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Overview of Contract Law

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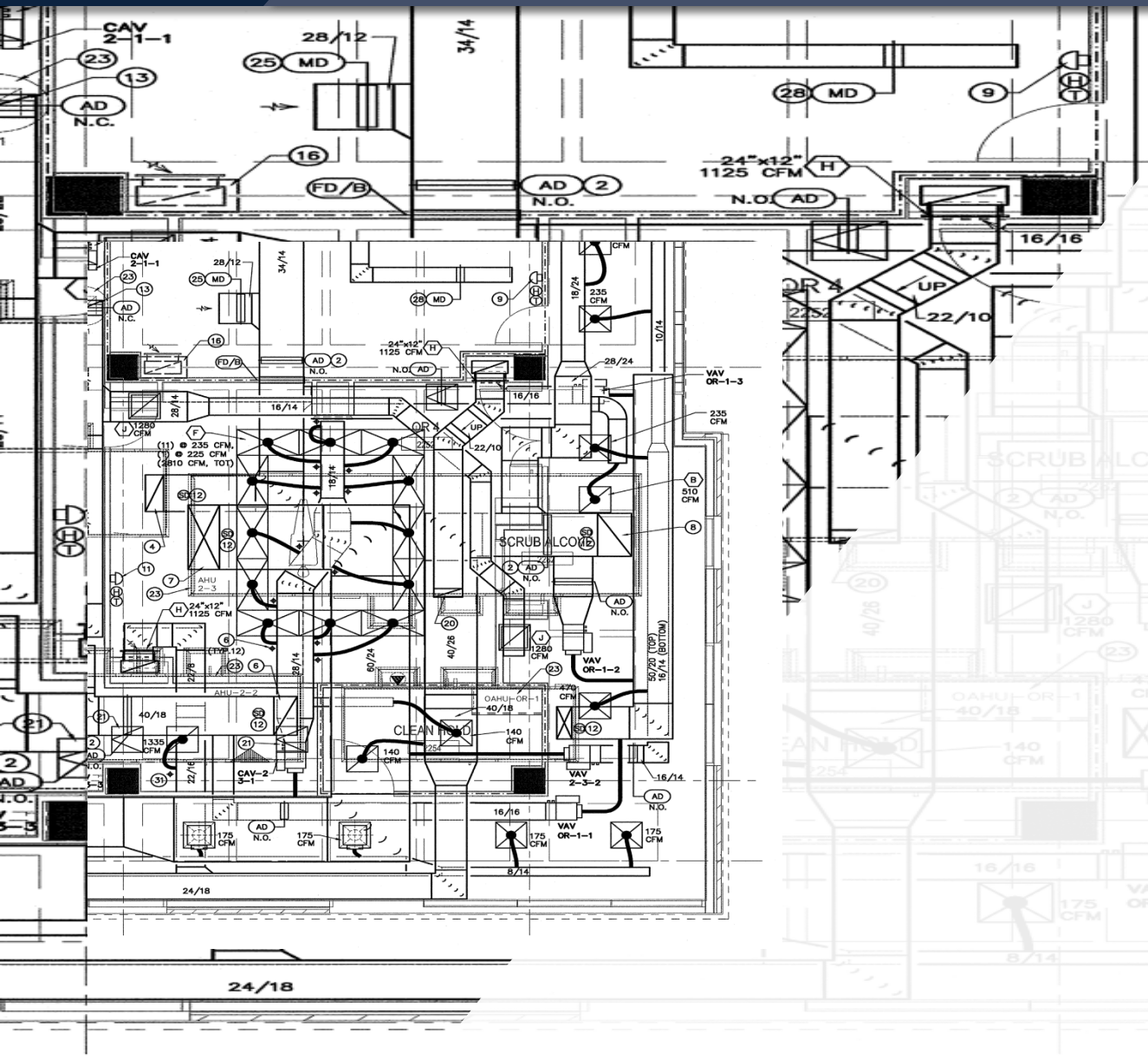

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"Contracts" – What are they good for, anyway?

- Create enforceable rights
- Help the parties understand their duties
- Define the parties' obligations

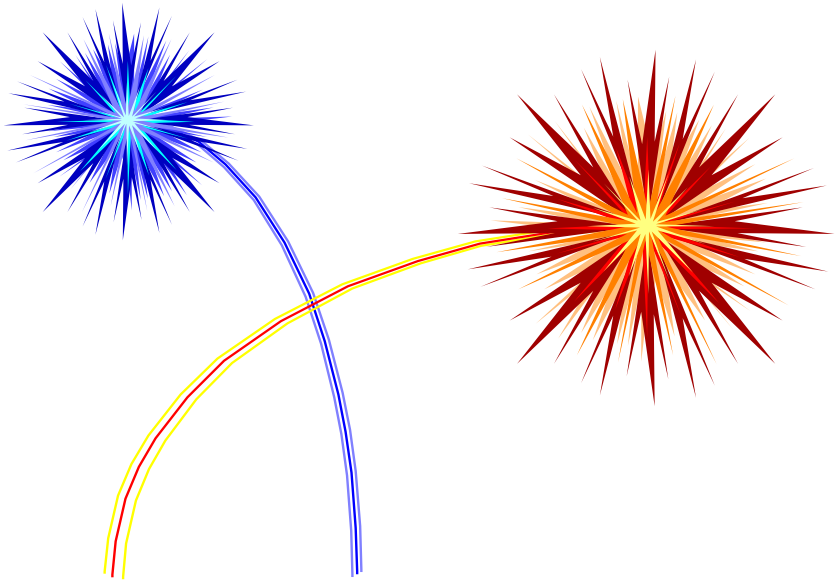
BOTTOM LINE: A contract is an ***asset***, not just a book of obligations.

Stuff Happens

Goals

TO LEARN ABOUT:

- Typical Contract Forms
- Key Contract Clauses
- Contractual Risks
- Laws Impacting Contract Terms



Industry Standard Contract Forms

- American Institute of Architects **("AIA")**
- ConsensusDOCs
- Engineers Joint Contract Documents Committee **("EJCDC")**
- Design-Build Institute of America **("DBIA")**
- Construction Management Association of America **("CMAA")**

AIA Contract Documents

- **AIA** was founded in New York City in 1857 by a group of 13 architects to promote scientific and practical perfection of its members and elevate standing of profession.
- Published first set of **Standardized General Conditions** for Construction in 1911.
- Publishes nearly **200** agreements and administrative forms.
- Most prominently used contract forms on commercial construction projects.

ConsensusDOCs Contract Documents

- Associated General Contractors of America **(AGC)** spearheaded industry-wide effort to develop alternate contract documents to the **AIA** documents during the '90s.
- The first set of contract documents was published in 2007.
- Publishes over **100 agreements and administrative forms**.
- **CD** contract forms are gaining popularity on commercial construction projects.

EJCDC Contract Documents

- Was created in 1975.
- It includes a major portion of the professional groups engaged in practice of providing engineering and construction services for **engineer-led construction projects**.
- Publishes **5 families of over 70 contract documents and forms**.
- Contract forms are the most prominently used forms on **civil and engineer-led** projects.

DBIA Contract Documents

- Was created in 1993.
- Its mission is to promote the value of **design-build project delivery** and teach effective integration of design and construction services to ensure success for owners and design and construction practitioners.
- Publishes over **40 contract documents and forms**.

CMAA Contract Documents

- Was formed in 1982.
- Its mission is to **promote the profession of construction management** and the use of qualified construction managers on **capital projects and programs**.
- Publishes several construction manager-agent and **construction manager-at-risk** contract documents.

Contractual Risks

- Warranties and Guaranties
- Heightened Standards of Care
- No Limitation of Liability
- Poorly Defined Scope of Services
- “Flow-Down“ Provisions from Prime Contract
- Contingent Payment Clauses
- Clauses Imposing Fiduciary Obligations
- Clauses Related to Achieving “Green” Building Distinction
- Indemnity Clauses

Warranties and Guaranties

- What is a **warranty or guaranty**?
  - A stipulation of assurance of some particular in a contract.
  - **Example** – "Architect/Engineer warrants each task and all services rendered hereunder shall be performed in accordance with Architect/Engineer's Standard of Care, all Applicable Laws and the requirements of this Contract."
  - Warranties can also be related to other items such as performance of systems.

Warranties and Guaranties

- So what's the problem with **express warranties** or **guaranties**?
  - Create a heightened legal obligation, allowing the other party to bring breach of express warranty claims.
  - Potentially allow other party to recover benefit of the **bargain damages**, i.e., additional cost to achieve guaranteed result.
  - Generally excluded from coverage under professional liability policies.

Heightened Standards of Care

- **Who/What Sets the Standard for Engineers:**
  - Without a standard of care included in a contract, it is the reasonably prudent engineer in the geographic location in question.
  - The standard of care establishes duty of engineer.
  - **Example of Heightened Standard of Care** – "Engineer shall perform its services hereunder with that degree of professional skill and care practiced by similar firms, using similar **collaborative project design methods**, and **having industry leading knowledge and skill** engaged in providing similar services for **major construction projects of comparable value in the United States** under the same or similar circumstances."

No Limitation of Liability

- **A Limitation of Liability Clause is a clause setting forth maximum liability of a party under a contract.**
  - **Example** – "Owner agrees that Architect/Engineer's liability to the Owner for any and all claims, losses, expenses or damages arising out of this Agreement shall be limited so as not to exceed the aggregate sum of **$1,000,000.00**."
  - Can it limit all liability for a party arising out of its services performed under a contract?
    - **NO!**

No Limitation of Liability

- It is one of the **most significant clauses in a contract**.
- Many times amount of maximum liability is tied to the contract amount or the amount of professional liability insurance.
- Many engineers attempt to negotiate this clause into the contract to avoid unlimited liability.

Poorly Defined Scope of Services

- **Basic Services and Additional Services** should be clearly defined.
- Deliverables for each interim milestone during the design phase should be outlined.
- Any special services such as **LEED-related services** or **BIM** should be detailed.
- Lack of definition in the scope of services leads to unnecessary disputes.

"Flow-Down" Provisions

- **What is a "flow-down" provision:**
  - A provision from a prime contract that "flows down" to consultant obligations included in agreement with Owner.
  - **Example** – "Engineer assumes toward Contractor all obligations Contractor has assumed toward Owner under the Prime Contract."
  - Could be in a **Design-Build contract** between Contractor and Engineer.
  - Could be in a **consulting agreement** between Architect and Engineer.

"Flow-Down" Provisions

- **The problem with "flow-down" provisions:**
  - Obligate engineers to covenants, promises and responsibilities contained in a different contract.

- **Ask to see a copy of the prime contract if the contractor or architect insist the "flow-down" provision remain in the contract.**

Contingent Payment Clauses

- What is a contingent payment clause **("CPC")**:
  - A clause making payment from another a condition precedent to the obligation to pay the other party to contract.
  - **Texas Business & Commerce Code Ch. 56** restricts enforceability of CPCs as to most construction contracts.
  - Courts will not enforce CPCs unless they strictly comply with statute.
  - **However, generally speaking, architects and engineers are not afforded protections of Ch. 56.**

Contingent Payment Clauses

- Since Ch. 56 generally does not apply to protect architects and engineers, the common law still controls enforcement of CPCs in **design services contracts**.
- To be enforceable, courts want the clause to clearly state that the owner's payment to the architect (or contractor) is a condition precedent to payment to the engineer.
- **Bottom Line** – CPCs are significant risk-shifting clauses.
- If other party insists, consider requiring disclosure of owner's audited financial records.

Clauses Imposing Fiduciary Obligations

- A **fiduciary obligation** is one arising from a relationship of trust and confidence in which one party is to act in best interests of the other party.
  - **Example of Clause Raising Fiduciary Concerns:**
    - "Architect/Engineer accepts the **relationship of trust and confidence** established by this Contract and covenants with the Owner to cooperate with the Owner throughout each phase of the Project and to exercise the Architect/Engineer's skill and judgment in **furthering the interests of the Owner**." (clause based on ConsensusDOCS 240 clause)

Clauses Imposing Fiduciary Obligations

- Texas law is unclear regarding whether design professionals, simply by performing design services, enter into fiduciary relationships.
- Other state jurisdictions have recognized a fiduciary duty owed by design professionals, especially when they maintain a supervisory function over the project.
- Regardless of the state in which the project is located, most engineers attempt to avoid clauses creating potential fiduciary obligations if at all possible.

Clauses Imposing Fiduciary Obligations

City of Victorville Case (Cal. Superior Court, 2010)

- City of Victorville was awarded over $50 million from engineering firm because of failed cogeneration power plant project.
- Engineering firm acted as design engineer and construction manager for project.
- Jury found engineering firm negligently misrepresented key facts to City which were relied upon by City in making decision to build plant.
- First case where a breach of fiduciary duty verdict was returned against a California engineering firm.

Clauses Stipulating "Green" Building Distinction

- More and more owners want their buildings to be **high-performing green buildings**.
- The most prominent green building distinction is **LEED** certification.
- Many contracts fail to adequately address the complexities of achieving such a certification.
- The **AIA E203-2013** sets forth a party's responsibilities for LEED certification.
- **ConsensusDOCs 310 Green Building Addendum** appends to "Green Building Facilitator's" Contract.

Clauses Stipulating "Green" Building Distinction

- Be sure to clearly define LEED responsibilities by LEED Credit Section.
- Make sure Owner's desired level of green building distinction is established in contract, e.g., **LEED Gold, Silver, Platinum**.
- Making representations or warranties as to achievement of a certain level of green building distinction is generally excluded from PLI policies.

Indemnity Clauses

- **Indemnity: What is it?**
  - An “indemnity” is simply an agreement to assume another’s liability to a third party.
- **Types of Indemnity Clauses:**
  - Broad form (one party covers the other’s negligence)
  - Comparative or Intermediate (shared responsibility)
  - Limited (each party responsible for own negligence)
- **Who are third parties who might assert liability claims?**

Typical Indemnity Arrangement

OWNER

Damaged And Sues Owner

THIRD PARTY

Owner Requires Contractual Indemnification from Engineer

ENGINEER

Types of Indemnity Clauses

- **Type I, Broad Form** – one party (indemnitor) indemnifies the other party (indemnitee) for its negligence, even indemnitee's sole negligence.
- **Type II, Comparative or Intermediate** – one party (indemnitor) indemnifies the other party (indemnitee), even if the loss was due **in part** to the negligence of the indemnitee.
- **Type III, Limited** – one party (indemnitor) indemnifies the other party (indemnitee) only if loss was caused by the negligence of indemnitor.

Broad Form Indemnity Clause

- To the fullest extent permitted by law, Engineer shall indemnify, defend, save and hold the Owner and its respective partners, officers, employees and anyone else acting for or on behalf of the Owner (hereinafter collectively called “Indemnitees”) harmless from and against all liability, damage, loss, claims, demands and actions of any nature whatsoever which arise out of or are connected with, or are claimed to arise out of or be connected with the performance of Engineer’s Services hereunder, whether or not such liability, damage, loss, claim, demand or action was **caused solely by the negligence or fault of an Indemnitee**.

Intermediate Form Indemnity Clause

- To the fullest extent permitted by law, Engineer shall indemnify, defend, save and hold the Owner and its respective partners, officers, employees and anyone else acting for or on behalf of the Owner (hereinafter collectively called “Indemnitees”) harmless from and against all liability, damage, loss, claims, demands and actions of any nature whatsoever which arise out of or are connected with, or are claimed to arise out of or be connected with the performance of Engineer’s Services hereunder, whether or not **caused in part by the negligence or fault of an Indemnitee**.

Limited Indemnity Clause

- To the fullest extent permitted by law, the Engineer shall defend, indemnify and hold harmless the Owner, the Owner's officers, directors, members, consultants, agents and employees (the Indemnitees) from all claims for bodily injury and property damage, including reasonable attorney's fees, costs and expenses, that may arise in connection with this Agreement, but only to the extent **caused by the negligent acts or omissions of the Engineer**.

Laws Impacting Contract Terms

House Bill 2049

- **HB 2049** was passed by the 84th Legislature in 2015 and took effect on **September 1, 2015**.
- The law is codified under the amendments to Section 271.904 of the Local Government Code.
- It does not allow a governmental agency to seek a defense for its partial or sole negligence from an engineer.
- It stipulates the standard of care clause that can be included in a contract between a governmental agency and an architect/engineer.

House Bill 2093

How Does it Impact Indemnity Clauses?

- **HB 2093** was passed by the 82nd Legislature in 2011 and took effect on **Jan. 1, 2012**.
- Law is codified as Ch. 151 in Insurance Code.
- Ch. 151 makes void broad and intermediate form indemnity clauses, except for certain limited exceptions.
- Many indemnity clauses in contracts will require modification because of the new law.

Civil Practice and Remedies Code

- **§ 130.002(b) Civil Practice & Remedies Code. Covenant or Promise Void and Unenforceable (1987)**
  - Voids an indemnity clause requiring an engineer or architect to indemnify an owner from liability for damage that is caused by or results from the negligence of an owner or an owner's agent or employee. (broad and intermediate form indemnity)
  - The law applies to any construction contract on a public or private project, except for residential projects, e.g., single family, apartment complex, condominium, townhomes and etc.
  - It only limits indemnity required by public or private owner.

House Bill 1456 – Mechanic's Liens

- **HB 1456** was passed by the 82nd Legislature in 2011 and took effect on **Jan. 1, 2012**.
- Law made significant revisions to Ch. 53 of Property Code.
- Ch. 53 sets forth rules related to mechanic's liens.
- 53.021(c) entitles architects and engineers to file liens.

House Bill 1456 – Mechanic's Liens

- **HB 1456** only amends the language of Ch. 53 of the Property Code (private projects) and not Ch. 2253 of the Government Code (public projects).

- HB 1456:
  - provides a set of standard waivers and releases of lien to be used under various circumstances
  - makes any waiver or release that does not follow the statute unenforceable

Open Discussion & Questions

Contact Me

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