

SURETY BONDING & CONSTRUCTION RISK MANAGEMENT 2020 CONFERENCE

January 27-29, 2020 | Bonita Springs, FL



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**AGC's Surety Bonding & Construction
Risk Management 2020 Conference**

The 'New Reality' of Design Responsibility for Contractors and Subcontractors and Common Sense Recommendations

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About Your Presenter

- Ron Robey is a senior partner of Smith, Currie & Hancock.
- Education: B.A., Centre College and University of Kentucky (with distinction in the Honors Program); J.D., University of Kentucky; Order of the Coif; lead articles editor, *Kentucky Law Journal*.
- States Admitted: Florida, Georgia, Kentucky, Nevada, New York, and Michigan.
- Co-Editor of Smith, Currie & Hancock's COMMON SENSE CONSTRUCTION LAW – 5th Edition (2015), and the recently released 6th Edition (2019), John Wiley & Sons.



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- Elysha Luken is a Florida Bar Board Certified Construction Attorney and partner at Smith Currie's Fort Lauderdale office.
- Education: B.A., University of Florida; J.D., *magna cum laude* Florida State University College of Law; Legislative Editor, *Florida State University Law Review*.
- Elysha represents all industry segments in public and private construction disputes, from bid protests and contract negotiations to prosecuting and defending claims for delay, compensation and construction lien and bond claims. She has served as project counsel on larger projects, including involvement in DRBs, subcontractor disputes and compliance matters.
- Elysha lectures frequently on construction contract drafting; legal considerations for green building and sustainable projects; and alternative project delivery, design-build and P3.



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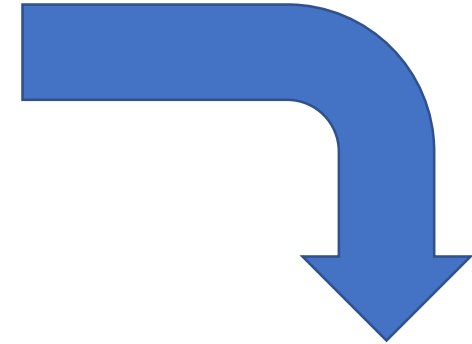
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Shifting Design Responsibility

Design Responsibility

- Risk/liability tied to project delivery method
 - D-B-B (either as GC or CMAR)
 - D-A
 - D-B
- Value assessment vs. time and money
- Erosion of protections
 - *Spearin* chipped away
 - Owner's cost avoidance = increased Contractor risk
- Movement to collaborative approach



SHOP DRAWING REVIEW	
Review is for general compliance with the Contract Documents. Sole responsibility for correctness of dimensions, details, quantities, and safety during fabrication and erection shall remain with the Contractor.	
<input type="checkbox"/>	No Exceptions Taken
<input type="checkbox"/>	Furnish with Changes Noted
<input type="checkbox"/>	Amend and Resubmit
<input type="checkbox"/>	Rejected: _____
By _____	Date _____

Design-Bid-Build

- Spearin Protection
 - “...if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications...” (*United States v. Spearin*, 248 U.S. 132, 135-36 (1918)).
 - Unless you’re in Texas because...it’s Texas (*El Paso Field Services, L.P. v. MasTec North America, Inc.*, 389 S.W.3d 802 (Tex. 2012)), relying on the *Lonergan* line of cases extending back to 1907.
 - “for an owner to be liable to a contractor for breach of contract based on faulty construction specifications, the contract must contain terms that could fairly imply the owner’s guaranty of the sufficiency of the specifications...” *Lonergan v. San Antonio Loan & Trust Co.*, 101 Tex. 63, 104. S.W. 1061, 1066 (1907).
- Contractor responsible for means/methods

Design-Bid-Build

- Contractor warrants compliance with Contract Documents
 - Contractor is required to perform work specified in the contract documents and any work “reasonably inferable from them as being necessary to produce the indicated results.”
 - The intent of the Contract Documents is to include all items necessary for the proper execution and completion of the Work by the Contractor.
- Give an inch...
 - “Contractor has reviewed all plans and drawings...and understands and agrees...that they were prepared in accordance with the designer’s *best understanding* of all applicable Codes; provided, however, it is Contractor’s responsibility to properly interpret and conform with all applicable Codes relating to the Work.”

Design-Bid-Build – Design Risk

- VE
 - Purely cost/time input?
 - ConsensusDocs: Constructor-initiated value-engineering changes may alter the Parties' respective responsibilities concerning the adequacy of the component designs and thereby shift risk for design responsibilities to Constructor.
- RFIs
 - Provide a sketch with **your** suggested fix

Design-Bid-Build – Design Risk

- BIM
 - Responsibility/liability for input
 - Can patent defects exist?
 - Garbage in, garbage out
 - Is there adequate insurance coverage?
- Precon/constructability review
 - Typically performed by non-A/Es

Design-Bid-Build – Design Risk

- Shop Drawings – delegated design in disguise
 - The “final word as to how work proceeds” and “supersedes architectural plans”
 - Contract Documents? Architects – *what* and *why*; Contractors – *when* and *how*
 - “Diagrammatic in nature”
 - “Zone of reasonableness”
 - Review req’ts and the rubber stamp
 - But I built off the approved ones! – AIA A201 3.12
 - Approval = evidence of reasonableness (*Farrell Construction Company, Inc.*, 84-3 BCA ¶17582)

Design-Bid-Build – Design Risk

- Performance specs
- Delegated design scopes
 - Design-by-committee
 - Interface/coordination with overall design
 - Timing of delegated design scope procurement
 - Structural loading
 - MEP loading
 - Seismic

Design-Assist

- Limited *Spearin* protection
- Contractor still responsible for means/methods
- Early understanding of design and constructability aspects
- Most useful with complex MEP scopes
- Contractor still warrants compliance with contract documents

Design-Assist

- Is it D-A or D-B? Or both?
- Does it matter?
- Limits of assistance
 - Where does collaboration stop and liability start?
 - Clear definition of scope and risk

Design-Build

- Spearin protection nearly eliminated
- Understanding intent/expectations
 - Able to use as intended, fitness for a particular use, suitability/adequacy/sufficiency
 - Fully functional, fully operational
 - Watertight, weathertight
- What did the owner buy?
 - What if approved design > RFP requirements?

Design-Build

- Standard of Care
 - What is ordinary?
 - Reasonable contractor, D-B contractor, or A/E
 - Heightened contract requirements
 - “[Contractor, Subcontractor, Architect, CM, Designer] represents that it is an expert in its field...”
- Licensing, Insurance
 - State boards
 - PL policies

Risk Allocation/Avoidance

- Boilerplate language
 - AIA A201 – 3.2.1 through 3.2.4
 - ConsensusDocs – 2.3, 3.15, 3.3.1-3.3.2
 - DBIA
- Make it **known** – knowing failure to report design errors/omissions
- Clear scope and definition of risk allocation
 - What is being assumed?
 - What is being reviewed and when? Who is performing the review?

Dispute Resolution Considerations

- Is it defective design or defective construction?
 - Affidavits, CoMs
 - Limitation of liability
 - E&O coverage “limitations”
- Who should have caught it? When?
- Privity and the Economic Loss Rule

Design Responsibility Considerations in Contract Terms and Practice

- Design specifications v. Performance specifications
- Implications of “preliminary drawings” and implied warranty
- Scope change/change orders
- Contractor/subcontractor relationship/termination of team member with design responsibilities

Design Specifications v. Performance Specifications

Design Specifications

- **Design Specifications** require strict compliance – “prescriptive specifications”
- Detail clear instructions for materials or equipment: “Install a 20,000 BTU Carrier air conditioner”
- If owner dictates how element is to be designed – Liability for Owner
- Contractor (and Subcontractor) is protected by *Spearin* – “the Contractor will not be responsible for the consequences of defects in the plans and specifications.”

Spearin Doctrine Applies to Design Specifications

- **Owner provides Contractor with two specific implied warranties:**
 - *The plans and specifications it furnishes are accurate*
 - *The plans and specifications are suitable for their intended purpose*
- **Contractor may be entitled to additional time and money**
 - *Contractor must show reasonable reliance on what Owner furnished*
 - *Judicially recognized with few exceptions at both state and federal level*

Contract Terms for Design Specifications

DBIA Standard Form of Agreement between Owner and Design Builder (Doc. 530)

3.4 If Owner's Project Criteria contain design specifications: (a) Design-Builder shall be **entitled to reasonably rely on the accuracy of the information represented** in such design specifications and **their compatibility with other information** set forth in Owner's Project Criteria, including any performance specifications; and (b) Design-Builder shall be **entitled to an adjustment in the Contract Price and/or Contract Time(s)** to the extent Design-Builder's cost and/or time of performance have been adversely impacted by such inaccurate design specification.

Specific Instructions re: Section 3.4

The Owner is cautioned that if it includes design specifications in its Project Criteria there is case law holding that the **Design-Builder is entitled to rely on such information**, and to the extent such information is not accurate, the Design Builder will be entitled to an adjustment in the Contract Price and/or Contract Time. Accordingly, the Owner, to avoid such potential liability **should consider using performance specifications**.

Performance Specifications

- **Performance Specifications** require end product to deliver certain productivity or meet qualitative requirements
- Objective standard to be obtained: “Install an air conditioning system capable of maintaining an indoor temperature of 72° F.”
- Owner sets requirements for end result of element designed by others
- Liability for performing party to achieve required performance
- *Spearin* does not apply to performance specifications

Design-Build Does Not Always Equate to Performance Specifications Only

Donahue Electric (2002)

- VA Ambulatory Care Center – Design-Build project
- Design-Builder responsible for multiple performance requirements, but Owner specified a specific sterilizer and specific boiler
- Specified boiler did not work with specified sterilizer
- VA Argument: Design-Builder was responsible to make the boiler work with sterilizer because Design-Builder had ultimate performance obligation

Design-Build Does Not Always Equate to Performance Specifications Only

Donahue Electric (2002) – Rationale

VA Loses – Court relied on Owner’s design specification

“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.*”

“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.*”

“Hybrid” Contracts

- Owner may have design specifications for some elements, performance specifications for others – “Hybrid” scenario
- *Spearin* will apply to Owner-provided design specifications
 - Where owner designates particular components, dimensions, material types, or quantities, owner impliedly warrants *those* details
- But where specifications set forth performance characteristics of end product and leave it to Contractor to achieve results, no implied warranty
- One contract may contain both, and each term will be evaluated separately

Blake Rule

Blake Construction (2002)

- Court of Claims has held that each specification should be reviewed to determine whether it is a design or performance specification, even in a design-build contract:
 - **One size does not fit all:** “the distinction between design and performance specifications is not absolute. . .” *Blake Construction v. United States*, 987 F.2d 743, 746 (Fed. Cir. 1993)
 - **Contracts may have both:** “Contracts may have both design and performance characteristics.” *Id.*

Hybrid Example

AAB Joint Venture (2007)

- Design Build for military storage base in Israel
- Contract documents included design specifications for groundfill stone size (6 inches), and performance specifications requiring achieving groundfill density using AASHTO standards
- D-B Contractor determined using design specification for stone size would not achieve performance specification - AASHTO density standard
- D-B Contractor claimed defective specifications and submitted REA for >\$900,000 to meet AASHTO standard



Hybrid Example

AAB Joint Venture (2007)

- Government argued that AASHTO standards were “performance specifications,” and that contractor could have met similar standard using the six-inch stones
- **Held:** Contract required contractor to meet AASHTO standards, which could not be met using required material specifications for stone size
- Government specifications were defective, breaching implied warranty:
 - **Government impliedly warrants that “. . . when the contract contains design specifications, satisfactory contract performance will result if the contractor follows those specifications.”**

Contract Protections if Performance Specification Not Achieved

- Performance specifications create a single point of responsibility
- Contract terms to protect against failure to meet performance spec
 - “Make good” provisions (up to pre-agreed upon amount, or unit price limitations)
 - Liquidated damages (tailored to performance spec failure – reduce fee by specific amounts)
 - Liability caps (specific amount or all or part of fee)
 - Waiver of consequential damages

Takeaways

- Contracts may contain both design and performance specifications; each will be interpreted individually regardless of project delivery method
- Identification of both critical to evaluate design responsibilities
- Design specifications must be compatible with performance specifications – if in conflict, default position could be either
- Consider contract protections in event of failure to meet performance specification

Preliminary Drawings and Implied Warranties

“Preliminary Drawings” and Implied Warranties

- Challenges of performance specifications:
 - Relinquishing control; clearly defining desired results; mixing of performance and design specifications
- To bridge gap, Owners (and sometimes Design-Builders) provide:
 - “Preliminary drawings,” “conceptual drawings,” “indicative design,” “preliminary design,” “design criteria”
 - May be labeled at percentage of completion: 30%, “preliminary,” etc.

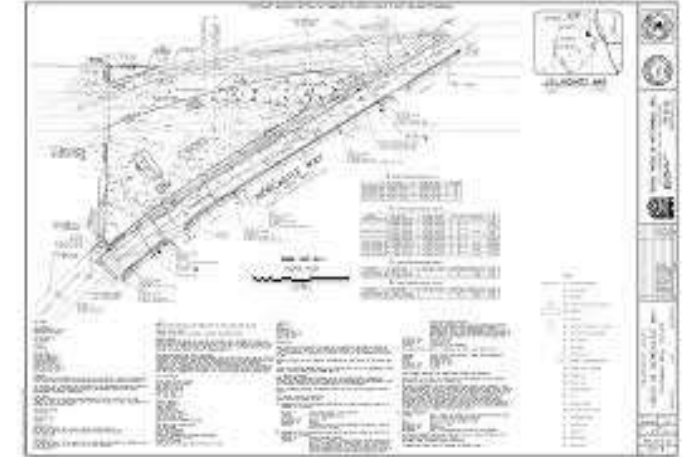
“Preliminary Drawings” and Implied Warranties

- Often contain express disclaimers: “must be verified,” “design intent only,” “include all costs”
- Are preliminary drawings impliedly warranted to Contractor or Subcontractor?
- Is Contractor required to follow preliminary drawings?

Implications of Preliminary Design Documents

Lovering-Johnson, Inc. (2005)

- Design-Build for multi-family housing/community center
- Navy furnished “preliminary drawings” that included sizing for drainage pipes in bid documents
- D-B Contractor presumed sizing correct (but minor investigation would have revealed that pipes needed to be much larger)
- Plan size was insufficient to handle water passing through the site
- **Held:** No implied warranty of specification suitability – sketches not usable for construction, and contract required D-B Contractor to design the system to meet “performance specification”



Implications of Preliminary Design Documents

Acquest Govt Holdings U.S. Geological LLC v. GSA (2007)

- Design Build Lease – Facility with animal holding rooms
- Bid documents included government provided drawings and performance specifications with caveats
- On completion, animal holding rooms lacked proper ventilation and heating
- D-B Contractor sought reimbursement for \$936,000 to make animal holding rooms functional



Implications of Preliminary Drawings

Acquest Govt Holdings U.S. Geological LLC v. GSA (2007)

- Government position:
 - Drawings were only “30% complete;”
 - Contractor could not rely on preliminary drawings; and
 - Performance specifications (requiring ventilation performance) governed
- D-B Contractor position:
 - Reliance on drawings provided by government in its bid;
 - Contractor complied with government furnished drawings; and
 - Compliance with drawings made it impossible to achieve performance specifications

Implications of Preliminary Drawings

Acquest Govt Holdings U.S. Geological LLC v. GSA (2007)

- Did government warrant drawings or was risk shifted to D-B Contractor?
 - Bid Documents: Drawings were meant to show “design intent only,” and should “not be relied upon.”
 - Bid Documents: “All offers shall meet the requirements of this SFO **and associated schematic design** drawings.”
 - Bid Documents: Variances to solicitation to be noted in offer; if no variances, “offer will be considered to meet all the requirements of the SFO and **associated schematic.**”

Implications of Preliminary Drawings

Acquest Govt Holdings U.S. Geological LLC v. GSA (2007)

- Government position (performance specification)
- D-B Contractor position (design specification)
- **Held:** Contract Ambiguous – Evidence supported both interpretations

Implications of Preliminary Drawings

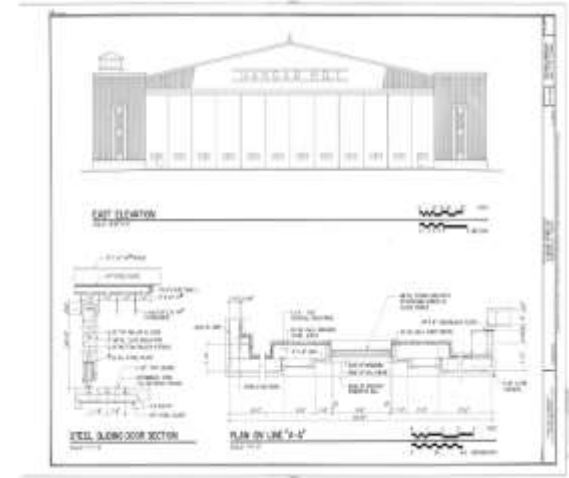
Acquest Govt Holdings U.S. Geological LLC v. GSA (2007)

- Genuine dispute over whether D-B Contractor was permitted to change initial design in its subsequent drawings – no SJ
 - Ambiguity over drawings (whether required or a “starting point”) left risk allocation uncertain
 - Responsibility for unacceptable result unclear
 - D-B does not eliminate need for precisely defined initial specifications and whether and how they are incorporated into final design

Implications of Preliminary Drawings

Edsall Const. Co. Inc. (2002)

- Design-Build for Army Hangar facility
- Bid documents had initial drawings of two 21,000 lb hangar doors, cables attached at three pick points
- D-B Contractor discovered that doors would only function with cables attached to four pick points
- D-B Contractor claimed increased costs based on reliance on initial drawings in bid documents



Implications of Preliminary Drawings

Edsall Const. Co. Inc. (2002)

- Contractor: Government's initial drawings warranted the door's design would meet performance specifications
- Government: Warranty was disclaimed on drawing, duty to investigate
 - "Canopy door details, arrangements, loads, attachments, supports, brackets, hardware, etc. must be verified by the contractor prior to bidding"
- Court: Not even close, *Spearin* applies.
 - "General disclaimer" inadequate to shift risk – no patent ambiguity
 - Drawings were "design requirement rather than merely a performance specification" because any change in design required government approval
 - Main factors: Drawing specificity and requirement for owner approval of changes

Takeaways

- **Takeaway I:** Specificity of contract and bid documents determines who bears risk of imperfect design specifications, i.e., whether it is design specification
- **Takeaway II:** The more developed Owner's (or Contractor's) preliminary design, the more likely the implied warranty will be inferred to Owner (or Contractor)
- **Takeaway III:** Disclaimers require specificity and more than simply requiring "verification" – e.g., if changes require approval, implication is that required

Design Responsibility Considerations in Scope Changes / Change Orders

Design Responsibility Considerations in Scope Changes / Change Orders

- Traditional project delivery change order subjects:
 - Impacts caused by Owner (scope changes, interference, disruption)
 - Changed conditions (differing site conditions, force majeure)
 - Design issues (errors, omissions, ambiguities in plans and specifications)
- Each instance presents another opportunity for the imposition of design responsibility.

Design Responsibility Considerations in Scope Changes / Change Orders

- Contractors should evaluate changed work for inclusion of design obligations and attendant liability
- Inform owners when changed work includes design work outside the scope of the contract.
- Unless Contractor agrees to the price and potential design liability, give notice that the design work is being performed under protest.
- Consequences of acting as “volunteer” without documenting and providing notice: responsibility for design may fall on the contractor, including design cost and potential liability for the design.

Scope Changes in Design-Build

- “Scope” is project criteria or “basis of the design documents”
 - Negotiated criteria: Performance requirements, general scope and generally minimum performance level to be met
 - “Basis of the design documents” (DBIA) comprehensive document set that design-builder agrees to follow, generally includes project criteria
- Exceeding project criteria may can increase construction costs and claims among project participants

Owner Involvement in Design Build

- Owner involvement = “Scope Creep”?
- As project progresses, “new focus” on project details not discussed during negotiations or included in project criteria
- Owners will seek additions and changes

Takeaways

- Designer to design consistent with project criteria – front line of defense against scope creep and expanding scope over minimum requirements
- Recognize Owner “suggested revisions” that depart from Design-Builder’s plan with potential cost and time impacts – and added design responsibilities
- Communicate Clearly:
 - Recognize Owner crossing line from “reviewing” to dictating design decisions
 - Emphasize limited Owner rights to control the design process
 - Design-Builder and Designer must both attend – contractual privity!

Design Responsibility – Subcontractor Considerations

Design Responsibility Implications – Subcontracting

- Subcontractor generally takes on portion of the work with all attendant obligations of Contractor to Owner with respect to such work
- Flow down provisions – to apply or not to apply to design responsibilities?
- Application of additional scrutiny for flow down provisions – e.g., in design-assist model, a wholesale flow-down may not be appropriate
- Implications for control of work and allocation of responsibility
- Ultimate risk of subcontractor default in context of design responsibility

Design Responsibility Implications – Subcontracting

- Subcontractor default on traditional D-B-B project can be problematic, but manageable; GC generally may terminate and hire a replacement
 - New subcontractor takes over
 - Subcontract termination clause determines liability of the defaulting subcontractor.
- Default of subcontractor with design responsibilities is more complex, particularly when design has commenced and schedule is tight

Design Responsibility Implications in Terminations

BMAR Associates, Inc. v. Midwest Mechanical Group (2010)

- Medical building renovation Design-Builder subcontracted design and construction of boiler work to mechanical subcontractor
- Subcontract divided boiler package into two design phases and separate construction phase (only construction phase required P&P bonds)

Design Responsibility Implications in Terminations

BMAR Associates, Inc. v. Midwest Mechanical Group (2010)

- Subcontractor anticipated self-performing the installation work:
 - Construction documents not prepared to same level of detail that independent Designer may have provided
 - Planned that any design issues arising during construction would be addressed and resolved by subcontractor's own field forces
 - Design-Builder left the technical details of the boiler design to the subcontractor

Design Responsibility Implications in Terminations

BMAR Associates, Inc. v. Midwest Mechanical Group (2010)

- Subcontractor unable to provide P&P bonds for field work
- Design-builder understood added complexity created by design responsibilities of original subcontractor
 - Sought substitute subcontractor for field work and to negotiate transition of the full boiler package to a second subcontractor
 - Instructed the original subcontractor to complete the boiler design

Design Responsibility Implications in Terminations

BMAR Associates, Inc. v. Midwest Mechanical Group (2010)

- Extensive negotiations with proposed substitute subcontractor – D-B wanted single point of responsibility, but no overall agreement reached
- Original subcontractor wanted to perform field work without P&P bonds, or be excused from further project involvement

Design Responsibility Implications in Terminations

BMAR Associates, Inc. v. Midwest Mechanical Group (2010)

- Increased scheduling pressures to commence field work, so D-B issued lump sum installment agreement for replacement subcontractor to perform field work
 - Incorporated boiler design developed by the first subcontractor
 - Did not place any specific design responsibilities on new subcontractor
 - Design-Builder felt this was a preliminary agreement with negotiations about single point of responsibility for all boiler design obligations to continue

Design Responsibility Implications in Terminations

BMAR Associates, Inc. v. Midwest Mechanical Group (2010)

- Replacement Subcontractor
 - Declined to accept design responsibilities
 - Raised numerous complaints about poor design
 - Construction claims for asserted design errors and omissions
 - Stopped work and litigation ensued

Takeaways

- Subcontractors with design obligations are not easily replaced
- Allocation of design obligations downstream requires vetting of subcontractor and specifically defined flow down of obligations
- Contractors may want to consider alternatives to termination
- Subcontractors with design obligations should evaluate all performance requirements and ability to comply
- If must terminate, transition is critical

Design Responsibility – Common Sense Recommendations

Common Sense Recommendations

- Project Staff Education
 - Risks of assuming design responsibility unless design is expressly agreed by contract (through appropriate design build or design delegation agreement)
 - Encourage early identification of express design obligations and obligations that have potential to implicitly impose design obligations
 - How to identify express design responsibility (e.g., performance specifications)
 - How to identify implicit design responsibility (e.g., owner requests for “fix” or “field resolution”)

Common Sense Recommendations

- Development of Risk Matrix / Tracking System by project phase:
 - Bid Phase (preliminary drawings by owner, performance specifications, contract clauses for compliance and coordination, etc.);
 - Preconstruction (constructability review, subcontract terms and flow down, design-assist obligations, etc.); and
 - Construction (construction coordination drawings, value engineering, shop drawings, RFIs, etc.).
- Evaluate Management and Mitigation Strategies
 - Policy/Procedure
 - Contract Clauses
 - Disclaimers

Common Sense Recommendations

- Contract Clauses for Express Responsibilities (design-assist, constructability review, etc.)
 - Contractor's recommendations, advice, or input regarding design alternatives, constructability reviews, or design modifications are subject to the review and approval of owner and designer.
 - Designer shall decide all questions arising as to the interpretation of the project design, including any input or recommendations from contractor.
 - Contractor's consultation with owner and the designer regarding selection of building systems, equipment or materials, or any alternative solutions offered affecting construction feasibility, schedules, cost or quality, including value engineering services, are not to be construed as assumptions of the designer's responsibility for design.

Common Sense Recommendations

- Disclaimers During Performance:
 - Contractor is not assuming design responsibility and design responsibility remains with the architect (engineer) of record.
 - By making these constructability comments, Contractor is commenting only on the means and methods of implementing the design and is not assuming design responsibility or supplanting the design from the architect (engineer) of record.
 - By submitting shop drawings and construction coordination drawings, Contractor is not assuming design responsibility and design responsibility remains with the architect (engineer) of record.

Questions?

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