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Green and Sustainable Design: Part 1: Professional Liability Risk and Insurability Issues for Design Professionals

By David J. Hatem, PC

T HIS PAPER WILL IDENTIFY AND DISCUSS professional liability risk and insurability issues for design professionals associated with green and sustainable (“G/S”) design. There are many published articles that address the background and benefits of G/S design and the reasons for its increasing prevalence and popularity. There are other articles that anticipate the legal theories upon which claims may be asserted against design professionals in the G/S design context. This paper, in contrast to those articles, will focus on why potential professional liability risk in G/S design, as well as the associated professional liability insurance concerns, are so significant for design professionals. The intent of this paper is not to discourage the G/S movement, but rather to contribute to the understanding of the associated professional liability risk, and to lay the foundation for Part II of this paper which will set forth risk management and contractual recommendations for design professionals to manage that risk and maximize the availability of professional liability insurance for claims associated with G/S design.

There are many excellent resources that contain detailed discussions of G/S definitions, standards, codes, regulations, performance objectives and available contract documents.¹ This paper will not cover that same ground. However, a basic definition of G/S as relates to the design and construction of a building or other structure (“project”) is a necessary starting point for the discussion of professional liability risk and exposure.

In general, projects are considered G/S in nature if they are environmentally sensitive in their siting, planning, programming, design, construction, operation and maintenance. This very definition or characterization of a G/S project demonstrates that the achievement of G/S standards and performance objectives cuts across the entire multi-decade life cycle of a project, and embraces and depends upon the adequate performance of virtually all project participants - owner; design professional and subconsultants; constructor and subcontractors; specialized G/S consultants; product manufacturers; and operations and maintenance firms - in their respective roles and responsibilities.

Client Expectations in G/S Design Context

The achievement of a project that complies with G/S standards and performance objectives is of great interest to many project owners. That achievement may well result in front-end (e.g., credits, investments and incentives) and longer-term (increased revenue) benefits for such owners, as well as more subjective, positive reputational and related attributes for both the owner and the project. G/S compliance represents the potential for much to gain and much to lose for the project owner. This context of “expectations” serves to define both the promise and benefits of G/S, as well as the underpinning of the significant risk and liability exposure for the design professional arising from disappointed client (and other party) expectations.

On the front-end, the ability to achieve G/S standards and performance objectives impacts project cost and schedule. Some owners will choose to incur those impacts, others may be compelled to do so as a matter of legal compliance. Also, as in most design contexts, there are choices that may be

¹ See Kate Bowers & Leah Cohen, *The Green Building Revolution: Addressing And Managing Legal Risks And Liabilities* (Environmental Law & Policy Clinic, Harvard Law School, March 10, 2009). Significantly, one commentator has noted that terms such as “Green Building,” “Sustainability,” “Green Building Certification” frequently are not defined in contracts. See Frank E. Riggs, Troutman Saunders LLP, *The Legal Risks Of Green Construction*. 2 (February 2, 2009).

made in the implementation of G/S design that will affect cost, schedule and quality, as well as project performance, whether G/S design is a matter of choice or legal compulsion.

Project owners expect to be in a position to make informed decisions on G/S design issues and choices and, increasingly, design professionals are expected to be qualified and experienced in their ability to advise clients regarding such matters. That advice extends to the more immediate risks and other implications (e.g., cost or schedule) of G/S design choices, as well as the longer-term ability to achieve and maintain G/S standards and any performance objectives, and the longer-term cost implications over the life of the structure to “sustain” those owner decisions.

G/S objectives represent one of the many programmatic choices of the project owner in the development of a project. Decisions regarding the more traditional owner choices represent a tension in balancing among cost, schedule and quality. G/S involves all of these three competing considerations, as well as project performance over an extended period - potentially as long as the expected life span of the project.

More specifically, G/S design choices and implementation may involve products that cost more or take longer to procure than more traditional products; products that are experimental and untested in nature; and construction means and methods that are more costly and time-consuming (e.g., recycling of construction waste). G/S design development will involve new and more project participants (e.g., sustainability consultants, commissioning consultants, energy modelers) at a greater cost and adding more time to the design development schedule; and the operations and maintenance of a completed G/S project may require more specialized skill and be more costly. In addition, there may be risks associated with new, innovative, experimental and untested processes or technologies, including the risk that those products may require a longer lead delivery cycle or may no longer be available when needed during construction or during the longer operations and maintenance period for replacement or upgrades over the life of the operating project. Further, accomplishing G/S objectives may involve delays in project acceptance in order to meet G/S documentation needs. These (mostly shorter-term) cost and time increases certainly need

to be balanced against the increased revenue and other economic and consequential (mostly longer-term) potential benefits of a G/S project.

In many instances, the project owner will have the ability to make significant choices with respect to G/S design and implementation issues. However, in some respects, the legal and regulatory environment may mandate or constrain the owner’s decision-making as to such choices.

A principal risk management consideration for design professionals is to use due care in presenting to the owner the range of permissible G/S choices, explaining them, especially as to cost and schedule implications, informing the owner’s decision-making, and in documenting that entire process.

In the ordinary course, there will be communications between the design professional and the project owner regarding these subjects. Those communications often serve as the foundation - in reality or perception - of client expectations as to G/S objectives. As in the case of any communication with a client regarding important expectation subjects and project objectives, discussions regarding G/S issues should be informed, realistic and documented.

Project owners need to understand the role of the design professional relative to the achievement of G/S standards and performance objectives. Specifically, there are many important aspects of that subject that are beyond the control or ability of the design professional to achieve. G/S “success” depends upon performance of products and systems (for which sparse experience or reliable actual performance data may exist); the constructor’s selected means and methods; product and systems selection; and, perhaps most importantly, the project owner’s (and user’s) operation and maintenance of the completed project. The various roles and responsibilities of all project participants in the achievement and “sustainability” of G/S standards and any performance objectives must be understood and acknowledged in defining and applying the professional standard of care. Contract terms are an important mechanism to document those understandings and allocate risk in a fair and balanced manner.

Professional Liability Risk: Contextual Background and General Considerations

Before addressing professional liability risk exposure in the *specific* context of G/S design, it would be helpful to present some context and considerations that impact professional liability risk in *general*.

Some of the principal considerations that impact, in general, professional liability exposure for design professionals in all design and professional project delivery approaches include:

- Lack of qualifications or experience of the design professional to undertake the client's commission
- Misrepresentation of the design professional as to its qualifications or experience to undertake the commission
- Unrealistic or unreasonable client expectations as to project result or performance capabilities, or the design professional's ability to achieve those expectations
- Lack of documentation as to important communications between the client and the design professional as to the definition, qualifications and limitations regarding the achievement of the client's expectations
- Contractual terms that heighten the generally applicable negligence-based professional standard of care (the "professional standard of care") or impose specific warranty or performance standards or obligations upon the design professional, the achievement of which are beyond the professional standard of care or the control or ability of the design professional
- Circumstances in which the design professional provides certifications or collateral warranties that address subjects beyond the design professional's service scope or ability to control, or representations that exceed the professional standard of care
- Project design involving new, experimental, untested or innovative practices, products, processes, systems or technologies
- Practice in an area in which the application of the professional standard of care is especially ill-defined and experience undeveloped
- Projects in which the consequential damage exposure for performance deficiencies or failures is significant and may occur over an extended period
- Projects in which design is developed in an "integrated" process involving multiple project participants, but in which the professional standard of care and risk allocation provisions are defined in a traditional manner in the design professional's agreement that do not adequately account for the integrated design development process
- Projects in which design responsibility is not clearly defined or understood and diffused among multiple project participants
- Projects in which design of permanent project work is delegated to a constructor, or in which performance specifications assign design responsibility to a contractor, but in which the extent of the design delegation or assignment is not clearly defined
- Projects in which services are undertaken in an ill-defined and evolving regulatory environment in which federal, state and local law or codes may conflict or have not been previously or consistently interpreted or applied
- Projects in which the interests and objectives of the initial client "developer" may not be consistent with those of the intended or ultimate project occupant or user
- Projects in which the performance and functionality of the design relative to the completed project inextricably depends upon the competent and consistent implementation of certain minimal operations and maintenance standards, assumptions and expectations
- Practice in an area in which legal principles relating to risk and liability of design professionals is uncertain due to paucity of directly applicable legal precedent

While much uncertainty exists in the precise prediction and definition of potential professional liability risk for design professionals in the specific G/S design context, it should be reasonably clear that G/S design involves *all* of the preceding general considerations. For that reason, this subject - professional liability risk for design professionals involved in G/S design - is and should be of intense interest to design professionals (and their professional liability insurers), as well

as be intriguing for students of the design professional liability experience.

Professional Standard of Care

The professional standard of care is, for the most part, the most widely and generally accepted “baseline” for evaluating the adequacy of design professional performance. In general, the professional standard of care has been defined as follows:

As a general rule, '[a]n architect's efficiency in preparing plans and specifications is tested by the rule of ordinary and reasonable skill usually exercised by one of that profession. . . . [I]n the absence of a special argument he does not imply or guaranty a perfect plan or satisfactory result. . . . 'Architects, doctors, engineers, attorneys and others deal in somewhat inexact sciences and are continually called upon to exercise their skilled judgment in order to anticipate and provide for random factors which are incapable of precise measurement. The indeterminable nature of these factors makes it impossible for professional service people to gauge them with complete accuracy in every instance. . . . Because of the inescapable possibility of error which inheres in these services, the law has traditionally required, not perfect results, but rather the exercise of that skill and judgment which can be reasonably expected from similarly situated professionals.²

The application of the professional standard of care, by definition, is variable and dependent upon the specific relevant facts, circumstances and contract terms. In addition, the application of the standard should take into account consideration of what other similarly qualified and experienced design professionals would or should have done in the same or similar circumstances. Applying the professional standard of care in the context of service activities that are considered innovative, such as G/S design issues, in itself poses a heightened degree of risk in that the “standards of the profession” are, by definition, not well-defined or defined at all in such a context.

The professional standard of care is intended to set forth an objective or “reasonable” baseline for evaluating the adequacy of professional performance. Applying that standard in the context of more ill-defined innovative practice areas tends to invite and allow for the consideration of more subjective evaluations than would typically be the case in the traditional professional liability claim context. Subjectivity in the application of the professional standard of care increases uncertainty and hence, risk.

Quite apart from these increased risk factors associated with the application of the professional standard of care in the G/S design context, contracts may impose heightened risk due to special provisions relating to the explicit definition of professional standard of care obligations and specifically-required performance objectives or warranty obligations regarding G/S issues. These provisions may represent contractual obligations that not only exceed the customarily governing negligence-based professional standard of care, but also represent liability exposure for durations that exceed typically applicable statutes of repose or limitations, see Anthony's Pier Four, Inc. v. Crandall Dry Dock Engineers, Inc., 396 Mass. 818 (1986); as well as pose potentially significant insurability concerns due to warranty exclusions contained in professional liability insurance policies. Moreover, in most instances, the ability to achieve those contractually-defined performance requirements may not be within the primary or exclusive control of the design professional.

In addition, application of the professional standard of care may be influenced by the extent to which a design professional has made representations as to its qualifications, expertise or experience in G/S design. Further, legitimate issues have been raised as to whether the “LEED AP” designation will result in imposition of a “higher obligation” for G/S design and performance standards and objectives compliance upon those possessing that designation or status.³

In the context of innovative design approaches, questions are often raised about the effectiveness and enforceability of contractual liability waivers (i.e. releases) and limitations

² Klein v. Catalano, 386 Mass. 701, 718 (1982).

³ G. William Quatman AI., AIA Trust, White Paper: Managing The Risks And Embracing The Benefits Of Going Green 13 (February 2008); Stephen Del Percio, Victor Schinnerer: New LEED A.P. Program Raising Standards of Care, Changing Risk Profiles, June 25, 2009, <http://www.greenrealestatelaw.com/2009/06/new-leed-ap-program-raising-standards-of-care>.

on remedies. In most states, the prospective release or waiver of professional liability or similar prospective discharge of any duty of care otherwise owed by a design professional to a client is likely unenforceable as a matter of common law or statutory public policy prohibitions, or as a matter of professional registration regulations.⁴ Limitations on remedies, for design professionals, on the other hand, generally are enforceable with respect to breach of professional liability and negligence claims.⁵ At a minimum, design professionals should inform clients of the risks associated with the achievement of G/S standards and performance objectives.⁶ However, to the extent that such disclosures go beyond “informed consent” and contractually seek to prospectively release professional liability exposure, serious questions and uncertainty exist in terms of effectiveness and enforceability of such a contractual approach.

A number of commentators have rightfully expressed concerns that the “enthusiasm” and “zeal” of design professionals for G/S design will instill, fuel and foster unrealistic project owner expectations. Some have suggested the need for “dampening” that enthusiasm and zeal as a prudent risk management precaution. Concerns in this regard are often grounded in the AIA Board’s New Position Statement No. 42 entitled Energy and the Built Environment which states: “Architects must strive for energy efficiency and waste reduction in the built environment, encourage energy-conscious design and technology, and support a national program for more efficient use of nonrenewable resources and the development of renewable energy sources.” Pure expression of aspirations, unconstrained by the pragmatic realities of service scope, professional standard of care considerations, the ability of the design professional to

achieve a G/S objective, and the client’s genuine and voluntary desire for the achievement of such an objective - could lead to a danger zone for the design professional.

What appears reasonably clear - even at this relatively early point in the G/S professional liability developmental cycle - is that factors extraneous to pure technical skill and capability are likely to predominate in the professional standard of care application. These factors will be disproportionately and unconventionally influenced by such considerations as:

- The strong political and design professional practice “environment” encouraging and promoting G/S development and design
- Economic incentives to developers to implement G/S design
- Project owner (or design professional) aspirational goals may predominate over pragmatic or realistic technical and professional abilities to achieve those goals
- The increasing growth of design professionals and others promoting the development of G/S design
- The “backend” or longer-term economic benefits of owning a G/S-designed project, in terms of potentially reduced operating and maintenance costs and increased revenues
- Professional ethical standards that create obligations to promote or implement G/S design objectives⁷
- The degree of the project owner’s informed understanding of risks involved in G/S design and the achievement of G/S standards and performance objectives

⁴ M. Healey, Professional or Not: Should Courts Preclude Contract Limitations of Liability Solely Because of the Architect or Engineer’s Status as a Licensed Professional? J. of the American College of Construction Lawyers, Winter 2010, at 23, 27, 31.

⁵ M. Healey, Professional or Not: Should Courts Preclude Contract Limitations of Liability Solely Because of the Architect or Engineer’s Status as a Licensed Professional? J. of the American College of Construction Lawyers, Winter 2010, at 23, 27, 31.

⁶ See AIA Trust, Client Waiver and Informed Consent to Use Experimental Green Product App. C.

⁷ To what extent do ethical standards relating to G/S design affect professional liability exposure of design professionals? Both NSPE and the AIA have chosen to promulgate ethical guidelines relative to G/S design. Kristin Ballobin, Victor O. Schinnerer & Co., Inc., Sustainable Design Risk Management 3, (2008). The issues whether violation of an ethical standard or guideline establishes a breach of the professional standard of care or whether such a violation is admissible in evidence in a civil proceeding against the design professional are primarily resolved under governing state law. G.W. Quatman et al., AIA Trust, White Paper: Managing the Risks and Embracing the Benefits of Going Green 30 (February 2008); David J. Hatem, Administrative, Regulatory and Registration Proceedings Involving Design Professionals, Wiley Construction Law Update, 1991; Taylor, Thon, Thompson & Peterson v. Cannaday, 749 P.2d 63 (Mont. 1988).

There will also be a growing class of expert witnesses of *varied* qualifications and backgrounds who will be available to offer opinions regarding G/S professional standard of care compliance issues. More specifically, non-design professionals *may* be allowed to offer opinions as to a design professional's compliance with professional standard of care in the G/S design context. This will naturally evolve because design professionals do not "have an exclusive" on "LEED AP" designation. The ultimate question as to admissibility of such opinions offered by a non-design professional G/S expert against the design professional will depend upon state and federal court evidentiary rules and, probably, the discretion of the trial judge.⁸ The latter represents yet another heightened risk (i.e., uncertainty) factor.

In this largely uncharted G/S professional liability risk and potential liability environment, design professionals should be careful to clearly comprehend, and realistically define and document client G/S objectives and expectations, making certain that their contractual obligations reflect the reality of their capabilities measured in terms of professional proficiencies and capability, as well as their ability to control the variables and factors that may and will impact the achievement of G/S standards and performance objectives.

Some maintain that the most effective risk management and contractual "counter" to the anticipated concern about subjectivity dominance in the professional standard of care application, is to strive for a more exacting definition of G/S performance standards and objectives in the design professional contract. The reasoning is that the more specific and objectively-defined the standards and obligations, the less opportunity for importation of subjectivity in the professional standard of care application. However, there is another side to this discussion.

Although case law - especially at the appellate level - has yet to develop in the specific context of G/S design liability, there is every reason to expect that it is just a matter of time for that evolution to occur. In the interim, there is ample

legal precedent derived from related professional liability contexts that provide some meaningful guidance.

Allow a digression. This digression demonstrates the point that in the relatively uncharted territory of G/S professional liability exposure, those searching for predictive and analogous legal principles will look to legal precedent in related contexts. For example, in the area of liability of design and other professionals under federal and state false claims acts ("FCA"), courts have recognized the importance of the distinction between representations made in claims for payment submitted to the government by design professionals based upon (a) statements of compliance with specific legal (statutory regulatory code or otherwise) or specific contractually-required performance or warranty obligations and (b) more general statements as to standard of care compliance.⁹ As a general matter, the more specific the statement as to compliance and the more objectively ascertainable the measurement of compliance, the more likely professional liability exposure for FCA liability. Based on that precedent, there are clearly some lessons to be learned in terms of G/S contracting practices.

The same principle is likely to apply in the context of professional liability risk and exposure for G/S design issues. Specifically, the more specific the contractual performance standards or objectives for G/S, the more likely professional liability risk and exposure and the easier the process of evaluating (or, more accurately, measuring) the adequacy of the design professional's performance. The more generalized the objective the articulation of the professional standard of care, and the more discretion and judgment conferred on the design professional, the less likely and more complex the professional liability evaluative process and determination.

Having said this, as previously stated, some commentators recommend that design professionals contractually negotiate a more specific G/S performance standard in their agreement. The suggestion has been made that G/S contractual performance terms in the design professional agreement should be "tangible" and "quantified" so as to reduce the

⁸ See J. Sweet & M. Schneier, *Legal Aspects of Architecture, Engineering and the Construction Process*, (8th ed. Cengage 2009), ¶14.06, pp. 255-61.

⁹ *Megaprojects: Challenges and Recommended Practices* (David J. Hatem & David H. Corkum eds., ACEC June 2010) at Part II, Chapter 16, 5.0 (discussing false claims act liability of design and construction management professionals).

degree of subjectivity required in the evaluative process as to whether the professional standard of care has been met.¹⁰

The application of the professional standard of care in the G/S design context does and should take into account professional practice and performance evaluated in the context of:

- Contractual terms, including scope of services and performance obligations and objectives
- Roles and responsibilities of the various project participants relative to G/S design development¹¹
- Degrees of uncertainty associated with interpretation or application of relevant codes, statutes, regulations - and the law relating to G/S design¹²
- The innovative nature of the design or the products, technology and processes presented in the G/S design at issue
- The experience and qualification of the design professional, including representations made by the latter in that regard
- Other circumstances relevant to the professional standard of care application, including the nature of service delivery (e.g., collaborative or integrated design approach to G/S design development issues, or fast-track); specification of new or experimental products, systems, technologies or processes;

influence of construction means and methods in the achievement of any performance objectives; and the influence of other factors outside the control of the design professional, such as the project owner's post-completion operations and maintenance of the project on the ability to achieve or sustain any performance standards or objectives

- LEED standards are relatively new, evolving and varying (no or minimal uniformity), and the application of those standards in any specific design context allows for significant discretion and flexibility as to how to achieve any given level of LEED certification or other sustainability standard.

Integrated Design Development Process, Performance Specifications, and Delegated Design in G/S Projects

The process of integrated and collaborative design development in G/S design represents the prospect for both risk reduction¹³ and risk exposure for design professionals.¹⁴

The G/S design development process often is undertaken in an integrated and collaborative mode. As has been stated:

. . . Achieving . . . green objectives may require additional integration of the designers, contractors, subcontractors, installers and other project team members. Under the LEED Rating Systems, several

¹⁰ See Edward Keegan, Actionably Eco?, Architect Magazine, August 3, 2009, at 3, <http://www.architectmagazine.com/legal-issues/actionably-eco.aspx> ("use language that's tangible and can be quantified, so there's no room for debate as to whether the design professional satisfies their obligations."); Darren A. Prum & Stephen Del Percio, Green Building Claims: What Theories Will a Plaintiff Pursue, Who Has Exposure, and a Proposal for Risk Mitigation, 37 Real Est. L. J. 243, 258 (Spring 2009); Matt Hudgins, Are You Covered?, National Real Estate Investor, September 1, 2008.

¹¹ The public regulatory influence over G/S design and construction is increasing, at the federal, state and local levels; see K. Bowers & L. Cohen, The Green Building Revolution: Addressing and Managing Legal Risks and Liabilities (Environmental Law & Policy Clinic, Harvard Law School, March 10, 2009), and the expectation that regulation and mandatory G/S standards will yet further increase in the foreseeable future is realistic, if not certain. What has largely been a matter of choice or preferential programmatic objectives for the project owner is now becoming a matter of mandatory legal compliance. Design professionals will need to be aware of these regulatory requirements in fulfilling obligations owed to their clients in G/S design. Design professionals should require in their contracts with owners that the latter provide qualified legal advice in the specialized area of G/S legal requirements.

¹² See David A. Ericksen, Is the Standard of Care Evolving in a World Gone Green and High Tech (Victor o. Schinnerer & co., Inc., The 48th Annual Meeting of Invited Attorneys, 2009).

¹³ See Dale E. Ahearn, Geoffrey M. White & Frost Brown Todd, Negotiating and Structuring Construction Contracts Leading Lawyers on Protecting Client Interests, Managing Risk and Understanding Recent Trends and Developments, Aspatore, 2009 WL 1339225 (ASPATORE) at 8.

¹⁴ See David J. Hatem, Design Responsibility in Integrated Project Delivery: Looking Back and Moving Forward, Donovan Hatem LLP, January 2008; David J. Hatem, Roles and Responsibilities, Risk Allocation and Professional Liability Exposure in the Collaborative World of Building Information Modeling and Integrated Project Delivery: Business as Usual or Fundamental Change?, Donovan Hatem LLP, March 2010; H. Ashcraft, Building Information Modeling: A Framework for Collaboration, The Construction Lawyer, American Bar Association, September 2008.

project team members are sometimes responsible for achieving any one point toward certification. For owners who desire LEED certification for their projects, this factor presumably gives an integrated project team an advantage over the more segregated approach of conventional project teams.

These green objectives, and the additional integration required to achieve them, create new risks for owners, architects, contractors and for each of the other project team members. The structure of green building standards, such as LEED, further magnifies the potential impact of these risks on each of the project team members. For example, LEED awards certification based on an aggregate of points achieved and therefore, a failure to achieve any one point can result in the failure of an entire project to achieve the desired (or required) certification level. Thus, because several project team members may be involved in achieving any one point toward LEED certification, a failure by a single member of the project team can result in the same project-wide failure to achieve certification.¹⁵

In circumstances in which G/S design is undertaken on an integrated or collaborative basis involving the constructor's participation, the constructor's otherwise applicable and available implied (or Spearin) warranty rights may be negated or significantly undermined due to (and depending upon the degree of) that participation.¹⁶ As a general matter, the Spearin implied warranty obligation of the project owner applies in contexts in which the owner has furnished or issued a detailed design has been to the constructor and in which the latter has had no (or no meaningful) opportunity

to participate in the development or finalization of that design. In the integrated design development context in which the constructor (and its subcontractors) participate in the development and detailing of the design, the underlying rationale or predicate for application of the Spearin implied warranty obligation of the project owner may not exist since the constructor may have had an active and meaningful role and participation in the G/S design development process.

In other circumstances, the contract documents may include "performance specifications" in which a specific G/S performance or other standard or result is defined that the constructor is obligated to achieve, without providing the constructor with a detailed design or prescriptive specifications that must be followed for the constructor to achieve that standard or result. In such circumstances, a constructor may well be assuming responsibility for producing a design that achieves the standard or result.¹⁷ In situations in which performance specifications contain prescriptive "design" details or significantly limit the design or other discretion or judgment of the constructor in its ability to achieve the performance standard or result, the determination as to responsibility for final design may become obscured. In circumstances in which performance specifications contain such prescriptive details or significantly limit design discretion or the methods for achieving the specified performance standards or results, issues of responsibility for failure of the design to achieve the standards or result may lead to complicated and contentious disputes and claims among all project participants, especially the design professional.¹⁸

¹⁵ B. Phillips & S. Sentman, Structuring and Drafting Project Agreements to achieve Green Building Objectives, Green Building and Sustainable Development: The Practical Legal Guide (J. Furr et al. eds, American Bar Association, 2009). In addition, it has been stated:

Another complicating factor for contractors and designers is that stated green building goals require the proper performances of both design professionals, contractors and trade contractors, as well as material suppliers. No one party controls all of the project aspects which must come together in order to achieve the sustainable building goal. As a result, sorting out the responsibilities of the various parties for failure to achieve the green building goals can be difficult, expensive and time consuming. Each member of the construction team is cautioned to carefully document the correctness of each of its steps toward the satisfaction of green building requirements. Designers, contractors, trade contractors and suppliers are cautioned to avoid LEED rating 'guarantees' in favor of contract references to certification 'goals' or desired performance metrics for the building (e.g., energy and water efficiency targets)", F. Riggs, The Legal Risks of Green Construction, Troutman Sanders, February 2, 2009, p. 3. See also, D. White & F. Todd, Negotiating and Structuring Construction Contracts Leading Lawyers on Protecting Client Interests, Managing Risk, and Understanding Recent Trends and Developments, 2009 WL 1339 225 (ASPATORE), p. 8; K. Bowers, & L. Cohen, The Green Building Revolution: Addressing and Managing Legal Risks and Liabilities, Environmental Law & Policy Clinic, Harvard Law School, March 10, 2009, pp. 15-16.

¹⁶ See D. Hatem, Design Responsibility in Integrated Project Delivery: Looking Back and Moving Forward, Donovan Hatem LLP, January 2008; David J. Hatem, Roles and Responsibilities, Risk Allocation and Professional Liability Exposure in the Collaborative World of Building Information Modeling and Integrated Project Delivery: Business as Usual or Fundamental Change?, Donovan Hatem LLP, March 2010.

¹⁷ See W. Allensworth et al., eds., Construction Law, American Bar Association (2009), pp. 152, 604-05; J. Sweet, Legal Aspects of Architecture, Engineering and the Construction Process, ¶19.01 D, 413-16 (Cengage 8th ed.) (2009).

¹⁸ See, Federal Government Construction Contracts 491-524 (M. Branca, et al. eds American Bar Association 2d ed.).

In those circumstances in which performance specifications are utilized in conjunction with an integrated or collaborative G/S design development process, the responsibility for final design adequacy - constructability or performance - may be yet further obscured or complicated.

Finally, responsibility for the achievement of G/S design or performance standards or objectives may be explicitly delegated to the constructor (or to specialty trade subcontractors). Depending upon a number of factors, including the degree of clarity of the design delegation, and the interrelatedness of the delegated design to other project design components, there may be significant opportunity for ambiguity, disputes and claims, diffusion of responsibility, and non-accountability for design defects and unintended design risk assumption.¹⁹

The bottom line is that given the anticipated utilization of an integrated design development, performance specifications, and/or design delegation in the G/S design process, there will be significant potential for complexity, diffusion and ambiguity in G/S design responsibility and, hence, the inherent and consequent uncertainty, risks and disputes in the determination of G/S design responsibility. Lack of clarity and accountability in design responsibility in any context, including G/S design, is problematic and poses risk for project owners and constructors, as well as for design professionals.

Product Risk

G/S design involves the potential for specification and use of many innovative, untested and experimental products, the selection of which may significantly increase the professional liability risk exposure of design professionals.²⁰ The absence of any or any reliable data regarding product experience or performance; the availability of the product; the potential discontinuance of product manufacture if experimental or

marketing goals are not met; - are all factors accounting for that increased professional liability risk exposure.²¹ In addition, these products may be in high demand, have low stock or supply availability and may be long lead in nature.²² To further exacerbate matters, the manufacturer of these products may "puff" as to the product performance capability.

It has been noted that especially in an integrated G/S design process, the involvement of various project participants may lead to more than usual changes or substitutions in originally specified products leading to uncertainty (i.e. risk) as to who bears responsibility for the research, investigation or adequate/expected performance of the ultimately selected product. The design professional may well be expected or obligated to consider the impact of a product or system selection in the ability to achieve LEED certification or sustainability goals, but "[t]his is challenging because many of the green products that will be considered beneficial in an attempt to achieve LEED certification do not have the same history of effectiveness as conventional products."²³

Other Factors Impacting Professional Liability Exposure of Design Professionals

There are other factors that impact and influence professional liability in G/S design:

- The legal community has expressed a keen interest in G/S issues and some lawyers have sought and have themselves obtained the LEED AP designation. It should reasonably be expected that this interest will spawn legal specialization in G/S issues, and generate G/S litigation especially, if not initially, in the prosecuting/claimant side.
- G/S design often involves a mix of performance and design specifications. In some instances a pure performance objective or standard may be specified leaving explicitly or implicitly delegated design

¹⁹ See D. Hatem, *Design Responsibility in Integrated Project Delivery: Looking Back and Moving Forward*, Donovan Hatem LLP, January 2008.

²⁰ See D. Ericksen, *Is the Standard of Care Evolving in a World Gone Green and High Tech* (Victor O. Schinnerer & Co., Inc., The 48th Annual Meeting of Invited Attorneys, 2009); B. Phillips & S. Sentman, *Structuring and Drafting Project Agreements to achieve Green Building Objectives, Green Building and Sustainable Development: The Practical Legal Guide*, 181-82 (J. Furr et al. eds, American Bar Association, 2009).

²¹ G.W. Quatman et al., AIA Trust, *White Paper: Managing the Risks and Embracing the Benefits of Going Green 3* (February 2008).

²² See, U.S. Green Building Council, *The Legal Risk in "Building Green": New Wine in Old Bottles?*, A USGBC Panel Discussion 4.

²³ See D. Ahearn et al, *Negotiating and Structuring Construction Contracts Leading Lawyers on Protecting Client Interests, Managing Risk and Understanding Recent Trends and Developments*, Aspatore, 2009 WL 1339225 (ASPATORE) at. 7.

responsibility to the contractor or specialty subcontractor.²⁴ In other situations, the specifications may be “hybrid” in nature; i.e. consisting of both performance and detailed design characteristics. In general, the experience has been that use of performance specifications - in the absence of explicit design delegation - or utilization of “hybrid” design and performance specifications often leads to disputes, conflicts and claims among project participants.²⁵

- The evaluation of G/S design and the integrated design development process depend upon new roles for design professionals (as well as for other project participants). These new roles involve learning curves and the need for behavioral adjustment.²⁶
- G/S design performance for the design professional will involve an evolving professional standard of care application. As has been stated:

The rapid shift towards sustainability in the real estate industry may result in an equally rapid shift in the professional standard of care applicable to architects. The standard of care may be more stringent if an architect holds itself out to be a green expert or specifically as a LEED AP. Much like the LEED plaque on a building announces that a building is green, the LEED AP designation imputes knowledge of all LEED standards and how to satisfy them on the professional holding the accreditation. From the point of view of an owner hiring a LEED AP architect, the accreditation gives the owner comfort that the project is being designed by someone with the necessary skill for understanding and achieving the requirements for LEED certification. These legitimately-raised expectations on the part of the owner could result in a LEED AP architect being held to a higher standard of care than their unaccredited peers. Further, given that errors and omissions insurance policies (E&O) only cover architects for breaches of the customary professional standard of care, the application of a higher standard of care would almost certainly lead to defense and insurance coverage issues.

On the other end of the spectrum, some design professionals have maintained a traditional architecture practice and have not adapted to or learned about green design. These individuals may find themselves performing below the standard of care, as articulated above, in circumstances where the community of architects ‘in the same or similar locality’ has developed, embraced, and are practicing their green design skills. One would expect to see this scenario in jurisdictions with mandated green standards. Mandated standards that dictate professional design requirements may establish a ‘floor’ for the standard of care; moreover, where the design norm is shifting, so too will the standard of care . . .

Whether or not an architect incorporates green-specific language in the professional standard of care provision of the contract, the law may impose the standard upon him. Designers can attempt to mitigate risks arising from an arguably heightened standard of care both by including a provision in the owner-architect agreement that clearly qualifies their knowledge of green design and by avoiding any representations that could lead to expectations of advanced skills in green building . . .²⁷

- G/S design may be developed and implemented in the context of a variety of different project delivery methods. As has been stated:

For owners developing green projects, the unique aspects of these projects, and the resulting risks and liabilities, should guide the preliminary decisions on the method of project delivery, and on the selection of the various members of the project team. Unique aspects potentially bearing upon selection of the optimal project delivery method (e.g., design-build, design-bid-build, construction manager at-risk . . .) include (i) consideration of the benefits of involving contractors, the mechanical, electrical and plumbing (MEP) engineers, and other project team members in early project design phases and (ii) responsibility

²⁴ *Megaprojects: Challenges and Recommended Practices* (D. Hatem & D. Corkum eds., ACEC June 2010) at § Part II, Chapter 15, 5.1.3.

²⁵ See D. Hatem, *Design Responsibility in Integrated Project Delivery: Looking Back and Moving Forward*, Donovan Hatem LLP, January 2008; See, U.S. Green Building Council, *The Legal Risk in “Building Green” New Wine in Old Bottles?*, A USGBC Panel Discussion 3.

²⁶ Ujval K. Vyas, *Green, Sustainable or High Performance? Knowing the Difference and Managing the Risks*, *Construction Briefings*, September 2008, at 15-16.

²⁷ B. Phillips & S. Sentman, *Structuring and Drafting Project Agreements to achieve Green Building Objectives*, *Green Building and Sustainable Development: The Practical Legal Guide* (J. Furr et al. eds, American Bar Association, 2009).

for overseeing the achievement of the specific green objectives that require the participation of two or more project team members.

The key to building green is designing and constructing projects for maximum efficiency with minimal impact. To achieve this goal while minimizing complications along the way, planning and design meetings should include input from a contractor. If involved early enough on a project, a contractor can provide input on matters such as construction feasibility for designs and on the availability of certain green materials. A project delivery method that includes the pre-construction services of the contractor should be given due consideration.

Employing the design-build project delivery method is perhaps the most effective way to include a contractor in the early stages of a project. Under this method, the designer and contractor are the same entity, meaning the most essential parties to achieving green building objectives are providing input as a single entity throughout the design process. Another benefit of design-build is an owner's ability to have the design-builder shoulder the full burden of achieving green objectives. Rather than pursuing separate designers and contractors for failing to achieve green objectives, an owner would only pursue a single entity; thus avoiding complications resulting from attempts of the designer and the contractor to shift blame onto the other. From the owner's perspective, however, the traditional criticisms of design-build apply to green projects. Quality control issues may result from the lack of oversight that a separately retained design professional offers to a design-bid-build project . . .²⁸

Legal Bases of Professional Liability

The lack of legal precedent at the appellate court level in the area of G/S design has not curbed or frustrated the interest, speculation or extrapolation of legal commentators in attempting to divine the legal bases for design professional liability exposure in the G/S design context. The legal theories of professional liability include:

- Breach of contract

- Breach of warranty (i.e. failure to achieve specific standards or performance requirements explicitly or implicitly required or referenced in the design professional's agreement)
- Breach of the professional standard of care, or negligence
- Negligent misrepresentation (arising principally in the context of a claimant alleging that the design professional made negligent statements as to G/S compliance or performance)
- Misrepresentation as to the design professional's qualifications or experience in G/S design
- Strict liability under certain codes, statutes or other legal requirements
- False Claims Act liability (arising out of circumstances in which a design professional is contractually obligated to achieve specific and objectively-defined and ascertainable G/S standards or performance objectives and in which the design professional invoices and is paid with public funds based upon its statements of compliance)

Some commentators have observed that applied in the context of G/S design claims, these legal theories are nothing more than "new wine in old bottles."²⁹ In many states, liability under some of these legal theories will subject the design professional to exposure over a longer period than that typically governing professional negligence claims under generally applicable statutes of limitations or repose.³⁰

The claims experience to date generally demonstrates that G/S design issues have been folded-into or coupled with more traditional professional liability (e.g., errors and omissions) claims. However, it is reasonable to predict that before too long, G/S professional liability claims will have their own special "place in the sun" as featured or predominant professional liability "main event" issues overshadowing other, more traditional, professional liability allegations.

²⁸ B. Phillips & S. Sentman, Structuring and Drafting Project Agreements to achieve Green Building Objectives, Green Building and Sustainable Development: The Practical Legal Guide (J. Furr et al. eds, American Bar Association, 2009).

²⁹ See, U.S. Green Building Council, The Legal Risk in "Building Green": New Wine in Old Bottles? A USGBC Panel Discussion.

³⁰ See *Anthony's Pier Four, Inc. v. Crandall Dry Dock Engineers, Inc.*, 396 Mass 818 (1986).

For design professionals, the emphasis on professional liability claims exposure will be on breach of express and implied contractual and warranty obligations. This is not to say that breach of professional standard of care or negligence claims will not be asserted or of concern, but simply to emphasize the predicted centrality of contract and warranty-based claims in the G/S professional liability context.

Third-Party Liability

The number and variability of potential third-parties involved in the G/S design development process, in the construction and certification process, in the operations and maintenance of a completed green facility, and in the investment, funding, use, occupancy and real estate transactions (rental and ownership transition), should serve to evidence the complexity and diversity of varied participants potentially involved in G/S disputes and litigation. In addition to project owner (client) direct claims against design professionals, project owners may assert indemnification claims against design professionals seeking reimbursement of costs or liabilities incurred (or to be incurred) by the project owner allegedly due to the design professional's failure to meet the professional standard of care or contractual/warranty obligations relating to G/S design.³¹

Given the range of professional liability exposures, and the scope and significant types and durations of potential consequential damages that may result if failure to meet the professional standard of care or contract-specific performance standards in G/S design occurs, it should not be surprising that, in addition to client (or project owner) claims, the design professional may (depending upon state law) be exposed to claims by a host of third-parties for economic damages incurred or to be incurred as a consequence of some failure of the design professional. Those third-parties may include:

- Subsequent project owners
- Tenants or other end-users of the completed facility

- Investors
- Construction lenders

In many states, third-parties (i.e., those not in contractual privity with a design professional) are precluded from recovering purely economic damages based on claims of professional negligence asserted against a design professional.³² However, in many of those states, third-parties are allowed to assert negligent misrepresentation claims against design professionals.³³ To the extent that design professionals provide certifications or warranties which are intended for the reasonable reliance by third-parties, the former will be subject to increased risk of third-party liability in some jurisdictions for negligent misrepresentation claims.

Consequential Damages Exposure

Any evaluation of professional liability risk exposure for G/S design must take into account the significant potential consequential cost impacts of the design professional's actual or alleged failure to meet performance standards (either contract-specific or professional standard of care). The consequential damage exposure essentially derives from the expected benefits over the multi-decade useful life of a G/S project and includes:

- Reduced energy, water and other operational costs
- Increased market value and revenue (e.g., rental or sales)
- Increased investor participation and revenue (investor return) expectations and opportunity
- Decreased insurance premiums
- Increased worker productivity
- Tax incentives and credits, as well as rebates
- Development credits and incentives

³¹ C. Cheatham, *As The Green Building Industry Grows, So Will Green Building Claims*, Construction Briefings, October 2009; Frank F. Musica, *Don't Let Green Design Cause Red Ink* (AIA Convention 2007).

³² J. Sweet & M. Schneier, *Legal Aspects of Architecture, Engineering and the Construction Process*, (8th ed. 2009 Cengage), 14.08C, pp. 266-68.

³³ *Id.*, at pp. 268-73.

- Enhanced project and project owner reputation
- Potential increase in sales or increased revenue potential if the completed facility is a more pleasant or “green-friendly” place to transact business

Clearly, project owner (and other, e.g., investor) disappointed economic expectations may translate and escalate into substantial “consequential damage” exposure in the G/S context and represent a significant professional liability exposure over a potentially extended period. This exposure will not only be more “subjective” and speculative in nature, but cover a potentially very long period of time - several decades of damage calculation and assessment. The management of this risk should be contractually accomplished through a mutual consequential damage disclaimer or waiver provision that embodies an explicit and encompassing (i.e. with specific examples of consequential damages anticipated and prefaced by the words “including without limitation”) definition of the term “consequential damages” so as to include within its scope all of the above examples (and potentially more).

Professional Liability Insurance

The professional liability insurance industry largely is responding to G/S professional liability risk exposures not through expansion of coverage but (more or less depending upon the insurer) in developing and promulgating proactive risk management recommendations for design professional insureds.³⁴ Some insurers are also offering credits to design professional insureds who implement prudent contract provisions addressing and mitigating professional liability risk exposures in the G/S design context.

As previously noted, most professional liability insurance policies exclude coverage for claims exclusively based on breach of warranties that result in liability that exceeds

breach of the professional standard of care or negligence-based liability.³⁵

Another insurability issue that may be presented is whether certain “non-traditional” architectural/engineering services performed on G/S projects constitute, or fall within the definition of, “professional services” under professional liability insurance policies. Certainly, pure design services would qualify for coverage, but beyond that the coverage analysis may be less clear. The fact that persons other than registered design professionals may obtain the LEEP AP designation potentially may further complicate the coverage analysis. In addition, the fact that G/S design may be developed as part of an “integrated” process involving project participants - e.g., project owners, constructors, specialty trade subcontractors, product manufacturers and other non-registered professionals - may raise other coverage considerations, such as product liability and other exposures.³⁶

Given the substantial exposure associated with G/S design, it is not likely that professional liability insurers will expand coverage to include warranty liability. That would be a sound decision given all of the factors and considerations outside the reasonable control or ability of the design professional to achieve consistent with the professional standard of care. Moreover, expansion of coverage to include warranty liability will likely create an “opportunity” for claimants by rendering the design professional a more lucrative and promising target for recovery.

Risk Management and Contractual Considerations

Part II of this paper will discuss this subject in more detail. The key in developing effective risk management and contractual precautions in G/S design is to understand and

³⁴ Marsh, *The Green Build Environment in the United States, 2008 Year-End Update of the State of The Insurance Market* 3-4 (2008).

³⁵ See, Nicole C. Kibert, [What You Should Know About Sustainable Development Projects](#), 25 No. 2 *Prac. Real Estate Law*, 19, 21 (2009); Marsh, *The Green Build Environment in the United States, 2008 Year-End Update of the State of The Insurance Market* 3-4. (2008); B. Phillips & S. Sentman, *Structuring and Drafting Project Agreements to achieve Green Building Objectives*, *Green Building and Sustainable Development: The Practical Legal Guide* 184-86 (J. Furr et al. eds, American Bar Association, 2009); F. Riggs, Troutman Saunders LLP, *The Legal Risks of Green Construction*. 3 (February 2, 2009).

³⁶ David J. Hatem, [Roles and Responsibilities, Risk Allocation and Professional Liability Exposure in the Collaborative World of Building Information Modeling and Integrated Project Delivery: Business as Usual or Fundamental Change?](#), Donovan Hatem LLP, March 2010.

divine the sources and reasons for professional liability exposure, which has been the focus of this paper. As a matter of preview, there are many risk management and contractual considerations that the design professional should take into account in the G/S design process:

- Realistically informing, managing (qualifying or limiting) and documenting client expectations
- Avoiding warranties or guaranties in contracts, certifications or otherwise - especially as to subjects beyond the ability of the design professional to control or otherwise reasonably be responsible for achieving
- Developing a specific standard of care provision that explicitly references the various factors and circumstances that (along with general considerations) should be taken into account in the G/S design context
- Including limitation of remedies provisions in the contract of engagement
- Developing specific and encompassing consequential damage disclaimer and waiver provisions
- Limiting compliance with laws, statutes, codes, regulations and standards to the extent required or expected by the professional standard of care
- Clearly defining roles and responsibilities of project participants in the G/S design development and implementation process and documenting same in relevant contract provisions, project management plans, and submittal review stamp language
- Do not certify or warrant as to matters beyond the scope, control or responsibility of the design professional
- Reviewing marketing and related materials for representations made regarding the design professional's qualifications and experience in G/S design and the ability to achieve G/S objectives and standards
- Recognizing that, generally, professional liability insurance does not cover pure warranty liability or

related liability beyond breach of professional duty, care or negligence

- Limiting liability for claims arising out of integrated design service activities
- Tempering and moderating zeal and enthusiasm for G/S aspirations and objectives³⁷
- Appreciating the risk exposure of the project owner and of the constructor, and the limitations on insurance coverage for G/S design risk exposures. As has been stated:

Although the specific risks of building green are far from settled, the foresight of attorneys strapped in the various project contracts may be the best tool for preventing unforeseen liabilities for project team members. The ability of these attorneys to divine the pertinent issues and draft the appropriate language for the project documents depends on input from the various project team members. First, the owner must determine the particular green objectives for the project. After making this determination, the owner, with the assistance of carefully selected project team members, should breakdown the objective into the specific services and work required for successful achievement. Armed with this information, the attorneys should draft project contracts that reflect this breakdown and clearly identify the roles and responsibilities of each team member with regard to the green objectives. In addition to identifying the roles and responsibilities, the contracts should allocate risk for the various requirements to the project team member in the best position to control that risk. When drafting these project contracts, attorneys must bear in mind that the usual backstops of insurance and bonds may not cover certain risks of building green.³⁸

Conclusion

Green and sustainable objectives are clearly not a passing fad and will predominate in the definition of excellence in project development and design for the foreseeable future. That preeminent distinction is understandable.

³⁷ U. Vyas, Green, Sustainable or High Performance? Knowing the Difference and Managing the Risk, Construction Briefings, September 2008, at 10; J. Hackett, LEED Us Not Into Temptation... Sustainable Design/LEED From an Insurer's Risk Management Perspective, Internal News Letter for Pro-Indemnity Insurance Company, September 2006.

³⁸ B. Phillips & S. Sentman, Structuring and Drafting Project Agreements to achieve Green Building Objectives, Green Building and Sustainable Development: The Practical Legal Guide (J. Furr et al. eds, American Bar Association, 2009).

This new G/S reality and design “environment,” however, requires that design professionals recognize the significant professional liability risks and the potential professional liability insurance issues associated with G/S projects and design. That recognition provides the sound foundation for the development of responsive risk management and contractual mechanisms to anticipate and limit those risk exposures. Part II of this paper will provide specific risk management and contractual recommendations in the G/S project and design context.

In addition, the professional liability risk exposures in G/S design - especially the heightened risk of warranty liability and the risks associated with G/S design responsibility

derived from an integrated design process, and utilization of performance specifications and design delegation to achieve G/S design objectives and performance standards - represent the significant potential for uncertainty (at a minimum) in the availability and applicability of professional liability insurance. Expansion of professional liability insurance to include warranty liability is neither realistic nor a sensible risk management response to G/S design liability exposure. ■

New Rhode Island Legislation Proposes to Alter Retention Process for A/E Firms on Public Projects

By Brian C. Newberry, Esq.

THE RHODE ISLAND GENERAL ASSEMBLY is poised to enact legislation that would change the manner in which architectural and engineering firms could be retained on public projects. House Bill 8103 sponsored by Representative Walsh (D. Charlestown) modifies the existing statute § 37-2-59.1 relating to the selection of professionals based on place of business located in Rhode Island.

Current language states:

“The state of Rhode Island and Providence Plantations has a large number of architectural, engineering, and consulting firms well qualified in their fields of endeavor. In instances where contracts are entirely supported by state funds, it is in the best interest of the state pursuant to the provisions of sections 37-2-59 – 37-2-69 that all other things being equal, the services of these qualified and capable professionals with offices in Rhode Island, or secondly those professionals who propose a joint venture with a Rhode Island firm, be utilized.”

The bill would change this section to read:

“The state of Rhode Island and Providence Plantations has a large number of architectural, engineering, and

consulting firms well qualified in their fields of endeavor. Except where expressly forbidden by federal purchasing policy in instances where contracts are whole or partially supported by state funds, pursuant to the provisions of sections 37-2-59 – 37-2-69, the services of these qualified and capable resident professionals with offices in Rhode Island, possessing experience with comparable site and scope projects built in Rhode Island or secondly those non-resident professionals who propose a partnering with a Rhode Island firm, wherein the Rhode Island firm is lead/prime, shall be selected, contingent upon the consideration of resident professionals’ qualifications and performance data pursuant to section 37-2-62, and fair and reasonable prices pursuant to section 37-2-59.

For the purposes of this section, a “non-resident professional” shall mean a business that is not a resident of

the State of Rhode Island, that submits a bid in response to an invitation to bid by a state agency; "resident professional" shall mean a business that submits a bid in response to an invitation to bid by a state agency and whose main office is located in this state that has paid unemployment and income taxes in this state during the twelve (12) calendar months immediately preceding submission of such a bid that has a business address in this state, and that has affirmatively claimed such status in the bid submission."

As this article goes to press, the legislation has been heard before the House Small Business committee of which I am a member. A substitute bill that will revise the statute

in order to make it clear that it is not designed to restrict state business only to those firms that are headquartered in Rhode Island but rather will provide state business to those firms with a physical presence in Rhode Island is under consideration. The key terminology will revolve around the definition of "non-resident professional" as, under the current version of the proposed legislation, the definition includes only those professionals whose "main office" is located in-state. Obviously this will have a potential major impact on certain professional firms. All design professionals who either conduct business in Rhode Island and/or are interested in pursuing such business should pay close attention to how this process moves forward. ■

Indemnification—A Contractual Sword and Shield: Tips on How to Enter Into Contracts Which Leave Design Professionals Well Armed and Well Protected

By Peter C. Lenart, Esq.

INDEMNIFICATION IS A LEGAL TERM which design professionals are generally familiar with but it is also a term which causes confusion, and sometimes results in bad contracts for the unwary. In plain terms, indemnification is an agreement to be responsible for the liability, such as errors and omissions, of another party. Indemnification clauses appear in owner-design professional contracts, and frequently in design professional-sub-consultant contracts. These clauses should be read and understood fully. If they are unclear in any way, a design professional should seek the advice of an attorney.

Since indemnification provisions in contracts can shift the liability for losses on a project, it is essential that a design professional is aware of the scope and obligations imposed by any such indemnification language. Design professionals should remember that they need not sign form contracts submitted to them. A better practice is to negotiate or modify terms. If an actual negotiation of terms is not possible, design professionals can always resort to crossing out unfavorable indemnification clauses in form contracts supplied to them. Often, if a party gets most of its preferred form's terms agreed to, it may not fight to maintain one or two stricken terms. If the work goes forward and payment is made, the stricken terms are generally deemed to have been accepted. Design professionals should not be shy about

modifying or crossing out terms in form contracts which they view as unfavorable to their business.

In a perfect world your company's contracts would require those you contract with for project work and professional services to indemnify your company broadly, while at the same time, your company has limited or eliminated its own indemnification obligations as thoroughly as possible. While this approach may not seem "fair" from a certain perspective, it is important to remember that today's litigious world requires that each company work aggressively to manage its own risk. Entering into agreements with terms favorable to your company is good business practice. Companies cannot be reluctant in limiting

liability and protecting their own interests. Similarly, design professionals should never sign another entity's form contract without having it reviewed by an attorney or a contract specialist. The expense associated with a few minutes of review is often miniscule compared with the costs associated with defending a claim or a lawsuit.

If there is no in-house counsel or contract specialist, design professionals should have a general business attorney on retainer in order to review contracts. The attorney selected should have working knowledge of construction, AIA documents, and litigation. Another risk management option is offered by some professional liability insurance carriers who offer contract review services for their insureds at no charge beyond the policy premium. If your design firm is unaware of these no cost services provided by certain carriers, you should indicate to your broker that you would like a policy which encompasses these additional services when you are evaluating premiums as part of your company's next annual renewal.

In addition to rejecting indemnification provisions in form contracts received by your company for signature, there are other options for limiting indemnification liability. For instance, if a party refuses to eliminate an indemnification provision completely, at least attempt to rework the language so that it reads indemnification is limited to the insurance coverage in place by your company at the time the contract is entered into.

A more advantageous clause would be to state that the parties to the Agreement have negotiated an indemnification provision where there is a limit to the indemnification amount. For instance the Agreement could state that the parties have evaluated the Project and its risks, and have mutually agreed to cap indemnification liability at a negotiated amount. Obviously, the lower amount your company can negotiate the less risk your company has.

A less desirable option is a mutual indemnification agreement. Mutual indemnification provisions evolved as a remedy to indemnification negotiations, and essentially say that each party to the contract indemnifies the other. Typically these mutual clauses cause more problems than they solve, as they wind up being the subject of dispute

and litigation. While a mutual provision might be offered to satisfy the insurance requirements of a well known, longstanding client, aside from such rare circumstances mutual indemnification clauses are best avoided.

If you are entering into a sub-consultant agreement, ideally you would like language in the Agreement which states that the sub-consultant agrees to defend and indemnify your company, and further requirements that the sub-consultant carry a certain level of professional liability and commercial general liability insurance. Certificates of Insurance which supply proof of coverage should also be required in the terms of the sub-consultant agreement.

If possible, there should be a term in the sub-consultant agreement which requires the sub-consultant to identify the other contracting party as a "named" or "additional insured" on the sub-consultants' policies. This is often overlooked, and is sometimes admittedly difficult to bring about. However, on particularly large or risky projects the additional attention to detail in the contracting phase is well worth any additional effort.

Indemnification provisions also often contain the term "defend." This places the obligation of legal representation upon the party agreeing to undertake the defense duty. If your company is being asked to defend as well as indemnify, you should attempt to avoid both obligations. The burden of defending is expensive and will be triggered even if there is no meritorious claim. Anybody can make a claim or file suit. Even if such a claim or suit has no merit, the costs involved in defending such matters can be significant. Design professionals should get in the habit of crossing out any defense obligations in contracts entered into.

It is also a good habit to use your own company's standard documents as frequently as possible. You should have a comprehensive variety of attorney authored, or at least attorney-reviewed, proposals and agreements. Proposals should contain a one page list of terms at the end which will govern in circumstances where a proposal is accepted, perhaps by performance or by Letter Agreement, but where no full formal Agreement is executed. An attorney can help draft an appropriate proposal add-on form specific for the needs of your business and typical clients. Having an

appropriate range of business documents and agreements comes with a cost, and is an investment, but it is one which protects your business and gives peace of mind when undertaking a project.

Proposals and Agreements have far reaching implications beyond the typical concerns of pricing and completion dates. Indemnification clauses are one example of how an unnoticed or un-negotiated term may create substantial exposure for an unwary design professional. In today's slow economy owners' claims against design professionals are common, and such claims are complicated if the design professional has undertaken a broader duty to the owner of the project beyond responsibility for its own work.

Design professionals need to be pro-active in managing their risk, and this includes being careful and selective about the terms and conditions to which they agree. The old adage that "bad contracts make bad claims" remains true. Design professionals should make certain that they avoid bad contracts by negotiating their agreements effectively using their own customized attorney-created forms as often as possible, and by crossing out terms which are plainly disadvantageous to their business. Since clauses providing for the defense and indemnification of other parties are rarely advantageous, design professionals should seek out and delete those provisions in the normal course of entering into a project agreement. ■

Illinois Court Expands Engineer's Duty of Care Beyond the Terms of the Applicable Contract

By Lynn M. Squillace, Esq.

THE ILLINOIS APPELLATE COURT recently held that an engineer's duty of care may extend beyond the scope of the terms of the applicable contract to include a duty to recognize and address potentially unsafe conditions, when the contract at issue calls for the "degree of skill and diligence normally employed by professional engineers or consultants performing the same or similar services." *Thompson v. Gordon, et al.*, 2009 WL 3969619 (Ill. App. 2 Dist. 2009).

This matter arose out of a contract the defendant engineering companies (hereinafter "defendants") had entered into calling for the defendants to provide a design for a roadway interchange and a replacement for a bridge deck in connection with a larger project to construct a shopping mall. The defendants' structural designs for the bridge deck replacement included a median that was four feet wide by seven inches tall (the previous median that had been four feet wide by six inches tall).

In November 1998, a vehicle traveling eastbound lost control, hit the median, became airborne, and hit the westbound vehicle of plaintiff's husband and daughter who died as a result of the accident. Plaintiff, individually and as

administrator of her husband's and daughter's estates, filed suit alleging that the defendants were negligent in designing the bridge deck "without considering or designing a median barrier that would have prevented the eastbound vehicle from becoming airborne and causing the accident."

Plaintiff produced an affidavit from a civil engineer stating that had the defendants utilized the degree of skill and diligence normally employed by professional engineers or consultants performing the same or similar services, they would have been aware, or should have been aware, of the vaulting characteristic of the existing median and were or should have been on notice that the proposed work was dangerous and likely to cause injury.

The trial court granted defendants' motion for summary judgment on the ground that the contract controlled the defendants' duties and, "'did not call for an assessment of the sufficiency of the barrier' and '[did] not require the defendants to modify or redesign the road surface or the raised median,' but instead indicated that, '[t]he road surface was to be removed and replaced by others without modification of the existing design.'"

In reversing the trial court, the Appellate Court recognized that the existence of the duty of a defendant accused of negligence due to a failure to perform a contractual obligation will be determined by the terms of the contract. The court agreed with the defendants' interpretation of the word "replacement" in the contract, but concluded that a clause requiring the defendants to employ "the degree of skill and diligence normally employed by professional engineers or consultants performing the same or similar services" added an important qualifier to the defendants' obligations. Namely, that, as a matter of law, they owed a duty to perform the contractual task of replacing the bridge deck as it existed prior to the construction project using the degree of skill and diligence normally employed by professional engineers. The court then examined the plaintiff's expert's affidavit to determine whether the defendants breached this standard and concluded that they did. In response to the defendants' objection that, absent an ambiguity, expert testimony is not appropriate in a matter of contract interpretation, the court explained that the interpretation of the contract resulted in a finding that the contract imposed a professional duty of care on the defendants' work; therefore, the extent of that duty, and the existence of a breach, were factual questions subject to expert testimony. Here, based on the expert affidavit, the court reasoned that the defendants, if they had followed the professional standard of care required by the contract, should have discovered the problems with the median and consequently had a duty to "go beyond the specifically mentioned task of replacing the bridge deck and to ensure that the replacement was safe."

Defendants also argued that the review and acceptance of their work by the state proved that they did not breach a duty. The court rejected this argument pointing out that the state's minimum standards are not equivalent to the professional standard of care required.

However, the dissenting opinion found that the majority holding represented a "disturbing disregard for the applicable authority." The dissent supported the rule that, when a defendant is alleged to have breached a contractual obligation, the existence of an actual duty will be determined by the contractual provisions, and the standard of care will not be expanded beyond the terms of the applicable contract. Citing the "well-settled" maxims that the defendants' contractual obligations must be determined by the court and that when interpreting a contract, a court's primary objective is to give effect to the parties' intent the dissenting opinion found that, "The defendant[s] contracted . . . to perform only the task of designing plans to rebuild the bridge deck and median as they existed, with the degree of skill and diligence normally employed by a professional engineer, which defendants did." Absent a specific contractual commitment to do so, in either the standard-of-care or the scope-of-services provision, the dissent concluded that the defendants were not required to redesign the bridge to include a jersey barrier.

Utilizing the same reasoning as that of the Thompson majority, courts in other jurisdictions could potentially find a duty on the part of a defendant engineer to go beyond the terms of the applicable contract if that engineer knew, or should have known, that the work required by the contract was insufficient to ensure safety. There is a public policy motivation behind requiring an engineer to have a duty to ensure safety, even if that duty effectively expands the scope of the applicable contract.

It is also important to recognize the factual context of the case at hand. Here, the court was examining a wrongful death case and may have been persuaded to allow the plaintiff to move past the summary judgment stage due to the loss of life. The dissent described the majority's action as a "strained effort to reach a predetermined result." ■

The Economic Loss Doctrine Bars an Owner from Asserting Negligence Claims Against a Design Professional with Whom the Owner is in Privity of Contract

By Kristina S. Raevska, Esq.

IN A RECENT DECISION, THE SUPREME COURT OF ARIZONA extended the application of the economic loss doctrine to construction defect cases, holding that a property owner/client is limited to its contractual remedies when its architect's negligent design causes economic loss but no physical injury to persons or other property.

The owner of an apartment complex filed a complaint against its Architect, alleging breach of contract and negligent design. The Owner subsequently voluntarily dismissed the contract claim, but refused to dismiss the negligence claim, arguing that "economic loss" did not bar a claim for *professional negligence*. The Supreme Court granted the Architect's petition for review because the application of the economic loss doctrine in the context of *professional negligence* was an issue of first impression.

The Supreme Court defined the economic loss doctrine in the context of existing contract, where the plaintiff is trying to obtain tort damages for purely economic losses, as: "a common law rule limiting a contracting party to contractual remedies for the recovery of economic losses unaccompanied by physical injuries to persons or other property."

In explaining its decision, the Supreme Court revisited its decision in *Salt River Project Agricultural Improvement and Power District v. Westinghouse Electric Corp.*, 143 Ariz. 368, 694 P. 2d 198 (1984), where the economic loss doctrine was applied in the context of a product liability dispute. In *Salt River*, the Supreme Court rejected the seller's argument that the contractual provisions also preclude a tort claim for strict product liability. *Salt River*, 143 Ariz. at 375, 381. In reaching its *Salt River* conclusion, the Supreme Court relied on the distinct policies served by contract law and tort

law. Specifically, contract law seeks to preserve freedom of contract and promote the free flow of commerce, whereby strict liability as part of tort law, specifically seeks to promote product safety and distribute the costs of accidents.¹ The Supreme Court distinguished this case from *Salt River*, reasoning that "economic loss" may vary in its application based on context-specific policy considerations. The Supreme Court then looked behind the underlying policies of contract and tort law to determine whether "economic loss" would apply in the context of design professional liability: First, contract law protects the expectations of the parties to a contract and, therefore, has as much, if not greater force in construction defect cases. Second, unlike product liability contracts, construction contracts are negotiated between the parties on a project-specific basis, containing detailed provisions for risk allocations and remedies. Allowing a tort claim to proceed in this context would present the potential for undermining the policy of contract law intended to encourage risk allocation of future losses and identify of remedies to enforce an agreement consistent with the parties' expectations.

In construction defect cases involving purely pecuniary losses, there are no strong policy reasons to impose tort liability because contract common law provides more than an adequate remedy. The common law of contracts allows recovery of the costs for repairing the defects, as well as other damages reasonably foreseeable by the parties

¹ A three-part test was applied to determine the application of "economic loss:" (1) whether the loss is purely economic; (2) whether the defect is "unreasonably dangerous;" and (3) whether the loss occurred in a "sudden, accidental manner." *Salt River* at 379. If these three factors were present, the plaintiff would be allowed to recover in tort for purely economic loss, even if a contract exists. *Id.*

upon entering the contract. The policies underlying tort law are mainly accident deterrence and distribution of the loss expenses, which are also adequately addressed in the context of contract law. When the parties to a project-specific contract have allocated the risk of loss and the remedies for non-performance, allowing tort remedies is unnecessary.

The Supreme Court concluded that in construction defect cases: "the policies of the law generally will be best served by leaving the parties to their commercial remedies" when a contracting party has incurred only "economic loss, in the form of repair costs, diminished value, or lost profits." Therefore, in the context of construction defects, the Arizona courts should apply the economic loss doctrine and limit a contracting party to only its contractual remedies for purely economic losses from construction defects.² The Supreme Court reasoned that construction contracts are negotiated on a project-specific basis and the parties should be encouraged to prospectively allocate the risk and identify remedies within their agreements, rather than relying on a court to make a post hoc determination later.

The Supreme Court also addressed the application of the economic loss doctrine in the situation where the plaintiff does not have a contract with the defendant. The principle function of the economic loss doctrine is to encourage parties to determine their economic relationships and uphold their expectations as memorialized in their contract, a purpose which is meaningless among parties without a contract. The Supreme Court explained that rather than rely on "economic loss" to preclude tort claims by non-contracting

parties, the courts should instead focus on whether the applicable substantive law allows liability in the particular context. For example, whether a non-contracting party may recover economic losses for a defendant's negligent misrepresentation would depend on whether the elements of that tort are satisfied.

This case is very important for design professionals practicing in Arizona because it limits an owner's remedies to only the remedies specified in the owner-design professional agreement. A carefully crafted agreement, tailored to the specific project, and providing a clear outline of potential remedies would be of great use to a design professional under the circumstances. It would provide a clear-cut outline of the parties' expectations, and it could eliminate the potential for protracted and costly litigation.

Also of note in this decision is the analysis of the application of "economic loss" in the context of disputes where no contract exists. The Supreme Court appears to state that, for tort claims asserted by non-contracting parties, the courts should investigate whether the applicable substantive law for the tort is satisfied, rather than take into consideration the lack of a contract. If the substantive law is satisfied, a non-contracting party may be allowed to proceed with its tort claim, even though the claim may allege only economic damages. In practice, this portion of the Supreme Court's decision has a negative impact on design professionals as it would appear to allow direct claims to be asserted by, for example, a contractor against a design professional, in those situations where the contractor can show that the design professional owed him a duty and that duty was breached. ■

² The Supreme Court also pointed out that freedom of contract allows the parties to agree to preserve tort remedies, if they so desire, for purely economic loss, just as they may otherwise specify remedies that modify common law recovery.

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Seaport East
Two Seaport Lane
Boston, MA 02210

main 617 406 4500
fax 617 406 4501

Herald Square Building
1350 Broadway, Suite 2100
New York, NY 10018

212 244 3333 main
212 244 5697 fax

DONOVAN HATEM LLP
counselors at law