

Risk Management for the Small Design Firm: Dealing with the “Big Three”

Question & Answer Log

Answers provided by:

Robert vanArsdall

Director, Business and Sector Analysis

XL Group, Design Professional

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Q: Our GDP comes from our multinational companies making great profits from low wage jobs in other countries. Doesn't our at home GDP still reflect a miserable situation? [Anne Surchin]

The components of GDP include many other factors than just multinational companies. One of the benefits of the recession is that the US dollar fell in comparison with other countries' currencies, making US goods and services “better buys” for other countries. US exports have risen as a result. The following slides in the webinar on the influence of consumer confidence reflect an improving situation, unfortunately just not for designers as yet. As I mentioned, that has to do with the overbuilding of residential housing we did in this country pre-2007.

Q: In California no license is required for residential firms up to 2 stories. Do these slides reflect these small non-architecturally licensed firms? or when it's A/E firm, it meant licensed architectural firms? [Raymond Pan]

Our numbers are based solely on registered designers. Where a slide says “A/E” it is architects and engineers.

Q: Should people be brought on as contract before they are brought on to your payroll to make sure they are the right fit? [Steve Engelhardt]

That is a hiring strategy that works for some firms, as is having a probationary period. Our data shows that the Risk Driver problem relating to hires is more in the actual integration and continuing education area than in having the wrong people, though.

Q: How do you keep up with overhead of staffing up while waiting for the large project? [Steve Engelhardt]

Great question that I tried to answer on the webinar. It is a gamble on risk and reward that requires internal investment by the owner(s). If you don't take on the increased overhead by hiring ahead of a large project, you will end up paying for that and more on the other side in rework, overruns, and lawsuits.

Q: So, does XL [Group] suggest no Facebook pages for firms or to treat all discussion as 'discoverable', or to have a firm wide policy "no work discussions on social media?" [Lisa Stacholy]

Firms can opt to have their own Facebook pages, certainly. It is a natural extension of having a website and the same rules apply. Employees should be informed that any discussion of company matters on their own pages or network media accounts is discoverable if they are involved in a claim, and should act as though their pages are being read by the public.

Q: What is the best way to check out a residential client in regard to risk? [Sheri Olson]

Find out whether they have adequate funding for the work they propose. Find out if they have any experience in construction or understand the process. Find out whether they have a history of litigation.

Q: On this slide, scope creep pie wedge looks bigger than 3%. Please confirm the percentage. [Joel Niemi]

Thanks for catching that! It should be 13%, and will be corrected next time I use it.

Q: How do you require a residential client to continue your services during CA? Sometimes they want to save money by cutting the architect out. [Sheri Olson]

There is no way to “require” an owner to do anything, except by contract. As I mentioned on the webinar, XL Group suggests including language that indemnifies the designer for claims if the owner elects to cut out the designer from CA services.

Q: It seems sued firms get sued more than once while some firms never get sued. Is there research as to what is different about these two types? If so what does it tell us? [Mark Robin]

This is a huge question with many answers. As I showed in the webinar, much depends on the designer’s practice area, the type of owner involved, and the contract used. As I tried to show towards the end of the webinar, it also depends on the firm’s internal investment in training.

Q: How can I best learn about negotiation and contract issues, if I have very little experience with it? [Rebecca Ward]

If you are insured with XL Group’s Design Professional unit, we offer the Contract eGuide for Design Professionals, and have an entire series of self-study courses devoted to these topics. If you are not insured with XL Group, you may want to contact your broker or insurance company to see what they have to offer.

Q: Does the Design-Build firm generally have to pay more for E-O insurance? [Awad Eskander]

Design-build firms generally have to have more than one contract to cover their work, though some simplified contracts are becoming available. Generally, designers carry professional liability insurance (PL) and contractors carry general liability (GL). A true design-build firm may pay more for a combined policy, but it is usually less than the sum of two independent policies.

Q: Do you have any documentation on types of clients vs. risk - developer, government, etc. [Adam Perrino]

We have a great deal of documentation on this, some of which I presented in the webinar.

Q: How do small one man firms increase fees without trying to undermine all other firms? [David Lohmeier]

Actually the reverse of the question is more often true. Small firms with little overhead can charge less than other firms, and frequently do.

Q: 1) Lump summing preferable to hourly billing? 2) Writing off \$ at the end of the project --> or where can I get the background information to get me up to speed. [Allegra Kochman]

I'm not sure of the question here. Our statistics have found that the most profitable A/E firms predominately lump sum their work while the least profitable ones work by the hour or on a cost-plus fixed fee basis. In terms of writing off money at the end of a project: everyone has done this—the problem is that no one takes the time to understand why. Without doing the project post-mortem, a design firm will continue to repeat the same write-off causes forever.

1. It seems like the speaker was suggesting lump sum is better than hourly billing. My lawyer does not agree with this, and I think there is an AIA practice management discussion on linked in about this as well. It was an idea that was tossed out but not explained. Can you explain this point of view?

“Better” is the key word to your question. We have a substantial amount of data, as does ACEC, to show that firms that lump-sum projects are more profitable than firms that quote by the hour or on a cost-plus basis. Unfortunately, quoting by lump-sum exposes the firm to more business risk, especially if you have not constructed a very tight scope of services. A lawyer will advise you to avoid or transfer as much risk as possible, because their job is to keep you out of trouble. Unfortunately, as any undergraduate finance course teaches, with risk comes the opportunity for reward. Note: just the opportunity, not the guarantee. Since 1900 bonds have performed at an average annual rate of about 8%, small-cap stocks at about 13%. If you wanted to avoid all risk, you would invest in nothing but federal government treasury bills. So are bonds “better” than stocks? Are stocks “better” than bonds? Whether lump-summing is “better” very much depends on your point of view, your goals for being in business, and your appetite for risk. We have data to show it is more profitable, though.

2. The speaker said that there is a way to write off money at the end of the project. They were talking about projects needing more time than projected (and looking at how not to repeat the same processes that led to the cost overrun). I have never been able to write off \$ at the end of the job, I eat it and my accountant has told me that these expenses cannot be written off. How is this possible?

Two different meanings of the term “write off” here, especially relevant at tax time. You are asking about tax write-offs. I was speaking of what most people call “write-downs”, sometimes “write-offs”, what your accountant would specifically call a “reconciliation”. This amount is, for example, the difference between the number of hours you worked and the number of hours you can charge the owner. As you say, you “eat it”. Your accountant is correct: there are no tax write-offs for this. That was my exact point on the webinar. Most design firms write down (“eat”) money on almost every job they do and never take the time to understand why.

Consequently, when a similar project comes along some months later, they pull out the same methodology and project assumptions and repeat those same mistakes over and over. We need to know why these reconciliations/write-downs/write-offs occur so that we can improve our internal processes.

Q: How would you handle the client who decides to stop paying towards the end of the project? And how to handle the client who thinks the contractor knows more than the architect? [Arlene Tunney]

XL Group has found that stopping payment is one early warning sign of a potential claim arising. Contact your insurance provider promptly, even though it does not involve an actual claim. They should be able to suggest alternatives to discover whether a potential problem exists. If the owner trusts the contractor more than the designer, the solution is always client education and communication, communication, communication.

Q: Do you have any suggestions for advising parties to an agreement that the risk should be properly allocated to the parties involved and the design professional is not forced to accept the full risk including that which is beyond their control. [Paul Levine]

What you've asked is the central tenet of negotiations and negotiation strategy. The first steps are not to go into any negotiation blind, and to understand and quantify the risks you may be taking on before you go into the negotiation.

Q: Is having a separate corporation entity doing the Design contract while another corporation doing the construction going to reduce the risk of E-O Insurance?[Awad Eskander]

If I understand the question, you're asking about two different design firms rather than one design firm and one construction firm. This is a complicated question, but the answer is, "Not necessarily." Designers can be sued for the design itself; designers present at construction can be sued for not adequately conducting their duties during the construction administration phase.

Q: Shouldn't managing risk include managing client expectations as relates to the fact that regardless of technologies, QA/QC measures, etc., there will never be a perfect set of construction documents? It would seem that there is some "expected" or "acceptable" percentage of "betterment" items experienced in project execution. [Joseph Pyatek]

Unfortunately, client expectations are frequently different from designer's ability to fulfill them. That is why the naïve clients – residential, k-12 schools, churches – are frequent problems. Managing client expectations is a huge part of a designer's job, especially in terms of getting them to understand the actual process and work product. I'm unsure of the exact question about "betterment" in the second half of the question.

Q: Please send language of "kill clause" if owner does not use architect during CA and "limit of liability" language. [Allegra Kochman]

Such a clause may read:

The Consultant's commitments as set forth in this Agreement are based on the expectation that all of the services described in this Agreement will be provided. In the event Client later elects to reduce the design professional's scope of services, Client hereby agrees to release, hold harmless, defend and indemnify Consultant from any and all claims, damages, losses or costs associated with or arising out of such reduction in services.

Q: Will this clause help limit contractor claims? Is it enforceable in Pennsylvania? Architect makes no claims to ease of build-ability of a project? This Contract is with Client not the Contractor. By beginning the work, the Contractor certifies they have reviewed the design documents and site conditions affecting the work and accept same. Contractor is solely responsible for construction methods, sequencing and safety. Architect's liability to the Client for any losses or damages, direct or indirect, arising out of this Agreement shall not exceed the total amount collected from the Client for the performance of the particular work task which gave rise to the loss/damage or to the limit of our E&O insurance at the time this contract is signed (if any), whichever is less. Under no circumstances will personal property, earnings or holdings of Architect be attached, pursued or taken for any losses or damages arising out of this Agreement, by the Client or anyone acting on the Client's behalf. This provision shall supersede any other provision of this Agreement that may be deemed inconsistent with it. If Client requests additional E&O insurance limits beyond our standard limits (if any), Client will be charged the additional premium fees which are in excess of our standard E&O insurance premiums (if any). [James Spinola]

Some firms require a "Bidder's Representation" to be submitted with the bid, in which the contractor acknowledges that the bid is based on a thorough understanding of the design documents and site conditions, that any substantive questions about the design have been asked and answered, and that the contractor's price incorporates their understanding of the design, site conditions, and questions.

Within the owner-designer agreement, it is also common for the consultant to disclaim all responsibility for construction means, methods, sequencing and safety.

For further information, XL Group insureds can consult Lessons in Professional Liability and the Contract eGuide for Design Professionals. If you are not insured with XL Group, you may want to contact your broker or insurance company to see what resources they have to offer.

It is always best to check any contract language with either your professional liability insurance agent or your legal advisor if there are questions on local applicability.

Q: Regarding learning about negotiation I have used: the book Getting to Yes and some Slate podcasts on negotiation. [Allegra Kochman]

Q: What is your opinion on why there is such a discrepancy between the incomes of Architects and Engineers vs. Doctors, Lawyers, Dentists, etc. [James McKay]

This, too, is a very large question. Let me provide a quick answer - the perception of value by the consumer of services. If consumers value one thing more than another, they will pay more for the former than the latter. We go to doctors in matters of life and death, sickness and wellness. We go to lawyers to keep us out of trouble, keep us in compliance, protect us from lawsuits, administer our wills, etc. Dentists, too, have a hand in keeping us healthy and in protecting our personal image. Although architects and engineers are very assuredly professionals

if judged by the amount of schooling and licensure they have to attain, they are defenders of life and death in the abstract, not on the personal level. Perhaps, too, it is because most non-commercial private clients don't need the services of engineers and architects; they are an elective expense of disposable income, not a necessary expenditure.

Thanks for your questions and for listening to the AIA Small Project Practitioner Knowledge Community Webinar. If you have further questions or would like more information from XL Group's Design Professional unit, please visit us online at www.xldp.com.