How to Handle a Pre-Claim Incident

When is a professional liability claim not a claim? It's when you discover that something may be wrong with the project, yet your client or another project team member has not confronted you with a formal complaint and demand.

So why make a big deal about a pre-claim incident and stir up a hornet's nest when chances are the issue will likely just blow away? Why not just wait and see if it develops into a claim and address it then?

The old adage is that no problem is smaller than the day you first realized it, and the sooner you address a problem or potential problem, the quicker you'll be able to find a solution and minimize damages. That logic applies tenfold to a construction project. If there's a potential problem with the integrity of a building's foundation, for example, it certainly is a lot smarter and cheaper to fix the foundation before proceeding with construction of the building that sits upon it. This reasoning alone makes it clear why pre-claim incidents should be addressed quickly, not swept under the rug until combustible.

There's another reason why it makes a whole lot of sense to address pre-claim incidents promptly: the nature of professional liability insurance (PLI). PLI is a type of insurance known as "claims made and reported," with emphasis on the word reported. This means that in order for your insurance coverage to come into effect, a claim must be made against you, and you must report it to your insurance company during the current policy period. Even if the alleged error or omission that led to the claim occurred years previously, coverage only kicks in when the claim is made and then reported to your current carrier.

Smart PLI companies take this concept a step further. The carrier will trigger its insurance coverage as soon as an insured reports a pre-claim incident that it believes may result in a claim. If the insurance company agrees that this incident may lead to a claim, then it will provide loss prevention assistance, likely on its own dime. It will open a loss prevention file and provide pre-claims services, likely spending its own money, not your deductible, to resolve and/or monitor the incident before it turns into a claim. Further, these forward-thinking carriers make it a policy not to increase an insured's premium or deductible simply because it reported a pre-claim incident. Also keep in mind the carrier who originally accepted the pre-claim is legally obligated to resolve the matter should it later develop into a claim, even if the firm has switched carriers.

Should the pre-claim develop into a formal claim years later, the policy in force when the original pre-claim was submitted will apply. This allows a firm to reduce the exposure for impairment of policy limits in existing terms. Firms can benefit from this by possibly having a lower deductible in past years, not impairing limits during existing policy terms, and allowing more time to pass for impacting claims to transition outside of carrier underwriting windows.

If we've successfully convinced you that tracking and reporting pre-claim incidents is a good loss prevention practice, then you'll want to institute company policies that will assist all of your employees – not just management and the risk management staff – in handling potential project upsets. Here are some of the basics.

IDENTIFY RED FLAGS

The red flags that indicate there may be a pre-claim incident brewing just below the surface take a wide range of shapes and sizes. Here are a few clues of impending trouble that you should have your staff look out for:

- You discover your client has initiated litigation with other designers and contractors.
- A client who has been a good communicator suddenly stops returning your calls or answering your emails.
- A client who has always paid your monthly invoices on time becomes 30, 60, then 90 days past due with their payment.
- An in-process project is unexpectedly put on hold with no clear explanation as to why.
- A client hires an outside design professional or construction manager to oversee your work.
- A client representative has a heated exchange with the contractor regarding project specifications, and then badmouths the contractor to you.
- You hear secondhand that your client recently badmouthed you to another design firm.
- You discover that project costs are running significantly over budget.
- You learn that your client was recently sued by another design firm for nonpayment of fees.
- Your client informs you that you will not need to attend this month's project meeting with the contractor.
- Your client or its contractor issues an inordinate number of requests for information (RFIs).
- You complete the project, but the ending balance due to you becomes past due.

Provide your own red-flag list to your employees, and then as a group, have them contribute to the list as it applies to their job duties. What red flags should they be looking out for?

IMPLEMENT FORMAL INCIDENT REPORTING PROCEDURES

Explain to employees that you want them to speak up at the first sign of trouble and report a red flag to the appropriate member of management, typically their immediate supervisor. Explain that you are not out to kill the messenger and, instead, appreciate the forewarning of a potential claim.

Discourage employees from trying to resolve a pre-claim incident by themselves. If they have received a complaint from a client representative, contractor, subcontractor or another party to the project, they shouldn't try to defend your company's actions or shift blame elsewhere. Nor should they admit responsibility for an error or omission in services, or offer to make payments or provide additional services to correct alleged mistakes. Instead, they should record the complaint, verify their understanding of the issue and commit to get back with a response once the situation had been investigated. Stress to employees that they should remain calm and not overreact.

If company employees discover a pre-claim incident on their own, they should report it to their supervisor prior to discussing it with the client or another party to the project. Once an incident has been reported to management, your company should begin collecting all relevant documents and other information. Do not destroy any project records. Someone (likely the project lead or a risk manager) should be appointed manager of the incident file.

When sufficient information has been gathered, all employees should be informed of the incident. They should be instructed not to discuss the matter with anyone outside the firm and be alert to possible further developments regarding the incident. Meanwhile, the manager of the incident file should reassure the claimant that the incident is being taken seriously and investigated, and a response will be forthcoming once the initial investigation is complete.
When sufficient information has been gathered, your professional liability insurance agent should be notified. Generally, you shouldn't wait more than 24 hours from the time you became aware of the incident. Same day notification is even better.

Share necessary, but basic information with your agent and ask for advice on how to proceed. Specifically, ask whether the incident should be reported to any of your insurance carriers. If your PLI carrier has a loss prevention assistance program that provides pre-claim services, chances are your agent will recommend that the incident be reported immediately. If your carrier has a higher threshold for claim reporting, you may be advised to hold off until there is further evidence that a claim may be forthcoming. Have your agent assist in determining whether your commercial general liability and excess carriers need to be notified as well. And you always have the right to report an incident to your PLI carrier, even if your agent advises you to wait.

WHEN AN INCIDENT IS REPORTED

Once an incident is reported to your PLI carrier, the carrier will likely appoint a claims manager to handle your case. The claims manager will meet with you directly or remotely to discuss the incident, review your client contract and other relevant project documentation, pinpoint the underlying issues that could lead to a claim, and provide advice on how to proceed.

Based on the specifics of the situation, the claims manager may advise you to take no action at that time, other than to keep open communications with your client and report any further signs of project upset. In other instances, the claims manager may assign legal counsel or subject matter experts to assist with the investigation. Each situation is different and the appropriate response can run the gamut from doing nothing, to soothing ruffled feathers, to aggressively building a strong defense team and legal case.

Where appropriate, your claims manager may wish to contact the potential claimant directly to gather further information or begin to seek resolution to the complaint. However, rest assured that you and members of your firm will be actively involved in any such decisions and subsequent dispute resolution efforts. Your knowledge of the situation and of the client will be key in determining how best to resolve the issue.

It may be best for you to keep communicating directly with your client (or other potential claimant), with the claims manager providing you background advice. Other times it will be more effective to begin direct dialog between your claims manager or legal counsel and your potential claimant's representatives. Either way, your claims manager should keep you abreast of all developments. The ability to manage this process discreetly retains relationships and allows projects to proceed in a productive manner.

Do your best not to upset the potential claimant, and follow the instructions of your claims manager regarding ongoing communications pertaining to the incident and your continued work on the project. In most cases, these incidents can be handled and resolved without formal litigation and your business relationship can be retained through project completion and beyond.

HEADING CLAIMS OFF AT THE PASS

The best claim is an avoided claim. Take loss prevention and risk management seriously by following these basic risk management steps:

- Select your clients and projects carefully.
- Use protective language in your contract calling for limitation of liability and mediation as your dispute resolution method of choice.
- Provide loss prevention education for your whole staff.
- Promote open communication with your client throughout the life of the project.
- With the assistance of an insurance agent who specializes in your profession, procure adequate professional liability insurance from a carrier with expertise in the architect and engineer arena.

Beyond these basics, take steps to identify and address signs of possible project upsets before they turn into claims. To recap:

- Develop with your staff a list of red flags that could indicate possible project troubles bubbling beneath the surface.
- Encourage employees to report incidents to management at the first sign of trouble.
- Educate employees on what to say and not to say when dealing with a client or other potential claimant.
- Gather the basic facts and alert your PLI agent of the incident in a timely manner.

- Take advantage of your carrier's pre-claim incident, loss prevention assistance program.
- Heed the advice of your claims manager regarding your ongoing relations with the potential claimant.

WAIT, NOT ALL CARRIERS ARE CREATED EQUAL:

When selecting a professional liability carrier, the allowance for pre-claims reporting and the amount of incurred costs by the carrier varies by company. While some carriers may budget a ‘cap’ of how much money they will spend, others will reduce the deductible up to a certain amount if the matter ever develops into a formal claim – each is different. These subtle differences should be considered, particularly with carriers offering significantly less expensive programs come renewal time.

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