

Business Practice and Risk Management

By John Tawresey, S.E.

Reviewed by the CASE Risk Management Program

This fourth article in our series is about connecting risk management to business practice. In the previous three articles, risk management was connected to professional practice. However, when discussing risk management, it is impossible to only consider professional practice. Business practice is always an important part.

If you record your hours for billing to a client, you are in business. For most, the process of billing is not as enjoyable as doing the engineering. It would be nice to practice engineering unencumbered by the mundane process of recording hours onto end-less breakdowns of project numbers and deadlines for reporting. But, getting paid is necessary and so we are not only practicing a profession, we are also in business. How professional and business practices mix is a key issue for every practicing professional and their firms. How they mix has a direct connection to the reduction of claims, and is the subject to follow. But before proceeding, here are a few additional comments about the previous article in the April 2007 issue of STRUCTURE®.

In the last article in this series, we discussed the “cosmetic crack letter” as an example of how to increase the chance of a claim. The “cosmetic crack letter” should be taken in its broadest context. In addition to the cosmetic crack letter, there is the “deflection within code limits” letter; there is the “expected vibration” letter; there is the “all buildings leak” letter; there is the “no floors are flat” letter; there is the “not in our scope” letter and there are many more. The message: if your client, or the owner, or others think there is a problem, then a letter of denial will likely increase the chance of a claim. Your letter may be accurate and a legal theory may absolve you of responsibility, but choosing to accept the problem as your own until you can properly pass it on to the appropriate parties will reduce the chance of a claim.

Let's return to business practices and risk management. To start with, the amount of fee received for a project has nothing to do with the chance of a claim. It is important to recognize that a low project fee is not necessarily a source of increased risk on a project. Rather, it is the change in behavior in response to the low fee that is the source of increased risk. The change in behavior is within our control. We can avoid the increase in risk by simply ignoring the low fee. When accepting a commission for work, the amount of work that needs to be done should not be

dictated by the fee received, but rather by the requirements of the project. If the fee is not sufficient, then don't take the commission or accept it as a marginally priced project (contribution to overhead concept). If, however, in response to a low fee you lower your level of service, then you will likely increase the chance of a claim.

Moonlighting is another business issue. I am sure we have all done it. It is almost unavoidable and is not often talked about. Moonlighting is defined as working for a client as an individual, not as a participant or representative of your firm. Sometimes you may pocket compensation or you may do it for free. The compensation doesn't matter. You are providing services outside the oversight of your organization. Most firms, in writing, prohibit the practice of moonlighting. There is a good reason for this, and it is not just related to the bottom line. If a claim results from the activity, your firm likely will become involved if any connection can be made. Liability can be transferred from yourself to the firm by something as simple as taking a phone call while at work, and liability will be transferred from yourself to the firm. It can be very embarrassing.

If your neighbor asks you to size the members for the wood deck he is building, it is likely you will be unable to say no. But a wise engineer would take out a job number and do the work within the professional practice standards and oversight of the firm. The wise firm would allow the pro bono (no charge) work to be done, recognizing we have all been in that situation.

Contracts are another business practice issue. Once a project is accepted, it is good business practice to execute a written contract. For a contract to be valid, four things are necessary: 1) mutual assent, 2) consideration, 3) legal capacity and 4) a legal activity. Mutual assent means that there is an agreement between two parties to do something. Usually, the acceptance by the client of the engineer's proposal constitutes mutual agreement. Consideration means there is an agreement involving a fee or money (it does not have to be a reasonable amount). Legal capacity

means being of legal age and in authority by your firm to enter into the contract including proper licensing of the firm in the state. And finally, a legal activity means states will not uphold contracts for illegal activities.

It is not reasonable to expect practicing engineers to be fully competent in the subject of contracts. Outside help is usually required. But knowing when to ask and knowing when clauses don't seem right is necessary. Some study of contract theory can help. There are many resources available including your professional liability insurance carrier.

When it comes to contracts and risk management, allocation of risk is always discussed. Risk can be allocated by a contract. Indemnity clauses can be used in an attempt to allocate risk to other members of the design team, or the owner, or the contractor. Limitation of liability clauses can be used in an attempt to cap the damage amounts thereby transferring part of the risk, and professional liability insurance can be used to allocate risk from the firm to the insurance company.



Indemnity clauses are typically written so that only lawyers can understand them and lawyers seldom agree on interpretations. Expensive litigation is the predictable consequence of attempting to enforce an indemnity clause. If no indemnity clause exists, risk would be allocated between parties in accordance with legal precedent or the traditional way. Since we have our standard of care responsibilities beyond our contract, indemnity clauses almost never reduce our risk and almost always increase our risk. Thus, experience has demonstrated that the best indemnity clause is no indemnity clause.

Limitation of liability (LOL) is a contract clause that limits the damages. A \$50,000 dollar number is usually used. But the LOL clause should make sense. It should be used when the project risk is not consistent with the fee. An example would be an inspection of a residential masonry fireplace for an owner who happens to be an attorney. You can probably finish the story.

Finally, professional liability insurance (a contract between the firm and the insurance company) is a way to transfer some of the firm's risk to an insurance company.

There are many other business practice issues that impact the chance of a claim. Not all can be covered here. However, here is one that is particularly interesting. We have all experienced the project from... well, you know where; let's call it the "Project from Hell" (a project with problems outside our control). A principal in the firm may drop one on our desk or we may do it to ourselves. One sure way to avoid a claim is to decline the project. The decision to reject should consider the risk inherent with the nature of the project (a condo as an example), the capabilities of the firm to do the project, the capabilities and history with the client, the process of design and delivery, the construction climate and other factors. But, if you decide to accept a *problem-project*, extra work may be required to prevent *project-problems*. It is good risk management and business practice to match the level of documentation and contract document quality to the risks involved.

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Considering again our "Project from Hell", the CASE ten foundations of risk management begin with "Create a culture of managing risk and preventing claims". Within this recommendation, CASE states "Quality must take precedence over profits". But in many firms an individual's compensation is directly related to project performance, which relates to individual project profitability. If bonuses are formulated based on an engineer's profit on his/her projects, then this business practice will likely increase the chance of claims. On the "Project from Hell", to lower the chance of claims, it is best to assign the most talented staff available. Unfortunately, if compensation is tied to project profitability the talented staff will also be talented enough to avoid the project, or find other employment. On the other hand, if compensation is subjectively distributed within a group of engineers involved in many projects, then it will be easier to succeed in having quality take precedence over profits.

In conclusion, business practice and risk management are connected. Fees should not be used as an excuse for limiting necessary services. Firms should recognize and accommodate employee pro bono professional work. Moonlighting should be avoided. Knowledge of contract issues is

part of professional practice, but expert help is usually required. Allocation of risk using contract indemnity and limitation of liability clauses are common risk management tools. It is good risk management and business practice to match the level of documentation and contract document quality to the risks involved. The "Project from Hell" usually results in a conflict between business practice, professional practice and risk management and is always a challenge for those involved. ■

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Risk Management Recommendation:

Don't change professional behavior because of fees. Don't moonlight. Learn about contracts and risk allocation through indemnity, LOL and insurance.

Avoid problem-projects or avoid project-problems. Don't penalize staff for working on a "Project from Hell".

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