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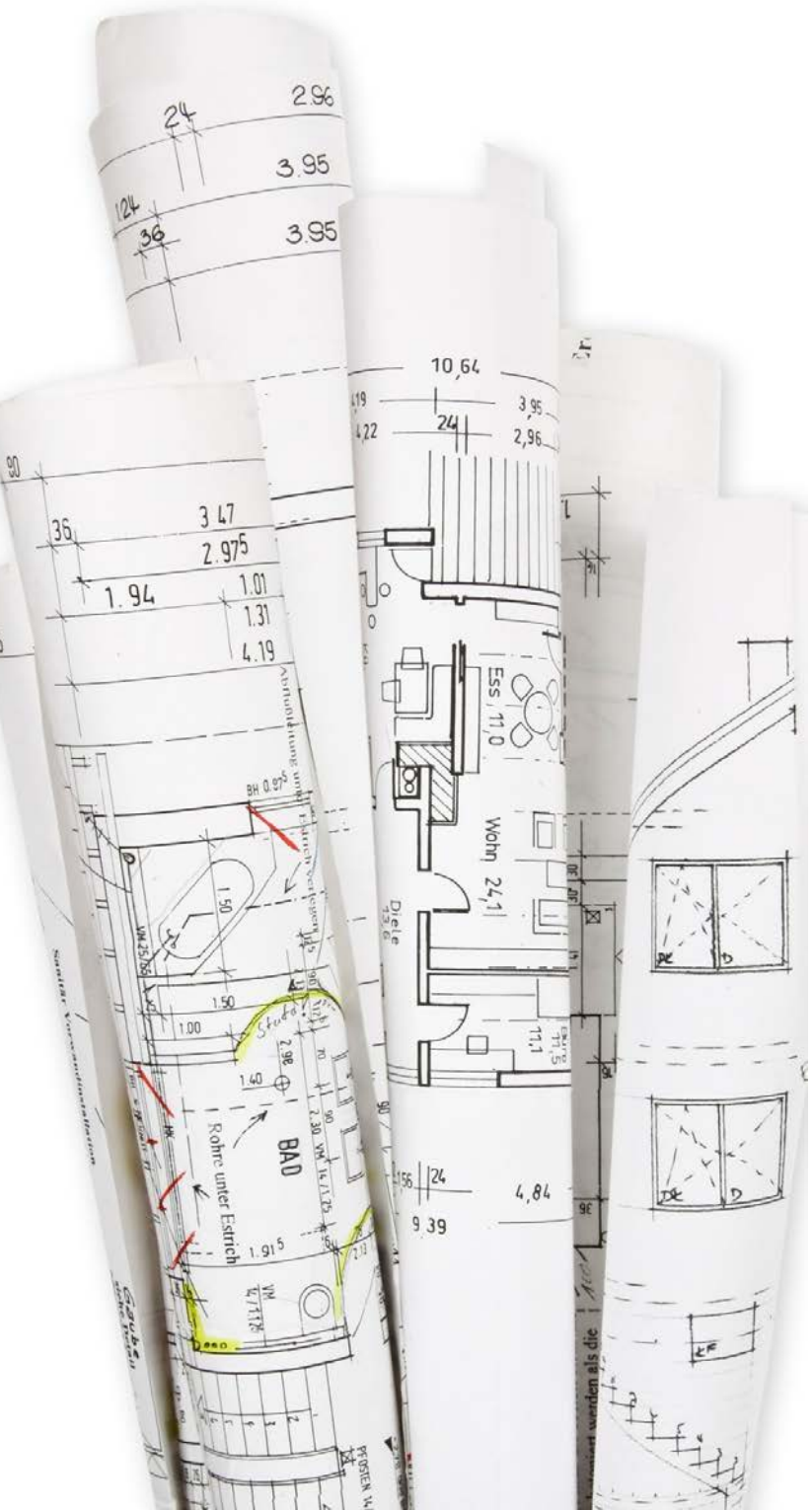

DISPUTE & CLAIM HANDLING – A RISK MANAGEMENT TOOL: #10 OF THE TOP 10 RISK MANAGEMENT PRINCIPLES FOR DESIGN PROFESSIONALS

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In the October 2019 issue of Building Blocks, we outlined the top 10 risk management principles regarding design professionals for the next 10 months, one principle at a time, focusing on one each month.[1] Consequently, in the tenth and last of the top 10 principles, the August 2020 issue of Building Blocks is focusing on "**Dispute & Claim Handling**." The top 10 principles are based, in part, upon the Council of American Structural Engineers' (CASE) "Ten Foundations for Risk Management," and the National Council of Architectural Boards' (NCARB) two of the six educational modules titled "Practice Management" (PcM) and "Project Management" (PjM) of the Architectural Registration Examination (ARE). The first five risk management principles related to practice management, and last five risk management principles relate to project management.

IN THIS ISSUE:

DISPUTE & CLAIM HANDLING IS BEST NOT BASED ON-THE-JOB TRAINING

Almost every project has issues to be resolved from design through construction. Only when those issues become troublesome, an approach is needed to protect your firm's best interests. Develop and implement a dispute and claim handling procedure that involves the appropriate personnel in your firm, be it the principal in charge or a project manager. Communicate both internally and externally in a timely manner, including your firm's insurance agent and risk manager, professional liability insurance carrier and legal counsel. Understand that dispute and claim handling is something that is not taught in school, but a firm's best approach is not based upon just on-the-job training.

Let's address dispute handling first, because claims are usually the matured stage of a dispute. But even before considering dispute handling, the best way to resolve a dispute is to prevent it in the first place. Prevent claims by implementing the risk management tools that we addressed and suggested over the last 9 months in DesignPro Insurance Group's Building Blocks. Not having a risk management plan in a professional practice results in misunderstandings and misaligned expectations by all parties in the project process (the design professional, their client, their staff and consultants, etc.).

Design professionals should strive to educate their clients regarding what they do, and some more than others. After that, if a situation arises that can evolve into a dispute, address it immediately. Don't try to "sweep the situation under the rug." Situations do not resolve themselves over time—they usually worsen. If a circumstance has the potential to evolve into a dispute, gather all your resources on the project involved, and then meet with your client (in person or virtually). Your resources should include:

- firm member(s) with knowledge of the project, and the circumstance involved (consultants too),
- documentation relating to the situation (drawings, specifications, emails, reports, photos, etc.)
- your firm's professional liability insurance agent, who may suggest that the circumstance be reported to your insurance carrier,
- and any other information relative to the situation.

A DISPUTE HAS EVOLVED INTO A CLAIM—WHAT IS A CLAIM & WHAT HAPPENS NEXT?

From a professional liability insurance perspective, assuming a dispute has evolved into a claim, an understanding what a "claim" is important. A claim is usually defined as a "demand for money or professional services" by your client, or even a third party. If a claim results, the next needs to be considered—litigation, arbitration and mediation.

LITIGATION IN A COURT OF LAW

If your agreement with your client does not require that the dispute is to be resolved by arbitration, your claim will likely be tried in a court of law. Most cases are filed in the court of common pleas where the jurisdiction is determined by a certain set of rules. It is unlikely that the claim will end up in federal court, for what is called "diversity of citizenship," if the plaintiff and defendants are from different states.

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Likely, the first thing that will happen is a legal pleading called a "complaint" will be delivered to your office. It will name your firm as a defendant (and likely other defendants as well—this is called "shotgun" litigation hitting anyone in sight connected to the matter). Sometimes, the lawyer who prepared the complaint may add the principals of the design professional firm as defendants as individuals. Not to worry too much, since your professional liability insurance policy likely covers the defense of the firm, the firm's owners and employees. Typical allegations in the complaint include that the defendants:

- were negligent in performing their services for the client's project,
- breached their contract (agreement) with their client,
- breached warranties, both express and implied, for services provided,
- and any other allegations that your client's lawyer can think of.

A breach of warranties is most troublesome for the defendants, since professional liability insurance policies typically excludes coverage for this allegation. The firm's coverage is designed to cover professional negligence, and no other allegations. Your firm's insurance carrier will likely send a "reservation of rights" letter to the firm and the firm's insurance agent, stating there is no coverage but will defend the complaint since all the allegations are wrapped up into one legal pleading. At the end of the litigation, if it is determined that a warranty existed for professional services, and was breached, the insurance carrier may deny coverage for the damages proved by the plaintiff. That is why it is extremely important for design professionals to strike out any contractual language proposed by their client that creates an express or implied warranty.

Express warranties are easy to detect:

> *The Architect/Engineer warrants that their services will comply with all laws, rules and regulations, and that the A/E further warrants that the project documents will be error free, and the project will be built in strict and in complete accordance with the drawings and specifications.*

Implied warranties are not so easily to detect:

> *The Architect/Engineer's drawings and specifications are fit for their intended purposes.*

After the firm receives the complaint, they should immediately forward the complaint to their professional liability insurance agent. The agent will send the complaint to the insurance carrier, who should acknowledge receipt of the complaint, and soon after assign legal counsel to the matter. It is critical that you report the claim to your insurance carrier through your insurance agent during the policy period. Reporting a claim, if your policy has expired, will result a denial of coverage for the matter. The first thing your legal counsel will want is a copy of your agreement with your client and any consultants. The legal counsel will then file an "answer" to the complaint, denying all allegations.

NOW COMES THE HARD PART

The period of time from receipt of the complaint to the resolution of the claim, called the "discovery" period (that is when all parties can conduct "discovery" of all the relevant facts relating to the matter) can be:

- arduous, involving or requiring strenuous effort, difficult and tiring dealing with the procedures in discovery,
- time consuming (a matter may extend into years),
- expensive for your firm's deductible and time spent on the matter that is unbillable,
- upsetting, especially if your firm is arguably not at fault causing the claim, and the allegations are baseless,
- and is distracting to the firm's principals, and probably the firm's staff (the buzz around the office—but consider using the claim as a "lesson learned" meeting for the firm involving senior and junior staff, but do not create incriminating documentation from the meeting that can end up in hands of opposing legal counsel).

Your legal counsel should explain what information that is communicated internally and externally during the discovery period can be considered "attorney-client" privilege. The attorney-client privilege refers to a legal privilege that works to keep confidential communications between an attorney and his or her client protected from disclosure (a secret). The privilege is asserted in the face of a legal demand for the communications, such as a discovery request or a demand that the lawyer testify under oath.

> **Discovery war story #1 of 2—the case of the "smoking gun."**
>
> An engineer conducted a construction site visit, and back at his office prepared a draft of a report of the observations. The engineer made edits and comments on the draft before it was completed, and issued the final version to the project's parties involved. One comment (in the margin in red ink) on the draft, which did not make it into the final version of the report stated "boy, we really screwed this project up." The draft of the report ended up in a cardboard box under the engineer's desk, and was produced in the discovery period. The engineer's firm's attorney explained that the discovery period is an "open-book" process, and includes the opportunity for opposing counsel to review and have copies of not only the official project file, but also working files and drafts, documents in desk drawers and job site cabinets, computers at office and home, etc. The

engineer was deposed by the attorneys involved in the matter, and was drilled on why the engineer made the marginal note. It was very difficult for the engineer to explain why his firm was not negligent in the claim. *(If you have not had the displeasure of being deposed, all attorneys ask questions creating sworn testimony in a verbatim transcript that can be used to your detriment as evidence for the jury trial.)*

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The moral of the story—don't create a "smoking gun" in your firm's records and documents. A document that can come back and bite you should not be created in the first place. Internal written or electronic memos incriminating your firm should not be created. There are numerous examples of this situation in the news media. And consider that opposing counsel could make a claim, during discovery, that your firm intentionally destroyed incriminating evidence detrimental to your firm. This is called "spoliation" of evidence, and can carry with it serious liability and potential sanctions by the court of law.

All this being said, a firm should have a document retention policy that address what is intentionally saved for future use, as a risk management tool. Over time, records may be routinely purged and destroyed as a standard business practice, when they are not involved in litigation. Thus, if your firm's record retention policy is carried out in good faith, it could serve as a defense to a spoliation claim that your firm intentionally destroyed incriminating documents detrimental to your firm.

Discovery war story #2 of 2—the case of the "if it is not documented, it as if it does not exist, and the absent CYA letter."

Many years ago, an A/E firm was engaged to design an addition to a shopping mall, to include a drug store. The A/E project manager verbally requested his client, the real estate developer, to supply a supplemental soils report to the report that the developer had paid for, for the mall. The developer verbally stated they would obtain a supplemental report, but neglected to do so, even after several verbal requests by the project manager. To move the project design along, the project manager directed his in-house structural engineer to make soil bearing capacity assumptions based upon the existing soils report, and design the foundations of the addition. After the store was built, the store began to settle unevenly, causing large cracks on the exterior split face concrete block walls and racked the store front. As it turned out, the addition was built on top of debris from the mall's construction. Litigation ensued, and the A/E's attorney took the deposition of the developer. When asked why the developer did not supply a supplemental report, the developer (keep in mind that depositions require the deponent to be under oath) testified that had the A/E's project manager requested a supplemental report, he certainly would have done so. *(The moral of this story, is that litigation may not be a "truth telling contest." The project manager should have documented his requests in writing, and send a writing to the developer that he would proceed without the supplemental report—but ne neglected to do so. The case eventually settled through a mediation.)*

Another topic in the discovery period is the use of “expert witnesses.” “Fact witnesses” are people who are those who are project participants. Expert witnesses are engaged by the parties to the case to opine on aspects of the project. Expert witnesses investigate the facts, prepare an expert report, and if need be, testify in front of the jury to support the plaintiff’s or defendants’ position. The theory is, a jury who has been empaneled to be the trier of the facts, is usually comprised of people who have no knowledge of the claim and the design profession and/or the construction industry. These jurors are educated by the expert witnesses.

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ARBITRATION

If your agreement with your client does require that the dispute is to be resolved by arbitration, the arbitration tribunal will send the complaint to your firm. The tribunal can be the American Arbitration Association or the Judicial Arbitration and Mediation Services, Inc. (JAMS), but there are other tribunals that may have jurisdiction as well.

The pathway to resolution of the claim differs from litigation in that, theoretically:

- the arbitration will take less time (resulting in less expenses),
- and the discovery period will be shortened and limited in scope.

Historically, arbitration had been favored as the dispute resolution over litigation, and has found its way into some professional societies’ model agreements. However, the favored position has waned over the years, because arbitration (especially in complex arbitrations with larger amounts money involved) has become drawn out where increased discovery has been allowed, and that arbitrations are non-appealable (except in very extreme cases where a party or the arbitrator may have failed to disclose a conflict of interest, or the arbitrator has unduly influenced by a personal interest).

All that being said, in the COVID-19 err, the favored dispute resolution may swing back to arbitration. The courts of law are being severely delayed, and litigation is taking much longer to run throw its normal course including a jury trial. Arbitration, which is a private matter, does not require the court system to be involved.

MEDIATION

The favored dispute resolution choice, especially in the design professions and construction industry, is now mediation. The parties, with the involvement of their legal counsel, need to move towards setting up the process of a mediation to involve ALL parties involved in the project. A global resolution after a successful mediation can distribute the remedy of the claim to the responsible parties on an agreed upon percentage basis. Mediations are efficient in saving time and money. Mediations may also preserve relationships between the parties, whereas litigation and arbitration polarizes the parties in the claim. In other words, litigation and arbitrations are adversarial processes, whereas mediation’s goal is to reach a compromised resolution.

Mediations have proven to be successful. Even if the mediation does not result in a consensus on the claim, the discussions in the mediation may continue, such that a settlement agreement can be reached down the road (well before discovery chews up more time and money, leading to a jury trial).

IN CONCLUSION

We can gather from the two war stories above that proper documentation in the regular course of your professional practice is critical, and is punctuated in this August 2020 DesignPro Insurance Group Building Block issue. Including this tenth and last of the top 10 risk management tools, we feel all of the ten risk management

strategies are important to share, based upon our experiences and thoughts.

Recognizing this, each dispute and each claim will have its own unique attributes, so one size does not fit all. When disputes and claims do arise (and they will in this imperfect world), employ the risk management tools that work best for your design professional firm. And as always, these top 10 risk management tools are general in nature, and not meant to be an exhaustive coverage of the topics. The information in these risk management articles are for your information only, and is not legal advice. Confer with your insurance agent, risk manager and legal counsel for responding to a dispute and claim handling situation when it arises.

[1] *The above risk management principles have been adapted, in part, from an article that originally appeared in the June 2012 issue of STRUCTURE magazine, published by the National Council of Structural Engineers Associations (NCSEA), and is* ***reprinted with permission****. The top 10 principles of risk management for design professional are 1) A Firm's Culture & Ethical Practices, 2) Mentoring And Education, 3) Communication Skills, 4) "Go/No Go" Policy, 5) Contracts & Ownership Of The Firm's Documents, 6) Develop A Scope Of Services With Appropriate Compensation, 7) Producing Quality Contract Documents, 8) Construction Phase Services****,*** *9) Utilize A Certificate Of Substantial Completion, and* ***10) Dispute and Claim Handling.***
https://csengineermag.com/article/principles-and-tools-for-risk-management/

About the Author

Eric O. Pempus, FAIA, Esq., NCARB has been a risk manager for the last 15 years with experience in architecture, law and professional liability insurance, and a unique and well-rounded background in the construction industry. He has 25 years of experience in the practice of architecture, and as an adjunct professor teaching professional practice courses at the undergraduate and graduate levels for the last 33 years. As a Fellow of the American Institute of Architects and a member of the AIA National Ethics Council, he has demonstrated his impact on architectural profession. He has presented numerous loss prevention and continuing educational programs to design professionals and architectural students in various venues across the United States and Canada.

The above comments are based upon DesignPro Insurance Group's experience with Risk Management Loss Prevention activities, and should not be construed to represent a determination of legal issues, but are offered for general guidance with respect to your own risk management and loss prevention. The above comments do not replace your need for you to rely on your counsel for advice and a legal review, since every project and circumstance differs from every other set of facts.

MARK YOUR CALENDARS FOR ERIC'S UPCOMING CONTINUING EDUCATION PROGRAMS:

Speaking Engagements:

"Ethically Looking Outward – Architecture/Interior Design Perspectives"
The Alberta Association of Architects, Banff
Alberta, Canada
April 24, 2021

"World Around Us Panel Discussion on the Environment"
Nashville, TN
Rescheduled to spring 2021

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