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Forum on the Construction Industry

*After the Dance: Substantial Completion
and Beyond*

**Understanding, Negotiating and Documenting the Relationships Between and
Among Prime Design Professionals and Their Consultants**

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UNDERSTANDING, NEGOTIATING AND DOCUMENTING THE RELATIONSHIPS BETWEEN AND AMONG PRIME DESIGN PROFESSIONALS AND THEIR CONSULTANTS

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I. INTRODUCTION

This presentation deals with the issues, skills, challenges and recommended approaches used by the modern construction industry lawyer to negotiate, draft and evaluate the contracts and agreements used to document the legal and business relationships between the Prime Design Professional and the subcontractor and subconsultants¹ that it must or should retain to deliver a quality project on time, within budget and which performs within expected or required parameters.

II. UNDERSTANDING THE CONCEPTUAL RELATIONSHIPS BETWEEN THE MODERN PRIME DESIGN PROFESSIONAL AND ITS DESIGN TEAM MEMBERS

Most modern projects require that the Prime Design Consultant select, organize and contract with a “Design Team” of professionals and specialists that is lead by a Prime Design Professional. Today’s buildings, shopping centers, office parks, local and state government facilities, federal projects, high tech plants, transit systems, airports, multi-modal terminals and the like, require the talents, skills, expertise and experience of teams of architects, engineers, cost consultants, scheduling specialists, curtail wall designers and other specialty consultants. A “Design Team” may be as simple as a two person grouping of an individual architect and structural engineer—who produces a relatively simple set of drawings consisting of drawings for a single family, “stick built” residence—to a Design Team of over twenty highly-specialized professionals to design a major project such as an airport, a corporate headquarters facility or a multi-building corporate campus. In the latter situation, there may be several different architectural firms, an assortment of specialized professional engineers and specialty consultants

who are specialize in acoustical, audio-visual, kitchen and communications. The sophisticated structures, facilities, mixed-use urban developments and complicated housing/recreational/retail/commercial developments that most of us are called upon to document can require a large grouping of design professionals who must have sophisticated, effective, practical and understandable written documentation of the expectations, reciprocal relationships, payment provisions, scheduling, performance requirements, insurance, indemnity and other similar risk allocation and shifting provisions.

A. The Prime Design Professional—Prime Contractor to Owner, Developer or Design-Build Contractor

In all cases, there will be a lead-design professional who has the prime design responsibility and who must obtain the services of various major, specialty and use-specific design consultants to assist it in producing the deliverables required to provide guidance to the construction team. The Prime Design Professional is typically a business entity formed by a group of architects, engineers and/or other construction-industry professionals, who must select, organize, document and manage the relationships between the Prime Design Consultant and its subcontractor-design professionals, who are typically called “consultants.”

The details of the negotiation and documentation of the prime contract is outside the scope of this paper. However, preliminary assumptions regarding the terms and conditions of the prime design contract are required in order to properly understand, negotiate and document the subconsultant agreements.

The prime design contract consists of a scope of service, compensation or fee, and other essential and customary terms and conditions. The “other terms and conditions” will customarily include provisions for: standards of performance such as code requirements, standards of practice or care, insurance requirements, risk allocation, schedule or periods of performance,

indemnity provisions, third-party obligations such as lender or landlord rights, reporting or documentation requirements or standards, specific personnel or staffing obligations and any other unique owner-imposed requirements.

There are many electronically based “form” or “template” agreements that are used as the starting point for the prime design contract. Some of the most commonly available types, such as the AIA, AGC, EJCDC and DBIA “forms” are discussed later in Section IV of this paper. In our experience, many projects rely upon either the owner’s “form” design services agreement, one-of-a-kind, custom agreements or standard electronic/templates as the starting point of negotiation for the prime design contract. However, even where a standard electronic form/template is used, the final, executed contract will always contain some unique provisions. Accordingly, you must be aware of the subconsultants’ expectations before you get too deeply into the negotiation of the prime contract. Additionally, you should be careful to avoid agreeing to deliver a service, liability, standard of performance or deliverable to the owner that you cannot obtain from your subconsultant.

Without making your probable subconsultants parties to the negotiation with the owner, you should consult or communicate with the subconsultants in order to know what you can “sell” or “impose” upon them. Surprises in this area can be very costly to your client and you, if you represent the Prime Design Consultant. If you represent the subconsultant, you can avoid or at least minimize the amount of unnecessarily contentious subconsultant negotiations later, by alerting the other counsel to “non-negotiable” provisions that you will insist upon including in your agreement.

Prime consultants should never sign subconsultant contracts before the prime design agreement has been signed. The premature execution of a subconsultant agreement will almost always come back to haunt your client—and perhaps you.

B. The Prime Design Professional Typically Engages Three Types of Subconsultant to Join The Design Team: “Principal/Major,” “Specialty” and “Shared or Limited Risk”

The Prime Design Professional’s consultants typically fall into three categories or groupings: “principal or major” consultants, “specialty” consultants and “shared risk” consultants.

1. Principal or Major Subconsultants

“Major Consultants” are those consultants whose expertise is typically required to produce the structure, facility, building, development or project of the type at issue. Classically, the Prime Designer is an architect or engineer, and the major consultants will be the structural, civil, electrical, mechanical, and plumbing design professionals. The Major Subconsultants typically consist of licensed or certified professionals who have significant responsibility from the beginning of the design process through the production of final drawings and specifications which must be stamped, sealed, signed or certified for submission to the code review authority for approval before a “building permit” may be authorized for issuance.

2. Specialty Subconsultants

“Specialty Consultants” are subcontractors to the Prime Design Professional and who are retained to provide specialized technical expertise for some particular system or portion of the project. The variety, level of specialization and expertise of Specialty Consultants range from the very common to the very specific. Examples include elevator or vertical transportation, interiors, kitchen, acoustical, scheduling, cost estimating, parking, surface transportation, graphic

or signage, fire protection, communication, audio visual, security, curtain wall, shoring, steel connections, lighting, etc.

The evolution of the “standard of care” that is a minimum performance standard for design professionals has caused some areas of consultancy that thirty years ago were limited to only high-budget or unique projects to become as common and necessary as structural or civil engineering. Some examples include:

- Lighting consultants on commercial, office, governmental or other public facilities
- Security consultants
- Acoustical consultants
- Communications consultants on governmental or headquarters office facilities
- Elevator or vertical transportation consultants on office complexes, shopping centers or multi-modal transportation hubs

3. Limited or Shared Risk Subconsultants

In the modern world of design professional contract negotiation, drafting, evaluation and review, a third area of subconsultant is frequently encountered. These subconsultants are technically subcontracted to the Prime Design Professional but with some significant modification in the normally expected line of authority, reporting relationships, allocation of risk or responsibility for performance. Unique contractual provisions that modify the normal level of liability of the Prime Design Professional typify the agreements between these subconsultants and the Prime Design Professionals, which have corresponding provisions in the prime design contract. Some examples of these subconsultant disciplines include soils engineering, surveying, environmental and hazardous materials or explosives removal.

A significant characteristic of this grouping is that the discipline or specialty is not insured or insurable under the professional liability insurance of the Prime Design Professionals. For many years, the use of the project professional liability insurance policy reduced the need for construction lawyer to have special agreements or provisions for this grouping. However, over the last 1 to 1 ½ years, and particularly since “9/11,” we have observed project professional liability insurance become less available for certain types of projects, i.e. condos. Furthermore, the significant increase in premium costs since September has made project policies less attractive even when they are available. Accordingly, contractual risk limitation, sharing or avoidance will make this grouping more common and special subcontracts more necessity.

III. NEGOTIATING THE CONTRACTUAL RELATIONSHIP BETWEEN DESIGN PROFESSIONALS AND THEIR CONSULTANTS

The first step in negotiating the contractual relationships between the Prime Design Professional and its subconsultants is the identification of the specific disciplines and specialties that are required. Typically, the Prime Design Professional will have tentatively selected the consultants and will have a summary of their key information: name, address, phone, fax, email, website, contact person, scope and fee information. In our experience, it is fairly common for the subconsultants to submit their scope and pricing or fee information to the Prime Design Professional in the form of a proposed subcontract or consulting agreement.

We have “long” and “short” forms/templates for use as a starting point for the preparation of subcontract agreement, samples of which are attached hereto as Exhibits A & B, respectively. Typically, the “long” form is used for the principal or major subconsultants, e.g. structural, civil, mechanical, electrical, plumbing and fire protection.²

We typically start our negotiations by making a comparison of the terms of the executed prime contract with the subconsultant fee and scope proposals and our long form subconsultant

agreement. This comparison will identify those provisions or subjects in the prime contract that will impact our negotiations. We look for subjects or provisions that are identical or substantially equivalent. There are always some of these provisions that can form the basis of the first draft of the subconsultant agreements. Next, we identify the “business” scope and fees issues and provisions and make a list of these provisions. This list is provided to the client for his/her review and comments so that we can determine which of these provisions can be resolved on a relatively quick basis and which ones will require more attention. Finally, we determine the basic subconsultant provisions, clauses and terms that we feel must be requested to protect our client’s interest. This exercise will allow us to prepare a first draft of the agreement. It will also allow us to identify issues that will need to be negotiated.

A. Understanding the Basic Legal, Business and Liability Issues That Are Inherent In The Prime Design Contractor-Subconsultant Relationship.

The following legal, business and/or liability principals govern these contractual and professional relationships. These principals and concepts are substantially the same in each jurisdiction.³

1. Who is Professionally Liable?

Architects and engineers often consult with other experts for guidance such as subsurface or soil engineers. In order to obtain their guidance on a specific project, design professionals will often enter into contracts with other design professionals having such specialized expertise directly. In such situations, the “prime” contractor in contractual privity with the owner remains liable for any errors caused by its consultants.⁴

Courts may employ several legal theories in holding the Prime Design Professional liable. Using agency law, a court may view the consultants as agents of the prime contractor, holding the prime contractor responsible for consultants’ conduct.⁵ Additionally, the owner or

the employer may have a breach of contract action against the Prime Design Professional for errors caused by the consultants, depending on the terms of the contract.⁶ For example, the contract may provide that the design professional is liable for the work of subcontractors that they hire. The Prime Design Professional may also be liable under tort law, which imposes on the design professional the duty to exercise reasonable degree of care.⁷ It is important to note, however, that many states have applicable comparable negligence laws that apportion damages based upon a finding of negligence or fault.

In an attempt to decrease the liability arising from agency law, some standard contracts describe consultants as “independent contractors” rather than agents of the design professional.⁸ Moreover, independent of any contractual language, courts have held that the prime professional is not liable for any acts by its consultant if the design consultant: (1) retained control over the manner and means of the work; or (2) was only responsible to the Prime Design Professional for the results.⁹ Nevertheless, a court may still hold the consultant to be an agent of the prime professional depending on the amount of control exercised by the prime contractor.

Liability for the subconsultants negligence, breach of contract and proportionate fees, costs and expenses to the subconsultant may be shifted contractually, through the use of appropriate indemnity language. Another mechanism for managing this risk is to carefully draft the language of the prime contractor so that you do not assume unreasonable risks.

2. Indemnification and Contribution

Two legal concepts govern the allocation of liability between a Prime Design Professional and its consultants: indemnification and contribution. Indemnification may arise either contractually in anticipation of future claims or, in some states, by operation of law if, once a claim has arisen, a passive tortfeasor is required to pay damages to a third party.

Contribution may arise by operation of law if one party is unjustly required to pay damages to a third party that should rightfully be borne by several tortfeasors.

Liability on a particular project may be shifted among a Prime Design Professional and its consultants through the incorporation of an indemnification clause in their contracts. An indemnification clause is a contract clause intended to shift all or a portion of the liability from one party to another “in a manner that would not have occurred in a predictable manner under common law in the absence of the contract.”¹⁰ The scope of a contractual indemnity provision may range from a somewhat narrow obligation, i.e., for one party to reimburse the other for actual damages paid to a third party following an assessment of damages, to the much broader obligation of one party to provide legal counsel for the other party based upon allegations which, if proven, would come within the scope of the indemnity provision.

Some states also recognize equitable indemnification as a part of their common law. Under this theory, if “. . . a passively negligent tortfeasor is required solely through operation of law . . . to pay for damages to a third person which have been primarily caused by the active negligence of another . . . the active tortfeasor will be held to be the indemnifier of the passive tortfeasor.”¹¹ With equitable indemnification, therefore, one party may be required to indemnify the other as if there was a contractual indemnification clause in place *if* that tortfeasor actively caused the damages paid for by the passive tortfeasor.¹²

A second way in which liability may be shifted among multiple design professionals is through contribution. “. . . [U]nder [the] principle of ‘contribution,’ a tortfeasor against whom a judgment is rendered is entitled to recover proportional shares of judgment from other joint tortfeasors whose negligence contributed to the injury and who were also liable to the

plaintiff.”¹³ Many states recognize the right to contribution following damages paid for negligent design or construction either under their common law or by statute.¹⁴

3. Insurance Issues

Insurance and indemnity provisions “drive” professional liability contract language. In allocating the risk among multiple design professionals, the proper insurance coverage is essential. A project professional liability policy (“Project Policy”) is a particularly appealing insurance product for a project involving multiple design professionals. Under such a policy, coverage applies to design services provided for the project itself. Under a practice professional liability policy (“Practice Policy”), by contrast, professional services rendered by an individual design professional on all projects during a policy period are covered. Rather than having overlapping Practice Policies for each design professional where gaps in coverage and conflicts may arise, a Project Policy covers the Prime Design Professional as well as its consultants for their collective work on a project. As such, a Project Policy replaces the design professionals’ annual policies with regard to services provided for the project. To ensure that coverage will apply against any potential claims arising out of the project, an extended reporting period should be in place until the time limits set forth in the applicable state’s statute of repose have expired.

With a Project Policy in place, one may want to consider drafting a deductible payment agreement in order to fairly allocate the insurance deductible among the various design professionals should a claim arise under the policy. One straightforward way in which to divide the payment is to require each professional to pay the same percentage of the deductible as they will receive of the total design fees.

A design professional hired as a design-builder has added insurance concerns. As both the contractor and the designer, a design-builder must ensure that it has adequate insurance

coverage for both aspects of the project. In addition to professional liability coverage, the design-builder must provide commercial general liability insurance, automobile insurance, employer's liability insurance and workers compensation insurance. Although a Commercial General Liability ("CGL") policy will provide most of the coverage needed, the standard policy excludes professional services from coverage. Furthermore, though endorsements specifically created for CGL policies may be added to cover certain aspects of design, they are not intended to provide the scope of coverage found in a professional liability policy. Because both the contractor insurance risks and the design insurance risks are not covered by most single insurance products, the design-builder will likely have to purchase professional liability coverage in addition to its basic coverages as a contractor.

4. Allocation of Professional Liability

An owner may contract directly with multiple design professionals for various stages of construction. Generally, each design professional is only liable for the breach of their contractual duties, and not for errors committed by other independent contractors.¹⁵ Thus, a design professional may be retained in a limited capacity, with his contract not calling for the supervision of the work of other design professionals.¹⁶

On the other hand, a design professional may be liable for errors, omissions or defects caused by others if he contractually assumes such responsibility.¹⁷ An architect who contracts to supervise or administer construction may have the duty to report serious defects in the design he either knows of or reasonably should have known and to make the necessary recommendations.¹⁸ If such responsibility is undertaken and the design work is found to be defective in some way, courts may apply the doctrine of comparative fault to determine the percentage of liability of

each professional.¹⁹ Courts may also apply the doctrines of indemnification or contribution, discussed above. However, this area of law still remains unsettled.²⁰

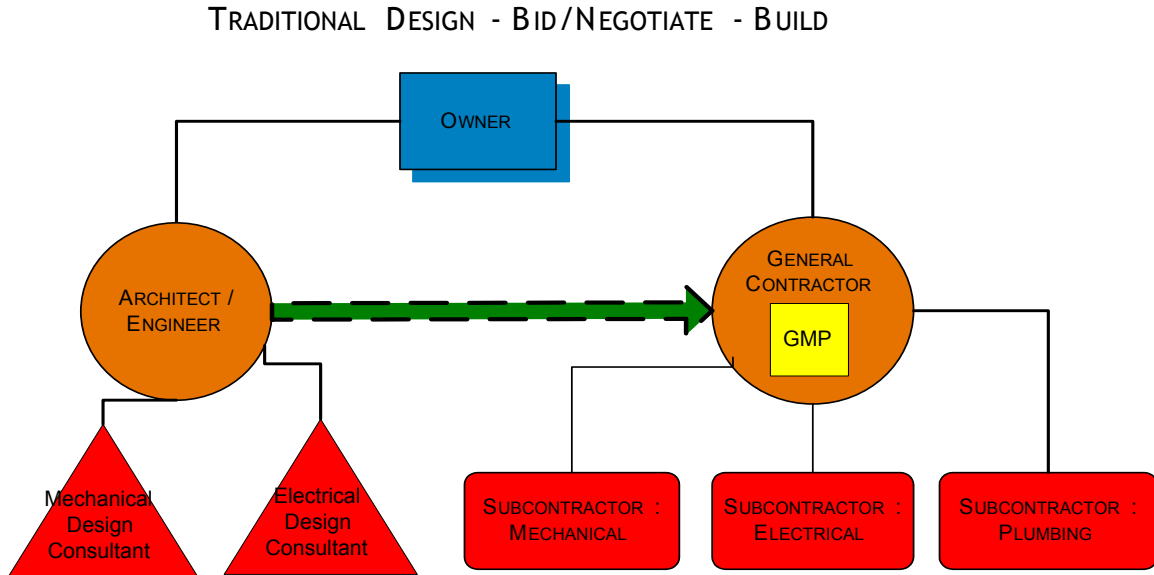
5. Multi-State Practice Issues: Licensing and Liability for Stamping Drawings of the Out-of State Design Professional

With multiple professionals involved on different aspects of the same project, multi-state practice may become an issue. Most state statutes impose various licensing and performance requirements on design professionals, and therefore, a design professional must obtain a state license or registration in order to practice in that jurisdiction.²¹

In some states, a non-resident architect may be able to obtain registration in a foreign state within a short period of time after applying, thereby remaining directly liable for design work done for property in the state.²² Another way to overcome the licensing concern if professionals from out-of-state are involved in a project is to have the resident design professional contract with those out-of-state and approve their design work. It is fundamental for the resident professional to understand that by entering into such a contract with an out-of-state design professional, the resident professional will be liable for the approved work. “[When] the owner contracts with a [resident] architect . . . he, in turn, is free to arrange for all manner of supporting services from any architect in the world. The [resident] architect, of course, remains fully and solely responsible for the professional services rendered to the owner.”²³

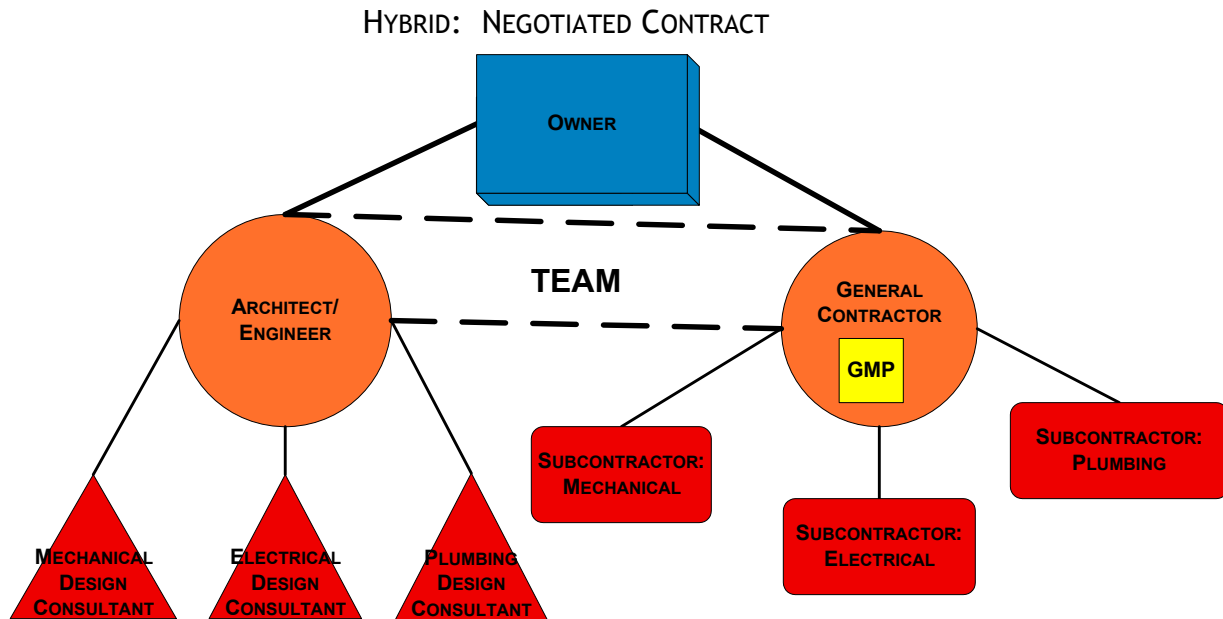
IV. THE IMPACT OF TRADITIONAL PROCUREMENT METHODS UPON SUBCONSULTANT CONTRACT DOCUMENT: DESIGN PROFESSIONALS AND THE CONSTRUCTION TEAM

A. *Classic or Traditional Procurement Method: Design-Bid/Negotiate-Build*²⁴



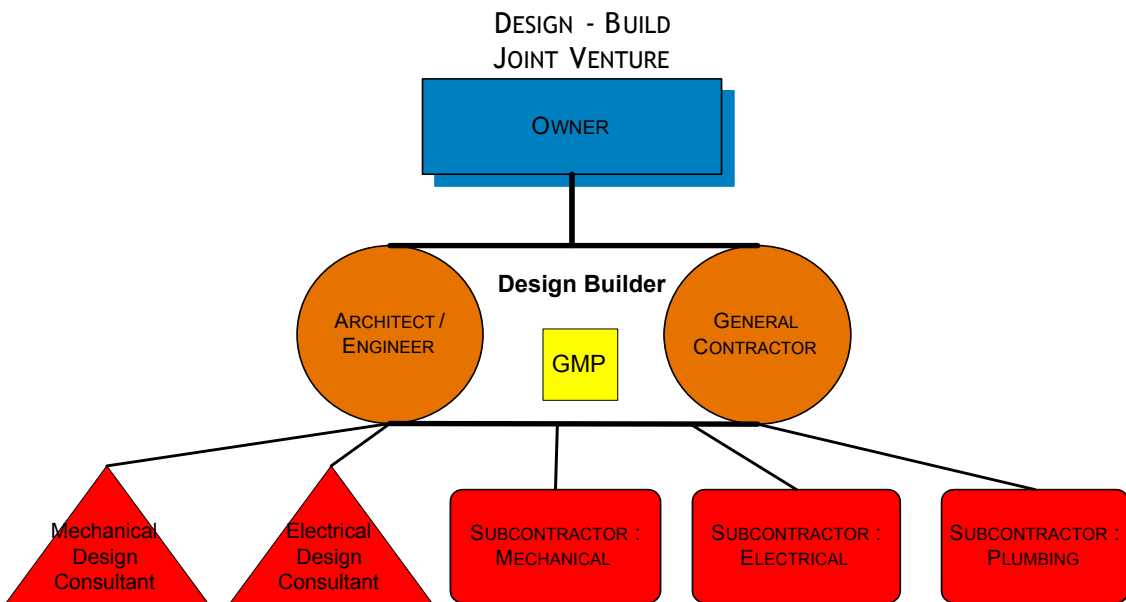
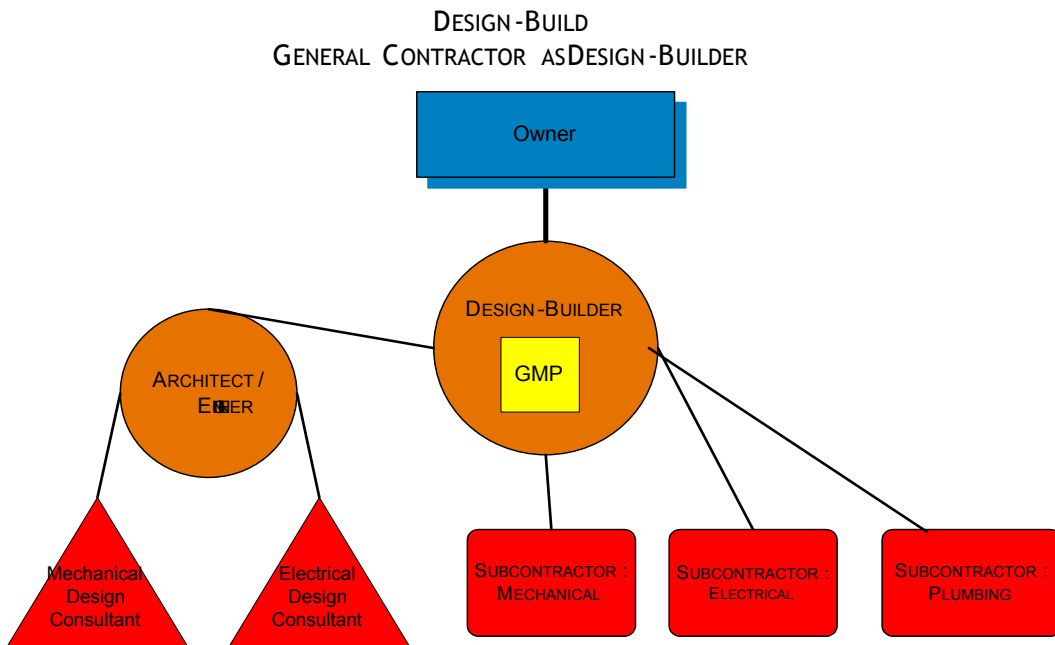
With the traditional design-bid-build or design-negotiate-build project, the owner first enters into a contract with the design professional. The design professional is responsible for completing the design phase of the project first and is the only entity besides the owner involved at this stage. Once the design is complete, the owner opens the project to bidding by contractors if it is a public entity. If the owner is a private entity, it negotiates a contract to build the project with a general contractor. The owner then enters into a separate contract with the successful general contractor who takes over the construction phase of the project. During the construction phase, the general contractor is responsible for hiring and entering into contracts with all subcontractors and generally coordinates the project so that it is kept on schedule and within budget. The design professional remains on-hand to coordinate the project, observing construction to ensure that the project is constructed according to the plans and specifications of

the design. In this scenario, the design professional is only liable for the design of the building and the accompanying specifications.

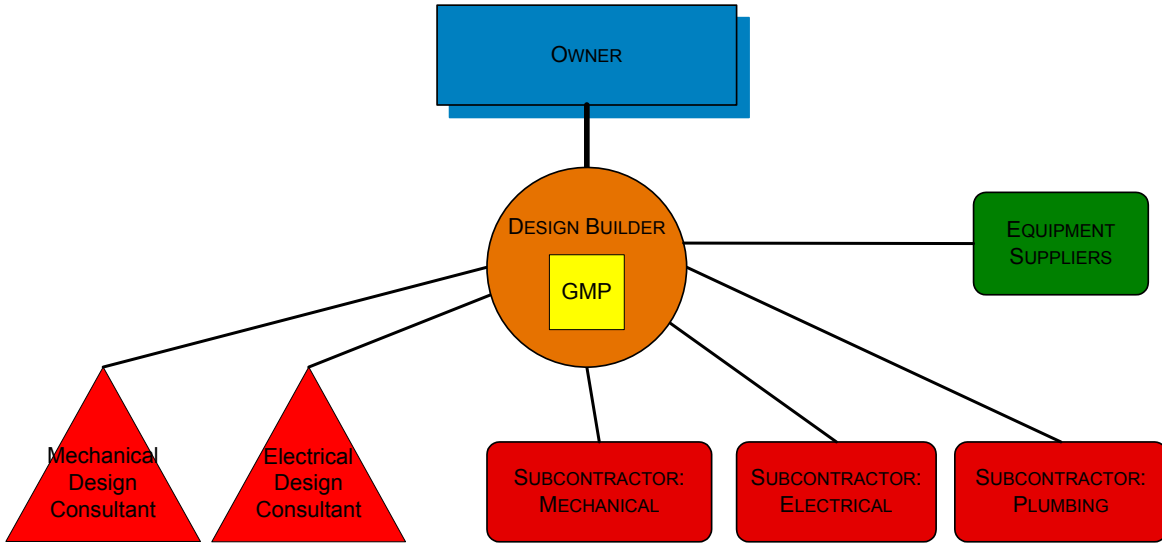


This method is a hybrid of the traditional design-bid-build method. Here, the owner first contracts with the design professional who begins the design process. The general contractor selection process then begins with input from the design professional—in other words, both the owner and the design professional decide on the general contractor. The design process is finished from here with the owner, design professional and general contractor working as a team to establish a budget, review constructibility and value engineer the project. From there, the general contractor “team member” takes over construction and works in conjunction with the design professional “team member,” who oversees construction to ensure it is built according to the design. Liability for the design professional under this method is the same as under the traditional method, i.e., it is limited to the design of the project.

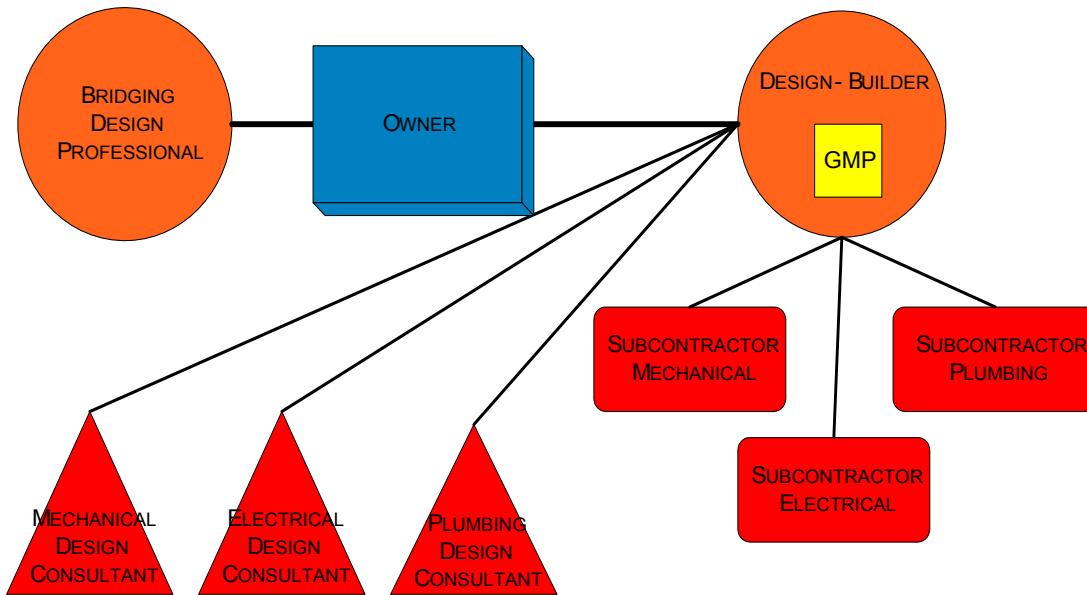
B. Design-Build Method



**DESIGN-BUILD
IN-HOUSE DESIGN CAPABILITIES
(ENGINEER PROCURE & CONSTRUCT "EPC")**

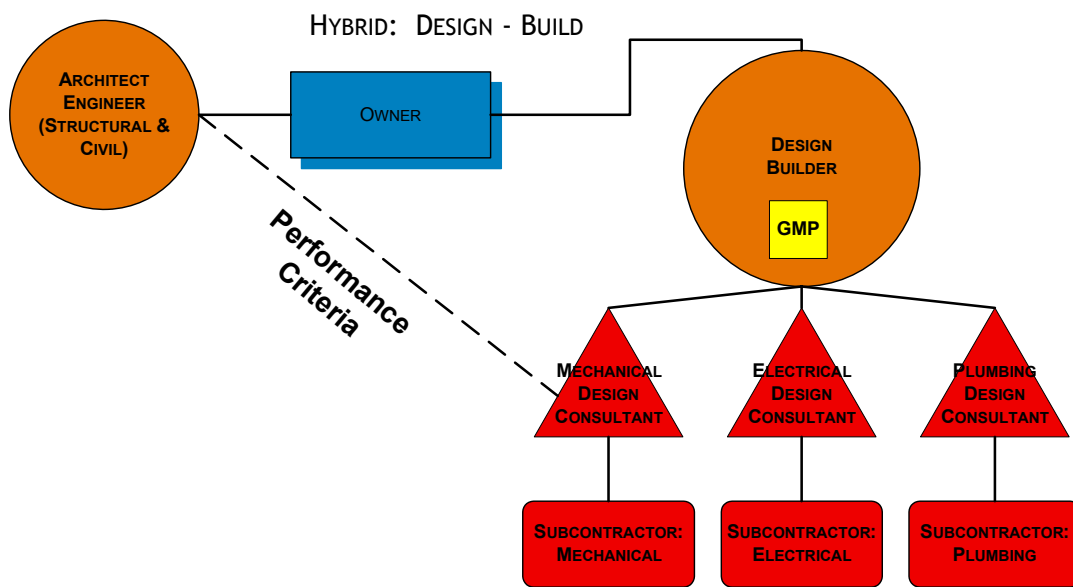


HYBRID: DESIGN - BUILD BRIDGING



In the bridging hybrid of the design-build method, a design consultant is hired first by the owner to prepare conceptual design documents. Once these preliminary drawings are reviewed for cost estimating, constructibility, etc., these conceptual design documents are bid on by

prospective design-builders. The successful design-builder then uses these documents to develop its GMP, thereafter assuming the responsibility for design completion and construction of the project. In this scenario, the original design consultant would have liability limited to the preliminary drawings and would not be responsible for the final design or project construction. Of course, as explained in the Design-Build section, if a design consultant is also involved as the Design-Build entity its liability would extend from final design through construction.



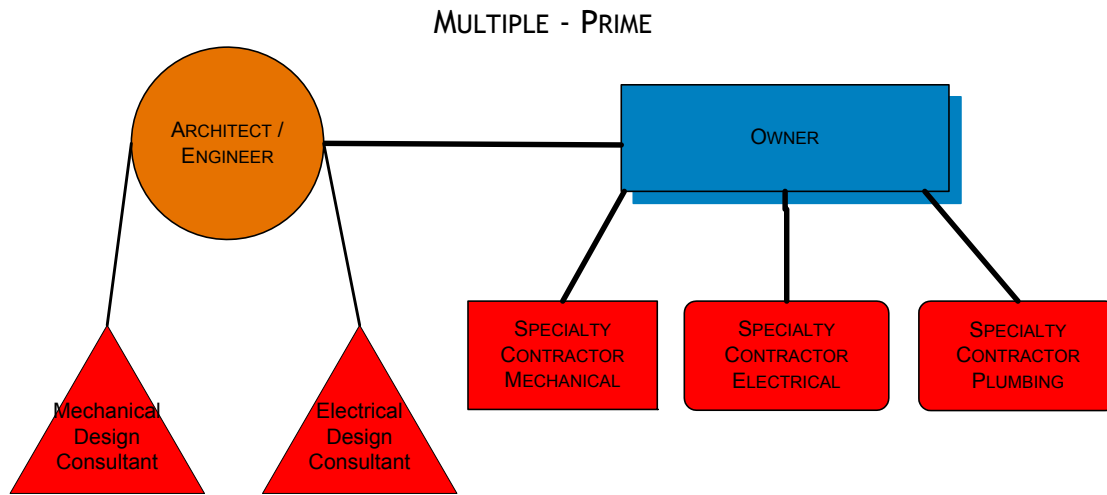
This method is a hybrid of the design-build method. Here, the owner enters into a contract with a design professional for some portion of the design, usually structural and civil. This design consultant provides the criteria for the design but does not actually design it. The owner then contracts with a design-build entity to complete the design as well as the construction phase of the project. The Design-Builder often subcontracts with a design consultant(s) to complete the remaining aspects of the design, such as mechanical, electrical and plumbing. In the alternative, the Design-Builder may possess design capabilities in-house. In this scenario, design professional liability varies with the scope of the professional's role. If the design

professional is the original consultant is hired by the Design-Builder, it is liable only for those aspects of the design that it undertook (such as structural, mechanical and civil) and the criteria it provided to the Design-Builder. If, on the other hand, the design professional is the Design-Builder, it is potentially responsible not only for those portions of the design not finalized by the original consultant, but construction as well.

C. Distinctions Between The Traditional and Design-Build Procurement Methods That Affect The Contracting Process

The central difference between the traditional method and the design-build method is that with design-build, all operations and responsibility run through a single entity. With this method, the owner accepts bids on a project that encompass every stage of the project, from the design through construction. The owner then enters into one contract with the Design-Builder. This entity is then responsible for every facet of the design and the construction of the project. Every other contract that may be needed to complete the project is entered into with the Design-Builder rather than the owner. The Design-Builder may be a joint venture formed between a general contractor and a design firm, a construction entity with in-house design professionals, or a general contractor who then contracts out the design work to a professional. This method is often used when the owner wants to “Fast-Track” a project and minimize overruns on cost with a guaranteed maximum price (“GMP”). If the Design-Builder is a design entity, it takes on liability for the design as well as construction of the project.

D. Multiple-Prime

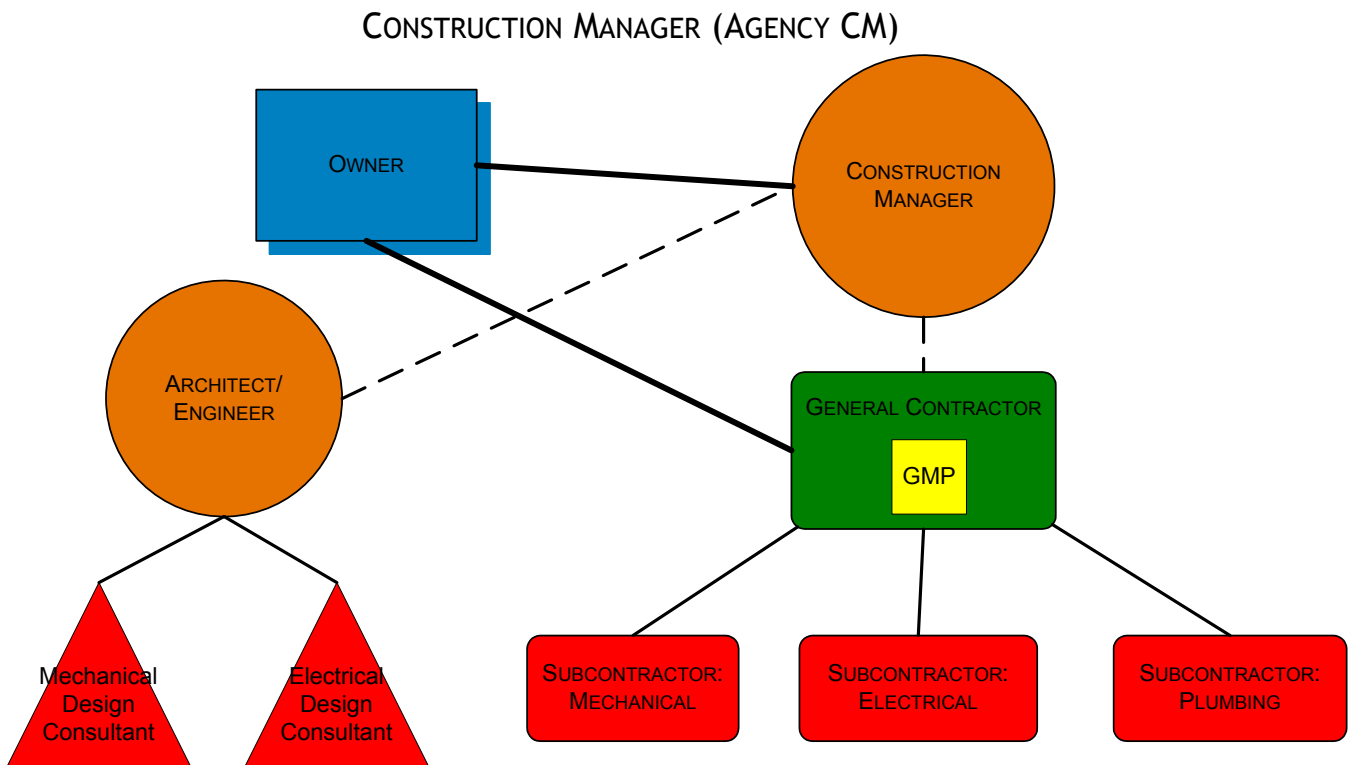


This method is often used when the sophisticated owner wants to retain more direct control over the construction of the project by selecting the contractors that will be performing the work. With multiple prime, the owner first hires a design professional to complete the design. Once the design is complete, the owner then contracts with several contractors to complete construction. In this scenario, an owner will typically contract with contractors specializing in the major components of construction, such as structural, mechanical and electrical. The method works well with “Fast-Tracking” on the construction end as the owner can bid-out phases of construction separately and begin building while later phases of construction are still being bid.

Because they are separate entities, the structural contractor may begin working while the electrical contractor, for example, is still in the process of producing its bid or entering into its contract with the owner. A GMP is not usually available with this method because each phase is controlled by a separate entity specializing in that particular phase of construction. With

multiple prime the design professional is liable for the design of the project, as in the traditional method.

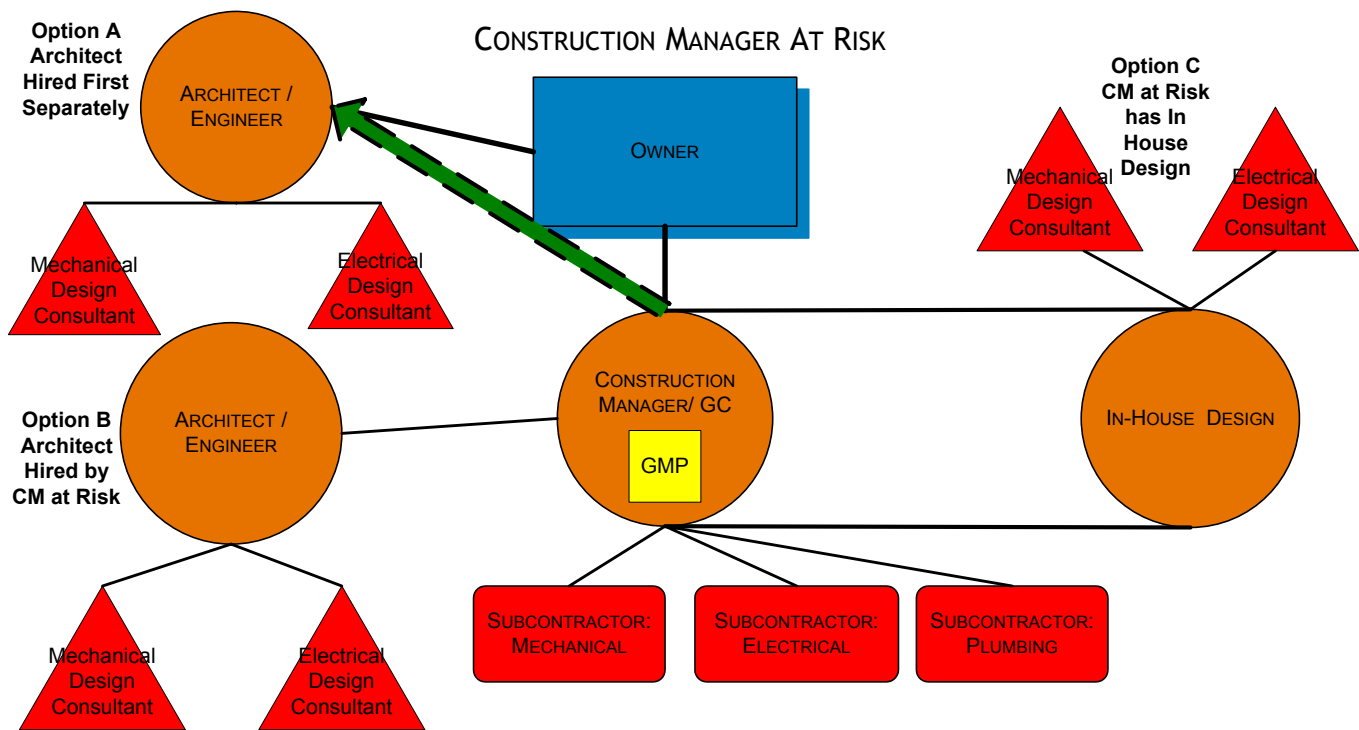
E. Construction Manager (Agency CM)



A Construction Manager (“CM”) of this type may be used with any type of project delivery method: traditional design-bid-build, design-build, multiple prime, etc. A construction manager (CM) is hired by the owner to serve as an administrator with construction expertise overseeing the project. This option is especially appealing to owners with little construction know-how. The CM is often hired during the pre-construction phase for cost estimating, assessing constructibility, providing value-engineering services, and scheduling development. It remains on hand throughout construction to ensure that construction is per the design specifications and that the project continues on schedule.

In this scenario, the CM does not hold a contract with the design professional, general contractor or any subcontractor and does not take on any risk guaranteeing the cost of the project. The CM only holds a contract with the owner and is not directly liable for either the design or construction. A design professional may be a CM on a project. If so, two design professionals are involved: one creating the design and one administering the entire project from design through construction.

F. Construction Management At Risk



In the construction manager at risk (“CM at Risk”) scenario, the CM at Risk is hired to perform the same tasks as a CM. However, in addition to these tasks, the CM at Risk provides all construction services (and potentially design services as well). The CM at Risk, rather than the owner, holds the contracts with the subcontractors and has control over the construction. The CM provides the GMP to the owner and is the single point of responsibility for the construction phase. The design professional may hold a separate contract with the owner to complete the

design. Alternatively, the CM at Risk may hire the design professional and the design professional will hold a contract only with the CM or, the CM at Risk may itself have in-house design capabilities. Whether the design professional has a separate contract with the owner or whether it contracts directly with the CM at Risk, the CM reviews the design and verifies the design's constructibility, cost, etc. If the design entity is the CM at Risk, it has expansive liability including not only design but construction as well.

G. Other Hybrid Procurement Methods

1. Build-Operate-Transfer (BOT)

With this method, one entity is in charge of (1) design, (2) construction, (3) construction financing, and (4) temporary operation of the facility. The owner enters into one contract with the BOT entity, which then enters into additional contracts with design professionals and subcontractors as needed. The BOT entity may contract separately with a design professional or it may be a design entity capable of producing the design in-house. The facility, once constructed, is under the control of the BOT entity until the end of a defined operations period, at which time it is transferred to the owner. In this scenario, the BOT entity takes on expansive liability, including not only design and construction but also financing and the operation of the facility for the period defined in the contract.

2. Turnkey

Under the turnkey approach, one entity is in charge of (1) design, (2) construction, (3) either short-term financing or long-term financing, and (4) acquisition of the site and governmental approval if necessary. The contractor may also retain ownership of the property until construction is complete. In essence, one entity is in charge of everything through substantial completion, at which time it “turns the keys over” to the owner. This technique is

very common in residential construction. If a design professional is the turnkey entity involved, their liability is the most expansive of any of the project delivery methods—they are responsible for every facet of construction until the keys are handed over to the owner including design, construction, financing as well as zoning or other government approval issues.

IV. STANDARD CONTRACT FORMS AVAILABLE FOR SEVERAL TYPES OF PROCUREMENT METHODS

The Most widely used standard forms are as follows:

- American Institute of Architects (AIA) Contract Documents
- Association of General Contractors (AGC) Contract Documents
- Building Owners and Managers Association (BOMA) Contract Documents
- Engineers Joint Contract Document Committee (EJCDC) Contract Documents
- Design-Build Institute of America (DBIA) Contract Documents
- Construction Management Association of America (CMAA) Contract Documents

V. UCC ISSUES WHERE PRIME DESIGN PROFESSIONALS CONTRACT WITH EQUIPMENT AND MATERIALS SUPPLIERS

A unique issue in Engineer-Procure-Construct (“EPC”) contracting is the application of the UCC to the sale of the equipment procured and installed by the EPC Contractor. The UCC applies to the sale of “goods.” UCC § 2-105 defines “goods” in relevant part as “all things, including specially manufactured goods, which are movable at the time of identification to the contract. . .” “Goods” can include items commonly found on EPC projects such as steam turbines, package boilers, HRSGs, process piping, combustion turbines, generators, stacks, roofing materials, prefabricated buildings, condensers, furnaces, etc.

A. Application of the UCC to Construction Contracts

To determine whether a contract is a sale of “goods” and therefore subject to the UCC, courts often apply what has been referred to as the predominant purpose test. This test stresses the fact that the goods must be movable to fall within the UCC. Courts also consider the incidental services/goods test to determine if the services to install the item are merely incidental to the sale of the goods. Under this analysis, even roofing materials have been deemed “goods.” These issues are fact-specific and typically involve an analysis of both the contract and the nature of the goods involved. We have handled claims against a package boiler manufacturer, which were installed as part of a production process system where the sale of the boilers was held subject to the UCC. The significance of this to the EPC Contractor is that its contracts for procuring the necessary equipment or materials necessary to the completion of the project may be covered by the specific provisions of the UCC and not the implied duties and obligations of common law.

B. UCC Limitations on Damages, Statutes of Limitations and Remedies

Sales subject to the UCC may be subject to limitations on the EPC Contractor’s right to rely upon manufacturer’s warranty, remedies and statutes of limitation. This is significant because the rights afforded to parties under the UCC may not be consistent with the EPC Contractor’s obligations under its contract with the Owner. Consequently, the EPC Contractor must be alert to and understand UCC issues reflected in its procurement contracts and how those issues relate to its obligations to the Owner.

1. Warranty disclaimers

The UCC allows the parties to a contract for sale of goods to disclaim warranties. Transactions between sophisticated buyers and sellers of goods will routinely provide for a

disclaimer of all implied warranties. EPC Contractors will see such disclaimers common in contracts for procurement of equipment or materials. Nevertheless, such implied warranties are not typically contained in EPC Contractor's contract with Owner.

2. Limitations on remedies

Many contracts will contain provisions that limit the EPC Contractor's remedy to repair or replacement of the defective materials. Unless these limitations can be said to "fail of its essential purpose," they are generally upheld. Under UCC § 2-719, sellers can also disclaim liability for incidental or consequential damages, which may include such items as delay costs, lost efficiency, additional overhead, interest, and the like.

3. Statute of limitations

Section 2-725 of the UCC allows the parties to shorten the normal statute of limitations period for breach of contract actions to as little as one year from delivery. A breach of warranty occurs at time tender of delivery is made unless warranty expressly goes to the future performances of the goods and discovery of the breach must wait until the time of performance. Note that the date of delivery can occur much earlier than the date the equipment is installed, tested and put into operation.

In one case we handled, delivery occurred "FOB Manufacturing Plant." The equipment had to be shipped via railcar cross-country, then placed upon a barge for the final portion of its trip. It was then removed from the barge by crane and set on-site. Additional months passed as the process-piping, stack and other equipment was installed. By the time the unit was actually tested in the field, the one-year limitation period had already expired. The court enforced this limitation even though the EPC Contractor was not aware of the defect until after testing had occurred.

C. UCC Issue Avoidance

It is unlikely sophisticated counsel for suppliers of major equipment will agree to indemnify the EPC Contractor to the same extent EPC Contractor must indemnify the Owner. There are creative ways to seek to address this issue, however. For example, it may be possible to obtain agreement from Owner to directly procure equipment, which the EPC Contractor will then install.

VI. CONCLUSION

The relationships between the between the Prime Design Professional and its consultants can be very complex and a source of unnecessary liability unless the construction lawyers involved in the contracting process understand the relationships and negotiate the business and liability terms and conditions properly. Risk allocation and insurance are significant factors in determining the contractual roles and rights of the parties. Once understood, the clear and legally proper documentation of the relationships is essential in order to avoid unnecessary disputes and waste of our clients' precious assets and resources.

¹ As with most things in the construction industry, the terminology that is used to refer to the subcontractors of the Prime Design Professional has some interesting applications and twists. Subcontractors to the prime designer who are licensed professionals or whose professional expertise evolved as a highly specialized subset of a professional design discipline, are typically referred to as "sub consultants." Subcontractors to the prime designer whose expertise or specialty does not customarily require licensure or which evolved from a skill or technical but not professional competency are frequently referred to as "subcontractors. Elevator, fire protection, such as cost estimating, scheduling, roofing design (metal or non metal),

² We frequently see fire protection handled as a design-build subcontract component of the construction contract. On a less frequent, but very common basis, we see HVAC or MEP handled on a design-build subcontract basis as well.

³ There are many subtle but important variations in the applicable legal principals in different jurisdictions. There are also specific statutory differences that must be considered and addressed as appropriate to your deal.

⁴ See, e.g., *Scott v. Potomac Ins. Co.*, 217 Or. 323, 341 P.2d 1083 (1959) (architect held liable for failure of heating system designed by sub-consultant engineer); *Garver & Garver, P.A. v. Little Rock Sanitary Sewer Comm.*, 300 Ark. 620, 781 S.W.2d 24 (1989) (engineer held liable for supplier failing to meet specifications); *Playskool, Inc. v. Elsa Benson, Inc.*, 147 Ill. App. 3d 292, 497 N.E.2d 1199 (1986) (architect held liable for failure of pre-cast concrete floor designed and fabricated by its sub-consultants); *Eastover Corp. v. Martin Builders*, 543 So. 2d 1358 (La. Ct. App. 1989) (architect held liable for its mechanical consultant's failure to detect plumbing defect); *R.D. Sepper Co. v. Venetian Iron Works, Inc.*, No. 89-C4174, 1990 U.S. Dist. LEXIS 17706 (N.D. Ill. Dec. 31, 1990) (architect held liable for its structural engineer consultant's failure to provide adequate specifications).

⁵ See, e.g., *Bayuk v. Edson*, 236 Cal. App. 2d 309, 46 Cal. Rptr. 49 (1965).

⁶ See *Getzchman v. Miller Chem. Co.*, 232 Neb. 885, 898, 443 N.W.2d 260, 270 (1989) ("If there is an express contract for architectural services, an architect's duties are determined by the contract for the architect's employment"); *Kahn v. Terry*, 628 So. 2d 390 (Ala. 1993) (quoting *Getzchman*).

⁷ See, e.g., *H. Elton Thompson & Assoc., P.C. v. Williams*, 164 Ga. App. 571, 572, 298 S.E.2d 539, 540 (1982) ("The law imposes upon persons performing ... engineering[] and other professional and skilled services the obligation to exercise a reasonable degree of care, skill and ability, which generally is taken and considered to be such a degree of care and skill as, under similar conditions and like surrounding circumstances, is ordinarily employed by their respective professions") (citations omitted); *Milton J. Womack, Inc. v. House of Representatives*, 509 So. 2d 62, 64 (La. Ct. App. 1987) ("The architect's duty is not to provide perfect plans but to exercise the degree of professional care and skill customarily employed by other architects in the same general area"); *Nelson v. Commonwealth*, 235 Va. 228, 236, 368 S.E.2d 239, 244 (1988) ("Absent a provision to the contrary, implicit in every contract of employment between an owner and an architect is the duty of the architect to 'exercise the care of those ordinarily skilled in the business' . . . This professional standard of care applies to the administration of project construction as well as to project design") (citations omitted); see also *Winsted Land Dev. v. Design Collaborative Architects, P.C.*, No. CV 960071571, 1999 Conn. Super. LEXIS 2180 (Conn. Super. Ct. Aug. 12, 1999); *Riggins v. Bechtel Power Corp.*, 44 Wn. App. 244, 722 P.2d 819 (Wash. Ct. App. 1986); *Laukkanen v. Jewel Tea Co.*, 222 N.E.2d 584 (Ill. Ct. App. 1966); *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 677 P.2d 1292 (Ariz. 1984); *Vonasek v. Hirsch & Stevens, Inc.*, 221 N.W.2d 815 (Wis. 1974); *Seiler v. Levitz Furniture Co., Inc.*, 367 A.2d 999 (Del. 1976).

⁸ See, e.g., AIA Doc. C141, Standard Form of Agreement Between Architect and Consultant, at 2 (1987 ed.).

⁹ See *Schoedinger v. Hess*, No. 99AP-1254, 2000 Ohio App. LEXIS 2409 (Ohio Ct. App. June 8, 2000).

¹⁰ Robert L. Meyers & Debra A. Perlam, *Risk Allocation Through Indemnity Obligations in Construction Contracts*, 40 S.C. L. REV. 898, 990 (1989); *see, e.g., Marino Constr. Co. v. Renner Architects*, 214 Wis. 2d 589, 571 N.W.2d 923 (Wis. Ct. App. 1997); *Kehoe v. Commonwealth Edison Co.*, 296 Ill. App. 3d 584, 694 N.E.2d 1119 (1998).

¹¹ *Green Constr. Co. v. United States*, 506 F. Supp. 173, 178 (D. Mich. 1980).

¹² *See, e.g., Woolard v. JLG Indus., Inc.*, 210 F.3d 1158 (10th Cir. 2000); *Medallion Dev., Inc. v. Converse Consultants*, 113 Nev. 27, 930 P.2d 115 (1997); *District of Columbia v. Murtaugh*, 728 A.2d 1237 (D.C. Cir. 1999); *Beitzel v. City of Coeur d'Alene*, 121 Idaho 709, 827 P.2d 1160 (1992); *Winnsboro v. Wiedeman-Singleton, Inc.*, 307 S.C. 128, 414 S.E.2d 118 (1992); *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, No. 38966-1-I, 1997 Wash. App. LEXIS 1801 (Wash. Ct. App. Oct. 27, 1997). Although adopting the phrase “equitable indemnity,” several states have adopted a hybrid mix of the concepts of indemnification and contribution. *See, e.g., Benner v. Wichman*, 874 P.2d 949 (Alaska 1994) (recognizing right of “equitable apportionment” following state abolition of right to contribution); *Far West Fin. Corp. v. D & S Co.*, 46 Cal. 3d 796, 760 P.2d 399 (Cal. 1988) (concept of comparative equitable indemnity covers whole range of apportionment of liability).

¹³ *Medallion Dev., Inc. v. Converse Consultants*, *supra* note 9, quoting Black’s Law Dictionary.

¹⁴ *See, e.g., Hartford Accident & Indem. Co. v. Scarlett Harbor Assoc.*, 109 Md. App. 217, 674 A.2d 106 (Md. Ct. Spec. App. 1996); *Standhardt v. Flintkote Co.*, 84 N.M. 796, 508 P.2d 1283 (1973). Several states recognize a statutory right to contribution, often stemming from comparative negligence principles, rather than one grounded in the common law. *See, e.g., Brochner v. Western Ins. Co.*, 724 P.2d 1293 (Colo. 1986); *Rothberg v. Reichelt*, 270 A.D.2d 760, 705 N.Y.S.2d 115 (2000); *Clearwater v. L.M. Duncan & Sons, Inc.*, 466 So. 2d 1116 (Fla. Ct. App. 1985); *Good v. Lemcon Dev., Inc.*, No. 12837, 1992 Ohio App. LEXIS 847 (Ohio Ct. App. Feb. 24, 1992).

¹⁵ *See generally Getzchman v. Miller Chem. Co.*, *supra* note 3, at 270.

¹⁶ *See generally Seiler v. Ostarly*, 525 So.2d 1207 (La. Ct. App. 1988); *Krieger v. J.E. Greiner Co.*, 282 Md. 50, 382 A.2d 1069 (1978).

¹⁷ *See supra* note 1.

¹⁸ *Nelson v. Commonwealth*, *supra* note 4.

¹⁹ *See City of Urbandale v. Frevert-Ramsey-Kobes Architects-Eng’rs, Inc.*, 435 N.W.2d 400 (Iowa Ct. App. 1988).

²⁰ *See* 2 Robert F. Cushman & James J. Myers, *Construction Law Handbook* § 4.04 [A] (1999).

²¹ *See, e.g., Minn. Stat. § 326.02(1)* (2001) (“In order to safeguard life, health, and property, and to promote the public welfare, any person in either public or private capacity practicing, or

offering to practice, architecture, professional engineering, land surveying, landscape architecture, or professional geoscience, or using the title certified interior designer in this state, either as an individual, a copartner, or as agent of another, shall be licensed or certified as hereinafter provided”); N.M. Stat. Ann. § 61-15-6 (2001); *see also Ransburg v. Haase*, 224 Ill. App. 3d 681, 682, 586 N.E.2d 1295, 1296 (1992); *Rolls v. Bliss & Nyitray, Inc.*, 408 So. 2d 229 (Fla. Dist. Ct. App. 1982).

²² *See, e.g.*, R.I. Gen. Laws § 5-1-9 (2001) (“A non-resident licensed architect seeking to practice architecture in the state of Rhode Island shall, upon application, obtain a certificate of registration by submitting evidence satisfactory to the board that he or she is registered to practice architecture in another state, that he or she has fulfilled the requirements for National Council of Architectural Registration Board’s certification, and that he or she meets the requirements prescribed in § 5-1-8. The board shall act upon the application for a certificate of registration within forty-five (45) days of submission of evidence that the applicant is registered in that manner”).

²³ *Dalton, Dalton, Little, Inc. v. Mirandi*, 412 F. Supp. 1001, 1104 (D.N.J. 1976).

²⁴ 1: Solid Line = Contract Between Entities

2: Dotted Line/Arrow = Oversight/Administrative Responsibilities Without Contract Between Entities

3: GMP = Entity Responsible for Guaranteed Maximum Price

4: FIN = Entity Responsible for Short or Long-Term Financing