

# Evolving Liability for Design-Build Contracts:

## The Perfect Storm of Conflicting Interests

By

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### Introduction

Inherent in every design-build contract is the non-delegable duty to properly design and construct. Equally significant, the trust and confidence reposed in the design-builder necessarily creates a fiduciary duty owed to the owner. Simply stated, the owner is led to believe everything is being included in his project and relies completely on the sufficiency of the plans and specifications provided by the design-builder. Similarly, the owner relies on the actual and presumed knowledge of the design-builder. The key focus is the owner's complete reliance on the design-builder's skill and judgment, together with the inevitable expectation that the design-builder will provide a "turnkey" project.

The design-builder makes implied representations, ordinarily indispensable to the project, that he has used reasonable skill, competency and judgment in designing and constructing the project. On the other hand, the design-build clients do not customarily possess the skill or design knowledge of the design-builder and are unable to fully examine either the design or the completed project and its components. Owners generally rely on the *all-inclusive* services of the design-builder, and that blanket reliance often results in misunderstandings and litigation. This is because the traditional design professional has "morphed" with the traditional builder to become a new super entity called a "design-builder." One persistent question is whether fiduciary obligations require the new *super entity* to disclose to its clients that it now holds all the cards in the deck, leaving no independent entity to "watchdog" the project. This paper addresses the rapidly evolving liability of design-builders who sell, market, design, supervise, and implement design-build contracts.

Design-builders wear "two hats:" a design hat and a builder hat. This amalgamation of duties blurs traditional lines of responsibility between design professionals and builders. Common sense questions become evident when owners give one entity plenary authority for both design and construction. The courts have been adamant that design-builders must both competently design and competently build. Remarkably, courts are only now coming to the realization that when design-builders don "two hats," they are fully responsible for the omnibus accumulation of legal duties and obligations that are traditionally imposed on designers and builders.

Moreover, independent (non design-build) case law exists that designers who cross over and perform traditional "builder activities," lose any limitation of liability traditionally enjoyed by design professionals. As will be demonstrated, designers who act like builders shed the mantle of immunity from implied warranty and products liability. Conversely, builders who cross over and perform "design activities" assume

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responsibility for design deficiencies and can no longer exculpate themselves by pointing at the design professional. Ultimately, the *transmogrification* of designer and builder into “design-builder” puts the new super entity into a position where it assumes liability for the “sum of all the parts.”

Reminiscent of the venerable "master builder," today's design-builder is typically authorized to contract and implement design-build ventures that include all aspects of design and construction. California courts are heading toward a broader design-build liability by expanding insular role liability to match the comprehensive “turnkey” offerings of design-builders.

As a result, design-builders may seek to limit risk from defects or design deficiencies by including limitation provisions in contracts or by including owner approval provisions that would purportedly shift the risk and exculpate the design-builder. However, this exculpation attempt undermines the design-builder's non-delegable duty to properly design and construct. If such limitation of liability provisions are included, does this constitute an unfair business practice under Business and Professions code §7200? We examine below some of the significant consequences of donning “two hats” and merging the roles of designer and contractor.

## **1. What is Design-Build?**

In a design-build process, both the design and construction of a project are performed by a single entity. This differs significantly from the traditional *design-bid-build process*, in which an architect or engineer is selected by the owner to design the project, and competitive bids are taken from other entities for the performance of construction services. *Consulting Engineers and Land Surveyors of California v. Dept of Transportation* (2008) 167 Cal. App. 4th 1457, 1462, 84 Cal. Rptr. 3d 900.

Typically, under the traditional design-bid-build system, the owner warrants the correctness of the plans and specifications to the construction contractor under the *Spearin Doctrine*, *United States v Spearin* (1918) 248 U.S. 132, 137, 63 L. Ed. 166, 39 S. Ct. 59, applied in California by *Souza & McCue Constr. Co. v. Superior Court* (1962) 57 Cal. 2d 508, 511, 20 Cal. Rptr. 634, 370 P.2d 338. A design professional does not warrant the sufficiency of the plans and specifications furnished to the owner, unless there is an express warranty agreement that the design professional assumes responsibility for the accuracy of the plans. *Allied Properties v. John A. Blume & Associates* (1972) 25 Cal. App. 3d 848, 855-856, 102 Cal. Rptr. 259; *Gagne v. Bertran* (1954) 43 Cal. 2d 481, 487, 275 P. 2d 15. Accordingly, a contractor who has followed plans, specifications or directions provided by the owner, or one acting on behalf of the owner, traditionally cannot be held liable for alleged construction defects or insufficiencies attributable to the plans. *McConnell v. Corona City Water Co.* (1906) 149 Cal. 60, 64.

In contrast, design-builders assume the responsibilities of a design professional (architect/engineer) and furnish all services – designing, engineering, constructing – necessary to deliver a completed project for an agreed price. *Thomas v. Buttress & McClellan, Inc.* (1956) 141 Cal. App. 2d 812, 815. A design-builder assumes total responsibility from design through completion -- until “handing over the key” to the

turnkey project to the client. See, e.g., *White v. Cascade Oil Co.* (1936) 14 Cal. App. 2d 695, 702. Consequently, in a design-build contract, the builder has no one to blame but itself for defective plans and specifications or differing site conditions. See *M.A. Mortenson Co.*, 93-3 BCA par. 26, 189, No. 39, 978 (ASBCA 1993). A design-builder is expected to exercise its own expertise in attaining the objective. *Sterling Millwrights, Inc. v. United States* (Ct. Cl. 1992) 26 Cl. Ct. 49; *Aleutian Constructors v. United States* (Ct. Cl. 1991) 24 Cl. Ct. 372.

The making of a contract for design services with an owner necessarily implies that the designer possesses architectural and/or engineering skill and ability and that he or she promises to exercise them reasonably and without neglect. See *Benenato v. McDougall* (1913) 166 Cal. 405, 408. This duty includes the obligation to properly design all components and equipment needed for the project without “short cuts” or substitutions that are not equal or better. Moreover, an architect assuming supervision duties is required to exercise due care in the performance of that supervisory function and is liable to the owner for negligent supervision. *Palmer v. Brown* (1954) 127 Cal. App. 2d 44, 59-61, 273 P. 2d 306. Thus, a design-builder assumes a fiduciary duty as the project designer and is also obligated to exercise due care in the performance of his design and supervision duties.

A design professional is required to keep apprised of building restrictions, codes and regulations, and must prepare plans and specifications in accordance with those various regulations. *Davis v. Boscou* (1925) 72 Cal. App. 323, 327, 237 P. 401. A design-builder voluntarily assumes the responsibilities of an architect and/or engineer. To protect the public, design responsibility for proper design must lie with the design professional (design-builder), not owners, who likely have a limited knowledge of architecture and engineering.

Engineers in California have a duty of care to owners based on the special relationship factors first promulgated by the Supreme Court in the 1950’s: the extent to which the transaction was intended to affect plaintiff, the foreseeability of harm to plaintiff, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant’s conduct and the injury suffered, the moral blame attached to the defendant’s conduct, and the policy of preventing future harm. *Biakanja v. Irving*, (1958) 49 Cal.2d 647, 650; *Rowland v. Christian* (1968) 69 Cal.2d 108, 113; *Tarasoff v. The Regents of the University of California* (1976) 17 Cal.3d 425,435; Moreover, a registered engineer retained to investigate structural integrity who discovers structural defects and code violations, that pose an imminent risk of serious injury to occupants, has a “whistleblower’s” duty to warn the occupants or the authorities of that determination. 68 Ops Atty Gen 250 (1985)<sup>2</sup> Indeed, former Attorney General Janet Reno stressed this very point in a speech to a group of architects: "If a client told you to design a building with one fire exit when two are required, or to use a design that was

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<sup>2</sup> “It is our opinion that a registered engineer retained to investigate the integrity of a building who determines, based on structural deficiencies in violation of applicable building standards, that there is an imminent risk of serious injury to the occupants therein, and who is advised by the owner that no disclosure or remedial action is intended and that such determinations are to remain confidential, **has a duty to warn** the identifiable occupants or, if not feasible, to notify the local building officials or other appropriate authority of such determinations.” 68 Ops Atty Gen 250.

structurally unsound, we'd expect you to tell your client that you could not participate in creating such a safety risk." Michael Cannell, *Down in Front*, Architecture 116, 118 (Aug. 1999).

A design-builder has a *non-delegable duty* to properly design and construct. The design-builder cannot assert that these duties were shifted to the owner because of conduct or a contract provision. Non-delegable duties cannot be shifted. This is because overriding public policy concerns preclude a design-builder from shifting responsibility for structural design defects, code compliance, safety precautions, and supervisory duties to the owner. See *Maloney v. Rath* (1968) 69 Cal. 2d 442, 446-447, 71 Cal. Rptr. 897.

“Hybrid” liability in the design-build context is not without precedent in California. Even under the traditional *design-bid-build system*, assumption of dual roles has resulted in *hybrid liability*. For example, in *Connor v. Great Western Sav. & Loan Assn.* (1968) 69 Cal. 2d 850, the Supreme Court held that a construction lender owed a duty to third party home buyers to discover and prevent major defects in homes it was financing as “lender.” Liability was imposed on Great Western Savings for construction defects because Great Western Savings had stepped into the contractor’s shoes and completed the project it was financing. *Id.* at 864. The lender's assumed activities as builder/developer effectively created hybrid lender liability for the quality of the construction.<sup>3</sup> The *Connor* lender thus wore two hats: one as a builder/developer of a subdivision under construction and the other as the traditional financing entity for the project. *Id.* at 858.

## **2. A Design-Builder Assumes a Designer’s Fiduciary Duties to the Owner**

The fiduciary duty of design professionals (architect or engineer) is long standing in California. See *Palmer, supra*, 127 Cal. App. 2d at 59 (architects owe a fiduciary duty of loyalty and good faith to their clients); *Edward Barron Estate Co. v. The Woodruff Co.* (1912) 163 Cal. 561, 576 (design or construction professional occupies a relationship of trust to his client and owes his client a fiduciary duty of loyalty and good faith). A fiduciary relationship is traditionally defined as a relationship between parties to a transaction in which one of the parties is duty bound to act with the utmost good faith for the benefit of the other party. Such a relationship ordinarily arises where trust and/or confidence is reposed by one party (owner) on the integrity of another (design builder), and where that party voluntarily accepts the confidence of the other. *Wolf v. Superior Court* (2003) 107 Cal. App. 4th 25, 29, 130 Cal. Rptr. 2d 860. In such a case, the party in whom the confidence is reposed can take no advantage from his acts relating to the interest of the other party without the trusting party’s knowledge or consent. Failure to do so exposes the trusted party to breach of fiduciary duty claims. *Id.*

“Inherent in each of these relationships is the duty of undivided loyalty the fiduciary owes to its beneficiary, imposing on the fiduciary obligations far more stringent than those required of ordinary contractors.” *Id.* As Justice Cardozo noted, “Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of

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<sup>3</sup> The *Connor* holding resulted in the 1969 enactment of Civil Code section 3434.

the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.” *Meinhard v. Salmon* (1928) 249 N.Y. 458, 464, 164 N.E. 545, 546, 62 A.L.R. 1.<sup>4</sup>

A design-build contract necessarily implies that the contractor possesses the necessary architectural and/or engineering skill and ability to perform its duties reasonably and without neglect. See *Benenato*, supra, 166 Cal. at 408 (architect’s skills and promise of professional performance implied in contract for services). A design-builder has a fiduciary duty as the project designer to exercise due care in the performance of its design and supervision functions. See *Palmer*, supra, 127 Cal. App. 2d at 59-61 (architect assuming supervision duties required to exercise due care in the performance of his supervisory function, and is liable to the owner for negligence on his part). In short, a design-build contract necessarily imposes the fiduciary duty to properly design and prepare plans in accordance with the applicable standard of care and in compliance with building codes.

The *all inclusive* nature of design-build contracts often triggers public policy concerns that lead courts to impose broad duties on design-builders. For example, design-builders are affirmatively obligated to exercise that level of fiduciary care that would be required of a design professional for the design and supervision of the typical construction project.

Design-build owners are entitled to rely on the design-builder’s “all inclusive” representations even though they might excite suspicion on a reasonable owner’s part. See *Lee v. Escrow Consultants, Inc.* (1989) 210 Cal. App. 3d 915, 921. For example, the design-build relationship allows for a lesser duty of inquiry and the degree of justifiable reliance can also be lessened because of the fiduciary relationship. See, e.g., *Fragale v. Faulkner* (2003) 110 Cal. App. 4th 229, 232. This approach is consonant with the principle that “the faithless fiduciary shall make good the full amount of the loss” which his breach has caused. *Salahutdin v. Valley of California, Inc.* (1994) 24 Cal. App. 4th 555, 567.

The animating principle in the fiduciary cases is that design-builders owe the highest duties to their clients. See, e.g., *Palmer v. Brown*, supra, 127 Cal. App. 2d at 59. A design-builder *assumes* this long recognized fiduciary duty of a design professional by

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<sup>4</sup> Rummaged from the archives of legal history, the new role of design-builders resurrects the extensive fiduciary duties of the “*master builder*” of ages past. For much of recorded history, the “master builder” was responsible for all phases of the building process including design, engineering, and construction. See Kahn, *The Changing Role of The Architect*, 23 St. Louis, Inc. 216 (1979). As master builder, the designer had full responsibility and ultimate liability for the project. 5 Bruner & O’Connor Construction Law § 17:52. In ancient history, this liability could be quite harsh. In 1800 B.C., the *Code of Hammurabi* imposed the death penalty on a person creating a defect in the construction of a house if the defect led to the death of its owner. Comment, *Constructing a Solution to California’s Construction Defect Problem* (1999) 30 McGeorge L.Rev. 299, 306-307. Today’s design-builders don the mantle of the proverbial master builder, and likewise will be held accountable as fiduciaries for the quality of their construction, although the penalties for defects are now considerably less severe.

the design activities encompassed in the design build project. Fiduciary liability may extend beyond traditional remedies and expose design builders to disgorgement of profits and/or contract proceeds.

In *Salahutdin v. Valley of California, Inc.* (1994) 24 Cal. App. 4th 555, a fiduciary was "...liable to his principal for **constructive fraud** even though his conduct was not actually fraudulent. Constructive fraud is a unique species of fraud applicable only to a fiduciary or confidential relationship." *Id.* at 562, quoting 2 Miller & Starr, Cal. Real Estate (2d ed. 1989) § 3:20, p. 119, fn. omitted. *Salahutdin* held that the **failure of a fiduciary to disclose a material fact** to his principal which was known, or should been known, to the fiduciary, could constitute **constructive fraud**.

"As a general principle constructive fraud comprises any act, omission or concealment involving a breach of legal or equitable duty, trust or confidence which results in damage to another *even though the conduct is not otherwise fraudulent*. Most acts by an agent in breach of his fiduciary duties constitute constructive fraud. . . . Also, a careless misstatement may constitute constructive fraud *even though there is no fraudulent intent*." *Salahutdin, supra*, 24 Cal. App. 4th at 562, quoting 2 Miller & Starr, *supra*, at 120-121, fns. omitted.

A broker who is merely an innocent conduit of another's fraudulent statements "...may be liable for negligence on a constructive fraud theory if he or she **passes on the misstatements as true without personally investigating them**. In such instances disgorgement of profits may be warranted. [Citations.]" *Salahutdin, supra*, at 562,<sup>5</sup> quoting Cal. Real Property Remedies Practice (Cont. Ed. Bar 1982) § 3.36, p. 88.

Imposition of a fiduciary duty for design activities is well supported in California. Extending that fiduciary duty to the actual performance of design and construction by a design builder should logically follow. To protect the public, imposition of fiduciary duty must evolve to include both design and construction and the entire panoply of activities and roles undertaken by the design-builder. Since the design-builder's duties are all-inclusive, its fiduciary duties to the owner should also be all-inclusive.

### **3. Applying Design Professional Duties to Design-Builders**

The "two hats" worn by a design-builder makes that super-entity responsible to the owner for three types of duties, each accompanied by a standard of reasonable care:

- (1) a design professional's duty to prepare plans and specifications, with the degree of competence ordinarily exercised in like circumstances by reputable members of the profession,
- (2) a design professional's duty to supervise the implementation of plans and specifications, with a degree of competence ordinarily exercised in like circumstances by reputable members of the profession, and

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<sup>5</sup> In *Savage v. Mayer* (1949) 33 Cal. 2d 548, 203 P. 2d 9, and *Simone v. McKee* (1956) 142 Cal. App. 2d 307, 298 P. 2d 667, the damages awarded included **disgorging of secret profits by the fiduciary**. Additionally, in *Walsh v. Hooker & Fay* (1963) 212 Cal. App. 2d 450, 459, 28 Cal. Rptr. 16, the appellate court maintained that the award of the broader measure of damages under section 3333 was not limited to the secret profit situation. *Salahutdin, supra*, at 564-565.

(3) a contractor's duty to supervise the conduct of work methods, with the reasonable care which would be exercised by a person of ordinary prudence under like circumstances. See *Paxton v. Alameda County* (1953) 119 Cal. App. 2d 393, 259 P. 2d 934, 938. See also *Acosta v. Glenfed Development Corp.* (2005) 128 Cal. App. 4th 1278, 1298 (general contractor's duty to supervise).

The clearest definition of a design professional's duty is found in *Paxton, supra*, in which a California appellate court approved the following jury instruction:

"By undertaking professional service to a client, an architect impliedly represents that he possesses, (and it is his duty to possess), that degree of learning and skill ordinarily possessed by architects of good standing, practicing in the same locality. It is his further duty to use the care ordinarily exercised in like cases by reputable members of his profession practicing in the same locality; to use **reasonable diligence and his best judgment in the exercise of his skill** and the application of his learning, in an effort to accomplish the purpose for which he is employed. . . . The standard is that set by the learning, skill and care ordinarily possessed and practiced by others of the same profession in the same locality, at the same time." *Paxton, supra*, 119 Cal. App. 2d at 398-99 (emphasis added).

This general duty underscores the duty of a design professional (design-builder) to guard against design insufficiencies. For instance, under paragraph 4.2.2 of the AIA A201 document, the architect is to "guard the Owner against defects and deficiencies in the Work." AIA Document B141 has similar provisions in paragraphs 2.6.4 and 2.6.5, and contains in paragraph 1.1.7 an acceptance by the design-builder of the relationship of trust and confidence established between it and the owner.<sup>6</sup>

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<sup>6</sup> The American Institute of Architects ("AIA") has developed a series of standard form contract documents that are widely known and used in the construction industry. The following are excerpts from AIA's Document A201, General Conditions of the Contract for Construction and Document B141, Standard Form of Agreement Between Owner and Architect AIA doc A191 Owner-Design/Builder Agreement (1996 edition)

ARTICLE 1 GENERAL PROVISIONS (excerpts)

1.1.7 The Design/Builder acknowledges that the Owner is entering into this Agreement in reliance on the Design/Builder's special and unique abilities with respect to the services and the manufacture of the "Equipment" as the quoted term is defined in the Part 1 Agreement and that the Design/Builder is experienced in the Work proposed. The Design/Builder accepts the relationship of trust and confidence established between it and the Owner by this Part 2 Agreement. The Design/Builder agrees that it shall perform its obligations hereof in a manner consistent with that of a first-class construction and manufacturing firm experienced in performing sophisticated and complex work similar to the Work required for the Project.

1.2.1 Design services required by this Part 1 Agreement shall be performed by qualified architects and other design professionals. The contractual obligations of such professional persons or entities are undertaken and performed in the interest of the Design/Builder.

1.3.2 The Design/Builder has visited the site, become familiar with the local conditions, and correlated observable conditions with the requirements of the Owner's program, schedule, and budget.

1.3.3 The Design/Builder has reviewed laws applicable to design and construction of the Project, correlated such laws with the Owner's program requirements and advised the Owner if any program requirement may cause a violation of such laws.

ARTICLE 3 DESIGN/BUILDER 3.1 SERVICES AND RESPONSIBILITIES

Likewise, an engineer has the duty to exercise the same skill and competence ordinarily exercised by professional engineers under similar circumstances. Failure to discharge that duty will subject the engineer to liability for negligence. CAJUR ARCHITECTS §53, *Liability for Professional Incompetence*; citing *Bonadiman–McCain, Inc. v. Snow* (1960) 183 Cal. App. 2d 58, 70, (The engineer's undertaking with respect to the plans he prepares is comparable to that of an architect.)

#### **4. Failure to Warn - Failure to Properly Design.**

A breach of this standard of care may also be shown by a failure to warn or disclose. For example, a design-builder who is aware of certain material conditions or circumstances, but fails to warn the owner or to account for them, incurs liability. See *Mallow v Tucker, Sadler & Bennett Architects & Engineers, Inc.* (1966) 245 Cal. App. 2d 700, 54 Cal. Rptr. 174 (Architect who knew of existence of underground high-voltage line was negligent in **failing to delineate line on plans** or to note that he was unable to locate line.). The inquiry is simply **whether the failure of the design-builder to warn the owner of a design insufficiency** was within the range of acceptable practice for a design professional. The *Mallow* court held that the failure to warn of the design insufficiency exposed the design professionals to negligence liability. *Mallow, supra*, 245 Cal. App. 2d at 703.

Support for this reasoning exists in cases from foreign jurisdictions. In *St. Rita's Home, Inc. v. Town of Amherst* (N.Y.A.D. 1972) 38 A.D. 2d 109, 327 N.Y.S.2d 674, an engineer created a danger where none had existed and was held liable in negligence. The civil engineering firm was engaged to draw plans for disposal of plaintiff's sewage but **failed to include a gate valve**, required by ordinance, in its plan for connection with the city sewerage system. The plaintiff had told the engineer that she knew nothing about sewage, and asked him to design something that would take care of the premises "and to see to it that we get it correct." 38 A.D. 2d at 110-111. **With knowledge of the ordinance and that gate valves were not present in septic tank systems**, the engineer drafted plans and specifications for connection of plaintiff's sewage system to the sanitary

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3.1.1 Design services required by this Part 2 Agreement shall be performed by qualified architects and other design professionals. The contractual obligations of such professional persons or entities are undertaken and performed in the interest of the Design/Builder.

3.1.3 The Design/Builder shall be responsible to the Owner for acts and omissions of the Design/Builder's employees, subcontractors and their agents and employees, and other persons, including the Architect and other design professionals, performing any portion of the Design/Builder's obligations under this Part 2 Agreement.

3.2.6 The Design/Builder shall be responsible for all construction means, methods, techniques, sequences and procedures, and for coordinating all portions of the Work under this Part 2 Agreement.

3.2.8 The Design/Builder shall be responsible for correcting Work which does not conform to the Contract Documents.

3.2.9 The Design/Builder warrants to the Owner that materials and equipment furnished under the Contract will be of good quality and new unless otherwise required or permitted by the Contract Documents, that the construction will be free from faults and defects, and that the construction will conform with the requirements of the Contract Documents. Construction not conforming to these requirements, including substitutions not properly approved by the Owner, shall be corrected in accordance with Article 9.

3.2.11 The Design/Builder shall comply with and give notices required by laws, ordinances, rules, regulations and lawful orders of public authorities relating to the Project.

trunk sewer “to comply with the Town of Amherst ordinance. The engineer exposed plaintiff to danger because he **negligently “failed to make provision for, or advise of the need for, a protective device - a gate valve.”** *Id.* at 110, 114.

A Louisiana design-build case involved the duty to warn of design deficiency as well. See *J. Ray McDermott and Company v. Vessel Morning Star* (5th Cir. 1970) 431 F.2d 714, overruled on rehearing on other grounds (5th Cir. 1972). In *J. Ray McDermott, supra*, the defendant shipbuilder undertook the construction of eight fishing vessels of prescribed draft and fish hold capacity, that subsequently proved to be wholly unsatisfactory for the use intended as well as unseaworthy. The shipbuilder had employed a naval architect to design the vessels; **certain changes were made in the vessels at the request of the owner that interfered with the efficiency and seaworthiness of the vessels.** The architect was not named as a defendant. The court held that the shipbuilder could not escape his contractual responsibilities by claiming the defect to be in the specifications rather than the construction, that **the architect, San Miguel, had a duty to warn the owners of the potential negative effect of the changes requested,** and that the trial court erred in telling the jury that the unsuitability of the vessels would not indicate that they had not been constructed according to the contract. 431 F. 2d at 722. “There was testimony in the record that San Miguel **issued no warning that these changes would interfere with the efficiency or seaworthiness of the vessels.** If the changes were likely to produce negative results in these respects, it was San Miguel’s duty to warn of these possibilities.” *Id.*

The duty to warn the owner that design defects would cause unseaworthiness in *McDermott*, has been acknowledged in California. A California appellate court focused on the “duty to warn” aspect of *McDermott, supra*, agreeing “. . . **it is negligence for the architect to fail to warn the owner of the negative effect of changes.**” *Allied Properties v. John A. Blume & Associates, supra*, 25 Cal. App. 3d at 856-857, fn 17.

The duty to apprise an owner of defects that will cause an insufficiency was applied to a non-design-build contractor in *Banducci v. Frank T. Hickey, Inc.* (1949) 93 Cal. App. 2d 658, 662, 209 P. 2d 398. The *Banducci* court held that a contractor who knows, or has reason to believe, that plans are defective and **follows such plans without pointing out the defects** to the owner, cannot recover if the project proves insufficient because of such defects. *Id.* at 662. See *Raimer v. Stout* (1978) 14 V.I. 568, 586: “It has been repeatedly held that, even though he be bound to follow fixed plans and specifications, the contractor owes the duty to examine such plans and judge their sufficiency; that he is bound to discover defects that are reasonably discoverable or patent, and where he knows or had reason to believe that the plans are defective, and follows them without pointing out such defects to the owner or architect, he is not entitled to recover if the building proves insufficient because of such defects.” quoting *Rubin v. Coles* (City Ct. New York 1931) 142 Misc. 139, 142, 253 N.Y.S. 808, 811.

The imposition of this burden on the design-builder is reasonable and logical and certainly within the intentions and expectations of the parties. The design-builder is licensed by the state, and educated in the requirements of state and local building codes and ordinances. Also, the design-builder should be experienced in construction and possess practical knowledge of the requirements and effects of the applicable laws. Therefore, if the design-builder finds any incongruity between the plans and

specifications and the building codes or ordinances, it should notify the owner so that the appropriate changes may be made.

## **5. Inclusion of a Limitation of Liability Clause As *Per Se* Unfair Business Practice**

Inclusion of a limitation of liability clause in a design-build contract may constitute a *per se* violation of California's Unfair Competition Law (the UCL). Business and Professions Code ("B. & P.C.") §§ 17200 et seq. On the one hand, the design-builder provides an *all-inclusive* project (design and construction) and then seeks to limit its design-build obligations. Under §17200, this type of transaction is typically labeled "bait and switch." See e.g., *Buick v. World Savings Bank* (E.D. Cal 2008) 565 F. Supp. 2d 1152, 1155 (In UCL case, plaintiffs alleged they were victims of a bait and switch with loan terms less favorable than promised.); See also *Daghlian v. DeVry University, Inc.* (C.D. Cal 2006) 461 F. Supp. 2d 1121, 1156.

By definition, a design-builder assumes responsibility for the design and construction of the project. Typically, the motivation for parties to enter into a design-build contract is the understanding that the design-builder agrees to be responsible for both faulty construction and faulty design. This arrangement is attractive to owners who seek "one stop shopping" and desire that the risk of failure be borne by the design builder. Moreover, the design-build approach requires that the finished project comply with the owner's expectations of performance. This obligation may be expressed by the design-builder's acceptance of a *performance specification* as the measure of the contractual undertaking: for example a performance specification that the design builder design and construct a 100,000 square foot warehouse with heating and air conditioning. Under such generic performance specifications, it is illogical for the design builder to point to exclusions or limitations that are in conflict with the broad based specification.

It has been long established in California that "risk of loss" is most appropriately borne by the party best able to prevent its occurrence." *Escola v. Coca Cola Bottling Co.* (1944) 24 Cal. 2d 453, 462, 150 P.2d 456 (conc. opn. of Traynor, J); *Rodgers v. Kemper Constr. Co.* (1975) 50 Cal. App. 3d 608, 618, 124 Cal. Rptr. 143; Holmes, *The Common Law* (1881), p. 117. Moreover, special scrutiny should be imposed on the design builder for attempting to shift risk to owners, when the design builder created those design build risks and is the party best suited to avoid them. Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719 (2)* (1977) 65 Cal. L. Rev. 28, 47. Thus, any design-build contract which attempts to shift design or construction liability to the owner eviscerates the very purpose of the design-build protocol and violates California's Unfair Competition Law.

The Unfair Competition Law defines "unfair competition" as including "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising" and any act prohibited by B. & P. Code §17500 et seq. (false advertising); B. & P. Code §17200. The Legislature intended this "sweeping language" to include "anything that can properly be called a business practice and that at the same time is forbidden by law." [Citations.]” *Bank of the West v. Superior Court* (1992) 2 Cal. 4th 1254, 1266-1267, 10 Cal. Rptr. 2d 538, 833 P. 2d 545.

“‘The statute imposes strict liability. It is not necessary to show that the defendant intended to injure anyone.’ [Citation.] To state a claim under section 17200, a plaintiff ‘need not plead and prove the elements of a tort. Instead, one need only show that members of the public are likely to be deceived.’ [Citations.] ‘Allegations of actual deception, reasonable reliance, and damage are unnecessary.’ [Citations.] Further, the statute authorizes ‘courts to order restitution without individualized proof of deception, reliance, and injury if necessary to prevent the use or employment of an unfair practice.’ [Citations.] ” *South Bay Chevrolet v. General Motors Acceptance Corp.* (1999) 72 Cal. App. 4th 861, 877-878, 85 Cal. Rptr. 2d 301, fn omitted.

Since section 17200 is in the disjunctive, it establishes three separate types of unfair competition. The statute prohibits practices that are either “unfair,” or “unlawful,” or “fraudulent.” *South Bay Chevrolet, supra*, 72 Cal. App. 4th at p. 878. Shifting design liability to the owner in a design-build project is unlawful under the UCL if it falls within any of these three practices.

#### **a. Unfairness**

"[A]n 'unfair' business practice occurs when it offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers." *Spiegler v. Home Depot U.S.A., Inc.* (C.D. Cal., 2008) 552 F. Supp. 2d 1036, 1045. However, "California's unfair competition law, as it applies to consumer suits, is currently in flux." *Id.*, quoting *Lozano v. AT & T Wireless Services, Inc.* (9th Cir. 2007) 504 F. 3d 718, 735. For many years, California courts have applied a balancing test. Under that test, "the determination of whether a particular business practice is unfair necessarily involves an examination of its impact on its alleged victim, balanced against the reasons, justifications and motives of the alleged wrongdoer. In brief, the court ... weigh[s] the utility of the defendant's conduct against the gravity of the harm to the alleged victims." *Motors, Inc. v. Times Mirror Co.* (1980) 102 Cal. App. 3d 735, 740, 162 Cal. Rptr. 543.

Ten years ago, the Supreme Court rejected this test in *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal. 4th 163, 83 Cal. Rptr. 2d 548, 973 P. 2d 527, holding, in the context of an unfair competition claim brought by a competitor, that "any finding of unfairness ... [must] be tethered to some legislatively declared policy." *Id.* at 185. The *Cel-Tech* court expressly limited its holding to competitor lawsuits. *Id.* at 187, fn 12.

Since then, the Courts of Appeal have applied two different tests in Unfair Competition Law consumer cases alleging unfair practices in the wake of *Cel-Tech*. One group of cases has continued to apply the original balancing test. See, e.g., *Smith v. State Farm Mut. Auto. Ins. Co.* (2001) 93 Cal. App. 4th 700, 113 Cal. Rptr. 2d 399; *Gregory v. Albertson's* (2002) 104 Cal. App. 4th 845, 854, 128 Cal. Rptr. 2d 389. A second group of cases has adopted the *Cel-Tech* test by requiring that an “unfair” practice violate a specific constitutional, statutory, or regulatory provision or a policy embodied in the provision. See, e.g., *Schnall v. Hertz Corp.* (2000) 78 Cal. App. 4th 1144, 93 Cal. Rptr.

2d 439; *Scripps Clinic v. Superior Court* (2003) 108 Cal. App. 4th 917, 134 Cal. Rptr. 2d 101.

Design-build projects typically involve a supplier of goods / services and a consumer, not a competitor as in *Celtech, supra*. Accordingly, the *Smith* line of cases (*Smith, supra*, 93 Cal. App. 4th at 718), and the **balancing test** should be applied in design-build cases. Practitioners should anticipate that design-builders will insert adhesive limitation of liability clauses in design build contracts to attempt shifting the design responsibility to owners. Such anti-consumer provisions may not only be void as unconscionable, but also “unfair” under the *Smith* balancing test. An objective consumer would reasonably understand that a design-build contract places responsibility for proper design and construction on the design-builder. A design-builder’s insertion of an adhesive limitation of liability clause vitiates the very purpose of “design-build,” and results in a *deceptive appellation* and an illusory contract.

The interplay between the UCL and the doctrine of unconscionability is unavoidable in design-build analysis, where limitation of liability clauses, prepared by construction and design professionals, seek to impose a “cap” on liability not to exceed the contract price or other fixed sum. One such clause was at issue in *Markborough California, Inc. v. Superior Court* (1991) 227 Cal. App. 3d 705. The Court of Appeal held that such a clause was not unconscionable “if the parties had an opportunity to accept, reject or modify the provision.” *Id.* at 708. Where the parties do not have equal bargaining power with respect to the provision or there is no negotiation concerning the provision (and “absence of meaningful choice”), the provision is no more than “a standardized adhesion contract of exculpation” and the party with “superior bargaining power” cannot enforce it. *Id.* at 715.

A suspect contractual provision is substantively unconscionable if it is harsh or one-sided, or if it unreasonably or unexpectedly “reallocates the risks of the bargain.” *A & M Produce, Inc. v. FMC Corp.* (1982) 135 Cal. App. 3d 473, 487 (unconscionable warranty disclaimer by design-builder agricultural company sued for design deficiency in tomato weight sizing machine it designed and installed). If a party is “forced to accept the [provision] without negotiation,” the provision is unconscionable and unenforceable. *Id.* at 488. A “**surprise**” provision in a one-time only transaction unrelated to any transactional experience or course of dealing between the parties is equally suspect. *Id.* The inclusion of a clause shifting design and construction liability back to the owner in a design-build contract is clearly within this “suspect” category.

In a design-build contract, the design-builder obligates itself to provide labor and materials (equipment) for the design and installation of the project. As the ultimate designer, constructor and supplier of equipment, the design-builder, not the owner, is in a position to evaluate the “performance characteristics” of the project building or system and its components. See *Id.* at 492. The typical consumer may possess no expertise with construction or equipment and is “an inexperienced buyer.” (Farming company had no previous experience with weight-sizing machines because it had never grown tomatoes or any other crop requiring a weight-sizer). *Id.* As such, the consumer is compelled to rely on the design-builder’s representations about the construction, equipment, and its services, and design-builders know this. The design-builder’s representations are

“absolutely necessary” to enable the owner/consumer “to make an intelligent choice among the competitive options available.” See, e.g., *Id.* (Inexperienced buyer was forced to rely on representations of performance by FMC, who either expressly or impliedly guaranteed a performance level which the machine was unable to meet.) A design-builder’s attempt to shift liability with a limitation of liability clause negates the purpose of the design-build contract it markets and promotes to consumers. If effective, it would preclude consumers from “reasonably relying” on the design-builder’s contractual representations concerning competent workmanship and defect-free design and construction.

Indeed, by inserting a limitation of liability clause, a design-builder purports to be “guaranteeing nothing about what the product would do,” thereby making its warranty illusory and worthless. *Id.* at 491. In the context of design-build, then, **any** limitation of liability clause that is unconscionable (See *Id.* at 492-493), is an unfair business practice in violation of the Unfair Competition Law. B. & P.C. §17200. See, e.g. *People v. McKale* (1979) 25 Cal. 3d 626, 634-637, 159 Cal Rptr. 811, 602 P. 2d 731 (*Unfair business practices include unconscionable provisions in standardized agreements.*).

**b. Unlawful**

*Barquis v. Merchants Collection Assn.* (1972) 7 Cal. 3d 94, 101 Cal. Rptr. 745, 496 P. 2d 817, construing the statutory definition of unfair competition, noted:

(a) An unlawful business practice need not be deceptive or fraudulent. “. . . [T]he Legislature . . . intended by this sweeping language to permit tribunals to enjoin on-going wrongful business conduct in whatever context such activity might occur.” *Id.* at 111.

(b) The UCL “. . . undeniably establishes only a wide standard to guide courts of equity.” *Id.* at 112.

Therefore, it may be unnecessary in a given case to determine “fairness” of the design-builder’s alleged conduct if it involves repeated violation of statutes, and is therefore enjoined as an “unlawful” business practice. *Id.* See *Alch v. Superior Court* (2004) 122 Cal. App. 4th 339, 400, 19 Cal. Rptr. 3d 29 (Unlawful practice may violate UCL even if practice poses no potential competitive harm or is not likely to deceive consumers.); *People v. Cappuccio* (1988) 204 Cal. App. 3d 750, 758, 251 Cal. Rptr. 657 (Unlawful practice may violate UCL even without proof that defendant intended to injure competitors or destroy competition.).

Pivotal to an analysis of the statutes and laws potentially violated by a design-builder shifting liability to an owner is California’s Contractors’ State License Law (B. & P.C. § 7000 et seq.). The Contractors’ State License Law provides a comprehensive scheme for protection of persons who enter into agreements with “contractors,” requiring the licensing of contractors and providing for governmental supervision over contractors. Design professionals are also subject to regulation of their licensing and work. Design-builders are arguably subject to all of these laws when undertaking a project involving design and construction. Paramount in this framework is the requirement that design-

builders comply with the statutory duty to be properly licensed and to comply with applicable building standards, regulations and codes established by local, state and federal agencies.<sup>7</sup> An attempt by a design-builder to shift responsibility for building and safety code compliance to the owner may be considered a statutory violation triggering unfair business practice liability under B. & P.C. §17200.

**c. Deception**

The fraud prong of B. & P.C. § 17200 of the Unfair Competition Act is unlike common law fraud or deception. Traditionally, a violation could be shown even if no one was actually deceived, relied upon the fraudulent practice, or sustained any damage. Instead, it was only necessary to show that members of the public were likely to be deceived. *Shvarts v. Budget Group, Inc.* (2000) 81 Cal. App. 4th 1153, 97 Cal. Rptr. 2d 722; *Bank of the West v. Superior Court, supra*, 2 Cal. 4th 1254, 1266-1267, 10 Cal. Rptr. 2d 538, 833 P. 2d 545. ““This means that a section 17200 violation, unlike common law fraud, can be shown even if no one was actually deceived, relied upon the fraudulent practice, or sustained any damage. (Citations).”” *South Bay Chevrolet, supra*, 72 Cal. App. 4th at p. 888.

This precedent is, however, under consideration before California’s Supreme Court. Proposition 64 restricts private enforcement to an individual who has suffered injury in fact and lost money or property as a result of unfair competition or false advertising. B. & P.C. § 17204. After enactment of Proposition 64, the California Supreme Court granted review of a published appellate court decision addressing Proposition 64’s requirement of injury in fact: *Pfizer, Inc. v. Superior Court* (2006) 141 Cal. App. 4th 290, 45 Cal. Rptr. 3d 840, review granted July 11, 2006, S145775) (holding, *inter alia*, that mere likelihood of harm to members of public was insufficient for standing under the UCL and that Proposition 64 added a reliance element to misrepresentation claims brought under the UCL.).

It is likely that reliance and actual injury would be found in construction defect litigation involving a design-build contract, since, as discussed, the reliance by the consumer on the design-builder’s expertise is inherent in the arrangement. Accordingly, a design-builder that outwardly offers to undertake projects as a single source supplier shouldering responsibility for the project from design to completion faces unfair business practices liability if it then provides an adhesion contract containing language shifting design defect liability to the owner.

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<sup>7</sup> In *City and County of San Francisco v. Jen* (2005) 135 Cal. App. 4th 305, 37 Cal. Rptr. 3d 454, a licensed civil engineer repeatedly misrepresented the character and extent of the work that he intended to perform in his requests for a building permit, and violated building and safety codes. A preliminary injunction was issued against the engineer on the city’s complaint for public nuisance, violation of the state housing law, and unlawful business practices under B. & P.C. §17200. An award of attorney’s fees and costs of \$837,604.05 and a civil fine of \$150,000 against the engineer was affirmed on appeal.

## 6. Design-Builders Non-Delegable Duty for Design-Build Projects

Under the doctrine of non-delegable duty, a design-builder will be held liable for the acts of its design professional and builder / subcontractor team. The doctrine is designed to prevent parties from shifting important duties "downstream" to less accountable participants. *Alaska Airlines, Inc. v. Sweat* (Alaska 1977) 568 P. 2d 916, 925-926. These special situations arise by statute, by common law, by franchise, and by contract. The non-delegable duty doctrine is simply a form of vicarious liability. See *Srithong v. Total Inv. Co.* (1994) 23 Cal. App. 4th 721, 726-727, 28 Cal. Rptr. 2d 672, 675. Vicarious liability "means that the act or omission of one person . . . is imputed by operation of law to another[.]" *Far West Financial Corp. v. D & S Co.* (1988) 46 Cal. 3d 796, 819. Thus, vicarious liability is a departure from the general tort principle that liability is based on active fault. *Mary M. v. City of Los Angeles* (1991) 54 Cal. 3d 202, 208.

Where there is a non-delegable duty, the principal is "held liable for the negligence of his agent, whether his agent was an employee, or an independent contractor." *Maloney v. Rath, supra*, 69 Cal. 2d at 445- 448 (Car owner had non-delegable duty to maintain brakes in compliance with Vehicle Code, so the fact that the brake failure was the result of her independent contractor's negligence is no defense). See generally, Rest. 2d, Agency §§ 214, 251(a) (1958). Regardless of " 'how carefully' " the principal selected the independent contractor, the principal " 'is answerable for harm caused by the negligent failure of his contractor[.]' " *Brown v. George Pepperdine Foundation* (1943) 23 Cal. 2d 256, 260, 143 P.2d 929.

In California, supervisory obligations over the actual construction in construction contracts cannot be delegated to independent contractors, whether or not they are licensed. *Dow v. Holly Mfg. Co.* (1958) 49 Cal. 2d 720, 725, 321 P. 2d 736 (Contractor, who has control over and is primarily responsible for the construction, should inspect installations, and is liable for the harm despite the fact that a subcontractor [independent contractor] did the particular work.). As explained in *Acosta v. Glenfed Development Corp., supra*, 128 Cal. App. 4th at 1298:

" . . . The contractor. . . has supervision over the entire building and its construction, including the work performed by a subcontractor, and where he negligently creates a condition, either by himself or through a subcontractor, he is primarily responsible for that condition and the consequences that may follow from it. . . . Such supervisory obligation is a **non-delegable duty** and cannot be avoided by entrusting it to an independent contractor." (Emphasis added.)

Inherent in every design-build contract is the non-delegable duty to properly design and construct. This duty arises from the *inclusive* definition of the design-build contract or project. Most case law involving non-delegable duty liability for principals and agents or contractor and subcontractors does not assess design-build duties and liabilities because those projects are only now being reported in appellate decisions. However, it is axiomatic that if there are non-delegable duties for a contractor arising

from the work of its subcontractors, those same non-delegable duties exist for a design-builder whose project subsumes both design professional and contractor work.

A design-builder is required to keep informed of building restrictions and regulations, and to prepare plans and specifications for buildings that conform to those regulations. See *Davis v. Boscou* (1925) 72 Cal. App. 323, 327, 237 P. 401 (architect's plans must meet codes). A design-builder's duty to comply with applicable safety regulations and statutes cannot be avoided by entrusting it to an independent contractor. See *Padilla v. Pomona College* (2008) 166 Cal. App. 4th 661, 671, 82 Cal. Rptr. 3d 869; citing *Felmlee v. Falcon Cable TV* (1995) 36 Cal. App. 4th 1032, 1036, 43 Cal. Rptr. 2d 158. Non-delegable duties may arise when a statute provides specific safeguards or precautions to insure the safety of others. *Id.* at 1038-1039; see also Rest. 2d, Torts, § 424.

In *Evard v. Southern California Edison* (2007) 153 Cal. App. 4th 137, 142-143, plaintiff was injured while working on a billboard replacing an outdoor advertisement. Plaintiff was using a metal pole, which came into contact with defendant Southern California Edison's overhead utility lines, causing the plaintiff to fall from the billboard and suffer severe injuries. *Id.* The regulation at issue in *Evard* required that “[a]ll outdoor advertising structure platforms, over 7-1/2 feet above ground, which are not provided with standard guardrails and where employees' work requires horizontal movement, shall be provided with a horizontal safety line. Exception: When the employee's safety belt or harness lanyard is secured to the special purpose poster ladder.” *Id.* at 146. The court in *Evard* concluded that the regulation imposed a **non-delegable duty** on Southern California Edison. *Id.* at 147. See also *Finnegan v. Royal Realty Co.* (1950) 35 Cal. 2d 409, 423, 218 P. 2d 17 (fire sprinklers).

The non-delegable duty to comply with building codes is imposed in other states as well. In *Johnson v. Salem Title Co.* (Or. 1967) 246 Ore. 409, 425 P. 2d 519, the court viewed the project architect's engineering consultant as an independent contractor, but decided that the architect could be still liable for the consultant's negligence in providing a design in violation of the building code, since the architect had a non-delegable duty to design the project in conformity with the code. *Id.* at 523. See *Atlantic Nat'l Bank v. Modular Age, Inc.* (Fla. Dist. Ct. App. 1978) 363 So. 2d 1152, 1155 (non-delegable duty of architect), citing *Johnson, supra*, 425 P. 2d at 523. Even if a design-builder delegates design obligation to an independent contractor, the design-builder remains contractually responsible to the owner for all of the services in the contract with the owner.

Likewise, *Council Co-Owners Atlantis Condominium, Inc. v. Whiting-Turner Contracting Co.* (1986) 308 Md. 18, 22-23, 517 A. 2d 336, 338-339, involved a claim by a condominium owners' association against the general contractor, developer, and architects of the building. The plaintiffs alleged that, as a result of the defendants' negligence, the utility shafts and related electrical work were constructed according to the plans and did not comply with the applicable building code. *Id.* The developer was found liable solely by reason of vicarious liability arising from his non-delegable duty to comply with the building code, but was entitled to indemnity from the contractor he employed whose negligence caused the breach of the developer's duty. *Id.* at 40-41.

A similar situation occurred in *Gardenvillage Realty Corp. v. Russo* (1976) 34 Md. App. 25, 366 A. 2d 101. In *Russo*, the owner and the builder sought indemnity from a concrete slab supplier. The slab had formed the base of a back porch which had collapsed, injuring a tenant and her invitee. *Id.* at 27. It was proven that the concrete slab was in a defective condition because the metal reinforcing bars ran in the wrong direction. *Id.* at 29. The improper placement of the reinforcing bars caused the porch to collapse, and violated the Baltimore City Building Code as well. *Id.* Under the Building Code, the owner and builder were liable for the injuries because they were a direct result of the violation. See *Id.* at 33 (Liability attached to the owner and permit holder if the violation of the code was a cause of injury.).

Non-delegable duties may also arise from the use of *performance specifications* in construction contracts, which effectively turns those portions of the project covered by the scope of the specifications into a design-build contract. 5 Bruner & O'Connor, Construction Law § 17:76. Performance specifications are often found in such complex building components as a curtain wall system. *Id.* Even under the traditional design-bid-build method, an owner can shift design responsibility to the contractor by using performance specifications rather than descriptive or design-type specifications. Performance specifications describe **what the owner desires as the end-product** without giving design information requiring the builder to use a certain method to accomplish that result. See 2 Bruner & O'Connor, Construction Law § 6:26.

Issues may arise, however, as to whether using performance specifications in certain circumstances causes an illegal delegation of design responsibility to unlicensed individuals. See, e.g., *Cupples Prods. Div. of H.H. Robertson Co. v. Morgan Guar. Trust Co.*, Index No. 19448190 (Sup. Ct. New York County 1993), *aff'd*, 199 A.D. 2d 206, 606 N.Y.S. 2d 2 (N.Y. App. Div. 1993). In other words, the delegation issue arising from provision of performance specifications does not abolish the issue of design responsibility. It simply shifts responsibility of project design from one participant to another. 5 Bruner & O'Connor, Construction Law § 17:76. If design functions are then performed by non-design professionals, questions of whether certain duties are non-delegable or whether a designer may be responsible for facilitating the unlicensed practice of a regulated profession may arise. See *Atlantic Nat. Bank of Jacksonville v. Modular Age, Inc.*, *supra*, 363 So. 2d at 1155 (Building code compliance is non-delegable - architect was responsible for independent contractor's failure to comply with codes.); *Mayor and City Council of City of Columbus, Miss. v. Clark-Dietz and Associates-Engineers, Inc.* (N.D. Miss. 1982) 550 F. Supp. 610, 624 (Designer's duty to exercise professional judgment is non-delegable - reliance on specialty firms was legally irrelevant.).

Even under a traditional design-build-bid contract, if a licensed design professional is employed by a contractor, rather than the owner, issues of design responsibility arise within the context of a design-build delivery system. Depending upon the contract terms involved, the design professional and/or the builder delegating the design functions may have design responsibility for the delegated work. In any event, performance specifications which prove to be impossible or commercially impracticable to attain may be found to be defective. See *Appeal of Regan Const. Co., Inc.*, 81-1 B.C.A.

(CCH) ¶15074, 1981 WL 6955 (Postal Serv. B.C.A. 1981); *Concrete Placing Co., Inc. v. U.S.*, 25 Cl. Ct. 369, 37 Cont. Cas. Fed. (CCH) ¶76267, 1992 WL 28945 (1992), *aff'd*, 985 F.2d 585, 38 Cont. Cas. Fed. (CCH) ¶76497 (Fed. Cir. 1992).

Courts in many states impose responsibility for improper design on the design-builder. Louisiana, in particular, has a longstanding doctrine of design-builder liability for negligent design mirroring that of architects and engineers. In *Barraque v. Neff* (1942) 202 La. 360, 11 So. 2d 697, the design-builder recommended to the owner that the walls of her new home be built from porous “super-rock.” *Id.* at 361. The result was that the house was hardly habitable until the owner had the walls veneered and renovated. *Id.* at 362. The question was whether the mistake of using super-rock in a particular manner was error attributable to the design-builder or to the owner. The design-builder argued that the use of super-rock for the walls was specified in the contract, and that the work was done under the supervision of a competent and experienced building inspector employed by the owner. *Id.* at 363-364. The owner contended that under the contract, the design-builder was required to re-do any work that failed to conform to the contract requirements and to remedy any defects due to faulty materials or workmanship that appeared within a year.

The court found that the design-builder “designed the building, drew the plans and specifications, and prepared the contract for Mrs. Barraque's signature. She had no architect to advise her or to supervise the construction of the building. The inspector she hired was regularly employed as a building inspector for a building and loan association; and his duties for Mrs. Barraque consisted merely of observing that the construction of the building was being done in accordance with the terms of the contract.” *Id.* at 364.

Reversing the trial court’s judgment for defendants, the *Barraque* court held that the design-builder was responsible for the mistake of using the super rock. The owner knew nothing about super rock before the design-builder suggested and recommended it. By consenting to the use of super rock or by employing an inspector, the owner did not abandon her right to depend upon the design-builder's guarantee that he would remedy any defect resulting from faulty materials or workmanship. *Id.* at 365.

The *Barraque* court relied upon the earlier design-build case of *Louisiana Molasses Company v. LeSassier* (1900) 52 La. Ann. 2070, 28 So. 217. In holding the architect/builder responsible for defective design that caused cracks in arches of the plaintiff’s brick building, the Louisiana Supreme Court commented:

"The architect who prepared the plans and specifications of a building, and afterwards became the contractor and agreed with the owner to put up the building according to plans and specifications, is responsible for any defect or insufficiency in the specifications. He cannot escape responsibility for defectiveness of the work by taking the ground that the defect was in the specifications and not in the work. He is responsible for both." *Id.* at 2070.

The Louisiana Supreme Court confirmed the different responsibility of a design professional in design-build construction, as opposed to traditional design-bid-build construction protocol:

“In our view, there is a difference in matter of the responsibility of an architect. If he has only furnished defective plans and specifications, he can be held bound and accountable only in case the building has been constructed strictly in accord with them when no fault is imputable to the builder or contractor. He is then independent of the contractor and builder and one surety or the latter would not be bound for the error of the architect, but it must be different where the architect has taken charge of the execution of his plan. Here he had his own plan, selected his own sub-contractors, and his own workmen and the materials which were used in the construction of the building. He then becomes responsible to the owner with whom he contracted. Architecture is the art of building according to certain determined rules. The owner does not know the rules. He employs an architect who makes the plans in accordance with them, and if the architect undertakes to carry out his plan, he is not to be heard after he has executed it, to urge, as an architect, that his employment having changed from that of an architect to that of a builder, he is no longer bound for his defective plan. . .” *Id.* at 2076-2077.

## **7. Consequences of an Owner’s Acceptance of an “Under-Designed” Project: Can the Owner Be Estopped by its Own Conduct?**

“The performance of a condition may be legally excused on several different grounds.” *Platt Pacific, Inc. v. Andelson* (1993) 6 Cal. 4th 307, 319, 24 Cal. Rptr. 2d 597, 862 P.2d 158; citing, e.g., Rest. 2d, Contracts, *supra*, § 225, com. b, p. 166; 5 Williston, Contracts, *supra*, § 676, pp. 219-223. “When a condition is legally excused, the obligation of the other contracting party becomes unconditional and may be enforced (Citations).” *Id.* An owner that accepts an under-designed project may be estopped from claiming the design-builder breached its obligation to meet the performance criteria in the contract.

Under California law, an election of remedies need not be made until just before judgment. *Civic Center Drive Apartments Ltd. Partnership v. Southwestern Bell Video Services* (N.D. Cal., 2003) 295 F. Supp. 2d 1091, 1104, citing *Riess v. Murchison* (9th Cir., 1974) 503 F. 2d 999. Prior to that point, the question of whether an owner’s acceptance of performance prevents it from arguing that a contract has been terminated is one of waiver and estoppel. See *Id.* An owner may be estopped from asserting that a design-build contract was terminated on the basis of actions that may constitute acceptance of performance by the owner.

Four elements are necessary to establish estoppel: "1) the party to be estopped must know the facts; 2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; 3) the latter must be ignorant of the true facts; and 4) he must rely on the former's conduct to his injury." *United States v. King Features Entm't, Inc.* (9th Cir. 1988) 843 F. 2d 394, 399; see also *Platt Pacific, Inc., supra*, 6 Cal. 4th at p. 319 (holding that the question of waiver and estoppel is generally a question of fact).

How would this apply in the design-build context? First, the design-builder would need to present evidence that the owner was aware that an incompatible

component insufficient to meet performance specifications had been installed in the project. Second, the design-builder would show that the owner was aware during construction that the component was defective/under-designed, and yet approved the component. Based on this approval, the design-builder completed the project with the component, which would be expensive to replace at that point. This presents a question whether the owner waived any rights it might have had under the contract to insist that the design-builder replace the insufficient component. Critically, "[t]here can be no estoppel unless the party asserting [the existence of a cause for estoppel] relied to his detriment on the conduct of the person to be estopped." *Rheem Mfg. Co. v. United States* (1962) 57 Cal. 2d 621, 626, 21 Cal. Rptr. 802.

It is clearly established under California law that waiver and estoppel may result from either a statement or conduct. See, e.g., *Sawyer v. Sonoma County* (9th Cir. 1983) 719 F. 2d 1001, 1008. The "intention to commit a waiver must be clearly expressed." *Moss v. Minor Props., Inc.* (1968) 262 Cal. App. 2d 847, 857, 69 Cal. Rptr. 341 (Waiver not established by purchaser merely doing what it covenanted to do.). "There can be no waiver [of a right] unless the relinquishment is intentional or is the result of an act which, according to its natural import, is so inconsistent with an intent to enforce the right as to induce a reasonable belief that such right has been relinquished." *Rheem Mfg. Co., supra*, 57 Cal. 2d at 626.

In any analysis of potential design-builder liability and waiver/estoppel against the owner, it is critical to evaluate just how "collapsed" the design and construction functions are in the *particular* design-build construction project. The owner may not have completely divested himself of all design functions. Even when an owner tries to shed all design responsibility, he still must communicate what he desires to be built by the design-builder. This might involve communicating design criteria from the owner to the design-builder. The owner may even secure design services and then ask the design-builder to assume the design contracts after a large portion of design work is done. Unsurprisingly, where the owner has supplied some design work upon which the design-builder relies (even if the latter assumes responsibility for the design work), disputes may occur as to whether the owner impliedly warranted the adequacy of the design criteria furnished to the design-builder. In such situations, the issue may not automatically disappear just because the contract places the risk of insufficiency of the assumed design upon the design-builder. *Appeal of M.A. Mortenson Co.*, 93-3 B.C.A. (CCH) ¶ 26189, 1993 WL 261019 (Armed Serv. B.C.A. 1993).

Out of state cases are instructive on the issue of estoppel and waiver in the design-build context due to the paucity of California precedent. It has been held that an owner's mere *approval* of plans does not absolve the design-builder from design defects. In *Simpson Bros. Corp. v. Merrimac Chem. Co.* (1924) 248 Mass. 346, 348, 142 N.E. 922, a plaintiff contractor who designed and built reinforced concrete structures, including reinforced concrete oil tanks, entered a contract with the owner, a corporation that manufactured heavy chemicals, to build an underground concrete tank for the storage of fuel oil. The contractor prepared a plan and submitted it to the owner. The drawings and specifications were part of the contract. The specifications provided:

“The work shall be done in accordance with drawings accompanying specifications as made by the contractor and approved by the owner.” *Id.*

In arbitration, the contractor contended that it had performed its contract and was entitled to the balance of the contract price. The owner claimed that the tank was badly designed, that the contractor failed to use reasonable and ordinary engineering skill in designing the tank, and that the owner was entitled to recover damages. *Id.*

The arbitrators found that “*no representative of the owner approved of the plans showing the design of the tank 'in any particular relating to its strength or ability to hold oil unless such approval is to be implied as a matter of law by reason of the recital in paragraph 2 of the specifications'; that no representative of the owner attempted to supersede the judgment of the contractor's engineer in any matter relating to the design or construction of the tank; that the design of the tank was inadequate for the conditions as they already existed; that in designing the tank the contractor did not use reasonable and ordinary engineering skill and care; and that the failure of the tank was due solely to this fact. (Citation.)*” *Id.* at 349 (emphasis added).

The Supreme Judicial Court of Massachusetts reasoned:

“The approval of the plan by the owner, under the clause in the specifications already referred to, did not, as a matter of law, mean an unqualified acceptance and sanction of the whole scheme in all its details, as planned by the contractor. **By approving the plan the owner did not excuse the contractor from the exercise of ordinary and reasonable skill in designing the structure.** The owner had the right to rely on such skill and had the right to assume that it would be exercised. It could approve the plan submitted, without depriving itself of a remedy, if the plan was inadequate, or, because of a lack of reasonable skill on the contractor's part, the tank failed to hold the oil for which it was designed. . . . The owner approved the general plan submitted. This did not mean that all the particular details of the plan - the engineering skill and the sufficiency of the structure - were approved in all the respects called for by the contract. See *Shipman v. State*, 43 Wis. 381, 390, 391. **The owner was not estopped from showing the defects in the plan and the contractor's lack of skill.**” *Id.* at 349-350 (emphasis added).

Under *Simpson*, a client’s approval of a planned project will not excuse the designer-builder from liability for exercising less than ordinary and reasonable care in the preparation of those plans. *Id.* at 349.

This may hold true even when the owner has been warned that the design is deficient. In the non-design-build Virgin Island case, *Raimer, supra*, the contractor advised the owner on four occasions that a retaining wall or some kind of protection for the structure should be built or there could be detriment to the building from water undermining it. 14 V.I. at 574-575. At no time, however, did the contractor take any corrective action, nor did he insist that the owner remedy the situation before proceeding with construction. Instead, the contractor went ahead and completed the house. *Id.* at 575. Apparently, corrective action would have involved additional expense to the owner.

The *Raimer* court held the contractor liable for breach of express and implied warranty. The court reasoned:

“Defendant, however, seeks to obfuscate the issues by directing the court's attention to the retaining wall. His position is that the contract called for the construction of a home, which he maintains he built, and that he was under no further contractual obligation to erect a retaining wall. He further maintains that his advice to the plaintiff concerning the wall should be characterized as a ‘commendable,’ ‘gratuitous,’ and ‘magnanimous’ gesture on his part but one that he was under no duty to make. This misses the point. To reiterate, the defendant was obligated to build a solid foundation by whatever means necessary. If, in order to accomplish this, Stout had to destroy the partially completed foundation and redig the trenches and begin the entire project anew, and this was the only way to ensure the integrity of the structure and make good on the specific and general warranty provisions of the contract, then this is what the defendant was obligated to do. If, however, the erection of a retaining wall would have proven equally efficacious in preserving the integrity of the structure and ensuring the security of the foundation from runoff, and this alternative was easier, less time consuming or less expensive, then it was within the builder's professional discretion to build it. By whatever the means, the contractor obligated himself to build a house with a solid foundation. The fact that the defendant did not realize that performance would be more expensive and time-consuming than he originally had forecast until after he signed the contract and began excavation is legally non-cognizable.” *Id.* at 581-582.

Finally, an owner who restricts the design-builder's ability to remedy design problems may be precluded from complaining about latent design defects. For example, in *Appeal of Maddox Indus. Contractors, Inc.*, 88-3 B.C.A. (CCH) ¶ 21037, 1988 WL 81125 (Armed Serv. B.C.A. 1988), a contractor agreed to design and build a water filtration system for an existing government water treatment plant. Neither party knew there was a latent discrepancy in the interface between the existing equipment and the new system. Initial work revealed that there was insufficient water pressure in the existing system for the new system to work properly. When the contractor suggested several methods to address this problem, the government chose the solution that incurred extra costs. The Armed Services Board of Contract Appeals decided that the government's selection of the most expensive solution constituted a change and, therefore, the additional costs were the government's responsibility.

Considering the fiduciary duty flowing from the design-builder to the owner, and the design-builder's utter control of the design-build project upon receipt of the performance expectations from the owner, it is likely courts will examine very critically any attempts by the design-builder to claim the owner is estopped from complaining of design defects or performance insufficiencies.

## **8. “Two Hat” Implied Warranty For Design-Builders.**

Thirty-five years ago, in the landmark case of *Pollard v. Saxe & Yolles Dev. Co.* (1974) 12 Cal. 3d 374, the California Supreme Court held that apartment owners could sue for breach of the implied warranties of quality and fitness because owners of new

construction do not usually possess the knowledge of the builder and are unable to fully examine the completed construction. The Supreme Court held that builders and sellers of new construction should be held to what is impliedly warranted - that the completed structure was designed and constructed in a *reasonably workmanlike fashion*.

The doctrine of implied warranty is based on the knowledge of the builder, the owner's reliance on the builder's skill or judgment and the ordinary expectations of the parties. *Id.* at 379. The *Pollard* decision recognized a *common law implied warranty of quality* that attaches to the sale of new construction. *Id.*

"In the setting of the marketplace, the builder or seller of new construction--not unlike the manufacturer or merchandiser of personalty--makes implied representations, ordinarily indispensable to the sale, that the builder has used reasonable skill and judgment in constructing the building. . . Thus he generally relies on those in a position to know the quality of the work to be sold, and his reliance is surely evident to the construction industry. [¶] Therefore, we conclude builders and sellers of new construction should be held to what is impliedly represented - that the completed structure was designed and constructed in a reasonably workmanlike manner." *Id.* at 379-380.

In finding an implied warranty, the *Pollard* Court reasoned that a contract to build an entire apartment building is essentially a contract for material and labor, and there is an implied warranty protecting the owner from defective construction. *Id.* at 378; citing *Kuitems v. Covell* (1951) 104 Cal. App. 2d 482, 485, 231 P. 2d 552. It would be incongruous to imply a warranty of quality against a builder and/or developer of new construction, but fail to recognize a similar warranty for new design build construction projects.

*Pollard* followed the well established principle in California that,

"[a]ccompanying every contract is a common-law duty to perform with care, skill, reasonable expedience, and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract.' The rule which imposes this duty is of universal application as to all persons who by contract undertake professional or other business engagements requiring the exercise of care, skill and knowledge; the obligation is implied by law and need not be stated in the agreement [citation]." *Kuitems v. Covell, supra*, 104 Cal. App. 2d at 484-485 (Common law implied warranty that a roof covering would be proper and fit for its intended use.); quoting *Roscoe Moss Co. v. Jenkins* (1942) 55 Cal. App. 2d 369, 376, 130 P.2d 477.

While California's general rule is that neither strict liability, *Del Mar Beach Club Owners Assn. v. Imperial Contracting Co.* (1981) 123 Cal. App. 3d 898, (architects and engineers), nor liability for implied warranty, *Allied Properties, supra*, 25 Cal. App. 3d 848, applies to engineers or architects, the "*construction arm*" of the design build contractor creates the same implied warranty liability that would exist for any builder or contractor in the state. The majority rule in other jurisdictions follows California, and does not recognize the existence of the implied warranty of fitness with respect to professional services, including those of an architect. *EMS Industries, Inc. v. Thomson, Ventulett, Stainback & Associates, Inc.* (Utah 2001) 28 P. 3d 669, 678. See also *City of*

*Mounds View v. Walijarvi* (Minn. 1970) 263 N.W. 2d 420, 423; *Garaman, Inc. v. Williams* (Wyo. 1996) 912 P. 2d 1121, 1124; *Lekeane Homeowners Association, Inc. v. Oliver* (La. App. 1991) 586 So. 2d 679, 681. However, the design-build protocol changes this equation because both construction and design functions are merged so that design builders have responsibility for both.

It is neither an extension of California law to assert that implied warranty exists for contractors or builders, nor to assert that implied warranty exists for the “contracting arm” of the design builder. In such cases, the contractor impliedly warrants that plans will be suitable for the construction of the improvements and that the completed improvements will be suitable for their intended use. Similarly, in design-build contracts, there is an implicit representation, that a design-builder is competent, knowledgeable and will deliver completed projects designed and constructed in a reasonably workmanlike manner. Simply stated, a “builder” within the design build entity, it is still a builder.

The implied warranty of fitness, when applied in the construction setting, has its genesis in common law. An early California example of this expanded liability may be found in *Leonard v. Home Builders* (1916) 174 Cal. 65, 69, 161 P. 1151. In *Leonard*, the Supreme Court ruled that a contractor who prepares plans and specifications for the owner assumes the same level of responsibility as the architect who prepares them for the owner. In such cases, the contractor impliedly warrants that plans will be suitable for the construction of the improvements and that the completed improvements will be suitable for their intended use. 174 Cal. at 69.

When there are no plans or specifications for the particular work to be done and the contract merely describes the results to be accomplished, courts hold that the contractor, a.k.a. design-builder, assumes the responsibility that the product will be constructed properly for the owner's purposes. In such cases, the contractor impliedly warrants that the work will be fit for its intended use as to both workmanship and materials. See *Aced v. Hobbs-Sesack Plumbing Co.* (1961) 55 Cal. 2d 573, 582-583, 12 Cal. Rptr. 257; *Kuitems, supra*, 104 Cal. App. 2d at 485. The California Supreme Court's reasoning in *Aced* is relevant to design-build cases. Since the subcontractor selected the materials to be used and the manner of their installation, the Supreme Court held that the subcontractor impliedly warranted that the system would be merchantable and suitable for the intended purpose. When the pipes the subcontractor used developed leaks, the Court held that there was a breach of this warranty. *Aced, supra*, 55 Cal. 2d at 582.

Similarly, in *Mack v. Hugh W. Comstock Associates, Inc.* (1964) 225 Cal. App. 2d 583, 585, 587, 37 Cal. Rptr. 466, the complaint alleged that the contractor agreed to construct a home for the owners "in accordance with the plans and specifications," but the court held that the owners could recover damages, including consequential damages, "resulting from the **defective radiant heating plant manufactured, designed and installed**" by the contractor, based on the theory of implied warranty.

California's implied warranty in *Kuitems* and progeny has been followed in neighboring jurisdictions in design-build cases. An Arizona court held in a design-build case that even in the absence of a specific contractual provision, the law implies a requirement that a contractor who undertakes to design and install an electrical system must do so in a good workmanlike manner and in a manner befitting a skilled contractor.

*Reliable Elec. Co. v. Clinton Campbell Contractor, Inc.* (Ariz. App. 1969) 10 Ariz. App. 371, 374, 459 P.2d 98, citing *Kuitems, supra*. In *Reliable Electric*, the owner filed an action to recover damages claimed to have been incurred when, due to an electrical malfunction, the dome on a brick kiln was hoisted or raised beyond the normal limits, thereby shearing the lifting cables, and thus allowing the dome of the kiln to crash down, demolishing most of the dome and the kiln. The defendant electrical company had designed and installed the electrical system involved pursuant to an oral agreement with the owner.

The Court of Appeals found that the spontaneous raising of the dome was caused by an electrical short circuit due to rainwater in an exposed switchbox. The switchbox had been installed by the contractor in such a way that rainwater could pass through it. Thus, the contractor breached an implied warranty of good workmanship. *Id.* at 374. The trial court had found that the plaintiff was unaware of the defect in workmanship and had relied upon the defendant to properly install the electrical system. *Id.* The contractor contended that it suggested a power limit switch to prevent a spontaneous raising which might be caused by lightning or a power surge, but that this suggestion was rejected by the owner, who stated that the circuit breaker cutoff switch would always be turned to the “off” position when not in actual operation, and that therefore the power limit switch would be unnecessary. *Id.* The court held that by rejecting the power limit switch, the owner was not assuming the risk that the contractor would defectively install other components of the system. *Id.*

Similarly, an implied warranty of fitness for a particular purpose was imposed on a professional design-builder in *Prier v. Refrigeration Engineering Co.* (1968) 74 Wash. 2d 25, 442 P. 2d 621. In *Prier*, an engineering company represented itself as a refrigeration expert and contracted to design and install the refrigeration system for an ice skating rink. The rink later proved to be defective. Without analyzing the professional nature of the design-builder, the court held that the owner's reliance upon the design-builder's representations during selection of the system created an implied warranty of fitness that the system would be suitable for the purpose intended. *Id.* at 26-27.

A design-builder was also held liable for breach of an implied warranty of fitness for a particular purpose in *Robertson Lumber Co. v. Stephens Farmers Cooperative Elevator Co.* (Minn. 1966) 143 N.W. 2d 622. In *Robertson*, the design-builder expressly warranted that the building could store 100,000 bushels of wheat for one year. After the building was filled with wheat, it collapsed. The Minnesota Supreme Court held that the design-builder lumber company which used a faulty design and inadequate materials could be held liable for breach of implied warranty of fitness. *Id.* at 21. The lumber company had represented itself, expressly or by implication, as competent to undertake the project. The farmer's cooperative which owned the building had no particular expertise in the kind of work envisioned, provided no plans, designs, or specifications, and had either passively or expressly relied on the experience and the skill of the design-builder after informing it of the specific *purposes* for which the building was intended. *Id.* at 22-23.

Likewise, in *Kennedy v. Bowling* (Mo. Banc 1928) 4 S.W. 2d 438, a contractor was retained to design and build a 4-story warehouse to store chemicals, but was given only four months to build it. The floors and their supports did not withstand the strain of

the weight of the chemicals and other stored articles. The owners sued for their costs in strengthening the floors and supports, upon the ground that the design-builder knew the contemplated use, but failed to design and construct the building in such manner that the floors would withstand the strain put upon them under that use. *Id.* at 445. The jury awarded the owners their costs of repair under a theory of implied warranty for particular purpose, which was upheld on appeal. *Id.*

*O'Dell v. Custom Builders Corp.* (Mo. banc 1978) 560 S.W. 2d 862, reached the same result. In *O'Dell*, the design-builder designed and built the shell for a house. The owners were awarded damages for breach of an implied warranty that the design-builder's plan was fit for use in construction of a house; i.e., the design sold was not fit for use for a particular purpose. See also *Tips v. Heartland Developers, Inc.* (Tex. App. 1998) 961 S.W. 2d 618 (When the builder provides the design, there is an implied warranty that its design will be sufficient and will meet the applicable building codes.).

Although the evidence in any given design-build design defect litigation may also support a negligence theory, the inquiry in a warranty cause of action focuses on the **adequacy of the final product**, and the ultimate result of the services performed, rather than on the reasonableness of the design-builder's conduct. See *Aced, supra*; *Kuitems, supra*; W. Prosser, *Law of Torts* s 95 at 636 (4th ed.).

## **9. The Standardized Design-Build Contract Forms From Professional Associations Address Risk Allocation Differently**

Securing practical terms and conditions in contract documents is a critical element in risk-management for design-builders and other parties to the design-build construction project. With the advent of design-build construction, some professional associations decided to provide new forms for use in this construction type. In recent years, design-build contract forms have been issued by the *American Institute of Architects*, the *Engineer's Joint Contract Documents Committee*, the *Association of General Contractors of America*, and the *Design Build Institute of America* (see [www.DBIA.org](http://www.DBIA.org)). Issues are addressed differently in each form contract. Kent Holland (May 2002) *Contract Documents of the Design-Build Institute of America*, p. 1. The most widely used standard form design-build documents in the construction industry are those promulgated by the *Design Build Institute of America* ([www.dbia.org](http://www.dbia.org)) and by the *American Institute of Architects* ([www.aia.org](http://www.aia.org)). 1 Bruner & O'Connor Construction Law § 2:12.

Since a design-builder is responsible to the owner for both design and construction, it is difficult to separate the provisions regarding performance of the construction from the design work. Some design-build contract forms state that the design services will meet the generally accepted standard of care (i.e., not negligent), and provide separate warranties for the construction work. Rather than create segregated contractual obligations as to the standard of care and responsibility for these components, the DBIA forms provide that where an owner has specified performance requirements, the design-builder is to meet the standard of care necessary to provide work achieving the agreed-upon performance standards. "Work" is defined as both design and construction. Under the DBIA contract form, then, the design-builder warrants his design and his work. See *Id.* at 3.

The importance of specifically delineating design obligations in the contract documents cannot be overstressed. The design-build case of *Conam Alaska v. Bell Lavalin, Inc.* (Alaska 1992) 842 P. 2d 148, illustrates some of the issues that can arise. The design-builder subcontracted out design work for four oil storage tanks to two design firms, and the construction work to another subcontractor. The design-build contract included general project specifications and required the design-builder to create project-specific plans and specifications. These detailed plans were to be approved by the owner. Work was delayed when the owner changed the location of the tank storage site, requiring revisions to the plans and forestalling site preparation. More problems arose when the owner would not accept tanks supplied by the design-builder's subcontractor because they did not fit the owner's general specifications.

The owner and the design-builder settled their differences, but one of the subcontractors continued its claim against the design-builder. The jury found for the subcontractor on its breach of contract and abandonment causes of action, awarding more than four million dollars. The subcontractor appealed the dismissal of its professional negligence claim. The deficiency in that cause of action was the subcontractor's inability to show that certain damages were caused by specific acts of professional negligence. The subcontractor's expert, its primary witness regarding professional negligence, admitted that he was unable to show causation. The Alaska Supreme Court upheld the dismissal, ruling that there were insufficient grounds upon which a jury could have awarded damages for design negligence. 842 P.2d at 156-57.

Many such disputes occur because the design-builder does not adequately communicate with its design subcontractor. The design-builder tells the owner that it will comply with the owner's general specifications, but it does not provide the specifications to its subcontractor. Further compounding the problem, *many contract documents do not clearly state whether the owner's preliminary design is a limitation placed upon the design-builder.* Moreover, design-builders may modify costs and other data, and remove references to lack of contract drawings and other schedule impacts when forwarding change order requests from its subcontractors to the owner. These practices, combined with poorly drafted contract documents, assure later conflict. See 2 Bruner & O'Connor, Construction Law § 6:45.

## **10. Public Safety Concerns Dictate, Inclusive Liability for Design Builder**

Finally, the important public safety concerns underlying design build contracts are only now making their way to the appellate courts. The design builder's voluntary assumption of compliance with building codes, contractors' licensing law,<sup>8</sup> and regulations governing the responsibility of design professionals should be determinative when balancing public safety concerns.

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<sup>8</sup> "The contractors' license law 'was enacted for the safety and protection of the public.'" *Fraenkel v. Bank of America* (1953) 40 Cal. 2d 845, 848, 256 P. 2d 569, 571 (emphasis added); *Conderback, Inc. v. Standard Oil Co. of Cal., Western Operations* (1966) 239 Cal. App. 2d 664, 677, 48 Cal. Rptr. 90 (Concern for the public inherent in the statute is the motivating influence in the policing of such work and practices for the protection of all concerned.).

The recent “Unpublished” design-build case of *Nadelman v. Paul*, 2007 WL 4261103 (Cal. App. 1 Dist.) illustrates in detail some of the safety concerns being addressed by modern courts. In *Nadelman*, homeowners sued a design-builder for breach of contract, negligent construction, professional negligence, false advertising, violation of the Consumer Legal Remedies Act (CLRA) (Civ. Code § 1750 et seq.), violation of B. & P.C. § 17200, and intentional misrepresentation related to a defective and unsafe deck and sunroom. The homeowner had stepped through the prematurely rotten deck, but, fortunately, had not fallen 18 feet to the ground below.

The *Nadelman* trial court found the design-builder had violated the CLRA by misrepresenting that he was an architect or designer qualified to design the deck project. The design-builder also misrepresented the dimensions of the property to the civil engineer hired by the design-builder, and misrepresented the dimensions of the as-built deck to the engineer after the building inspector refused to approve the project. The court found that the design-builder’s conduct violated the CLRA, and that the homeowners received a deck that was unsafe and subject to premature deterioration. The homeowners’ damages were the costs of repair or construction of a safe structure that would withstand the marine environment of Pacifica, California. *Id.* at 4.

As to the causes of action for breach of contract, negligent construction, and intentional misrepresentation, and Business and Professions Code section 17200, the court found the design-builder liable for his inadequate design of the project and for his misrepresentations to the civil engineer, which caused the project to be erroneously approved as safe by the City of Pacifica. *Id.* at 4.

The Court of Appeal in *Nadelman* affirmed the trial court because the design-builder had a contractual responsibility not only to competently design the deck, but also to oversee the project and respond to design-related problems that arose during construction. The appellate court held that the design-builder breached that duty. *Id.* at 6. In addition, the design-builder’s subsequent conduct was consistent with his **assuming both design and oversight responsibility**. After his associate had procured the initial contract, the design-builder had measured the construction site, prepared the design, hired an engineer to perform structural calculations, applied for and obtained a building permit, and billed the homeowner for all of these tasks. *Id.* Finally, the Court of Appeal held that the design-builder had assumed responsibility for responding to design-related problems that arose during construction. *Id.* at 7.

## **11. Conflict of Interest**

Design-build contracts are replete with potential and actual conflicts. In design-build projects, the checks and balances provided by the architect/engineer in the traditional design-bid-build system can be lost. In typical construction projects, the architect is seen as an antagonist to the contractor, where the contractor is seeking maximum profits, while the architect is seeking the best final product for the owner. In these instances, the architect reports directly to the owner to whom he owes a fiduciary duty. Contrast this to working within a design-build setting where the architect cannot report to the owner because his allegiance has been contractually purchased by the contractor whom he would normally critique. In such instances, there may be no one to report to the owner that the contractor is “trying to cut corners.” Because the

architect/engineers in a design-build project contract directly with the design-builder and not the owner, they may find themselves with an actual conflict of interest.

This conflict of interest was recognized in the case of *Wise v. State Bd. Of Examination, Qualification & Registration of Architects* (Ga. 1981) 274 S.E. 2d 544.<sup>9</sup> Wise, a licensed architect in Illinois, was employed by a design build firm and applied for a license in Georgia through the “reciprocity process.” The Georgia Licensing Board determined that Wise’s experience as an employee of the design-build firm did not meet the Georgia minimum requirements for reciprocity. The Georgia Supreme Court held that the board’s decision was reasonable and noted the inherent conflict of interest that arises when an architect is employed by a design-build firm:

“The job of an architect is to ensure that his plans are followed precisely, irrespective of the additional cost to the contractor. In many respects, the architect is seen as an antagonist to the contractor, as the contractor is seeking the maximum profit, while the architect is seeking the best final product possible. Individuals working in a setting of a “design/build” firm **experience a constant conflict of interests not normally present in the setting of an independent architect**. Thus, the experience requirement in question is rationally related to the legitimate state interest of ensuring that all licensed architects are properly qualified and will competently practice in the interest of the public health, safety and welfare.” *Id.* at 207-208 (Emphasis added.).

Design-builders must diligently allow “the chips to fall where they may” and not become entangled in project defect “cover-ups.” The design-builder can neither “look the other way” nor conceal critical flaws from the owner. When this occurs, it is always at the expense of the owner who has placed plenary trust and confidence on the good faith of the design-builder to properly perform all aspects of the project.

Finally, an owner may not be in a position to evaluate whether the design submitted by the design-builder represents the **best-value design solution** for the owner’s project. The owner may not be in a position to evaluate whether the design-builder is, in fact, building the project in accordance with its own plans and specifications or to something less. Without independent architect / engineers, the owner may not be able to properly evaluate the design-builder’s progress and requests for progress payments, additional compensation, or time extensions. Without in-house personnel to evaluate the design and performance by the design-builder, an owner may be required to retain a construction manager to evaluate each of these functions. However, there are practical limits to the project knowledge possessed by the construction manager compared to the *complete* project knowledge possessed by the design-builder.

## 12. Practice Tips

Design-build practitioners should consider the following checklist when drafting, evaluating and/or litigating design-build projects:

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<sup>9</sup> Overruled on other grounds in *Innovative Clinical & Consulting Services, LLC v. First National Bank* (Ga 2005) 620 S.E. 2d 352.

1. Obtain sufficiently detailed design-build specifications or flush out *performance specifications* to meet client's expectations and analyze whether the performance specifications are feasible within the budget allowed.
2. Consider use of standardized design-build contract forms promulgated by professional associations, such as the Design Build Institute of America, which has the forms available for purchase online at [www.DBIA.org](http://www.DBIA.org).
3. Verify proper licensing for the entire scope of the design-build project.
4. Avoid unlawful delegation of non-delegable duties such as design responsibility to unlicensed individuals.
5. Disclose potential or actual conflicts of interest in the design-build contract.
6. Research limitation of liability provisions, warranty disclaimers, or other exculpatory / risk-shifting provisions and their enforceability.
7. Avoid inclusion of risk shifting limitations of liability which may trigger Unfair Business Practice claims.
8. Assure that contract exclusions are clearly and unambiguously recited.
9. Confirm that the design-builder and all design professionals / subcontractors are properly qualified, skilled and experienced to perform the entire project.
10. Confirm that the design-builder has identified all applicable codes, regulations, ordinances, and statutes pertaining to the design-build project, including public safety concerns.

## CONCLUSION

Notwithstanding the *transmogrification* of designers and builders into the new "super-entity," design-builders fail to recognize their wide-ranging obligations and often include "exculpatory" provisions they claim *limit* design and construction responsibilities. The design-builder must assume liability for the "sum of all the parts," and owes its clients non-delegable and fiduciary duties. Moreover, this merger of design and construction obligations creates implied warranties in favor of owners because of the design-builder's construction services. Any attempt by design-builders to shift liability to owners eviscerates the basic premise of the design-build protocol, and may constitute a *per se* violation of California's Unfair Competition Law. Simply stated, "design-build" and "turnkey" must mean something beyond a marketing ploy and their creators must be held responsible for the hybrid responsibilities they have assumed.

Because owners reasonably expect that the design-builder will properly assess, design and engineer the project, the design-builder cannot "*rob Peter to pay Paul*." If the "construction arm" complains that design is overly conservative or will place the project over budget, the "design arm" cannot scale back the design and violate its own professional design duties. Conversely, if the building arm encounters design problems during construction, it must raise and resolve them, even though the design professionals may suffer exposure for faulty design. Design-builders must understand that the all-inclusive obligations assumed means "*the buck stops here*."

Design-build contracts are replete with potential and actual conflicts and too often result in the “*scratch my back, and I’ll scratch yours,*” syndrome. This is exactly the paradigm design-builders should avoid. Each arm of the operation should perform and be evaluated independent of possible detriment to the other. The inherent conflict in the merger of these opposing roles requires that design-builders face a broader standard of liability than their traditional counterparts.

Essentially, the design-builder must allow “*the chips to fall where they may*” and not become entangled in project defect “*cover-ups.*” The design-builder has the unique ability to avoid problems by either “looking the other way” or concealing critical flaws from the owner. When this happens it is always at the expense of the owner who has placed his trust and confidence on the good faith of the design-builder to properly perform all aspects of the project. In essence, the design-builder must be held to a fiduciary standard for the enormous degree of trust and confidence reposed in them by owners.

In the end, design-builders would be prudent to **disclose potential or actual conflicts** as part of their design-build contracts. Such disclosures have already been mandated by the California Supreme Court in attorney-client retainer agreements containing “Attorney Lien” provisions.<sup>10</sup> Failing to disclose such conflict(s) may result in the courts’ invalidating any limitation provisions in design-build contracts as the Supreme Court has done with attorney lien provisions.

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<sup>10</sup> In *Fletcher v. Davis* (2004) 33 Cal. 4th 61, the Supreme Court held that “a charging lien grants the attorney considerable authority to detain all or part of the client’s recovery . . . that would unquestionably be detrimental to the client. (Cf. *Brockway v. State Bar* (1991) 53 Cal.3d 51, 64–65. . . [an adverse interest exists where the fee arrangement ‘gives the attorney an ownership interest in client property that has a value *greater* than the amount absolutely agreed upon in fees’ (italics added)].) A charging lien is therefore an adverse interest . . . and thus requires the client’s informed written consent. Requiring the client’s informed written consent has the additional benefit of ensuring that the client truly agrees to the creation of the lien and its scope, thus making it less likely that a disagreement will arise that could lead to litigation or other action adverse to the client, and also impressing upon the client the importance of his or her consent and of the right to withhold it. (Cf. *Chambers v. Kay* (2002) 29 Cal.4th 142, 157 & fn. 9.)”