Legal Issues and Risk Allocation in Design-Build

by Jack Rephan

The design-build project delivery method has caught on, especially during the past ten years. Of three hundred billion dollars spent on nonresidential construction in the United States in 1996, 23 percent or sixty-nine billion dollars was spent on design-build projects.

According to a 2005 survey conducted by Pinnacle One, a construction management and consulting firm in Phoenix, Arizona, more than 37 percent of the public owners participating in the survey either currently use or are planning to use design-build on some of their projects.

The percentage of municipal governments using or planning to use design-build was 45 percent according to the survey. Design-build has become the preferred delivery method for many federal projects. In Virginia, the Department of Transportation and other state and local public entities have begun to increase their use of design-build. Industry analysts expect that, ultimately 50 percent of nonresidential construction will be design-build.

Design-build involves different and potentially greater risks than more traditional forms of construction contracting. This article will examine the benefits, risks, liability and other legal issues relating to design-build.

Design-Build Defined

Design-build is a construction delivery method in which one entity has responsibility for both the design and construction of a project.

Virginia Code § 11-37 defines a design-build contract as "a contract between a public body and another party in which the party contracting with the public body agrees to both design and build the structure, roadway or other item specified in the contract."

Advantages

- Single contract simplifies the lines of liability and responsibility for design and construction.
- Owners do not have to deal with disputes between designer and contractor.
- Design-builder warrants all of the work, including the design.
- Opportunity for shortening project duration and reducing costs.

Disadvantages

- Designer no longer in the role of protecting owners' interest.
- Possibility of adverse relationship between designer and builder.
- Not suitable for competitive bidding.
- Bonding requirements may be more difficult to meet because of exposure beyond that normally undertaken by a performance or payment bond surety.
- Different insurance requirements must be met. The contractor's commercial general liability policy may not cover liability for design errors. Design team should have its own errors and omissions policy. The cost of insurance may be more than in traditional construction methods. Gaps in coverage may exist and coverage may not be available for added risks.

The Design-Build Contract

For public projects, the form of contract usually will be the one prescribed by the public agency. Opportunities for modification may be limited because of the competitive requirements of federal or state law. On federal projects, the form of the design-build contract may also be dictated to some extent by the Federal Acquisition Regulations.

For private projects, there are a number of standard form agreements available for use in a design-build project, including those promulgated by American Institute of Architects, American General Contractors of America, Engineers Joint Contract Documents Committee, and Construction Management Association of America. These can be modified to meet the requirements of a project.

The American Institute of Architects has issued a new design-build form, AIA A-

141. The new A-141 adopts certain risk shifting provisions, such as when part of the design is proposed by the owner before the engagement of the design-builder. The A-141 anticipates that the owner will provide some "design criteria" for which the owner will remain responsible. However, the design-builder must certify that the design documents are consistent with the design criteria. Unlike the traditional AIA documents, which designate the architect as the party with authority to initially resolve disputes, A-141 allows the parties to nominate a "neutral," for this purpose but if no neutral is named in the contract, the owner is charged with resolving disputes.

Pricing of Design-Build Contracts

Design-build contracts are, in most all cases, awarded on either a fixed-price or a cost-plus fixed fee, with or without guaranteed maximum price, basis.

In Virginia, design-build contracts with the commonwealth must be awarded on a fixed-price basis.[1] Other public bodies may award contracts on a fixed-price or a "not to exceed price" basis.

Licensing Requirements

Design Team

In Virginia, all architects and engineers or any person or entity offering to practice architecture, engineering or land surveying services must be licensed.[2]

Licensed contractors are not required to be licensed to perform architectural, engineering, or land surveying services under design-build contracts as long as the architect, engineer or land surveyor offering and rendering such services is licensed.[3]

A person or entity offering architecture, engineering or land surveying or landscape architecture must register with the Board of Licensing of Architects, Professional Engineers, Land Surveyors and Landscape Architects.[4]

Contractor

The contractor must be licensed under Chapter 11 of Title 54.1 of the Virginia Code.

Contracting for or bidding upon construction services without a license is a Class 1 misdemeanor.[5]

Contracting for construction services without a license, but with actual knowledge of the licensing requirement, may also result in a forfeiture of the contractor's right to payment.[6]

The Design-Build Entity

There does not seem to be a specific requirement in Virginia for the licensing of the design-build entity as long as both the designer and contractor licensing requirements are met.

Design-Build on Public Projects in Virginia

Contracts with the Commonwealth

Only fixed-price design-build contracts are authorized.[7]

The department, agency or institution wishing to award a design-build contract must first request authority to use design-build. The request must justify that design-build is more advantageous to the state than competitive sealed bidding.

There does not seem to be a specific requirement in Virginia for the licensing of the design-build entity as long as both the designer and contractor licensing requirements are met.

The design-build procurement requires the offeror to submit its qualifications and then the commonwealth selects not more than five offers.

Thereafter, a request for proposals is issued and the offerors then submit technical and cost proposals. The commonwealth then evaluates the technical proposals and may negotiate an amendment to the cost proposals. An award may then be made to the offeror submitting "an acceptable technical proposal at the lowest cost . . . "

Contracts with Other Public Bodies

Design-build contracts may be awarded by public bodies other than the commonwealth on a "fixed price or not-to-exceed price."[8]

The public body must first obtain approval of the Design-Build/Construction Management Review Board.[9] Additionally, the public body must make a determination that design-build is more advantageous than competitive sealed bidding.

The public body must also adopt procedures for award of design-build contracts, including a two-step competitive negotiation process consistent with that required in the case of contracts with the commonwealth.

The award must be made "to the fully qualified offeror who submits an acceptable proposal at the lowest cost" in response to the request for proposals.[10]

Legal Basis for Design-Build on Federal Contracts

Design-build is expressly authorized by statute for executive agencies.[11] Contracting officers must make a determination that "two-phase selection procedures are appropriate for use in entering into a contract for design and construction of the project."

After development of a scope-of-work statement, proposals are requested from prospective offerors who first submit technical proposals without any detailed design or cost information.

The technical proposals are reviewed and the agency selects the offerors to participate in the second phase, in which the offerors submit the design concepts and cost proposals. After evaluation of the phase-two proposals, the agency will negotiate with one or more of the offerors and then make its selection. Note that price alone will not necessarily result in an award as would normally be the case under traditional sealed bidding.

Risk Shifting and Legal Liability in Design-Build

Owner's Responsibilities and Liabilities

Under what is known as the *Spearin* doctrine, which has evolved from the 1918 case of *United States v. Spearin*, 248 U.S. 132 (1918), and which is followed in Virginia,[12] a contractor is not responsible for defects in the plans and specifications furnished by the owner. In essence, the owner impliedly warrants that the plans and specifications are accurate and that the owner may be liable to the contractor for any damages resulting from the defective plans and specifications. Under the design-build method, because the contractor agrees to design and build the project, the *Spearin* doctrine generally will not apply. Nevertheless, if the owner provides faulty preliminary information on which the design is based, the owner may be liable to the contractor for any added costs resulting from the defective design.[13]

Contractor's Risks and Liabilities

Under the traditional competitive-bid method of delivery, the *Spearin* doctrine generally relieves the contractor of any responsibility for defects in design. In design-build, however, the design-build team, not the owner, warrants the accuracy of the design. The plans and specifications are created by the team, while the owner merely provides the design goals or program and some basic information. However, if the information furnished to the design-build team by the owner is inaccurate, there can be a shifting of risk back to the owner.

In Virginia, a contractor impliedly warrants that the building will be erected in a reasonably good and workmanlike manner, and when completed will be reasonably fit for its intended purpose.[14] This warranty may be voided, however, by the terms of the contract.[15] Also, a basic principle on any construction project is that the contractor must perform its work in accordance with the requirements of the plans and specifications. An exception to this rule in federal and other construction is known as the doctrine of substantial completion—minor deviations from the requirements of the contract will not be considered to be a breach of contract, especially where the cost of correcting or replacing the nonconforming work is disproportionate to the damages resulting from the nonconforming work.

An architect or an engineer can be held liable for professional negligence in the design of the project where the defect causes injury to persons or property.

Designer's Risks and Responsibilities

An architect or an engineer can be held liable for professional negligence in the design of the project where the defect causes injury to persons or property. The architect may also be liable to the owner for defective design that causes damages to the owner.

In Virginia, the law states that the architect does not guarantee a perfect plan or satisfactory result. However, in the contract of employment, the architect impliedly warrants that he or she possesses the necessary competency and ability to enable him to furnish plans and specifications prepared with a reasonable degree of technical skill.[16]

In addition to design responsibility, an architect in a traditional agreement may also have an obligation to oversee compliance by the contractor with the plans and specifications. The architect may also have an obligation to detect any defects in the design and to recommend to the owner any necessary changes and corrections as construction progresses.[17] In design-build, the architect's contract is often no longer with the owner, but with the contractor. As a result, duties that the architect normally owes to the owner will be owed to the contractor, and the architect may have liability to the contractor for those instances of negligence or defective design that would normally result in the liability of the architect to the owner. Where the architect is not insulated from liability by the design-build entity selected—such as a joint venture or general partnership—the architect may still have liability to the owner.

Economic Loss Rule

Under the traditional owner/architect/contractor arrangement, there is a common-law legal principle in many jurisdictions, including Virginia, known as the "economic loss rule."

Under this rule, absent privity of contract between the parties, one party may not hold another party liable for economic damages based upon a negligence or other theory. Thus, an architect has no duty to protect the contractor from purely economic loss, and, absent a contract between the architect and the contractor, an architect has no liability for the contractor's damages caused by the architect's negligent performance.[18] Consequently, under the traditional construction delivery method, while the owner may be liable to the contractor for defective design under the *Spearin* doctrine, in most jurisdictions the contractor will not be able to look to the architect for damages caused by the architect's defective design.

In design-build, because a contractual relationship generally exists between the contractor and the designer, the lack of privity of contract will no longer insulate the designer from liability or preclude the contractor for looking to the designer for damages resulting from the designer's defective design. Moreover, the designer may be exposed to liability for defective design to subcontractors where a contractual relationship exists between the design-build team entity and the subcontractor(s). This would not be the case under the traditional owner/architect/contractor relationship.

The Design Build Entity

Contractor/Subcontractor

Under this arrangement, the contractor awards a subcontract to the design firm for architectural/engineering services. Under the economic damage rule, the designer may be insulated from liability to the owner for design errors, but the contractor will not be.

Joint Venture

This type of entity is used frequently in design-build team arrangements. The contractor and the architectural/engineering firm form a joint venture for the purpose of entering into a contract for design-build services. A joint venture is generally governed by the same rules of law as a partnership,[19] and there need not be much evidence of the existence of a joint venture other than a few formalities and the parties' conduct in light of other facts and circumstances.[20] Each party is liable for the debts and obligations of the joint venture.

Limited Partnership

Under this concept, the contractor and an architectural/engineering firm form a limited partnership. Generally, only the general partner will be liable for the debts or obligations of the partnership. Because of the necessity of having active participation in the project by both the contractor and the designer, a limited partnership may not be practical.

Limited Liability Company

A limited liability company (LLC) affords all of the benefits of both a partnership and a corporation. Under this arrangement, the contractor and design firm form a limited liability company and the contractor and designer become members of the company. The business of the LLC is conducted by its manager or managers. An LLC is treated as a partnership for tax purposes but as a corporation for all other purposes. Generally members of an LLC are not liable for debts and obligations of the LLC. However, it is uncertain whether the designer can fully insulate himself from liability through the use of an LLC.

Employer/Employee

Under this option, the contractor hires the architect or engineer as an employee. Both the contractor and the architect must meet licensing requirements. Under the doctrine of *respondeat superior*, the contractor will be liable for design errors.

Conclusion

Because design-build offers advantages to owners not found in more traditional construction delivery methods, there is an increasing interest in the use of the design-build rather than competitive sealed-bidding or other methods of awarding contracts for construction. However, it is important that owners, designers and contractors be aware of the changes in their relationships which will occur under the design-build concept, and the parties also must be aware of the different and potentially greater risks and liabilities that the designers and contractors will be assuming. If the team concept is to work, its members must be carefully selected, and the documents that serve as the foundation of their relationship must be carefully drafted to define their rights and responsibilities. ⚖

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Endnotes:

1 Virginia Code § 11-41.2(a).

2 Virginia Code § 54.1-406.

3 Virginia Code § 54.1-406(f).

4 Virginia Code § 54.1-411

5 Virginia Code § 54.1-1115.

6 Virginia Code § 54-1-1115(c).

7 Virginia Code § 11-41.2.

8 Virginia Code § 11-41.2:2(A).

9 Virginia Code § 11-41.2:5.

10 Virginia Code § 11-41.2:2(B).

11 41 U.S.C. § 253m.

12 *Southgate v. Sanford & Brooks Co.*, 147 Va. 554, 137 S.E. 485 (1927)

13 Two decisions of the Armed Services Board of Contract Appeals illustrate this principle. In *Pitt-Des Moines Inc.*, ASBCA 42838,96-1≠BCA ¶ 27, 941 (1995), the contractor was allowed to recover its increased costs under the differing site conditions clause because the actual wall thickness of the existing building was found to be thicker than shown in four (4) drawings depicting the existing building which were supplied with the Request for Proposals. In the earlier case of *M.A. Mortenson Co.*, ASBCA 39978, 93-3≠BCA ¶ 26, 189 (1993), the government was held liable for a design-builder's increased costs in constructing the foundation of a building as a result of faulty information contained in the government's drawing which was included in the RFP.

14 *Mann v. Clowser*, 190 Va. 887, 59 S.E. 2d 78 (1950).

15 33 Va. Cir. 265, 267 (Citing 184 Va. 588).

16 *Surf Realty Corp. v. Standing*, 195 Va. 431, 78 S.E. 2d 901 (1953).

17 *Virginia Military Institute v. King*, 217 Va. 751, 232 S.E. 2d 895 (1997).

18 *Blake Construction Co. Inc. v. Alley*, 233 Va. 31, 35 S.E. 2d 724 (1987) See also Sensenbrenner v. Rust, Orling and Neale, Architects Inc., 236 Va. 419, 374 S.E. 2d 55 (1988).

19 *See, e.g., Roark v. Hicks*, 234 Va. 470, 475, 362 S.E.2d 711, 714 (1987).

20 *Smith v. Grenadier*, 203 Va. 740,744, 127 S.E.2d 107, 111 (1962).