

Using Pre-Claims Assistance to Mitigate Loss

Architects and engineers work through problems on projects every day. Some of the problems involve ordinary design and construction issues, but others are potential claims just waiting to happen. The better you understand the difference, the more successful you can be in getting in front of the problem before it escalates. Part of that is in knowing where to turn for help in resolving those conflicts.

In times past, design firms facing problems hesitated to call their insurers. They would not get much assistance, the expenses incurred would be charged to their deductibles, and the problems reported to their insurers might result in higher renewal premiums. That led to a prevailing sentiment among design firms that they were better off handling problems on their own. Times and attitudes have changed, but some design professionals still live under this now-mistaken impression.

The professionals that help architects and engineers manage their risks—insurers, law firms, and insurance brokers among them—have recognized for some time that dollars spent on the early recognition and prompt resolution of problems provide an excellent return on investment. In this issue article we look at how pre-claims assistance can help your firm. In other words, “A stitch in time saves nine”—and can have a direct positive impact on your firm’s profitability.

A Change in Approach

Today, insurers encourage early reporting. They will engage their own people, as well as outside resources as needed, at no cost to their insureds to help their clients manage problems.

This change in approach was first introduced more than 20 years ago. The concept was simple: to provide a proactive mechanism to:

- ▲ address potential problems head-on with the goal of claims avoidance; or
- ▲ begin early resolution or defense if a claim occurred later.

Insurers foresaw that dollars invested in resolving problems would provide a favorable return in the form of lower claims payments. What started with one insurer in the mid-1990s is now widely available.

Pre-Claims Services

Insurers provide a range of services to mitigate problems. They will start by involving their claims specialists, some of whom are attorneys or former architects or engineers. Their specialists will interview involved parties, review relevant documentation, and recommend strategies. When

outside resources are needed, insurers will engage and pay for the cost of:

- ▲ legal counsel;
- ▲ expert or forensic analysis; and
- ▲ facilitation experts such as mediators or partnering facilitators.

In some cases, insurers will pay for the cost of fixing a problem.

While most insurers offer pre-claims services, the manner in which they are willing to respond can vary. We suggest you ask the following questions when selecting a new insurer:

- ▲ If needed, will you engage outside resources to help resolve a potential problem? If so, how often does this happen? Can you provide some examples?
- ▲ Will any internal and/or external costs incurred on a pre-claims matter count against my firm’s loss experience?
- ▲ What is the typical or average amount you spend on a pre-claims matter?
- ▲ What is the largest amount spent in the last 12 months on a pre-claims matter?

- ▲ Is there any official or unofficial cap on what can be spent on pre-claims matters?

Incentives for Using Pre-Claims Services

Some things improve with age; claims and the circumstances that lead to claims do not. Insurers have come to recognize this. The sooner an insurer's claims specialist becomes involved in a client's problem, the better the resolution of the problem is likely to be.

Even with circumstances that later become claims, early involvement can prevent mistakes that might increase the cost of settling a claim and can create an activity and a thread of documentation that assists in the ultimate resolution.

To encourage the use of pre-claims services, most insurers do not include expenses related to pre-claims assistance within an insured's loss history. This eliminates the risk of a premium surcharge for using the service. Expenses the insurer incurs in providing legal or other assistance to resolve a problem are paid outside of the policy limit and are not subject to a deductible.

Another incentive for using pre-claims services relates to who pays for most claims. According to one leading insurer, 75 percent of all claims are settled within the deductible. For larger firms, the percentage is closer to 85 percent. One-third of all claims are closed with payment of defense costs only, and defense costs represent 50 percent of total claims payments. With substantial uninsured dollars at stake, there is a strong incentive for firms to use a service that adds no cost and has no deductible.

Pre-Claims versus Claims

So what's the difference between circumstances and pre-claims matters versus claims? The answer lies in the definition of "claim" provided in every professional liability policy. The following is typical of the definitions used in most policies:

- ▲ **Claim:** a demand made against the insured for money or services, where the claimant believes

the insured design professional's actions directly led to the claimant's loss.

A key component of this definition is the need for a demand from a claimant. On the other hand, a "circumstance" or "pre-claims matter" is generally considered by insurers to fit the following description:

- ▲ **Circumstance:** an event reported during the policy term from which the insured reasonably expects that a claim could be made.

According to a CNA/Schinnerer publication, some "early indicators" of problems that may lead to pre-claims circumstances include the following:

- ▲ the client's unreasonable refusal to accept the design professional's advice concerning a recommended scope of services or level of effort;
- ▲ the unwillingness of the client to negotiate fair terms and compensation;
- ▲ the client's requirement that the design professional perform services within a certain time frame when the design professional's ability to meet that schedule is not entirely controllable;
- ▲ the client's arbitrary refusal to pay for the services performed, particularly as the services are being completed; and/or
- ▲ communications between the contractor and client that consistently erode the client's respect for the design professional's ability.

Of course, every insurance policy is unique and needs to be reviewed carefully to determine the parameters of coverage. As a basic rule, however, if there is no demand for money or services made against the insured, a reported problem is treated as a pre-claims circumstance.

Reporting a Circumstance

Once a circumstance occurs, you need to be certain to report it in a way that complies with your firm's insurance policy. In most architects and engineers professional liability insurance policies,

the “Conditions” section of the policy includes an explanation of what information is needed when reporting a circumstance. Typical requirements include the following:

- ▲ written notice, including how the insured first became aware of the circumstance;
- ▲ specifics on what happened;
- ▲ description of the services the insured was performing;
- ▲ names of individuals and entities that may have suffered harm; and
- ▲ the nature of what potential damages or injuries may have occurred.

Circumstances can be reported by mail, fax, or e-mail. If your firm’s insurer deems that the information provided is not sufficient to provide assistance, you will be contacted to obtain additional information.

When reporting claims or circumstances to your insurer, we recommend that you report through your insurance broker or agent. This allows your broker/agent to provide additional assistance and to track the insurer’s response.

Building Awareness

Our focus, with this article is to build awareness of circumstance reporting. In our decades of experience with architects and engineers, we have found the leading causes of professional liability claims to be:

- ▲ poor communication;
- ▲ lack of experience; and
- ▲ design professionals “too willing” to their please clients.

This combination of factors results in design professionals’ being either unaware of or unwilling to ask for help. Too often, less senior design professionals want to handle problems themselves, but only end up making matters worse. Design firms need to create a culture in their firms that

encourages project managers to ask for help from senior partners when needed. Firms also need to understand the resources available from their insurers and how to use them.

For larger firms, awareness of what to do in the event of a potential circumstance can be a problem. “Home office” does not always find out about problems until it is too late. Many larger design firms have in-house general counsel and more resources than most firms to manage claims, but financial incentives—in the form of pre-claims assistance—still can help. Insurers will provide the pre-claims services for larger firms even if a substantial self-insured retention is in place.

Case Studies

A look at some recent pre-claims circumstances can be helpful in understanding how the process works and what the benefits are:

- ▲ **Road project:** A design firm was served with a subpoena related to an injury incurred by a construction worker on a road project. Although the design firm was not named in the original lawsuit, the subpoena requested an extensive number of documents and a deposition related to the insured’s role on the project. The nature of the subpoena suggested that the plaintiff’s attorney was “fishing” for information that might possibly implicate the insured.

The counsel retained to assist the insured with the response to the subpoena was able to limit the documentation required as well as to eliminate the demand for the deposition. This sent a clear signal to the plaintiff’s counsel that the “fishing” expedition was not going to work and that counsel would have to file a formal claim/demand against the design firm—represented by a leading insurer and qualified counsel—to pursue this route.

The ultimate result was the action was not pursued. The expenditure of a few thousand dollars early in the process prevented significantly higher defense costs and potential liability later.

- ▲ **Collapsed Wall:** During the course of construction, a wall collapsed and killed three

workers. As part of the clean-up process, the contractor began removing materials from the site almost immediately.

Due to the severity of the accident, the design firm's professional liability insurer quickly retained counsel, who in turn employed a forensic expert to track down the materials removed from the site. The materials collected provided evidence that the contractor substantially deviated from the engineer's design and specifications, and there was no liability imposed on the insured firm.

Had the insurer not responded quickly, the evidence that served as a strong defense might have been destroyed. This case is an excellent example of the benefits of early involvement as a vehicle to obtain evidence that might otherwise disappear with the passing of time.

Insurer Data About the Benefits With 15 to 20 years of experience by leading insurers, comparative data are now available regarding pre-claims assistance. A recent survey of insurers yielded the following information:

- ▲ Pre-claims matters get resolved between 65 percent and 85 percent of the time without reaching the status of a "claim."
- ▲ The ratio of pre-claims matters reported versus claims reported is roughly four to one.
- ▲ About 50 percent of pre-claims circumstances are closed with some payment for either attorney fees or the retention of expert consultants to assist the insured.
- ▲ Most pre-claims matters are either closed or develop into actual claims within 12 to 18 months of reporting.
- ▲ Insurers normally spend a few thousand dollars per circumstance on pre-claims assistance; however, there are times when pre-claims expenses can exceed \$50,000.
- ▲ The majority of pre-claims prevention matters consist of subpoenas for documentation or

depositions. These generally are requests that the insured testify in a dispute between a contractor and the project owner.

Benefits of Pre-Claims Assistance

There are many benefits to an insured design firm that takes advantage of this free service. Among them are the following:

- ▲ Pre-claims matters have a better chance of being resolved favorably when the insured has the support of the insurer's technical claims experts and the assistance of knowledgeable claims counsel.
- ▲ Costs are paid in addition to the policy limit of liability and are not subject to the deductible.
- ▲ A firm's loss history is not adversely affected by money spent on pre-claims prevention matters.
- ▲ Pre-claims assistance can help a design firm preserve a good relationship with its clients. In some cases, problems between design firms and clients can lead to threats of termination. Insurers have gone as far as hiring public-relations firms to repair the design firm/client relationship and avoid the potential loss of a client.

In Closing

Pre-claims services provided by professional liability insurers represent an excellent value to architecture and engineering firms. To take full advantage, firms need to be certain that their design professionals understand when to ask for help on a problem and whom to contact. With proper training and awareness, effective use of pre-claims services will keep claims to a minimum and have a favorable impact on the bottom line.

We know that it may seem counterintuitive to call your insurer when there is a circumstance that might give rise to a claim. Your inclination may be to hunker down and hope everything blows over, but your firm will be better off if you run toward trouble with your broker/agent and your insurer at your side.