

Professional Liability Update



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A/E Risk Review

The Check Is in the Mail: Get Paid Without Getting Sued

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Signs of economic recovery continue to sprout up across the country, albeit slowly in many areas. Clients who have delayed projects during the lingering slowdown are beginning to revive or renew plans for new buildings, commercial and residential.

Many of those owners who are taking the plunge and investing in new projects have been struggling financially in recent years. Their bank accounts are likely not flush with funds and loans can still be hard to come by. Therefore some of these new projects are being started on shoestring budgets and it wouldn't take much in terms of project delays or unexpected costs to put these owners in a pinch. And when money is tight, it is often the design professional that is last in line when the owner is handing out the dollars.

Designers who do not get paid for their services according to contract terms may have to take legal action in an attempt to collect the money they have earned. Unfortunately, these designers face the distinct possibility of being hit with a counterclaim from their non-paying clients.

Clients who are sued for fees are very likely to respond by suing the design firm in return. These clients may file a counterclaim for negligence, and these counterclaims are not always meritless. Almost all instruments of service have some degree of error, omission, inconsistency or ambiguity. While such imperfections may not rise to the level of negligence, a client's legal counsel may have little trouble finding a "hired-gun" expert witness who will testify that the design firm performed below the standard of care. They will contend that negligent performance damaged the client – and presented a valid reason for nonpayment.

In many cases, the cost of defending a negligence claim will be greater than the amount of fees a design firm would likely net from a successful claim of nonpayment. This puts the client in a position of leverage, especially if payment terms and the consequences of late payment or nonpayment are not detailed in the contract. That's why many design firms are forced to settle payment disputes by accepting only a fraction of the fees they are owed.

How do you avoid being stuck between a rock and a hard place during a payment dispute? The following steps are your best bet to getting paid in full and on time.

Select Your Clients Carefully

Careful client selection is a cornerstone of risk management. In uncertain economic times, it becomes paramount. Design firms must avoid the temptation to take on any project offered when business has been slow.

Familiar clients with whom you've worked successfully in the past, of course, represent the lowest financial risk. Historically, public and institutional projects have been more financially sound than private ones. But with so many municipalities facing money crunches that is no longer always the case. Developers as a group are perhaps the greatest financial risk.

It's always wise to have frank up-front discussions about financing with a potential client. In addition, check a potential client's history of litigation with other design firms. Ask for a list of references and follow up with those design firms to determine past payment history. Examine the potential client's financial statements. Run a credit check. Consider the viability of the project itself. How are similar projects progressing in your locale?

Assuming the client and project check out, your next line of defense is your contract. Work with your legal counsel to draft appropriate terms.

Establish Payment Provisions in Your Contract

There are many contractual measures you can take to increase the chances of being paid and to help avoid a countersuit related to client nonpayment. Spell out in your client agreement payment terms for services rendered and your rights to remedies in the event you are not paid according to the contract. The more precisely you define the details of these payment terms and your right to enforce them, the more likely you'll receive prompt payment – and the less likely your client will consider a counterclaim.

Your billing and payment terms should address the following issues:

Retainer. *Require the client to make an initial payment upon execution of the agreement. Hold the retainer and apply it to the final invoice.*

Payment Terms. *Specify the timing of your invoices, e.g., weekly, monthly or upon completion of project phases. Specify the period of time for payment (e.g., upon delivery, net 30) and when payment is considered past due. It is advisable to specify that payment for services already rendered shall be due regardless of any subsequent suspension or termination of the agreement by either party.*

Interest. *Establish interest due on late payments and how that interest rate is accrued. Also set how future payments are applied – e.g., first to accrued interest and then to the unpaid principal.*

Collections. *Address how any collection costs will be recovered. Contractual clauses often specify that the client agrees to pay for all collection costs incurred, including legal fees, collection agency fees, court costs, reasonable consultant staff costs and other expenses.*

Contingency Funds. *Try to negotiate a contingency fund into the contract to cover unanticipated expenses due to scope creep, change orders, increased material expenses, unknown site conditions, and other surprises. Having money set aside for the unexpected helps avoid payment delays.*

When setting billing and payment terms, try to make it easy for your client to write those checks. For example, work your payment schedule to fit their billing cycle. Have your accounts receivable person call their accounts payable person as bills are issued to ensure receipt and understanding. These two should converse immediately should a payment be late. Offer discounts for advance payments or for setting up a pre-funded account upon which you draw as you work.

Use a Satisfaction-with-Services Clause

If possible, incorporate a satisfaction-with-services clause in your contract. Such a clause can help you in the event a client fails to pay a subsequent invoice and later claims dissatisfaction with your entire range of services.

Essentially, the clause states that your client's payment of an invoice shall be taken to mean that they are satisfied with your services to date and that they are not aware of any deficiencies in your services unless otherwise noted.

Withholding Fees for Disputes

Refuse to allow your client to include contract language that permits the withholding of all fees for disputed invoices. If the client insists on a clause regarding disputed fees, make sure it reserves your right to collect fees on all undisputed portions of the invoice.

Set a time limit (e.g., within 10 business days of receiving your invoice) for notification of any objection or dispute regarding the invoice. Require that the client identify in writing the specific cause of the disagreement and the amount in dispute. Also require that the portion of the invoice not in dispute be paid according to your payment terms.

Your contract should specify that any disputes over an invoiced amount will be settled according to the dispute resolution provision of your contract – preferably mediation. Require that interest be paid on any disputed invoice amounts that are subsequently settled in your favor.

Suspension of Services

One of the most effective contract provisions for getting paid on time requires the client to pay any undisputed due portion of the bill within a specified period or otherwise face a curtailment of your services. But first, check with your attorney to determine whether such language is enforceable within your state.

If you can use a suspension-of-services clause, have it specify that if your client fails to make payments when due under your contract terms, you have the right to suspend your services upon reasonable notice to your client (e.g., when payment is 60 days late.) The clause should also state that you will not be liable to the client for any costs or damages that may result from your suspension of services due to nonpayment. Agree to resume your services upon payment in full of invoices due or past due. The clause should state that upon resumption of services the project schedule and compensation will be equitably adjusted to reflect any delays or additional costs to you caused by the suspension of services.

Termination of Services

When all else fails in your efforts to collect fees past due, you should have the right to terminate your contract. A termination-of-services clause should state that the client's failure to make payments to you for services rendered in accordance with the payment terms of the contract constitutes a material breach of your agreement and this material breach is cause for termination of the entire agreement.

Withholding Transfer of Documents

Consider making payment in full for services rendered a condition of transferring the ownership of your design documents to the project owner. This condition often serves as effective leverage to ensure you receive your final payment. Similarly, you might make payment of all due invoices to date a condition for you submitting documents for permit approvals and other activities during the course of construction.

Work with your attorney to develop payment terms and language best suited to your firm's unique needs. Check out the advice offered by your professional societies as well. Once you have language in place, seek to apply it consistently among all of your clients.

Be Wary of a Resistant Client

Be wary of potential clients who balk at signing any language that protects you from nonpayment. Occasionally, however, clients may have legitimate problems with specific obligations of your payment terms. So be flexible. For example, a client's billing and accounting procedures may require it to extend the length of invoice payment beyond 30 days. A client who wants to pay in 60 or 90 days should expect to pay a premium for that luxury.

If the client balks at accepting a termination-for-nonpayment clause, as opposed to objecting to its specific terms, be aware that the client may be contemplating slow or no payment and does not want you to have the ability to suspend or stop services. In such cases, you have to ask yourself, "Do I really need this client?"

By using appropriate contract language with real teeth and by following a consistent, well-designed billing and collection system, you can minimize the risks of write-offs and slow-paying accounts as well as threats of retaliatory liability claims.

Avoid Contentious Counterclaims

Lawsuits, liens, and other actions taken or threatened against a client who doesn't pay its bill will likely lead to a counterclaim of negligence. And unfortunately, a counterclaim filed over fee disputes is one of the most contentious areas of litigation between design firms and clients. The relationship can rarely be repaired.

Adding protective language to your agreements and establishing good communication with your client helps reduce the chances of having a project and client relationship turn sour. Furthermore negotiating your billing and payment terms up front enables you to judge your clients attitude regarding your ability to enforce the agreed-to fee and payment schedule for your services. It's usually far better to avoid a project rather than start a project for which you don't get paid.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.

STUCKEY INSURANCE is the leading provider of Professional Liability to design professionals in Arizona. Please call us if you like to schedule a consultation for your insurance needs.



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