

**Workshop K**

***JOINT VENTURE LIABILITY***

**Presented by**

**David J. Hatem  
Attorney  
Donovan Hatem LLP**

**Wayne Snow  
Vice President, Risk & Insurance  
AMEC Inc.**

**Susan G. Staff  
Risk Manager  
Zachry Construction Corporation**

In construction, contractors may enter into a joint venture with another contractor, or on a design-build project with a design firm. Joint ventures present some unique challenges for participants, including the allocation and insuring of project risks. This session will address the efforts to align joint venture risks with insurance coverages for a design-build project and identify key insurance coverage challenges joint ventures pose for participants. Case studies will be used to demonstrate the importance of drafting a precise joint venture agreement.



INSURANCE IN TOUCH WITH BUSINESS

CNA has provided insurance solutions to construction businesses worldwide for over 100 years. This depth of experience, combined with our understanding, of the industry, has made CNA the preferred choice of more contractors than any other insurance company.

The construction industry faces a variety of risks and exposures. CNA and your local insurance agent or broker can provide the insurance that best meets your individual company's needs. Together we can work with you to reduce your exposures and protect your assets.

CNA construction products are tailored to small, medium and large businesses. Our core strengths—comprehensive property and casualty, surety and professional liability coverage—combined with financial strength, offer outstanding value to all construction businesses.

For small and medium businesses, CNA offers basic coverage such as Workers' Compensation, Commercial Property and Commercial Umbrella. Your local insurance agent can review the entire CNA product line to show how you can create truly customized protection.

For larger construction businesses, our Risk Management team can help reduce loss costs, enhance productivity and facilitate communications to employees. We offer a variety of benefits including claim service, cost management services, fraud protection, information services, risk control, and work place productivity seminars and planning.

CNA's Surety operation, the largest publicly traded surety company in the U.S. provides all types and sizes of contract and commercial surety bonds in all 50 states, and many foreign countries with a focus on small and middle market contractors with bonded backlogs up to 150 millions. We are known for our consistent and reliable approach to meeting our clients' needs.

In partnership with Victor O. Schinnerer & Company, Inc., CNA has provided professional liability protection to architects, engineers, and contractors for more than 45 years through our AEC Design Liability coverage. We offer professional and pollution liability programs to address continually evolving project delivery techniques and methods. Whether your firm is providing value engineering, design, design-build or construction management services we can tailor a program to meet your needs.

Maintain and protect your business and your assets by obtaining customized insurance coverage, selected especially for you. To find out how, visit [www.cna.com](http://www.cna.com) or contact your local independent CNA agent.

**David J. Hatem**  
**Attorney**  
**Donovan Hatem LLP**

Mr. Hatem is one of the presenters for Workshop K, "Joint Venture Liability," on Wednesday. He is a nationally recognized expert in the design and construction process. He has substantial experience in providing various legal and risk management services in connection with subsurface projects, including the Boston Central Artery/Tunnel, the Seattle Sound Transit, New York East Side Access, L.A. Metro, Pasadena Blue Line, and Boston Harbor Cleanup. Presently, he is providing risk management/insurance advice regarding a proposed professional liability OCIP program for the Second Avenue subway project in New York. In connection with those various projects, Mr. Hatem has provided various services for engineering consultants, including contract negotiations; preparation of contract documents (for design-bid-build or design-build procurement); preparation of request for proposals from constructors and/or design-builders; preparation and review of portions of geotechnical reports (including geotechnical baseline reports); review and evaluation of general and supplementary conditions for construction contracts, particularly with regard to risk allocation and dispute resolution provisions; claims management and defense of claims. In addition, Donovan Hatem LLP has provided program management services on behalf of professional liability insurers who underwrite project-specific professional liability policies on major construction projects.

Mr. Hatem is the author of numerous articles on the topics of tunneling and subsurface conditions. He is also the editor of *Design-Build Subsurface Projects*, published by Zeni House (2002).

Mr. Hatem teaches a course at Tufts University, "Legal Aspects of Engineering Process." He is also legal counsel to American Consulting Engineers of Massachusetts.

**Wayne Snow**  
**Vice President, Risk & Insurance**  
**AMEC Inc.**

Mr. Snow is one of the presenters for Workshop K, "Joint Venture Liability," on Wednesday. At AMEC Inc., he is responsible for the management of the Insurance and Surety Program for AMEC Americas and he sponsors the Total Risk Management initiative with AMEC Americas. Previously, he was with Aon Reed Stenhouse Inc., where he spent 10 years focusing on the energy, petrochemical, rail, forestry, mining, and transportation sectors. Near the end of his tenure with Aon, he was responsible for the development of major new business.

His business achievements include successfully leading the combination of the former Morse Diesel and AGRA Insurance programs into one combined insurance program for new AMEC Americas, nurturing strategic business relationships with his employer's principal insurance company providers, facilitating the orientation of Total Risk Management throughout AMEC America, procuring insurance placement of several capital projects from both an owner and contractor perspective, and managing the satisfactory settlement of large claims.

Mr. Snow's education and professional development include Fellow, Chartered Insurance Professional; Canadian Risk Management diploma; Fellow of the Insurance Institute of Canada (Risk Management major); Canadian Chartered Insurance Broker; and Associate of the Insurance Institute of Canada.

**Susan G. Staff**  
**Risk Manager**  
**Zachry Construction Corporation**

Ms. Staff is one of the presenters for Workshop K, "Joint Venture Liability," on Wednesday. She currently serves as risk manager for the San-Antonio-based Zachry Construction Corporation's Industrial Group Division. Through its various divisions, Zachry Construction Corporation is one of the largest contractors worldwide, providing construction and construction management services for infrastructure projects such as highways, dams, and airports; power plant development and construction; and plant maintenance and capital improvements for the utilities, pulp and paper, and petrochemical industries.

Ms. Staff is responsible for all aspects of project risk management for the company's Industrial Group Division, as well as corporate and project environmental and professional liability risk issues. Her duties include reviewing and negotiating contract provisions regarding risk allocation and insurance, providing project risk management and insurance premium indications, procuring and negotiating project insurance policies with insurance industry professionals, and developing and evaluating subcontract documents and qualification criteria. Other activities with H.B. Zachry have included serving as the leader of the first Zachry Home Office Safety Team and serving on the company's Subcontracting Task and Contract Language Review Teams.

Prior to joining H.B. Zachry, Ms. Staff served as risk manager—projects for the Power Generation segment of Asea Brown Boveri, Inc., in Windsor, Connecticut, and as manager, corporate insurance, for Rust International, Inc., in Birmingham, Alabama.

She is currently a member of the Risk and Insurance Management Society. As a volunteer, she serves as chair of the YMCA of San Antonio and the Hill Country Risk Management Committee. Ms. Staff has made presentations in the areas of contractual risk transfer, additional insured, and subcontract risk management at regional and national RIMS conferences as well as the IRMI Construction Risk Conference.

Ms. Staff earned a bachelor's degree in business administration from the University of Georgia, where she majored in risk management and insurance. She has earned the Environmental Risk Management designation from the Institute of Environmental Risk Management at Southwest Texas State University.

# ***JOINT VENTURE LIABILITY***

---

***David J. Hatem  
Donovan Hatem LLP***

***Wayne Snow  
AMEC Inc.***

***Susan G. Staff  
Zachry Construction Corporation***

In construction, contractors may enter into a joint venture with another contractor or on a design-build project with a design firm. Joint ventures present some unique challenges for participants, including the allocation and insuring of project risks.

## **Part I: Wayne Snow**

### **I. Session Objective/Overview**

- a. Purpose of forming joint ventures for construction projects
- b. Identify risk profile for parties to a design/build project joint venture
- c. Alignment of insurance coverages and contractual risk exposures for a joint venture/design-build project
- d. Case study examples

### **II. Why Joint Venture**

- a. Expand market penetration
  - i. Geographical
  - ii. Industry-related
- b. Need for particular expertise
- c. Risk sharing
- d. Bonding capacity
- e. Compliance with federal, state, or local regulations/bidding requirements

### **III. Joint Ventures for Design/Build Projects**

- a. Choosing a partner
  - i. Compatibility
  - ii. Proven knowledge in product type
  - iii. Design/build experience
  - iv. Financial capacity
- b. Team approaches—why a teaming agreement?

### **IV. Joint Venture Risk Mapping**

- a. Risk identification
  - i. Late project completion
  - ii. Performance/warranties/guarantees—not just limited to rework of design plans
  - iii. Indemnity/insurance obligations
  - iv. Limitations of liabilities
  - v. Construction errors/faulty workmanship
  - vi. Third-party claims
  - vii. Rework
- b. Risk allocation
  - i. Traditional design-bid-build approach
  - ii. Design/build joint venture

## **Part II: Susan Staff**

### **V. The Joint Venture Agreement**

- a. Use of joint venture agreement templates
  - i. Advantages
    - 1. Checklist helpful to avoid omissions
    - 2. Useful in expediting agreement

- ii. Disadvantages
  - 1. May not address project-specific issues
  - 2. May not take into account different scopes of work between partners
  - 3. May not take into account differences in risk allocation/management philosophies of partners
  - 4. Venue differences
  - 5. Control of use of document
- b. Key provisions
  - i. Clearly defined business objectives
  - ii. Degree of participation and management roles of each joint venturer in the business
  - iii. Contribution of capital and ownership rights to property
  - iv. Division of the profits and losses
  - v. Termination/liquidation of the JV and buy-out provisions
  - vi. Confidentiality
  - vii. Indemnification
  - viii. Insurance

**VI. The Prime Design-Build Agreement—Flow-Downs and Insurance Requirements**

- a. Insurance requirements may not reflect insurance requirement needs of JV agreement
- b. Acceptance by owner of joint venture partners' practice insurance policies

**VII. The Joint Venture Agreement—Alignment of Risk Allocation, Indemnity, and Insurance**

- a. The chicken or the egg?
- b. Sharing profits/losses while remaining responsible for the consequences of each party's scope
- c. Does risk allocation intent conflict with legal interpretation of joint venture liability?
- d. Does risk allocation intent conflict with application of insurance coverages of the parties?

**VIII. Insurance Structure—Project Joint Venture Policies or Not???**

- a. Workers Compensation
- b. General Liability
- c. Automobile Liability
- d. Excess Liability
- e. Professional Liability
- f. Builder's Risk

**Part III: David Hatem**

**IX. Defining Design Adequacy Risk Exposure**

**X. Design Risk Exposure of Contractor as Prime or Joint Venture Partner**

- a. Final design risk exposures
- b. Other professional liability risk exposures
- c. Joint venture liability

**XI. Design-Build Agreement Provisions Which Impact Design Adequacy Risk and Related Professional Liability Claim Exposures**

**XII. Limiting Design-Adequacy Risk in a Design-Build Agreement**

**XIII. Insurability of Defective Design Risk**

**XIV. Special Issues under Project-Specific Professional Liability Policies**

**XV. Examples of Design Adequacy Risk and Related Professional Liability Claims**

**XVI. Use of Performance Bond to Protect Against Defective Design and Related Claims**

# **JOINT VENTURE LIABILITY**

---

**Wayne Snow**  
**AMEC Inc.**

**Susan G. Staff**  
**Zachry Construction Corporation**

**Wayne Snow**

## **Session Objectives/Overview**

- **Purpose of forming Joint Ventures for construction projects**
- **Identify risk profile for parties to a Joint Venture Design/Build project**
- **Alignment of Insurance Coverages and Contractual Risk Exposures for Joint Venture/Design-Build project**
- **Case Study examples**

## **Why Joint Venture**

- **Expand market penetration**
  - Geographical
  - Industry related
- **Need for particular expertise**
- **Risk Sharing**
- **Bonding Capacity**
- **Compliance with Federal, State, or local regulations**

## **JV's for Design/Build Projects**

- **Choosing a partner**
  - Compatibility
  - Proven knowledge in product type
  - Design/Build experience
  - Financial capacity
- **Teaming approaches:**
  - Why a teaming agreement?

## **Joint Venture Risk Mapping**

- **Risk Identification**
  - **Late project completion**
  - **Performance/Warranties/Guarantees-not just limited to rework of design plans**
  - **Indemnity/Insurance Obligations-Does insurance respond in the manner that the parties intended?**
  - **Limitations of Liability**
  - **Construction Errors/faulty workmanship-rework**
  - **Third party claims**

## **Joint Venture Risk Mapping**

- **Risk Allocation**
  - **Traditional design-bid-build approach**
  - **Design/Build JV**

**SUSAN STAFF**

## **The JV Agreement**

- **Use of Joint Venture Agreement Templates**
  - **Advantages**
    - Checklist helpful to avoid omissions
    - Useful in expediting agreement (short-fuse projects/proposals\_

## **The JV Agreement**

- **Use of Joint Venture Agreement Templates**
  - **Disadvantages**
    - May not address project specific issues
    - May not take into account different scopes of work between partners
    - May not take into account differences in risk allocation/management philosophies of partners
    - Venue differences
    - Control of use of document

## **The JV Agreement**

- **Key provisions**
  - **Clearly defined business objectives**
  - **Degree of participation and management roles of each joint venturer in the business**
  - **Contribution of capital and ownership rights to property**
  - **Division of the profits and losses**
  - **Termination/liquidation of the JV and buy-out provisions**
  - **Confidentiality**
  - **Indemnification**
  - **Insurance**

## **The Prime Design-Build agreement— Flow-downs and Insurance requirements**

- **Insurance requirements may not reflect insurance requirement needs of JV Agreement**
- **Acceptance by Owner of joint venture partners practice insurance policies**

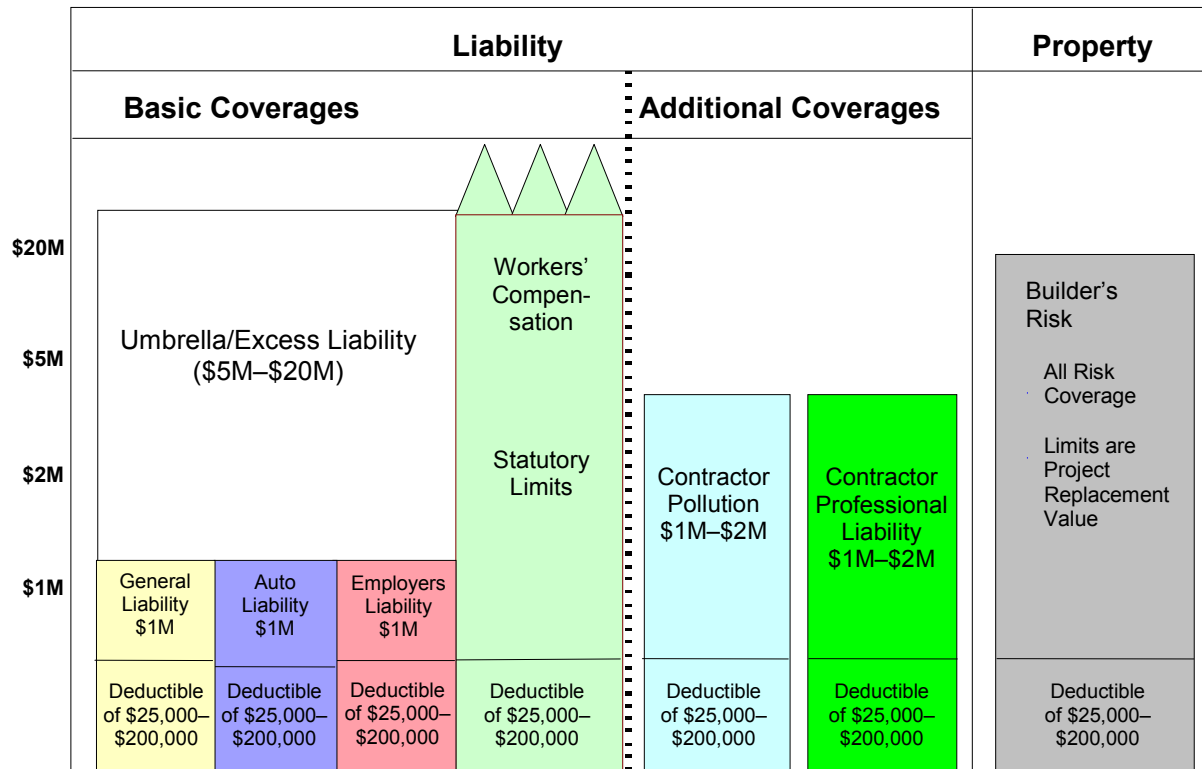
**JV Agreement- Alignment of Risk Allocation, Indemnity and Insurance**

- **The Chicken or the Egg syndrome –**
- **Sharing profits/losses while remaining responsible for consequences of each parties scope**
- **Does risk allocation intent conflict with legal interpretations of JV liability?**
- **Does risk allocation intent conflict with application of insurance coverages of the parties?**

**Insurance Structure—  
Project/JV specific policies or not?**

- **Workers Compensation**
- **General Liability**
- **Automobile Liability**
- **Excess Liability**
- **Professional Liability**
- **Builder's Risk**

**Exhibit 5.2  
Typical Contractor Insurance Program\*  
(\$20M–\$100M Annual Revenue)**



\*"M" notation indicates "millions."

"Design-Build Risk and Insurance," Copyright © International Risk Management Institute, Inc.

# Definitions/Terminology Related to Joint Ventures

## BLACK'S LAW DICTIONARY SIXTH EDITION

Community of Interest

### Joint Venture Corporation

A corporation which has joined with other individuals or corporations within the corporate framework in some specific undertaking commonly found in oil, chemical, electronic and atomic fields.

### Joint Adventure

Any association of persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill and knowledge. A "joint adventure" exists where there is a special combination of two or more persons jointly seeking to profit in some specific venture without actual partnership or corporate designation; it is an association of persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill and knowledge.

### Joint & Several Contracts

Contracts in which the parties bind themselves both individually and as a unit (jointly).

### Joint & Several Liability

Describes the liability of copromisors of the same performance when each of them, individually, has the duty of fully performing the obligation, and the obligee can sue all or any of them upon breach of performance. A liability is said to be joint and several when the creditor may demand payment or sue one or more of the parties to such liability separately, or all of them together at his option. A joint and several bond or note is one in which the obligors or makers bind themselves both jointly and individually to the obligee or payee, so that all may be sued together for its enforcement, or the creditor may select one or more as the object of his suit.

Term also refers to the liability of joint tortfeasors (i.e., liability that an individual or business either shares with other tortfeasors or bears individually without the others).

### Joint Enterprise— Also called "Common Enterprise"

The joint prosecution of common purpose under such circumstances that each has authority express or implied to act for all in respect to the control, means or agencies employed to execute such common purpose. The necessary elements are: (1) an agreement among the group's members, either express or implied; (2) a common purpose that the group intends to carry out; (3) community of pecuniary interest among members of the group in that purpose; and (4) an equal right to a voice in control and direction of the enterprise which gives an equal right of control.

### Joint Liability

Liability that is owed to a third party by two or more other parties together. One wherein joint obligor has right to insist that co-obligor be joined as a condendant with him, that is, that they be sued jointly.

### Jointly

Unitedly, combined or joined together in unity of interest or liability. In a joint manner; in concert; not separately; in conjunction. To be or become liable to a joint obligation. Participated in or used by two or more held or shared in common.

### Joint Negligence

In case of "joint negligence" of several people, proximately causing accident, they act together in concert and either do something together which they should not do or fail to do something which they are together obligated to do under circumstances.

### Joint Tort

Where two or more persons owe to another the same duty and by their common neglect such other is injured, the tort is "joint".

### Joint Tort-Feasors

Term refers to two or more persons jointly or severally liable in tort for the same injury to person or property. Those persons who have acted in concert in their tortuous conduct and are, accordingly jointly and severally liable. Those who act together in committing wrong, or whose acts if independent of each other, unite in causing single injury.

### Joint Venture

A legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit. An association of persons or companies jointly undertaking some commercial enterprise; generally all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit and losses.

A one-time grouping of two or more persons in a business undertaking. Unlike a partnership, a joint venture does not entail a continuing relationship among the parties. A joint venture is treated like a partnership for federal income tax purposes.

### Several Liability

Liability separate and distinct from liability of another to the extent that an independent action may be brought without joinder of others. Exists where each of the parties specifically promises to be individually bound, using language such as "each of us makes this promise severally, not jointly."

# TEAMING AGREEMENT RISK ISSUES

## TEAMING RISK ISSUES

- Cost of materials and preparations: Which team member bears the cost? When will these costs be paid, and from what source?
- Bonding requirements: What are the owner's desires? What is required by the teaming agreement? What is a surety willing to bond?
- Acceptance of the design-builder as the team leader for both the design and construction aspects of the project
- Front end costs: Maneuver to designate an artificially high value on the schedule of values for early contractual activities (mobilization to site, office costs, equipment rental, etc.) so that the party may improve cash flow. Is this acceptable by the team or should it be avoided?
- How will front end costs be handled if there is a delay in the project?
- The role and responsibility of each team member
- Withdrawal by a team member
- Dispute resolution between team members

# Joint Venture Liability

## General Liability

### COMPLETED OPERATIONS COVERAGE FOR PAST JOINT VENTURES

The following is added to Section II—Who Is an Insured:

5. With respect to the “products-completed operations hazard,” you are an insured for your liability arising out of the conduct of the partnerships(s) or joint venture(s) listed in the schedule below. This coverage will not inure to the benefit of any party except you.

## Insured Partnerships/Joint Ventures:

### BLANKET COVERAGE—CURRENT AND PAST JOINT VENTURES

The following is added to Section II—Who Is an Insured:

5. With respect to “your work,” you are an insured for your liability arising out of the conduct of any partnership or joint venture of which you are or were a partner or member, even though such partnership or joint venture is not shown as a Named Insured in the Declarations. This coverage is excess over any available liability insurance purchased specifically to insure the partnership or joint venture.

This coverage will not inure to the benefit of any party except you.

Contractors normal CGL coverage excludes losses due to design errors:

- Exclusion—Contractors—Professional Liability Endorsement—CG 22 79
- Limited Exclusion—Contractors—Professional Liability Endorsement—CG 22 80
- Exclusion for Damage to Contractor’s Own Work
- Coverage must be triggered by actual bodily injury or property damage

CGL Contractual Liability insurance limitations for design liability:

- Definition of insured contracts
  - Obligations to indemnify an architect or engineer for injury or damage arising out of professional services are not “insured contracts”
  - An insured architect or engineer’s obligations to indemnify another for liability arising from the insured’s rendering or failure to render professional services are not “insured contracts”.

**Differences between General Liability and Professional Liability Policies**

|                                   | <b>Contractors General Liability</b> | <b>Architects &amp; Engineers Professional Liability</b> |
|-----------------------------------|--------------------------------------|--|
| Policy Form                       | Occurrence                           | Claims Made  |
| Coverage Trigger                  | Bodily Injury or Property Damage     | Negligent Professional Acts                              |
| Coverage for "Pure Economic" Loss | No                                   | Yes  |
| Contractual Liability             | Yes                                  | No   |

**Limitations/Cautions with relying on design party's practice professional liability insurance to cover Joint Venture design liability:**

- **"Aggregate" limits:**
- **Limited contractual coverage:**
- **Low limits:**
- **Policy covers *only* the insured:**
- **Negligence versus design error:**
- **Potential for cancellation of design subconsultant's professional liability coverage:**
- **Design subconsultant cannot pay its deductible after a loss:**

# **SAMPLE JOINT VENTURE AGREEMENT OUTLINE**

## **1. PARTIES**

- 1.1. Affiliates
- 1.2. Third Parties
- 1.3. Definitions
- 1.4. Name

## **2. PURPOSE**

## **3. ADMINISTRATION**

- 3.1. Establishment of Committees
- 3.2. Executive Committee
  - 3.2.1. Authority and responsibilities of Executive Committee
- 3.3. Operation Committee
  - 3.3.1. Authority and responsibilities of Operations Committee
- 3.4. Business Development Committee
  - 3.4.1. Authority and responsibilities of Business Development Committee
- 3.5. Process Improvement facilitators

## **4. PROJECT TYPES**

- 4.1. Domestic EPC Contracts
- 4.2. Projects from Third Parties
- 4.3. International Projects
- 4.4. Other Projects

## **5. DEVELOPMENT COSTS**

## **6. PROJECT PURSUIT**

- 6.1. Identification of Projects
- 6.2. Pursuit of Projects

- 6.3. Limits of Authority
- 6.4. Terms of Joint Participation after Award
- 6.5. Project Agreement

**7. INFORMATION SYSTEMS**

- 7.1. Cost information

**8. CONFIDENTIALITY**

**9. PERSONNEL EXCHANGE**

**10. TERM & TERMINATION**

- 10.1. Termination
- 10.2. Effect of Termination

**11. PARENT COMPANY GUARANTEES**

**12. EXCHANGE OF FINANCIAL DATA**

**13. INDEMNITY**

- 13.1. Employee Claims
- 13.2. Acts of Employees
- 13.3. Third-Party Claims
- 13.4. Benefit of the Parties

**14. WAIVER OF CONSEQUENTIAL DAMAGES**

**15. EPC TERM SHEET (APPENDIX D)**

**16. ASSIGNMENT**

**17. INSURANCE (APPENDIX E)**

**18. BONDING**

**19. ADDITION OF THIRD PARTIES**

**20. DEFAULT**

- 20.1. Default under this agreement
- 20.2. Default Under Any Project Agreement

- 21. DISPUTE RESOLUTION**
- 22. ASSIGNMENT OF PERSONNEL TO AWARDED PROJECTS**
- 23. ENGINEERING AND CONTRACTOR'S LICENSES**
- 24. RECORD KEEPING AND RETENTION**
- 25. INTELLECTUAL PROPERTY**
- 26. NOTICE PROVISIONS**
- 27. GOVERNING LAW**
- 28. AMENDMENT AND MODIFICATION**

## **LIST OF APPENDICES**

- APPENDIX A      INVOICING TO THE JOINT VENTURE
- APPENDIX B      MODEL PROJECT AGREEMENT (Joint Venture Form)
- APPENDIX C      PARENT COMPANY GUARANTY FORM
- APPENDIX D      EPC TERM SHEET
- APPENDIX E      INSURANCE REQUIREMENTS
- APPENDIX F      (reserved)
- APPENDIX G-1    AGREEMENT FOR TEMPORARY ASSIGNMENT OF PERSONNEL—JV PARTNER A
- APPENDIX G-2    AGREEMENT FOR TEMPORARY ASSIGNMENT OF PERSONNEL—JV PARTNER B

## **APPENDIX B MODEL PROJECT AGREEMENT (Joint Venture Form)**

- 1. Project Description**
- 2. Proposal**
- 3. Formation of Joint Venture**
- 4. Participating Interests**
- 5. Project Management Committee**
- 6. Project Management Team**
- 7. Project Executive**
- 8. Capital**
- 9. Default**
  - a. Suspension of Participation in Profits
  - b. Suspension of Voting Rights
  - c. Voluntary Loan to Joint Venture
  - d. Loan obtained from Third Party by Joint Venture
  - e. Assignment of Profits, Proceeds and Other Distributions
  - f. Defaulting Party's Liabilities
- 10. Repayment on Demand**
- 11. Reinstatement of a Defaulting Party's Rights**
- 12. Assumption of Participating Interest; Share of Losses**
- 13. Remedies Not Exclusive; Special Performance**
- 14. Bank Accounts**
- 15. Distribution**
- 16. Losses**
- 17. Books and Records**
- 18. Expenses of the Joint Venture**

- 19. Insurance (note there may be other requirements on a project specific basis, i.e. environmental, builder's risk, etc.)**
  - a. Professional Liability
  - b. Commercial General Liability
  - c. Automobile Liability
  - d. Workers Compensation and Employers Liability
- 20. Indemnity**
  - a. General Indemnity
  - b. Exception to General Indemnity
  - c. Acts of Employees
  - d. Application of Indemnities
  - e. Benefit of the Parties
- 21. Tax Returns**
- 22. Equipment**
- 23. No Right to Create Obligation**
- 24. No Right to Accept Process**
- 25. No Right to Borrow Money**
- 26. Payment and Performance Bonds**
- 27. Transfer of Interest in Joint Venture**
- 28. Modifications to Agreement**
- 29. Governing Law**
- 30. Termination**
- 31. Confidentiality**
- 32. WAIVER OF CONSEQUENTIAL DAMAGES**
- 33. Legal Representation**
- 34. Severability**
- 35. Dispute Resolution**
- 36. Safety Practices**

**APPENDIX D**  
**MAJOR COMMERCIAL TERMS**  
**GENERATING STATION**

---

OWNER

CONTRACTOR

CONTRACT SCOPE

OWNER RESPONSIBILITIES

CONTRACT PRICE

PAYMENT TERMS

PERFORMANCE SECURITY

SCHEDULE GUARANTEES

LIQUIDATED DAMAGES

CHANGES AND FORCE MAJEURE

WARRANTY

INDEMNITY AND LIABILITY INSURANCE

RISK OF LOSS AND PROPERTY INSURANCE

LIMITATION OF LIABILITY

SUBCONTRACTORS AND SUPPLIERS INTELLECTUAL PROPERTY

SUSPENSION

TERMINATION FOR DEFAULT

TERMINATION FOR CONVENIENCE

GOVERNING LAW AND DISPUTE RESOLUTION

**DESIGN ADEQUACY RISK FOR CONSTRUCTORS ARISING OUT OF  
PRIME CONTRACTUAL OR JOINT VENTURE RELATIONSHIPS  
WITH DESIGN PROFESSIONALS ON  
DESIGN-BUILD PROJECTS:  
RISK ALLOCATION/MANAGEMENT AND INSURABILITY  
CONSIDERATIONS**

---

**David J. Hatem  
Donovan Hatem LLP**

In the Design-Build delivery method (“Design-Build”), a construction contractor (“Constructor”) contractually priming or leading the Design-Build team or in joint venture with a design professional, undertakes responsibility for the adequacy of the final project design. This outline will survey some of the more important contractual risk allocation/management and insurability issues pertaining to the design adequacy risk exposure of Constructors in such relationships on Design-Build projects.

**1. What is design adequacy risk exposure?**

In general terms, design adequacy risk is the risk that one assumes by virtue of either (a) actually performing design services; and/or (b) vicariously or otherwise legally assuming responsibility for design services performed by or delegated to others. Design adequacy risk exposure may lead to professional liability claims against a party who assumes that risk. In more specific terms, design adequacy risk is the risk that design is deficient in one or more respects, including errors or omissions; failure to meet contractual or professional standards; incompatibility of, and/or inappropriate design relative to project objectives or requirements; and conflicts, inconsistencies and ambiguities in the design development and finalization process. This risk exists in the context of both design of temporary work (e.g. construction means, methods, techniques, sequences or procedures of construction—“construction means/methods”) and permanent project work. Design adequacy risk is to be distinguished from legal liability; whether the occurrence of such risk exposes one to legal liability depends upon contractual and legal standards and considerations.

In the Design-Bid-Build delivery method (“Design-Bid-Build”), Constructors typically have design adequacy risk exposure regarding their construction means/methods design obligations; that exposure duration is relatively limited given the temporary and incidental character of construction means/methods and, to the extent that problems do occur, they generally result in bodily injury/property damage, as distinct from economic loss.<sup>1</sup>

---

<sup>1</sup>In circumstances in which design of permanent project work is delegated to a Constructor on a Design-Bid-Build project, the Constructor’s design adequacy risk exposure will be similar to that of the Constructor in Design-Build, albeit restricted to the delegated design and potentially its interface with other portions of the non-delegated project design. [Cite DJH Design Delegation article—June 1998].

In Design-Build, the Constructor, leading the Design-Build team or in joint venture with a design professional typically has design adequacy risk exposure for both construction means and methods and the final design of permanent project work for which it directly (by contract) and/or indirectly (by delegation or assignment to one or more design professionals) assumes responsibility. In respect of design adequacy risk relating to permanent project work, the period of exposure is significantly longer (potentially, the life span of the project, unless limited by contract provision and/or statute of limitations or repose), and typically manifests in not only bodily injury/property damage, but also economic loss.

## **2. To what degree does a Constructor as prime in Design-Build have design risk exposure?**

As the prime in Constructor-led Design-Build, the Constructor typically, by contract, has single point responsibility to the project Owner for the both the design and construction of the Project. The terms of the Design-Build Agreement will define the nature and extent of the Constructor's responsibility for inadequate or defective design [cite chapter of my Design-Build book]. Even though the Constructor may delegate design services and/or responsibility to one or more Design Professional Subconsultants, and even though the Constructor may be entitled to indemnification from those subconsultants, the Constructor, as prime, remains contractually responsible to the project Owner for defects or inadequacies in the design.

Final design risk exposures

- Deficient or inadequately developed in accordance with the Owner-furnished preliminary design or performance specifications
- Errors, omissions or other inadequacies or deficiencies in the Design-Builder's development and finalization of the design
- Failure of the Design-Builder to coordinate the design development performance of its multiple prime design professional consultants, all of which are under direct contract with the Design-Builder
- Failure of the Design-Builder to construct the project in accordance with approved design and/or contract documents

Other Professional Liability Risk Exposures

- Failure to perform on time
- Error/Omissions Preliminary Design Evaluations, estimating, recommendations upon which Design-Builder relied in negotiating prime agreement
- Error/Omissions in understanding/interpreting Owner/Furnished Preliminary Design, Performance Specs or information (such as site information) furnished by Owner
- Construction means and methods design
- Geotechnical and environmental exposure

- Cost estimating during design development
- Indemnity and warranty claims
- Field advice/decision making
- Failure to cooperate or efficiently manage the design professional subconsultant(s)
- Heightened risk arising out of unfair risk allocation in prime agreement (e.g. differing site conditions)
- Underestimation of level of design effort
- Prescriptive designs vs. performance/preliminary design
- Risk due to limited construction phase involvement
- Unavailability of betterment defense
- Design-Builder's *Spearin* obligation to subcontractors
- Design-Builder's *Spearin* obligation to Owner
- *Spearin* "gap"-related liability exposures
- Defective product/system design
- Cost overrun claims
- Breach of fiduciary duty
- Risk associated with working for a construction contractor leading the Design-Build team
- Design-Builder business risk or loss due to professional liability?
- Redesign cost/consequential delay impact of redesign
- Disputes regarding design professional fees—inefficiencies, mismanagement, lack of coordination, redesign, timeliness
- Conflict of Interest Claims

In addition to its design adequacy risk exposure to the project Owner, the Constructor typically owes an implied warranty or *Spearin* obligation to those, such as trade subcontractors—to whom

it furnishes detailed and final design for use in the construction of the project.<sup>2</sup> Under the *Spearin* implied warranty principle, the party which furnishes detailed and final design to another for use in construction impliedly warrants that the design is complete, accurate, adequate and suitable for construction of the project and that, if followed, and found to be deficient in any of those respects, the recipient of that design will not be held responsible for the consequences thereof and may be entitled to a remedy of damages incurred as a result.

Significantly, the *Spearin* implied warranty obligation for defective design is broader than design liability predicated upon the negligence-based professional standard of care. Under the latter standard, a design professional is expected to exercise reasonable care, skill and diligence in the preparation of design documents and is not obligated to produce an error-free or perfect design (unless it has contractually agreed to do so, [cite DJH cost recovery article]). The *Spearin* implied warranty obligation is substantially more expansive requiring, in effect, that the design be defect-free and liability attaches regardless of whether the design was prepared in accordance with the professional standard of care. As such, a Constructor leading the Design-Build team which furnishes detailed design to its trade subcontractors may be subject to liability based upon a

---

<sup>2</sup>The origin of the implied warranty of design adequacy is the landmark United States Supreme Court case of *United States v. Spearin* [citation]. In that case, the Government's detailed plans and specifications required Spearin, a construction contractor, to excavate the site and to relocate and reconstruct a six-foot brick sewer line that intersected the site. After the sewer was relocated and reconstructed, heavy rains caused it to back up which, in turn, created water pressures, which broke the line in several places and flooded the dry dock excavation. The Government insisted that Spearin clean up the site and reconstruct the damaged line at its expense. United States Supreme Court ruled that the Government was liable for breach of its "implied warranty" of the adequacy of the final design depicted and described in the plans and specifications, and that Spearin was not obligated to perform or pay for the corrective work. *Spearin* has been adopted by the vast majority of courts in the United States. Although *Spearin* was initially used in the defensive context by a contractor (i.e. to avoid performing or paying for corrective work), that original application was later expanded to utilize *Spearin* as the basis for offensive or affirmative claims by contractors against project owners for additional costs for direct or indirect impacts occurred by the contractor based on defects in owner-furnished detailed design. See, e.g. *Big Chief Drilling Co. v. United States*, 26 Cl. Ct. 1276, 1304 (1992), in which the Court stated that if defective design specifications issued by the Owner prevent or delay completion of the contract, the contractor is entitled to recover damages for the Owner's breach of the *Spearin* implied warranty obligation. In that case, the Court stated that it is well-established that the Owner warrants the adequacy of design to the extent that compliance with that design will result in "satisfactory performance". In circumstances in which a contractor is delayed or incurs additional cost due to design deficiencies, the contractor is allowed to recover additional costs resulting from delay due to such design deficiencies. [Cite new Construction Briefings Article.]

The *Spearin* doctrine has been discussed and clarified over the years, often with the words "design" and "performance" specifications used to differentiate between contracts for which the design warranty does and does not apply. See *Stuyvesant Dredging Co. v. United States*, 834 F. 2d at 1582; *J.D. Hedin Constr. Co. v. United States*, 171 Ct. Cl. 10, 76-77, 347 F. 2d 235, 241 (1965); *Utility Contractors, Inc. v. United States*, 8 Cl. Ct. 42, 50-51 (1985), aff'd, 790 F. 2d 90 (Fed. Cir.), cert. denied 479 U.S. 827, 93 L. Ed. 2d 53, 107 S. Ct. 104 (1986). The warranty applies only to "design specifications" because only by utilizing specifications in that category does the government deny the contractor's discretion and require that work be done in a certain way. When the government imposes such a requirement and the contractor complies, the government is bound to accept what its requirements produce. "Design specifications explicitly state how the contract is to be performed and permit no deviations. Performance specifications, on the other hand, specify the results to be obtained, and leave it to the contractor to determine how to achieve those results." *Stuyvesant Dredging Co. v. United States*, 834 F. 2d at 1582.

Thus, whether the specifications are design or performance specifications is critically important for an understanding of the existence of any "warranty" claims and the parties' respective rights and obligations. The United States Court of Appeals for the Federal Circuit spoke to this issue, as follows:

Performance specifications "set forth an objective or standard to be achieved, and the successful bidder is expected to exercise his ingenuity in achieving that objective or standard of performance, selecting the means and assuming a corresponding responsibility for that selection." ... Design specifications, on the other hand, describe in precise detail the materials to be employed and the manner in which the work is to be performed. The contractor has no discretion to deviate from the specifications, but is "required to follow them as one would a road map."

breach of the design adequacy implied warranty obligation, even though that Constructor (or its design professional subconsultants) may have satisfied the professional standard of care and even though the Constructor may not be able to recover against its design professional subconsultant in the absence of proof of the more stringent professional standard of care requirement [cite Hatem, Subsurface Conditions].

**3. To what degree does a Constructor in a prime joint venture relationship with a Design Professional on a Design-Build Project have design adequacy risk exposure?**

In some situations, Constructors and design professionals enter into joint ventures and in that combined capacity lead or prime the Design-Build Agreement with the Project Owner. As a general matter, a joint venture is a specialized partnership formed for a particular or dedicated purpose; it is not a separate or distinct legal entity. Joint venture partners who enter into a contract are jointly and severally responsible or liable to their contracting partner (i.e. the project owner) for the entirety of their contractual obligations and performance; if either joint venture partner breaches, the other contracting partner (i.e. the project owner) has the election to pursue appropriate legal remedies against either the breaching joint venture partner, the other (“innocent”) joint venture partner, or both of them.<sup>3</sup> While it is possible to vary these general rules by provisions in the prime Design-Build Agreement between a project owner and the joint venture partners which limit the responsibilities of each joint venture partner—say, for example, that the Constructor is responsible only for construction and the design professional only for design—this differential allocation approach is not likely to succeed or be attractive to most project owners who chose the Design-Build method since it would contradict or undermine the hallmark Design-Build principle of single-point responsibility under which one party—the Design-Builder—in direct contractual privity with the owner is singularly responsible for both the design and construction of the project [cite DJH Subsurface Conditions].

Similarly, while it is possible for the joint venture partners to allocate risk between themselves, reinforced by appropriate cross-indemnity and corresponding insurance protections (see question and answer number 6 below), such risk allocation provisions will not relieve each joint venture partner of its contractual and other legal obligations to the project owner for design adequacy risk as stated above, the hallmark single-point responsibility principle of Design-Build would be undermined and subverted through such an allocated and differential allocation of risk approach, leading to fragmentation of responsibility and erosion of the single-point principle.

Thus, as a general matter, a Constructor in a prime joint venture relationship with the design professional on a Design-Build Project will have substantially the same design adequacy risk exposure discussed previously in response to question 2. See *Bruner & O’Connor on Construction Law*, §7:58 (2002).

**4. What types of provisions in a prime Design-Build Agreement may impact design adequacy risk and related professional liability claim exposure?**

There are several provisions in a prime Design-Build Agreement that may impact design adequacy risk and related professional liability exposure of Constructors in a prime contractual or joint venture relationship. While the relevance and applicability of some of these provisions may be more apparent than others, all of these provisions have a potential impact on such exposures.

- Standard of care.
- Warranty obligations.

<sup>3</sup>Since the joint venture is not a distinct legal entity typically it lacks capacity to be sued as an entity and the appropriate legal recourse is against the joint venture partners [cite Wright & Miller, Rule 17].

- Performance guarantees—extent and qualifications.
- Scope of services.
- Coordination of multiple design disciplines.
- Time for service performance/liquidated damages.
- Extent of cost guaranty.
- Risk allocation provisions.
  - Differing site conditions.
  - Site information responsibility.
  - Design responsibility—preliminary and final.
- Redesign
- Responsibility for consequential damages.
- Design to cost—fixed limit.
- Responsibility for permit, regulatory and code issues—obtaining/compliance.
- Degree of owner involvement in review/approval of Design-Builder’s design development submissions.

**5. To what extent may a Constructor solely or in joint venture leading a Design-Build team contractually limit design adequacy risk exposure?**

Some of the more important contractual provisions that may serve to limit design adequacy risk exposure include a negligence-based standard of care; limitations or disclaimers of consequential damage exposure; and limitation of liability. In agreements between the prime Constructor and its trade subcontractors, efforts may be made to negate the otherwise applicable *Spearin* implied warranty obligation through the inclusion of provisions limiting responsibility for design adequacy to a negligence-based standard. As a general proposition, expressed disclaimers of implied warranty obligations unambiguously restricted to specific risks are upheld. See *Massachusetts Bay Transp. Authority v. United States*, 129 F. 3d 1226 (Fed. Cir. 1997) (warranty disclaimer construed to exclude owner liability for negligence); *J.F. White Contracting Co. v. Massachusetts Bay Transp. Authority*, 40 Mass. App. Ct. 937 (1996) (owner’s implied warranty obligations disclaimed by clear and specific disclaimer). In such circumstances, however, the Constructor should expect the trade subcontractors will price and include contingency for the heightened risk of deficient (non-negligent) design in bidding or pricing the work.

In addition, consistent with generally accepted risk allocation principles, design adequacy risk should only be contractually assumed in circumstances in which one has sufficient control over the design development and finalization process. More specifically, a Constructor should not assume responsibility for preliminary design developed by others and furnished by an owner in the Request for Proposal unless it is reasonably satisfied and comfortable with that preliminary design [cite *Hammett*]; and, similarly, a Constructor should be reluctant to accept unqualified and absolute final design responsibility in circumstances in which the Owner and/or its design professional consultant will control and dominate the design development and finalization process

through an overly intrusive role and/or plenary authority in the review/approval of final design. [Cite Hatem *Subsurface Conditions*].

## 6. To what extent is the risk of defective design insurable?<sup>4</sup>

A Constructor may have coverage for inadequate design risk exposure under various types of insurance policies. The following outlines potentially applicable coverages:

- Commercial General Liability Coverage—Professional Liability Exposure
  - C.G.L: Typically standard form covers professional liability exposure but policies issued to contractors and design professionals routinely are endorsed to exclude such coverage
  - Definition of “insured contract” which determines the scope of coverage for contractual-assumed liabilities, specifically does not include the assumption of a design-professional’s liability; nor does it include the assumption by an A/E insured of another’s liability for the A/E’s provision of professional services
  - Limited buy-back of coverage under certain endorsements—but these are not likely to cover claims involving economic loss or design of *permanent* work, as distinct from construction means and methods.
- Contractor’s Professional Liability Insurance
  - Vicarious or contingent E/O versus direct liability exposure
  - Contractual Indemnity
  - Construction means and methods not professional services (designed to reduce risk of overlap between CGL and Contractor’s professional liability coverage)
- Professional Liability Insurance
  - May be procured on non project-specific basis by virtually all Design-Build project participants, except Owner (unless on Owner’s protective basis).
  - Retroactive date/prior acts (pre-award services)
  - More than one Design-Build team member may (will) have professional liability insurance
  - Coverage typically is negligence-based
    - Contractual liability/warranty exclusion
    - Design-Build exclusion
    - Equity interest/common management exclusion

<sup>4</sup>This subject is discussed in greater detail in [cite IRMI, Design-Build book].

- Definition of "damages" (fee withdrawal)
  - Joint Venture exclusion
  - "Affiliate" claims
  - Definition of "Professional Services"
  - Aggregate limits—defense costs within limits
  - Typically (and soundly) no additional insured status for Owner and/or Design-Builder
- Builder's Risk Insurance
    - All risk/no fault/damages during construction
    - Design error exclusion
    - Modification of design error exclusion

By way of general observation, note the following:

- Under most circumstances, all Design-Build project participants may be covered under one or more practice policies for their respective professional liability exposures for design adequacy risk.
- Primary coverage reliance should be placed on a professional liability policy.
- Under many circumstances, more than one practice policy could be applicable to any professional liability claim.
- Joint defense of professional liability claims is more challenging when relying solely upon practice policies.
- Reliance on practice policies increases subrogation claim potential.
- Difference in deductibles/retention levels could influence the direction in which claims are asserted/settled.
- Need to align coverage with contractual indemnification.
- Reliance on practice coverages creates enormous potential for coverage disputes, cross-claims and subrogation claims.

**7. Are there any special issues under a project-specific professional liability policy relating to insurability of design adequacy exposure on a Design-Build project?**

Although, in general, project-specific professional liability insurance policies solve many of the issues associated with insurability of professional liability claims on a Design-Build project, there

are a number of important considerations which must be taken into account in the procurement and design of a project-specific professional liability insurance policy and program.

- Project-Specific Professional Liability Insurance In the Design-Build Context: Some Issues
  - General Considerations
    - Definition of Project-Specific Professional Liability Insurance
    - Appropriate for what size (construction value) project?
    - Who is Insured?
      - o Design-Builder(?)
      - o Design Professional Members of the Design-Build Team
      - o Owner’s Design Professional Consultant(s)
    - Indemnification Endorsement
    - Fee Withdrawal/Definition of “Damages”
    - Joint Defense
    - Retention Allocation
    - Owner As Additional Insured
    - Prior Acts
- Professional Liability Claims Between Insureds:
  - Insured v. Insured Exclusion
    - In general, centrality of Insured v. Insured exclusion and joint defense provisions to the success of the Project-Specific insurance approach.
    - Are those provisions, however, always sensible and workable in the Design-Build Project-Specific Insurance context?
    - Indemnification endorsement works most of the time, but are there other options?
- Claims by one insured against another insured under a project-specific policy.
  - *Derivative Claims*: (for example, third-party (not insured under the project-specific policy, such as the Project-Owner) asserts a primary claim against Insured No. 1. Based on that *primary* claim, Insured No. 1 may have a *derivative* claim against Insured No. 2 based on negligence, indemnification or contribution.

Under most project-specific policies, such *derivative* claims would be precluded (and coverage therefore negated) under the Insured v. Insured exclusion and/or Joint Defense provision.

In this *derivative* context, there is probably no good reason to modify the Insured v. Insured exclusion or Joint Defense provision.

- *Independent Claims*: Insured No. 1 asserts a direct and independent (primary) claim against Insured No. 2—i.e. a claim which does not arise out of or derive from a third-party claim against Insured No. 1. Example: Insured No. 1 has an agreement with the Project Owner under which Insured No. 1 is obligated to provide a design that meets the professional standard of care. Insured No. 1 retains Insured No. 2, a design professional, to design a particular portion of the project. The agreement between Insured No. 1 and Insured No. 2 obligates the latter to indemnify Insured No. 1 for claims, liabilities, losses and expenses to the extent caused by Insured No. 2's failure to furnish design that adheres to the professional standard of care. Insured No. 2 furnishes defective design to Insured No. 1 that fails to meet the professional standard of care for the design that Insured No. 1 is required to furnish to the project owner. As a result, Insured No. 1 incurs substantial fees in redesigning the project. Insured No. 1 is not able to recover additional compensation from the project owner to cover those substantial fees because the project owner takes the position (which is legally correct) that Insured No. 1 is obligated to provide a design that meets the professional standard of care and any failure of Insured No. 2, as a subconsultant to insure No. 1 to satisfy that standard is the contractual and financial responsibility of Insured No. 1.
- Under a Project-Specific Policy, Insured No. 1 would be precluded from asserting (and denied coverage for) any such "independent" claim that it would make against Insured No. 2 arising out of the circumstances. The short answer from most Professional Liability insurers to Insured No. 1's dissatisfaction in this scenario is that this type of independent claim represents a "business risk" and, beyond that, to allow coverage for such a claim would be disruptive of the Joint Defense approach and violate the Insured v. Insured exclusion, and, in any event, the project owner who paid the premium would not benefit from the assertion of (or coverage for) such a claim. Insured No. 1 would respond by saying that while that may be the case, in the absence of the Project-Specific Policy, Insured No. 1 would be able to pursue its independent claim against Insured No. 2 based upon a right of contractual indemnification (predicated upon a violation of the professional standard of care) from Insured No. 2 and Insured No. 2 would be covered for such a claim under its practice professional liability policy. Simply put, Insured No. 1 would be saying that the Project-Specific policy stands in the way of (and subverts) its ability to pursue its negotiated contractual rights against Insured No. 2 and thereby mitigate its corporate exposure to the pursuit of an independent claim against Insured No. 2 that will be covered by the latter's practice professional liability insurance.
- What are the policies and underwriting concerns that underline the preclusion of, and coverage exclusion for, such "independent" claims?
  - Distinguishing between "business" risk of Insured No. 1 and Insurable Risk
  - In the practice policy context, the following advice typically would be given to affirm in the position of Insured No. 1 in terms of risk allocation protection: (i) make sure

that your contractual standard of performance obligation to the project owner is consistent with the professional standard of care and, hence, “insurable” under your professional liability practice policy in the event of a claim by the project owner; (ii) make sure that the latter obligation is “flowed-down” to your subconsultants—for example, Insured No. 2—in the form of an indemnification obligation that is consistent with the professional standard of care and, thereby, insurable under Insured No. 2’s practice professional liability policy; and (iii) make certain that Insured No. 2 has professional liability insurance coverage for its errors/omissions exposure including indemnification claims by Insured No. 1 based upon Insured No. 2’s failure to meet the professional standard of care.

- This advice would be fairly standard. The thrust of the advice would be (a) to align Insured No. 1’s contractual performance standards and result in professional liability risk exposure with Insured No. 1’s own professional liability practice insurance coverage; and (b) to allocate to Insured No. 2 indemnification risk consistent with the professional standard of care and thereby maximizing the availability of Insured No. 2’s professional liability insurance to cover the latter’s exposure to Insured No. 1 for Insured No. 2’s failure to meet that standard. In other words, the overall intent is to transfer risk from the “business” risk category to the “insurance” risk category.
- Why should the achievability of this result be any different when a project-specific policy has been procured?
  - The Insured v. Insured exclusion and Joint Defense provisions of a project-specific policy serve the legitimate and salutary objectives of (a) eliminating “cost-claims” among design professionals who are insured under the policy; (b) facilitating the resolution of professional liability claims by promoting the joint defense of those claims; (c) maximizing the availability of coverage for claims of the project owner (who, for the most part, are the primary claimants and procure and pay the premium); and (d) reduce the risk that policy proceeds will be utilized (reduced) by the payment of claims that should be self-absorbed as “business” risk. A broader, but often less-articulated, objective would be that from an overall perspective, the advantages of project-specific coverage (dedicated and guaranteed coverage limits for a specific duration with joint defense of “derivative” claims among design professionals) outweigh the fact that in all respects the project-specific coverage may not necessarily equate with the coverage that may exist or be available to any participating design professional in the absence of such a policy. Another way of saying the same thing is that the project-specific policy is procured for the “greater” benefit of the entire project and, in so doing, individual design professionals may need to relinquish some individual aspects of practice coverages that otherwise would be available to insure professional liability risk.
- Is there a reasonable accommodation that will allow, at least to a qualified degree, certain *independent* claims by one insured to be pursued against another insured and provide coverage for such claims?
  - If so, how do we deal with and balance the other salutary objectives of project-specific professional liability insurance—i.e. reducing cross-claims and adversarial relations among insured members of the project team—especially on a Design-Build Project—and facilitating/expediting the resolution of such claims (without

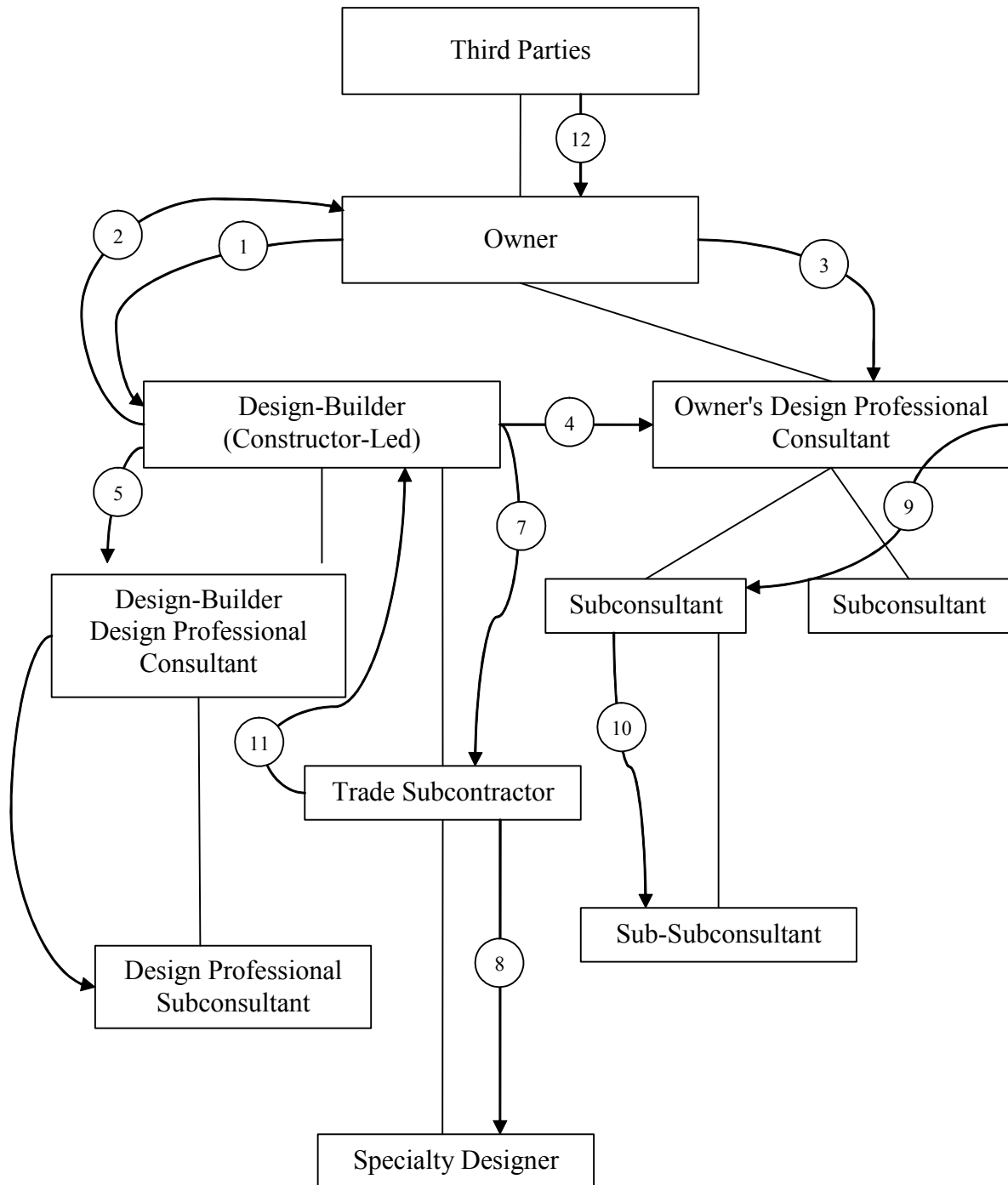
compromising the integrity and utility of the joint defense approach in connection with third-party claims against the insureds)

- The conceptual solution is somewhat of a hybrid between a third-party liability coverage and a first-party coverage. More specifically, and focusing on the hypothetical claim scenario above between Insured No. 1 and Insured No. 2, like a third-party coverage, Insured 1 would need to identify the design professional (i.e. Insured No. 2) which caused Insured No. 1 to incur a loss due to an event otherwise insured under the project-specific policy and Insured No. 1 would be required to establish legal liability of Insured No. 2 that falls within the scope of coverage otherwise afforded under the project-specific policy; the professional liability insurer (perhaps with the assistance of a program manager) would evaluate the claim and the insurer would ultimately determine merit, and the latter determination would be final (i.e. Insured No. 1 would have no right to pursue the claim against Insured No. 2—or the insurer—through litigation, or otherwise). Like a first party coverage, however, the professional liability insurer may limit the amount (subject to the higher retention amount) and/or type of recoverable (insured) damages for the “loss” I, for example, excluding coverage for indirect expense (overhead) or other consequential damages allegedly incurred by the claimant, Insured No. 1.

**8. What are examples of design adequacy risk and related professional liability claims on a Design-Build project in which a Constructor primes or joint ventures with a design professional?**

The following diagram depicts design adequacy risk and professional liability claims on a Design-Build project in which the Constructor is the prime. The Constructor has virtually the same risk and liability claims exposure when it joint ventures with a design professional.

## EXAMPLES OF PROFESSIONAL LIABILITY CLAIM SCENARIOS CONSTRUCTOR-LED DESIGN BUILD



## General Notes

- Arrows indicate potential claims
- The number of claim scenarios will increase dependent upon the number and tiers of Design-Build participants
- The commentary assumes that a separate project-specific Professional Liability Insurance Policy has been bound naming as insureds the Owner's Design Professional Consultant and its Subconsultants, with an Owner Endorsement.
- Under an Owner Endorsement, the professional liability insurer agrees to indemnify the Owner for all costs, expenses, judgments, settlements and attorneys' fees incurred on account of professional liability of the Owner's Design Professional Consultants.
- *Constructor-led*: The various claim scenarios assume that the Design-Build Team will probably be led by a joint venture or construction Contractors who retain design professionals as subconsultants.
- The outline identifies several contractual (see ¶\_\_\_\_\_) provisions that will influence professional liability exposure for the Owner, the Owner's Design Professional Consultant and the members of the Design-Build Team. Contractual provisions will impact not only professional liability exposure for those parties, but also the structure and availability of professional liability insurance required to provide adequate coverage for those exposures. Moreover, the existence of adequate project-specific professional liability insurance coverage should assist in reducing the amount of Design-Builder contingency for anticipated, but unquantifiable exposures due to defective design and subsurface information, and related risk contractually allocated to the Design-Builder. These comments emphasize the advisability and importance of defining, structuring and binding project-specific professional liability insurance prior to or, at the latest, at the same time as contract procurement of the Design-Builder. The latter admonition is reinforced by the need for a coverage retroactive date that coincides with the inception of the first professional service performance which, on a Design-Build Project, typically commences during the RFP response.

## Claims Scenarios

### Claim Scenario 1:

This scenario involves claims by the Owner for breach of contract, breach of express or implied *Spearin* warranties, negligent misrepresentation, breach of fiduciary duty or other related theories arising out of defective final design or performance of the completed project, deficient quality (non-compliance with Contract Documents) of the completed project, late completion or excess costs. Damages to the Owner include direct repair/corrective work costs, payments to third-parties, consequential damage, including revenue loss, directly resulting from professional liability exposure.

**Comments:**

1. The Owner's ability to pursue and succeed on these types of claims will, of course, be dependent upon the standard of care, warranty, design responsibility, risk allocation, differing site condition provisions (if any), subsurface information responsibility, indemnification and related provisions of its Prime Agreement with the Design-Builder.
2. Most Constructors eligible to lead this type of Design-Build Project will either not carry their own (contractor's professional or other) practice professional liability insurance coverage or will have a policy with relatively low, inadequate and non-dedicated limits written on an annually-renewable basis. Any such coverage would likely not name as insureds other members of the Design-Build team and would not contain an Owner Endorsement providing indemnity coverage to the Owner.
3. Most Constructors leading the Design-Build Team would procure their own project-specific policy (especially on a major and complex project) and directly or indirectly obtain reimbursement of the premium from the Owner. Such a policy may or may not include other Design-Build team members as insureds and will likely not name the Owner in an Owner Endorsement (primarily because not requested by the procurer). The Owner would have no ability to control the scope of coverage, specifically tailor and define the scope of "professional services" coverage, define the policy and extended reporting periods, amount of limits, specify who is an insured, as well as influence other important aspects of coverage that may materially and adversely impact the Owner's interest in obtaining the timely and quality completion of the project and in the reduction and streamlining of professional liability claims and in expediting and facilitating the resolution thereof.
4. Depending upon whether the Design-Builder's Design Professional Consultants and their Subconsultants are named as insureds under any such project-specific policy procured by the Design-Builder, it is probable that the Owner's primary claims in Claim Scenario 1, will lead to the assertion of indemnification, contribution or related third or fourth party claims by the prime Design-Builder against its Design Professional Consultant and, in turn, by the latter against its Subconsultants. If not covered by the Design-Builder's project-specific policy, the Design Professional Consultant and its Subconsultants may or may not have any or adequate practice professional liability insurance. In our experience, many specialty designers involved in underground projects have no professional liability practice insurance or barely minimal (e.g. \$500,000) in aggregate limits. Even assuming such professional liability practice coverage, the Owner's primary claim and the result and third or fourth party claims would require the participation of at least three or more professional liability insurers and multiple defense counsel for the respective professionals, the net effect of which would be to delay the resolution of all claims, potential disruption of project progress due to adversarial relations among project participants and other adverse consequences that directly or indirectly impact the Owner in connection with the protraction of claim resolution. There would also be the possibility of subrogation claims among those professional liability insurers and their respective insureds, as well as other parties involved in the project.
5. In addition, it is probable that the Design-Build Design Professional Consultant may procure its own Project-Specific Professional Liability Insurance policy to cover itself and lower-tier engineering subconsultants. Directly or indirectly the Owner would pay the premium cost of such a policy but would not be in a position to influence or control the coverage scope and terms. Also, it is unlikely that any such project-specific policy would contain an Owner Endorsement providing indemnity coverage for the benefit of the Owner.

### **Claim Scenario 2:**

The Design-Builder may assert claims against the Owner based upon breach of contract (potentially including breach of *Spearin* implied warranty obligation) and negligent misrepresentation due to defective Owner-furnished (a) site, subsurface or other project information; and/or (b) preliminary design or performance specifications. The Design-Builder may also claim that the Owner—directly or by its Design Professional Consultant—interfered with, directed or intruded upon the Design-Builder’s design development discretion, or wrongfully altered preliminary design or performance specification requirements or criteria.

### **Comments:**

1. The viability (and, hence, defensibility) of these types of claims will substantially depend upon contractual provisions in the Design-Build Agreement pertaining to use of, reliance upon and/or disclaimers of Owner-furnished site, subsurface or other project information and allocation of risk provisions relating to owner-furnished preliminary design and/or performance specifications. The degree of completeness of the Owner-furnished information and/or design should be an important consideration in making decisions about these types of contract provisions. With respect to the defense of Design-Builder claims alleging that the Owner and/or its Design Professional Consultant interfered with, directed or intruded upon the Design-Builder’s design development discretion, or wrongfully altered preliminary design or performance specification requirement or criteria, it should be noted that contract provisions defining the scope and purpose of the Owner’s (and/or its Design Professional’s Consultant’s) review of the Design-Builder’s design development submissions will play an important role. The authority of the Owner and/or its Design Professional Consultant should be specifically defined in the Design-Build Agreement with respect to the review and final action (“approval”, “no exceptions taken”, etc.). The Design-Build Contract Documents should also define and establish a procedure under which the Design-Builder is required to provide prompt notice of any action, statement or other conduct of the Owner and/or its Design Professional Consultant which the Design-Builder considers to constitute a change in the scope or terms of its contractual obligations, including any changes in the base preliminary design criteria or concept and/or performance specification requirements. Design-Build submittal review stamp language should be prepared which is consistent with the contractually-defined scope and purpose of the submittal review. Finally, and as important as contract provisions, the Owner and its Design Professional Consultant should always conduct themselves in accordance with their contractually-defined role and within the limits of authority set forth in the Design-Build Agreement.
2. The Owner should have indemnification coverage for such claims under an Owner Endorsement issued in connection with the Owner’s Design Professional Consultant’s project-specific policy.

### **Claim Scenario 3:**

The Owner may have direct claims for negligence and/or breach of contract against its Design Professional Consultant arising out of defects in the preliminary design-performance specifications; failure to adequately represent its interests in connection with the Design-Builder’s design development and construction of the Project; failure to perform services on time; negligent development and/or preparation or description of site, subsurface or other information furnished to the Design-Builder; and/or negligent cost estimating. In addition, the Design Professional Consultant may have derivative for third-party claims against its Subconsultants arising out of circumstances presented in Claim Scenario 2.

**Comments:**

1. The Owner would be allowed to pursue, and would have indemnity coverage for, such claims under the Owner's Endorsement to the Owner's Design Professional Consultant's Project-Specific Policy. Similarly, to the extent that the Owner's primary professional liability claims involve professional services of the Owner's Design Professional Subconsultants, such claims would also be covered under the Owner's Design Professional Consultant's Project-Specific Policy since the subconsultants would be insured under that policy. The joint defense provision and the insured v. insured exclusion would preclude "third-party" claims by the Owner's Design Professional Consultant against its subconsultants, thereby expediting and facilitating the resolution of the Owner's primary claims and conserving policy limits for satisfaction of the Owner's claim (rather than exhausting those limits through unnecessary expenditure of legal fees and claims expenses incurred on behalf of the independent defense of each member of the Owner's Design Professional Consultant—prime and sub-tier—team whose services are implicated in the Owner's primary claims.

**Claim Scenario 4:**

The Design-Builder may assert claims against the Owner's Design Professional Consultant which are based upon or involve some or all of the allegations that underlie the Design-Builder's claims against the Owner in Claim Scenario 2.

**Comments:**

1. In most jurisdictions the economic loss doctrine would provide a defense to negligence claims alleging purely economic loss; however, negligent misrepresentation claims would not be precluded by that doctrine.
2. The Owner's Design Professional Consultant would be covered for such professional liability claims under the Project-Specific Policy procured by that consultant. Similarly, to the extent that the Design-Builder's claims involved the services of engineering subconsultants of the Owner's Design Professional Consultant, see preceding comments regarding Claim Scenario 3, above.

**Claim Scenario 5:**

The Design-Builder may have *direct* claims against its Design Professional Consultant for breach of contract or negligence in failing to adequately perform professional services, including, final design of the Project. In addition, the Design-Builder may have derivative or third-party claims against its Design Professional Consultant based on the Owner (see Claim Scenario 1) or other (see Claim Scenario 12) Claims Against the Design-Builder.

**Comments:**

1. It should be anticipated that Claim Scenario 5 would represent the vast majority of professional liability claims in the Design-Build context, especially on Constructor-Led Design-Build Projects in which the Design-Builder's Design Professional Consultant would be responsible for the adequacy of the Final Project Design.
2. As in Claim Scenario 1, questions relating to the availability and scope of professional liability insurance coverage for the Design-Builder's Design Professional Consultant and its Engineering Subconsultants will depend upon whether they are insured under any Project-

Specific Policy procured by the Prime Design-Builder, whether they carry their own (if any) practice professional liability insurance, or whether they have procured their own Project-Specific Professional Liability Insurance Policy. The implications of these various coverage scenarios are discussed in the comments following Claim Scenario 1 and Claim Scenario 3.

3. Assuming that an appropriate Owner-Controlled, (not necessarily procured) project-specific professional liability insurance policy is bound that covers the Design-Builder and all of its Design Professional Consultants (of all tiers) this will serve to (a) insure that adequate (scope and dedicated limits) coverage exist for a guaranteed duration and (b) expedite and facilitate resolution of professional liability claims, especially those initiated and driven by the Owner's primary professional liability claims against the Prime Design-Builder (Claim Scenario 1 and related commentary).

#### **Claim Scenario 6:**

This scenario involves third-party and related downstream professional liability claims for indemnification, contribution or otherwise from one tier Design Professional subconsultant to another tier.

#### **Comments:**

1. Assuming an appropriately structured project-specific policy naming the Design-Builder and all of its Design Professional Consultants (of all tiers), this type of third-party indemnity and related claim adversity would be eliminated by virtue of the joint defense provision and the insured v. insured exclusion of such a policy. Especially when any such claims in Claim Scenario 6 are initiated or driven by the Owner's primary claims against the Design-Builder, placement of such a Project-Specific Policy would (a) insure that adequate (scope and dedicated limits) coverage exists and (b) expedite and facilitate resolution of professional liability claims, especially those initiated and driven by the Owner's primary professional liability claims against the Prime Design-Builder (see Claim Scenario 1 and related commentary).
2. Absent such a project-specific policy, the Design-Builder and each of its Design Professional subconsultants may or may not have adequate professional liability practice coverage (scope and limits). Even if they do, any professional liability claim would require the participation of multiple professional liability insurers and respective (individual) defense counsel, which will make more expensive and protracted the resolution of the claim. In such circumstances, the Owner's direct claim against the Design-Builder will be driving these types of third-party claims and, consequently, the Owner will be adversely impacted by the delay in claim resolution due to the required participation of all those insurers and respective defense counsel on behalf of each of the various professional insureds.

#### **Claim Scenarios 7 and 8:**

These scenarios involve professional liability claims (direct and third-party) by the prime Design-Builder against its trade subcontractor and/or the latter's specialty designer(s).

#### **Comments:**

1. All of the advantages of an Owner-Controlled Project-Specific Professional Liability Policy are discussed above, and certainly applicable in this context. These advantages include, opportunity to define adequate coverage scope and definition of "professional services"

coverage; identification of named insureds; joint defense and claims resolutions streamlining features; and dedicated coverage for guaranteed coverage duration.

2. These considerations are especially important in the context of specialty designers retained by trade subcontractors on subsurface projects. Typically, these designers are involved in critically important project design elements (for example, tunnel lining systems) that impact the quality of the *completed* project—something of primary interest to the Owner. Also, typically, these specialty designers have *no* or inadequate practice professional liability insurance coverage.
3. Under an appropriately-structured Project-Specific policy procured under the Owner's control, both trade subcontractors and their specialty designer(s) would be named as insureds under the Project-Specific policy for professional liability exposure.

#### **Claims Scenarios 9 and 10:**

These claims involve third-party (indemnification, contribution, or otherwise) professional liability claims by the Owner's Design Professional Consultant against its subconsultants.

#### **Comments:**

1. See prior comments regarding Claim Scenario 3. In substance, all of the Design Professional subconsultants would be insured under the project-specific policy procured by the Owner's Design Professional subconsultants would be insured under the Project-Specific policy procured by the Owner's Design Professional Consultant and, accordingly, any professional liability claims against them would be covered under that policy and defended and resolved in accordance with the joint defense provisions of the policy.
2. To the extent that any such third-party claims are initiated or driven by the Owner's primary claims against its Design Professional Consultant (and those claims involve the services of the Design Professional Consultant's subconsultants, hence leading to the third-party claims), the existence of the project-specific policy insuring all of the design professional subconsultants on the Owner's Design Professional Consultant team and the naming of the Owner on an Owner Endorsement, will significantly facilitate and expedite the resolution of all such claims—primary as well as third-party.

#### **Claim Scenario 11:**

This Scenario involves claims by a trade subcontractor against the Design-Builder alleging damages due to breach of contract, breach of *Spearin* implied warranty obligations, negligence and/or negligent misrepresentation on the basis of defective design or information furnished by the Design-Builder to the trade subcontractor.

#### **Comments:**

1. The Design-Builder in most cases will have a *Spearin* implied warranty obligation to the trade subcontractor in this type of claim situation. This type of claim will likely lead to a professional liability claim by the Design-Builder against its Design Professional Consultant.
2. This scenario raises all of the same professional liability insurance coverage issues as discussed in the comments following Claim Scenarios 1, 5 and 6.

### **Claim Scenario 12:**

This claim scenario involves a variety of third-party claims against the Owner alleging economic loss, property damage and/or bodily injury due to deficiencies and professional services furnished by or through the Design-Builder and/or its Design Professional Consultant Team). These claims may be asserted by project abutters, members of the public, state or federal finding or regulatory agencies, adjacent construction contractors, etc.

### **Comments:**

1. Absent a project-specific project policy, the Owner would not be covered under any professional liability insurance policy for any such third-party claims. Although the Owner may be protected by contractual indemnification obligations of the Design-Builder in such a situation, the Design-Builder may not have adequate practice professional liability coverage to fund that obligation.
2. If the Design-Builder procures its own Project-Specific Policy, it is probable that any such policy would not contain an Owner Endorsement. Also, the Design-Builder will not likely name as Insureds its Design Professional Consultant Team, thus to the extent that the third-party claims against the Owner involve services of the Design-Builder's Design Professional Consultants, the non-insured status of the latter under the Design-Builder's project specific policy will protract and complicate the resolution of any such third-party claims.
3. Under an Owner controlled project-specific placement, however, the Owner would be covered for such claims under an Owner Endorsement and the inclusion of the entire Design-Build team will facilitate and expedite the resolution of such third-party claims against the Owner.

### **9. To what extent will a performance bond protect against defective design risk and related claims?**

- Distinction between surety and insurance.
- A surety or performance bond is a risk transfer mechanism under which the surety assumes certain risks of the Owner—i.e. the surety provides the Owner with assurance that the bonded contractor will perform its contractual obligations and, in the event of the contractor's default, the surety will protect the Owner from the financial consequences of the default.
- Current surety market is extremely restrictive—generally and especially on Design-Build projects.
- The Constructor-led Design-Builder's assumption of design responsibility and performance warranties (especially those dependent upon adequacy of design) represent a new set of risks, contractual and legal obligations for not only the Constructor(s) leading the Design-Build team, but also for the surety or sureties guaranteeing or bonding their performance.
- From the surety's prospective, standing behind (i.e. protecting the Owner from default in) the Constructor's obligation in Design-Bid-Build to construct in accordance with a detailed and complete design furnished by others is *significantly different* from standing behind a Design-Builder's obligation to adequately design

and construct in accordance with merely preliminary design/performance specifications and to warrant the adequate performance of the completed project.

- The surety's obvious concern is that by writing a performance bond on a Design-Build Project, it will become the guarantor of design adequacy and accuracy.
- As a general proposition, sureties do not write bonds in the expectation of a loss and bond premiums are insufficient to cover the degree and duration of expenses associated with professional liability or other claims based on defective design.
- The existence of project-specific professional liability insurance will certainly increase the receptivity of the surety market to providing performance bonds on a Design-Build Project. As one commentator has stated:

“Once the extent of the Design-Builder's risks has been determined, the surety will want to assess whether the Design-Builder has the proper risk transfer products in place to address the risks... The extent to which [a project-specific professional liability insurance policy] effectively and comprehensively covers the Design-Builder's design exposure is a crucial factor in the surety's underwriting of a performance bond for a Design-Builder.” R. Duke, *Bonding Design-Build Projects, Design-Build Risk and Insurance* (A. Hickman, Ed., International Risk Management Institute, Inc., 2002).

- Even assuming a project-specific professional liability insurance policy, the surety's obligations regarding defective design risk are co-extensive with those of its principal(s)—i.e. the Constructor leading the Design-Build Team. Hence, the extent to which defective design risk—especially relating to owner-furnished preliminary design and/or performance specifications—has been allocated to the Design-Builder in the Design-Build Agreement, along with contractual performance warranty obligations (which are dependent upon adequacy of the final design based on owner-furnished preliminary design and/or performance specifications), coupled with the *Spearin* implied warranty obligation, will also be significant considerations influencing the surety's underwriting decision. See, C. Hammond, *Dealing with Defects: Defective Owner-Provided Preliminary Design and Design-Build Contracting*, 15 *International Construction L. Rev.* 193 (1998).
- The surety's implied warranty liability exposure under *Spearin* similarly is co-extensive with that of the Design-Builder, which means that some portion of its design defect exposure will go beyond the negligence-based coverage of professional liability insurance, and, hence, the surety's subrogation remedies generally may be unavailing to recover against the engineering consultants (directly based upon violation of the professional standard of care, or through their professional liability insurer) for damages due to those exposures.
- In deciding whether to write a performance bond on a major subsurface project, the extent and manner in which subsurface condition risk is allocated (or otherwise addressed, or not) in the Design-Build Agreement will also be an important surety underwriting consideration. See, P. Bruner, *Design-Build Viewed From the Surety's Perspective*, *The Construction Lawyer* (American Bar Association, July 2000).
- Sureties, rightfully so, are concerned about bonding the Design-Builder's assumption of control over the design development and finalization process and the consequent professional liability exposure.

- Typically, sureties decide whether to underwrite a performance bond on a Design-Build Project on a project-specific basis. The underwriting process includes an evaluation of the specific risks and contractual responsibilities assumed by the Design-Builder. In this evaluative process, the surety underwriter will consider, among other things, the prior experience, working relationships and management of the Design-Build team including design quality control procedures; the terms of the Design-Build Agreement particularly those relating to standard of care, warranty, performance guaranties, allocation of differing site condition risk, scope and insurability of indemnity obligations, allocation of risk/disclaimer for consequential damages. In addition, the surety underwriter, as relates to potential professional liability exposure, will evaluate the overall insurance requirements and program of the owner and all Design-Build participants, including the availability, terms, limits and duration of professional liability insurance, including whether project-specific professional liability coverage will be provided.
- Is excluding the design risk from a performance bond a feasible approach? DBIA maintains that such an approach “counters the position taken by the Design-Build Institute of America, which recommends that a single bond cover the faithful performance of the entire contract, including professional design services, and specifically recommends against allowing separate bonds or construction-only bonds on Design-Build projects. This position is consistent with what most owners expect and demand given the single-point responsibility associated with Design Build contracting.” Loulakis and Shean, Risk Transference in Design-Build Contracting, Construction Briefings No. 96-5 (April 1996).

The AGC disagrees. AGC Document No. 470, “Design-Build Performance Bond (where surety is liable for design cost of the work)” (1999), ¶13, “Limited Liability for Design” provides:

“This bond shall cover the cost to complete the Work but shall not cover any damages of the type specified to be covered by the Design-Builder’s liability insurance or by the Professional Liability Ins. required pursuant to the Contract, whether or not such insurance is provided or in an amount sufficient to cover such damages.”

- Here discuss *Nicholson & Loop, Inc. v. Carl E. Woodward, Inc.*
- As some commentators have observed:

“Design-Build assumes that the owner will furnish general program requirements and performance specifications in conformance with which the Design-Builder will prepare the detailed design. From both surety’s and the contractor’s perspective, the design risk either is to be rejected or, if accepted, passed off to the maximum extent possible to a professional liability insurer or other parties...” Bruner & O’Connor On Construction Law, §12:89, p. 626 (2002).

- What are the surety’s remedies against the Design-Builder and/or its design professional joint venture partner or subconsultant?

“The surety’s recourse against design professionals who prepare a defective design relied upon by the Design-Builder is straight forward. The surety may generally pursue its traditional rights of indemnification against the Design-

Builder where the design professional is a co-venturer of the principal. Where the Design-Professional is a subcontractor, the surety's rights against the design professional, like those against any other subcontractor, flow through the surety's right of subrogation standing in the shoes of the Design-Build principal and owner.

One wrinkle in pursuing a subcontractor design professional exists in the burden of proof. Whereas, owners and contractors who furnish detailed designs upon which other parties rely are held to an implied warranty standard, the liability of design professionals for defective design is judged under the applicable standard of care. The design professional does not guaranty an error free design. It thus is possible for the design/builder to be liable under its implied warranty without recourse against the design professionals because liability is judged under a different standard." The surety's recovery from the design professional, who usually is without assets sufficient to pay major claims in the absence of insurance, also may be impacted by the 'claims made' and 'declining limits' features of most professional liability policies, the potential risk of cancellation or nonrenewal, the depletion of available coverage by losses on other projects and the risks that professional liability coverage may not be available during the post-completion warranty period for which the Design-Builder and surety may remain liable under the performance bond. Thus, the extent to which design risks inherent in the Design-Build process are insured must be most carefully considered." *Bruner & O'Connor on Construction Law*, §12:95, p. 640-41 (2002).

## **Conclusion:**

Constructors who singularly or in joint venture lead a Design-Build team face substantial professional liability risk for defective design. Some of that exposure may be effectively allocated and managed through contractual provisions and/or through traditional risk transfer—i.e. insurance coverages. In all instances, however, it is critically important, that the Constructor, in such prime relationships, recognize the potential for such design adequacy risk exposure and take prudent steps to effectively allocate and manage that risk. This paper has endeavored to outline some of the more important issues in this regard and recommend approaches to effectively allocate and manage design adequacy risk exposure for the Constructor in a prime Design-Build relationship.