



# Avoiding Claims In a Recession

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## **Recession: Impact On Design Firms**

- Revenues decreasing**
- Profit margins decreasing**
- Future is uncertain**
- Financial viability of firms tested**
- Supply outweighs demand for services**



## Recession: Actions

- **Budget cuts**
- **Acquisitions**
- **Productivity gains & operational efficiency**
- **Follow the money = Going global**



# Recession: Increases Risk

## Clients

- Project financing
- Owners looking for \$ = more claims

## Firm Expertise

- Dabble Effect: Design firms exploring new markets and new projects
- More with Less = Opportunity for mistakes

## Contracts

- Client terms = poor contracts

# Mistakes Can Be Costly

- The Firm loses time
- The Firm loses money



# The True Cost of a Problem

## Cost of problem

- \$1,000
- \$10,000
- \$50,000

## Revenue needed to offset problem cost\*

- \$20,000 (400 Staff hours)
- \$200,000 (4,000 Staff hours)
- \$1MM (20,000 Staff hours)

*\*Assumes 5% after tax profit*



# Good Business Practices Reduce Professional Liability Risk

- Study after study has shown that good business practices reduce both the frequency and the severity of professional liability claims and lawsuits.
- 20/20 hindsight vision often identifies a poor business practice as the root cause of a claim.



# The First Commandment

# Client Selection



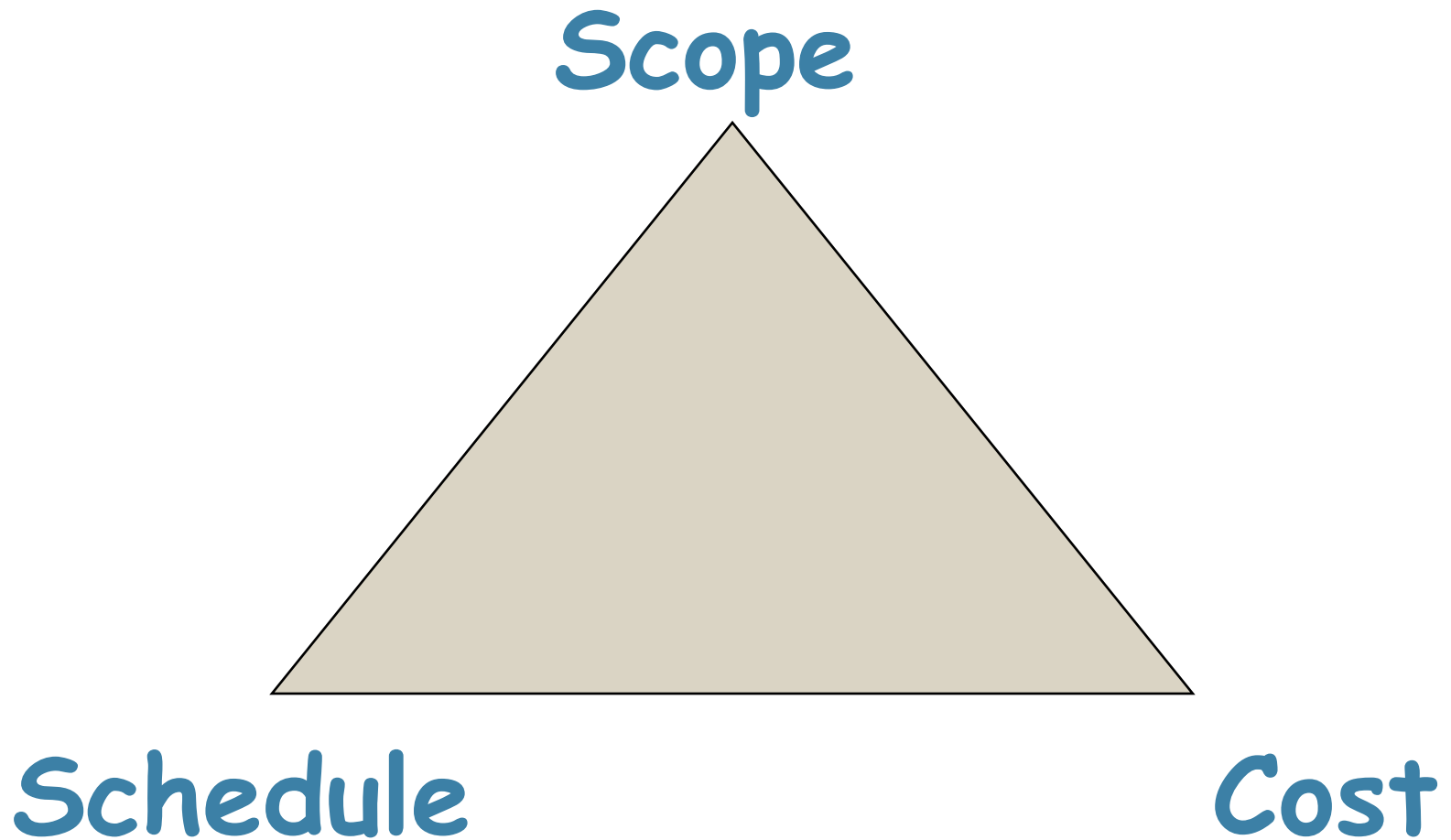


# Today's Realities

- Risk management begins with client selection
- All clients are *not* created equal
- Clients pay your fees, not projects
- Most firms chase projects, not clients
- There are some clients you cannot afford to have

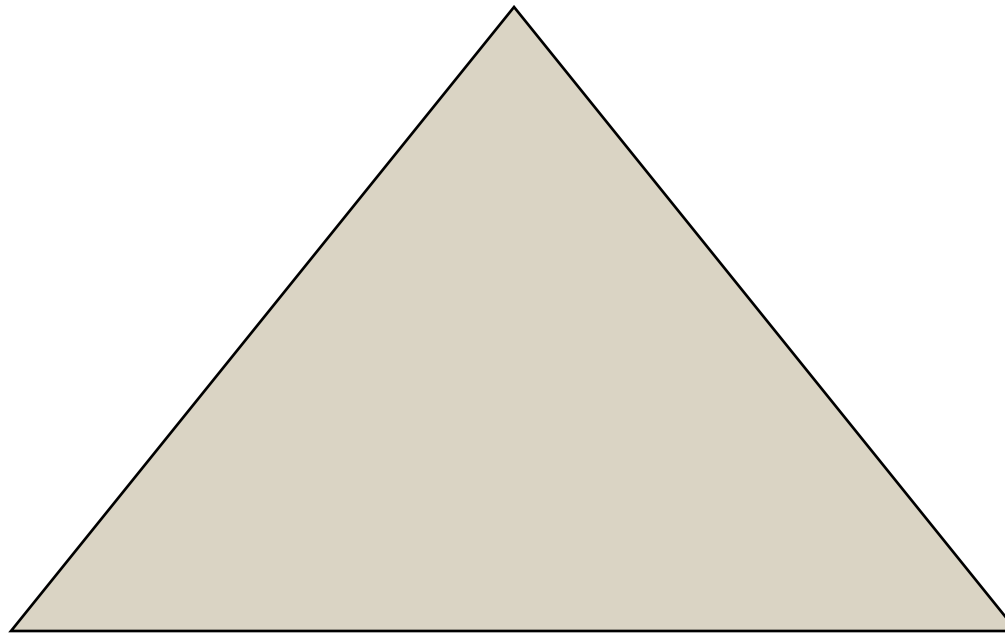


# The Business Reality



# The Client Perspective

**Better**

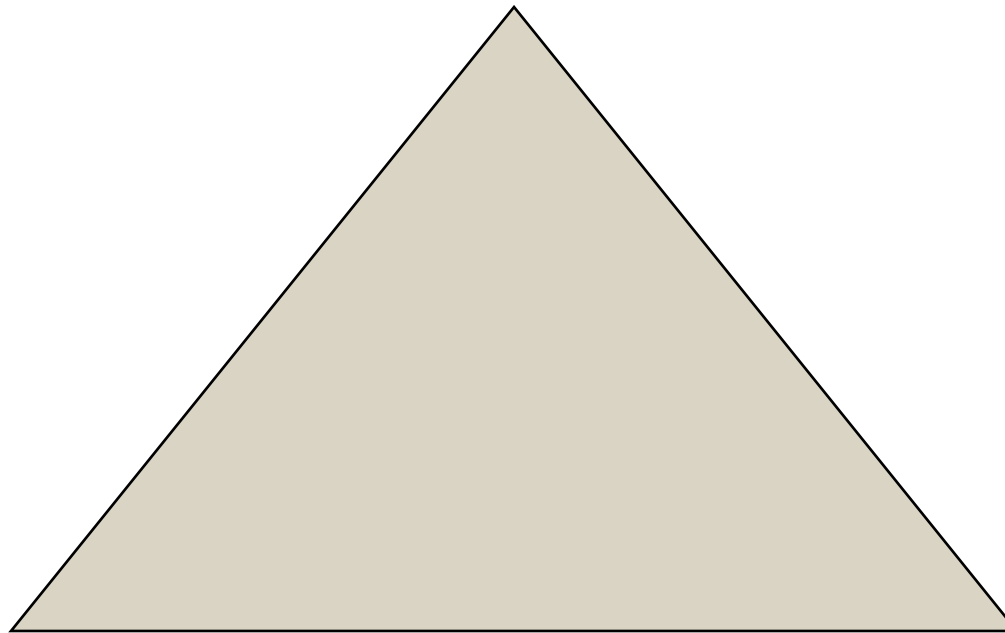


**Faster**

**Cheaper**

# The Designer's Perspective

It can always be improved



It will be ready  
when I'm finished

It cost what  
it costs

## A Good Client Will...

- Take time to discuss the project and their own business drivers.
- Be interested in your firm and how you can add value to the process.
- Communicate evaluation criteria and be open to your suggestions about potential changes.
- **Pay you on time**



Some of your best clients are the ones  
you never had



# What to Look For

- Reputation
- Financial condition
- Experience/sophistication level
- Dispute resolution
- Communication style



# Manage Client Expectations

- Project goal
- Educate
- Expectations
- Responsibilities
- Risk items
- Contingencies





# Alchemy of a Successful Project?

\_\_\_\_\_ % Technical

\_\_\_\_\_ % Communication



# Managing Client Expectations

- Communicate and Document
- Stick to your scope
- Scope changes mean fee changes
- Client changes mean change orders
- Cost-schedule-quality



# The Second Commandment

## Project Selection and Firm Capabilities



# How do you choose your project teams?

- Necessary skills and experience
- On-going, established teams
- Any pair of hands
- A combination of availability and qualifications
- Whomever I'm stuck with by management



# Matching Team and Project Criteria

- Projects can fail when the team's capabilities are not in sync with the:
  - Client's needs: budget and schedule
  - Project's needs
  - Required technical knowledge
  - Essential project experience



# Project Selection

- Successful firms know their strengths and weaknesses
- Successful firms position their people for success



# Project Selection

"Organization doesn't really accomplish anything.  
Plans don't accomplish anything, either.  
Theories of management don't much matter.

Endeavors succeed or fail because of the people  
involved. Only by attracting the best people will  
you accomplish great deeds."

General Colin Powell



# The Third Commandment

## Negotiate Indemnities





# Use Caution with Client Prepared Contracts

- Learn the skills to read, review and understand your agreements
- Get help from a competent lawyer
- Review insurance, indemnity, certification and guarantees with your insurance agent
- Always balance risk against reward!



# Use Caution with Client Prepared Contracts

## — Reality Check:

- Who reviews client prepared contracts for the firm?
- Are they properly trained to recognize potential problems?
- Does the firm utilize legal and insurance resources?



# Indemnity

By including an indemnity in the agreement with you, your client is attempting to transfer some or perhaps all of his or her risk to you



# The Golden Rule

The party with the most control and influence over a risk should be responsible for bearing that risk.



# Different Approaches to Indemnity

- Option 1: No indemnity. More common on smaller projects with less sophisticated owners.
- Option 2: Get the client to indemnify you. This scenario is unlikely.
- Option 3: You indemnify the client for your negligence only.
- Option 4: You and the client indemnify each other.
- Option 5: You indemnify the client for everything.



# When Negotiating Indemnity Agreements, Know Your Policy Coverage

- Your policy provides coverage for DAMAGES as a result of CLAIM(S) arising out of the rendering of PROFESSIONAL SERVICES.
- PROFESSIONAL SERVICES are “those services performed for others in the practice of architecture, engineering, land surveying, landscape architecture, interior design, construction management, environmental consulting . . .”
- Someone else’s legal fees are not PROFESSIONAL SERVICES.
- Someone else’s negligence is not a PROFESSIONAL SERVICE.



# Defense v. Indemnity – Big Difference

- Who are the “Indemnatee” and the “Indemnitor”?
- Indemnity obligations typically accrue once the Indemnatee pays money.
- In most jurisdictions, indemnity does not automatically cover the cost of defense. You have to specifically agree to defend another party.
- The cost of defense can be exorbitant, and is not covered by insurance.



# Is the Defense Obligation Always a Deal Breaker?

- Commercial reality: you might have to agree to defend a client if you want the project; e.g., government jobs
- Make an informed business decision
- Evaluate your risk
- Be mindful of your subconsultants' contracts





# What to do if you have to defend a client

- Try to negotiate the following:
  - Counsel of your choosing or counsel “reasonably acceptable” to you
  - At reasonable rates for that type of work in that particular community
  - Reimbursement for reasonable fees actually paid
  - Not all attorneys are created equally



# What to do if you have to indemnify a client

- Try to negotiate the following:
  - Indemnify your client for your negligence
  - Negligence triggers – “upon a finding of negligence”
  - Mutual indemnity provisions – they can cancel each other out; e.g., where joint and several liability applies.

# Common Indemnity Provision

The Consultant shall defend, indemnify and hold harmless the Client, its officers, directors, attorneys, lenders and employees against all actions, causes of action, demands, damages, fees, expenses and costs, including any attorney's fees, arising directly or indirectly, resulting from or connected in any way in whole or in part from the Consultant's performance of the services under this Agreement.



## What to Negotiate

The Consultant shall ~~defend~~, indemnify and hold harmless the Client, its officers, directors, ~~attorneys, lenders~~ and employees against all ~~actions, causes of action, demands~~, damages, fees, expenses and costs, including ~~any~~ **reasonable** attorney's fees, arising directly ~~or indirectly, resulting from or connected in any way in whole or in part~~ from the Consultant's **negligent** performance of the services under this Agreement.



## Better Indemnity

The Consultant shall indemnify and hold harmless the Client, its officers, directors and employees against damages, fees, expenses and costs, arising directly from the Consultant's negligent performance of the services under this Agreement.



# The Fourth Commandment

## Limitation of Liability



## No Project is Perfect

- Today's construction projects involve a high degree of complexity and sophistication, involve numerous participants in the design and construction process, and are done under greatly compressed time schedules within tight budgetary constraints.
- Do not accept unlimited liability on a project.

# Limitation of Liability

- Limitation of Liability (LoL) is an agreement between the design professional and the client to establish the maximum liability for which the consultant will be liable if there is a claim by the client on the project.
- Purpose: to allocate the risks in some reasonable proportion to the profits and other benefits to be derived by each party.





## Limitation of Liability

- Such a clause can make or break your company
- The nature of the project should dictate whether the absence of a LoL is a deal breaker; e.g., hazardous materials, condominiums, design without construction phase services
- Be up front with your client about limiting your liability



# Limitation of Liability

- Depends on State law – consult with your attorney first.
  - Some states do not allow or strongly disfavor
- Rules of contract interpretation apply
- Generally, if the LoL is agreed upon by parties of relatively equal bargaining strength and is clearly drafted, it will be enforceable.



## Choosing a Limitation Amount

- Amount of the fee or \$100,000, whichever is more or less?
- Using a “whichever is more” clause could be risky if your scope of work is constantly expanded
- Most courts will strike unreasonably small LoLs; e.g., \$100



# Tips for Negotiating an Enforceable LoL

- Was there an “opportunity” to negotiate the LoL?
  - How sophisticated is the client?
  - Is it a standard pre-printed form, or was there a blank to fill in which evidences that the clause was negotiated?
  - Was there a space for the client to initial, thereby evidencing consent and the opportunity to negotiate?
  - Does the provision stand out in the contract?
  - Did your proposal reference your prior conversation in which you agreed upon the LoL?

## Tips for Negotiating an Enforceable LoL

- Client’s objection to a “whichever is less” LoL is evidence of actual negotiation
- Always use this language: “...but in no event shall the Consultant’s liability exceed the amount of available insurance proceeds.”
  - This clause ties your LoL to your remaining policy aggregate.
  - Try to use this clause even if you cannot limit your liability to your fee or a set dollar amount.



# Sample Limitation of Liability

- Consultant and client have discussed the risks and benefits associated with this project as well as the consultant's fee for services. Consultant and client agree to the fullest extent permitted by law, except for circumstances caused by the willful misconduct of consultant, all claims for damages of any kind arising out of the Services furnished under this Agreement and any Change Orders to this Agreement, asserted against consultant by client (including client's officers, directors, employees, shareholders, members, agents, architects, other consultants, contractors and subcontractors) including claims against consultant's officers, directors, employees, shareholders, members, and agents, are limited to ...



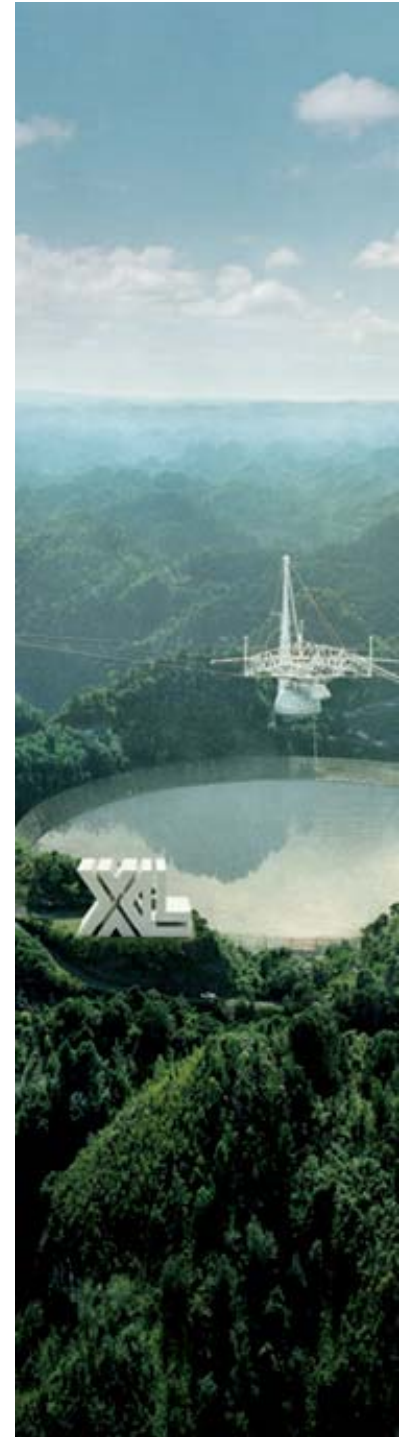
## Sample Limitation of Liability Continued

- The lesser of (i) \$100,000; or (ii) the total invoiced dollar value of the Services provided by consultant under this Agreement and paid by client, but in no event shall consultant's liability exceed the amount of consultant's available insurance proceeds.



# The Fifth Commandment

## Document and Confirm





# Document and Confirm

- General rule: He who has the most paper wins.
- Secondary rule: Never assume communication; always confirm.



# Document and Confirm

- Establish standards for what is documented (What, When & Why)
  - Meetings, job site visits, telephone conversations, e-mail, voice-mail messages, fax transmittals
- Establish standards for how documentation is organized and stored
  - Paper files, electronic files or both?



# Document and Confirm

- Documentation needs to become part of a firm's culture
- Lawyers charge you for documenting their work for you
  - Do you consider documentation costs in your fee?



# Document and Confirm

## — Reality Check:

- What do you document? (Meetings, job visits, phone calls, voice-mail, e-mail)
- How do you document? (Paper, electronic or both?)
- Is all documentation organized and in one place?
- How do you confirm important communications?



# Self Assess

- How does your firm measure up?
- Where are your firm's weaknesses?
- Are any practice or project management weaknesses exposing your organization to excessive risk?
- Contact Stuckey Insurance or XL Design Professional, and take advantage of our A/E industry expertise

