

The Architect's Liability for Construction Cost Overruns

Many owner-architect contracts are written to compensate the architect on a percentage of the construction cost. For instance, if the architect's fee is 8% of the cost of construction, and that cost is \$10 million, the architect's fee will be \$800,000. From the owner's point of view, there are a number of problems with this type of fee arrangement. For instance, the architect has an economic incentive to keep the cost of the project high, as opposed to saving the owner money.

The most commonly used form of owner-architect agreement, the AIA B141-1997, attempts to address this concern by establishing a not-to-exceed fixed-limit budget, called the "Cost of the Work" in that document, and has these provisions relating to bids that come in over budget:

2.1.7.5 If the budget for the Cost of the Work is exceeded by the lowest bona fide bid or negotiated proposal, the Owner shall:

- .1 give written approval of an increase in the budget for the Cost of the Work;
- .2 authorize rebidding or renegotiating of the Project within a reasonable time;
- .3 terminate in accordance with Subparagraph 1.3.8.5; or
- .4 cooperate in revising the Project scope and quality as required to reduce the Cost of the Work.

2.1.7.6 If the Owner chooses to proceed under Clause 2.1.7.5.4, the Architect, without additional compensation, shall modify the documents for which the Architect is responsible under this Agreement as necessary to comply with the budget for the Cost of the Work. The modification of such documents shall be the limit of the Architect's responsibility under this Paragraph 2.1.7. The Architect shall be entitled to compensation in accordance with this Agreement for all services

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performed whether or not construction is commenced.

The idea is that if the cost comes in too high, the architect will have to redesign for free. In theory, this sounds fine, but in practice it can be much more difficult. Note that the B151 does not establish a fixed limit of construction. This is one reason that owners prefer the B141.

There is one problem with this scheme that can be resolved if both the owner and architect timely recognize the problem and address it: how is the architect compensated if the lowest bid exceeds the budget amount, but the owner still wants to construct that more expensive building? The simple answer is found in the contract at Section 2.1.7.5.1, with the owner giving approval for an increase in the budget. When that occurs, the architect will bill the owner based on this increased cost. The owner may well hit the ceiling upon receipt of this bill, but find himself with little recourse.

Let's look at an example. The budget is \$10 million, with an 8% fee for the architect and his consultants. The owner reasonably expects to pay no more than about \$800,000 for design services. The architect assures the owner throughout the design process that the final cost will come in well under budget, and even furnishes the owner revised cost estimates on a regular basis. The owner, of course, absolutely loves the building designed by the architect. It is the perfect building for the owner, with no fat – nothing can be deleted from this design without destroying it. Imagine the owner's chagrin when the lowest bid comes in at \$15 million.

Under 2.1.7.5, the owner has several options, including abandonment of the project. This, of course, is totally unacceptable. Rebidding seems futile, especially after discussions with the contractors. Cutting a third of the building is likewise unacceptable. The owner is mad at the architect, but what can he do except bite the bullet and build this building at the higher budget amount? The owner's chagrin turns to absolute rage when he receives the architect's bill for \$1,200,000 in place of the \$800,000 bill! The architect, after carefully reading his contract, decides that the contract gives him the absolute right to bill based on the "lowest bona fide bid," resulting in the increased fee. By accepting the first option, so the argument goes, the owner waives any claim against the architect related to the cost overrun. In any event, litigation or arbitration between the architect and owner is likely.

Had the owner recognized the dilemma prior to deciding on a course of action, the owner should have been able to negotiate with the architect to continue on with the project, but without increasing the archi-

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tect's fee. An even better approach might be to convert the architect's percentage fee to a fixed fee just prior to bidding. At that time, the parties should be able to agree on the final budget and establish a fee that will neither increase or decrease based on variations in the actual bids. In this example, the parties would have agreed to a fee of \$800,000 prior to the bids. The owner could still maintain the options permitted by Section 2.1.7.5, with the architect responsible for designing to that budget. From the owner's viewpoint, this also eliminates the architect's perceived incentive to keep the cost of the building high.

The parties don't need to wait until the end of construction documents to convert a percentage fee to a fixed fee. Once the parties are comfortable with the project budget, perhaps at the end of design development, this conversion can take place. The risk associated with wildly varying bids is removed from the architect's fee. This is a plus to both the architect and owner.

Both the owner and architect must be thoroughly familiar with their contract. As unexpected events occur, that contract should be reviewed. The parties are free to renegotiate their contract in light of such events, but that can only succeed if the negotiation is timely and both sides perceive the negotiation to be in their mutual interest.

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