

Design/Build... A Good Marriage?

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This article by Mr. Nielson is the second of two Guest Essays offered on the a/e ProNet Web Site on the subject of Design/Build. Mr. Nielson's article appeared in a recent issue of the South East Florida Constructor and is reproduced with the permission of the South East Florida Constructor and the author.

As with the previous Guest Essay by Mr. Meade Collinsworth, this article explores the Design/Build delivery system from legal and contractual obligations as viewed from the Contractor's vantage point with the expression of concerns of a Bonding Agent and Company and Attorneys representing the contractor. If as a Design Professional you are considering accepting the lead responsibility of a Design/Build project, you need to be aware of the added responsibilities you undertake that include (but are not limited) to on-time completion of the project, project completion within the contract price, guarantees, warranties and in some instances guarantees of performance standards, all of which are not typically required of you as a design professional practicing your professional discipline.

If as a Design/Professional you are considering participating with a contractor on a Design/Build project, you need to pay particular attention to your contract of hire. Typically, contractors hiring design services under a sub-contract for a Design/Build project attempt to hire professional services under documents used for trade sub-contractors with the usual broad form indemnity agreements, warranties and guarantees of the sub-contractor's work product, all of which are beyond the normal "Standard of Care" required of a design professional and usually beyond the coverage furnished by a design professional's errors and omissions insurance policy. This "attitude" of attempting to make the design professional responsible for "anything and everything" results from the sobering realization that the contractor is the single point of responsibility with the owner and is therefore responsible for design errors and omissions for the project. The contractor's attorneys believe they are properly protecting their client by drafting an "air tight" indemnity agreement. The problem being that "overkill" in the language of the indemnity can void the insurance coverage of the sub-contracting design professional and make the design professional responsible for an elevated standard of care not required by Common Law. If a design professional contractually agrees to assume responsibilities beyond the Common Law standard, there is a very strong possibility a Court would hold the design professional responsible to the standards recited in the contract document.

When reading this article, pay particular attention to the advice given relative to the "mutually beneficial Indemnification and Hold Harmless-Defense Agreement" in Paragraph 2 and Sub-Paragraphs A. B. C. and D. If you plan to participate as a "sub-contractor" for design services to a Contractor undertaking a Design/Build project, be sure to have your proposed contract of hire reviewed by your attorney, your insurance agent and your professional liability insurer **before** signing your agreement. It's also a good idea to insist the contractor hiring you maintain Contractor's Professional Liability

Insurance. This way you can be confident you are not accepting greater responsibility than you are required to by common law, the indemnification obligations will be covered by your professional liability insurance policy and the Contractor has Professional Liability Insurance to cover his obligations under the Design/Build Contract.

Read on for Mr. Nielson's informative article...

Design/Build is like an "intercultural marriage" that in a perfect world would be accepted and even embraced. But in the real world, prejudices, perceptions and small-mindedness often make it difficult for intercultural marriages to exist in peace. The good news is that society is becoming more and more tolerant of such unions and as time passes and our world evolves, these unions will more than likely take place without a second thought from society at large. The "shotgun" marriage between construction professionals and design professionals has followed a similarly rocky road to acceptance, particularly with our legal society.

Such unions, however, are becoming more and more acceptable principally because it is happening more and more often. Eventually, these marriages between construction professionals and design professionals will have become so common that the legal issues and difficulties currently confronting such unions will have resolved themselves and the legal community as a whole will acquiesce to the validity and vitality of such arrangements. The legal and contractual difficulties faced by the "**construction/design marriage**" in Florida has been difficult for both well-meaning parties as they have in good faith strived to meet their individual and combined contractual responsibilities to the Owner of the project in question.

The purpose of this article is to examine the Design/Build process both from a legal and contractually cultural standpoint through the eyes of a "Bond Agent". Because **Design/Build** is by far the fastest growing method of project delivery in the United States, I think it warrants a close look at some of the very difficult issues that are currently facing this contractual marriage to see how the potential impact of these issues might be minimized on this union. According to statistics compiled by the **Design/Build Institute of America** and F.W. Dodge, the total number of **Design/Build** contracts is increasing by more than 100% annually, and use of **Design/Build** in large civil projects is growing between 80% and 150% annually.

The popularity of **Design/Build** is driven by owners, primarily because of the shortened project-delivery times and the single-point responsibility for project design and construction process. Approximately 95% of all **Design/Build** projects are contractor-led today. In the State of Florida, particularly the Southeast portion of the State, I have estimated that this percentage of the **Design/Build** projects that are contractor-led is even greater.

Design/Build projects come in many shapes and sizes. Standard design-bid-build contracts may have latent design responsibilities and exposures and **Design/Build** contracts can also be "absolute." **Design/Build** with only concept documents provided by the Owner or they can have any amount of varying degrees of design that is provided by the Owner. At the very extreme of this process are the "**Turnkey projects**" where delivery is seamless and may include financing, site selection, purchase, operation and/or equity interest.

Likewise, **Design/Build** teams also come in many shapes and sizes. The **Design Builder** can be a construction firm with an in-house design team or they may subcontract all of the design services to an outside Architectural/Engineering firm. Although we seldom see it in this marketplace, an Architectural/Engineering firm may be the "**Design Builder**" and will subcontract the construction services of an outside construction firm in a **Design/Build** contract. Each of these delivery systems are unique as it relates to the risk factors involved for both the **design and construction professionals**.

The primary issue relating to Design/Build contracts is the single-point responsibility for the project design and construction. In other words, the clear distinction between design responsibility and construction responsibility is lost when both fall under a single contract. The co-mingling of these responsibilities allows design issues to directly affect the construction progress including payment for work performed. Furthermore, design-related delays which are often very lengthy, can lead to liquidated damage assessments, increased interest expense and escalation of material and subcontractor prices. It can never be forgotten that one of primary objectives of Design/Build is to eliminate the issues relating to the Owner's dissatisfaction with Change Orders and their desire to avoid any responsibility! Therefore, required changes in construction may be uncompensated for under the Design/Build concept. All of these issues must be considered before a construction firm and a design firm can properly evaluate the financial and organizational issues in a proposed marriage.

A contractor must never forget that through the Design/Build process, the contractor takes upon itself the Construction services and Design Liability services for the project in question. There are appropriate ways in which the contractor can be protected from the "design-liability" which should be considered before entering into a contractual union with a design professional. In that regard -

1. Contractors may consider negotiating for separation of the contractual responsibilities of design from the contractual responsibilities of construction. Separation is often difficult to negotiate since this practice is perceived to undermine the **Design/Build** philosophy. There are several ways in which a separation can be attempted:
 - a. The Architect/Engineer could contract directly with the owner, who could then assign the contract to the construction firm.

- b. Two (2) separate contracts could be created between the **Design/Build** firm and the owner. One (1) contract for design and the other contract for construction.

The clients that I deal with are most often working with owners who require that the **Design/Build** projects be bonded. Most surety companies have required "**Project Specific Professional Liability Policies**" for contractors who are bonded on **Design/Build** projects...this way **the entire Design Team** is insured on one policy...but not the contractor. This policy is providing the "**peace of mind**" that most surety companies demand. The **Project Specific Policy** becomes the primary E&O policy for the **Design Team**. It simply insures that if the design professional does "screw-up" the owner does not have to worry about the various limits that may be on each Design Professional's **General Practice Professional Liability policy**. **The project policy will obviously protect the entire Design Team**. Putting it very simply, if the marriage between the contractor and design professional ends up in divorce court because of design issues, then the contractor has assets (policy limits) to go after...if the problem is the fault of the Design Team. **But this does not obviate the need for Contractor's Professional Liability insurance!**

2. Again...perhaps the best protection for a contractor in the **Design/Build** contracts is the purchase of what is called a "**Contractor's General or Project Specific Professional Liability policy**" for its **Direct and/or Contingent** Professional Liability exposures. This policy covers the design liability exclusions which are a part of all the Commercial General Liability and Umbrella policies that all construction firms would normally have as a part of their insurance portfolio. **The Contractor's Professional Liability policy is in addition to the contractor's portfolio of other insurance coverages**. Although this falls outside of my area of expertise, it is my understanding that it can be purchased on a single **Project Specific** basis or as on annual **General Practice** type policy which becomes a part of the contractor's portfolio of coverages. For questions in regards to this coverage, please check with your insurance professional. If he/she is not aware of this coverage, feel free to contact my old partner... Mr. W. Meade Collinworth at (305) 822-7800, extension 254.

Where the contracting entity is the typical joint venture between the contractor and the design professional, a mutually beneficial "Indemnification and Hold Harmless-Defense Agreement" should be executed between the Design Team and the Contractor, each legally holding the other harmless for losses or expenses caused in whole or in part caused by their **negligent acts or omissions** of the Design Professional or the Contractor. **In other words, the contractor will hold the architect harmless for negligent acts or omissions in the construction process of the project. Then...the design professional will also provide an "Indemnification and Hold Harmless**

Agreement" holding the contractor harmless for negligent acts or omissions on the part of the design professional arising out of the design phase of the project.

It is obviously necessary on the contractor's part to be certain that he has the proper Professional Liability in order to back up the understandings of both parties as a result of the mutual Hold Harmless Agreements. It should be noted that if the contractor and the design professional utilize the AIA-491, Section 11.7 as referred to as "Indemnification" provides the mutual Hold Harmless Agreement between contractor and design professional. Most contracts that I have noted between the contractor and design professional, however, do not have the mutual Hold Harmless Agreements included. I would, therefore, recommend separate Hold Harmless Agreements. Obviously, the ability of each party to hold the other harmless is a product of the financial strength and/or insurance coverages available for that purpose. **I, therefore, continue to recommend the Contractor's Professional Liability policy as the best protection for the Contractor,** to fund the "Indemnification and Hold Harmless Clause" which is a part of the Design/Build contract.

In the Design/Build process...the General Contractor often finds themselves in a position that may require that they pass on design work to their construction subs. For instance, if the owner makes you responsible for a project's HVAC System, the General Contractor may pass that design responsibility on to their construction sub. **Even if the sub does the design work, your contract with the owner most likely makes you responsible for any claims or damages arising from all design work on the project itself.** If the item that the sub designs doesn't perform "in accordance with requirements of the contract documents" or if the damage occurs as a result of faulty design, you may be liable for those damages. **The key step to protecting yourself from this risk is to shift the responsibility for a design error to your design sub** and make sure they (too) have "**funded**" this exposure with Professional Liability insurance. To do this, include what is known as an "Indemnification Clause" in your subcontracts. In an Indemnification Clause, the sub agrees to indemnify you; i.e., "compensate you" for damages you incur due to or arising out of the claims due to negligence in the design process. Where the sub does the design work in-house or hires an outside professional, **the sub still remains liable if they have indemnified you.** Under those circumstances, if the owner or anyone else makes a claim against you on faulty design work that the sub provides, the sub must pay damages including legal fees that you incur. As suggested by Mr. Stanley B. Edelstein, Esq., any Indemnification Clause should include the following:

- A. Provide an agreement to the additional indemnification. Clearly state that the indemnification is in addition to any other indemnification in the subcontract and specifically applies to design services that the sub provides.**
- B. Make the sub responsible for all claims related to the design services which result in claims arising out of your sub's professional negligence. Spell out the fact that the sub is responsible and liable for "any and all" claims which result from negligent professional design services provided.**
- C. Get the Indemnification signed by the sub. Make sure that the indemnification covers you for all kinds of costs relating to or arising out of**

the negligent design services. But...as mentioned before, it must be funded by the proper insurance coverages. As a word of caution, the indemnification that you will get from the subcontractor is no better than the subcontractor's financial statement. This will provide a very clear message and it will provide some protection for the General Contractor.

- D. Make sure your professional sub...funds this with the proper insurance coverages identified in this article.**

(Your attorney and insurance agent obviously should be involved in the contract review and administration process must start at the RFP stage.)

The only way for a contractor to protect his assets against the additional liability assumed under a Design/Build contract is to be cognizant of the fact that there is extensive additional liability assumed. As previously mentioned, the contractor, through the Design/Build contract, assumes the construction and design liability for the project. As a result, the contractor can no longer assert the comforting defense of *United States v. Spearin*, which states that "if the project was built according to plans and specifications, the contract is not liable for project performance."

Should there be any deficiencies arising out of negligent design, the liability for this would fall on the **Design/Build** contractor. These deficiencies are often latent and losses can occur or be discovered many years after project completion. In fact, over 70% of all Professional Liability claims are reported three (3) years after project completion and 90% are reported within seven (7) years. Design deficiencies can cause large losses long after project completion which, **under the Design/Build approach in most instances becomes the responsibility of the contractor at the end of the day.**

Considering the fact that many of the **Design/Build** projects are accompanied by a Performance and Payment Bond supplied by the contractor, when the potential design deficiencies arise, if the contractor has not protected his assets through the proper insurance policies, Hold Harmless Agreements, etc., the financial responsibility will fall directly upon the balance sheet of the contractor. If the contractor is unable to perform, the contractor's surviving partner (the Surety) will be called upon to remedy the deficiencies. The surety will then seek reimbursement from the construction firm and/or individuals signing the Indemnity Agreement.

Because Design/Build projects presents some unusually complex legal, technical and surety issues, in summary it would be my suggestion that these projects be pursued with a high degree of conservatism. It is also advisable to seek the advice of an experienced construction attorney and insurance/risk management professional.

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NOTE: This article is intended for general discussion of the subject, and should not be mistaken for legal advice. Readers are cautioned to consult appropriate advisors for advice applicable to their individual circumstances.