

## Workshop Q

*Wednesday, November 9, 1:30-3 p.m. and 3:30-5 p.m.*

# ***TRENDS IN CONSTRUCTION AND DESIGN LIABILITY***

Presented by



**Michael C. Loulakis**  
President  
Wickwire Gavin, P.C.



**Owen J. Shean**  
Shareholder  
Wickwire Gavin, P.C.

The areas of design and construction liability evolve over time. A significant statutory development for contractors is the growing number of state right to repair laws. Similarly, the courts are constantly reshaping the scope of construction and design liabilities. This session will address the most significant statutory changes and judicial rulings pertaining to construction and design liability. How much protection do right to repair laws provide contractors? How are the responsibilities of design-builders and construction managers changing over time? Find out the answers to these and many other liability issues.

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#### Contact Us

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E-Mail: [info@datatracplus.com](mailto:info@datatracplus.com)

Phone: 800.379.9055

704.549.0770

Fax: 704.503.3890

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**Michael C. Loulakis**  
**President**  
**Wickwire Gavin, P.C.**

Mr. Loulakis is copresenting Workshop Q, "Trends in Construction and Design Liability," on Wednesday afternoon. He is president of Wickwire Gavin, P.C., a national law firm headquartered in the Washington, D.C., area that concentrates on representing domestic and international clients on construction-related matters. His legal practice focuses on representing members of the construction industry, including owners/developers, sureties, contractors, and design professionals.

Mr. Loulakis is nationally recognized for his expertise in design-build, and he has served as counsel for some of the most visible and challenging design-build projects in the country. He was a member of the board of directors of the Design-Build Institute of America (DBIA) for 8 years and served as chairman of DBIA's Manual of Practice Committee. Mr. Loulakis is currently legal counsel to DBIA. He had principal responsibility for drafting the DBIA Contracting Guide and DBIA's standard form design-build contracts and subcontracts. In addition to his client work on design-build, Mr. Loulakis is a highly acclaimed speaker and author on the subject. Among his publications is a series of books he began writing in 1995 titled *Design-Build Lessons Learned*, where Mr. Loulakis reviews all of the case law in a given year affecting design-build relationships. He is also the coauthor of *Construction Management: Law & Practice* and author of an interactive CD-ROM program titled *Construction Project Delivery Systems: Evaluating the Owner's Alternatives*, produced and distributed by A/E/C Training Technologies. Prior to joining Wickwire Gavin in 1979, Mr. Loulakis was a practicing engineer with a Boston, Massachusetts, area geotechnical consulting firm.

He received a bachelor of science degree, *magna cum laude*, in Civil Engineering from Tufts University in 1976 and a juris doctor degree from Boston University School of Law in 1979.

**Owen J. Shean**  
**Shareholder**  
**Wickwire Gavin, P.C.**

Mr. Shean is copresenting Workshop Q, "Trends in Construction and Design Liability," on Wednesday afternoon. He is a shareholder in the national law firm of Wickwire Gavin, P.C., in its Vienna, Virginia, office. Mr. Shean represents clients in commercial litigation and arbitration. His practice focuses upon construction-related matters, insurance, government contracts, and creditors' rights. Mr. Shean has worked with clients in the construction, insurance, semiconductor, software, and chemical processing industries. Mr. Shean received a B.A., *magna cum laude*, and J.D. from the University of Virginia. He lectures and writes frequently on insurance and construction law. He is coauthor of *Construction Insurance: Coverages & Disputes*, The Michie Company, 1994, updated 1995, 1999, 2000, 2001 and 2003. Mr. Shean has been an adjunct professor of law at Georgetown University Law Center since 1988.

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# TRENDS IN CONSTRUCTION AND DESIGN LIABILITY

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**Owen J. Shean**  
**Wickwire Gavin, P.C.**

## I. Construction Trends

- A. Construct Defect Reform Act/Repair Laws
  - 1. Contractor right to list of alleged defects
  - 2. Grace period for indemnity-claim statute of limitations
- B. Economic Loss Doctrine as Applied to Contractor's Claims
  - 1. The *Moorman* precedent
  - 2. *Bilt-Rite v. Architectural Studio*
  - 3. *Calloway v. Highland Construction*
  - 4. *Mars, Inc. v. Heritage Builders*
  - 5. Emerging issues
- C. Recovery of Attorney's Fees in Indemnity Actions
- D. State Law Developments on Contractor's Pass-Through Claims
  - 1. *Severin* Doctrine
  - 2. Texas—*Interstate Contracting v. City of Dallas*
  - 3. California—*Howard Contracting v. MacDonald Construction*
  - 4. Connecticut—*FDIC v. Peabody*
  - 5. Oregon—*Gilbert Pacific v. State of Oregon*
- E. Status of Contractor's Right To Finish Early
- F. Joint Defense Privilege in Construction Litigation
  - 1. *Brooklyn Navy Yard Cogeneration Partners, L.P. v. PMNC*
  - 2. *Oxy Resources California LLC v. The Superior Court of Solano County*
- G. State Statutes Mandating Arbitration of Disputes in Public Contracts

## **II. Design Trends**

- A. Changes in AIA Design/Build Documents
  - 1. Scope of services
  - 2. Dispute resolution
  - 3. Contract sum
  - 4. Instruments of service
  - 5. Certifications
  - 6. Acknowledgement of substantial completion
- B. "Betterments" in design/build procurement
- C. Developments in Licensure Laws Defining Practice of Architecture
- D. Scope of Warranty of Design in Design/Build Contracts
  - 1. Owner's warranty of design/specifications
  - 2. Implied warranty of design—*Maddox v. Benham Group*
  - 3. *American Family Mutual v. American Girl*

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## Trends in Design and Construction Risk

Michael C. Loulakis, President  
Wickwire Gavin, P.C.  
703-790-8750  
mloulakis@wickwire.com

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## Risk Realities

- **Owners' perspective**
  - lip service to effective contractual risk allocation
  - enamored by competitive procurement approaches
  - need for control without responsibility
- **Designers' perspective** – talking out of both sides of their mouths
- **Contractors' perspective**
  - “low bid” general contractors are now design-builders
  - willingness to fight even if there is no legitimate claim
- **Ineffectiveness of DRB and mediation processes for early resolution of claims**

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## The Current Construction Market May Change the Risk Dynamic

- Unprecedented boom in chemicals and refineries
- Supply and demand problems in engineering firms
- Lump sum contracting no longer preferred delivery approach
- Move to alternative delivery in public sector changing dynamics of risk
- Surety market finally stepping up to the plate

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## Liability Trends

- Single point of responsibility
- Owner liability for defects in the RFP documents
- Conflicts within the design-build team
- Ownership rights of design documents
- Liability of owner consultants
- Sureties and guarantor liability

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**Trend No. 1**

**Single Point of Responsibility  
is Alive and Well**

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***Lockheed Martin v. EG&G (2004)***

- **Turnkey environmental remediation contract**
  - Radioactive waste at Idaho National Laboratories
  - Three phase contract
    - proof of concept
    - limited demonstration
    - final remediation
- **Project included removal of plutonium**
- **Estimated amounts of plutonium came from agency at Rocky Flats site**
- **Proof of concept passes**

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## ***Lockheed Martin v. EG&G*** (cont'd)

- **Lockheed subsidiary wins \$174 million contract**
  - Guarantee that if substantial completion date not met, full return of all monies paid
  - ROD requires “chemical extraction and physical separation”
- **Lockheed concludes that process won't work**
  - Ultimately agrees to new approach
  - Unsuccessfully tries to get government to approve baseline design

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## ***Lockheed Martin v. EG&G*** (cont'd)

- **Request for equitable adjustment**
  - Conversion to cost plus contract
  - Cash flow
- **Termination for default issued**
- **Lockheed argues:**
  - Commercial impracticability
  - Failure of owner to approve baseline was a breach of contract
- **Court rejects all defenses raised by Lockheed**

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## ***Action Industries v. USF&G (2004)***

- **Turnkey installation of a conveyor system for manufacturing facility**
  - Production rate of 11 units/minute
  - 47% rate achieved
- **Arbitration award in favor of owner for negligence and breach of warranty**
- **Appeal based on award of consequential damages**

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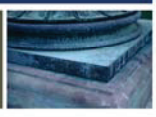
## ***Action Industries v. USF&G (cont'd)***

- **Court found language to allow recovery of those damages:**

If [Contractor] had actually intended to prohibit all consequential damages, it should have simply drafted a blanket prohibition of such damages. Instead, [Contractor] drafted a warranty provision which prohibited only certain types of consequential damages.

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## ***Mead Corp. v. ABB Power Generation (2003)***

- **Failure of gas turbine installed in December 1995**
  - Fan-blade failure in March 1996
  - Settlement of all outstanding issues and damage to stator coils
  - Turbine fails again in January 1998 due to improper pin setting
- **One year warranty expired**
- **Court says need “clear indication that remedy is exclusive”**

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## **Take-Aways: Single Point of Responsibility**

- **Issue arises in context of warranty claims**
  - same results for buildings and residences
  - failed attempts to use CGL insurance
- **Design-Builders need to take this liability seriously**
  - fees should be higher than at-risk CM
  - commercial risks can't be passed off
- **Owners – with control comes responsibility**

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**Trend No. 2**

**Owners Bear the Risk of Design Errors  
in the RFP Documents**

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***Donahue Electric (2002)***

- VA Ambulatory Care facility in Las Vegas
- Donahue and HCE (Allen) form a team
- Budget problems change nature of the procurement and team
- VA-furnished boiler needed 25HP boiler
- Parker B-3 boiler listed on equipment schedule was a 7HP boiler
- VA claimed that Donahue had “total design responsibility” and denied claim

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## ***Donahue Electric (cont'd)***

**At a minimum, the drawings were provided as guidance/concepts for the design-build bidders. The 'Note' that the drawings are 'information only' is not consistent with that approach. VA's position would require that bidders design the project prior to bid.**

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## ***Donahue Electric (cont'd)***

**The VA could simply have stated, 'install the Steris 3400 GFP sterilizer and a boiler to operate it.' Such a specification would have made Donahue responsible for choosing a boiler that would properly operate the sterilizer. When, as here, the VA specifies [the] boiler, absent actual knowledge to the contrary a bidder may rely on that information.**

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## *Donahue Electric* (cont'd)

Specifications included in a design/build contract, however, to the extent specific requirements, quantities and sizes are set forth in those specifications, place the risk of design deficiencies on the owner.

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## Take-Aways: Responsibility for RFP Errors

- *Spearin* doctrine is applicable to design-build
- Owner response to date has been ineffective:
  - inclination to shift risk contractually
  - with control comes responsibility
- Recommendations:
  - money issue vs. performance issue
  - post-award “scope review” period

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## Trend No. 3

### Conflicts Within the Design-Build Teams Are Becoming More Common and Complicated

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### *Metropolitan Steel Industries, Inc. v. Perini Corp (2004)*

- **Bus depot for NYC Transit**
  - disputes among entire team
  - STV sued for indemnity and breach of implied warranty of design
- **Court rejects wholesale liability against STV**
  - Perini had control over entire design process
  - subcontract said nothing about pre-proposal responsibilities
  - Perini failed to prove existence of oral contract

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## *Siemens Westinghouse v. Dick Corporation (2003)*

- **Power plant in New Hampshire for AES**
  - Stone & Webster went bankrupt
  - SWPC had \$164 million turbine contract
- **Dick and SWPC enter into consortium**
  - 75 “pool days” to perform corrective work
  - \$85,000/day in liquidated damages
- **\$18 million drawn from an LOC posted by Siemens**
- **Dick was found to bear the risk of “fronting” the payment**

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## *Siemens Westinghouse v. Dick Corporation (2004)*

- **Dick sues SWPC for fraud and misrepresentation**
  - SWPC spent 200 days correcting problems
  - alleged that CT was still experimental
  - no significant operating experience
- **Court rejects claim**
  - no justifiable reliance
  - consortium agreement had formula for 75 days
  - Dick’s pricing based on project that had the “bad information”

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## Take-Aways: Teaming Relationships

- Other A/E cases:
  - *Maddox v. Benham* (liability for bid)
  - *Lehrer McGovern* (definition of fee)
- Design professionals remain at great “theoretical” risk in design-build
- Far too much “back of napkin” contracting
- Critical need for all parties to think through the ramifications of the deal

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## Trend No. 4

### Courts Protect the Rights of Those Who Own the Design Documents

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## *Trek Leasing, Inc. v. U.S. (2004)*

- **USPS design-build contract**
  - successfully completed by Trek
  - B141 contract between Trek and architect
  - Trek registered design with Copyright Office
- **Trek sues USPS for copyright infringement**
- **USPS claims Trek did not own design**
- **Court disagrees**
  - architect was employee
  - “work for hire” doctrine applied

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## *R.D. Wolf, Inc. v. Brancard (2004)*

- **Custom homebuilder in Connecticut**
  - \$5,000 contract for plans
  - remained property of and to be built only by contractor
  - plans stamped with builder’s name
- **Owner stiffs builder on fee and uses plans**
- **Builder prevails against owner and follow-on contractor**
  - preempted by copyright law
  - liability under Deceptive Trade Practices Act

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***R.D. Wolf, Inc. v. Brancard* (cont'd)**

**“Brancard’s actions at the very least were unscrupulous and unethical, seemingly unfair, and without question caused a substantial injury to a competitor.”**

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**Take-Aways:  
Ownership of Documents**

- **Other cases supporting the principle:**
  - *Johnson v. Jones* (copyright)
  - *Sokoloff* (specific performance)
- **Reinforces need for a preliminary agreement**
- **Commercial terms that contemplate what happens to design**
- **Special risk to the follow-on firm**
- **Licensing agencies may have a say in this**

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## Trend No. 5

### Courts are Struggling to Deal with the Unique Role of Design Professionals in Alternative Delivery Systems

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### *IPSCO Steel v. Kvaerner (2004)*

- **Project Management Agreement by Kvaerner**
  - Recommend subcontractors
  - Agency-CM for IPSCO
  - GMP of \$182 million with cost sharing
  - Litigation manager
- **Professional liability policy for \$20 million**
- **Design-builder fails and results in \$26 million claims**
- **\$60 million claim by IPSCO vs. Kvaerner**
- **Kvaerner not able to control settlement with contractor**

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## ***Pompano Masonry v. HDR Architecture (2004)***

- **UNC project for Biological Science Research Center**
  - HDR was “project expediter”
  - Metric was prime contractor for general construction
  - Pompano was subcontractor
- **Initial schedule had masonry lagging MEP**
- **HDR refused to resequence work**
- **Court found Pompano had right to sue HDR for failure to properly schedule work**

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## **Take-Aways: Owner's Consultants**

- **Evolving area of law:**
  - liability for defective design
  - interference with design-builder
  - EPCm relationships
  - conflicts of interest
- **Critically consider the commercial deal**
- **“Does it smell right?”**

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## Trend No. 6

### Courts are Quick to Recognize the Responsibility of Sureties and Third-Party Guarantors

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### *USF&G v. Braspetro Oil Services (2004)*

- Two major contracts
  - Conversion of exploration platform into semi-submersible production platform
  - Oil tanker into floating production, storage and offloading vessel
- Consortium of Brazilian contractors defaulted
- \$240 million in surety bonds

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## ***USF&G v. Braspetro Oil Services*** (cont'd)

- Owner attempts to get surety involved failed
  - 3-6 months to investigate
  - Change nature of contract
  - Advance payments by utility prejudiced surety
- Sureties lose in court
  - “After the fact reconstruction”
  - Total of changed work relatively small (5-13%)
  - Damages included LDs and attorney’s fees

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## ***USF&G v. Braspetro Oil Services*** (cont'd)

- Sureties lose (mostly) on appeal to 2<sup>nd</sup> Circuit Court of Appeals
  - Exhaustion of funds
  - Requirement to pay sureties
  - Law does not help surety who “sits by and takes no action”
- But:
  - Liquidated damages clause considered unenforceable (\$63 million)
  - Attorneys’ fees not collectable (\$38 million)

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### ***Mitsubishi Power Systems v. Shaw Group (2004)***

- **Covert Generating signs \$250 million equipment contract with MPS**
  - Assigned to Shaw
  - 10% LOC in favor of Shaw
- **Shaw claims overruns of \$60 million and alleges MPS responsible for \$20 million**
- **MPS files declaratory judgment to stop draw on the LOC, citing financial condition of Shaw**
- **Court upholds right of Shaw to draw as necessary**

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### ***Choctaw County Cogeneration v. Bechtel (2001)***

- **440MW lignite-fired plant in Mississippi**
- **16 months of delay**
  - labor force majeure
  - miscellaneous owner-caused problems
- **\$85 million in liquidated damages**
- **Replenishing letter of credit**
- **Surety required to pay money**

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## Take-Aways: Sureties and Guarantors

- **Powerful tools for resolving disputes**
  - “Isn’t this the risk that you were paid to assume?”
  - caselaw expects a reasonable response
- **Contracting considerations:**
  - do we need the third-party security?
  - will I ever call on this security?
  - how much am I paying for the security?
- **Beware of forum resolution inconsistencies!**

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## Conclusion

- **Expansion of caselaw gives the industry a unique opportunity to improve itself**
  - need for smart risk allocation
  - owner accountability and *Spearin* applicability
  - design-build team awareness of risks
- **Lots of gray areas remain**
- **Influence of arbitration**
- **Protect your position if something goes wrong**

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# Trends in Design and Construction Risk

Michael C. Loulakis, President  
Wickwire Gavin, P.C.  
703-790-8750  
mloulakis@wickwire.com

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