

XL Insurance @-Clips

Adding Up The True Costs Of Litigation

Chances are pretty good that your firm will be sued sometime in the next few years. According to one source, nearly 800,000 civil lawsuits were filed last year in the United States. The figure in Canada, while not as proportionally high, is also significant.

But wait, you say. I don't have to worry about a lawsuit; I have professional liability insurance. It's true that your professional liability policy provides essential protection to minimize your firm's financial exposure in the event of a lawsuit. But even the best insurance policy can't cover everything. The true costs of litigation can have a profound impact on your firm for many years to come.

HARD AND SOFT COSTS

The hard costs of a lawsuit include your deductible payment for legal fees and any internal expenses related to litigation (your travel, for example, or copying). These costs are easy to calculate. There are, however, additional soft costs that are just as real but more difficult to quantify.

Time is a design professional's most valuable asset, and time spent preparing a defense is time not charged to a project. You and other members of your firm (often your most senior people) may be required to spend days testifying at depositions, assembling and reviewing internal documents and meeting with attorneys to gather facts, plan strategy

and assess opposition papers. The result: substantial soft costs to your firm over and above the hard dollar costs.

CALCULATING LOST BILLABLE HOURS

For example, let's suppose you're suddenly faced with a claim in which the client alleges damages in the amount of \$75,000. Now let's suppose you went all the way through a two-year litigation process and—like 95 percent of claims brought against design professionals—ended up settling on the courthouse steps. Let's assume a \$50,000 settlement figure; legal fees might amount to another \$22,000.

What did that claim really cost you? Let's look at the hard costs first.

Deductible: \$15,000. Your insurance policy covered the remaining \$57,000 of indemnity payment and expenses over and above your deductible. Not too bad, right? Not so fast. Let's look at all your costs, including those lost billable hours.

Pre-discovery: \$9,000. This includes your time spent in interviews with the claim supervisor and lawyer, inspecting the site and reviewing files, plans and specifications, calculations, time sheets and



computer files. We'll give it a conservative figure of 60 hours at \$150 per hour.

Discovery: \$20,000. The purpose of discovery is to collect and inform the parties about the key facts of a case. But sometimes it seems more like a runaway train than a legal process. Plaintiff lawyers often use discovery as a tactical weapon to impose oppressive costs on the defending party in the hope that he or she will settle rather than incur further costs. Others use discovery as a fishing expedition for damaging evidence. Those hours can add up to perhaps several weeks' staff time.

Trial: \$21,000. This is a conservative estimate based on a five-day trial. In reality, a trial can last from six weeks to six months. Usually, several key staff members as well as a firm principal will need to testify and assist counsel. Depending on the duration, lost billable hours can skyrocket.

That's a total of at least \$50,000 in lost billable hours. And the news just gets worse. If you think about it, that \$15,000 deductible actually represents the profit from \$300,000 gross billings (assuming you make a 5% net profit margin).

Now, add to those figures the incalculables: the loss of your client relationship, emotional wear and tear, and damage to your reputation, employee morale and productivity. Thus, although your insurance company is defending you, the cost to you and your firm is substantial. For a smaller firm, or a firm with more than one claim, the price can be staggering.

A BETTER IDEA: MEDIATION

While there are no simple solutions, there are alternatives you can build into your business relationships that may offer some relief.

Voluntary, non-binding mediation, one of the best dispute resolution methods, offers many advantages over litigation or arbitration. Mediation is a sophisticated form of negotiation, distinguished by a neutral third party who helps the two sides come up with their own solutions. Relatively quick, inexpensive and confidential, mediation often allows parties to settle their disputes while preserving their working relationships.

Studies show that mediation is successful in resolving 85 percent of the business disputes that use the process. Even if you participate in a mediation that's not totally successful, it can clarify the facts in a case and narrow the issues that remain to be resolved, thereby reducing costs and shortening the life of a conflict.

Returning to our earlier example, you can see that if you and your client agree to mediation instead of going to trial, the costs drop:

Deductible: \$3,750. If you resolve the dispute through mediation within one year, the Design Professional group of the XL Insurance companies will reimburse 75 percent of your expenses already incurred under the deductible—up to \$50,000. (Incentives vary in Canada. Please ask your broker for details.)

Pre-discovery: <\$9,000 in lost billable hours. To be conservative, we'll assume that you and your client went through pre-discovery before choosing to mediate. But many times mediation can be initiated during this phase, eliminating the costly hours lost during the discovery phase.

Discovery: <\$20,000. While some mediated claims do go all the way through the discovery process, mediation can often be used to facilitate discovery,

allowing the parties to narrow and define the issues. Result: far fewer hours and dollars spent during this phase.

Trial: \$0.

Mediation Process: \$2,400. In most cases, a mediated result can be obtained in a matter of one or two days and require fewer staff members.

By mediating, you've cut out some soft costs in pre-discovery, discovery and trial, and reduced your hard costs under your deductible—a nice improvement.

Now, let's suppose your contract with your client called for mediation as the first dispute resolution option and you mediated the conflict early on. Chances are your costs—hard and soft—could be cut even further. In many cases, a mediation conference can be scheduled very quickly and require a relatively small amount of preparation time.

So why don't we mediate every dispute automatically? We'd like to. But while the AIA and EJCDC standard agreements call for mediation as the first step in resolving disputes, other contracts may not. Without a contract to back you up, it's often difficult to convince an angry plaintiff (or his or her lawyer) to mediate.

Mediation clauses are not the only solution. While most claims against a design professional are brought by the client, the rest are brought by the contractor or other third parties—parties with whom you have no contract and who may be reluctant to mediate.

Still, if every contract you enter into calls for mediation, you and your client will have on tap a proven means by which you can inexpensively settle most disputes and very likely emerge from the process with your business relationship intact.

Let's face it: the only people who make money in litigation are the lawyers. And the only way your firm can make a profit is by selling billable hours profitably. So it makes sense to try any process that will eliminate the time spent in litigation and get you back to your projects.

This article is reproduced with the permission of X.L. America, Inc. The Design Professional group of the XL Insurance companies is the industry leader in offering innovative professional liability insurance programs for architects and engineers. Its programs protect against and minimize professional liability risks through insurance, proactive loss prevention techniques and expert claims service. For additional information on this topic and others, or to contact an agent in your area, go to www.xldp.com.



XL Insurance
 Design Professional Group
 30 Ragsdale Drive
 Suite 201
 Monterey CA 93940-7811
 800-227-8533 ext.2102508
www.xldp.com/eclip

"XL Insurance" is a registered trademark of XL Capital Ltd. XL Insurance is the global brand used by member insurers of the XL Capital Ltd. group of companies. Coverages are underwritten by Greenwich Insurance Company, Indian Harbor Insurance Company, XL Specialty Insurance Company, and XL Insurance Company Limited – Canadian Branch. Coverages not available in all jurisdictions.