technology for internal benefit, they are going to miss out on additional opportunities with owners who are looking to improve project management efficiencies. Five years ago—even three years ago—a smaller percentage of owners were concerned about this. In 2014, you’re going to start to see this as a baseline expectation of owners. Firms are going to have to rise to this occasion, if they aren’t already there.

2. Implement enterprise risk management models
Owners have been using enterprise risk management models for years, and they are looking for partners to do the same. It’s not just about providing great service anymore. Firms need to identify and manage all aspects of potential business risk. It’s also about how a business can sustain profitability and staff over the long term. Whether it’s better practice management, quality control, or contract negotiations—firm leaders need to look more critically at these sides of their business and ask: Do we have some weaknesses and how can we improve on them?

3. Don’t get pushed out—stay a relevant and valuable project partner
Whether it’s caused by the use of technology or the delivery system chosen by the owner, the engineer is at risk of being relegated to a subconsultant role. This is not a new issue, but the new twist is the growing number of owners looking for alternative delivery systems or sole responsibility design-build type contracts. The design firm has to make clear its role through the contractual relationship. A firm may want to partner with a contractor on projects where the firm is responsible for design and the contractor is responsible for construction as a joint venture to remain at play in these projects. If firm leaders don’t want to be in that type of partnership, use technology or internal business efficiencies to be more valuable to the team and remain a key player.

4. Beware of a changing client on public government and infrastructure projects
We are finding discouraging trends for firms that provide services to government entities. You have the elimination of the state- and local-level engineer on the client-owner side and they are being replaced by a nonprofessional engineering employee who is more sensitive to the political climate. This is greatly influencing the relationships between design firms and the public owner. We are starting to see increases in claim frequency and severity on public projects. This bears some watching today and into the future. The mentality of the AEC community is that there’s more of a long-term relationship, and a small problem on a project tends to get worked out and doesn’t result in a claim. We aren’t seeing that as much anymore. On public projects, there has been a change in mentality at the owner level. Firms need to treat the public sector just like the private sector.

5. Focus on retaining skilled talent and closing experience gaps
During economic recessions, you have a void that can grow between highly experienced staff and younger staff, such as EITs and recent graduates. An experience gap at all levels will become more evident as there’s a need for more staff members with 10–15 years of experience to step into leadership roles and mentor less experienced staff. Firms that can effectively address this issue are going to have people who can manage and build relationships with owners over time. Whether it’s retaining projects for existing clients or acquiring new ones, that generation of leadership sometimes leads to that same generation within the owner’s business. If firms do not address this issue, you’ll have very senior staff members who are likely the rainmakers, yet they aren’t matching up well with the owner representatives involved on these projects. You’ll also have staff with less experience that don’t have the negotiation skills to bring in new business.

6. Engaging a new generation of engineering professionals
Members of the millennial generation have an increasing ability to ignore the hierarchy within firms because of technology and a mindset that stresses more immediate innovation, success, and involvement. They are more entrepreneurial and don’t want to wait around for their turns to run the firms or go through a long process to make partner. Firm leaders need to look at themselves,
determine the type of firm they want to be, and determine if they are missing opportunities for recruiting new professionals. The old mainstay of an engineer starting work as an EIT, becoming a PE, and moving up the ranks within 10 to 20 years doesn’t work in today’s new environment. Firms need to find new and diverse ways to recruit and retain young talent. The firms that are finding more success are ones that recognize what’s driving this generation of professionals.

Avoiding the Traps—Contract Do’s and Don’ts
Professional engineers serving as design consultants can never be too careful when negotiating contracts and assessing their risks and potential professional liability. Even having many years of experience in the industry doesn’t always prepare someone for the tricky things that can show up in a contract. When offering their contract review services, Gary Prather, P.E., and Katherine Dimit regularly see the liability traps that design professionals can fall into. Here are their top contract do’s and don’ts for reducing risks, avoiding conflicts, and ensuring fairness.

Gary Prather, P.E.
Principal, Architects/
Engineers Dispute Resolution Group

1. Never Enough Time and Never Enough Money
Consulting engineers often enter into contracts where the client’s budget and timelines are unrealistic. Engineers should always evaluate the client’s program and explore the reasoning that went into establishing design fees, construction budgets, and the overall project schedule.

2. Indemnity Confusion and the Duty to Defend
Contract indemnity provisions continue to be one of the most problematic issues facing engineers when negotiating professional service agreements. Many of the problems can be attributed to the confusion created by the differences in general and professional liability insurance. Client contracts frequently include indemnity provisions that require an affirmative defense while limiting the engineer’s indemnify obligations to bodily injury and property damage. These all relate to general liability insurance coverage. In contrast, professional liability insurance provides much broader coverage but does not provide an affirmative defense to indemnified parties. Additionally, most general liability insurance policies exclude professional services.

3. Risk Shifting
Be aware that owners choose design-build to limit their liability by shifting significant design risk to the design-builder. Two of these methods are betterments and nonnegligent errors/omissions. The legal theory of betterments is based on the principle of unjust enrichment. The project owner using design-bid-build would typically be expected, as an example, to pay for an additional concrete catch basin or VAV box due to a design error or omission. In design-build, however, the owner is unlikely to willingly pay for either, in as much as the owner contracted for a functional and complete project. Similarly, the risk of errors and omissions that do not fall below the standard of care must be allocated between the design professional and the design-build contractor. Design-builders can also present design professionals with construction subcontract forms. Unfortunately, these subcontract forms do not address professional services and include uninsurable warranty and perfection standards that are not covered by professional liability insurance.

4. Trickle-Down Disconnects
Contract provisions that incorporate the requirements of the prime design or design-build contract on engineers are all too often accepted as normal contracting. Many times the prime contract is never provided to the engineer, or the engineer simply does not request a copy to review. These “trickle-down” contract provisions need to be addressed head-on to avoid assuming uninsurable contract risks.

5. Impossible Performance
Client contracts are chronic offenders of the design professional’s standard of care. Sprinkled with words and phrases that raise the standard of care, client contracts can make the design professional liable for any and all design errors or omissions. Examples of impossible and uninsurable contract language include:
- Highest quality
- Free of defects
- Error free
- Design will be in strict conformance
- All*

*Agreeing that services will be in conformance with all applicable laws, codes, and ordinances constitutes a legal opinion that professionals are not qualified to offer. It is unreasonable for professionals to be familiar with “all” laws that might govern a project. Additionally, projects are often governed by the laws of many jurisdictions, some of which may be in conflict.

Katherine Dimit
Vice President, Architects & Professional Liability at Hanover Insurance Co.

1. Trickle-Down Clauses
These clauses are generally contained in a contract between the prime design professional in their prime contract with the project owner, requiring the prime to require all subconsultants or subcontractors to be held to the same contractual obligations as contained in the prime contract. Engineers must always delete and avoid such clauses. Often, engineers are hired as subconsultants to the prime design professional or contractor. Even though the engineer may have a separate contract with the prime—with fair and insurable indemnity,
standard of care, and scope of services—the contract may vaguely reference the prime’s contract with the project owner as superseding all terms of the subcontract.

Even more challenging is obtaining a copy of the prime agreement, which may contain proprietary financial information that the engineer’s client may not wish to share. In essence, the engineer is being asked to be contractually responsible for terms to which they are not privy and may be inappropriate or uninsurable. For example, the engineer will contract for a very incidental service on a large infrastructure project for a small fee and inadvertently become liable for actions beyond their normal responsibility because of a trickle-down clause.

2. Indemnity Clauses
The only purpose of an indemnity clause is to contractually transfer risk from one party to another. Therefore, indemnity clauses should be avoided. Instead, rely on well-written standard of care and scope of services clauses.

Professional liability insurance policies provide only contractual liability coverage to the extent that the liability would have been attached anyhow, absent the contract. So, engineers who enter into overly broad indemnity agreements run the risk of self-insuring those exposures as well as assuming liability not otherwise required by law. Win-win contracts are better than uninsurable and possibly unenforceable contracts.

The most common uninsurable indemnity provisions include:
- **A duty to defend** the engineer’s client: Unlike a general liability policy, a professional liability policy provides an affirmative defense only for the named insured. A good alternative is to agree to reimburse reasonable legal expenses to the extent of engineer’s negligence in the performance of professional services after a determination of fault.
- Assumption of liability for an **indemnified parties’ own negligence** or wrongful acts: This is uninsurable, not legally required, and needs to be avoided.
- **Third-party over indemnity** makes the engineer liable for the bodily injury of their own employees beyond the amounts covered by workers’ compensation insurance. A typical clause reads, “engineer shall indemnify ... the owner from ... all claims arising out of any injury or death to any person, including engineer’s employees, agents and contractors.” Delete any contractual reference to indemnifying the client for injuries to engineer’s own employees.

3. Insurance Requirement Clauses
In addition to meeting generally accepted insurance requirements from their client, engineers should always require to be named as an additional insured under the contractor’s general liability policy. This is a good risk management technique and helps protect the engineer against having to defend unwarranted claims, including third-party personal injury and property damage claims arising out of construction. A typical clause reads similar to “the contractor shall cause the commercial liability coverage to include the owner, the architect, the engineer, and their consultants as additional insureds for claims caused in whole or in part by the contractor’s negligent acts or omissions during the contractor’s operations.”

4. Limited or No Construction Phase Services
Due to budget constraints or goals, clients often do not want to pay the engineer for construction-phase services. In those instances, the engineer should:
- Educate the client on the importance of construction-phase services;
- Include contract language addressing client’s decision;
- Negotiate an indemnity provision relating to design changes during construction; and
- Document the client’s decision in writing.

Construction-phase services are an important element of any design contract involving construction. Design documents cannot be effectively implemented in a vacuum. Construction requires a constant exchange of information and decisions that can be accomplished only when the design team is an active participant in the process. There is nothing more important to this process than making sure that site visits are developed with input from all stakeholders.

5. Job Site Safety
The roles of each party in a construction project need to be clear. The contractor has responsibility for all work-site safety. We recommend that architects and engineers should:
- Avoid supervising the work;
- Avoid control over contractor’s means, methods, and safety; and
- Avoid review/approval of contractor’s safety program.

There are clients who are not experts at design or construction, such as developers or manufacturers, and try to treat design professionals like contractors. You’ll see no difference in the contract wording, some of which will even refer to the design professional as a contractor or vendor. If the contract language refers to you as a contractor or a vendor when, in fact, you’re a PE, this should raise a red flag: This probably is not an appropriate contract for you.

6. Scope of Services
Contracts with very vague scopes of services can lead to claims in which it may be difficult to even define what you’re responsible for. Instead of leaving it open ended, be very detailed in your scope of services in case something happens. These tips can help:
- Develop the scope of services with your client;
- Be specific and detailed;
- Involve project managers;
- Avoid words like “all,” “comprehensive,” “thorough,” and “complete”; and
- List exclusions or excluded services.