The Honeymoon's Over

By Dana Coleman Caparoso*

Successful Mergers of Design Firms Take Planning

Ah, the excitement of an upcoming marriage. Couples spend a great deal of time choosing a reception hall, flowers, the band, and honeymoon spot, without giving much thought to what happens when the honeymoon is over. When design firms merge, however, they need to beware that mergers are much like a marriage of two firms and families. And design firms need to prepare for the post-honeymoon period – including how to deal with what the other "spouse" did in their past and how they will handle past projects in the future.

Indeed, when design professional firms prepare to jump the broomstick together, they anticipate all of the future business and additional money they will be earning in the days to come. Oftentimes, though, they forget this is a relationship and each design firm needs to do their due diligence before the marriage is consummated. Although their future together may look bright, the past can come back to haunt them.

Call it a prenuptial agreement of sorts. But no matter what you call it, design firms would be well advised to memorialize their new relationship with another firm or designer in a comprehensive merger agreement that includes how to handle the past and provisos for what to do in the future if the relationship ends. One thing is certain – it is a lot easier to negotiate during the honeymoon period than during the heat of a divorce.

As an initial matter, the design firms should address up front in the merger agreement what they will do if the merger is unsuccessful and the parties eventually split up. Who will take responsibility for the projects the firms performed? Will one firm indemnify the other firm if they break up? Who will pay the deductible for any claims that may arise on a project after the firm splits up? Will both firms maintain professional liability insurance policies to cover those projects? If so, who will be named insureds on those policies? Will work performed for the old firm be covered under one policy or another? Do liability limits have to be increased?

One architectural firm learned this the hard way. Following a heated "divorce," the partner who left the firm agreed to be responsible for a certain set of projects and he continued to work on those projects. The agreement between the firms was not clear as to which firm would maintain insurance coverage on claims arising from those projects, or who would pay for deductibles and defense costs. When a claim was later asserted on one of those projects, the partner who left the firm – and who had supposedly accepted responsibility for the project – did not have any insurance coverage for the claim.

And because the lawsuit alleged the professional services that were provided when the partner was with the old firm, the professional liability policy for the old firm had to cover it – and the old firm had to pay the deductible.

How can other design firms avoid this? A first step should be to retain a qualified attorney with experience working with architects and engineers, as well as an accountant, to help with the merger. An experienced A/E attorney can often identify issues that could arise after the merger and help prepare for potential liabilities. For example, was the other

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design firm serving as a construction manager on a project, did they direct or control the work, or was someone injured on the project? If so, this could serve as a red flag that a claim may be coming down the pike on the project, and the attorney can help plan for it.

Indeed, there are often hidden risks and liabilities that an attorney versed in general practice may be unfamiliar with, and they may not recognize issues a design firm needs to address. In New York, for example, one attorney who represents design professionals cautioned that, with limited exceptions, New York Law prohibits architectural and engineering firms from being general business corporations, or what people understand as having an "inc." at the end of a name.

There are numerous considerations that design firms need to contemplate and investigate as part of their due diligence prior to a merger with another firm or design professional. While the following it not an exhaustive list, some information the design firms may want to review includes:

1. Contracts – Request copies of existing contracts for projects the other firm has worked on. Does the firm use written contracts, letter agreements, or no contract at all? Design firms should also review contracts from the past, beyond the active projects, as professional services provided on these projects could be an issue for claims asserted at a later date. The range of time for reaching back to past projects can vary, for example, perhaps looking back anywhere from 4 to 10 years. An experienced attorney can assist the designer in determining how far to reach back into past contracts.
2. Business records – This can include everything from financial information and clients to projects and other documents.
3. Project types and clients – What types of projects do the other design firms work on? For example, do they work on what could be considered higher-exposure projects, such as condos, coops, schools and high-end residential projects? What type of clients does the firm work with? Is there a good relationship with the clients? Has either firm assumed projects from other designers? If so, this could raise a red flag. Did the designer obtain permission from the other designer, or is a potential copyright claim on the horizon? The project and client types could be an indication of whether there could be potential claims in the future.
4. Insurance policies and loss run history – Review the other firm's loss run history. Have claims been asserted against the firm? Are any claims pending? *What are the sources of the claims?*
5. Risk management procedures and quality control – What type of procedures are in place at the other firm? Is there a lack of quality control? Do they allow anyone to stamp drawings? How many processes does the firm go through to check for coordination and integration? If the firm's procedures are less than exemplary, this could be a sign of times to come, and claims to come.
6. Leases
7. Payroll and Employee Benefits

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8. Software agreements – Does the other firm have software for each computer, or have they downloaded one version of software onto numerous computers without paying a requisite fee? If the firm has not paid appropriate licensing fees or purchased enough software, the firm could face fines and penalties for the unauthorized use.

One of the key measures design professionals need to do is plan for the future and for the "what ifs." What if the firm breaks up? What if a claim is asserted on an old project or after the firm breaks up? Each designer's professional liability insurance coverage provisions have to be reviewed. Does the firm have insurance for acts occurring prior to the policy? If there is a deductible, who will pay for it? Is the merged firm going to obtain a professional liability policy for the firm on a going-forward basis? Are the old firms going to be named as additional insureds on the policy to cover prior acts, or are the old firms going to maintain their professional liability policies to cover any potential errors and omissions that occurred prior to the merger?

Finally, the newly merged firm may want to consider using the merger as an opportunity to form a new company and potentially limit past liabilities. The bottom line is prior to jumping into the new relationship, design firms should proceed cautiously and consult an experienced attorney for advice, as well as their insurance representative, as it could save a lot of aggravation – and costs – in the future.

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