PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 07/2003: ""Professional Liability Insurance Implications of an Acquisition" July, 2003

Professional Liability Insurance Implications of an Acquisition

At some point in the life cycle of a design firm, consideration is usually given to either acquiring or selling to another firm.

Although a number of issues and dual points are involved with these types of transactions, one that should not be overlooked or deferred is how to handle the prior acts exposure of the firm being acquired.

Acquisitions may take the form of either a stock sale (in which the acquiring company buys both assets and liabilities) or an asset sale (no liabilities). In the first case, the acquiring company is generally held responsible for insuring the prior acts of the acquired firm. In an asset sale, the acquired firm is usually responsible.

The cleanest way to provide coverage is to endorse the acquiring firm's policy to provide prior acts for the acquired company. This will normally require a copy of the acquired company's most recently completed professional liability application, including a copy of the current policy and a comprehensive loss history. This approach has a couple of critical advantages, not the least important of which is that it provides continued coverage for as long as the acquiring company maintains its professional liability coverage. In addition, it eliminates confusion on those projects which were started prior to the acquisition and finished afterwards. More on this in a moment.

The alternative way to handle the exposure is to have the acquired company buy a "tail" policy or extended reporting period endorsement. This extends the pe-

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riod of time within which the acquired firm can file a claim for negligent acts, errors or omissions which took place prior to the acquisition. These "tail" policies usually are not cheap (a firm will typically pay about 175% to 225% of the most recent annual premium for a three-year tail), and are available for a limited term (five years is about the longest you will see these days).

The main problem with this approach, other than the cost and limited term, is the confusion created on those projects which were started before the acquisition and completed after the acquisition. If the negligent act took place before the sale, and the claim is made within the extended reporting period, the tail policy should apply. If the negligent act took place after the sale, the practice policy of the acquiring firm would apply. Unfortunately, it's hard to pinpoint exactly "when" the negligent act took place, and in these situations there is always a question as to which policy should provide coverage.

Some insurance companies are not willing to provide prior acts under any circumstances, and other companies underwrite these exposures very carefully. If, for example, the acquired firm has an adverse loss history or is involved in practice areas the insurance company is not comfortable with, the underwriter may decline to provide terms.

Summary

For most acquired firms, protection for prior acts errors or omissions is critical. Failure to deal with this exposure is usually a deal breaker and more often than not will squelch the entire deal. Therefore, this issue should be dealt with up front and clearly addressed in the buy-sell agreement.

A good first step is to complete an Acquisitions Insurance Checklist and discuss it not only with your lawyer, but also with your insurance broker.

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.*

Acquisition – Insurance Checklist

1. Name of Firm _____
   Address _____
   _____
   Phone Number _____ Fax Number _____
   Web Site _____
2. Insurance Contact _____
   Phone Number _____ Fax Number _____
   E-Mail Address _____
3. Date of Acquisition _____
4. Did you acquire assets only or stock? Assets Only ☐ Stock ☐
5. Who will be responsible for the firm's prior acts? _____
6. Please attach the following items of information:
   - Copy of current Professional Liability policy
   - Most recent Professional Liability application
   - Loss history (10 years if possible)
7. Has their current company been put on notice of any claims or potential claims which have yet to be reported? Yes ☐ No ☐

Changing the Unchangeable:
How to Modify Clients' Contract Terms

By Michael Strogoff, AIA
***Negotiating Strategies** Publisher*

Many clients, especially those that commission a lot of building designs, have a take-it-or-leave-it attitude about their contracts. It is not unusual for public entities to require design professionals to accept their boilerplate agreement with few or no changes. A recent request for Statements of Qualifications by the Sacramento City Unified School District included their 35-page agreement preceded by the statement, *"The terms and conditions of this Standard Contract are, with the exception of fees for services and expenses, non-negotiable."* Other clients wait until after design professionals have spent valuable resources getting selected to inform them that portions or all of their agreement are not open to discussion. Don't accept any of this at face value.

To understand how to persuade clients to make changes, you first need to understand why clients might adopt such a take-it-or-leave-it stance. Reasons might include:

- The client thinks it is an effective negotiating tactic.
- The client believes there is no leeway in the project schedule to process changes.
- The client does not want to establish a precedent by making changes.
- The client's representative does not understand the issues sufficiently to feel comfortable discussing changes.
- The client has already paid its attorney to review its boilerplate and does not want to incur additional legal costs reviewing changes.
- The client's representative is overly cautious or lacks initiative.

When negotiating with a public agency recently, I was emphatically told that their standard boilerplate was not changeable. We heard all of the familiar themes: the client spent a long time developing this agreement; other architects had accepted the agreement "as is"; there was no time to make changes without delaying the project; the agreement was already on the Board's agenda for next week. I'm sure the client had the routine memorized.

After telling the client's representative that our team could not proceed unless certain provisions were modified, we suggested meeting with their risk manager and attorney. These were the only two people who had the authority to approve exceptions to the agency's boilerplate. We agreed that we would limit our comments to the few clauses that were truly deal breakers for our team. Sensing a standoff, the representative reluctantly scheduled the joint meeting.

We quickly reached the same impasse with the agency's risk manager and attorney. While they agreed that most of our proposed modifications were reasonable, they did not want to establish a precedent or delay the project. But rather than give up, we explored other ways of addressing our concerns. In the end, we gained their buy-in to modify the exhibit containing the design professional's scope of services. In exchange, we agreed to leave the main body of the contract intact, thereby not establishing a precedent and not causing the client to pull the contract from the following week's Board agenda. (Modifications to exhibits could be substituted by the risk manager without formal Board approval.)

Without changing the agency's boilerplate, we were able to incorporate terms that provided valuable protections and limited our liabilities. To counteract objectionable provisions within the main agreement, we incorporated language within the context of our scope of services. For example, the unacceptable standard of care provision contained within the main body was superceded by the fol-

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lowing language in the exhibit: *"In providing the following services, the Architect shall meet the standard of due care for architects in the community in which the project is being constructed . . ."*).

Our team did not feel compelled to limit our proposed exhibit modifications to items pertaining to our scope of services. We added clauses pertaining to copyright, reuse of documents, schedule extensions, construction cost control and responsibility for change order costs.

We reconvened a few days later with our proposed changes incorporated into an electronic copy of their document. This eliminated any resistance on their part based on the limited time available to process the modifications. They accepted most of our modifications including the insertion of this important sentence into the exhibit: *"In the case of conflicts between the agreement and this Exhibit, the terms and conditions of this Exhibit shall prevail."* We ended up with a reasonable agreement. The agency preserved their boilerplate.

Lessons Learned

- No matter what a client first tells you, almost any contract clause is changeable.
- Creativity and persistence pay off.
- It's usually easier to modify an exhibit than the main body of a contract.
- Negotiate directly with the people who have the authority to make exceptions.

*This article initially appeared in **Negotiating Strategies**, the monthly newsletter for design professionals and their advisors with practical, proven techniques for negotiating better and more profitable agreements.*

*To view a sample newsletter or find out about subscribing to **Negotiating Strategies**, go to http://www.strogoffconsulting.com/pages/articles/articles_newsletter.html, call 866 ARCH ENG (1 866 272-4364), or email Newsletter@StrogoffConsulting.com.*

"Negotiating Strategies" Seminar Raises Nearly $7,500 for Local Associations

By Jeffrey W. Cavignac, CPCU, RPLU

Cavignac & Associates recently hosted a seminar for its design professional clients focusing on "Negotiating Strategies."

The keynote speaker was negotiation expert Michael Strogoff, AIA, publisher of the "Negotiating Strategies" newsletter (see page two for the article "Changing the Unchangeable: How to Modify Clients' Contract Terms" written by Mr. Strogoff).

Sponsored by both Design Professionals Insurance Company (DPIC) and San Diego Gas & Electric Company (SDG&E), the seminar drew over 75 attendees.

All of the proceeds from the seminar, which totaled nearly $7,500, were donated to either the CELSOC Scholarship Fund or the American Institute of Architects San Diego Chapter.

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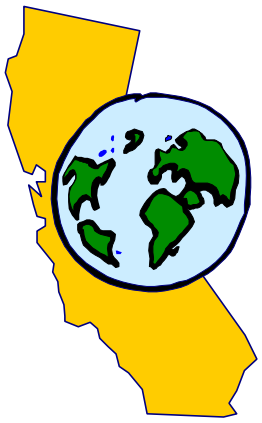

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