



THE RULES OF CONSTRUCTION: LEGAL RELATIONSHIPS IN THE DESIGN-BUILD AND INTEGRATED PROJECT DELIVERY ERA

by Steven K. Stawski*

Introduction

This article juxtaposes three project-wide construction contracting models to highlight privity-related risks following the recent clash of competing lines of jurisprudence in *Keller Construction v U.P. Engineers & Architects*.¹ *Keller* employs the Supreme Court's decision in *Fultz v Union-Commerce Associates*² to overrule the construction law cases that follow *Williams v Polgar*.³ This conflict breathes life into the centuries-old debate between first-party obligations and third-party duties, which is relevant to almost all forms of civil practice.

Owners, architects, engineers, and contractors are entering into new contractual arrangements that shift traditional design and construction responsibilities in ways that challenge our common law and statutes. These recent changes are fueled by industry trends, such as sustainable design and Building Information Modeling (BIM), which broaden planning, design and construction perspectives, force earlier collaboration and coordination among participants, and focus attention on the delivery of a product to expecting owners.

Under *Keller's* reasoning, a construction project's overall privity structure is critical to the stakeholder risk, especially as contracting models continue to evolve. Can an owner sue for defective plans and specifications when the architect is a sub-contractor to the design-builder? Can a contractor sue an architect for negligence in a design-bid-build model? Does a design-builder that promises a certain LEED rating imply a warranty to the owner? Do the common law rules of construction apply to Integrated Project Delivery? If the respective remedies arise in tort, what protections does the common law provide as precedent? As new project-centered contracting models separate construction law stakeholders from their traditional privity relationships, contractual term and extra-contractual interpretations by our judicial system become increasingly important to define the rights and obligations of the owner, architect, and contractors on projects.

Judicial Developments in Extra-Contractual Liability

Foreseeable Reliance

Assessments of extra-contractual liability are important for successful project planning and useful for risk analysis if a project stalls or fails. Michigan jurisprudence speaks to two lines of extra-contractual liability: the first expands duty to third parties by focusing on foreseeable reliance; the second, and more recent, limits duty based on an analysis of the obligations between the contracting parties.

- 1 *Keller Construction v U.P. Engineers & Architects*, unpublished opinion of the Court of Appeals per curiam, issued July 8, 2008 (Dkt No 275379), 2008 Mich. App. LEXIS 1378 (Mich Ct App July 8, 2008), *lv den*, *Keller Construction v U.P. Engineers & Architects*, 482 Mich 1068; 757 NW2d 500 (2008).
- 2 *Fultz v Union-Commerce Assoc*, 470 Mich 460, 467; 683 NW2d 587 (2000).
- 3 *Williams v Polgar*, 391 Mich 6; 215 NW2d 149 (1974).

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In the widely-quoted *Williams* opinion, the Michigan Supreme Court placed foreseeable reliance as the hallmark of tort actions that survive absent privity of contract in holding that “there is a valid tort cause of action in the nature of negligent misrepresentation arising from a contract for an abstracter’s services in favor of a non-contracting damaged third-party whose reliance on the abstract could be foreseen.”⁴

Williams translates to the construction environment in *Bacco Const Co v American Colloid Co*,⁵ where a contractor maintained a tort action against a design professional despite lack of privity arising out of defective plans and specifications for the lining material for wastewater lagoons. The *Bacco* Court held that such negligence actions are viable despite lack of privity:

It is certainly foreseeable that an engineer’s failure to make proper calculations and specifications for a construction job may create a risk of harm to the third-party contractor who is responsible for applying those specifications to the job itself. The risk of harm would include the financial hardship created by having to cure the defects which may very well not be caused by the contractor.⁶

Similarly, in *National Sand, Inc v Nagel Construction*,⁷ an excavation subcontractor sued Progressive Engineering, Inc. in tort when it incurred damages associated with two failed site plans. Specifically, Progressive failed to locate the sewage pits in an area that contained sufficient clay deposits to re-use as a lining. As a result, National Sand incurred \$258,000 in costs for extra excavation work for the two failed footprint locations and sued Progressive to recover based on the plans. In reversing the Trial Court’s dismissal of National Sand’s negligence action against Progressive Engineering, the Court of Appeals rejected the lack of privity as a defense:

Thus, what can be concluded is not, as plaintiff suggests, that a breach of contract claim can be maintained regardless of privity; rather, it is that a plaintiff may maintain an action *in tort* where he is injured by the defendant’s negligent performance of contract even where there is no privity between the parties. Thus, in the case at bar, the trial court properly dismissed plaintiff’s breach of contract claims against

⁴ *Williams*, 391 Mich at 26.

⁵ *Bacco Const Co v American Colloid Co*, 148 Mich App 397; 384 NW2d 427 (1986).

⁶ *Id.* at 416 (emphasis added).

⁷ *National Sand, Inc v Nagel Construction*, 182 Mich App 327; 451 NW2d 618 (1990).

Progressive Engineering and the drain commission since there was no contractual relationship between plaintiff and those two defendants. *However, that does not preclude plaintiff from maintaining its tort claim against Progressive Engineering.*⁸

Extra-Contractual Duty

The second, and more recent, line of cases under *Fultz* limits the rights of non-signatory third parties to sue in tort absent a duty that is separate and distinct from contractual obligations between signatories to the contract. “Specifically, the threshold question is whether the defendant owed a duty to the plaintiff that is separate and distinct from the defendant’s contractual obligations. If no independent duty exists, no tort action based on contract will lie.”⁹ These cases place the primary emphasis on the language of a contract to which the aggrieved person is not a signatory. “[T]he jurisdictional question is not to be resolved by mere allegation, but rather by analysis of whether the facts pled give rise to a legal duty in tort independent of breach of contract.”¹⁰

The Keller Opinion

These two conflicting lines of cases recently collided in *Keller*,¹¹ which arises from the construction of a water treatment and distribution system for the Village of Ontonagon. The Village entered into separate contracts for design and for construction services, using the design-bid-build model of contracting. Keller Construction sued the Village’s design professional, U.P. Engineers & Architects (UPE&A), in tort for malpractice, negligence, and tortious interference. In dismissing the tort-based claims against the design professionals, the *Keller* court concluded that “*Bacco and Nat’l Sand* have been overruled to the extent they are inconsistent with *Fultz*” and found no independent duty exists outside the design professional’s contract with the Village.¹²

The open question is whether the *Rinaldo*¹³ and *Fultz* line of cases, which arise in the commercial dispute and personal injury contexts respectively, are

⁸ *Id.* at 331 (emphasis added).

⁹ *Fultz*, 470 Mich at 467 (citing *Rinaldo’s Construction Corp v Michigan Bell Telephone Co*, 454 Mich 65; 559 NW2d 647 (1997)).

¹⁰ *Rinaldo*, 454 Mich at 82.

¹¹ *Keller* 2008 Mich. App. LEXIS 1378 (Mich Ct App July 8, 2008) (unpub. op).

¹² *Id.* at *10.

¹³ *Rinaldo’s Construction Corp v Michigan Bell Telephone Co*, 454 Mich 65; 559 NW2d 647 (1997).

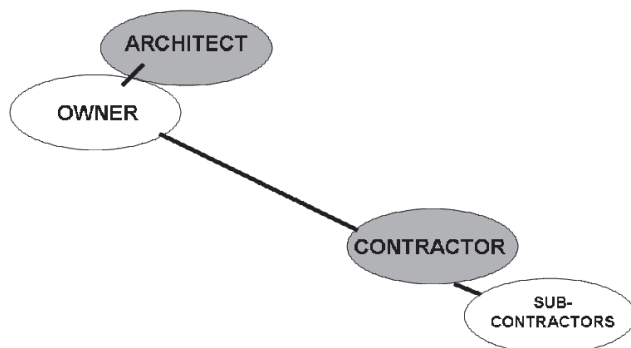
distinguished from the construction law environment. Construction contracting environments are replete with interlocking relationships that, as a practical matter, require foreseeable reliance and dependence on the plans and work of others. While the *Keller* opinion remains unpublished and not binding on Michigan courts, the changing contract models in construction law are important to all stakeholders in construction, especially those whose rights may be limited by a mere shift in privity relationships.

Shifting Privity Relationships on a Project-Wide Scale

The Design-Bid-Build Model

Michigan's common law rules of construction are founded on the traditional design-bid-build model. The owner contracts with the architect for design services and with a general contractor for construction services.

Design-Bid-Build Traditional Roles and Responsibilities



Generally speaking, the interests of the architect and related design professionals are aligned with the owner. The architect produces Instruments of Service, which include drawings, specifications, and related documents for use on the project.¹⁴ During construction, the Architect reviews submittals and pay certifications, issues bulletins, observes construction for compliance with the design intent, and sometimes serves as the first arbiter of disputes between the owner and contractor. For example, an owner may use an AIA B101-2007 Standard Form of Agreement Between Owner and Architect (based upon the B151-1997) as a base agreement with a design professional. Design professional services progress through schematic design, design development, and

¹⁴ Generally, the ownership of the Instruments of Service is retained by the architect and the owner is provided with a nonexclusive license.

construction documents phases, which result in plans and specifications for the project.

The Contractor is responsible for the means and methods of construction. An owner may use an AIA A101-2007 (formerly, A101-1997) Standard Form of Agreement Between Owner and Contractor where the basis of payment is a Stipulated Sum. The Contractor's role increases if the Architect issues performance specifications, in contrast to product specifications. The AIA Owner-Contractor contract incorporates the AIA A201-2007 (formerly, A201-1997) General Conditions of the Contract for Construction. While this General Conditions Contract speaks to the relationship of the owner, contractor, and architect (including the rights and responsibilities of the architect), it is not signed by the architect and does not control the architect's legal obligations to the owner during construction.

Traditional design-bid-build contracts often leave the risk of defective plans and specifications open to resolution by common law. For design services, architects in Michigan are not warrantors of their plans and specifications and the law does not imply such a warranty or guarantee of perfection.¹⁵ In *Borman's, Inc v Lake State Development Co*,¹⁶ the Michigan Court of Appeals rejected Plaintiff's (the tenant's/owner's) claim of an implied warranty against an architect that a drainage system was to be fit for its intended use, stating that "[w]e find this position to be untenable and contrary to law in this state." The *Borman's* Court quoted the rule of law in *Chapel*, affirming that "[t]he law does not imply such a warranty, or the guaranty of the perfection of his plans."¹⁷

Instead, architects are held to a professional standard of care: "The responsibility of an architect is similar to that of a lawyer or physician. The law requires the exercise of ordinary skill and care common to the profession."¹⁸

During construction, however, the burden of defective plans and specifications rests with the owner. Contractors in Michigan are not liable to the owner for defective construction so long as the work is performed in accordance with the plans and specifications provided

¹⁵ *Chapel v Clark*, 117 Mich 638, 640; 76 NW 62 (1898).

¹⁶ *Borman's, Inc v Lake State Development Co*, 60 Mich App 175; 230 NW2d 363 (1975).

¹⁷ *Id.* at 182.

¹⁸ *Ambassador Baptist Church v Seabreeze Heating and Cooling Co*, 28 Mich App 424, 426; 184 NW2d 568 (1970); see also *Chapel v Clark*, 117 Mich 638; 76 NW 62 (1898).

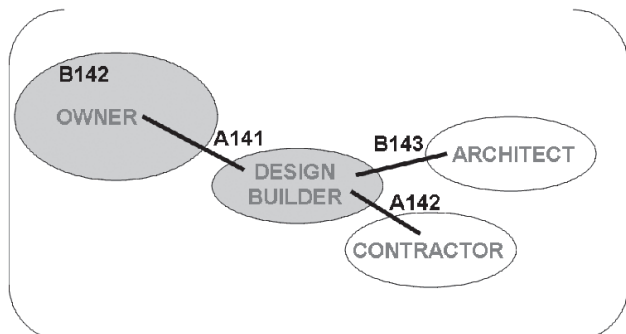
by the owner. In *L.W. Kinnear, Inc. v Lincoln Park*,¹⁹ a contractor was held not responsible for the collapse of a sewer where the contractor installed the type of sewer required by the specifications, but the sewer was found to be unsuitable for use under the existing conditions. This limitation of liability of the contractor to the owner is referred to as the *Spearin* Doctrine: “if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. [The] responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work”²⁰

Architects and contractors alike have benefited from these longstanding common law protections. These benefits are eroding, however, as the industry turns to new forms of project-wise design-build and integrated project development contracting models.

The Design-Build Model

In contrast to design-bid-build, a design-build contract structure (whereby the owner engages a contractor or party other than an architect to serve as the design-builder) eliminates the owner’s privity relationship with the architect. The architect becomes a member of, or subcontractor/subconsultant to, the design-builder. The design-builder promises to perform or obtain design and construction services for the owner in the form of a “turn-key” product.

Design/Build Contracting: AIA Family (2004)



This realignment of privity relationships effectively changes the rules of construction. The owner’s single contract with the design-builder becomes increasingly important, as its provisions may replace previous common law protections afforded to the owner, architect, and contractor. Under *Fultz*, the owner loses the ability to bring an action in tort against the architect for defects in the plans and specifications. The contractor loses *Spearin* protections because the owner is not providing the plans and specifications for the project. The architect effectively loses common law protections under *Chapel* because it is no longer performing design services directly for the owner.

Arguably, the design-builder, who is not delivering a product to the owner, may be subject to warranties and other such guarantees, particularly if the owner is expecting certain characteristics and results, such as a certain level of LEED certification or building performance upon commissioning. Lost tax incentives from the failure to achieve a certain LEED designation may become a form of consequential damages.

In the design-build environment, the rights of the stakeholders are determined by the contracts between the stakeholders, the terms of which vary greatly depending on the industry groups that produce the documents. Design-build contract families produced by the AIA, the Design-Build Institute of America (DBIA), Associated General Contractors (AGC), Consensus Docs, Construction Owners Association of America (COAA), and the National Society of Professional Engineers’ Engineers Joint Contract Documents Committee (EJCDC) vary greatly in form and substance, departing from traditional roles and responsibilities.

For example, in the AIA design-build family, the owner reviews submittals, inspects and certifies final completion, approves pay applications, and rejects non-conforming work. These changes, which represent tremendous shifts in owner control and responsibility, are one reason why the AIA design-build family of contracts includes the B142 Standard Form of Agreement Between Owner and Consultant, which the owner can use to secure the assistance of a design professional.

The DBIA contract between the design-builder and design-build subcontractor defaults to the local standard of care for an architect but specifically authorizes the parties to agree on specific performance standards for certain aspects of the work. An architect that contracts to a standard of care higher than what is required under the common law may be contracting out of professional

19 *L.W. Kinnear, Inc v Lincoln Park*, 260 Mich 250; 244 NW 463 (1932) (citing *United States v Spearin*, 248 US 132, 136 (1918)).
20 *Spearin*, 248 US at 136.

liability coverage depending on the terms and conditions of the architect's professional liability policy.

Some design-build contract documents specifically exclude any third-party beneficiary rights, which further limit actions by those who are not in privity of contract.

As a further consideration, Michigan statute restricts design-build entities from engaging in the practice of architecture or engineering without proper licensing: "[a] firm may engage in the practice of architecture, professional engineering, or professional surveying in this state, if not less than 2/3 of the principals of the firm are licensees."²¹ Recognizing this type of limitation, some design-builder contracts provide that when the design-builder is not an architect and engineer, the architectural and engineering services shall be procured from licensed and independent design professionals retained by the design - builder. As previously noted, the owner lacks privity of contract with the design-builder's contracted architect. If the design-builder is a project-specific entity without significant assets, then the owner's remedies may be limited by a judgment-proof party.

The Integrated Project Delivery Model

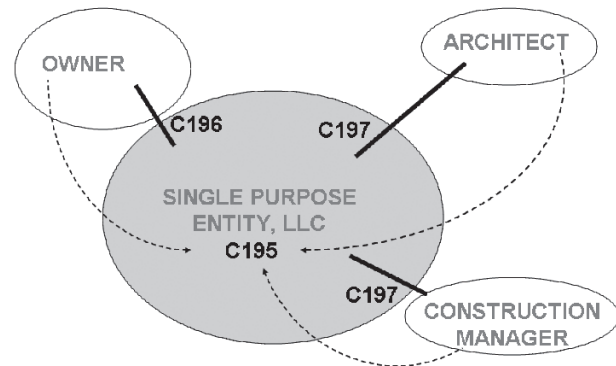
The Integrated Project Delivery Model (IPD) is a radical departure from the design-bid-build and design-build privity structures.²² The AIA 2008 C-family of Integrated Project Management documents center around a Single Purpose Entity LLC (SPE, LLC), which is formed jointly by the owner, architect, and construction manager as its initial members. This company serves the sole purpose of planning, designing, constructing, and commissioning improvements to real property.

Like spokes radiating from a central hub, all privity relationships attach directly to the SPE, LLC, including contracts with the owner, the architect, the construction managers, contractors, and suppliers.

²¹ MCL 339.2010 (emphasis added).

²² This article recognizes that multiple industry groups publish different versions of integrated project delivery contracts and that the AIA produces a "transitional" set of integrated project delivery documents that centers around the A295-2008 General Conditions of the Contract for Integrated Project Delivery. The AIA C-family is highlighted for its novel and unique structure.

Integrated Project Delivery: AIA Family (2008)



Unlike the design-bid-build and design-build contract models, this form of IPD contracting includes entity-based considerations that are governed by the Michigan Limited Liability Company Act.²³ Specifically, the terms of the SPE, LLC's operating agreement control the privity relationships for the project and minimum content of the contracts between the SPE, LLC and the owner and non-owner members, including the architect and construction manager.

In the standardized member agreements, the owner and non-owner SPE, LLC members will generally waive their rights to pursue claims and disputes against one another, except for claims arising out of a member's willful misconduct. The SPE, LLC also waives its rights to pursue claims and disputes against the owner, architect, and construction manager members, along with all other non-owner members, if any. These layered mutual-waiver provisions, which are supported by liability exculpation and indemnification provisions in the SPE, LLC operating agreement, constitute a radical departure from other construction law contracting models. All disputes between members and the LLC arising in equity, law, or contract are resolved privately through a private dispute resolution process, not through the courts or by arbitration.

The need for this entity-based structure is driven by technological advancements such as Building Information Modeling (BIM) that enable architects, engineers, and contractors to create three-dimensional, object-oriented, virtual models that can actively model and test various

²³ MCL 450.4101 et seq.

components and characteristics of buildings before they are constructed. For example, a BIM model identifies, and helps to resolve, conflicts between ducts and electrical systems that must pass through, above, or below certain structural components before construction begins.

While this form of IPD eliminates some of the common law issues associated with extra-contractual risk in the design-bid-build and design-build models, it opens a host of potential legal issues that will undoubtedly surface among members within the LLC operating agreement itself.

Conclusion

New legal relationships in the design-build and integrated project delivery era are shifting roles and responsibilities and altering the construction law

landscape. Owners are focusing on an ultimate product, such as a building designed and built by a design-builder that qualifies for a certain LEED rating or achieves a certain functionality based on commissioning tests. The terms of owner-driven, coordinated, and comprehensive project-centered contracting models are replacing traditional notions of the design-bid-build process. Different privity relationships have rendered the long-established common law protections afforded to architects and contractors as irrelevant. New jointly-formed entities employ a sophisticated use of operating agreements to dictate privity relationships and control the content of member and non-member contracts. These developments, combined with the recent clash in jurisprudence as to extra-contractual liability, are replacing the commonly accepted rules of construction with contractually agreed upon rights and remedies negotiated between and among the construction stakeholders.