

A/E RISK REVIEW

A PUBLICATION OF THE PROFESSIONAL LIABILITY INSURANCE NETWORK



FINANCE INSURANCE, LTD.
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VOLUME 39, 2003

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Design-Build Projects Present Unique Risks and Rewards

This material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Design-build is a familiar term for a series of project delivery methods that provide the owner with a single point of contact for both design and construction. The concept, which dates back at least to the “master builders” of ancient Greece, has gained great popularity in recent years as owners seek greater simplicity in directing and executing their new projects.

Architect and engineering firms of all sizes have found themselves involved in design-build projects, some serving as the design-builder, others as subconsultants. Some of these design firms achieve great results and rewards while others are saddled with unexpected consequences. Indeed, a basic awareness of the unique financial and liability risks associated with design-build is essential to avoiding some of the unpleasant - even devastating – surprises that can await.

Financial Risks

Design professionals can face increased financial risks with design-build projects, and the extent and scope of these liabilities depend on the role they play in these projects. Not surprisingly, the greatest risks occur when the design firm takes the lead role of the prime design-builder.

Serving as the prime in a design-build project typically means taking on a much larger portion of the liabilities associated with the project. In fact, the design-builder

may have full responsibility for managing, directing and coordinating the design and construction, including responsibility for the adequacy of the plans and for the construction means, methods, techniques, sequences and procedures, as well as for jobsite safety. Aside from retaining liability for the traditional design errors and omissions, the design professional acting as prime design-builder can now be held responsible for workplace accidents, specification errors, material failures and construction errors and delays. These liabilities can result in severe financial losses.

Other unique financial risks can occur when serving as prime on a design-build project. For instance, owners will often ask the design-builder to submit designs that are nearly half complete before committing to the project. This can lead to incurring significant expenses with limited recourse if the project is not built.

Further, with design-build projects, the full contract price is typically established at the beginning stages of the project. This presents a greater potential for unanticipated design and construction costs arising after the fixed contract price has been established. This, in turn, can lead to eroded profits or, worse, the temptation to cut corners in construction, which creates an increased chance for errors, omissions, claims and lawsuits.

Even the inexact wording of a design-build contract can pose additional financial risks. Problems inevitably arise when the lead design-builder contracts to “perform” services for which it is not licensed. For instance, a design firm may contract to perform construction services that require special licensing, or a contractor can contract to perform engineering services it is not licensed to carry out. In such cases, the contract can be voided, leaving the design-builder with little recourse for getting paid for services rendered and a

team of irate and unpaid subconsultants and subcontractors.

Liability Risks

When acting as the prime design-builder or participating in a joint venture, design firms become responsible for all aspects of a design-build project. Essentially, your liability expands from professional liability to strict liability. This change is profound.

Under professional liability, design professionals are negligent only when it can be shown that they have breached the standard of care. That is, negligence occurs only when the design professional fails to exercise the degree of care ordinarily exercised by peers performing the same type of work and, as a consequence, someone experiences injury or damage. When strict liability applies, it is no longer necessary to show negligence. Rather, one merely has to show that a warranty or guarantee was breached, or that the “product” involved -- in this case, a structure -- did not perform as it was supposed to.

Generally, an architect or engineer serving as a subconsultant faces considerably less risk than the design-builder directly responsible to the owner. This situation can change, however, when the subconsultant manages or simply observes construction. That observation might be considered construction supervision under the design-build umbrella. In that case, the architect or engineer could be liable for both work quality and workplace injuries.

In one court case, an architect in a design-build project was charged with liabilities for injuries to two workers. The architect had agreed to serve as construction manager on a limited basis and to develop and implement a project safety plan. For protection, the architect excluded responsibility for the means of construction or control over other parties' workers through exculpatory clauses in the design contract. The court held that the exculpatory clauses would have relieved the architect from responsibility for site safety under traditional project circumstances. However, in design-build projects, where the contract conflicts with those clauses, the more restrictive interpretation applies.

Another problem arises when the design professional reports to a contractor serving as the design-builder. Under the traditional design-bid-build method, if the

construction contractor doesn't follow design specifications, the design professional reports the situation to the owner. In this design-build scenario, the construction contractor is the client and, consequently, there is no recourse to the owner to report construction problems. As a result, these problems are more likely to go uncorrected and materialize as claims years after construction is complete. And you can bet the design professional will be named as one of the parties to the claim.

Another potential liability problem is that a design firm's existing insurance may not cover the added exposures. As noted, when acting as prime contractor, the design professional assumes liabilities for construction defects and workplace safety. Professional liability insurance does not cover these exposures. The design professional will need additional coverage, and it may be essential that multiple insurance policies dovetail with one another to avoid gaps. Likewise, the policies of other project participants must dovetail to help assure that all insurable exposures are covered.

Bonding requirements are also typically associated with design-build projects. Design firms are often surprised when surety bonds – as well as the personal indemnity or guarantee a surety bond company demands – are requirements of taking the lead on a design-build project.

Limiting Design-Build Risks

The added risks and liabilities associated with design-build projects, while daunting, are not insurmountable. By taking necessary precautions, design firms can have very successful experiences working under this project delivery method, even as the prime design-builder. Here are some issues you should address with your attorney and insurance broker before delving into the design-build field.

The Client and Project Team

Carefully evaluate the project and the client. Are the budget and schedule realistic? Is there adequate financing? What are the qualifications and design-build experience of other participants – and how were they selected? Does the client, contractor or others have a history of disputes and litigation?

Corporate Structure

Some design firms have established new corporate legal entities for each of their design-build projects. These new entities, typically set up as limited liability partnerships or companies, would then become the legally responsible parties for the projects. While this does not insulate design professionals from liability for their individual professional acts, it can protect assets used only for traditional design-bid-build projects. Consult your attorney and accountant on the protections, costs, advantages and disadvantages of this approach.

Contractual Considerations

Because of the increased potential liabilities, the design-build contracts between the design professional, owner, contractor and other parties gain extra importance. Careful attention should be paid to each party's work scope, indemnification clauses, limitation of liability provisions, construction observation requirements and dispute resolution methods.

The Design-Build Institute of America (www.dbia.org) has done substantial work in drafting appropriate design-build contract documents. The AIA, EJCDC and FIDIC have also published sets of standard form agreements for professionals providing design-build services. The AGC has established documents for its members as well. These standard documents are good starting points, but they will likely need to be tailored to fit your particular situation.

Also make sure the agreement under which you operate is legal within your state. Both the Design-Build Institute of America and the American Bar Association have published surveys of state procurement and licensing laws with regard to design-build. Also, where appropriate, include provisions that state the design-builder will "engage licensed professionals" rather than "perform services."

To maximize the benefits of design-build, it is essential that each party's responsibilities and obligations be clearly defined under the contract. This not only will avoid misunderstandings as to who is responsible for what, it can also prevent duplication of effort. Likewise, a "teaming agreement" is helpful to make sure that all parties to the project work together to maximize project successes and minimize potential disputes.

Also pay particular attention to opportunities to obtain indemnifications from other project participants for claims arising from their errors or negligence. Under the traditional design-bid-build system, obtaining indemnification from parties other than the client is extremely difficult because the design professional and contractors rarely have contractual relationship. However, in design-build, there is typically a contractual relationship with the contractor, subcontractors and suppliers. These relationships are conducive to including indemnification clauses as a condition of service.

If work stops due to conflicts, it is the prime professional who suffers most. For this reason, formal methods for clarifying questions and resolving disputes become more important than ever. Rather than relying on litigation or traditional arbitration, specify use of mediation or some other dispute resolution technique.

Insurance

The insurance requirements for design-build are both complex and critical. Your coverage needs will vary depending on your specific role.

If you are the lead design-builder or are part of a design-build entity, your insurance requirements will expand to include those of a contractor. You'll need to investigate the availability and cost of appropriate general liability coverage for contractor operations. You may also be required to provide surety bonds or rely upon the contractor's bonding.

Also make certain that all members of the design-build team carry appropriate insurance. You may find it appropriate to be listed as a named insured on certain policies – the contractor's general liability policy, for example. Specialized guidance from a qualified insurance agent or broker is a must.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.