



DESIGN-BUILD: CONTRACTS AND CLAIMS

RISKS AND LIABILITIES UNIQUE TO DESIGN-BUILD

Presented by

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Design-build construction continues to gain popularity. In response to the increasing demand for design-build construction, all of the major trade organizations (AGC, AIA, DBIA, EJCDC) have developed a standard design-build contract series. Each set of contracts allocates risks and responsibilities somewhat differently, based on the organization's overall goals and objectives. As some of these projects begin to see claims, trends can be seen developing in how the courts are construing various types of contract provisions. In order to effectively advise contractors on their insurance needs, agents and brokers must understand the liabilities assumed under different contracts as well as how the courts are interpreting key contractual and insurance coverage provisions. This session will get you up to speed on the growing body of case law in this expanding area.

Thursday, November 16, 9 a.m.–noon

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Mr. Ernstrom is one of the presenters for Workshop O, "Design-Build: Contracts and Claims," on Thursday. He is a founding partner of the law firm of Ernstrom & Dreeste, LLP. For more than 20 years, he has focused his practice on the construction and surety industries.

Mr. Ernstrom is counsel to the Contract Documents Program for the Associated General Contractors of America. In 1998, he was selected by the AGC as "Chairman of Year" for his work in representing contractors' interests in contract documents. He was recently awarded the AGC President's Coin for exemplifying skill, responsibility, and integrity as well as unlimited motivation on behalf of the Association. He was the primary author of many of the AGC series of contract documents, including the 1993 series of design-build documents and the newly revised and expanded 1999 series. Mr. Ernstrom has also been responsible for the drafting of other AGC contract documents such as the recently approved AGC 200 series of Standard Form Agreements that include an owner-contractor lump sum agreement, a cost plus with optional GMP contract, a straight cost plus contract, and an owner-A/E agreement. In addition, he has drafted the Construction Management Agency contract documents and the new Program Management Contract. From 1993 to 1997, he represented the AGC in its negotiations with the AIA concerning the A201 family of documents.

He is a member of the Surety Bonding Committee, Project Delivery Systems Committee, and Subcontractor Relations Committee of the AGC of America. In addition, Mr. Ernstrom is a founding member of the Construction Financial Management Association, Western New York Chapter. He is a member of the Fidelity & Surety Law Committee of the American Bar Association and has been a regular speaker for that Committee. He is a member of the National Bond Claim Association and the Surety Claims Institute. He has been a regular speaker at NASBP regional meetings on issues of concern to sureties, bond producers, and the construction industry. Mr. Ernstrom is the Region II vice chair for New York of the Public Contract Section of the American Bar Association. For 10 years, he was the chairman of the New York State Construction Dispute Resolution Council. He is also a mediator and a national arbitrator on the National Arbitration panel for the American Arbitration Association. He was the chairman of the first Dispute Review Board ever to be used by the New York State Office of General Services on a \$23 million prison hospital project.

Mr. Ernstrom has authored numerous articles on construction and surety law topics. Mr. Ernstrom graduated with honors from Hamilton College and Cornell Law School.

Notes

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RISKS AND LIABILITIES UNIQUE TO DESIGN-BUILD

*J. William Ernstrom
Ernstrom & Dreste, LLP*

I. Background

- A. What it is
- B. How it differs from all other project delivery systems

II. Risks Unique to the Design-Build Project Delivery System

- A. It will work for any project regardless of the parties and project success drivers
 - 1. Construction Industry Institute study
 - 2. AGC/AIA teaming checklist
- B. The corporate structure of the design-builder
 - 1. Who should lead?
 - 2. Licensure—is it legal?
 - 3. JVC—joint & several liability
 - 4. LLC/LLP
 - a. Avoid catastrophic tort liability
 - b. Performance guarantee to Owner
 - 5. Management and control of D/B—give A/E a say but only in interests of project
 - 6. Teaming agreement
 - a. Prenuptial to lock in A/E
 - b. Prequalifying the A/E

- C. Does the owner know what it wants?

- 1. The owner’s program—the necessity of having clear, complete, and well-defined program

- D. Single point of responsibility—what it means to the contractor’s balance sheet

- 1. Design liability flow-through
- 2. Implied warranty of performance?

- E. The O’s representative—does the representative have authority and experience?

- F. Other design issues

- 1. What is the D/B buying?

- a. Bridging
- b. Surety’s liability as completion contractor for injuries to owner or third-parties

- 2. Delay by A/E in furnishing documents

- a. Provide incentive—cut in on savings clause
- b. Share in liquidated damages exposure—set ceiling and floor

- 3. Ownership of documents

- a. What happens when A/E threatens to walk—who owns the documents?
- b. What happens when owner terminates—who owns the documents?

4. How to handle the subcontracted design
 - a. Requirement of a licensed design professional
 - b. Require A/E to coordinate
 - c. D/B liable for design defects caused by A/E when D/B subcontracts to A/E. *Rivnor Properties v Herbert O'Donnell, Inc.*, 633 So2d 735 (Ct App LA 1994)
 - d. Statutes of limitations and statutes of repose
 - (1) Varies state to state
 - (2) Owner
 - (3) Third parties
 - (4) Latent vs patent defects
- G. Compensation
 1. Lump sum vs guaranteed maximum price
 2. GMP
 - a. When is the GMP delivered?
 - b. Adjust after most trades purchased (GMP = sub prices + prices to be bought + contingency)
 3. Bonus payments
- H. Performance guarantee and warranties
 1. Failure to provide design capable of achieving performance criteria constitutes material breach. *Arkansas Rice Growers Cooperative Association v Alchemy Industries, Inc.*, 797 F2d 565 (CA8 Cir 1986).
 2. Failure to meet performance tests constitutes breach—U.C.C standard when sale of goods. *Omaha Pollution Control Corporation v Carver-Greenfield Corp.*, 413 F Supp 1069 (DC Neb 1976).
 3. Implied covenant to comply with codes. (*Tips v Hartland Developers*, 961 SW2d 618 (Ct App TX 1998).

4. D/B sues A/E for breach of implied warranty to supply bidding information. *C.L. Maddox, Inc. v Benham Group, Inc.*, 88 F3d 592 (CA8 Cir 1996).
- I. Dispute resolution—don't get caught in the middle (conflicting dispute resolution process)
- J. Fraud. *Richmond Metropolitan Authority v McDevitt Street Bovis, Inc.*, 507 SE2d 344 (S Ct VA 1998) (safeguard against turning breaches of contract into fraud claims); *Aiken County v BSP Division of Envirotech Corporation*, 866 F2d 661 (CA4 Cir 1989) (unproven system furnished).

III. How To Handle the Unique Risk

- A. Contract formation—use the right contract
- B. Insurance issues
 1. CGL
 2. Professional liability insurance for D/B
 3. Professional liability for A/E
 - a. No insurance
 - b. Insurance
 - (1) What it covers and what it doesn't cover
 - (2) Project-specific—prior acts and extended reporting period
 - (3) Limitations and deductibles/self-insured retention
 - (4) Vicarious liability coverage
 - (5) Surety as claimant
 4. Real-world examples of contractor or surety suffering financial loss on D/B project where A/E or contractor's insurance coverage insufficient
- C. Bonds—do they cover design liability?
 1. Louisiana case—*Nicholson & Loop v Woodward*

RISKS AND LIABILITIES UNIQUE TO DESIGN-BUILD

The Risk Factors of Design-Build

- Pre-Contractual
 - Corporate structure
 - Teaming
- Contractual Issues
 - The key risk issues
 - The philosophies of the standard documents

Pre-Contractual

The Corporate Structure

Who Should Lead?

- Contractor-Led Venture
 - licensure issue
- Integrated Entity
- A/E
- Special Purpose Entity
 - JVC
 - Parties assume unintended liability
 - LLC/LLP
 - Owner has contracted with a shell
 - Licensure issues.

REMEMBER . . .

**We are in the construction
business!**

Pre-Contractual

Teaming

Proposal Preparation

- To agree on roles and duties
- To agree on sharing of costs & honorarium
- To agree on how to handle disclosure and ownership of proprietary information
- To get confidentiality agreement
- To get non-compete

How to Team

- Establish the relationship before the RFQ (strategic alliance or project specific?)
- Pre-qualification (the Questionnaire)
- Use teaming checklist

Post Award Considerations

- Preparation of matrix of responsibilities
- Flow down of prime contract terms
- Establish process for coordinating design with construction
- Establish contingency
- Limitation of liability

Why a Teaming Agreement

Clear communication pathways

(Post Award Issues)

- Termination/Withdrawal of one team member
 - Portion of proposal unacceptable
 - Loss of licensure
 - What happens when a team member defaults?
 - Remaining team members should consider imposing a penalty for withdrawal.

DESIGN/ CONSTRUCTION LIABILITY

Single Point of Responsibility

- Who is creating the design?
- Implied warranty of performance
- Design liability pass through
- What is the standard of care for design?
 - Negligence to strict liability by virtue of warranty provisions?
 - Is there a difference between prime contract and sub-consultant's?
 - Non insurable.

Contractual Risk Issues

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- Design standard of care: care/skill ordinarily used by A/Es for similar conditions, same time/locality
- Warranty: materials/equipment new, good quality, conforming, workmanship not defective
- If specified by O, warranty of manufacturer governs
- One year correction period

DESIGN DEVELOPMENT

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- The Owner's Program
- Material Changes and Deviations
- Progressive Sign-Off

DBIA

- Standard of Care
 - Ordinarily Used by Members of Design Profession
 - Must Satisfy Specifically Identified Performance Standards
- Warranty of Construction
 - New, Good Quality, Free of Defects
- Correction of Defective Work
 - Not in Conformance With Contract Documents
 - One Year from Date of Contract Completion

DBIA

- Meet and Confer Concept - Interim Submissions and Construction Documents
- Conformed Set of Documents That Are Compatible with Requirements of Work
- Design Liability Not Transferred to Owner

**KEY OWNER
ROLES
AND
RESPONSIBILITIES**

PAYMENT

- AGC - Owner funding**
- Reasonable evidence of sufficient funds
 - Including allowance for changes
 - Not required to commence or continue
 - Stop after seven day notice

- AGC - Compensation & Payment**
- Ten Day Notice
 - Fifteen day payment time
 - Owner indicates reasons for rejection
 - Owner pays for items not rejected
 - Items rejected paid when reasons removed
 - Costs of the Work includes Corrective Work provided it did not arise “from the negligence of the Design-Builder”

- DBIA & AGC -Other Owner Responsibilities**
- Timely reviews and Approvals
 - Surveys, Geotech Reports, Easements, Environmental Studies
 - Hazardous Conditions
 - Third-Party Agreements
 - Permits

COST OF WORK/GMP AND RELATED ISSUES

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- THE GMP
 - Adjustments to the GMP
 - The Design-Builder's Contingency
 - costs which are reimbursable as a Cost of the Work but not the basis of C.O.
- Allowable Costs
- Defective Work
 - not arising from “from the negligence of the Design-Builder”.
- Savings-none (conflict)
- Time for Establishing a GMP
 - “At such time as the O & D-B jointly agree”

DBIA

- Allowable Costs
 - Reasonably Incurred, But Owner Approval Required
- Defective Work recoverable
- Contingency
- Savings
- Time for Establishing a GMP
 - At Execution or After
 - Meet and Confer, Accept or Reject

AMENDING AND SUPPLEMENTING THE DOCUMENTS

CHANGES

AMENDING AND SUPPLEMENTING THE DOCUMENTS

- Change Orders - Limitations on fees
- Work Change Directives
 - If Owner and the Design-Builder disagree as to whether work is within the scope of the Work, Design-Builder furnishes estimate of costs.
 - If Owner issues a written order to proceed, Design-Builder performs disputed work and Owner pays Design-Builder fifty percent (50%) of its estimated cost to perform the work.
 - Both parties reserve their rights as to whether the work was within the scope of the Work.
- Minor Work

**INSURANCE AND
BONDING**

BONDS

AGC: INSURANCE

PROFESSIONAL LIABILITY
INSURANCE

- General Office Coverage
- Project Specific

AGC: BONDING

- BONDS
- Choices
 - GMP (if there is no GMP, then the agreed estimated cost of the Project, including design and construction),
 - Agreed estimated construction cost of the Project
- Such Performance Bond shall cover the cost to complete the Work, but shall not cover any damages of the type specified to be covered by the insurance pursuant to Paragraph 11.2 and Paragraph 11.3, whether or not such insurance is provided or is in an amount sufficient to cover such damages.

DBIA: Insurance and Bonding

- Types of Coverages Specified
- Project Specific
- Fill in the Blanks

TERMINATION FOR CAUSE

- By Design-Builder
 - By Owner

TERMINATION & SUSPENSION

OWNERSHIP OF DOCUMENTS

TERMINATION FOR CONVENIENCE

premium payment concept.

AGC

- Owner receives ownership of property rights, except copyrights
- Termination
- Owner may use for subsequent renovation and remodeling of the Work, but not for other projects w/o authorization of D/B
- O's use on other projects is at O's sole risk; O defends and indemnifies.

DBIA

- Owner's payment in full
 - Use in connection with occupancy
- Owner's T for C or Design-Builder's election to terminate
 - Premium if resumes project
- Design-Builder's default
 - determination of default and satisfaction of Owner's obligations
 - Conversion to T for C

AGC

- Tiered Dispute Process
 - Negotiation (direct discussions)
 - Mediation
- Dispute Resolution Menu-choice of many alternatives
- Costs to prevailing party.

DISPUTES

WHAT THE COMPETITION IS SAYING ABOUT THESE DOCUMENTS...

DBIA

- Tiered Dispute Process
 - Negotiation
 - Mediation
- Status reports, Designated Individuals, Arbitration
- Loser Pays

IF YOU'RE NOT USING THESE DOCUMENTS...

**LEADING THE
INDUSTRY**

QUESTIONS ?