PROFESSIONAL LIABILITY INSURANCE

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PERSPECTIVES

ON PROFESSIONAL LIABILITY

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How to Get a Design Professional to Work for Free!

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Now that we have grabbed your undivided attention, the purpose of this article is to alert Design Professionals to an alarming trend. This trend involves the inclusion of contract provisions in agreements prepared by Owners/Developers and their attorneys that force a Design Professional to work for free in the event that the Owner/Developer unilaterally determines that there is a "dispute."

OVERVIEW

It goes without saying that every contract, especially in the design field, must be read thoroughly before it is signed, or the signer will be stuck with the ramifications. Generally speaking, the clauses in question here state that in the event of any dispute between the Owner/Developer and Design Professional, the Owner/Developer **may** withhold payment until the dispute is resolved, but the Design Professional **must** continue to perform services. This upsets the historical balance of power between the Owner/Developer and the Design Professional and creates a situation where the Design Professional may very well end up working for free or else be faced with being sued if they stop work or suspend services.

HISTORICAL PERSPECTIVE

This scenario was historically avoided by a more balanced philosophy in contracts whereby the Design Professional would be paid for the services rendered as these services were provided and invoiced. Because Design Professionals work under a "fee for services" arrangement, the balance between the party providing the service (Design Professional) and the party paying for those services (Owner/Developer) is really quite simple. As long as the Design Professional provides services, they should be paid. Likewise, as long as the Owner continues to pay, the Design Professional should

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continue to provide services and fulfill their obligations under the contract.

In the not too distant past, the type of provision discussed in this article was extremely rare in design contracts. Recently, however, there has been a clear trend of the inclusion of these provisions in both public and private contracts, and frankly, they appear in far too many of the contracts we review.

HOW DO THESE PROVISIONS UPSET THE BALANCE OF POWER?

Under the typical "fee for services" arrangement, if the Design Professional is not paid, they can simply suspend or stop services, as non-payment is typically considered to be a material breach of contract. In the event there is such a clause in place that allows the Owner/Developer to suspend payments in the event of a "dispute," the Owner/Developer is given unfettered power to simply determine that any given situation rises to the level of a "dispute." In such a situation, the Owner/Developer can legitimately refuse to make payment.

At this point, the Design Professional is faced with a quandary. If upon receiving notice from an Owner/Developer that payment will not be forthcoming because there is a "dispute," the Design Professional must make a decision on whether or not to continue to perform. Most often when confronted with this type of decision where there is a clause in place mandating continued performance, the Design Professional can either suspend service or continue to work without being paid. If the decision is made to suspend service, the Design Professional will be in breach of the contract because of the clause mandating continued performance even if payment is not made.

There has been more than a few times where this dilemma has resulted in serious financial consequences to Design Professionals. While there is always a risk of litigation any time a Design Professional is confronted with deciding whether to continue to perform professional services when faced with non-payment, this changes the discussion from a theoretical breach of contract to an actual breach of contract. Additionally, there is a much easier avenue for the Owner/Developer to recover damages when the Design Professional suspends services because the Design Professional is in breach of contract as of the minute services are suspended.

WHAT DO THESE PROVISIONS TYPICALLY LOOK LIKE?

You should look out for contract provisions that include language that would allow the Owner/Developer to withhold payment but require that you continue providing services or you will be in breach of contract. The following are three recent examples of such provisions taken from actual contracts that were presented to our clients for signature:

Consultant understands that a stoppage of work by Consultant could cause Owner and/or Developer substantial actual and consequential damages. This Agreement is separate and distinct from any other agreement(s) and/or contract(s) between Consultant and Owner and/or Developer. Any dispute or alleged breach that may exist or materialize between Owner and/or Developer and Consultant or any other agreement and/or contract shall not be a legitimate basis for Consultant to stop, slow, or suspend performance of work related to this Agreement in any manner. Should Consultant stop, slow, abandon, or suspend performance relative to this Agreement because of a dispute on another agreement and/or contract, Owner and Developer shall be entitled to recover from Consultant all actual and consequential damages which result from such action by Consultant.

Unless this Agreement is terminated as provided in Article 5.7 hereof, in the event of a dispute, controversy or question between Owner and Architect, Owner and Architect agree that pending the resolution or settlement of such dispute, controversy, or question, Owner and Architect shall continue to perform their respective obligations under this Agreement without interruption or delay, and Architect expressly agrees not to directly or indirectly stop or delay the proper performance of the Work.

Owner reserves the right to reject all or any portion of an invoice. If Owner disputes Architect's entitlement to payment for Architect's services for any reason (the "Disputed Amount"), Owner may withhold the Disputed Amount until the dispute is resolved by settlement, dispute resolution in accordance with Article 11, or judicial determination, and Architect shall be obligated to continue to perform Architectural Services set forth in this Contract without interruption. However, both Owner and Architect

shall use best efforts to resolve any such disputes expeditiously.

What these provisions mean is that no matter the nature of the dispute that arises between the Design Professional and the Owner/Developer, the Design Professional must continue to work. There is no obligation by the Owner/Developer to do anything, even pay the Design Professional. If the Design Professional did stop work, there would be extremely good odds that the Design Professional would end up having to pay any damages to the Owner/Developer for breach of contract.

ARE THESE PROVISIONS LEGAL?

Generally speaking, these provisions are legal and have been upheld in a number of states, including California. As a general proposition, parties are free to enter into such terms and conditions in any professional services contract as long as they are not illegal or against public policy. Therefore, it is unlikely that the courts will be terribly sympathetic to a Design Professional who decides to stop work under an executed agreement that mandates that the Design Professional continue to work in the event of a "dispute."

The problem with this scenario also stems from the fact that there is very often no definition whatsoever as to just what is a "dispute" or how it is determined or defined. Simply put, an Owner could determine that he disagreed with all or part of a professional service invoice, which therefore results in it being defined as a "dispute" under the agreement. At that point, the Owner could rightfully refuse to make payment and insist that the Design Professional continue to perform under the agreement.

The 13th Amendment to the Constitution of the United States makes involuntary servitude (slavery) illegal. An argument can be made that the provisions at issue here require illegal involuntary servitude by a Design Professional if a dispute arises with an Owner/Developer because the Design Professional would be forced to work without pay. While a parallel exists between the clauses being described in this article and a violation of the 13th Amendment, it would be rather difficult to get a court to agree that these clauses, if enforced, would amount to involuntary servitude that arises to the level of a violation of the Thirteenth Amendment.

The bottom line is that until a court rules otherwise in a reported decision, these provisions are perfectly legal. Design Professionals and Owners/Developers are able to negotiate these provisions in their contracts, and they are enforceable in courts of law.

AS A DESIGN PROFESSIONAL, WHAT CAN I DO TO PROTECT MY FIRM WHEN ENTERING INTO CONTRACTS?

All contractual provisions are, at least theoretically, negotiable. The simplest thing to do is to strike these types of clauses. In doing so, you are unequivocally stating to the Owner/Developer that under a "fee for services" arrangement, you expect to be paid for your services. Further, if there is a dispute, then the dispute needs to be resolved to the mutual satisfaction of both parties before you will continue to perform.

In the event you are unsuccessful in striking such a clause, you still need to work hard to negotiate a contract where you are paid for the services rendered and not required to work for free. One compromise might be to negotiate the clause so that if there were a dispute declared by the Owner/Developer, the parties would immediately meet to resolve the dispute within two days or such other short timeframe as might be agreed to by the parties. The Design Professional would continue to perform during this negotiated short timeframe. However, if the dispute cannot be resolved, then the parties are free to take whatever action they deem appropriate. In the case of the Design Professional, this could mean a suspension of service. In the case of the Owner/Developer, it could mean a refusal to pay an invoice that is disputed, at which point the Design Professional would take whatever action seems proper, including suspension or termination, depending on the circumstances (i.e., amount of money involved). On the other hand, the Owner/Developer could decide to make the disputed payment and reserve its rights to seek reimbursement later in the life of the project.

This option would better protect the Design Professional from having to work without being compensated for services rendered and avoid potentially disastrous financial consequences that could result from non-compensated continued performance.

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CONCLUSION

Some of these contract provisions can be financially disastrous for a firm that is trapped doing a job with an Owner/Developer when a dispute arises and a clause of this type is involved. These Professionals should know that when faced with a potentially disadvantageous clause in a contract, they should strike it or take measures to negotiate a different, more balanced provision where all parties are protected. The smart informed Design Professional will be able to protect themselves and their business with suitable contract provisions. It is always important for a Design Professional to read all clauses in a contract carefully and consult with an attorney if appropriate to decipher legal jargon and potentially onerous provisions.

Remember, as a general rule, just because you do not understand a provision in a contract, this is NOT grounds to have a court later hold that the clause is invalid. In fact, the opposite is generally true: if you signed it—you are stuck with it or will get stuck by it!!

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Nothing contained within this article should be considered the rendering of legal advice. Anyone that reads this article should a/ways consult with an attorney of their choice before acting on anything contained in this or any other article on legal matters as facts and circumstances will vary from case to case.

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