The cost of allocating design risk to contractors

Design flaws are a constant risk in construction, but the contractual allocation of that risk can sway considerably from project to project. Contract terms can vary from fully expressing an owner's warranty of the sufficiency of plans and specifications to transferring significant design risk to the contractor. On a traditional design-bid-build project, the default allocation of the risk of design errors is governed by the *Spearin* doctrine. That principle is derived from a Supreme Court decision holding that the owner bears the risk associated with inadequacies in the design it provides and on which the construction contract is based. But it is only a default principle. The *Spearin* doctrine is a gap filler, an implied term in a construction contract that can be undermined and limited by express terms to which the owner and contractor agree.

There are several reasons why construction contracts vary in their allocation of the risk of design failures. Some owners prefer to achieve the cost savings associated with limiting the contractor's risk concerning the design and curtailing the amount of contingency in the contractor's price. Other owners, however, prefer not to assume the residual risk that is not assumed by the designer under its standard of care.

Going further, some owners prefer to hold both the designer and the contractor liable for some of the same design problems. An owner might reason that an experienced contractor is in a better position to identify and manage the potential cost of design errors. An owner might be wary (or even weary) of being stuck between a designer and a contractor pointing fingers at each other. An owner might determine that it prefers to limit a contractor's justifications for requesting additional time or money to complete the work. An owner might decide that a contractor that has valuable equipment or other assets to support its bonding capacity, licensing, and business operations is a more solvent potential target than a designer's professional liability insurance that often has inadequate limits. Finally, an owner might conclude that the construction contract balance provides funds for fixing problems more conveniently and reliably than pursuing a designer or the designer's insurer.

There are many ways that a construction contract can allocate to the contractor certain risks created by problems with a project's design. These include the contractor accepting responsibilities to participate in design development or to verify the sufficiency of a design, procedural clauses dictating the contractor's obligations in the event of a design error, clauses limiting the owner's liability for certain claims or damages, and the owner simply disclaiming the accuracy or sufficiency of certain aspects of the design.

At a minimum, many construction contracts obligate the contractor to notify the owner of any errors, omissions, or inconsistencies in the design documents that the contractor knows to exist before beginning the work. It those cases contractors must take care to identify and report these patent or obvious defects and ambiguities or else risk waiving the right to a contract adjustment.

A contractor's early involvement often includes reviewing and commenting on design documents while they are in development. This is common in contracts for construction management at risk in which the contractor provides pre-construction services prior to establishing a guaranteed maximum price. In one recent case a state supreme court held that a construction manager at risk may benefit from the owner's implied warranty of the design only where the construction manager's reliance on the defective design was both reasonable and in good faith in light of its level of participation in the design phase.

A contractor accepts even more risk when it agrees to verify the accuracy and sufficiency of the design before beginning the work rather than simply reviewing the design for specific purposes. Contract provisions that obligate a contractor to verify the correctness of the design intend to establish a contractor's waiver of any claim for design flaws discovered after the work is begun. These provisions also take the form of an acknowledgement that at the time of the agreement the contractor has already resolved to its satisfaction any ambiguities, conflicts, or discrepancies in the design or the contract documents.

A no-damages-for-delay provision can significantly undermine a contractor's claim for additional compensation even if the owner is liable for the design error that caused the delay. Project delays caused by design defects extend and increase a contractor's field overhead and inspection and supervision costs. While the law in some states prohibits enforcement of these clauses, they are enforceable in many jurisdictions.

Both ConsensusDocs and the AIA Contract Documents address owners' and contractors' obligations related to design. ConsensusDocs obligate the owner to provide "all architectural and engineering design services necessary for the completion of the Work" except for design services delegated to the contractor in the contract documents. By contrast, the AIA A201-2017 General Conditions obligate the contractor to perform work that is not provided in the design but is "consistent with" and "reasonably inferable from" the contract documents "as being necessary to produce the indicated results."

ConsensusDocs obligate the contractor to "examine and compare the drawings and specifications with information furnished [in the] Contract Documents, relevant field measurements made by [the contractor], and any visible conditions at the Worksite affecting the Work." They also require the contractor to report to the owner "any errors, omissions, or inconsistencies" that they discover in the contract documents. But ConsensusDocs also clarify that the "examination is to facilitate construction

and does not create an affirmative responsibility to detect errors, omissions, or inconsistencies or to ascertain compliance" with any law, building code, or regulation. The ConsensusDocs construction management at-risk agreement goes a step further, acknowledging that the construction manager "shall have no liability for errors, omissions, or inconsistencies discovered . . . unless [it] knowingly fails to report a recognized problem to [the] owner."

The AIA A201 establishes an affirmative obligation for the contractor to become familiar with the local conditions under which the work will be performed and to correlate its observations with the requirements of the Contract Documents. It also affirmatively requires the contractor to "carefully study and compare the various Contract Documents relative to that portion of the Work" and any owner-furnished survey of the site and to "take field measurements of any existing conditions," and "to observe any conditions at the site affecting [the Work]." These duties are broader than the ConsensusDocs obligations to compare the drawings and specifications with visible conditions at the site and any field measurements the contractor might take. The A201 also places liability on the contractor for any costs that would be avoided by the Contractor performing these design reviews and verifications.

The lesson for owners and contractors in allocating the risk of design flaws is to neither rely on nor feel constrained by the implied warranty of the accuracy and sufficiency of the plans and specifications that an owner provides. The implied warranty can be altered significantly by the parties' agreement. Beyond an owner simply disclaiming the adequacy of all or part of the design, contract terms that obligate a contractor to verify the sufficiency of a design or that limit an owner's liability for certain claims or damages are common ways of allocating more risk to the contractor. Contractors cognizant of these risks price them in their bids and proposals.

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