

**BLACK LETTER LIABILITY CONCEPTS FOR NORTH CAROLINA
ARCHITECTS AND ENGINEERS**

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I. Liabilities Defined

“Liability” is a broad term with multiple meanings. A useful definition of a liability is a duty to pay which is enforceable by law. In the context of this paper, a design professional’s action (or failure to take action) may create a liability to another person, who would be entitled to bring suit against the design professional and recover a judgment. The judgment can be satisfied from the design professional’s assets. Liability is created out of two branches of law—the law of contract and the law of torts.

A. Contract Law

Contract law is the law of agreements, whereby a promisor agrees to perform a certain act for the promisee in exchange for consideration. The failure of either party to a contract to perform the agreed upon obligation constitutes a breach of the agreement, entitling the nonbreaching party to recover damages. In contract, a person’s liabilities arise directly out of the agreement.

B. Tort Law

Liability in tort arises from the violation of a duty imposed by law, not private contract, for which a court will provide a remedy in the form of an action for damages. Negligence is a creature of tort law. Negligence is based on the concept that the law imposes on all persons a duty to use ordinary care in relation to others. Whether an actor has used due care in a particular case is determined by comparison of a particular actor’s conduct with the conduct which an ordinary, prudent person would exercise under the same or similar circumstances. If an actor breaches his duty to use due care, causing harm to another, the actor may be sued in negligence for the damages caused. Because certain members of society have specialized knowledge and training—i.e. professionals—these persons are held to a higher standard of care than the ordinary, prudent person standard. Accordingly, the conduct of a design professional is compared with the conduct that another design professional, practicing in the same geographic area, would exercise under the same or similar circumstances.

Traditionally, a design professional performing professional services could only be liable in contract, not tort, based on a rule that no cause of action in tort could arise from the breach of a duty existing by contract. The effect of this rule was that a design professional could only be sued on the contract and only by persons engaged in a contractual relationship with the design professional. This requirement is referred to as “privity of contract.” Because design professionals traditionally contracted with the owner, not the contractor, the design professional had no privity with the contractor and could not be sued by the contractor. Privity of contract as a defense has gradually eroded in this century. The modern rule is that lack of privity does not bar an action by a contractor or even third party against the design professional. However, where an owner is entitled to sue on the contract, the contractor or third party generally is required to sue in tort. An understanding of both contract and tort law principals is essential for design professionals to effectively manage their risk.

II. Liability to Owners by Contract

A breach of contract claim involves the design professional’s failure to perform in accordance with the express or implied terms of the contract, and thereby subjecting the designer to a claim by the nonbreaching party for damages.

A. Express Terms

In the broadest sense, the failure of the designer to perform any particular express obligation contained in the contract gives rise to an action for breach. Such claims could arise out of a failure to achieve a particular result or the failure to perform on a timely basis, or the failure to perform a specific service, such as the preparation of fixtures schedules or plumbing details.

Current design professional contract formation relies heavily on standard form contracts such as the AIA or EJCDC families of documents. These documents establish a comprehensive set of responsibilities for all parties to the Project. In particular, the design professional is delegated substantial authority—and thus responsibility—over the Project and accordingly agrees to perform intensive professional services. A design professional may often face a cost conscience owner who wishes to limit the cost of professional services he will be required to pay. Unless the design professional specifically limits and excludes such services, a claim may be asserted for breach of contract if the standard form services are not performed.

Due to the comprehensive nature of the AIA/EJCDC system, such contracts may be more effective where the full scope of services is desired by the owner. On a smaller undertaking or where a limited scope of services is desired, a design professional that simply prints off and executes the office’s standard form contract in order to “get an agreement in writing” may run into problems unless services not required are carefully excluded or limited. For a small project, a letter proposal may be effective if the proposal specifically prescribes the services offered. However, letter proposals may leave out standard terms regarding termination, dispute resolution, indemnity and insurance issues, which many design professionals attach in boilerplate form to the back of a letter contract.

Contract formation should be a deliberative process whereby the design professional carefully considers: (1) the scope of services to be provided for the project and (2) the standard provisions which are necessary for a given contract. At a minimum, a design agreement needs to address the following:

1. What is supposed to be designed?
2. What duties are included in the designer's scope of services?
3. On what time schedule must the services be performed?
4. How will the designer's compensation be determined and paid?
5. Are there any cost constraints the designer must meet?
6. What insurance coverages will be required?
7. What standard of care must the designer meet?
8. Under what circumstances can the agreement be terminated?
9. How will disputes be resolved?

In addition, disagreements may arise as to whether the designer's responsibilities are limited to specific services listed in the agreement or, as the owner may prefer, all services required to achieve the stated objective of the contract. The designer will be unwilling to provide services that exceed the specific services stated in the agreement without additional compensation. Accordingly, the designer will typically list additional services which are available for a given project so long as additional compensation is paid. These will often include revisions generated by the client's change of mind, changes in the scope of the project, or changes made necessary by the contractor's failure to properly construct the project.

C. Implied Terms

In addition to express provisions, courts have consistently found that certain types of agreements contain implied terms. For instance, courts universally recognize an implied covenant of good faith and fair dealing in all contracts. In a design professional contract, an implied condition is that the designer will exercise the same skill and care that other design professionals would exercise under similar circumstances.

The practical effect of these rules is that a design professional may be liable to an owner for failing to fulfill a duty not expressly stated in the contract if the local standard of care requires that such duty be performed. Accordingly, a designer failing to investigate the zoning of a particular project prior to preparing plans may be liable for the failure to do so, if the professional standard in the community required a zoning check. Courts around the country have recognized various implied duties in designer contracts, such as a duty to:

1. Specify quality materials;
2. Furnish plans and specifications that would result in a building of the kind called for, without marked defects in character, strength or appearance;
3. Prepare specifications, which if followed, would result in a watertight, weatherproof building envelope;
4. Call for cavity wall flashings to redirect water out of a cavity wall;
5. Design a project which can be constructed within the owner's budget.

Although the same act or failure to act may give rise to a liability in contract or tort, an owner in privity of contract with a design professional is normally only permitted to bring an action for breach of contract. *North Carolina State Port Authority v. Fry Roofing Co.*, 294 N.C. 73, 240 S.E.2d 345 (1978) is the leading case in North Carolina on this issue.

In that case, the Port Authority sued a contractor for its failure to construct and roof certain buildings in accordance with the plans and specifications. The Port Authority alleged that

the contractor (1) breached its contract to roof the building according to the specifications; and (2) that the contractor was negligent in roofing the buildings. The court held that the owner was limited to suing in contract except in four limited situations, as follows:

1. Where the promisor, in performing the contract, causes loss or injury to a person or property of someone other than the promisee.
2. Where the promisor, in performing the contract, injures property of the promisee other than the property which was the subject of the contract, or causes personal injury to the promisee.
3. Where the promisor, in performing the contract, injures the promisee's property, which was the subject of the contract, and the promisor is charged by law, as a matter of public policy, with the duty to use care in the safeguarding of the property from harm, as in the case of a common carrier, an innkeeper or other bailee. (Rarely applicable in the construction context).
4. Where the promisor, in performing the contract, causes a willful injury to or a conversion of the property of the promisee, which was the subject of the contract, by the promisor.

Although a typical owner's complaint against a design professional will allege causes of action for breach of contract and negligence, generally only breach of contract will apply. However, because of standard of care issues, the design professional may face a challenge that it failed to attend to a duty required by the standard of practice, which makes the designer's liability broader than the express terms of the contract.

III. Liability to Third Parties

A. Negligence

As discussed above, under the privity of contract doctrine, designers could only be liable to the party with whom they contracted. However, North Carolina (as well as most states) no longer recognizes the privity doctrine as a defense to an action by a third party lacking privity with the owner. In 1979, in the case of *Davidson & Jones, Inc. v. New Hanover County*, 255 S.E.2d 580, the North Carolina Court of Appeals authorized an action by a contractor against the architect for economic loss resulting from breach of a common duty of care. The court held that where a breach of contract results in foreseeable injury to persons so situated by their economic relations and community of interests to the architect, the law imposes a duty of due care on the architect.

Said another way:

An architect who contracts to perform services is liable for damages proximately caused by his negligence to anyone who can be reasonably foreseen as relying on that Architect's performing its services in a reasonable manner.

For example, in *Browning v. Maurice B. Levian & Co.*, 44 N.C. App. 701 (1980) the court held that an architect hired by a lending bank to oversee and certify construction completion

could be liable to the owner for negligent certification because the owner may have reasonably relied on the architect's performance.

The reasonable manner referenced above is the "standard of care." The common law duty of due care will normally have to be established by another design professional. This is because a lay jury lacks the knowledge, skill and training of a licensed design professional and cannot fairly assess whether the professional in fact failed to perform as other professionals in the same circumstances would perform. In North Carolina, two appellate decisions come close to establishing an absolute rule that without expert testimony of the applicable standard of care, the plaintiff's case may be dismissed as a matter of law. However, if the conduct complained of is so grossly negligent or obviously substandard that a lay jury can appreciate such negligence without expert testimony, the Plaintiff may succeed in having its case submitted to the jury. This common knowledge exception arises out a case where a doctor, in setting a fractured leg, failed to sterilize the wound prior to setting the cast, causing infection. Under such circumstances, the court held a lay jury was competent to render a decision on the conduct of the doctor without the benefit of expert testimony.

Despite this limited exception, most litigation involving design professionals will involve a "battle of experts." The Plaintiff's expert will be required to establish that the defendant designer failed to exercise the same skill, care and diligence that other designers practicing in a similar community would exercise under the same or similar circumstances. A defense expert may be employed to rebut such testimony. It is generally advisable to allow an "objective" expert to make a standard of care defense because the defendant designer may be perceived as being overly motivated to defend his conduct.

A negligence action can arise out of a construction defect such as damage to property due to moisture intrusion. A negligence action against a designer may also lie in a personal injury action for collapse of structures, or injury arising out of construction activities. A mold case may involve elements of property damage as well as personal injuries. In addition, economic losses, caused by delay or lost profits, may form the basis of an action.

Designers performing work for a developer or general contractor constructing condominium projects or other multi-family housing projects may be liable to the Homeowner's Association or the ultimate owners of the dwellings in negligence, notwithstanding the fact that no privity of contract existed or that the association itself might not have existed at the time the professional services were rendered. In *Quail Hollow East Condominium Association v. Donald J. Schulz Company*, 47 N.C. App. 518 (1980), the court held that the architect could be liable to the Homeowner's Association of a condominium development, based on its reasoning that:

"It is obvious that that any architect's involvement in residential construction is intended to affect the ultimate consumer-purchaser in that the buyer anticipates and expects sound construction and solid workmanship. In addition, it is foreseeable that any defect in design or supervision may bring harm to the homeowner, who is met daily with any of the deficiencies that may develop."

A careful designer should therefore consider ultimate users of the design as potential claimants on a project. A condominium or multi-family housing project may warrant an additional fee given such increased exposure.

B. Third Party Beneficiaries

In some circumstances a person not a party to a contract may maintain an action on the contract if he can establish that he was an intended third party beneficiary of the agreement. In this scenario, a stranger to the contract may argue that certain provisions in the agreement were intended for his benefit. Accordingly, he is entitled to sue for the breach of such agreement if the failure to perform causes him loss or damage. In order for a third party to recover as a third party beneficiary he must prove that he is a direct, intended beneficiary under the contract. This is difficult standard to prove. In our experience, most contractors or subcontractors would fail to establish third party beneficiary status and would instead be required to pursue an action in negligence. Further, most standard form contracts contain provisions that the contract is intended to benefit the parties to the contract and none other. However, a feasible third party argument might be made by a spouse of the contracting party to the design agreement where no such provision exists.

C. Claims against the Design Professional as Arbiter of the Owner/Contractor Contract

Standard industry contracts allocate substantial authority to the designer to serve as the initial arbiter of the contract and the judge of the acceptability of the work, interpretations of the requirements of the contract documents, and decisions concerning change orders and changes in the work. Standard form contracts require the designer to act fairly and impartially to both the owner and the contractor when making decisions as an arbiter under the contract. In addition, such contracts provide that the designer shall not be liable to either the owner or the contractor so long as it renders decisions in good faith. These provisions may be found in the owner/contractor agreement, to which the designer is not a party. One question raised by these clauses is whether such a clause allows the contractor to maintain a cause of action against the designer in contract. The other question raised by these clauses is determining what constitutes "good faith."

North Carolina case law discussing the issue of good faith dates back to a time when the designer's decision regarding the work was binding and non-appealable unless the designer rendered such decision in bad faith. Modern standard contracts rarely give the designer authority to make a final, binding decision. Rather, the designer's decision is the initial decision which is intended to carry the parties through to the completion of the project, when they can again raise claims according to the dispute resolution mechanisms contained in the contract.

These older cases are instructive as to what constitutes good faith in North Carolina. A designer rendering a decision as arbiter of the contract acts in good faith unless he is grossly mistaken in his interpretation of the contract or issues a decision which is arbitrary and capricious. The careful designer will issue decisions in writing and will refer to the sections of the contract applicable to the issue and will state the basis for the decision. Also, the decision rendered should be timely.

North Carolina seems undecided as to whether a claim by the contractor against the designer as arbiter sounds in tort or contract. However, we suspect and have argued that the contractor must introduce expert testimony to support allegations that the designer acted unfairly or impartially under the contract.

D. Claims by Adjacent Property Owners

In addition to duties and liability to participants in the construction process, designers may face actions brought by adjoining landowners who are negatively impacted by construction activities. Site engineers dealing with erosion control and drainage issues are particularly susceptible to actions brought by adjacent owners. However since the site engineer is generally employed as a subconsultant to the architect, the architect may also be involved in the suit. This is particularly true where the adjacent owner names the owner of the project as a party to the action. In such circumstances, the owner will defend by asserting his reliance on the design professional to control the site. The Owner may file a third party action¹ against the architect with whom he enjoys privity and leave the architect to claim against his subconsultant engineer for indemnity or direct damages.

Common causes of action brought by adjacent owners include negligence as well as civil trespass and nuisance. Trespass is an intentional tort, unlike negligence. Trespass is an unauthorized entry on another's property, either by a person, material or thing. Nuisance claims can be brought against the owner of the property if the owner's construction activities unreasonably interfere with the neighbor's use and enjoyment of his property. Accordingly, those in physical proximity to the project should be considered when undertaking professional services. Reasonable accommodations to such neighbors may go a long way in preventing lawsuits brought by unhappy neighbors.

IV. Indemnity

An understanding of indemnity is essential to an understanding of construction law because of the multi party nature of the construction process. When a job site injury occurs, or construction defects exist, the injured party is presented with a selection of possible defendants, including the architect, engineer, contractor, subcontractors, owner, material suppliers and manufacturers. Defendants are presented with a selection of third party defendants which they are permitted to add to the suit if they can prove the third party is or might be liable for any damages owed to the plaintiff. The subject matter of indemnity concerns the allocation and apportionment of liability amongst the various parties responsible for a loss. Most construction contracts contain express clauses of indemnity whereby parties attempt to shift the risk of losses to another.

In North Carolina, whether express indemnity provisions in construction contracts are enforceable is governed by North Carolina Gen. Stat. Section 22-B. Pursuant to this statute, which is based on public policy concerns, a party to a construction contract may not enforce an indemnity provision which requires a party to indemnify another for acts of negligence caused by the party indemnified. If a court determines that an indemnity clause violates 22-B, the clause will be declared unenforceable and the clause will be stricken from the agreement. One caveat: the court may determine that the clause is so essential to the agreement that it cannot be stricken. In such circumstances, the court will simply void the entire agreement. (The standard AIA indemnity provision would appear to violate N.C. Gen. Stat. 22-B.)

¹ Third party actions are prevalent in construction litigation where the plaintiff (such as an owner) may simply sue the contractor for design defects. If the contractor believes other parties are responsible for the loss, the onus is on him to add these additional parties as third party defendants under Rule 14 of the North Carolina Rules of Civil Procedure. This means in practical terms that the contractor would then prove the loss was caused by these parties and pass along the costs of any judgment awarded.

In general, the design professional will be required to indemnify the owner against loss and damages caused by the architect's negligence. The owner will require the contractor to indemnify it as well. The design professional will require a contractor to indemnify it; the contractor will require the same from its subcontractors. Indemnity obligations or hold harmless agreements require the indemnifying party to reimburse the party indemnified for the cost of any judgment obtained, as well as defense costs and attorney's fees. In many cases, by the time suit is filed, the statute of limitations may prevent a suit by a design professional against other parties responsible for the loss. However, the right to demand indemnity does not accrue until the party pays the judgment or suffers the loss. This delayed accrual allows a party to use indemnity years after a project is completed and can be the only thing preventing the party sued from being solely responsible for the loss.²

In addition to express clauses for indemnity, indemnity obligations may arise in certain circumstances by law. These are generally referred to as implied contracts of indemnity. In North Carolina, indemnity obligations may arise in a negligence context in the absence of an express agreement for indemnity. This right arises when one party is sued by another for negligence. If the defendant can establish that another party caused the loss, and that party's negligence was active as opposed to the technical, or passive negligence of the first party, the first party may obtain indemnification from the second.

The North Carolina Court of Appeals narrowed North Carolina indemnity law as it relates to implied contracts for indemnity in the case of *Kaleel Builders, Inc. v. Ashby*, 161 N.C. App. 34 (2003). In that case, an owner sued its contractor for construction defects. The contractor later attempted to file third party actions against its subcontractors and the architect. The statute of limitations had run on all direct claims that the contractor had against these parties so the contractor alleged indemnity actions against such parties. Unfortunately, the contractor had failed to add express indemnity clauses to its contracts with the subcontractors. While the contractor attempted to rely on the "implied indemnity" doctrine, the court found such doctrine did not apply. Because the contractor was liable to the owner in contract, not tort, the contractor and subcontractor could not be joint tortfeasors to the owner and the passive/active indemnity doctrine did not apply. The same analysis applied to the contractor's claim against the architect. There was no contract between the architect and contractor and the passive/active indemnity doctrine did not apply where the contractor was solely liable to the owner in contract.

The lesson from *Kaleel* is for parties to include express (and enforceable) indemnity clauses in contracts. For designers, who contract with the owner, but also with subconsultants, it is critical to have written contracts whereby the subconsultant indemnifies the designer for loss or damage to the owner. This is because the designer is liable to the owner for the work performed by its subconsultants. Often the designer works regularly and informally with its subconsultants without a written agreement. The careful designer will use written agreements with its subconsultants and ensure that its subconsultants are solvent, hopefully insured, and that they contractually agree to indemnify the designer for losses.

V. Statutes of Limitation and Repose

² Subject to the statute of repose as discussed herein at Section V.

Statutes of limitation and repose govern the time periods in which claims can be filed. These periods are set by the legislature, which establishes different periods for different types of legal actions. In North Carolina, the statute of limitations for breach of contract and negligence is three years pursuant to North Carolina General Statute section 1-52(16) and N.C. General Statute section 1-50(5)(f). A case for negligence or breach of contract must be brought within three years of the accrual of the cause of action. A cause of action “accrues” when the plaintiff has the right to sue the defendant. Because the plaintiff has the right to sue, its failure to do so within the applicable statutory period bars the cause of action. The difficulty of applying the statute of limitations is determining when the period starts to run. For damage to real property, the cause of action accrues when the loss, injury, defect or damage becomes apparent or reasonably should be apparent to the claimant.

However, the statute of repose sets an outer boundary after which suits cannot be brought regardless of whether the party knows of the injury. Pursuant to N.C. General Statute Section 1-50(6), an action to recover damages to improvements to real property must be brought within 6 years from the later of (1) the specific act or omission of the defendant giving rise to the cause of action; or (2) substantial completion of the project. This applies to indemnity as well as direct actions.

However, exceptions exist. The statute of repose may not be asserted as a defense by a person who has committed fraud or willful and wanton negligence with respect to the improvement to real property. Fraud involves intentional misrepresentations which are calculated to deceive another. Willful negligence is negligence committed with a deliberate purpose not to discharge a duty imposed by contract or law. An act is wanton when done with wicked purpose or with reckless indifference to the rights and safety of others.

Although these exceptions have been asserted by numerous claimants in North Carolina attempting to circumvent the rule, courts have been reluctant to allow such suits to proceed. Most acts causing injury arise out of ordinary negligence, so the willful wanton exception likely requires that the tortfeasor be on notice of a defect or problem and then willfully avoid addressing it. Fraud is likewise difficult to prove and most courts will require the claimant to produce actual knowledge that the tortfeasor knew its representations were false and deliberately made such statements in order to deceive the listener. Because of the difficulty in proving such allegations, the statute of repose offers substantial protection for participants in the construction industry.

VI. Damages Recoverable

Various remedies are available in actions for breach of contract and negligence in North Carolina, as discussed below.

A. Damage to Owner’s real property

Where breach of contract causes damages to real property, the owner is entitled to have what he contracted for or its equivalent. If the defects can be remedied without destruction of the substantial benefit which the owner’s property has received, the owner is entitled to repair costs to make the work conform to the contract. However, if a substantial part of the work must be undone or destroyed in order to make the work conform, the owner is not entitled to the cost of repairs but is instead entitled to the difference in market value between the value of the structure contracted for and the value of the structure as built—the values to be determined as of the date of

tender or delivery of possession to the owner. See *City of Charlotte v. Skidmore, Owings and Merrill*, 103 N.C. App. 667 (1991).

In addition, an owner will be able to recover for the loss of use of the property if a defect renders the property unusable or if the owner is required to lease other property while the property is uninhabitable or is undergoing repairs.

B. Contractor's Economic Losses

A designer in North Carolina can also be liable to the contractor for economic losses arising from the designer's negligence. Such damages include:

1. Compensation for labor and materials spent to correct work which is based upon a defective design;
2. Costs of delay on the project, including extended jobsite overhead, anticipated or lost profits, additional insurance premiums and possibly damage due to lost or restricted bonding caused by the negligence.

C. Personal Injury Damages

A plaintiff suffering personal injuries due to another's negligence is entitled to recover a spectrum of damages including:

1. Medical expenses;
2. Past or future lost earnings;
3. Pain and suffering damages;
4. Lost capacity to work if permanent injury resulted;
5. Compensation for the permanent bodily injury.

D. Consequential Damages

Consequential damages are damages that result from breach of contract and/or negligence which arise indirectly from the breach, such as lost profits. Consequential damages are recoverable in contract where such damages were foreseeable when the parties entered into a contract, such as a project for commercial property where the project is delayed or damaged. They may be recovered in tort where they can be proven with reasonable certainty. Since the owner rather than the designer generally has a claim for lost profit, it is recommended that a waiver of consequential damages be included by the designer in the contract.

E. Exemplary (Punitive) Damages

In contrast to the compensatory damages discussed above, exemplary damages are intended to punish the wrongdoer and are recoverable in tort rather than contract except when a contract is breached under egregious circumstances. Punitive damages are recoverable by statute in North Carolina (N.C. Gen. Stat. Chapter 1-D) where a plaintiff can prove fraud, malice or willful conduct by clear and convincing evidence. The amount of damages to be awarded is within the discretion of the jury, taking into consideration the culpability of the defendant, the defendant's ability to pay and other factors set by statute. Punitive damages are capped at twice the amount of compensatory damages or \$250,000 maximum.

F. Limitations on Damages

Plaintiffs are required by law to mitigate their damages. In the construction context, this means an owner may have a duty to protect the work in place after terminating the designer and halt construction when defects are apparent so such defects can be addressed, rather than incurring additional costs. The owner's failure to mitigate its action may allow the defendant to offset the damages owed to the owner by the amount such failure to mitigate increased the owner's damages.

G. Liquidated Damages

A liquidated damages provision is a sum fixed as an estimate of the damages which would result from the breach of the agreement. A liquidated damages provision thus substitutes the liquidated damages stated for the actual damages resulting from the breach. The parties in setting damages must make a good faith effort to estimate the actual damages likely to ensue from a breach. The amount of liquidated damages claimed must not be unjust, oppressive or disproportionate to the damages that actually would result from the breach.

Liquidated damage clauses are enforceable where:

1. The damages which the parties might reasonably anticipate are difficult to ascertain because of their indefiniteness or uncertainty; and
2. the amount stipulated is either
 - (a) a reasonable estimate of the damages that would probably be caused by a breach; or
 - (b) is reasonably proportionate to the damages which have actually been caused by the breach.

Knutton v. Cofield, 273 N.C. 355 (1968). It is also well settled that liquidated damages for failure to complete the work under the contract within the time specified may not be asserted when the party claiming the damages is responsible for the delay. *L.A. Reynolds Co. v. State Highway Commission*, 271 N.C. 40 (1967). If the court finds that the sum stipulated is unreasonable or arbitrarily adopted without reference to a loss actually suffered, then it will not be allowed. *Lange v. Farmers Fed'n Coop, Inc.*, 249 F. Supp. 544 (W.D.N.C. 1966). If recovery of liquidated damages is not allowed, then actual damages may be recovered instead.

VII. Fee Disputes

Fee disputes may be the most common disagreement between owners and design professionals. The problem is particularly prevalent when an owner abandons the project and refuses to pay the designer's fee. A design professional that contracts directly with an owner is entitled to assert lien rights against the owner's real property pursuant to North Carolina General Statute Chapter 44A. Chapter 44A allows design professionals, among others, to obtain a lien on real property to secure payment for services rendered for "improvements" to the real property. A successful lien claimant is entitled to have the property sold and the proceeds applied to its fee.

Lien law is outside the scope of this paper. However, two principles of lien law are useful to a careful designer. First, obtain a written contract with the record owner of the property. If the property is held by a corporation, the corporate officer with authority should sign the contract. If owned by a husband and wife, both need to sign the contract because a judgment against the husband cannot be executed against property held by a husband and wife as tenants by the entirety. Second, a lien must be filed within 120 days of the last date the designer furnishes work to the project or lien rights are lost.

However, a designer pursuing its fee faces challenges particularly when the owner cannot afford to construct the project designed due to the budget being exceeded. A designer in such a position likely faces a counterclaim by the owner for professional negligence or a claim that the designer breached its contract. The issue in such a case is whether a designer is entitled to recover its fee in light of such claim.

The answer depends on a variety of factors, the most important being whether the contract provides for an agreed or guaranteed maximum cost. The simplest rule, supported by several cases from around the country, suggests that where a guaranteed maximum cost exists and is exceeded, the designer is not entitled to recover its fee. A larger number of decisions hold that the designer cannot recover compensation on the contract if the actual or probable costs of construction substantially exceed the agreed maximum cost. Factors courts have considered in these cases include (1) whether the cost figure is expressed as an absolute or an estimation; (2) whether the excess cost was attributable to changes by the owner; (3) whether, notwithstanding the cost excess, the owner approved or accepted the designer's performance; and (4) whether the designer suggested changes in the plans to reduce the cost of construction.

Obviously, an owner looks to the designer to provide some feedback concerning construction costs. Although the designer is not a contractor or a professional costs estimator, a designer is generally more knowledgeable than an owner about construction costs. Clearly the safest course of action for a designer is to provide by contract that estimates of construction cost are estimates only, not a guarantee. The 1997 AIA B141 deletes language from the former version which provided that "[n]o fixed limit of construction costs shall be established as a condition to this agreement by the furnishing, proposal or establishment of a project budget, unless such fixed limit has been agreed to in writing and signed by the parties hereto." Instead the architect is required to make a preliminary estimate and to refine the estimate of the costs of the work and recommend changes to the project scope and quality if the budget is exceeded; the owner is required to cooperate with such changes.

Even if a guaranteed price is not specifically stated, the owner may assert that the designer made oral representations concerning a fixed cost of construction, which representations became a condition of the contract. A North Carolina case from 1926 dealt with a fee dispute between an owner and architect where the owner asserted the architect made a representation fixing construction costs. No fixed construction cost limit was contained in the agreement. Generally, where parties reduce their entire contract to a written agreement, a court will not hear "parol evidence" (testimony of statements not contained in the written agreement) if such evidence would contradict or vary the terms of the agreement. However, if the court determines that the entire contract is not contained in the agreement, evidence of the unwritten portions may be admitted to establish the scope of the entire agreement, provided the unwritten portions do not contradict the writing. *Hite v. Aydlett*, 192 N.C. 166 (1926).

Worse, representations of probable cost made by the designer after the contract is executed may modify the contract, even where the contract provides that no guarantee of cost exists. In *Fishel and Taylor v. Grifton United Methodist Church*, 9 N.C. App. 224 (1970), the court held that the architect's representations that a budget could be met after a modest re-design constituted a waiver or modification of the original agreement, which contained no guaranteed cost limit. The court noted that "[t]he provisions of a written contract may be modified or waived by subsequent parol agreement, or by conduct which naturally and justly leads the other party to believe the provisions of the contract are modified or waived. *This principle has been sustained even where the instrument provides for any modification to be in writing.*"(emphasis in the original).

If an unguaranteed estimate is unsatisfactory to an owner, the designer has other options. If the designer does agree to a fixed limit, it becomes critical for the designer to fully understand the owner's program, which should be clearly defined in the contract. If preliminary work is done before contract execution, accepted drawings should be attached and incorporated into the agreement as evidence of the understood scope of the project. In addition, concerns about elements of the owner's program which affect the fixed costs should be stated in writing; if the owner continues to request or select additional elements, the designer should obtain approval for all such elements in writing. An alternative to a fixed cost is for the designer to provide a series of estimates for the different design phases, gradually reducing the designer's margin of error.

Fee disputes also arise when the designer's fee is stated as a percentage of construction costs. A common dispute is over which costs are to be considered as the cost of construction and what costs must be paid if the owner eliminates elements designed or abandons the project altogether. Again, careful contracting, communication with the owner and documentation are the most effective means for avoiding or prevailing in fee disputes.

VIII. Limitation of Liability Clauses

"Client agrees to limit the design professional's liability to client for the design professional's negligent acts, errors and omissions to the greater of the amount of the design professional's fee or \$50,000."

The above limitation of liability clause is commonly seen in boilerplate terms attached to a letter proposal. Such clause does not seek to immunize the designer from suit, but instead serves to cap damages recoverable by the client in the event of loss caused by the designer's negligence. A first question is whether such clauses are enforceable.

No case law exists in North Carolina construing such clause in the context of a contract for professional services. Such a clause has been recognized in North Carolina as a valid limitation of liability in a case involving the installer of a commercial security alarm for a jewelry dealer. *Reed's Jewelers, Inc. v. ADT Company*, 43 N.C. App. 744 (Ct. App. 1979). In that case, the court held that "except in the case of public service contracts, the contracting parties can by agreement limit their liability in damages to the amount specified therein." The court did not define a public service contract, but went on to state that the clause at issue was not contrary to public policy.

A South Carolina court has upheld a limitation of liability clause in an engineering contract. See *Georgetown Steel Corporation v. Union Carbide*, 806 F. Supp. 74 (D.C.S.C. 1992),

rev'd in part, 1993 U.S. Lexis 23541. The court in that case stated that although exculpatory clauses were disfavored, they were enforceable where the clause was (1) open and obvious and not hidden; (2) not contrary to public policy; and (3) the owner was a sophisticated commercial entity whose bargaining power equaled or exceeded that of the engineer. In addition, the court noted that the owner could have elected to raise the liability limit by increasing the fee it paid to the engineer, as provided in the provision.

In both these causes, the owner sought to recover for economic losses, rather than personal injuries. A court might be persuaded differently if the plaintiff's damages were for personal, bodily injury, particularly in a case of devastating injuries such as paralysis or death. Given the mandate of professional engineers and architects to protect the public, such a clause might be unenforceable in the appropriate case.

Another question might be whether such liability clauses are good for the profession and the public. This question is better posed by designers themselves, not their attorney. Such a clause seeks to avoid liability for professional conduct where insurance may be available to address a loss. If such a clause encourages substandard performance in the profession, widespread use of such clauses might be detrimental to the practice. If a clause is considered, the professional might choose to limit liability to the stated insurance policy limits. The clause might further offer the owner additional coverages upon payment of an additional fee, or simply increase the fee to cover the additional exposure. Such a limitation may serve to protect the designer from an excess judgment which could be satisfied from the designer's personal assets.

IX. Conclusion

As discussed herein, the construction process places designers into a setting with numerous potential claimants with multiple theories of liability at their disposal. A risk management outlook which focuses only on the designer/owner relationship is therefore inadequate. However, an understanding of the wide ranging liability issues discussed herein should assist designers in making more effective risk management decisions, which may ultimately spare the designer claims, suits and losses.

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