
Seven Legal Issues Unique to Design-Build

By Mark C. Friedlander
June 5, 2015

As design-build as a project delivery method continues to grow in popularity, practitioners have begun to question exactly it is different from traditional design-bid-build projects. In general terms, contractors are aware that design-build ordinarily shortens project delivery time and leaves the design-builder responsible for the entire project. However, there is a need for a greater understanding of precisely which legal and business issues have different implications for design-build projects as opposed to traditional design-bid-build projects.

The legal issues arising uniquely out of the design-build method of project delivery are *not* overly complex. Although all complex construction projects involve important legal issues, there are not a great number of additional legal issues that arise in design-build projects as opposed to the traditional design-bid-build mode.

After having been involved in a large number of design-build projects in both the public and private sectors, it seems to me that the legal issues that are *unique* to design-build projects can be broken down into the following seven categories:

- The relationships and loyalties among the parties.
- The design professional's standard of care.
- Performance warranties.
- Entitlement to Change orders.
- Licensing problems.
- Insurance/Bonding problems.
- Conflicts with competitive bidding laws.

The following is a brief summary of how these issues differ from those in traditional construction projects.

The Relationships Among The Parties

The most obvious change distinguishing design-build from traditional design-bid-build projects is that the design professional is not the owner's consultant, and is instead the contractor's teammate. Design professionals usually have contractual incentives to perform their services so as to further the design-build team's goals, which ordinarily are not fully congruent with those of the owner. The design professional has a disincentive to call the owner's attention to problems with the construction work, and the design is likely to value such factors as cost and constructibility over other criteria that the architect or owner would ordinarily emphasize.

The existence of a "team" comprised of contractor and designer raises unique legal issues regarding the relationship between them. Will one be prime to the owner with the other as a subcontractor? If the design-builder is not already a single entity, do the contractor and designer form a single entity to contract with the owner, and if so, should the entity be a joint venture, corporation, or limited liability company? Within the design-build entity how will decisions be made, and how will disagreements be resolved? These issues all involve important legal and business planning decisions.

The Design Professional's Standard of Care

The design-build relationship allows, but does not require, a change in the designer's standard of care. Ordinarily, an architect is only held responsible for exercising the degree of skill or care that the average, similarly situated architect would employ, and does not ordinarily warrant or guarantee a successful outcome for his services. The ordinary rule

for a contractor is different: contractors do impliedly warrant that the result of their services will be a successful project, provided that the design and other factors over which they have no control are proper and appropriate.

Most courts to consider the issue have held that a design-build contractor is more nearly akin to a contractor than to a design professional. Accordingly, design-builders are usually held to the same warranty standards as contractors. This is true even of the design services that they offer. (This is one of the primary reasons why owners like design-build construction: the whole truly is greater than the sum of its parts because the designer is held to a stricter standard in a design-build context than when there is a separate contract for design services.)

It is important to note, however, that the standard of care applicable to design in design-build projects can be changed by contractual agreement. The design-builder's liability for design problems can be returned to the usual "appropriate levels of skill and care" standard by including a contractual provision in the design-build agreement that so provides.

Performance Warranties

In a traditional construction contract, the contractor is asked to warrant the results of its work, but not the overall success of the project. This is because there are many other factors (primarily design) over which the contractor has no control that determine the success of the project.

In many design-build projects, the situation is reversed. The design-build contractor is responsible for so much of the project that it becomes feasible to require the contractor to warrant the project's performance. Of course, there usually remain some aspects of the project for which the owner is responsible, such as operation and maintenance, supply of feedstock, process design, etc. Any performance warranty must be drafted carefully to properly allocate the risks.

Some performance warranties actually guarantee the operation of the completed project for a period of time. More commonly, the contractor agrees to test the project following substantial or mechanical completion to verify that the appropriate performance criteria are met. The ability to quantify performance failure by comparing actual performance to specified performance criteria allows unusual precision in the drafting of liquidated damages provisions and often leads contractors to request certain limitations of liability (such as to a small percentage of the construction price, immunity from consequential damages such as lost profits, etc.).

Entitlement to Change Orders

In ordinary construction contracts, the contractor is usually entitled to a change order if any of three situations occur:

- Impacts caused by owner (i.e. scope changes, interference or disruption by owner or other parties for whom owner is responsible)
- Changed conditions (i.e. unknown subsurface obstacles, force majeure)
- Design problems (i.e. errors, omissions, ambiguities, etc. in the plans and specifications)

In design-build projects, the first two categories may still result in change orders, but the third category ordinarily does not. Since the contractor is responsible for the plans and specifications, it can not make use of errors and ambiguities in them to claim entitlement to an extra. However, if the owner's criteria from which the contractor prepares the design have ambiguities or omissions, the need to change the design to accommodate new or clarified owner's criteria may result in change orders.

Licensing Problems

Every state in the country regulates and restricts the practice of professional engineering and architecture, establishing educational, testing and organizational requirements. Most design-build contractors do not meet one or more of these requirements and therefore are not themselves licensed as design professionals. Design-build contractors usually provide engineering and architectural services by joining with a design professional or subcontracting these services to such a firm.

Somewhat surprisingly, many states forbid these practices. Many states will not allow a contractor to hold itself out as performing professional services as part of a design-build project unless the contractor itself is a registered design professional. There is a trend toward liberalizing these rules so as to allow a design-build contractor to hold itself out as offering architectural or engineering services provided that the professional services are performed by duly registered firms or individuals. Every state's law is different.

An interesting conflict may arise for design-build projects that are procured or funded by the federal government. Federal laws ordinarily preempt inconsistent state laws, but there is no federal law licensing or regulating the practice of architecture and engineering so as explicitly to supersede restrictive state laws.

Insurance/Bonding Problems

Issues relating to insurance and bonding affect the relationship between the design-build parties. Design professionals' errors and omissions insurance ordinarily excludes construction services, and contractors' general liability policies exclude professional services. These policies may have disparate impacts on the parties, since general liability policies ordinarily have little or no deductible, whereas professional liability policies have large deductibles. Certain states have anti-indemnity laws for construction projects that limit the parties' contractual ability to redress this disparate impact.

Surety bonds can lead to similar problems. For example, performance bonds may not cover an affiliated A/E's design services. Although it is certainly possible to arrange adequate and appropriate insurance and bonding, the unique legal issues require additional analysis.

Conflict With Competitive Bidding Laws

Projects funded with public money usually require a competitive process to choose a contractor, even in design-build projects. For federal projects, the process is well-established: the administering agency seeks competitive proposals from design-build contractors or teams and chooses the proposal with the best overall value for the government.

The federal government solicits competitive proposals for numerous other types of procurement action, including design professional's services, so there are few unique legal issues arising out of competitive proposals for design-build projects. The primary difference arises out of the fact that the competitive proposals are for the entire project at once, rather than in stages like a traditional design-bid-build job. This may create some new issues involving responsiveness of the proposals. For example, if a budget is identified, may the administering agency determine that a proposal that exceeds the budget is nevertheless the most valuable?

More difficult restrictions exist at the state and local levels. Some statutes and regulations absolutely require competitive bidding on the basis of price, a problem for design-build projects. As design-build increases in popularity, interesting issues of municipal law will likely arise, such as whether contractors can compete on the basis of number and quality of widgets for a fixed price, as opposed to the price of a fixed number of widgets described in technical specifications. In projects administered by state or local agencies but with federal funds, legal issues will likely arise as to whether federal procurement requirements will preempt inconsistent state or local requirements that could be read to restrict design-build.

Time and Material Design-Build Projects

Particularly when the project scope cannot early be identified, some design-build projects are structured on a time and materials or "cost-plus" contract. When the design-builder is working under a pure cost-plus contract, different considerations arise. The design professional's loyalty to the contractor becomes less pronounced because of the contractor's lesser degree of risk. The relevance and importance of change orders is drastically diminished. The owner ordinarily assumes a larger role in the project, and some jurisdictions provide that the owner, rather than the contractor, is responsible for subcontractor defaults. A guaranteed maximum price provision further affects these issues.

© 2015 Schiff Hardin LLP

This publication has been prepared for the general information of clients and friends of the firm. It is not intended to provide legal advice with respect to any specific matter. Under rules applicable to the professional conduct of attorneys in various jurisdictions, it may be considered attorney advertising material. Prior results do not guarantee a similar outcome.

For more information visit our Web site at www.schiffhardin.com.