

Talk to Me About A&E: Episode 20

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Sue Yoakum: We know from our experience on projects that there's going to be issues that arise during construction, that arise from design coordination. And we have found in our history and most firms have some kind of history to talk about, that you need a design contingency as well as a construction contingency.

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SPEAKER: 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 Talk to Me About A&E. I'm Dan Buelow, managing director of Willis A&E, and our topic today is on managing design contingencies. We've touched on this topic of contingencies in past Willis A&E podcasts and education programs. But today, we will be taking a deeper dive into this important subject. In past programs, we've discussed the importance of managing client expectations, noting that most claims against design professionals are, in fact, rooted in expectations not being met. We've asserted that it's the responsibility of the design professional to educate their clients and to clarify each party's respective roles and responsibilities and to review the standard of care of the design professional, which is not perfection.

We've discussed the importance of design professionals using the contract as a critical vehicle to establish expectations with their prospective clients and to actively manage these expectations with sound documentation processes throughout the life of the project. And we've discussed the importance of owners having a contingency fund. And you really can't negotiate a contingency fund without having a discussion about the standard of care of the design professional.

And because there is no such thing as a perfect set of drawings, we can reasonably assume that there will be some reasonable level of errors or omissions on every project, and there needs to be a proper budget and contingencies in place for this. We know that more often than not, if the design professional has not educated their prospective client as to their standard of care and if expectations have not been clearly established and if the project is not properly funded for unforeseen contingencies, then the likelihood of a costly claim against a design professional is greatly increased.

But how exactly should this issue of contingencies be addressed and negotiated? And how exactly would these contingencies be applied? Well, to help us with these questions and more, we have a very special guest, Sue Yoakum from the law firm Yoakum Law. Hello, Sue.

SUE YOAKUM: Hi, Dan. And thank you for letting me participate in this discussion that I think is really important for all our architects and engineers to understand and apply.

DAN BUELOW: Well, many of you know Sue. Sue is an attorney with Yoakum Law, LLC, which provides legal services for architects and engineers. Sue focuses her practice assisting design professionals by providing claims and risk management assistance, contract reviews, and other related legal services.

Sue frequently presents risk management seminars and has spoken at several national conferences and has authored numerous risk management articles and books, including Megaprojects-- Challenges and Recommended Practices published by ACEC and a chapter in the AIA's 15th edition of The Architect's Handbook of Professional Practice. Prior to pursuing her legal career, Sue practiced architecture for a decade with a focus on projects, on sport projects. I've had the pleasure of knowing Sue for many years. And as outlined in the bio I just reviewed, Sue has incredible experience as a legal expert and advocate for the design community.

Sue has been on my short list of special guests for this podcast series. And when I asked Sue what topics she might want to address, she was quick to recommend this topic of design contingency. So, Sue, that's a great first question for you. Why is the topic of design contingencies so important? And can you explain the distinction between a design versus a construction contingency?

SUE YOAKUM: Yeah, this was a topic that when you ask, it was the first-- I mean, it took me like, what, 30 seconds to get you a topic back. I think a design contingency is so important to manage what we call non-negligent errors and omissions. In your introduction, you did a nice job of explaining that architects and engineers are not held to perfection, which means they get to have the standard of care.

The law requires architects and engineers to have errors and omissions in their documents. That is a very hard concept for many owners, design builders, and sometimes architects and engineers to understand. So, when there is a claim on a project, as you know, Dan, we're fighting to see whether a breach of the standard of care has occurred. Because we don't have to do perfection.

So many times, an owner will say, well, tell me where that line is. When do I cross from non-negligent errors and omissions not a breach of the standard of care over the line to legal liability? A design contingency doesn't define the line. It helps set the expectation that as design professionals, architects and engineers, our drawings and specifications will not be perfect.

DAN BUELOW: So what is the difference? We'll hear when we see contingencies, sometimes we'll hear about a contract or contingency or construction contingency versus a design contingency. Is there a difference between design and construction contingencies?

SUE YOAKUM: There is. On every project, the contractor, the trade contractors, in their bids, they typically have a contingency. We may or may not know about it as an owner or a design professional, but they have a contingency built in. Even design build projects have contingency built in.

So the build side of the table is pretty good at building and contingencies. They have their construction contingencies. I'm talking about a contingency to the design side of the table, which is different and is in addition to a construction contingency. Because, again, because architects and engineers do not get to draw product specific in their drawings and specification, coordination when the trade contractors show up with the exact product that goes in has to occur.

And sometimes an owner, a contractor will think that there's an error and omission on the design side of the table, asking the architect or engineer to pay money when we need to really talk about, OK, is it a breach of the standard of care? Is it negligent performance? Or is this just the non-negligent errors and omissions that every project, every owner, every design builder should anticipate from architects and engineers?

DAN BUELOW: I mentioned the importance of establishing and managing expectations as a conversation around the standard of care and so on. Could you expand on that a little bit specifically to this, how design contingency can assist the design professional to reduce or mitigate claims?

SUE YOAKUM: The reality is, it gives you a bucket of money when the change order during construction that comes along-- and let's say, for example, I have an omission on my drawings as an architect. I forgot to put something on. The example that I like to use all the time is, I forgot to turn the layer that would show the lights in the penthouse of the floor of a high-rise office building.

So, all of a sudden, I have no lights on the penthouse floor. The contractor prices the documents. But he doesn't say, oh, did Sue do the drawing of the reflected ceiling plan and where are the lights? The electrical contractor prices the documents. And he doesn't say, where are the lights on the reflected ceiling plan?

But sometime during construction, a change order comes along to put the lights back in. And often, that change order might be handed to an architect or an engineer to say, this one's yours. You're going to whip out the firm checkbook and write a check for the change order. And often, the change order is for the total cost.

Let's say it's \$100,000 to put the lights in had I had them on my drawing. But the change order comes along and it's \$110,000 to put the lights in. It always costs a little more when it's during construction. And often, the owner-- the contractor says, the 10 is owed by the design professional.

Well, you and I both really only the 10 would go into the design contingency bucket to see where we might be at the end. I'm not saying the 10 is a breach of the standard of care. I'm saying these things happen on projects. These change orders occur on many projects.

It's nice to have a design contingency bucket to go to for these projects. Owners like projects that come within their cost and schedule. And we're just telling the owner to set aside some contingency for these issues that are not unusual for a custom design project.

DAN BUELOW: And what percentage would you recommend that contingency be? And how would you establish that? And would that be for all projects across the board?

SUE YOAKUM: That's the question that comes up all the time. What number do I put in as a design contingency? It is not the same for all projects. It's trying to do a handicap for a project. If it's a historic-- my go-to number for new projects given what-- maybe not the smaller ones, but maybe just the medium to larger is 5% of the estimated cost of the work at the start of construction.

This design contingency wants to be carried during construction, not design. We're talking about during construction. So, 5% of the cost of the work. If it's a historic renovation and we don't have good assets, that 5% is not going to be enough.

I get my range of contingency from the report that came out in 2014. I know you're very familiar with it, Dan, the Managing Uncertainty and Expectation in Building Design and Construction that was put out by AIA and Autodesk. There was a discussion with owners. What's the amount of contingency that an owner should expect on their next project to address non negligent errors and omissions? And that's what we're talking about here.

And the report came anywhere from 3% to 4%. Some with 1% to 2%. So, I do 5%. There is a range. I don't like to see anything less than 2.5%. So somewhere between 2.5% and 5%. But it can be larger. I have seen agreements signed by owners with 20% because the existing conditions component.

DAN BUELOW: So, what does that mean then if there's a 5% or a 20%? Is that, OK, there's that threshold, right?

SUE YOAKUM: We're really talking a bucket that I usually see. I've been trying to get these in agreements for about 15 years. And I'm surprised at my success rate.

DAN BUELOW: It's great.

SUE YOAKUM: And it is a-- 2.5% to 5% is where we usually land. And basically, it says, all right, owner has reserved 2.5% to 5% of the cost of the work at the beginning of the construction to deal with design-- I like to say design coordination-- that comes up during construction. Typically, the clause that I have in the agreement, the owner agrees to waive claims within this design contingency bucket.

I don't care if they waive claims or not. But the amazing thing is, it allows for the design team to have what I keep going back to-- the bucket of money to deal with when coordination comes up.

DAN BUELOW: Again, I think it's-- like I say, it's not one size fits all. You're thinking about it. It could be higher for renovation and/or design build projects and then the different complexity or the different sizes and even the sophistication of the client probably to get that conversation in place and actually get something where you're negotiating that contract.

And the report that Sue referred to, Managing Uncertainty and Expectations in Building Design and Construction really is an excellent document. And if anybody wants to get a copy of that, certainly just reach out to Sue or me, and we'll get you one. Because I think it's nice to have something in writing.

We know you're not perfect. We can tell you anecdotally it's 3% to 5%. But to see in this report where it's actually in writing from the owners saying they recognize that you're not perfect, we recognize there are going to be errors and omissions, and that range is in that 3% to 5%, I think, is pretty powerful.

So, Sue, on that, I was looking at this then, when you're negotiating or talking to these owners, do they really agree to insert a design contingency into their agreement? And what justification would you use to ask for a design contingency fund other than being sympathetic that you need to plan for our E&Os?

SUE YOAKUM: That is the \$64,000 question. It's about starting the conversation. We know your budget is important to you, Mr. Owner. We know from our experience on projects that there's going to be issues that arise during construction, that arise from design coordination.

And we have found in our history and most firms have some kind of history to talk about, that you need a design contingency as well as a construction contingency. I cite this a lot on design build because the contractor will say, oh, I've got your contingency-- or the design builder. Well, he has a contingency. But he's going to use it on build things first and not necessarily design. And it's not a separate contingency.

And I also typically say that this contingency is to be used for breaches of the standard of care. I try to stay away from negligent and errors and omissions. People seem to understand it's elastic. And having negotiated this for decades, that breach of the standard of care seems to work in the conversation.

DAN BUELOW: You touched on this a bit. But how can a design contingency be enforced so that it doesn't get repurposed for contractor changes or owner-driven changes?

SUE YOAKUM: From the architects and engineers that get design contingencies in their agreement, I tell them, you have to monitor it. And the way that you monitor the use of a design contingency is you monitor the change orders that come along during construction. Because the change orders do come along in construction.

Contractors categorize those change orders. And often, on their excel spreadsheet or whatever they might be using, there's a column that says, Design Errors and Omissions. Contractor can call it whatever they want. And in that column is the number associated with the change order.

In my review of claims-- I do claims. And sometimes the claims we've worked on are very large-- we usually get a change order log. And the change order log will have design errors and omissions. And typically, in that example I gave you, in the log, it'll have \$110,000 for the lack of lights on the reflected ceiling plan. What should be in that column is \$10,000.

So, an architect and an engineer probably not going to get the contractor design builder to change their change order log but they can track it simultaneously to say what should be in there. Especially when you get to the end of the project, often what I find, the design contingency bucket has not been filled up. And that's the owner's money. We're not going to do this split or anything. That's the owner's money to deal with design coordination.

DAN BUELOW: If you're successful in getting this contingency in place, then to have your project managers in line as far as how to best manage this process, right, this change order management, if you will.

SUE YOAKUM: Yeah, and you really do have to manage it. You know my background is large sports stadiums. And we had to manage the change orders along the way to see what was being put in our bucket. Because when we see claims as they go against architects and engineers, they tend to come at the end of the project.

And sometimes they come months after substantial completion. And the allegation is something like, well, we looked at your change order log. And there was a lot of money that arose from your lack of coordination or your design. And that's just a contractor categorizing them or a construction manager.

Well, we need to be prepared to have that conversation along the way-- along the way during construction and not wait until the end. So, this is just the ability to start this conversation at the negotiation of the contract and all the way through the project. It really starts and then it continues with every cost estimate. And then it really comes to fruition during CA.

So you get to the end, the owner doesn't call you to a meeting and say, I think you might have cost about \$600,000 in damages from your lack of coordination on a \$100 million project. And you and I both know, well, we should be having a party and calling it as a theft. And I have had some of my project managers be called to that meeting.

And the ones that had this conversation along the way, the meeting didn't happen. But the ones that didn't, you get called in. And you have to explain now, all of a sudden, wait, remember, I told you, it didn't have to be perfect?

DAN BUELOW: Again, back to that point of using that contract and establish-- and I know you have some language. I'm going to ask you to hit some of the high points on that. But I also-- sometimes firms will express a concern about putting an actual percentage in their contract and if it creates any insurability issues. What if I set this too low or too high or too low? It'd be probably the big concern there.

And is this a liability assumed under contract possibly? They're saying, well, now that you're over this percent, that's a clear E&O. I personally haven't seen that play out. But I can see where that concern might be. You have any experience on that or talking through that?

SUE YOAKUM: Yeah, I've got a design contingency clause. And you can use that and put it up with the podcast or make available. It talks about the design contingency clause. And then it talks about what happens if the bucket is full. Then the architect will be responsible for damages to the extent caused by the architect's breach of the standard of care.

Because we have to deal with, OK, the buckets full. What do we do now? And then we just go back to breach of the standard of care. I will tell you, if it's a 5% contingency and it's truly monitored and only the \$10,000 goes in to the bucket when we have the \$110,000 claim for the lack of lights and we only put the \$10,000 in the column, if we're about 5%, I'm worried about our performance. Not liking that number.

But I will tell you that we don't typically get there on a project that has a design contingency clause because the conversation along the way during the project has been had and the parties to the project understand that we as architects and engineers don't have to be perfect in our performance.

DAN BUELOW: I think it's such an important conversation to have because we know, as I stated early on here, is that if there's not enough money there to complete the project and you have this normal course of errors and omissions that should be expected, where is that money going to come from? If you didn't even talk about it, it's going to come from most likely the professional liability policy of the design team.

So they have to have this conversation. In your experience, what sort of clients maybe are open to this? I can think of some client types out there that you would have a difficult time trying to have this conversation. What's your experience in that?

SUE YOAKUM: It's a really great question. I started negotiating this with private clients on large stadium project. And I was shocked how easily they accepted it. But no conversation at all. Their attorneys read it and went oh, well, good. Great.

And then I moved on to public entities. You'd be surprised, public entities will be able to do this. So any client from small to big to public to private. I got pretty excited about six months ago when I read in a public RFP a contingency in the contract, a design contingency—

DAN BUELOW: Interesting.

SUE YOAKUM: --in the contract. You can imagine, I thought, yay.

DAN BUELOW: Yeah, best case scenario.

SUE YOAKUM: There's a big movement in the architect and engineer community to get limitations of liability. And those are important too. But they're hard to get. And public entities won't necessarily give them to you. This seems to be another article that I think is incredibly powerful during the project and at the end to avoid or mitigate claims that to me is easier to get. And you can get it from small, large, public, nonpublic owners. Even developers I've gotten to put this clause in on a small condominium project, if you can believe it.

DAN BUELOW: That's a great point. I was going to ask you about that. Because yes, we want to see a limitation liability in every one of our clients' agreements. And ideally, it's a multiple of their fees but at a very minimum to the proceeds of that available insurance that they agreed to contractually at the time of settlement.

But we also know that there are some attorney reps out there and owner types that simply will not agree to a limitation liability, even though we think it's reasonable and fair. It's a risk versus reward conversation. And then there's the waiver of consequential damages. And so that's what I was going to ask.

I mean, ideally, I'd like to see all three. Let's have a limitation liability and a waiver of consequential damages and a contingency. But talk a little bit about that, considering that-- because I was going to ask you that question.

What if the owner rejects inserting a design contingency into the agreement? Is there anything else a design profession can do? And I was thinking, well, limitation liability or waiver of consequential damages. But as you're suggesting, it might be easier to negotiate this contingency than a limitation liability in some cases.

SUE YOAKUM: I think that it is. And I've been negotiating agreements for too many decades to say. And yeah, we fight for limitations of liability. But the design contingency seems to be a little bit easier to get in at a percentage that's reasonable.

If you can't get any of these things in your agreement, the design contingency still can be very important with the first cost estimate of the work. Because then, you can tell the owner, OK, it's not in your contract. But now, it's in your meeting minutes. You can say, owner, where's the design contingency?

If you're doing the cost estimating, you can include it in your budget. The most standard form agreements say that a design professional gets to have a contingency. If an owner's CM or owner's cost estimator or contractor or design builder's doing the cost estimate, then you can really ask for the contingency of 5%.

So, you can get this along the way in the conversation. Plant the seed of, by law, architects and engineers do not have to provide perfectly coordinated document, drawings, and specifications. And you and I say that every day. But when I put my architect hat on that I practiced for 10 years, it's really hard to say, oh, I'm going to have errors and omissions in my documents. But hire me. I'm really good.

DAN BUELOW: Yeah, so back to that question, though, what would you suggest if we've made this effort, we've made the argument, and the owner still just says, sorry? I mean, again, like a lot of things in your contract, it's a business decision. A go/no-go consideration.

SUE YOAKUM: I would say, if you get to that point in the agreement, you just have to evaluate. I'm never really one to say, don't do the project. I know we signed agreements that we stuck in a drawer and hope never saw the light of day. But this is a way to just manage cost, which is so important on any project, to just have that conversation along the way to manage the cost of the project.

And I think that's all we can ask of our design professionals and to remind our owner that we're not going to be perfect. I had a really fun experience when a project manager-- I used to be an in-house counsel-- came back from a meeting that he was a little bit nervous about.

He got called to the meeting three to four months after substantial completion with the owner and the construction manager. Principal in charge of the project wasn't really sure what the meeting was about. And he was asked to write that \$600,000 check on a few hundred-million-dollar project.

And he said an answer that was so perfect. I mean, he said, you know that if we write this, you're asking us to be perfect. Are you asking the contractor and every trade contractor and the construction manager to be perfect as well? Because I saw a lot of construction waste taken off the site and containers every day. So, if you're asking us to be perfect, please, ask the rest of the team to be perfect. He was asked to leave the meeting. And he came back. And the owner said, I'm OK.

Now, not every conversation at the end of a project goes that way. But this is about having the conversation along the way.

DAN BUELOW: Yeah. No, I think, again, having that conversation is so important. And to your point, for an owner to look at it versus the limitation liability where we're saying, let's put a cap on your negligence, what they're saying there is, let's put something here that I can realize is a budget within my budget. They're looking, like you said, what's the cost here. And, OK, I can budget this for about 5% over. It could be more than that. But to your point, is it may be easier to negotiate?

SUE YOAKUM: It is. And if you remember, some owners are corporate boards. Say, owners don't want to go back to their bank or their board and say, I need more money. If they can get it in their upfront budget, it helps along the way. Because the owners have that responsibility often to third parties that we may not know about. You know as well as I do, Dan, cost and schedule-- claims come at a cost and schedule-- cost overruns and schedule delays. This is just trying to mitigate something that's very much in a design professional bucket-- the discussion of what's the cost of this project.

DAN BUELOW: Yeah, and you keep coming back to that point of having a discussion and communication. And I think you've seen this-- and I certainly have-- is that some design professional firms do a better job than others when it comes to negotiating and having these important conversations.

So I see some clients of ours that are working on very similar project types and are, in fact, getting a limitation liability and/or a waiver of consequential damages and, in this case, a contingency now is that they've got that art of the negotiation down a bit and understanding how to convey the message, if you will, as to why these clauses are fair and important.

SUE YOAKUM: Yeah, it really is about-- we always say this-- managing a client's expectations. And this is about managing the client's expectation around the standard of care for a design professional. That's a concept that's not so easy for everybody to understand. And part of this having a design contingency gets you into that conversation. The report that we talked about earlier, this Managing Uncertainty, that is comments from owners, so that has helped sometimes when we have an owner that doesn't understand. I passed that on to say, hey, have the owner look at this. Because it isn't like we're sitting in a vacuum making this stuff up to manage our risk.

DAN BUELOW: And it's not just an AIA or engineering EJ CDC document. It's something that seems to be bipartisan, if you will, in that conversation. I think that's been a great document to share.

SUE YOAKUM: So, I remind people that there is this document out there. And we're pulling from this document on why you need a design contingency, going back to how you manage non negligent errors and omissions, how you manage the concept of a breach of the standard of care.

DAN BUELOW: We'll talk a little more on that.

SUE YOAKUM: Managing the concept of a breach of the standard of care? Well, we need more time, Dan.

DAN BUELOW: Yeah, that's another topic for you, Sue. That's a good one. Well, before I let you go, though, I come back to this waiver of consequential damages again. Because I think that, again, often, firms may find themselves sued for damages that are totally out of proportion to their fee or grossly exceeding the cost of repairing the actual damages and that they need to ideally get something in their contract.

And I know that there's both something from the AIA B141 and the EJ CDC that contain mutual waivers of consequential damages. And I think that's something that, again, I think firms should really brush off and consider too because getting that wording in their contract can be very important. And it's worth noting, again, that clients in the private sector, at least, are used to waiver of consequential damage clauses and are often they will be asking for this same protection when they're selling their products and services out there.

So, they should be understanding of this, you would hope. At least the concept sometimes is a little more palatable than the limitation liability. But, again, I think understanding all three of these and this contingency, though, I think, is very important.

SUE YOAKUM: Yeah, the contingency also isn't really asking an owner to give up some damages that an owner thinks they might be able to get. A limitation of liability, as you know, is a cap on damages. But by law, they could get more waiver of consequential damages. I don't tend to have too many problems getting that in.

But we're seeing carve outs to those waivers. And, again, an owner thinks they might be giving something up that they would have by law. The design contingency isn't that. They're not giving anything up. They're just planning a little bit better in terms of the cost of the project.

DAN BUELOW: Well, Sue, this has been great. Excellent discussion, again, and a very important topic here. I want to thank you again for sharing your insights and expertise. Any final parting words of wisdom on this discussion of contingencies or the standard care?

SUE YOAKUM: Yeah, I want to just thank you for allowing me to take some time and talk about this topic that you could tell is pretty near and dear to my heart. I would tell our audience or anyone who listens to the podcast, try it, try to get a design contingency. You might be surprised how easy it is.

And it is so valuable for an attorney that might be fighting the claim at the end of the project. It's a wonderful thing to find in an agreement if you're the attorney defending the architect or engineer. So, thank you, Dan. And thank you for all the good content you guys are putting out there.

DAN BUELOW: I appreciate that, Sue. And I'm going to include with your permission a copy of the clause that you shared. But I would also encourage everyone to consider contacting Sue if you have any questions regarding this topic or anything on contracts or such.

She's an excellent attorney. And we're really lucky to have her representing the design community and helping us with these conversations on managing risks. So, Sue, thank you very much. I appreciate your time and everything and want to thank everybody for joining us for another episode of Talk to Me About A&E. We'll talk to you soon. Take care.

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