



## **GENERAL CONSIDERATIONS FOR CONTRACTING WITH DESIGN PROFESSIONALS**

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### **I. Considerations in Drafting Contracts With or on Behalf of Design Professionals**

#### **A. Standard Form Agreements Versus Owner Developed Custom Forms**

One of the first decisions to make in evaluating, drafting or revising a design agreement is whether to use an industry form document or a custom agreement. Often this decision will be driven by the type of project at hand and the designers' role in the project, or which party initiates the contracting process and thus is able to present what is termed as 'their standard form agreement' which establishes the agenda for further negotiations.

A number of organizations produce standard form contract agreements and the use of a standard form design contract has both advantages and disadvantages. Commonly used standard forms included those prepared by

- a. The Associated General Contractors (the "AGC"), which has developed forms for use between the owner and general contractor and form agreements for use between the general contractor and its subcontractors;
- b. The Engineers' Joint Contract Documents Committee (the "EJCDC"), which publishes its own form general conditions and forms which document agreements between an owner and engineer and between an owner and a general contractor for engineering projects. The EJCDC documents include a

comprehensive published guide, and the forms are interspersed with notes to users;

- c. The American Institute of Architects (“AIA”) which are the most widely used in the industry;
- d. The Design Build Institute of America; and
- e. Most recently, the Consensus DOCS created in 2007 in a collaborative effort between the 22 different industry groups including the AGC and the Construction Owners Association of American and which purport to level the playing field in balancing risks between project stakeholders including the designer, owner, contractors, sureties and subcontractors.

Advantages of using standard forms include, in no particular order, the following:

- a. Inclusive and comprehensive. Standard form documents are generally intended to be used with a “family” of related documents which are intended to cover and define the contractual relationships between all the parties to the project. Thus, use of standard forms puts all parties in the project on the same page. This eliminates the need to draft project specific general conditions intended to cover all parties to the project. In addition, a standard form document is internally complete meaning it will cover most if not all provisions that the industry deems the contract should contain. Accordingly, there is no need to re-invent the wheel each time a contract is contemplated and prepared.
- b. Widely used and reported. The American Institute of Architects (“AIA”) in particular have been widely used, and have been widely litigated and as a result a substantial body of law exists construing the terms of various AIA agreements.
- c. Familiar to Parties. Since standard form agreements are widely used, contract negotiations on the forms can proceed quicker and more efficiently than negotiating custom agreements.

Disadvantages exist as well, such as the following:

- a. Forms don’t match the project. Some projects and some scopes don’t fit neatly into the full-service, full scope type nature of many standard form agreements.

- b. Inherent bias in the documents. Most parties perceive inherent bias towards protection of one party over the others, i.e. the AIA's and EJCDC's tendency to shift risks away from the designer and on to the contractor, then the owner.
- c. Unintended consequences. The use of a standard form creates an interlocking web of well defined (and some would say overly onerous) tasks, duties and obligations, some of which are 'overkill' on the project at hand, and which the parties have no intention of performing. The parties to a dispute then may discover the contract is essentially meaningless as the parties have failed to follow portions of the agreement and thus may have waived the right to demand strict performance of the same. Moreover, modifying one agreement requires counsel to consider the ramifications on all the family documents to prevent ambiguities and inconsistencies.

## **B. AIA/EJDC**

### AIA Documents:

AIA documents are grouped into "families" according to project type or delivery method. The documents within each family provide a consistent structure and text base to support the major relationships on a design and construction project. The most pertinent to this paper are the "A" and "B" series. The "A" series are owner and general contractor agreements, which also include a standard form agreement between a general contractor and a subcontractor. The "B" series documents include a standard form agreement between an owner and an architect. Understanding these family groupings is essential in selecting the most appropriate standard forms to use on a particular project. The following families exist:

1. Conventional Family. On most sizeable projects it usually is appropriate to use the A201 family. This is the most commonly used family of documents. It is suitable for the conventional delivery approach of design-bid-build. This family is suitable for medium to large projects.
2. Small Projects Family. The small projects family may be appropriate when a project is small, has an uncomplicated design, is of short duration (less than one year from design to completion), and without delivery complications. It is suitable for residential or small commercial projects and other projects of low cost and brief duration.
3. Integrated Project Delivery Family. Integrated project delivery is a collaborative approach that uses the skill and insight of all project participants through all phases of design and construction. The AIA provides agreements for two levels in this family. Transitional forms are modeled after existing construction manager

agreements, while the Single Purpose Entity (SPE) creates a limited liability company for the planning, design, and construction. The SPE allows for complete risk-sharing and reward in a fully integrated collaborative process. This family of documents is suitable for large to extra-large private sector commercial projects.

4. Construction Manager-Adviser (CMa) Family. When the owner retains an independent adviser on construction management (CM) matters through design and construction, use of the CM-Adviser family is appropriate. This approach, in theory, improves the level of expertise applied to managing a project from start to finish, and is designed to preserve the CM's independent judgment. This family of documents is suitable for small to large public and private sector projects.
5. Construction Manager-Constructor (CMc) Family. When the owner retains a construction manager who also completes the construction and provides construction management services, use of the CM-Constructor family is likely appropriate. Under this arrangement, the contractor and construction manager functions are merged and performed by one entity who typically assumes control of the construction work by direct contracts with the subcontractors. This family of documents is suitable for small to large private sector projects.
6. Interiors Family. These documents are appropriate for furniture, furnishing and equipment ("FF&E") procurement services and for same combined with architectural interior design and construction services. These documents procure FF&E under a separate contract from design services, thereby preserving the design professional's independence from monetary interest in the sale of the goods. They are suitable for small to large tenant projects.
7. International Family. For use by United States design professionals working on projects in foreign countries. Because the designers typically are not licensed in the foreign country, this family of documents identifies the designer as a consultant, rather than an architect. They are suitable for small to large projects.
8. Design/Build Family. Used on projects where the project delivery system is design/build. Here, the owner contracts with a design/builder who is obligated to both design and construct the project. The design/builder then contracts with architects and construction contractors as necessary. This family is suitable for small to large projects.

#### EJCDC Documents:

The Engineers Joint Contract Documents Committee (EJCDC) is a joint venture of the National Society of Professional Engineers/Professional Engineers in Private

Practice (NSPE/PEPP), the American Council of Engineering Companies (ACEC), the American Society of Civil Engineers - Construction Institute (ASCE-CI), and the Associated General Contractors of America (AGC). It produces and promotes the use of quality administrative documents for construction projects involving professional engineering services. EJCDC represents a major portion of the professional groups engaged in the practice of providing engineering and construction services for a project. In support of its mission, EJCDC prepares and publishes the following documents: standard forms of agreement for professional engineering services; standard contract documents and related forms for various types of construction projects, and guidelines and commentaries on the use of EJCDC documents and matters related to the roles and responsibilities of the owner, engineer, contractor, and other parties involved in design and construction.

EJCDC prepares and publishes documents under the following seven families:

- a. Construction Related Documents
- b. Engineering Services Agreements
- c. Procurement Related Documents
- d. Multi-prime Design Agreements
- e. Design Build Documents
- f. Guides and Narratives
- g. Environmental Documents

#### Custom Form Agreements.

Custom form agreements have their place, such as in projects where a small scope of services is desired, or the project is unusual or where an owner such as an institutional client like a hospital engages in substantial construction on an ongoing basis and is motivated to prepare its own terms and conditions. However, given the number of required provisions to fully capture the rights and responsibilities in a typical design professional services agreement, custom form drafters have their work cut out for them. The agreement would typically include, at a minimum, provisions for:

- a. Scope of services;
- b. Basis for the fee and payment terms;
- c. Timing/scheduling issues;
- d. Ownership of documents;
- e. Use of electronic media;
- f. Responsibility for budgeting and estimating construction costs;
- g. Bidding and construction phase services;
- h. Basic (i.e., included in the fee) versus Additional services performed for an additional fee;

- i. Job-site safety issues;
- j. Review of contractor submittals;
- k. Preparation of record drawings;
- l. Incomplete services (for use where the owner rejects construction phase services or where there is a risk of premature termination of the agreement);
- m. Hazardous materials (where the presence of asbestos or pollution on the site is suspected or unknown or where specification of asbestos-containing products may be required by the owner);
- n. Insurance
- o. Licensure requirements
- p. Legalistic terms—indemnity, dispute resolution, damages waivers, statute of limitations provisions, prevailing party clauses, choice of law, venue, etc.

More detailed discussions of many of these provisions appear below.

## **II. Developing the Agreement**

### **A. Defining the Scope of Services**

Whether a form or custom agreement is used, tightly and accurately defining the services to be provided by the design for the fee specified is of paramount importance. Most owners will take the position that the designer is to do everything normally done to attain the goal intended, while designers will typically take a narrower view of services to be included. Architect led projects will require structural and site engineering and will often require specialized plumbing, mechanical system and electrical design and whether these services are included should be specified. Other specialty designers may be necessary on particular projects, such as theatres, medical facilities or industrial spaces.

Exclusion of services is just as important, as sins of omission seem to cause more problems on projects than sins of commission. As construction participants know, disputes often center around who should have done something that nobody did or thought they had to do. A designer will want to allocate excluded services to the owner or contractor in the agreement to avoid these types of disputes later. A designer will prefer that services such as geotechnical investigation, surveys, and wetland and jurisdictional water delineations be performed by consultants to the owner in order to bar liability for these activities.

Within the various categories of design services which should be considered for inclusion in the contract, decisions also need to be made as to the extent of the selected services to be provided. These may be different depending on whether the designer is an architect or an engineer or landscape architect/master planner.

Engineers will typically lead technical projects where strict compliance with state and federal regulations establishes the criteria for the project, as opposed to working directly with an owner to create the owner's vision of a project. An engineers' services might be broken down into a general investigative study of the project and a definition of the elements of the project, preparation of a simple schematic design followed by permit drawings to be submitted to reviewing agencies, and then construction and contract administration services. On an architectural project, the scope of work typically begins with the designer working closely with the owner to determine the programming or desired elements of the project. The designer will thereafter create a bare bones design, which is refined through further iterations. A review of typical "full phase" architectural services is set forth below.

## **B. Typical Full Phase Architectural Design Services.**

### **1. Programming**

Programming involves defining what designers call the "design problem" and crafting the "design solution" to same. It involves determining, in some systematic process, the goals and objectives and desired finished features of a project, as well as determining the known limitations of the project such the size and character of the site and the owner's budget and schedule. Often, programming will be captured in a memoranda or series of sketches and will be approved by the parties before subsequent design stages are commenced.

### **2. Schematic Design**

Schematic Design builds off the programming phase in which the designer prepares a design to establish the general scope and conceptual design of the project including the scale and the relationships among the various components of the project. The primary objective of schematic design is to arrive at a clearly defined, feasible concept while exploring the most promising alternative design solutions. The designer will prepare a series of rough plans, known as schematics, which show the general arrangement of rooms and of the building on the site. Models and/or illustrations may be prepared to help visualize the project as necessary. The designer will also typically contact government authorities and entities providing utility services and determine general permitting requirements. The project proceeds to the next phase when the owner approves the Schematic Design. The designer will be well served to have the owner approve in writing one phase before progressing to the next. The contract may provide that without written approval, subsequent phases will not commence, which will help avoid questions, often pointed, of just how a design ended up as it did.

Owners with commitment problems can slow down the design of a project, resulting in a significant amount of unanticipated – and uncompensated – time spent refining the project. The following clause favoring the Architect anticipates and addresses this problem:

The Architect has included \_\_\_\_\_ man-hours for providing Basic Services during the Schematic Design Phase. To the extent additional hours are required to complete the approved schematic design documents, the Architect shall be additional compensated as follows: \_\_\_\_\_.

### **3. Design Development**

In this phase, the designer expands upon the approved schematic design to develop more detailed drawings illustrating other aspects of the proposed design. This is a transitional phase of a designer's services in which the design moves from the schematic phase to the contract document phase. In this phase, the designer prepares drawings and other presentation documents to embody the design concept and describe it in terms of architectural, electrical, mechanical, and structural systems.

### **4. Construction Documents**

Once the owner has approved the Design Development phase, the designer prepares detailed working drawings and specifications, which will be used to establish actual construction cost either through bidding or through a negotiated process, and which will be used to construct the project. These drawings and specifications become part of the construction contract.

### **5. Bid Related Services**

Bidding includes the contractor selection process, either through competitive or negotiated bidding. The owner will likely desire the designer to participate in this process to evaluate the pricing submitted, either through the preparation of bid forms and instructions and answering requests for information (RFIs) as to any gray areas in the bid documents. The designer will also typically prepare the form of agreement between the owner and the contractor and may make a recommendation of award.

### **6. Construction Phase**

Construction phase services comprise a large portion of a designer's work load on a full services project, both for Architects and Engineers. Construction phase services will typically include the following:

- a. Observation: Construction observation of the work involves the designer's periodic (or in some cases full time) presence on site evaluating the work of the contractor to determine if the work is generally conforming to the contract documents. Observation is a double edged sword for a designer from a liability standpoint. On one hand, the ability to monitor the work in the field offers a designer the opportunity to detect any problems in the drawings before construction is finalized. On the other hand, when shortcomings exist, owners and contractors invariably want to know why the designer didn't catch the problem at the time. Designers will want to emphasize that performance of construction observation doesn't guarantee the contractor's workmanship. Owners frequently prefer to characterize this activity as "inspection", which connotes a higher level of responsibility for finding problems. An expectation that observation will prevent any and all problems is unrealistic; however, the risk in failing to perform these services can be even greater and result in increased cost to the owner. The contract should provide that the contractor remains responsible for the means and methods employed in accomplishing the work.
- b. Review/Approving pay applications. The power of the purse is substantial in construction projects and without the authority to review and approve the contractor's pay applications, the designer will likely find his ability to 'control' the contractor limited. Owners typically are not qualified to determine the exact quantity and value of work performed over a pay period and a professional is best employed to safeguard the owner from the contractor's natural and understandable desire to bill out the project as quickly as possible. Again, reviewing and approving pay applications can create liability on the part of the design professional to the extent non-conforming work is approved, and disclaimer language should be employed to limit the approval to the best of the professional's knowledge rather than language indicating that approval constitutes a final acceptance of the work as performed.
- c. Administration of the contract and resolution of claims. Standard industry contracts allocate substantial authority to the designer to administer the work of the project which involves serving as the owner's representative, processing paperwork, conducting meetings, preparing minutes and acting as the conduit through which information flows between the owner and the contractor. Standard forms also typically authorize the designer to serve as the initial arbiter of the contract and the judge of the acceptability of the work, interpreter of the requirements of the contract documents, and the decision maker on 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 typically 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 what constitutes good faith under the circumstances.

North Carolina case law addressing 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 it is determined that the designer was grossly mistaken in his interpretation of the contract or issues a decision that is arbitrary and capricious. See Ruffin Woody and Associates, Inc. v. Person County, 92 N.C. App. 129, 374 S.E.2d 165 (1988).

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. Unfortunately, the designer is often called upon to determine whether a problem in the design documents gives rise to a claim for additional compensation or contract time to the contractor, which creates the potential for substantial conflicts between the designer's own interests and that of the contractor. Counsel preparing documents on the designer's behalf may want to define "good faith" according to the standard set forth to clarify the battleground over whether "good faith" was used in a particular instance.

- d. Reviewing submittals and shop drawings. Portions of the work will typically require the contractor to refine the design through the use of shop drawings detailing specific systems and portions of the work, as well as submittals of product information which substantiate a particular components compliance with the contract criteria. Depending on how this duty is defined, responsibility for problematic approvals of submittals may be disclaimed or placed directly on the designer.

- e. Determining substantial and final completion and approving final payments. The hallmark of successful project delivery is completion of same. The projected date is typically written into the owner-contractor agreement. The AIA defines substantial completion as:

the stage in the progress of the Work where the Work or designated portion is sufficiently complete in accordance with the contract documents so that the owner can occupy or utilize the Work for its intended use.

A201-1997, Section 9.8.1.

The date of substantial completion may determine when the owner will assume responsibility for operating and maintaining the building and may also start the running of the clock for statutes of limitation and repose. It may also trigger the contractor's warranty period and it often determines obligations of the contractor for penalties for late completion or a bonus for finishing early. It also sets the projected end date of the designer's basic services, which typically occurs 60 days later. Determining the date of substantial completion, then, is not to be taken lightly. It demands accuracy, compliance, and fair dealing.

AIA Document G704-2000, Architect's Certificate of Substantial Completion, provides that: "The Work performed under this Contract has been reviewed and found, to the Architect's best knowledge, information and belief, to be substantially complete."

Final completion would be total completion of the project including finishing punch lists and turning over warranty documentation, manuals and record drawings showing the as-built condition of the work. Care should be given to the certifications given by a design professional to avoid giving a guarantee which may jeopardize coverage under a typical errors and omissions professional liability insurance policy. Such policies cover negligence but typically exclude coverage for contractual guarantees.

A significant problem can arise when there may not be enough money remaining in the contract to pay for the remaining work to be completed. Should this occur, the architect is empowered to withhold certification to protect the owner. AIA A201, Section 9.5(6), "Decisions to Withhold Certification" states:

The architect may also withhold a Certificate of Payment or, because of subsequently discovery evidence, may nullify the whole or a part of a Certificate for Payment previously issued, to such extent as may be necessary in the Architect's opinion to protect the owner from loss . . . because . . . of [r]easonable evidence that the Work will not be completed within the Contract Time, and that the unpaid balance would not be adequate to cover actual or liquidated damages.

A certificate may also be withheld for other reasons, including defective work not remedied, liens filed, damage to the owner, and a persistent failure to perform the work.

## **7. Additional Services**

Additional services include any service not listed as a Basic Service. They usually fall into two categories: (1) those services excluded at the time the agreement is executed and (2) those that arise throughout the course of the project. Typical additional services may include programming, land survey services, geotechnical services, space schematics/flow diagrams, existing facilities surveys, economic feasibility studies, site analysis and selection, environmental studies and reports, owner supplied data coordination, schedule development and monitoring, civil and landscape design, interior design, special bidding or negotiation, value analysis, detailed cost estimating, and other on-site project representation.

## **B. Typical Fee Structures**

Most design professionals use one of the following methods, or combination thereof, to set their fee and may negotiate to suit a client's particular needs:

1. Hourly or Hourly Not to Exceed– Compensation is based on actual time expended by the design professional on a project or specific service.
2. Percentage of cost of construction –a specified percentage of the total cost to the owner of the construction of all elements designed or specified by the owner. Typically ranges from 5-12%, with well known players charging in some cases up to 20%. Note, a common dispute arising out of this fee structure concerns 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, before bidding or the project is complete.

3. Lump sum – the design professional identifies a specific sum to cover cost exclusive of reimbursement for ‘reimbursable’ expenses such as blue prints, mock-ups, etc.
4. On a square foot basis.

The time of a design professional involved in the project from conception through completion typically will be allocated and billed out as follows, depending on the firm’s practices:

- schematic design 15-20%;
- design development 15% to 20%;
- construction documents 20-35%;
- bid related services 5%;
- construction phase 40 to 50%.

### **C. Contract Issues Unique to Design Contracts**

#### **1. Duties and Obligations for Evaluating or Budgeting Construction Cost**

Without question an owner retaining a designer has an expectation that the design will generally reflect the resources available to the owner for the Project. However, because designs evolve over time, because costs change over time, and because a designer is typically neither a contractor nor a professional cost estimator, responsibility to design to a guaranteed budget is viewed by most design professionals as an unacceptable risk unless the designer is given substantial control to select fixtures and finishes for the finished project. Moreover, owners may not always be candid with a designer about the total available budget, wanting to see what they can get for less and then knowing they can upgrade elements later.

However, because a designer is generally more knowledgeable than an owner about construction costs and because the owner looks to the designer for guidance in designing towards a budget, the design contract needs to define the designer’s responsibility for estimating probable 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 of the final cost of construction. Under current AIA Owner Architect Agreements the architect is required to make a preliminary estimate and to refine the estimate of the costs of the work with each design phase. However, if the bids or lowest negotiated contract exceeds the budget, the owner’s remedies are to (1) increase the budget; or (ii) terminate the contract; or (iii) authorize the architect to re-design the Project to bring

it in line with the budget, at no additional costs to the owner, which is the limit of the architect's liability under the contract.

Whether this remedy is meaningful to the owner is questionable. Under some circumstances, a project may be so pared down by the time the final construction drawings are prepared that a re-design will not achieve the owner's objections. Accordingly, an owner may demand a guaranteed cost in order to ensure that the project can be constructed within the budget and may pay a higher design fee to compensate the designer for carrying the risk of an overage. If the designer does agree to a fixed limit of construction, the owner's program needs to be tightly defined. Changes to elements of the owner's program which affect the fixed costs should be noted in writing and the budget should be increased as a result.

Architects are increasingly recommending that owners bring in professional cost consultants to price the work in phases in order to more accurately evaluate the cost of the proposed project. Another solution is bring in a contractor early to price the work; in some cases a contractor can give locked in prices on the phased drawings so long as the guaranteed to receive the project and are entitled to revise pricing with subsequent phases. The owner may contractually limit increases to a set percentage over the last quote.

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 to the contract. For instance, 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).

Given the potential for disputes over anticipated construction costs, this portion of the design agreement should be given careful consideration.

## **2. Copyrights**

Essentially, a copyright is a form of legal protection for property rights existing in creative works. Federal law gives the owner of a copyright certain exclusive rights over a protected work that only he or others authorized by him may exercise. The following are examples of some the rights restricted to the copyright owner:

- the right to make and distribute copies of the protected work;
- the right to make works that are derivative of the protected works; and
- the right to perform or publicly display the protected works.

Federal law prohibits anyone but the owner of the copyright or his agents from exercising any of the exclusive rights without the consent of the copyright holder. A person or entity that does so infringes upon the copyright. In such a situation, the owner of the copyright may bring legal action against the infringer seeking monetary compensation or an injunction halting the infringer’s activities.

The Architectural Works Copyright Protection Act (AWCPA), codified at title 17 provides express copyright protection for architectural works. The Act defined an “architectural work” as “the design of a building as embodied in any tangible medium of expression, including a building, architectural plans, or drawings. The work includes the overall form, as well as the arrangement and composition of spaces and elements in the design, but does not include individual standard features.” 17 U.S.C. §101. The so-called standard features include design details “such as windows, doors, and other staple building components, as well as functional elements whose design or placement is dictated by utilitarian concerns.”

While the AWCPA does not explicitly mention engineering or other technical drawings, the federal courts have concluded that such works fall within the scope of the AWCPA’s protections. See e.g. Guillot-Vogt Associates, Inc. v. Holly & Smith, 848 F.Supp. 682 (E.D. La. 1994).

A copyright is automatically obtained by the author when the creative work is fixed in a tangible medium for the first time. Thus, copyright registration is not required to

enjoy copyright protection. Therefore, a party seeking to use a copyrighted work in construction must obtain authorization from the copyright holder. This may be done by assignment or license.

An assignment occurs when one party transfers all the rights in a copyright to another party. Unless an express agreement says otherwise, the party transferring the copyright surrenders all the interests and protections of the copyright. After the transfer is complete, absent permission or a contrary agreement, the prior holder of the copyright may not exercise any control over the copyright, else he infringes upon the copyright.

A license is a grant from the copyright owner (the licensor) to another (the licensee) allowing that person to exercise some of the rights and privileges associated with that copyright. Unlike assignments, licenses allow the transfer of fewer than all the exclusive rights in a copyright. For example, a license can be restricted to a specific use, to a collection of specific uses, and even a specific geographic area. Additionally, licenses can be either exclusive or non-exclusive. An exclusive licensee is deemed to have complete control over the rights granted by the licensor. In such a situation, not even the original copyright owner can exercise any of the rights granted to the licensee without infringing upon the licensee. Where a non-exclusive license is granted, the copyright owner can grant similar licenses and even exercise control of the granted rights. Implied licenses can be inferred from the circumstances of a particular transaction.

Based on the foregoing, properly addressing copyrighted works is a critical function of the design agreement. The designer has a strong interest in retaining the copyright to the works (defined in the AIA documents as “instruments of services”) because unauthorized use of the drawings in a separate location can create additional liability to the designer. The default setting regarding copyright in the AIA is the authorization of a nonexclusive license in the instruments of service solely for the use of constructing and maintaining the project. The caveat to this grant is that it is conditional on the owner’s proper performance of its obligations under the Agreement; rightful termination for cause terminates the license. This gives the designer substantial leverage over an owner.

As a result of this leverage, owners may want more control over the work and may desire clauses which alter this scheme. An owner may provide that if the agreement is terminated for any reason, the owner retains the right to use the works to complete the project. Or the owner can make the grant of license irrevocable and also provide for their right to use the drawings in multiple applications, subject to a release of the designer for claims or damages resulting from subsequent use. The owner may also

provide for an assignment of the copyright in all works created by the designer in the project.

### **3. Insurance and Indemnity Provisions**

Agreements for design services should address insurance requirements of the designer. In addition to requiring a designer to carry general liability insurance, most owners will (and should) require the designer to carry professional liability insurance. Professional Liability or Errors and Omissions (E&O) Insurance provides coverage for damages arising from the design professional's negligent acts, errors or omissions, or those for whom they are legally liable. Unlike general contractors, design professionals cannot add additional insureds on their E&O policies because the other entities are not providing services on behalf of the designer.

E&O policies exclude coverage for intentional acts, some forms of contractual liabilities and for Chapter 75 claims. The policies are typically written on a claims made rather than an occurrence basis. Accordingly, the policy in effect at the time the claim is made will respond. Coverage limits on PL policies is frequently written on a "wasting" basis whereby defense costs and attorneys' fees erode the policy limits. In a case where limited coverage is available, an early settlement with the designer may be beneficial before the defense depletes the policy. PL policies are also unique in that the insured is given "consent to settle" authority.

The AIA 2007 documents for the first time contain provisions requiring E&O insurance as a default setting. The policy limits should be reasonably related to likely costs of deficient design claims. Careful counsel for owners will require that the policy be maintained for at least three years after Substantial Completion because of the claims made nature of the coverage. Project specific coverage beyond the designers' ordinary limits can be obtained for reasonable rates. Typically, if an insured carries at least \$500,000 in coverage, the insured can purchase an endorsement for project specific insurance for rates such as \$1,000-\$2,000 dollars for each additional million dollars in coverage. Some carriers will make the endorsement coverage primary.

In addition to requiring E&O insurance, design agreements, like other construction agreements, should include waiver of subrogation clauses. Such clauses cut off a carrier's right to pursue other entities for a loss after the carrier has paid the claim, keeping the claim with the party receiving a premium to cover the loss and cutting down on litigation.

In addition to insurance, owners will desire indemnification from the designer; the designer will push for this obligation to be reciprocal. Of course, the owner in

furnishing a design to the contractor warrants the acceptability of the plans and specifications for construction and is actually taking on liability to the contractor for design defects. While the AIA and EJCDC General Conditions provide indemnification in favor of both the owner and the design professional for claims caused by the contractor's negligence, no indemnity is required of the designer. Owners will want to amend these provisions and modify the standard indemnity provisions which likely violate N.C. General Statute Section 22-B.

#### **4. Electronic Media**

The digital age has changed the manner in which projects are designed and constructed and sophisticated owners and contractors are increasingly requesting electronic files. While file sharing promotes efficiency and accuracy, such files are subject to modification by recipients, which has the potential to create liability if the files are changed and a problem later develops. The AIA in 2007 produced a new document called the E201 Digital Protocol Exhibit, a sample of which is provided at the conclusion of this paper. This Exhibit is intended to be used as an attachment to all contracts on any project where digital data is to be exchanged. The document sets out terms and conditions governing the release of the data, such as a requirement that a transmitter warrant that they hold the copyright in the data, or are authorized to transmit same. It also requires the receiving party to indemnify the transmitter against any claims arising out the receiving party's unauthorized use or modification of the digital data.

#### **5. Dispute Resolution**

Where a project involves at least three parties—the owner, designer and contractor—one issue for negotiation is whether an alternative dispute resolution (ADR) mechanism can be drafted which will require the presence of all parties in the same proceeding. The AIA documents prior to 2007 prohibited joinder of the architect to arbitration between the owner and contractor. The 2007 revisions do not flatly prohibit such joinder, but instead allow for joinder upon the consent of the party. Other form documents such as ConsensusDOCs require the presence of all necessary parties to any ADR proceeding. The owner and contractor will want to amend documents to require the designer to participate in any ADR proceeding. The designer likely prefers those parties to fight it out first and then have to bring a separate proceeding against it.

### **III. Understanding How Delivery Method Affects the Designer's Role**

The Project Delivery System is the contractual structure and compensation arrangement the owner uses to acquire a completed facility that meets its needs. It

includes both design and construction services. Several different options are available and the project delivery system should be selected based on a careful evaluation of the process and its applicability to the owner's needs, priorities, and capabilities.

#### **A. Design/Bid/Build**

Design/Bid/Build is a construction project delivery system in which the agency or owner contracts with separate entities for the design and construction of a project. Design-bid-build is the traditional method for project delivery. The contract issues discussed above are all pertinent to this delivery method.

In the design phase, the owner hires an architect or engineer to design and produce documents upon which the contractors will bid, and which will ultimately be used to construct the project.

In the bid phase, the general contractors bidding on the project obtain copies of the design professional's design documents, and then put them out to multiple subcontractors for bids on the components of the project. Bids can be open, in which any qualified bidder may participate, or select, in which a limited number of pre-selected contractors are invited to bid. The contractor compiles a complete bid price for submission by the closing date and time. Once the bids are received, the architect ensures all documentation is in order, and advises the owner as to the ranking of the bids. The owner is not obligated to accept the lowest bid, and it is customary for other factors, such as past performance and quality of work, to influence the owner's decision. If all the bids exceed the owner's goals, the owner may elect to reject all bids and can then either abandon the project, request the design professional to revise the design, or select the lowest bid's general contractor to join the architectural team to assist with cost reduction.

If the owner lets the project it then contracts directly with the contractor. The design professional typically then acts as the owner's agent to review the progress of the work and to issue site instructions, change orders or other documentation necessary to the construction process.

Design/bid/build is a beneficial construction delivery system in that the owner can obtain competitive bids for the project and can rely on the architect to monitor the contractor and can expect the contractor to apprise it directly of any problems in the design.

However, design/bid/build also has disadvantages, including the delayed start to a project which requires that the design be finalized prior to bidding as well as the

tendency of the designer and contractor to blame the other for problems on the job. Further, since the general contractor is brought in post-design, there is little opportunity for input on effective alternates or value engineering. Finally, coordinating a designer and a contractor typically requires in-house personnel capable of managing construction issues on a daily basis.

## **B. Fast Track**

Fast track is a form of design/bid/build and is used to describe a process in which certain portions of the designer's services overlap with construction activities. The principle objective of Fast Tracking is speed since portions of the work can commence while the remaining elements of the design are finalized. Fast Track projects carry an increased risk of coordination issues in the project due to the fluid and dynamic evolution of design and simultaneous construction. This can create additional liability for the designer, and designers performing Fast Track work will desire to disclaim liability associated with the process, such as a provision as follows:

### **FAST TRACK DESIGN AND CONSTRUCTION**

The owner recognizes that this Project is to be designed and constructed on a "fast track" basis. Separate packages of drawings and specifications for various portions of construction will be issued according to a schedule which will enable construction to proceed at a rapid pace before all design is complete. This approach does not allow for complete coordination of the Architect's professional services. Of necessity, assumptions made by the Architect regarding earlier professional services may need adjustment as later professional services are performed. The Architect will endeavor to minimize any additional construction cost to the owner resulting from conflicts or discrepancies arising out of the "fast track" approach. In consideration of the benefits to the Client of employing the fast track process and in recognition of the inherent risks of fast tracking to the Architect, the owner agrees to waive all claims against the Architect for design changes and modification of portions of the Work already constructed due to the owner's decision to employ the fast track process. In addition, the owner agrees, to the fullest extent permitted by law, to indemnify, defend, and hold harmless the Architect, its officers, directors, employees and subconsultants (collectively, Architect) against all damages, liabilities or costs arising out of or in any way connected with utilization of the fast track approach on this Project, excepting only those damages, liabilities or costs attributable to the willful misconduct of the Architect. The owner further agrees to compensate the Architect for all Additional Services required to modify, correct or adjust the Construction Documents and coordinate them in order to meet the owner's program

requirements because of the owner's decision to construct the Project in a fast track manner.

### **C. Design-Build**

Design-build is a construction project delivery system where the design and construction aspects are contracted for with a single entity known as the design-builder or design-build contractor. Design-Build follows on the old "Master Builder" model, where a central figure held total project accountability from design to completion and was strictly liable to the owner for defects, delays, and other losses. The design-build delivery system is a return to some, but not all, of these fundamentals. Design-build as a method of project delivery has gained momentum only in the last 20 to 30 years. However, industry forecasters predict that design-build will overtake the "traditional" design/bid/build project delivery method within the next decade.

Design-build has several benefits. It often saves the owner money on the overall project, due in large part to an often earlier completion date and a shorter construction loan period (which typically has a higher interest rate than permanent financing). Rather than the traditional finger-pointing that is often commonplace in traditional design-bid-build construction projects, design-build allows the owner to look to one entity to address any and all problems. The owner is also afforded greater flexibility to change the project during construction without having to re-bid the entire project.

With its benefits, however, also come disadvantages. Cost estimating for a design-build project is sometimes difficult because design documents often are preliminary and change during the project. Accordingly, such contracts usually are written to allow for unexpected situations without penalizing the design professional or the owner. Further, because these types of projects often are designed as they are built, regulatory review is often limited, and projects completed prior to review can sometimes lead to costly change orders to bring the project into compliance with regulations. The owner can lose a measure of control over the design of a project. Design and construction may become driven by the bottom-line issues of the design-build firm, and the owner's interests in design selection or project quality may become secondary. The owner may also lose the benefit of the designer and contractor performing "watchdog" functions over one another. The owner may become the sole "watchdog", and may not have the in-house capability to handle that role.

The North Carolina licensing statute for architects specifically exempts design-build undertakings from architectural licensing requirements. See N.C.G.S. § 83A-13(b). Under this statute, a general contractor may enter into a design-build contract

provided that a properly licensed architect performs the architectural services and full disclosures are made to the owner as to the duties and responsibilities of the design-build participants. The statute does not change the requirement that the contracting party be a licensed general contractor. Thus, the design-build contracting entity must hold a North Carolina general contractor's license.

From a design agreement standpoint, in a design/build project there is only one "prime agreement" for design and construction between the owner and the Design/Build entity. This prime agreement may be entered between a contractor and owner; the contractor then essentially subcontracts the design to the designer. Under the AIA documents, the prime agreement resembles the A101 construction owner/contractor agreement with flexible pricing options. The concept requires the owner first to contract with a consultant to create a programming document setting forth the criteria for the project, which becomes the basis of the owner/design-builder agreement, and requiring strict conformance to the criteria.

Where the contractor subcontracts the design work to a designer, the scope of work desired will likely be truncated and compressed to save on paying for a full three phase design process. This lean and mean approach means the designer is afforded less time and iterative review of the design to catch any design problems throughout the process. Because the contractor will be liable to the owner for the design furnished, the contractor will require insurance and indemnification from the designer. The contractor will want to clearly establish the right to pass flow through claims down to the designer and will also want ensure that the designer can be included in arbitration if claims under the prime agreement are subject to arbitration.

#### **IV. Special Legal Issues Affecting Owner-Designer Claims and Relationships**

##### **A. Establishing the Standard of Care: Expert or Layperson Testimony?**

A case against a design professional for professional negligence will almost always require competent expert testimony concerning the standard of care required, which provides a template against which the finder of fact may measure the actual conduct of the professional. The purpose of introducing evidence as to the standard of care in a professional negligence lawsuit is to see if this defendant's actions lived up to that standard. Associated Indus. Contr'rs., Inc. v. Fleming Eng'g, Inc., 162 N.C. App. 405, 410, 590 S.E.2d 866, 870 (2004).

The only exception to the expert testimony requirement is where the "common knowledge and experience of the jury is sufficient to evaluate compliance with a standard of care." Delta Evn. Consultants of N.C. v. Wysong & Miles Co., 132 N.C. App. 160, 168, 510 S.E.2d 690, 695, *disc. Review denied*, 350 N.C. 379, 536 S.E.2d

70 (1999). The “common knowledge” exception applies where the conduct is gross, or of “such a nature that the common knowledge of laypersons is sufficient to find the standard of care required, a departure therefrom, or proximate causation.” Little v. Matthewson, 114 N.C. App. 562, 567, 442 S.E.2d 567, 570 (1994), *aff’d per curiam*, 340 N.C. 102, 455 S.E.2d 160 (1995).

In Handex of the Carolinas, Inc. v. County of Haywood & Municipal Engineering Services Co., P.A., 168 N.C. App. 1; 607 S.E.2d 25; 2005 N.C. App. LEXIS 148 (2005), Haywood County resolved to enlarge an existing landfill (“the Project”). It contracted with Municipal Engineering Services (“MES”) to perform engineering services, involving design, overseeing the bidding process, and supervision of the performance of the Project.

MES prepared the contract documents and specifications upon which the bids were based and served as the project administrator. Handex finished the job late and was subject to liquidated damages payable to the County and contended that the delay was caused by MES. Handex further contended that it was entitled to recover on 7 change orders requesting additional compensation as a result of the design defects in the plans and specifications.

Handex filed suit against MES for professional negligence and breach of contract and against the County for breach of contract. The County counterclaimed against Handex to recover liquidated damages allowed for delay under the contract. At the close of evidence at trial, MES was granted a directed verdict as to all claims against it, and was awarded costs. The County’s motion was denied, and the jury rendered a verdict against it for breach of contract and awarded Handex damages.

On appeal, the Court first affirmed the directed verdict on the breach of contract claim against MES based on the rule that where there are neither allegations of contractual privity, nor that the plaintiff was an intended third-party beneficiary under the professional contract, that plaintiff’s exclusive remedy against the professional sounds in tort. The Court found Handex’s asserted claim under the MES-County contract too tenuous to support either contractual privity or intended third party beneficiary status.

The Court then looked at the elements a plaintiff must prove to prevail on a professional negligence claim, which are: (1) the nature of the profession (2) a duty to conform to a certain standard of conduct; and (3) a breach of the duty which proximately caused injury. Green v. Pell & Pell, LLP, 144 N.C. App. 602, 604, 550 S.E.2d 522, 523 (2001).

Handex had offered the lay testimony of its vice-president, a Texas licensed civil engineer, who testified that MES provided misleading and ambiguous information during the bidding process, and that it improperly administered the contract in regard to the denial of Handex's modification requests. Handex also questioned MES's expert, a local North Carolina civil engineer, who testified that MES did not breach the standard of care and that he would not have done anything differently. Handex failed to offer expert testimony that MES breached the relevant standard of care.

The Court found the lay testimony insufficient to show what an engineer practicing under the relevant standard of care actually does or any breach of that standard. The Court further found that the expectations and terms of art relating to excavation and landfill construction were outside the realm of a layperson's common knowledge and experience; thus, expert testimony was required to establish a breach of the standard of care. The Court found that Handex had failed to prove the elements of a *prima facie* case for professional negligence.

## **B. Limitation of Liability Enforceable**

In two recent cases, the appellate courts of North Carolina recognized the enforceability of limitation of liability clauses in contracts of design professionals.

In Blaylock Grading Company, LLP v. Smith Engineering, 658 S.E.2d 680, 2008 N.C. App. LEXIS 2008 (2008), Smith Engineering ("Engineer") performed land surveying services for Blaylock Grading Company, LLP ("Blaylock"). The contract contained a "Risk Allocation" provision which stated:

[Engineer's liability to Blaylock] for any and all injuries, claims, losses, expenses, damages or claim expenses arising out of this agreement, from any cause or causes, shall not exceed the total amount of \$50,000, the amount of [Engineer's] fee (whichever is greater) or other amount agreed upon when added under Special Conditions. Such causes include, but are not limited to, [Engineer's] negligence, errors, omissions, strict liability, breach of contract or breach of warranty.

Per the contract, the Engineer provided land surveying for Blaylock, but mistakenly set the benchmarks higher than specified in the design plan, requiring Blaylock to import fill to raise the elevation of the site. Blaylock filed suit against the Engineer alleging breach of contract and negligence. The Engineer's motion for partial summary judgment based on the limitation of liability provision above was denied, and the trial judge ruled that it was void as against public policy. The jury rendered a verdict in favor of Blaylock in the amount of \$574,714.

On appeal, the Court cited with approval Gas House, Inc. v. Southern Bell Telephone Co., 289 N.C. 175, 221 S.E.2d 499 (1976), which held that a limitation of liability provision limiting a telephone company's liability for errors or omissions in an advertisement was not unreasonable and not contrary to public policy. It also noted that Blaylock acknowledged that there were no contract formation irregularities, and, therefore, no unconscionability arguments. The Court disagreed with Blaylock's argument, and the trial court's finding, that land surveying services fall within the public service exception because they are "extensively regulated" industries. It held that a profession is not converted into a public service, and thus limited in its ability to contract away its liability, simply because it is subject to regulation by the state. The Court cited the rule that when a breach of contract between two parties involves only economic loss, the health and safety of the public are not implicated. A third party who might be affected by the negligence of an engineer or surveyor can still bring a negligence suit against the engineer or surveyor. See Davidson & Jones, Inc. v. County of New Hanover, 41 N.C. App. 661, 666-67, 255 S.E.2d 580, 584 (1979). The Court concluded that the limitation of liability in the contract did not implicate the public health or safety.

The Court then considered the applicability of N.C.G.S. § 22B-1 (2007), titled "Construction indemnity agreements invalid" but found this statute inapplicable because the clause at issue was a limit on the Engineer's liability, not an indemnity clause whereby one party agrees to be liable for the negligence of another. The Court further held that the statute was intended to limit a promise from recouping damages paid to a third party as a result of personal injury or property damages when the damages were caused by the promise. It does not apply to contracts between a promisor and promisee limiting the amount of damages recoverable by one from the other, such as the contract at issue. The Court reversed the trial judge and remanded the case with instructions to enter judgment consistent with the limitation on liability contained in the Risk Allocation provision of the parties' contract.

In Mosteller Mansion, LLC v. Mactec Eng'g & Consulting of Ga., Inc., 2008 N.C. App. LEXIS 1011 (N.C. Ct. App. May 20, 2008), Mosteller Mansion, LLC ("Mosteller") contracted with Mactec Engineering and Consulting of Georgia, Inc., f/k/a Law Engineering and Environmental Services, Inc. ("Mactec"), in connection with Mosteller's plan to purchase a sixteen-acre tract of land in order to construct an apartment complex (the "Project Site"). The contract contained the following provisions:

3. Standard of Care. [Mactec] will perform [its services] using that degree of skill and care ordinarily exercised under similar conditions by reputable members of [Mactec's] profession practicing in the same or similar locality at the time of performance. . . .

....

8. Limitation of Liability. The inclusion of a limitation of liability provision in this Agreement under the terms set forth below is a material consideration for [Mactec's] willingness to perform the services. To the maximum extent permitted by applicable law and for additional consideration of \$10.00 from [Mactec], [Mosteller] hereby expressly agrees that the liability of [Mactec], including its parent and affiliated companies, officers, directors, employees, agents, successors, assigns and subcontractors, for any cause of action based upon breach of contract, strict liability, negligent professional acts, errors or omissions or negligent misrepresentation arising out of or in connection with this Agreement and/or any services provided, or work product developed, pursuant to this Agreement shall be limited to the aggregate sum, inclusive of amounts paid to secondary clients to whom work product is provided under a secondary client agreement with [Mactec] and to any other third parties, together with reasonable attorneys' fees and all other defense costs, of \$50,000 or the total fees paid to [Mactec] by [Mosteller] under this Agreement, whichever is greater. All third party beneficiaries to this Agreement, if any, are intended to be and hereby are bound by the terms of this limitation of liability and the aggregate limitation of liability contained herein.

9. Indirect Damages. Neither party shall be responsible to the other or to any third party for any economic, consequential or indirect damages (including, but not limited to, loss of use, income, profits, financing or reputation) arising out of or relating to this Agreement or the performance of the services.

....

18. Governing Law. This Agreement shall be governed by the laws of the State of Georgia. . .

Unlike any of the other provisions in the contract, the Limitation of Liability and Indirect Damages provisions were printed entirely in capital letters. Per the contract, Mactec conducted soil testing services at the Project Site and submitted a report and presented recommendations to Mosteller regarding foundation design. Mosteller paid Mactec \$8,900 for its services and purchased the Project Site and began grading operations. According to Mosteller's complaint, when it began grading it discovered soil unsuitable for the proposed construction and inconsistent with the findings and recommendations of Mactec's Report. Mosteller alleged that Mactec had caused in excess of \$ 3,000,000 in damages.

Mactec filed a motion for summary judgment asserting that all of Mosteller's claims arose out of services performed pursuant to the contract and were, therefore, subject

to the contract's terms and conditions. Mactec sought an order enforcing both the Limitation of Liability provision and the Indirect Damages provision. The trial court granted summary judgment in favor of Mactec on all of Mosteller's claims and certified its order for immediate appeal.

On appeal, Mosteller argued: (1) the law of North Carolina, not Georgia, applies to all of its claims, (2) the Limitation of Liability and Indirect Damages provisions violate North Carolina law, (3) even if Georgia law applies, the provisions violate Georgia law, and (4) even if the provisions do not violate either North Carolina or Georgia law, the provisions do not apply to the professional negligence or negligent misrepresentation claims.

The Court agreed that the law of North Carolina governs the resolution of the tort claims, as, under North Carolina law, the law of the state where a tort was committed controls the substantive issues of the claim. Gbye v. Gbye, 130 N.C. App. 585, 503 S.E.2d 434, disc. review denied, 349 N.C. 357, 517 S.E.2d 893 (1998). It concluded, however, that the law of Georgia controlled the resolution of the substantive issues of Mosteller's breach of contract claim. North Carolina courts generally recognize the validity and enforceability of contractual choice of law provisions and Georgia had a substantial relationship to the dispute (given that Mactec's principal place of business was located there). The Court concluded that this was not a case involving good morals or fundamental principles of natural justice and did not, therefore, violate the public policy of North Carolina. Thus, the choice of law provision was given effect and the limitation of liability provision was enforced.

In the forgoing cases, 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.

### C. Indemnity Cases

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. 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.

In general, the design professional will be required to indemnify the owner against loss and damages caused by the designer'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.

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. Conclusion**

As can be seen above, design contracts present different issues from construction contracts and an understanding of design issues is imperative to drafting cogent and thorough design agreements.

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