Managing Design Professional Risks in Design-Build Contracts

Presentation by

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Learning Objectives:

- Identify and manage risks in design contracts, including design-build contracts and projects;

- Learn risk management ideas and strategies from recent court decisions; and

- Gain a better understanding of how project delivery method and relationships of parties may impact responsibilities and risks of the parties to the contract;

Design-Build
Litigation and Risk Management

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An Analysis of Contractor Claims against U.S. Govt (Construction Financial Management Association (CFMA) September 2015

- Evaluation of 107 reported federal decisions issued between 2000 and early 2015
  - 25 DB, contractor prevailed (fully or partially) 32% of time
  - 74 DBB, contractor prevailed 45% of time
- Major conclusions
  - Misunderstandings regarding specifications are often at the root of disputes
  - Contractors lose because of inadequate evidence
  - DB has no advantage over DBB in generating favorable outcomes for contractors involved in a dispute

CFMA Analysis of Disputes (cont'd)

Conventional wisdom suggests that design-build project delivery methods, which emphasize pre-construction collaboration, should generate better outcomes. The expectation is that better upfront documentation may help contractors pursue their claims, though of course the same documentation is also available to agencies pursuing their points of view.

CFMA Analysis of Disputes (cont'd)

We conclude that while pre-project collaboration is useful, design-build has no discernible advantage along this dimension since many disputes arise over the course of performance. At the beginning of projects, parties are likely to feel optimistic. As performance proceeds, conflicts and misunderstandings arise. Eventually, these circumstances give rise to conflict that pre-planning neither necessarily foresaw nor could prevent. This is arguably the most surprising finding in this study.

Design-Build Risk Management
Lesson 1

Joint Ventures and
Teaming Agreements

Joint Venture:
A special purpose entity

- Viewed As a Partnership/Fiduciary relationship
- Sharing of Loses and Profits
- Management Committee
- Joint and Several Liability

• What Are Teaming Agreements?

- Agreement reflects parties' intent that if the Owner awards a contract to the prime contractor, then the prime contractor will enter into a subcontract with the other team member, and the teaming agreement often allocates the types and amounts of work to be done by each party.
- One of the reasons that teaming agreements are used is that they avoid the need for the parties to negotiate a detailed subcontract agreement that they may end up not needing if their proposal is not successful. But beware of State law in this regard.

Teaming Agreement Unenforceable

- A recent federal District Court decision holding a teaming agreement between two contractors unenforceable under Virginia law raises questions about the usefulness of these commonly employed agreements. *Cyberlock Consulting, Inc. v. Information Experts, Inc.*, 939 F.Supp.2d 572 (E.D. Va 2013), aff'd, 549 Fed. Appx. 211 (4th Cir. 2014);
- "The rules of contract law do not apply to the Teaming Agreement because it is merely an agreement to agree to negotiate at a future date." *Navar, Inc. v. Federal Business Council*, 291 Va. 338 (2016).

Case Study: Teaming Agreements

- Atacs Corp v. Trans World Communications, 155 F.3d 659 (3rd Cir. 1998)
- Subconsultant contributed significantly to obtaining design build contract.
- Court found enforceable teaming agreement; however, relief was limited to amounts spent in solicitation effort and "the fair value of the subcontractor's contribution to the prime contractor's agreement."
- Lost profits were too speculative

Case Study: Teaming Agreements

- Trident Constr. Co. v. The Austin Co., 272 F.Supp.2d 566 (D.S.C. 2003)
- Preliminary discussions between Trident (subcontractor) and The Austin Company (general) but could not agree on price
- Agreement to agree was not enforceable
- "Where a contract does not fix a definite price, there must be a definite method for ascertaining it."

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Lesson 2

Promises Made to Team Members During Proposal Process May be Binding

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MetroplexCore v. Parsons Transportation Group (5th Cir. 2014)

- Houston Metro design-build-operate (DBO) project
  - Original team included MetroplexCore (MC) as member of Parsons team to manage geotech and hazmat work
  - Parsons was awarded contract but didn't use MC
  - MC sued Parsons for lost profits ($3-4MM)
- 5th Circuit allowed MC suit to proceed on promissory estoppel theory
  - Promise
  - Foreseeability of reliance
  - Substantial reliance by MC to its detriment

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Lesson 3

Documenting the Agreement Between the Parties

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Battle of the Forms: What Terms Govern?

- On City of Savannah parking garage project, the design-builder and its engineering subconsultant litigated over what contract terms and conditions applied to the contract between them
- Engineer's Letter Proposal contained scope of services and a terms and conditions sheet
- Purchase Order (PO) by D-Bldr contained different terms and conditions (but also referenced the Engineer's proposal)
- Court found PO was the final form (counteroffer); the engineer did not object to it, but instead began its services
  - Trial necessitated by ambiguity and need to determine intent
    - *Batson-Cook Company v. TRC Worldwide Eng., (2011)*

Letters of Intent: When are They Enforceable? (cont)

- Developer sued Owner for breach of contract
- Owner moved for SJ, arguing
  - There was a letter of intent followed subsequently by series of unaccepted offers and counteroffers
  - There was no enforceable contract
- Court found the letter of Intent showed parties intended to be bound by its terms "at the moment of acceptance, before the negotiation of more formalized agreements"
  - It may have been intended as an interim agreement, but it was intended to be binding nonetheless
    - *Erdman v. USMD of Arlington (2011 WL 1356920 (N.D. Tex, 2011)*

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Lesson 4

Bidder Must Seek Clarification of Ambiguities in Contract Docs and Specs

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D-Bldr Must Ask About Obvious Conflicts in Specs

- RFP contained conflicting requirements regarding use of aluminum or steel for ventilation registers, grilles and diffusers.
- Govt required more expensive materials than D-Bldr said it intended to use.
- Govt denied change order (REA) – asserting even if the specification could be read to allow either or both materials, the discrepancy was "patent" and because D-Bldr failed to inquire about what material was required, it can't take advantage of the discrepancy to use the less expensive material.
  - *United Excel Corp.,* 04-1 BCA 32485 (2003).
- See Next Slide

D-Bldr Must Ask About Obvious Conflicts in Specs (continued)

- Board HELD: The rule pertaining to patent conflict applies to design-build projects just as to other projects.
  - "… The case law indicates that a design build contract shifts risk to a contractor that a final design will be more costly than the bid price to build and that the traditional rules of fixed price contract interpretation still obtain."
  - *United Excel Corp.,* 04-1 BCA 32485 (2003).

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Lesson 5

A/E Sub Liable to the Prime Design-Build Contractor

Designer Liable to Contractor

- D/Br contracted to design and fabricate storage.
  - subcontracted steel design to an engineer.

- Engineer miscalculations caused structure collapse

- Engineer liable for injuries because of duty to create design imposing no unreasonable danger to those implementing it.
- *Mudgett v. Marshall*, 574 A.2d 867 (Me. 1990)

A/E Liable to Design-Build Prime for Cost Overruns

- A/E breached implied warranty that its design was sufficient to enable Kr to adequately price bid for d-b proposal
  - Kr relied on drawings and specs prepared by A/E per oral contract to be used for bidding the job
    - Maddox v. The Benham Group, 88 F.3d 592

- Kr relied on A/E's drawings in preparing its guaranteed maximum price (GMP) proposal to owner. The drawings had major defects, requiring substantial changes - increasing project cost and causing delay. A/E held liable for costs.
  - Skidmore, Owings & Merrill, 1997 Wash. App. LEXIS 1505 (1997)

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Lesson 6

Indemnification

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DP indemnity should not be as broad as the D-B indemnity to project owner

- Contractor will typically agree to indemnify its client for more liability than the A/E can agree to under its subcontract.

- Limit A/E's indemnity to negligence and don't include a duty to defend.

  "Indemnification. Notwithstanding any clause or provision in this Agreement or any other applicable Agreement to the contrary, Consultant's only obligation with regard to indemnification shall be to indemnify and hold harmless (but not defend) the Client, its officers, directors, and employees ("Indemnitees") from and against those damages and costs (including reasonable attorneys fees and cost of defense) that Indemnitee incurs as a result of third party tort claims to the extent caused by the willful misconduct or negligent act, error or omission of the Consultant or anyone for whom the Consultant is legally responsible, subject to any limitations of liability contained in this Agreement."

Engineer Required to Defend Client against Routine Contractor Claim

Trial court held A/E owed its client, the town, a defense against a contractor suit that alleged that the plans and specifications prepared by the engineer and provided by the town to the contractor for bidding and construction were defective.

It was a routine breach of contract claim by the contractor against the project owner, but the court concluded the indemnification agreement in the engineer's agreement with the town was broad enough to obligate it to defend the town against the contractor's claim.

Penta Corporation v. Town of Newport v. AECOM Technical Services, Inc., No. 212-2015-CV-00-011 (Merrimack, New Hampshire Superior Court, 2016).

KR filed suit against town to recover payments it alleged were owed it under its construction contract.

- Complaint asserted construction was in accordance with engineer's plans and specs that called for a specific brand of disc filters for a wastewater treatment facility that were not capable of handling required wastewater flow.
- Upon receipt of the suit, the town sent the engineer a demand for a defense against the contractor's suit pursuant to the terms of the indemnification clause in the contract between the engineer and the town. The engineer responded to the town's demand, stating it would not defend (or indemnify) the town because the allegations of the contractor were not directed at the engineer.

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Lesson 7

Beware of Incorporation by Reference:
Flow Down Clauses

Flow Down Clause in Subcontract Limited the Incorporation of Design-Build K Terms and Conditions

- Sub filed summary judgment motion asserting that prime contract's limitation of liability (LoL) clause, incorporated into the subcontract through a flow-down clause, limited prime's ability to recover damages from subcontractor.
- Trial court granted the motion on the basis that the LoL clause in the prime contract applied to the subcontract by virtue of a flow-down clause.
- Reversed on appeal. Held: Prime contract LoL clause did not flow down to the benefit of the subcontractor.

Centex/Worthgroup, LLC v. Worthgroup Architects, L.P., 2015 WL 5316873.

See next several slides.

- The subcontract included a flow-down clause, which stated:
  - Worthgroup [the subcontractor] shall, except as otherwise provided herein, have all rights toward Centex which Centex has under the prime contract towards the Owner, and Worthgroup shall, to the extent permitted by applicable laws and except as provided herein, assume all obligations, risks and responsibilities toward Centex which Centex has assumed towards the Owner in the prime contract with respect to Design Work.
- But the subcontract also included a clause making sub responsible for any redesign costs and additional construction costs required to correct its errors and omissions.

See next slide

- How the court explained it:

- Although under the prime contract, the prime's liability to the owner was limited by a form of Limitation of Liability clause,

  – "The limitation of liability would not flow-down to the benefit of the subcontractor, however, because a provision of the subcontract specifically addressed the allocation of liability of the subcontractor's liability to Prime."

- The subcontract language that stated Sub would be liable for "any redesign and additional construction costs" did put any limitation upon the Sub's responsibility for those costs.

Example Incorporation by Reference

- AIA C401 - § 1.3 To the extent that the provisions of the Prime Agreement apply to This Portion of the Project, the Architect shall assume toward the Consultant all obligations and responsibilities that the Owner assumes toward the Architect, and the Consultant shall assume toward the Architect all obligations and responsibilities that the Architect assumes toward the Owner. Insofar as applicable to this Agreement, the Architect shall have the benefit of all rights, remedies and redress against the Consultant that the Owner, under the Prime Agreement, has against the Architect, and the Consultant shall have the benefit of all rights, remedies and redress against the Architect that the Architect, under the Prime Agreement, has against the Owner. **Where a provision of the Prime Agreement is inconsistent with a provision of this Agreement, this Agreement shall govern.**
  - NOTE: Often, the last sentence is replaced with something like: "Where there is a conflict between the prime agreement and subagreement the stricter provision shall apply."

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Lesson 8

Failure to Properly Manage the Design Process Creates Major Risk Exposure to Design-Builders

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Flatiron-Lane v. Case Atlantic Company (2015)

- Dispute between design-builder and foundation subcontractor
  - NCDOT bridge project with drilled shafts
  - Foundation took 44 weeks vs. 16-22 weeks
- Conflicting design assumptions
  - Oversized temporary steel casings vs. oversized permanent casings
  - Designers did not know what the sub planned
  - Prime did not permit Sub to directly communicate with designers
  - "With advance notice, the designers could have accommodated this construction method"

Flatiron-Lane (cont'd)

- Relationship adversarial on first day of construction and parties prepped for litigation
  - Responding to RFIs and accommodating Case's plan
  - Issues over annular space
  - Changing diameter of shafts
  - Support crane usage
  - Failure of designers to develop acceptance criteria for highly variable subsurface conditions
  - 11% of shafts had to be redesigned due to conditions encountered at plan depths

Flatiron-Lane (cont'd)

- Court finds both parties bore responsibility for delay
  - Design-builder
    - Should have known that its designers were designing in a manner inconsistent with the Trade Subcontractor's plan
    - Failed to coordinate subcontractors
  - Trade Subcontractor
    - Not familiar with NCDOT practices and customary techniques
    - Abnormal equipment breakdown
    - Workmanship
- Neither party attempted to apportion delay

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Lesson 9

Standard of Care and Warranties

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Designer not Liable for Implied Warranty of Habitability on Condo

- Condo association filed suit against a number of the parties involved in the design and construction of the condo complex, alleging breach of implied warranty of habitability.
- Association attributed air and water infiltration to latent defects in the design that were not discovered until 2007.
- Trial court dismissed suit against designer, and appellate court affirmed dismissal.

Board of Managers of Park Point at Wheeling Condominium Ass'n v. Park Point at Wheeling, LLC, 2015 IL App (1st) 123452

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A/E Does Not Warrant Perfection

- Court cited the principle that an architect does not warrant or guarantee perfection in his or her plans and specifications is long standing

- Court found implied warranty should be limited to subcontractors who were involved with the physical construction or the construction-sale of the property.

See next slide

Designers are not “workmen”

- Court rejected condo association's argument that DPs have an implied obligation to perform their tasks in a “workmanlike” manner.
- Citing to Black's Law Dictionary, the court noted a “workman” is a person who is “employed in manual labor, skilled or unskilled."
  - “Thus the term ‘workmen’ does not include professional persons such as design professionals, and design professionals are not obligated to perform their professional services in a workmanlike manner.”
- **Contract Lesson**: Architects and engineers should be careful not to agree to contract provisions that require them to perform their services in a "good and workmanlike manner." While the phrase is seemingly innocuous, a court could find that it imposes a higher standard than the professional standard of care.

Engineer Can be Sued for Breach of Warranty of Professional Services

- Pulte Homes sued A/E that performed engineering and testing services for it. After resolving defects asserted by the homeowner through arbitration proceedings, Pulte sued A/E to recover damages paid homeowner.
- The theories of recovery included a claim based on breach of express or implied warranties.
- Pulte alleged that "S&ME expressly or impliedly warranted to Pulte that all work performed by them would be performed in a careful, diligent and workmanlike manner, and that any materials and/or services designed, supplied or sold by them for use on the project would be merchantable and fit for their intended or specific purpose."
- In reviewing the contract language, the court agreed that it "includes language arguably in the nature of an express warranty."

Pulte Home Corp. v. S &ME, Inc., 2013 WL 4875077 (U.S. District Court, South Carolina, 2013).

Contract Drafting Tip

- Some design professional contracts I review contain so many blatant or hidden warranties buried throughout the fine print of the Agreement that I have found it necessary to create a catch all clause to attempt to disavow all warranties, just in case one slips through the cracks even after we have attempted to find and delete them all. A clause that I use for this purpose is as follows:
- **"Standard of Care**. Notwithstanding any clause in this Agreement to the contrary, Consultant expressly disclaims all express or implied warranties and guarantees with respect to the performance of professional services, and it is agreed that the quality of such services shall be judged solely as to whether Consultant performed its services consistent with the professional skill and care ordinarily provided by firms practicing in the same or similar locality under the same or similar circumstances. Nothing in this Agreement shall be construed to establish a fiduciary relationship between the parties."

Beware of Performance Guarantees under Design-Build Contracts

Performance Guarantees, Contract Obligations and Professional Liability Insurance

- Professional liability insurance policies exclude from coverage claims arising from any express warranty or guarantee

- Design-builders and EPC contractors frequently enter into subcontracts with designers to fulfill the design requirements of the design-build or EPC contract

- Prime contractors typically incorporate the prime contract into the subcontract; the subcontract often further requires the subcontractor assume to the design-builder the contractual obligations that the design-builder owes to its client, the project owner

GMP Design-Build Contracts Guarantees

- Shifting responsibility and liability to design subconsultant. Consider this language from a subcontract:

- "Design Consultant shall attend and participate in such meetings as are held between Owner and Design-Builder to discuss interim design submissions and the Construction Documents. Design Consultant shall identify during each such meeting, among other things, the evolution of the design and any changes or deviations from the Contract Documents, including the Basis of Design Documents, or, if applicable, previously submitted design submissions. To the extent that Design Consultant fails to identify such changes or fails to produce Construction Documents consistent with the Basis of Design Documents and identified and approved changes and Design-Builder incurs additional uncompensated costs as a result, Design Consultant shall be responsible for such costs."

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Lesson 10

Prescriptive Design Specs v. Performance Specs

Design-Builder must satisfy both

By submitting Proposal in Response to RFP, Design-Builder Represents It Can Meet Performance Specifications

- RFP called for windows at Alaska base to meet blast requirements and also meet high thermal requirements.
  - D-Bldr could not locate commercially available windows and had to custom build them instead.
- Govt denied change order (REA) for additional costs of windows
- Board HELD: D-Bldr represented it could meet the performance specifications by submitting its proposal.
  - Failure to adequately investigate availability of windows was D-Bldr risk.
  - *Strand Hunt Construction, Inc.*, ASBCA 55,671 (2008)

Where RFP Includes Design/Prescriptive Specs and Performance Specs – Both Must be Met

- Govt drawings "depicted four dust collectors and four exhaust fans." Govt specs included two different cross-draft ventilation rates (110 ft/min versus 60 ft/min).
- D-Bldr sought to meet the performance specs for ventilation by using different air flow and different number of exhaust fans and dust collectors than prescriptive, design specs called for.
- D-Bldr argued a design-build contract gave D-Bldr flexibility to meet the performance requirements differently than prescribed.
- *FSEC, Inc.*, 99-2 BCA 30512 (1999).
- See next slide

Where RFP Includes Design/Prescriptive Specs and Performance Specs – Both Must be Met (Continued)

- Board that D-Bldr (1) Must follow the detailed design specs even if could meet performance another way; (2) Should have sought clarification on flow rate – so must meet higher rate.
- Explained: "Obligations imposed by the specs determine the extent to which a particular spec is either performance or prescriptive, and it is not uncommon for a contract to contain both…."
- *FSEC, Inc.*, 99-2 BCA 30512 (1999).

CONTACT Information & DISCLAIMER

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Questions?

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