

DESIGN PROFESSIONAL

LEGAL UPDATE

Washington Oregon Alaska Idaho

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For information on a possible seminar on this subject please fill out the questionnaire on Page 5.

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**ACHIEVE YOUR PAYDAY:
COLLECTION STRATEGIES FOR EVERY FIRM**

We are in difficult economic times. As we write this newsletter, the depth and duration of this economic downturn is unknown.

Now is the time to quickly assess business practices, cash flow and the steps required to ensure timely payment. No firm wants to act as a bank for its clients, yet every firm that provides professional services before receiving payment for the work is a creditor -- at least until the bill is paid in full. Many firms have already started fine-tuning their billing and collection practices. While such efforts are important, they are not enough. The savvy firm will use a variety of methods to actively manage receivables throughout the life cycle of each project.

This article identifies valuable measures for ensuring that invoices are paid in a timely manner.

Establish a Culture of Good Business Practice

Ensuring timely payment starts with establishing and maintaining a culture of good business practice. The goal should be to get accurate invoices in the hands of clients as early as possible. This requires that time charges be posted by all employees on a daily basis, that draft bills be reviewed and edited by project managers within the billing cycle, and that the billing cycle itself be timed to coincide with the payment cycle imposed by clients. These simple steps often elude the best of firms. Yet, delays in billing usually produce delays in payment and a run-up of unnecessary accounts receivable.

Employees should be trained in good business practices. Project managers and other supervisors should monitor compliance with the firm's time-keeping requirements and, if necessary, develop and implement appropriate sanctions for non-compliance. Employees need to be reminded of the direct connection between how much they work and how bills are generated, approved, submitted and collected. Specifically, employees need to understand how their employer's behind-the-scenes administrative practices influence paychecks and, ultimately, job security.

In the Beginning (and Before It Is Too Late), Assess the Client and the Project

Before undertaking work, it is particularly important in this climate to perform a "due diligence" review of the potential project, the project funding and the financial security of your client. This due diligence can be aided by a Dunn & Bradstreet credit report or by using other financial reporting services. Bank references can also be helpful.

Be particularly careful of contracting with single purpose entities, such as project specific limited liability companies (LLCs). In these situations, it may be wise to obtain individual guarantees or other assurances directly from the members of the LLC. Be aware that project lenders often require personal guarantees. A design firm should be candid and forthright in explaining that the design firm is as much entitled to personal assurance that it will be paid as is the project lender.

Pay careful attention as to who is the proper

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contracting party. It is all too common that the ultimate party to the contract is not the party with whom you had preliminary dealings and negotiations. For example, a development company may negotiate with you and then assign the project to a wholly different entity or to a single purpose and undercapitalized LLC. You need to know who is obligated to pay your bills, whether the funds are there and how the funds will be released to you.

Watch carefully for draconian lender requirements that can greatly impact or delay your ability to get paid. Lenders are frequently requiring design firms to “assign” plans and specifications to the lender as additional security for the loan. Often, lenders will require that lien rights and other payment security rights be subordinated to the lender’s security interest. If you are presented with a subordination agreement, be sure you fully understand its terms and can live with them. Frequently, and especially during construction, lenders will require inspections and approvals of the client’s draw request and lenders will attempt to keep a tight rein on cash flow. All of these practices can have an adverse impact on your receiving timely payment.

Consider Advance Payment for Services

Even with longstanding clients, in this economic climate, it may be wise to require advance payment for your services. Consider including a provision in your standard contracts requiring advance payment for at least a percentage of the work before you begin work. The advance payment provides a cushion against uncertainty. The advance payment can be held in escrow to assuage the client’s concerns that the funds are at risk or security can be provided by a letter of credit.

Understand the Billing Process and How Payment Will Occur

Here, as with most everything, knowledge is power. Take the time to learn about each client’s billing process as it pertains to the specific project. Are your invoices clear and consistent with the client’s expectations so that the client does not later unnecessarily question details? Consider providing your client with a copy of your typical invoice as part of the initial contract negotiation and make sure there are no questions at the outset. A sample invoice can be an exhibit to your contract to avoid disputes later on. Also, understand whether a third party funding source, such as a bank, will be involved and whether this funding source will require review of your invoices before payment. When a third party is involved, payments can be significantly delayed. By clearly communicating your firm’s expectations and understanding the expectations of your client, the unnecessary aging of accounts receivable can be significantly reduced.

Work Only with a Signed Contract

Working with a signed contract is not only important from a liability protection standpoint, it is also extremely important to assure timely payment. This also applies to additional work and change orders. Before undertaking new work, make sure a signed change order, new contract or contract amendment is in place; otherwise, you risk your client refusing or delaying payment.



Never do work on the basis of a letter of intent; it is no substitute for a signed contract. Once work has commenced, you have lost significant leverage for negotiating reasonable payment terms.

In your contracts, if you are acting as a subcontractor, avoid “pay when paid” and “paid if paid” clauses.

Include a clause that allows you to stop work if you do not receive timely payment. Conversely, avoid clauses that require you to continue working if a dispute arises. It is all too common for a client to “manufacture” a dispute to avoid payment and then require that you keep working under a contract clause that requires you to continue performance until the dispute is finally resolved.

Provide for Interest and Attorneys’ Fees

Include in your contract a standard clause providing for interest on late payments and recovery of attorneys’ fees and costs for collection. Knowing that a client is faced with these additional expenses, the client may be more forthcoming in making timely payment.

Dispute Resolution Provisions

Spell out in the contract a step-by-step procedure for resolving disputes. As noted above, foremost among these is a “stop work” provision that allows your firm to stop work if you are not being paid. Establish reasonable timelines for giving notice to the client and a final opportunity for the client to pay. Be very careful if you specify alternative dispute provisions. In a collection setting, it may be much more important that you have an unrestricted right to file a lien or file a lawsuit without having to participate in mediation or resort to arbitration. If you do specify an alternative dispute process, such as arbitration, consider adding an exclusion for collection matters, such as the following: “*Nothing in these alternative dispute provisions shall alter, restrict or prevent Design*

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Professional from exercising its legal lien rights or pursuing collection of past due amounts under this contract in a court of competent jurisdiction.”

Know When To Just Say No

Every firm needs a mechanism in place for making a “go – no go” decision before signing significant contracts. There is nothing worse than doing a great deal of work and not getting paid. Besides the revenue loss and the risk of malpractice counterclaims in pursuing collection activity, the company has also lost an opportunity to pursue paying work. Bad economic times are when every productive work moment is the most critical. Expending critical resources only to end up in a collection action and malpractice dispute when the energy could have been expended on paying work and growing the firm is not acceptable. It is better to walk away from risky projects and use the energy elsewhere.

Actively Monitor Accounts Receivable

Certainly most firms are monitoring their accounts receivable. However, in these economic times, it is important to monitor the aging of accounts receivable on a monthly basis and act on accounts that are over 30 days old, rather than waiting 60 or 90 days. In addition, it may help to create a system where clients are contacted shortly after invoices go out to confirm their receipt and that no questions exist on the invoices. The longer a receivable remains a receivable, the more difficult -- and the more expensive -- it becomes to collect. Depending on your firm's culture, it may also be beneficial to involve your project managers in the collection process. Project managers have regular contact with the client and may be in the best position to brainstorm methods for motivating the client to pay. Some progressive firms have instituted a program of open book accounting to educate and empower their employees.

Protect and Leverage Your Lien Rights

Design professionals and construction contractors have important lien rights that can be of significant assistance in securing or leveraging payment. Lien rights are created by the legislature to ensure that those who provide goods or perform labor or services to improve real estate may tap into the value of the property, including the added value of the improvements, to get compensated. A lien is nothing more than a security interest in the real property upon which the project will be constructed or other improvements will be made. Once properly perfected, a lien can be foreclosed upon, just like a mortgage on a home can be foreclosed upon by a lender who is not being paid.

The decision to foreclose is an extremely critical one in the collection process. A foreclosure action can also invoke a counterclaim for professional negligence or breach of contract. In addition, the costs of foreclosure need to be considered. The priority of a lien is also critical, particularly in this present real estate market. If your lien is “behind” an existing deed of trust with the bank, then you need to understand that the sale price of the real estate must at least cover both the deed of trust and your lien. Often times in a sheriff's sale, this may mean that you, as the lien holder, may have to come up with the funding to take out a more senior mortgage or other liens. Otherwise, you may risk a transfer of the property to a primary lender or lien holder without receiving any payment for your lien. Theoretically, if the lien is foreclosed and the property is sold at a sufficient value, the design professional can then be paid out of the proceeds of the sale of the property. There are ways of investigating the priority of liens and the amount of prior indebtedness before these critical decisions are made.

The key to enforcing lien rights is to follow the statutory requirements for perfecting and enforcing liens. Lien rights can be lost if timely and proper notice is not provided.

The mere filing of a lien can provide leverage since allowing a lien to be filed can violate a loan covenant between your client and the primary lender. Liens can help leverage payments. This firm has published a more detailed newsletter on lien procedures and timing in Washington, which can be viewed at www.skellengerbender.com/publications (June 2008 newsletter). Skellenger Bender also maintains current lien procedure checklists for Washington, Oregon, Idaho and Alaska.

Regarding lien rights, it is most important to remember that a notice of lien must be filed within 90 days following the completion of your work. It is also important to remember that if you are not working directly in contract with the owner, it may be necessary to provide the owner with a timely Notice of Right to Lien. There are also provisions in the lien laws for notice to be given to lenders so your lien can have propriety over funds disbursed by a lender after your notice has been received. Lien rights can be highly technical and vary greatly from state to state. For these reasons, lien rights are a topic each firm should discuss with its attorney.

Pursue Litigation if Appropriate

If you are unable to assert a lien right because of improper notice or other lien deficiencies, your only recourse may be to sue on the contract. A decision to sue

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is not unlike a decision to foreclose on the property in that you must consider the possibility of malpractice counterclaims and the cost of the litigation. The cost of a lawsuit based on the contract may actually be more expensive and time consuming than a foreclosure action. In addition, before filing a lawsuit, you should perform some due diligence to determine whether money, personal property or real property exists that can provide a source of payment. As the saying goes, do not throw good money after bad. If a client is avoiding payment, it may be difficult to properly serve them. In addition, if a default judgment is sought, it is important to take the steps necessary to enhance the enforceability of these types of judgments.

Most payment delinquencies arise due to cash flow problems. To the extent that your client is experiencing difficulties with its own cash flow, litigation may be counterproductive. On the other hand, if the uncollected amount is significant and you believe that litigation presents the best opportunity to get paid, you are certainly not alone. This fall, the Houston-based law firm of Fulbright & Jaworski released the results of its fifth annual litigation trends survey. The report, which is based on responses from 358 companies, predicts an increase in lawsuits – particularly concerning contract and employment disputes – as the economic downturn continues into next year. According to the study, money and time are the two principal factors that parties consider when deciding whether to engage in litigation. In the past, when the construction industry was booming, parties had less time to dispute non-payment issues. And, apart from being a distraction, litigation was regarded as unnecessary because debtors could take proceeds from one project to pay creditors on another. Just as the credit freeze has made it difficult for borrowers to obtain credit from lending institutions, contractors are experiencing a similar tightening effect on a microeconomic level. As a result, more businesses have started turning to litigation in an effort to be made whole by their clients.

Executing on the Judgment

Once you obtain a judgment, then you need to consider actually executing on that judgment. In the state of Washington, a judgment automatically creates a lien on real property owned by the judgment debtor in the county where the judgment was entered. Therefore, a first step in execution is to determine where the judgment debtor owns real property and make sure the judgments are entered in those counties. In addition, a judgment can be entered in another state to allow enforcement on real estate or personal property in that state.

If you are unclear regarding the assets that are available, you can initiate “supplemental proceedings” and require the judgment debtor and related parties to appear and

answer questions regarding assets and how they intend to satisfy the judgment.

Options for execution on judgments, other than foreclosure on real property, include, among other things, garnishing bank accounts, income streams and seizing personal property.

Negotiate a Payment Plan

As an alternative to litigation, it may be acceptable to simply negotiate and agree to an extended payment plan. The payment plan can be evidenced by a promissory note and, if possible, secured by real estate or other assets offered by the client. Oftentimes, a payment plan shows that the client is making a good faith effort to meet its debt obligations. However, you must keep in mind that an unsecured promissory note is not unlike a simple contract and can sometimes be difficult and expensive to collect upon.

Use Third Party Collectors

Finally, one option to collection is to turn your bad accounts over to a collection agency. Collection agencies normally negotiate the amount that you will receive on their collection efforts, which is often significantly less than the face amount of the debt. In addition, third party collection agencies must abide by and are restricted by debt collection acts. See Fair Debt Collection Act, 15 U.S.C. § 1692; see also RCW 19.16.250.

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for Questionnaire

QUESTIONNAIRE

We are assessing the level of interest for a seminar covering account collection issues facing professionals in today's economy. Please fill out the questionnaire below and we will forward the results shortly after the first of the year.

Please send your response to Stephanie Correia at scorreia@skellengerbender.com
or fax to (206) 447-1973



1. Are you interested in attending a seminar on billing, payment, and collection issues during the first quarter of 2009?

If so, please indicate your preferred format:

- 2 hour breakfast seminar
- 2 hour lunch seminar
- half-day seminar

2. Would you like to earn CE credit for attending this seminar, if CE credits can be made available?

3. Please describe specific topics, if any, that would be of particular interest to you and your firm.