

Third Quarter 2004



## IN THIS ISSUE (click on each subject line to read more)

- Managing Professional Fees: What to expect if you file a lawsuit for fees
- Avoiding a Costly Mistake: Design without construction review
- To Survey or Not to Survey: Making sound business decisions
- Legislative Roundup: Indemnity statutes and private construction projects
- Pre-claim Assistance: How to effectively manage potential claims

We are pleased to introduce the first issue of **Stamped, Sealed and Delivered**. This periodic newsletter is designed to inform architect and engineer professionals like you of the potential risks that impact your business and suggest ways to prevent them. **Stamped, Sealed and Delivered** includes timely, insightful articles collected from our experienced claim specialists — people who work with claims related to your profession every day. We hope this newsletter will help you recognize the exposures that could affect you, both professionally and personally, so you can more confidently provide services to your clients.

## MANAGING PROFESSIONAL FEES

### What to expect if you file a lawsuit for fees

People say there are only two things certain in life – death and taxes. For the design professional, there is one more certainty: If you file a lawsuit for fees, you can likely expect a counterclaim for malpractice.

About 40 percent of claims — two out of every five claims or pre-claims reported — stem from fee disputes. If a client doesn't pay, there is often a reason behind it, and that reason may vary. A client may be unhappy with the service received, or a project may cost more than the client had anticipated. Perhaps there are more change orders on a project than the client is willing to pay for, or the client simply may have run out of money and is looking to the design professional to recoup some of the cost.

When a client fails to make a payment, design professionals have options available to obtain payment. A word of caution, though: How a design professional responds can set the tone for how the client responds.

#### **Option one – desist work**

Some designers threaten to quit the project if they don't receive fees. If you choose this course of action, expect the client to hire a replacement designer to finish the project. In all likelihood, the design professional can also expect to be served with a lawsuit or claim alleging professional negligence. The client may seek damages for the replacement-design firm's fees, as well as costs related to delays, change orders and other damages. Issues and claims may also arise from using the original design professional's plans.

#### **Option two – file a lien or lawsuit**

Some design professionals choose to file a lawsuit or place a lien on the client's property to recoup fees. Design professionals who choose this course of action can expect the client to file a lawsuit or claim for professional malpractice, alleging various errors and omissions on the project and seeking damages that often exceed the fees that are owed.

#### **Option three – allow the client to remedy the alleged breach of contract**

When design professionals have a written contract with their clients, they may call the clients, advise them that they are in breach of contract and ask the clients to work with them to remedy the situation. In these instances, prudent design

professionals should tell their clients they are committed to the project and will work with them to devise options for fee payment, such as a payment plan. Pursuing this course of action will demonstrate that the design professional is willing to work with the client to resolve the issue, which could yield a better result — and keep the matter out of court.

The bottom line is, when fees are in dispute, the design professional must keep an eye on the bottom line.

### **What to do before you sue**

Before suing for fees, design professionals must weigh the hidden costs in pursuing a fee claim, including litigation costs and the time and energy it would take to defend a suit. And given the fact that a design professional's fee suit will most assuredly result in a counterclaim for professional malpractice, other costs may be involved.

If a professional malpractice claim is alleged, design professionals must put their professional liability insurance carrier on notice to defend the claim. The design professional must pay any deductible applicable to the policy to defend or settle the claim, and expend time and legal expenses to defend the claim. This could impact insurance premiums, as well as take time away from business. (Consult your agent or broker as to the effect this may have on your insurance premiums.)

### **Preventing a fee dispute**

There are measures design professionals can take to prevent fee disputes from the start. The best way to avoid fee disputes is to engage in risk management from the beginning. For example, use a written contract that sets forth the specific payment terms. Include a billing and payment method provision in your contracts, along with language for termination and suspension of services for non-payment, and specify that in no case should payment of your invoices be subject to a set-off, back-charge or discount.

Design professionals may also want to include a provision in the contract that states that payment of their invoice shall be taken to mean that the client is satisfied with all services. In addition, a provision can be included stating that if the client is at all dissatisfied with the service received, the client must notify the design professional in writing within a specified number of days.

If a client insists on including language in the contract that allows the client to, for example, withhold a fee or back-charge for any disputed amounts, the design professional may want to re-think whether it would be worthwhile to become involved with the project.

These are just a few of the suggestions that design professionals can use as pre-emptive measures. Before proceeding, design professionals should obtain the advice of legal counsel to devise a contract that addresses fees and other issues for use on every project.

## **AVOIDING A COSTLY MISTAKE**

### **Design without construction review**

An architect was asked to perform design work for the expansion of a townhouse complex by an owner/developer with whom he had worked many times over the past 15 years. In fact, the architect had already designed another, almost identical, complex for the developer.

The architect knew the "drill" with this developer: prepare a "bare bones" set of plans, without detail, and the developer would provide the necessary details during construction. The architect prepared a design of the exterior wall of the complex, without the waterproofing, vapor barrier, insulation and dry wall details. He also intentionally omitted the flashing detail, at the developer's request. No contract was negotiated, no scope of services was defined, and no construction review was stipulated. The architect submitted his sketches, collected his fee and was finished with the job.

### **Construction problems galore**

After the project's completion, the architect found himself involved in a lawsuit. The developer, in fact, had *not* supplied the missing design details, and the contractor had followed the incomplete plans he was given. He built the townhouse without a vapor barrier and without the flashing between the pre-cast concrete columns and the exterior brick walls. These omissions resulted in extensive water penetration into the interior units, making the structure unsuitable for occupancy. Suddenly, the architect found he was involved in a project that required \$250,000 in repairs, and the developer, his friend, was suing him for \$134,000 in lost income.

## The legal battle

The legal battle began with a deposition of the developer, who painted an entirely different picture of the townhouse construction process. Contrary to the architect's testimony, the developer insisted that at no time did he direct the architect to prepare anything less than a "complete set of design drawings suitable for construction." The battle was based on the architect's word against the developer's. Unfortunately, in a high percentage of cases when a professional renders services that appear to be incomplete, and no documentation confirming the limited nature of the services is provided, juries find that the design professional violated the applicable standard of care. So it was no surprise that the architect was found liable.

## Lessons learned

Construction observation services should be part of every design plan — especially when design details are not provided. Had the architect provided construction review as part of this project, he would have seen that the townhouse was not being built according to his design and taken corrective action. Unfortunately, he had agreed to only provide the design without review. The lawsuit made it clear that design professionals should not rely on others to properly construct a project.

## TO SURVEY OR NOT TO SURVEY

### Making sound business decisions

A large development company retained a surveyor to conduct a partial survey of property to be developed. The surveyor had a long-standing relationship, both personally and professionally, with the developer. The surveyor knew that there were some problems with the development and that it might not be a good choice of property. In addition, his friend had lost money on his last two projects. Regardless, because of his friendship with the developer, the surveyor decided to take the engagement for survey.

The property was "L"-shaped and only the northern-most portion of the "L" needed to be surveyed. The developer wanted to purchase the property, but there were issues relating to wetlands that had to be addressed before the purchase could occur. The surveyor sent a quick acknowledgement of the assignment to the owner, verifying that the survey would be on the property at issue.

The survey was conducted on the northern-most portion of the property. The boundaries were verified and telephonically transmitted to the developer, who then requested the survey and the bill. An invoice was sent, stating that a survey was conducted.

Six months later, the developer called the surveyor and stated there was a problem. The developer indicated that the ownership problem was on the southern-most portion of the property, not the northern-most portion. "After we started excavating," said the developer, "we received a court order stopping the work. We may have damaged some animal habitat." At that point, the developer recommended that the surveyor notify his malpractice carrier.

The surveyor wondered what he had done wrong, since he had surveyed the land he was asked to survey. The problem was that he had no documentation to support his position. As far as everyone knew, his survey included the south portion of the property. The result: As the only viable party (the developer had few funds), the surveyor was hit with the full damages — approximately \$25,000.

## Lessons learned

- 1 Remain objective in taking assignments; don't allow personal relationships to cloud your judgment.
- 2 Take care when accepting work from clients in distressed situations.
- 3 Never undertake a project without a contract. In this case, no document existed detailing the scope of services.
- 4 If not using a contract, at least send a letter to the client confirming your scope of services.

Ideally, the surveyor should have sought a contract for services from the developer. In every situation, a surveyor should document all project details and obtain approval in writing from the client. This is especially important when conducting a partial survey, or when there is an issue relative to ownership.

## LEGISLATIVE ROUNDUP

### Indemnity statutes and private construction projects

#### Arizona to outlaw broad form indemnity provisions

Senate Bill 1391 has recently been introduced by Arizona's legislature in an effort to modify the anti-indemnity statute as it pertains to private construction projects. Current law allows owners to contractually require design firms to indemnify them — even if an owner is found to be the sole or partial cause of a particular claim being brought against them.

This bill would modify existing law so that owners will no longer be able to use broad form indemnity clauses on private projects. Consequently, a design professional firm could only be required to defend, indemnify or hold their client harmless for claims arising from the design professional's own negligence.

The bill also outlaws the use of additional insured requirements that require a design professional's insurer to defend or indemnify the additional insured for its own sole or partial negligence.

If passed, this bill will provide design firms with a significantly improved climate for negotiating fair and equitable agreements for professional services.

#### Texas Certificate of Merit law enacted in Texas

A significant event for design professionals in Texas was the recent enactment of the *Certificate of Merit* legislation, Texas Civil Practice and Remedies Code § 150.002 (Vernon Supp., 2004).

The statute reads: *In any action for damages alleging professional negligence by a design professional, the plaintiff shall be required to file with the complaint an affidavit of a third-party registered architect or licensed professional engineer competent to testify and practicing in the same area of practice as the defendant, which affidavit shall set forth specifically at least one negligent act, error, or omission claimed to exist and the factual basis for each such claim. The third-party professional engineer or registered architect shall be licensed in this state and actively engaged in the practice of architecture or engineering.*

The significance of the *Certificate of Merit* law is that it requires the plaintiff to consult with a third-party design professional to review the facts of the claim prior to filing suit against another design professional. Based on that consultation, the plaintiff attorney is required to file an affidavit with the court, signed by the third-party design professional, to the effect that, based on review of the allegations, the third-party design professional believes there is a reasonable basis for commencement of the lawsuit.

Observers believe this statute will go a long way to help reduce frivolous claims against design professionals. No longer will a plaintiff attorney “shotgun” the design professional into the lawsuit and “blackmail” them into contributing to a settlement. Plaintiffs are likely to think twice before naming the design professional, unless they have first consulted with a third-party design professional to support the merits of their claim.

Other states have *Certificate of Merit* statutes that provide certain protection for design firms against unsubstantiated claims, including Arizona, California, Colorado, Georgia, Hawaii, Kansas, Maryland, Minnesota, New Jersey and Wyoming. Design professionals in other states can contact the local AIA or ACEC chapter or their state legislators to check on their state's progress in pursuing such statutes.

## PRE-CLAIM ASSISTANCE

### How to effectively manage potential claims

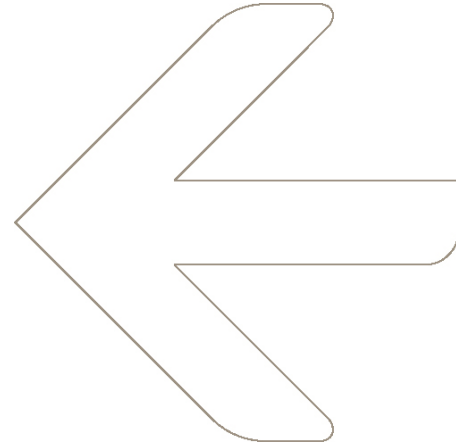
Effective claim management for construction claims starts with early claim notification. When a client notifies the insurance provider of a claim or potential claim *early in the process*, the likelihood of the claim being effectively resolved is significantly increased. Experience shows that early claim or pre-claim notification results in a positive outcome. The claim generally is resolved in less time, with reduced aggravation and fewer dollars. The insurance provider also benefits because early notification and quick resolution can mean decreased expenses and better settlements.

#### Situations that benefit from a pre-claim assistance program

St. Paul Travelers, recognizing the benefits of early notification of a potential claim, offers a pre-claim assistance program for design professionals to help them manage claims more effectively. The benefits of the program are not only in terms of time and money. By offering this program, we are reinforcing our commitment to a long-term relationship with our design professional policyholders.

Design professionals can encounter a number of situations in their day-to-day activities. Following are just a few of the instances when our pre-claim assistance program can help:

- Death or injury on the job site
- Death or injury on a completed project
- Cost overrun claim by a contractor against the owner
- Claim for extras by a contractor against the owner
- Excessive number of change orders or requests for clarification on a project
- Claim for changed site conditions by the contractor
- Design, specification or code errors or omissions by the contractor
- Unauthorized change to the design documents
- Termination of the insured, its sub-consultant, the contractor or subcontractor
- Failure or collapse in a building component or system
- Request for the insured's deposition as a non-party witness
- Request or subpoena for the insured's records
- Owner's refusal to pay the insured's outstanding fees
- Contractor's refusal to pay its subcontractors
- Owner asking insured to execute an unfair contract
- Dispute between the contractor and its subcontractors, including refusal to pay
- Investigation of the project by a government authority



### The pre-claim assistance process

As part of the pre-claim assistance process, St. Paul Travelers claim representatives will work with you to gather and assess the facts in an attempt to manage the investigation and disposition of the claim.

Our assessment activities include attempts to:

- Identify the wrongful act(s) that may be the basis for a claim being made against you.
- Identify the nature of any possible injury or damages that may result if a claim is made.
- Identify how and when you first became aware of the pre-claim situation.

As part of the process, we also help manage the legal counsel and experts. This includes:

- Retaining an attorney on your behalf and paying for legal expenses while attempting to mitigate the situation.
- Retaining an expert on your behalf and paying for the related consulting expenses while investigating the facts of the case.

Under the terms of your policy, attorney and expert expenses do not apply to your deductible or policy limit. Another advantage of the pre-claim notification, investigation and assessment process is that, once you have reported the situation to St. Paul Travelers, policy coverage is positioned to respond to any subsequent claim that might arise from the pre-claim situation.

When confronted with a pre-claim situation, prudent design professionals know the benefits of early pre-claim notification. If you encounter a potential claim, remember to take advantage of our pre-claim assistance program — designed especially for you.

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We hope you enjoyed the first issue of **Stamped, Sealed and Delivered**, and that you find it to be informative and worthwhile. If you have any questions regarding the articles in this newsletter, or you would like to submit topics for future issues, please contact Dana Coleman Caparoso at 732.205.9297 or at [caparos@stpaultravelers.com](mailto:caparos@stpaultravelers.com).



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