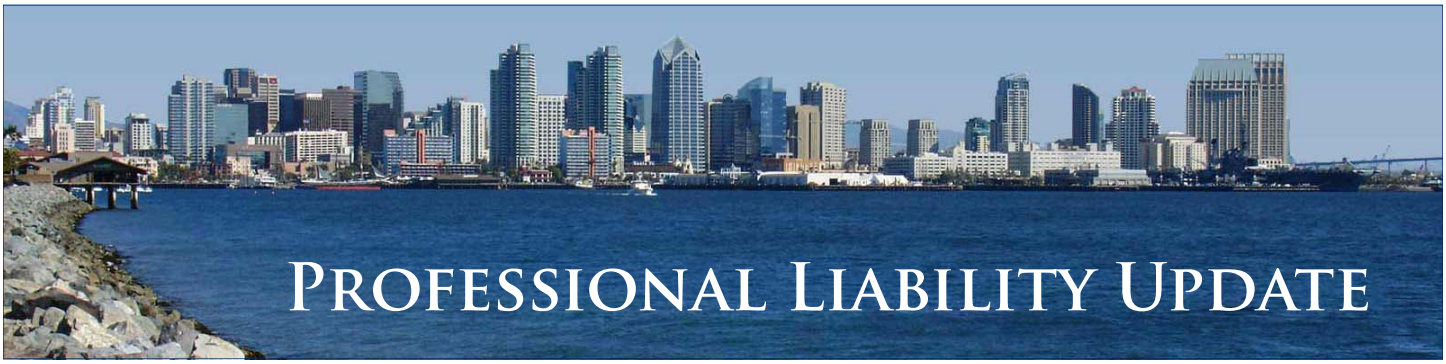

Professional Liability Update

A Loss Prevention Newsletter for the Design Profession

Prevailing Party Contract Clauses: Yes or No?

Article courtesy of Professional Liability Agents Network (PLAN)

A "prevailing party" contract clause (also commonly called an attorney's fee clause) is a contract provision that requires the loser of a lawsuit or claim to pay the winning party's legal fees. In the absence of such a contractual provision, each party typically bears its own legal costs.

Prevailing party clauses can be unilateral (applied to only one party to the contract) or mutual (applied to both parties). A typical mutual prevailing party clause includes language such as:

> *In the event of any litigation arising from breach of this agreement, or the services provided under this agreement, the prevailing party shall be entitled to recover from the non-prevailing party all reasonable costs incurred including staff time, court costs, attorneys fees, and all other related expenses incurred in such litigation.*

Historically, many in the insurance industry and the legal professions recommended that mutual prevailing party clauses be included in design professional contracts. The logic was that such clauses make a client think twice before bringing a frivolous or otherwise questionable claim against a design firm. The prospect of paying the defendant's legal bills in the event the plaintiff does not prevail makes a prospective plaintiff reconsider filing a lawsuit.

Prevailing party clauses were especially attractive from a design firm's prospective when forced to sue a client for nonpayment of fees. The prospect of spending thousands of dollars in legal fees to collect receivables without the possibility of recovering legal costs caused many firms to throw up their hands, forget about recovering the fees and chalk the loss up to experience. With a prevailing party clause, a design firm is more apt to keep its resolve and fight for the fees it deserves.

Pros and Cons

Recently there has been much discussion as to whether or not a prevailing party clause is, in fact, in a design professional's best interest. First, there is the fact that if your contract has such a clause and a court or other trier of fact finds you negligent as alleged, you

Prevailing Party *(continued on page 2)*

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Prevailing Party *(continued from page 1)*

have to pay the other party's legal expenses in addition to the damages you caused. Making matters worse, this voluntary contractual assumption of liability for the other party's legal defense costs may not be covered by your professional liability policy.

Professional liability insurance covers your legal liability arising out of your negligent acts, errors or omissions. However, it does not generally cover contractual assumptions of liability unless you would be legally liable in absence of the contract clause.

Because of this, the insurance industry remains divided on its opinion regarding the use of prevailing party clauses. Some companies continue to believe that these clauses effectively discourage frivolous claims. They encourage their usage and, for the most part, will cover prevailing parties' legal costs unless a unique circumstance prohibits it.

Other insurers see the clause as a double-edged sword and hedge their support of usage. They say they have had situations in which a prevailing party clause has been used to an insured's advantage, but warn that it can also result in significant costs should a plaintiff prevail against a design firm. They say a clause may or may not be covered by the professional liability insurance policy, depending on the specific language of the clause and the circumstances of the situation.

Other insurers are clearly against the prevailing party provision. In fact, they take the firm position that the contractual assumption of another's legal fees will not be covered under their PL insurance policies. While they acknowledge that prevailing party clauses can be a deterrent to a lawsuit, if the insured design firm is in fact the loser in a claim then the defense costs incurred by the plaintiff would be excluded contractual liabilities and uninsured as such. A liability assumed by contract that would not otherwise be a liability, they argue, would not be covered.

Interestingly, attorneys who represent design firms are also split on the value of the prevailing party clause. Attorneys in favor of the clause say they recommend them because they discourage frivolous claims. More specifically, these attorneys say that without a prevailing party clause, a design firm typically cannot afford to pursue fee claims.

Attorneys opposed to the provision state they may be a trap for design professionals, actually encouraging owners to sue if they think they have a strong case. This is particularly true, they say, for large clients who can extend a substantial (and expensive) effort to win their lawsuit. Plus, these attorneys recognize that

Prevailing Party *(continued on page 3)*

2010 Risk Management Series

- **Critical Thinking for the Human Resources Professional (HR)**
  Friday, October 15, 2010
  Registration: 7:30 am
  Program: 8:00 am - 10:00 am

- **Characteristics of Higher Performing A/E Firms**
  EXCLUSIVE Design Professional Risk Management Seminar
  Wednesday, November 10, 2010
  Registration: 7:30 am
  Program: 8:00 am - 10:00 am

- **Victims, Villains, and Heroes (HR)**
  Friday, November 19, 2010
  Registration: 7:30 am
  Program: 8:00 am - 10:00 am

- **Sexual Harassment Prevention Training (HR)**
  FINAL Training Session for 2010!
  AB 1825 Compliant
  Friday, December 17, 2010
  Registration: 7:30 am
  Program: 8:00 am - 10:00 am

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Prevailing Party *(continued from page 2)*

prevailing party legal expenses are uninsurable under a growing number of professional liability policies. They contend that the "American Rule" is that parties bear their own attorneys' fees in litigation and prevailing party clauses are far from typical. They argue these clauses can actually promote litigation when the proper thing for the parties to do is to work out their difficulties through alternative dispute resolution such as mediation.

Some attorneys who draft contracts for design professionals say they always discuss the pros and cons of a prevailing party clause. They advise clients that such a clause can deter a plaintiff from filing a claim out of fear of an award of attorneys' fees. They remind their clients, however, that most claims settle before going to court and the settlement rarely includes a recovery for fees and costs.

Your Course of Action

So what should a design firm do if a client presents a contract with a prevailing party clause? If the clause is unilateral in favor of the client, ask that the clause be removed. Explain to the client that the clause is not only unfair since it is being imposed unilaterally, but it is likely uninsurable.

Even if your insurance company agrees to cover the prevailing party legal costs at the time the contract is entered into, there is no guarantee these costs will be covered at the time a claim is made and reported. Remember: professional liability insurance is a claims-made and reported policy and the insurance that is in effect is the insurance in place when the claim is made and reported. At that time, your insurance company may have changed its policy toward prevailing party clauses or you may have a different insurer.

If the client refuses to remove the clause, then, at a minimum, design firms and their lawyers might try to negotiate a mutual prevailing party clause so that it applies to the client as well as the design firm. Also, your attorney may want to make sure that the clause specifies "reasonable" legal costs – otherwise, a client could pull out all the stops in mounting an extravagant claim and your design firm could be obligated to foot the entire legal bill. Some attorneys also recommend that the language specify that the clause only applies to "breach of contract" matters, rather than broader language such as matters "arising out of" or "related to" the contract.

Should a design firm ever present a prevailing party contract clause to a client? As a general rule, such an action is not recommended unless there are extenuating circumstances that may call for one.

For example, if a client is new to the design and construction process or has a less-than-stellar credit history, a design firm might want to negotiate a limited prevailing party clause in the contracts billing and collection provisions only. Such a clause would be limited to suits for fees, where such a clause makes it financially feasible to attempt to collect unpaid amounts. Such a clause might include language such as:

> *In the event legal action is required to enforce the payment terms of this agreement, the consultant shall be entitled to collect from the client any judgment or settlement sums due plus reasonable attorneys' fees, court costs and other expenses incurred by the consultant for such collection action.*

Alternative Contract Clauses

The primary purpose of a prevailing party clause, most proponents claim, is to reduce the number of frivolous claims and protect innocent parties from having to pay huge legal fees to defend themselves. Fortunately, there are two other types of contract clauses that can better achieve these aims:

1. **Certificate of Merit Clause** – This clause requires that before a party to the contract can file a claim against the other party, it must obtain a written certificate from a qualified professional that such a claim has merit.

Prevailing Party *(continued on page 4)*

Prevailing Party *(continued from page 3)*

2. ADR Provision – This contract clause requires that before a party can file a formal lawsuit against the other, it must first submit to an alternative dispute resolution (ADR) technique such as mediation or arbitration. Such a clause can dramatically lower the legal costs incurred by both parties to the claim and help reach an amicable resolution.

The inclusion or exclusion of a prevailing party clause – or any alternative clause intended to achieve similar objectives – should be discussed thoroughly with your attorney. We welcome the chance to answer any related insurance questions that you might have.

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

Designer's Dilemma:

How Does a Design Professional Lien Work?

By Pamela J. Scholefield, Esq., P.E. (Colorado), Principal Attorney
Scholefield Construction Law
Article used with permission

Question

I am an architect and I drafted plans for the re-design of an existing restaurant in downtown San Diego. I entered into a contract with the owner of the property and completed my end of the contract, although I have not yet been paid.

The city has issued all the necessary project permits. Construction is set to begin in the next few weeks; however, with the recent filing of bankruptcy by major financial institutions, I am extremely concerned that the construction lender will decide not to commit and the project will be scrapped.

I heard that there is something called a design professional's lien that is different from a mechanic's lien. How does it work?

Answer

You have a very valid concern considering the current state of the economy and the negative impact it may be having on the construction industry. However, you do have a way of protecting yourself if the owner does not pay you. You are right — there is a potential solution by using a design professional's lien.

The California Legislature has established this lien remedy exclusively for licensed design professionals in cases where no actual construction of the planned work of improvement is commenced. This remedy is found in the Civil Code starting with Section 3081.1.

One major difference between a design lien and a mechanic's lien is that a mechanic's lien only applies to labor, materials and services actually used in the project to improve the property, and thus requires that the project actually commences, whereas a design professional's lien is used when the construction never commences. However, first things first — who is considered to be a design professional and in what type of project is a lien available?

Under the Civil Code, a design professional is defined as any certified architect, registered professional engineer or licensed land surveyor who furnishes services under written contract with a landowner for the design, engineering or planning of a work of improvement. One exception is that the design lien cannot be used for design of a single family, owner-occupied residence with construction costs of less than $100,000 in value.

Design Professional Lien *(continued on page 5)*

Design Professional Lien *(continued from page 4)*

Also, there are some limitations to a design lien:

1. It attaches only to the land, and
2. It may not be recorded unless a building permit or other governmental approval in furtherance of the work of improvement has been obtained in connection with the design professional's services.

There is another significant constraint on the right to record a design lien — the lien can't be recorded unless the design professional knows, or has reason to know, that the owner is not going to build the project. Consequently, a defense to the lien could be that the owner is going to build the project. In your case, while your concern that the construction lender may pull out is valid, it may not yet be a strong enough indication that the project won't go forward unless that really happens.

Another important difference between a mechanic's lien and a design professional's lien is the timing, deadlines and required notice. For example, the time to file a mechanic's lien begins when the claimant's contract or work is completed with the deadline for recording tied to the completion of the entire work of improvement. But the time to record a design lien begins when the owner fails to pay under the terms of that contract, and the deadline is 90 days after the design professional knows or has reason to know that the planned improvement is not going to commence.

Even if these criteria are met, a design lien cannot be recorded unless at least 10 days before recording the lien, the design professional gives written notice to the owner, by registered or certified mail, that the owner is in default under the contract. The notice must include the amount owed. A claimant trying to record a mechanic's lien does not need to give any such notice.

The lien's priority over other liens and encumbrances is another significant difference between a design professional's lien and a mechanic's lien. With a mechanic's lien, the lien is deemed to have attached when the lien claimant first provided materials, labor or services to the project regardless of the fact that the mechanic's lien itself may not be recorded until months, sometimes years, later. But a design lien does not relate back to the time when the design professional rendered services to the proposed project. Instead, the lien is effective from the date of recording it with the county recorder's office.

Also, the design lien is only valid if the contracting owner is also the owner of the property at the time the design lien is recorded. This is not the case for mechanics' liens.

For both a mechanic's lien and a design lien, the failure to file a lawsuit to foreclose on the lien within 90 days of recording the lien will render the lien null and void. A design lien also becomes null and void if the work of improvement actually does commence. But the design professional is not out of luck if his or her lien becomes void due to the project commencing. This is because once the project commences, the design professional now has a right to a mechanic's lien under the same rules as any other clamant who has provided labor, materials, services or equipment to the project.

The key to perfecting your design lien is to keep tabs on the financing situation to see whether the current construction lender is going to back out. If it does, you need to investigate whether or not the owner has a viable funding source alternative lined up to confirm whether the project is scrubbed. If you know that it won't go forward, then go ahead with your design lien, keeping in mind the various deadlines and notice requirements. And good luck to you in this time of financial uncertainty.

Pamela J. Scholefield, Esq., principal attorney at Scholefield Construction Law, has been practicing exclusively in the area of construction law since 1998.

Ms. Scholefield graduated with honors from the University of Florida in 1984 with a B.S. degree in Industrial & Systems Engineering. She is a member of the National Engineering Honor Society as well as the National Industrial Engineering Honor Society, and holds an active Professional Engineering license from the State of Colorado.

In 1998 Ms. Scholefield earned her JD degree cum laude *from the University of San Diego. She currently serves on the Executive Committee of the Associated General Contractors (AGC) – San Diego, is an* ex-officio *Board Member of the AGC – San Diego, and is well versed in the laws that affect contractors. Ms. Scholefield is recognized within the Southern California community as a respected construction law practitioner.*

For more information about Scholefield Construction Law, visit www.construction-laws.com. To contact Ms. Scholefield, e-mail pam@construction-laws.com or call 619-544-0086.

Articles courtesy of Cavignac & Associates Employee Benefits Department

LIVE WELL, WORK WELL

Fall Fitness!

With kids back to school and temperatures cooling down, fall months present a perfect environment for getting back into your fitness routine. Try these tips for burning a few extra calories this fall:

- **Enjoy the Weather** — Cooler temperatures make fall a perfect time to exercise outdoors. Outdoor exercise doesn't have to feel like a workout. Take advantage of seasonal activities, such as raking leaves or apple picking.
- **Get Creative** — Instead of just sitting and watching your child's sports practice, consider walking around the area, or asking the coach if you can participate. While at work, consider walking outside during breaks.
- **Try Something New** — Fall is a great time to try a new workout routine or join a fitness class. Many classes at local gyms and health clubs start in the fall.

How's Your Cholesterol?

If you're looking to make some changes to reduce your heart disease risks and lower your cholesterol, consider these natural ways to do so:

- **Eat Low-fat Dairy Products** — Avoid dairy containing whole milk and cream.
- **Eat Complex Carbohydrates and Fiber-Rich Foods** — Fruits and veggies, whole grains and legumes.
- **Reduce Your Salt Intake** — Use herbs and spices to flavor your food instead of salt.
- **Monitor Snacking** — Opt for low-fat snacks, such as light popcorn, nuts, dried fruits, and veggies.
- **Reduce Saturated Fat During Cooking** — Replace butter or margarine with olive, soybean, sunflower or safflower oil.
- **Reduce Your Dietary Cholesterol Intake** – Eat no more than four egg yolks per week, and no more than six ounces of lean meat, fish or poultry per day.

Is Organic Produce Worth the Price?

Some non-organic fruits and veggies contain higher levels of pesticides than others. According to foodnews.com, these pesticides and chemicals can cause health damage, especially during fetal development and early childhood stages.

Rinsing fruit and veggies before eating reduces some pesticides, but it won't eliminate them. Peeling helps, but you often lose valuable nutrients contained in the peel itself. With some produce, the best way to avoid pesticide consumption is to buy organic varieties.

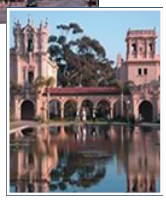
The following 12 non-organic fruits and veggies are considered to be the **most pesticide-ridden**: celery, peaches, strawberries, apples, blueberries, nectarines, bell peppers, spinach, cherries, kale / collard greens, potatoes, and imported grapes.

The non-organic fruits and veggies considered to be the **lowest in pesticide concentration** are onions, avocados, sweet corn, pineapple, mangoes, sweet peas, asparagus, kiwi, cabbage, eggplant, cantaloupe, watermelon, grapefruit, sweet potatoes, and honeydew melons.

Community Bulletin Board

"Neighbors helping neighbors in San Diego"

SAN DIEGO ARCHITECTURAL FOUNDATION



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- Halloween Doggie Café
- Web Site

DOWNTOWN YMCA
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- Web Site
- Questions? Contact **Alicia Gettys** by phone at **619-232-7451** or e-mail **agettys@ymca.org**

Monarch Schools

- Teacher of the Year
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Society for Design Administration
An Affiliate of the American Institute of Architects

Mission:

The Society for Design Administration advances management and administrative professionals in the A/E/C industry through education, networking and resources.

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The San Diego Police Foundation supports the men and women who "protect and serve" by raising community awareness of important unbudgeted or "discretionary" needs that will improve crime-prevention and law enforcement efficiency. The Foundation puts your tax-deductible contributions to measureable work in local communities.

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To provide quality and compassionate services for the survival, health and independence of seniors living in poverty

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