

PRO-FORM INSURANCE SERVICES

15 Allstate Parkway, Suite 220
Markham ON L3R 5B4
Tel: (905) 305-1054 Fax: (905) 305-1093
www.proforminsurance.ca



A Prudent Approach to Project Selection

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Assessing Project Risk

An architectural firm in a small Midwest town was celebrating a new project. It was a condo conversion involving a historic hotel. Sure, the client had a history of being litigious, but he was so nice and so enthused with the innovative design. That enthusiasm was pretty remarkable, considering the architectural firm had never done a condo conversion or historic restoration before.

The project budget was rather tight, but there were plenty of short-cuts the architect could take to save on expenses. Plus, the contractor was selected on a low-bid basis, so money was being saved there as well. It's a fast-track project and the scope of services is limited, so the architect won't have a lot of long-term overhead expenses either.

It sounded like a quick, slam-dunk project with high visibility in the community. The firm's principal thought it might be the perfect project to get this new architectural firm on the map. Right? Wrong!

Obviously the above scenario is far from ideal. Still, in the real world, it isn't always easy to pick and choose among potential projects. Sometimes, any project can look good. Yet careful project selection is essential because accepting the wrong project almost guarantees professional liability claims.

Let's look at several factors that must be weighed when selecting projects.

Type of Project

Some types of projects are so litigation-prone that only the most qualified – or most foolhardy -- architect or engineer would accept them. Condominiums, for example, are so high-risk that most 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 conditions.

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

This is not to say that no design firm should take on condos, historic restorations or other types of higher-risk projects. Design firms, however, should approach these types of projects cautiously, make sure they are qualified to do them, set their fees to reflect the higher risk and insist on protective contract language.

Project Delivery Method

These days, more and more projects vary from the traditional design-bid-build delivery method. It is important to realize that each alternative delivery project involves specific risks and requires a different allocation of responsibilities for those risks.

For example, 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 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.

Project delivery methods also include fast-track projects. These “ready, shoot, aim” 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.

Other Parties Involved

Even the most plain-vanilla, mundane type of project can be high risk if the other parties involved in the project are litigious or prone to errors and omissions. Indeed, the client may be the greatest risk factor associated with a project. A client with a history of litigation against design firms, contractors and others should be a huge red flag when considering a project. So is a client who does not recognize the value of a design firm’s construction-phase services.

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. Subcontractors and subconsultants (or the prime if you are a subconsultant) should be scrutinized as well.

Level of Experience and Knowledge

Take a hard look at the capabilities of your own firm when selecting 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 will need additional personnel to take on a new project, are those professionals available? Taking on a project that stretches your available staff and skills can be a recipe for trouble.

Project Funding

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 even 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.

Scope of Services and Fees

Even when overall project funding seems adequate, avoid 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" project. 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 may attempt to issue a purchase order 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 could be a make-or-break negotiating point.

A Project Selection 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.

Take for example, a well-financed client who wants to build an apartment complex as a speculative project and then sell it to the highest bidder. You might be able to negotiate a solid contract. But can you protect yourself from the subsequent purchaser of the complex? What could you do to mitigate risks if the apartment complex sells and goes condo in a few years and the complex suddenly has 300 new owners?

Your best course during project selection is to strive to identify all of the potential risks on a prospective project and then make a calculated decision based on a combination of factors. Some architects and engineers use a Project Evaluation Checklist to evaluate projects *before* submitting a proposal or negotiating an agreement. This can save a lot of time and money spent chasing projects you really shouldn't accept.

A Project Evaluation Checklist should cover issues such as:

- Is the project type one that is inherently risky, such as condominiums, amusement rides or renovations?
- Does the project team, including the owner, the prime consultant, subconsultants and the contractor, have experience with this type of project?
- 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 insisting on qualification-based selection of a competent contractor. You can also reduce your risk by developing a contract that is fair and precise, that accurately defines the intent of both parties -- and that includes reasonable indemnities and a limitation of liability clause. And, of course, you can limit your 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. If the owner refuses to shoulder his or her share of the risk, you should probably decline the project.

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 that you can afford to accept the risk? Making that determination may be the toughest decision you make on the project.

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.