
A/E RISK REVIEW

A PUBLICATION OF THE PROFESSIONAL LIABILITY AGENTS NETWORK

GETTING PAID IN A SLOW ECONOMY

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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.

With the economy firmly in the doldrums, design firms are not only finding it more difficult to secure new projects, they are finding it challenging to get paid promptly for the work they have started. Some clients who planned their projects when times were good are now finding themselves in a financial pinch. With real estate prices suppressed, demand for new commercial and residential properties diminished and credit lines vanishing before their eyes, many project owners are facing a cash squeeze. Increasingly, design firms are being paid late -- if they are being paid at all.

Making matters worse, designers who try to take legal action to get paid face the real possibility of being hit with a counter lawsuit from their clients. Even in good times, you tread on shaky ground if you threaten to sue your client for unpaid fees.

Clients who are sued for fees are very likely to respond by suing the design firm for negligence, and these counterclaims are not always meritless in the client's eyes. 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 lawyer 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 you would likely net from a successful claim of nonpayment. This puts your client in a position of great leverage, especially if payment terms are not detailed in your contract. That's why many design firms are willing to settle a dispute by accepting only a fraction of the fees they are owed.

It Starts with Client Selection

Careful client selection is a cornerstone of risk management. In bad economic times, it becomes paramount. Design firms must avoid the temptation to take on any project offered when business is slow. Instead, check a potential client's history of litigation with other design firms. Examine financial statements. 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.

Contractual Rights to be Paid

There are contractual measures you can take to increase the chances of being paid and to help avoid the problem of a countersuit related to client nonpayment. Add language to your client agreement that spells out payment provisions for services rendered and your rights to remedies in the event you are not paid according to contract terms. 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. Work with your legal counsel to draft the following contractual terms.

Billing and Payment Terms

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 always advisable to specify that payment for services 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.

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. 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 your late invoices. The clause should state that upon resumption of services the time schedule and compensation will be equitably adjusted to

reflect any delays or additional costs caused by the suspension of services.

Termination of Services

When all else fails in your efforts to collect fees due, you should have the right to lower the final hammer – the termination of 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

Where appropriate, 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 any potential client who balks at signing any language that protects you from nonpayment. Occasionally, however, clients may have legitimate problems with specific obligations of your payment terms. 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 want to deal with 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 pay accounts as well as threats of retaliatory liability claims.

Pay-When-Paid Clause

When it comes to payment terms, subconsultants have the right to be treated by the prime as the prime wants to be treated by the client. The prime expects to be paid promptly for work done for his or her client; so does the subconsultant.

In some instances, however, a prime consultant may feel the need to insist on a pay-when-paid provision in its agreement with subconsultants. In such cases, the subconsultant should consider accepting such an agreement as long as the contract language provides adequate protection. For example, the pay-when-paid clause should have an outer limit by which time payment must be made, whether the prime has been paid or not.

Consider these elements when drafting a pay-when-paid clause:

- The schedule of submitted invoices to the prime consultant – e.g., monthly, quarterly, by project phase.
- An approval process of the invoice and method for resolving disputes.
- The method and timing of the subconsultant's invoices being submitted to the client.

- The payment schedule once the prime is paid by the client – e.g., the subconsultant is paid within 10 days of the prime receiving payment from the client.
- The time limit within which the subconsultant is paid for services regardless of whether the client pays the prime – e.g., within 90 days of services rendered.
- Any interest due the subconsultant for payment beyond the contractual terms.

If a prime consultant and subconsultant enter into a joint venture sharing the risks and rewards of working with a client, then each may share the risk of nonpayment. However, in a typical consultant-subconsultant relationship, the subconsultant has the right to expect to be paid within a reasonable time, whether the prime gets paid or not.

Surviving Hard Times

A counterclaim filed over fee disputes is one of the fastest growing areas of litigation among design firms. The chances of nonpayment and subsequent litigation only increase during bad economic times when clients face illiquidity and must pick and choose who gets paid on time and who doesn't. Adding protective language to your client agreements not only helps reduce the chances of such counterclaims, it enables you to judge your clients attitude regarding contract provisions that give you the ability to enforce the agreed-to fee and payment schedule for your services.

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

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(PLAN). We're here to help.*