Talk to Me About A&E: Episode 1 — Critical basics on contracts

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DOUG PALANDECH: The best advice I can give is make sure that your scope of service is very clearly defined. You're going to have trouble negotiating terms and conditions. But at least get your scope of service clearly defined so that you get the best possible resolution in at least establishing scope. That's the best advice I can give.

ANNOUNCER: Welcome to Talk to Me About A&E, a podcast series focused on risk management for architects and engineers. Host, Dan Buelow, Managing Director of Willis A&E, will engage experts across the A&E spectrum on topics ranging from contract details to the broadest trends impacting design professionals in North America.

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DAN BUELOW: Well, hello, and welcome to our Willis A&E podcast series, Talk to Me About A&E, where we invite special guests to share their thoughts and insights on what design professional firms can do to manage their risk. We try to keep these programs to about 20 minutes in length on a specific topic or issue. I'm Dan Buelow, Managing Director of Willis' Architects and Engineers division. We are especially a division of Willis Towers Watson that is exclusively dedicated to providing insurance and risk management solutions to design professionals.

My special guest today is Mr. Doug Palandech, an old friend and an attorney from the law firm Foran Glennon in Chicago. Doug has considerable experience in defending architects and engineers in professional liability disputes and contract law. Hello, Doug.

DOUG PALANDECH: Dan, good morning. Good to be a guest today. Thank you.

DAN BUELOW: It's great to have you on our first podcast here. And our topic is on contracts, and this topic is so important to architects and engineers that we will, in fact, have three separate podcasts. And we're going to begin with this podcast on what we're titling as The Critical Basics. So let's talk about these critical basics when it comes to contracts. Most claims against design firms are, in fact, not rooted in technical error. Design firms certainly make their share of mistakes and are not perfect. And claims rooted in actual design error is on the rise when staffing is a significant problem in the industry.

However, most claims against design firms are, in fact, rooted in non-technical errors. And the top four non-technical errors based on a significant study conducted by DPIC many years ago and, again, in a recent survey that Willis A&E did from 12 leading A&E carriers. They've listed these four non-technical areas of concern, number one being negotiation of contracts. Number two, client selection. Number three, project team capabilities. And four, communication and documentation.

We'll talk about all of these. But we're going to focus on contracts today, as I noted. And Doug, do you agree with this? Do you agree that most claims are rooted in non-technical contributors and that contract negotiations should be at the top of this list?

DOUG PALANDECH: I do, Dan. And let me explain that you're correct. There are instances where there's technical glitches. Those cases are actually rare. More and more, the cases we have deal with expectation-- what the parties thought the deal was, what the scope of service was. Was there a clear

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expression of risk? Was there a clear expression of reward? So yes, most of our claims are generated because of misunderstanding or failure to communicate what the service and what the deliverable was going to be.

DAN BUELOW: And so using that contract then makes a lot of sense, does it not? As a vehicle to establish that expectation. It might be your very best opportunity because you're with a prospective client. And if they're unreasonable at this stage of your relationship, what can you expect down the road?

DOUG PALANDECH: This is mission-critical. In terms of criticality of the engagement, the contract comes first. And typically, we don't want the formation issue to be adversarial. This is a situation where the owner and the design professional should achieve consensus. And again, I think your point's well taken. If you're getting pushed around during formation, that's not good. That's a precursor to problems that are going to come up during performance.

DAN BUELOW: Yeah, and I always say, too, that I would much rather have my clients have a lot of back and forth on a specific contract and project opportunity with a prospective client where they can have a meeting of the minds, and they may not get everything they want in their agreement. I would rather have them go through that process than sign some so-called perfect association agreement with no dialogue. Would you agree with that?

DOUG PALANDECH: We do. And one of the things that your audience should know is that I know formation may be alien, like, well, why are we spending all this time with this? Courts will invariably look at the agreement and enforce it. Now, again, if it's one-sided, if it's pernicious, if it's unbalanced, they don't care if it's fair. They don't care. The courts are going to enforce what's written.

And you're exactly correct. Back and forth is perfectly acceptable. And you're also messaging to the owner that this is important to me. I want this to be fair to me and to you. Again, contract formation should actually be conceptual, but hold your ground. Make sure that the terms and conditions that you need are, in fact, in that agreement because the courts are going to enforce it. They will enforce it. And again, it is not an issue of whether it's a fair deal, or can the court make a better deal? They're not going to do that. They will enforce the written word.

DAN BUELOW: And you also have the problem, the challenge that our design firms run into when you're dealing with certain client types-- for example, public agreements. As you know, we have a seminar that you've helped us with over the years on for our Halloween special, where we modeled that after some of the worst clauses that we've come across, which happened to be in the city of Chicago's agreements, and which is not unusual with a lot of these public agreements that they're often chock full of uninsurable clauses and a real unwillingness to negotiate. What's your advice when you're thinking about, as a design firm, where you're approaching these different client types and if you do get a contract where it's-- and we'll talk more about deal breakers/makers later on. But what's your advice when you run into those different client types?

DOUG PALANDECH: Well, Dan, the contract of adhesion is the one that, of course, you can do so little with, where the owner has all the economic leverage and says, if you're going to work for me, you're going to be doing it on my form. And you're right. Government bodies are not critical. They're not looking for anything in terms of equity. They're not looking for partnership.

They're looking at the design professional as a vendor, which is not necessarily a healthy start. The best advice I can give is make sure that your scope of service is very clearly defined. You're going to have

trouble negotiating terms and conditions. But at least get your scope of service clearly defined so that you get the best possible resolution in at least establishing scope. That's the best advice I can give.

DAN BUELOW: That's great. And I want to drill down a little bit on scope here. But before we do, I want to talk about standard of care. We really can't have a conversation about managing contractual risk, can we, without a discussion on the standard of care. And the standard of care and the coverage under your professional liability insurance are closely aligned. And a design firm must really understand that.

A design firm's professional liability exposures is, by far, their greatest risk. And the good news is that a properly drafted architects and engineers professional liability policy should cover a design firm for essentially everything they do as a design professional. The challenge, however, is that you can take yourself over and above that standard of care by your actions and, certainly, as we're trying to address today, by contract. And so, Doug, talk to me a little bit about the standard of care and the relevance from a contractual standpoint.

DOUG PALANDECH: In terms of contract, it's fundamental, Dan, the concept of, what are you providing? You're providing that degree of care and skill, normally exercised by the discipline. So what is it not? Let's talk about the negative. It's not perfection. Strange as this may sound, there is studies that have been done were a good quotient of owners are thinking, I'm going to get something perfect, which is an impossibility unless you have an abundance of time and an abundance of money.

So there have been a number of studies done-- some very, very good by McGraw Hill, some by the Construction Industry Institute-- which talk about expectation. What are you going to really get for a project of this type, this delivery system, this complexity? What should the owner be getting? Sometimes, the industry says, 2% to 3% E&O. Sometimes, the industry says, 5% E&O. Sometimes, the industry says 10% E&O. But think about it. Isn't that a vital conversation to have with your owner going in? We are now doing this project, and I have to tell you that coming in, you, Mr. Owner, ought to establish this kind of contingency or have this kind of understanding for what the anticipated rate of E&O is.

What people will do-- and I think you hinted at it-- can you contract for something beyond that degree of care and skill normally exercised? Absolutely, you can do it. And we have seen contracts-- and they're terrible-- where they say, you will perform to the highest standards of the profession. You will do something extraordinary. What will the court do? Bad deal. I'm enforcing it.

You've also taken yourself out of coverage because you never got insured for doing the greatest job of all time. What you've said is that you will perform according to what the insurance policy says-- that degree of care and skill normally exercised. You may well have taken yourself out of coverage.

DAN BUELOW: That's a great point. You touched on highest, and we get into these red-flag words. Well, let's begin with that. You touched on highest. Hey, I'm an owner. I'm looking for the best. I'm looking for-- you've got a great reputation. What's wrong with me expecting that I want the highest degree of professional service from you? What's the pushback that I should be getting from a design professional on that?

DOUG PALANDECH: The pushback is, indeed, you are coming to me because I am excellent. But I'm not going to be contracting for something outside of my industry standard. I can't. The logical answer is, if you have me adhere to this request, you've taken me out of coverage. And that, Mr. Owner, is your best protection in the event I do fail you.

DAN BUELOW: And it does often come down to a battle of experts, doesn't it? Where you can-- someone's going to pay somebody to say, well, they did an OK job, but they weren't the highest.
DOUG PALANDECH: Exactly. If we're talking the highest, and I'm the judge, what are we talking about? 95 percentile? 99 percentile? An expert comes in and says, they did some really good things, but it's not the highest. It's not the best. It's not extraordinary. Now, all of a sudden, there's legal liability.
DAN BUELOW: So some other red-flag words-- let's throw some of these out. Warranty, guarantee, inspect, maximize, sufficient, any and all, again, to the client's satisfaction, and so on. These are all red-flag words, is it not? Because these are all bordering on over and above the standard of care. Back to your earlier point, you're not held to a standard of perfection.
DOUG PALANDECH: You're correct. That language is normally associated with the contractors. Warranty work is always something that the contractor will do. It's part of the consideration. It's part of the contract. This is not that deal. We're not we're not in the business of guaranteeing or warrantying. We're in the business of providing the service in accordance with standard of care. Again, warranties, guarantees are outside of insurance. That's liability without fault.
Remember, the design professional liability is premised on fault-- failure to adhere to the standard of care. Warranty and guarantee are terms that have nothing to do with fault. It is that the product itself did not meet the owner expectation. Again, what have you done? You've taken it outside of insurance. Are owners evil? No, they're not evil. Do they understand what they're doing? Do they understand the import of one warranty and guarantee is introduced into the contract? Then no, they don't. It's your mission, Mr. Design Professional, to say, again, you're hurting yourself, Mr. Owner. You're taking us outside of coverage.
DAN BUELOW: Yeah, and I think it's really important, I mean, along those lines is for everyone in the firm to understand these basics. And I always think about that design firms often miss a very important opportunity in managing risk when they work to negotiate a contract, and they usually have somebody in the firm that understands contracts, and they and they come to an agreement.
And then they put that agreement in the drawer. And then they send everybody out on the job site to go manage the project. How can they effectively manage scope creep if they don't understand at least what's in the scope of that contract? So I always say, let's have a dramatic reading of every contract for every project, I think, is a great idea. And I think it's something that's often overlooked.
DOUG PALANDECH: That'll be overlooked, and you're correct. In terms of firm graduation, isn't it a nice teaching tool to take your lower-level people and give this introduction? Because now, they're, if you will, being inculcated. They're being indoctrinated into contract formation. That is a value, and that is a skill set that is going to be utilized their entire professional life. So I agree with you. Take your team and say, guys, we just now entered into a deal. Let's go over this. Let's understand our risk. What's our reward? What's our scope? What are we providing? How are we communicating?
DAN BUELOW: Yeah, and, again, it's so important because not only are you worried and should be concerned about your contracts, but also all documentation that goes into that all of your staff may have some involvement with-- emails, field notes, and so on. And so these words are important, are they not? And so when we talk about-- and I think these red-flag words, I would really encourage design professionals and their staff to understand what these are. These are these warranty, guarantee, absolute words. And they don't belong in any of your correspondence. And you have to find some other words for those, don't you? So applicable, opinion, probable, endeavor to.

DOUG PALANDECH: Correct. What we're trying to do is make sure the risk-reward is in balance. And your point is well-taken. All the red-flag words that you've identified modify the risk reward. They now make the risk greater than the reward. And you're soon out of business because you've taken on risk that was never meant to be assumed.

DAN BUELOW: And I'm going to read you a very short clause that was an owner-drafted agreement that one of our clients unfortunately signed, and there was a very bad claim around this. And here-- and I'm quoting this now, "architect warrants that it shall provide its services in accordance with the highest degree of skill and care, and that the contract documents shall fully comply with all laws and building codes." And we talked about the first couple-- warrants and highest. But here you are. You're going to meet fully comply with all laws and building codes. That's a stretch, is it not?

DOUG PALANDECH: It's ridiculous. And what you've done is you've put a noose around your neck. This is a impossible to even defend. If I'm the court and I'm looking at this, becomes an easy case. I mean, this is a case of liability that's almost confessed if anything goes wrong. And on that last point, let me just give you a little highlight. What really goes on with the enforcement of codes and regulations is always third-party adjudicated. So are you now at the mercy of a city official who is a different code interpretation than you? Yeah, that's what you've done. You've now put yourself at the mercy of a third party.

DAN BUELOW: OK, so let's go back to that topic on scope here. And certainly, unclear, undefined, or inappropriate scope is an issue, is it not? And you mentioned it earlier is that, here, you have an owner drafted, and it's an agreement where we are getting a lot of pushback or even maybe, because it's a public entity, unable to really have reasonable negotiations. You mentioned earlier about focusing in on scope. Talk a little more about the issue of scope and how important that is.

DOUG PALANDECH: You bet. And again, what is in scope and what is not in scope becomes very, very important. We have won many a case because of an alleged duty that was after the fact being asserted that was never part of the formation. So the clarity of the expression-- so the design professional tells the owner, these are our services. These are our deliverables. These are the time frames in which we are going to do those deliverables. And in the event that there's something you want that's outside of scope, that's fine too. We can agree to an amendment.

But again, establishing what your service is going to be is vital to a later issue regarding-- oh, how about this phrase-- and any other service that may be necessary. OK, well, what does that mean? Have you opened up Pandora's box? What have you agreed to? So again, telling people what you're going to do and also negating what you're not going to do, as I said to you, many, many a case has been won in workplace accident because the design professional never assumed a responsibility for contractor means and methods or project safety.

DAN BUELOW: Actually, one of our podcasts that we're going to schedule here is on this whole area of scope creep, managing scope creep. And that's really important too when you're thinking about contracts is that you don't just stick it in a drawer then because scope will invariably creep on a project. You know, let's slap a gymnasium on this. Well, if you don't amend that agreement, you maybe find yourself in a situation where you've likely won't get paid in full. But also, are you not taking on additional risk there?

DOUG PALANDECH: Strange as it may sound, Dan, I want to talk just anecdotally about where we see it with longstanding business partners so that when you have a longstanding business partner, the owner says, oh, by the way, Bill, do you think you-- oh, yeah, Tom, not a problem. OK? No documentation. No understanding. No contract amendment. And exactly as you said, are you going to get paid for it? Or is

some aspect that needs to be the subject of separate negotiation and change order? We don't know because of the informality.

DAN BUELOW: So getting this in writing is very important, obviously.

DOUG PALANDECH: Critical, critical on scope creep-- critical. And I know it's difficult. You have to document. You have to call up and say, Tom, I'm going to send you an email now and just want to lay out what we're going to do as part of our add service.

DAN BUELOW: So there seems to be a lot of over lawyering, you know. And it doesn't seem to be getting any better. We're seeing these indemnity clauses and these contracts getting-- it's just becoming incredibly unreasonable. Why would an owner want to have an unfair and even uninsurable agreement? From my perspective, I don't know-- and I think that sometimes, it's an attorney that's working for them that comes from maybe construction law and doesn't understand professional liability or, certainly, the standard care of a design professional. But I also think there's others out there that know exactly what they're doing.

But from an owner standpoint, when I'm going to rely on an insurance policy as probably the only asset I can look to in the event that there's an error/omission, most design firms don't have really any assets to speak of. And there's no bond or anything. I'm relying on that professional liability policy. Why would I risk voiding that policy with bad contract language?

DOUG PALANDECH: One of the saddest things about our profession-- I'm speaking against my self-interest-- is that it is adversarial. It's always understood to be adversarial. It deals with the vigorous representation of a client. That is not the mindset that sits around formation, that you don't win a contract. it's not win-loss situation. What you're trying to do is make this fair and make it equitable. Do people come into-- from the owner side, do they necessarily have a good understanding of design professional liability? Typically not.

We see too many contracts being written by lawyers who might be general counsel, who may be litigators who don't really understand the risk-reward dynamic. So what we've been able to do-- and, again, not to brag-- but actually have that dialogue. You are now hurting yourself. Do you understand? And we want to hit your expectation. We want you to hit our expectation. So let's make this consensual. Let's not make this adversarial.

You know, it's funny we have this conversation. There's a few areas of law where you should get along famously with your opponent. This is one of them. Lets sit down and hammer something fair.

DAN BUELOW: Yeah, it certainly makes sense. And it seems that what happens is that there's an attempt, it seems, to establish contractual liability versus professional liability. And the problem that you have to remember as a design professional that, in every design professional insurance policy, there is an exclusion for contractual liability that if you assume that liability over and above the standard of care, essentially, which, in the absence of that contract, you would not be liable for, you're in an uninsurable position. And that's in every one of these contracts.

That's why it's so important to really understand these contracts, learn how to negotiate, get your staff involved. I always say, you want to have a good attorney lined up to be able to go through any unfamiliar language. It's so important here as we go through this. So I want to recap here just where we're at, Doug, I think, again, for keeping this very specific around this on the basics here. When I say, recap of the critical basics, some of the things that we talked about is, how important it is to manage these expectations using that contract as a vehicle to do that?

Don't take yourself over and above the standard of care, understanding those red-flag words, educate your staff on the importance and so that they're conversant on the standard of care as well as these red-flag words, and learn how to negotiate. And we're going to be talking about these specific clauses in our next podcast and how to think about and negotiate some specific clauses. But what would you say to sum this up here as far as recapping the critical basics of contract negotiation for a design professional, Doug?

DOUG PALANDECH: Well, the most important thing, I would say, is educating your owner and to always use contract formation as a time to express, first of all, your interest and your vitality and the project. But the fact that during this phase, you are going to be treated fairly, and you're going to be respected. And that will be established during the negotiation and during formation. Don't sign something blindly. Don't do that. The clause you gave us, Dan, was case history of literally committing suicide on a project. So again, use contract formation as a way to establish your legitimacy and your partnership.

DAN BUELOW: All right, well, that concludes this podcast, Talk To Me About A&E. Be sure to listen to part two of our podcast discussion, which we'll be bringing Doug back on contracts in which we'll discuss these deal makers and deal breakers with some specific clauses that every firm needs to understand in order to effectively negotiate and mitigate their risk. I want to thank our special guest, Mr. Doug Palandech for sharing his time and wisdom with us. Doug, thanks.

DOUG PALANDECH: My pleasure, Dan. Thank you for having me.

DAN BUELOW: Thank you.

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