Design and Construction Management Professional Reporter

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Donovan Hatem LLP is Pleased to Announce the Release of Two New Books:

Megaprojects: Challenges and Recommended Practices, ***Edited by David J. Hatem and David H. Corkum, published by American Council of Engineering Companies, August 2010***

This book addresses the challenges that plague many of the huge public infrastructure projects and offers concrete, practical solutions. Bringing together the diverse perspectives of dozens of past and current megaproject participants, the editors provide a comprehensive guide to successfully dealing with the unique planning, management, and execution of megaprojects, with a comprehensive focus on risk management and professional liability risk issues for consulting engineers. The book may be purchased through ACEC's online bookstore at www.acec.org.

Design-Build Subsurface Projects, Second Edition, ***Edited by David J. Hatem, David H. Corkum, and Gary S. Brierley, published by Society for Mining, Metallurgy, and Exploration, August 2010***

This cutting-edge book provides a straightforward, comprehensive look at how to make Design-Build work on complicated projects involving tunnels, dams, and deep foundations. This second edition is an indispensable resource for owners, engineers, construction managers, contractors, and others involved in the design and construction of subsurface projects. The book may be purchased through SME's online bookstore at www.smenet.org.

Inside this issue:

Green and Sustainable Design: Part 2: Contractual and Risk Management Recommendations for Design Professionals to Manage Risk and Maximize the Availability of Professional Liability Insurance

By Sue E. Yoakum, Donovan Hatem LLP, Donna M. Hunt, Lexington Insurance Company, Valerie P. Onderaka, Risk Specialists Companies Insurance Agency, Inc.

WELCOME TO PART II OF A TWO PART PAPER on Green and Sustainable Design. The initial installment, Green and Sustainable Design Part I: Professional Liability Risk and Insurability Issues for Design Professionals by David J. Hatem, PC, ("G/S Part I") identified professional liability risk and insurability issues arising out of the incorporation of green and sustainable ("G/S") standards into the design, construction and operations and maintenance processes. It would seem prudent to continue with an overview of the various risk management and contractual tools that design professionals should utilize to manage risks on G/S projects and maximize the availability of professional liability insurance coverage.

It is important that all project participants including the owner, design professionals, specialty consultants, contractors, operators and maintenance vendors identify, monitor and assess all aspects of the associated risks during the various stages of the planning, design process, programming requirements, construction and maintenance operations of a project.

Because of a heightened degree of risk in G/S projects it is even more important to allocate risks and responsibilities to the party who is most capable of controlling that risk. Requests for Proposals, program requirements, contract documents and quality control procedures between the owner, design professionals at all tiers, specialty consultants, contractors and trade subcontractors should articulate expectations and responsibilities of all parties. This process should begin in the initial planning stages and extend throughout the occupancy of the facility.

Risk Management Recommendations

Are you green? Are you getting green? Are your colleagues green? Enthusiasm for Green and Sustainable design appears to be elevated by either sheer excitement that our culture is quickly moving to environmentally friendly building materials and construction or, by utter terror that the failure to keep up with what is new will leave you behind. With this enthusiasm comes the reality that a pinpointed focus on a new technique, code, law, act or, in this case, the drive for LEED, (Leadership in Energy and Environmental Design), rating, may result in the design professional putting aside or temporarily losing track of tested and timeless risk management procedures and tools. Fortunately, the time tested and ever evolving risk management tool kit that most design professionals employ in day to day practice is especially applicable to and should be applied to risks associated with G/S design.

The Program

G/S Part I discussed the Owner's G/S design expectations. Identification and documentation of these expectations is paramount for use in the design professionals assessment and management of their potential risk associated with G/S design. How can this be accomplished? The first tool to consider is the development of a project program. A good project program outlines the Owner's G/S design expectations, and identifies and documents which project participant is responsible for each programmatic requirement. Each program requirement line item should address and respond to the Owner's G/S goal. In addition, the project program should document the Owner's priority regarding each program requirement. Because the end product is a documentation of the Owner's expectations, the project program should be as detailed as time and fee allow. LEED, developed by the U.S. Green Building Council (USGBC), offers a checklist that is a good starting place and framework for identifying G/S programmatic requirements for building design, construction, operations and maintenance. The LEED

checklist categories include the following: 1) Sustainable Site; 2) Water Efficiency; 3) Energy & Atmosphere; 4) Materials & Resources; 5) Indoor Environmental Quality; and additional categories for Innovation & Design, and Regional Priority. Within each category, items specifically relating to making the project green and sustainable are listed along with the responsible party for each item. The LEED Sustainable Site category is set out here to demonstrate the range of issues within each category:

1. Sustainable Site
   a. Pollution Prevention: Responsible Party - Contractor
   b. Site Selection: Responsible Party - Owner
   c. Development Density, Community: Responsible Party - Owner
   d. Brownfield Redevelopment: Responsible Party - Contractor
   e. Alternative Transportation Options: Responsible Party - Architect
   f. Site Development: Responsible Party - Landscape Architect
   g. Storm Water Design and Heat Island Effect: Responsible Party - Civil Engineer
   h. Light Pollution Reduction: Responsible Party - MEP Engineer

This checklist provides a sampling of the G/S issues to identify and consider up front during the process of developing the program.

Another program issue to consider and address focuses on the financial concerns and rewards that flow from a G/S executed building. What are the financial objectives pertaining to anticipated tax incentives, tax deductions, or other revenue enhancements your Owner anticipates receiving when their G/S project is complete?

The importance of a good program is nothing new and has been an important part of the design process for decades. You all know the old saying, if it's not in writing, it didn't happen. In the world of G/S projects, all too often the design team and the Owner's project requirements are at opposite ends of the spectrum. The establishment of a written project program that is approved in writing by all parties is an effective tool to keep the design team and the Owner heading together down the same green path.

After establishing the program requirements in writing, it is good practice to document the Owner's confirmation by requiring a page by page sign-off on all of the G/S programmatic requirements for building design, construction, operations and maintenance. Additionally, if you are the lead design professional on the project, coordination of the program requirements with all design consultants is imperative. Each design consultant should be involved with the prime and Owner when establishing the program requirements for their particular specialty area. Again, the purpose for this written program is to identify, establish and document the Owner's G/S expectations for the project during design, construction, occupancy, operation and maintenance.

As mentioned in G/S Part I, the process of integrated and collaborative project delivery represents the prospect of reducing risks associated with G/S projects. A number of G/S program requirements must be achieved by the various project team members, ranging from the Owner, architect, and engineer to the contractor and its subcontractors. A collaborative approach assists all team members in their understanding of the Owner's G/S goals and requirements.

The written and Owner confirmed project program for G/S projects can be key in establishing that all participants are operating following the same requirements as a guide towards the same G/S goal. The project program represents the documented end product of all the decisions, trade-offs, compromises, cost adjustments, schedule impacts and ultimate G/S decisions for the project. Most often, the final project program is very different from the Owner's initial project requirements. The written project program serves as a "road map" on how to achieve the Owner's G/S needs and priorities for its project.

This road map is critical not only for the design process but also to achieve the design and G/S requirements during construction. Anyone familiar with LEED certification forms knows that many LEED points are gained during construction and depend upon how the contractor and its subcontractors run the construction process and the construction site. The substitution of one product for another during the

construction phase can quickly erode and derail the Owner's G/S requirements and result in a building that cannot meet the Owner's targeted LEED certification level. Thus, an ideal project program clearly delineates the G/S expectations, requirements and responsibilities and leaves nothing to the discretion of others during the material selection and construction process.

Most Owners are not well versed in design and construction issues and will look for someone to take the lead in assisting and guiding them through this forest of G/S concern and general bombardment of G/S information. The Owner may not care who takes the lead, but the design professional should. Because design professionals are in the unique position to guide their Owners through this bombardment of G/S information, taking the lead is an opportunity for the design professional to carefully listen to and establish with its Owner the project's unique G/S needs. It is also an opportunity, at the very beginning of the construction process, for the design professional to exhibit its G/S subject matter knowledge and reinforce with the Owner why the design professional was retained.

USGBC: THE PROCESS FOR LEED CERTIFICATION

One of the benefits of establishing a written project program is it allows the Owner and design professional to determine which level of LEED certification the Owner desires and whether that level is feasible given the Owner's project goals and budget constraints. If the Owner desires a specific LEED certification, this information should be documented in writing in the project program and approved by the Owner. Every design professional should know, and educate its Owners, that design professionals cannot promise, warrant, or guarantee a certain LEED certification, nor can they promise the Owner that any LEED certification will be achieved. Rather the design professional will endeavor to provide a design that qualifies for a certain LEED certification. Design professionals cannot certify their design will be LEED compliant because a third party, the United States Green Building Council ("USGBC"), gives the building its LEED certification and determines the LEED category. In addition, not all the components of LEED certification are within the design professional's control. The contractor and its subcontractors also contribute substantially to LEED certification through their execution of the work. Compliance may involve factors beyond the control of the design professional including, but not limited to, the Owner's use and operation of the completed project.

It can be very disheartening defending a claim relating to LEED certification when the Owner's desired LEED certification level was never documented. For example, in a recent claim, the Owner argued that the LEED certification level desired was "platinum" and the design professional argued that the LEED certification level desired was "gold." The design professional believed the building would qualify for "LEED Gold" certification, but the Owner instead alleged damages because the building would not qualify for "LEED Platinum." The contract was silent as to the desired LEED certification level. In this instance, a good written program with the LEED certification level, clearly stated and with the Owner's sign-off, would have saved costs defending the design professional and, perhaps, avoided the claim all together.

In August 2009, the USGBC launched the Building Performance Initiative. This initiative is designed to compile data relating to building performance for all LEED certified buildings for the first five (5) years of occupancy. The vision of the initiative is to encourage owners of LEED buildings to be actively involved in measuring, analyzing and improving the building's performance. To assist owners in this effort, the USGBC in its LEED 2009 requirements calls for LEED certified building Owners to submit ongoing performance data, either through the Owners' own measurements or by allowing the USGBC to access utility bills.

As you can imagine, this requirement by the USGBC caused a fire storm of articles speculating on the "potential decertification" of LEED certified buildings. It appears that the USGBC's intent in gathering the data is not to determine whether a building should keep its LEED certification. Rather, it appears the USGBC's intent is to gather and share viable performance data, including cost and energy savings information, from LEED designed and certified buildings.

However, focusing attention on measuring the success and performance of a building at a certain LEED level through the review of actual utility bills may not be accurate. While energy usage is important, the primary concern of G/S designed buildings should be whether the building is operating efficiently and thereby taking full advantage of the

new technology incorporated into the building. There have been several reported instances where Owners have claimed that the design professional erred in its design of the building because the actual operating costs were significantly higher than estimated during the program stage. Though a building may, on paper, be categorized as a potential LEED Platinum building, once completed, the actual energy usage of the building may place the building at a LEED Gold level.

How does this happen, and is this something that the design professional can control? Some building Owners may run into this issue when the building is not run and maintained in accordance with the specific instructions outlined for the building. With building systems becoming increasingly complicated, the running, maintenance and operation of each system in accordance with the system manufacturer is extremely important in the realization of energy use expectations. Some Owners will be very involved in their buildings' running, maintenance and operation while others will not turn off lights or change filters. Conversely, others will shut down systems that should run without interruption. The performance of a building is based part on the design of the building and part on the running, maintenance and operation in accordance with the design of the building. Too often, buildings are not run, maintained or operated as designed, causing significant deficiencies in the performance of the building.

Slightly off topic, but serving as a good demonstration of whether an Owner received sufficient information and training in order to operate and maintain its project involves a project manager with vast experience in stadium design. Upon the project manager's return to one of "his" stadiums, he was appalled at the way the local authorities directed traffic before and after events. The design planned for traffic flowing in different paths and design studies showed the stadium traffic moving much more efficiently and quickly. No lawsuits were filed for the traffic delays on the part of fans and the Owner. However, the project manager probably did consider filing suit for the Owner's audacity in so ineptly running "his" parking lots.

Again, the key issue remains: were the Owner's expectations relating to energy usage at the design stage realized once the project is built? For some Owners the answer will be "yes" and for others it will be "no." Of concern to the design professionals is whether a "no" will result in claims against the design professionals; or, with the monitoring of such usage, will there be a decrease in the likelihood of claims?

The linchpin issue remains understanding the Owner's energy program requirements and reducing these requirements to writing in the project program. The leader in this effort should be the mechanical, electrical and plumbing ("MEP") engineers. The MEP engineers are in the best position to understand the building systems and document the Owner's energy requirements. It is important to document precisely and this may require a room by room understanding of energy needs for a particular building.

> **Example:** In a recent claim, the Owner alleged the HVAC system was deficient and the building's humidity and temperature were too high or erratic, which caused damage to archive and museum quality documents and that the building's HVAC system was undersized. The mechanical engineer's written program requirements - with confirmation from the Owner in writing confirming the program requirements on a room by room basis – was of great assistance in the defense. The project program completely countered the Owner's allegations, which included the maximum occupancy requirements for the HVAC system for the building. As many designers know and too few attorneys realize, the occupancy capacity for the HVAC systems can and often do differ from the building occupancy requirements.

Managing Risk Through Contract Language

Design professionals have historically managed risks through the inclusion and use of contract language pertinent to the services being performed and particular project under design. The management of G/S risks should be handled in the same manner. The project program discussed previously is envisioned to complement the contract and to provide additional information relative to the Owner's expectations as the project parameters are defined during the design process.

The typical contractual risk management concerns that design professionals have on G/S projects are frequently the same concerns that they have on non-G/S projects. On all projects, especially G/S projects, the contractual terms outlining and defining scope, schedule and fee should receive

particular attention. In addition, it is paramount that the contract clearly represents and includes all services to be provided by the design professional; and that the contract is signed. One contract clause that should be in all agreements for professional services is a standard of care clause that is tied to negligence. The following sample standard of care clause is recommended for contracts incorporating G/S requirements.

> **Sample Contract Clause:** "The LEED Green Building Rating System and other similar environmental guidelines (collectively "LEED") utilize certain design and usability recommendations on a project in order to promote an environmentally friendly and energy efficient facility. In addressing these guidelines, the Design Professional shall perform its services consistent with the professional skill and care ordinarily provided by design professionals practicing in the same or similar locality under the same or similar circumstances. The Owner acknowledges and understands, however, that LEED is subject to various and possibly contradictory interpretations. Furthermore, compliance may involve factors beyond the control of the Design Professional including, but not limited to, the Owners' use and operation of the completed project. Therefore, the Design Professional does not warrant or represent that the Project will actually achieve LEED certification.
>
> The Design Professional shall use reasonable care consistent with the foregoing standard in interpreting and designing in accordance with LEED. The Design Professional shall not be responsible for Contractor's failure to adhere to the Contract Documents and any applicable laws, codes and regulations incorporated therein, nor for any changes to the design made by the Owner without the direct participation and written approval of the Design Professional. Likewise, the Design Professional shall not be responsible for any environmental or energy issues arising out of the Owner's use and operation of the completed project."

This clause clearly states a negligence based evaluation of the design professional's services will apply if an Owner alleges negligent performance on the part of the design professional and further alleges such negligent performance caused the Owner damages or monetary losses. The standard of care clause clearly indicates how the design professional's performance will be reviewed to determine liability. This standard of care language is in line with most jurisdictions' frameworks for legal liability of design professionals and professional liability insurance policies' coverage.

Of concern to design professionals embracing G/S design is whether there should be additions to this clause acknowledging the involvement of LEED accredited design professionals and the use of new and untested G/S products. At present, the answer is no. The standard of care clause as currently written and applied is sufficiently "elastic" to cover concerns relating to G/S projects.

For example, assume an Owner of a G/S project alleges negligence on the part of the design professional because the resultant building did not qualify for Platinum LEED certification. In the defense of the design professional and in order to confirm and demonstrate the design professional performed "its services consistent with the professional skill and care ordinarily provided by design professionals practicing in the same locality and under the same or similar circumstances," it is anticipated that the expert retained for the defense of the design professional will be LEED accredited. A non-accredited design professional would not have experience in performing similar services, which undermines the credibility of their testimony as to what is and is not within the standard of care when implementing a G/S design.

Another issue of concern is the application of the traditional standard of care to the specification of new G/S products. What determines if the design professional has done what a "reasonable design professional under these circumstances would do" since there is no history of the new G/S product specified? Design professionals have been reviewing and specifying both tested and un-tested products for both new and time tested installations for decades, and the standard of care measurement has remained the same. The critical difference today is that rarely have there been times with more new building products on the market that focus on one major building issue: G/S design. What is a design professional to do?

The first thing to keep in mind is that all design professionals specifying and utilizing new G/S materials and techniques will continue to be measured against each other. It will be the design professionals who will set the standard for the review of new G/S materials and procedures. Therefore, it is the design professional who will ultimately dictate what a "reasonable design professional" is "under the circumstances" presented. Design professionals should continue to review and research products just as they have

always done with a few adjustments for products that are untested in their application.

One adjustment is to obtain "Informed Consent" from the Owner for new products used on the project. The best "Informed Consent" is in writing. The AIA Trust has produced a form entitled "Client Waiver and Informed Consent to use Experimental Green Products" that can be found on the AIA Trust website which is an example of a good form to document the Owner's "Informed Consent."

One area of concern is the "untested, no track record" product. How do you know if this product meets your and your Owner's expectation regarding its G/S attributes? The answer is you do not and thus do not know the risk associated with these products. However, some design professional decades ago, specified the first bamboo floor. Hopefully, he or she had written consent from the Owner agreeing to this product, with an understanding of the innovative, untested nature of the product.

The following is a sample contract clause for use on a G/S project when "Informed Consent" is anticipated;

> **Sample Contract Clause:** "If the Owner's program includes any level of LEED®, Green Building Rating System and other similar environmental guidelines (collectively "LEED"), the Owner recognizes that the achievement of such certification is subject to third parties over whom the Architect has no control, and may require the cooperation of the Owner, the Contractor and others. The Owner acknowledges and understands LEED is subject to various and possibly contradictory interpretations. Therefore, the parties agree that if LEED certification is a stated goal of the Owner, the Architect shall use reasonable care in its design to achieve the same but makes no warranty or guarantee that the Project, when completed, will actually achieve LEED certification. In addition, the Owner acknowledges that its desire to achieve LEED may impact the available design and product options and may impact the overall cost, schedule and performance of the completed project. The Owner has accepted these potential impacts in the recognition of the importance it has placed on the values of a LEED building. In addition from time to time, the Architect may request the Owner to sign a "Client Waiver and Informed Consent to use Experimental Green Products." Attached to this Agreement as Exhibit A is a sample of this waiver and informed consent form."

Throughout this article we discussed the importance of a good written project program and establishing anticipated energy requirements for the project. The following is a sample contract clause to assist in setting the Owner's expectations and verifying the contractual obligation. The G/S design development process often is undertaken in an integrated and collaborative mode. As has been stated:

> **Sample Contract Clause:** "If the Owner's program includes goals or requirements for Project energy usage, the Owner agrees to confirm the energy goals and usage in writing to the Architect. The Owner recognizes that the achievement of such goals or requirements is subject to operational and maintenance activities and decisions over which the Architect has no control. Furthermore, continued LEED compliance may involve factors beyond the control of the Architect including, but not limited to, the Owner's use and operation of the completed project. Therefore, the parties agree that the Architect shall use reasonable care in its design to achieve the energy usage goals or requirements but makes no warranty or guarantee regarding actual energy usage."

We briefly mentioned above the Owner's expectation relating to financial advantages of having a G/S building and/or a LEED certified building. These financial advantages include tax credits, deductions, and incentives, not to mention the social advantages relating to providing a G/S building. Your Owner's financial expectations relating to their G/S building are likely very important to the Owner and should be included in the program.

It can be difficult for a design professional to invest the time to understand all the financial incentives available to its Owners when providing a G/S design building. After all, your profession is architecture, not financial planning. As such, it is not recommended that any aspect of G/S financial incentives be included in your scope of services. As a design professional, you should be able to rely on your Owner to establish their financial requirements in writing for inclusion in the project program. That said, we recommend the following contract clause allocating risk to the party best suited to assume this risk:

> **Sample Contract Clause:** "If the Owner's program includes goals for qualifying for energy related tax credits, deductions, incentives, etc., the Owner recognizes that qualifying for such goals is subject to certification or

decisions by third parties over whom the Architect has no control. Therefore, the parties agree that the Architect shall use reasonable care in its design to achieve such goals but makes no warranty or guarantee regarding qualification."

Other good risk management clauses that design professional should be familiar and regularly include in your contracts are; 1) waiver of consequential damages, 2) waiver of subrogation actions, and 3) limitation of liability. As many of you know, these contract clauses reduce the potential damages that may be recovered from the design professional in the event of a claim. Sample clauses are included below:

Sample Contract Clause for Waiver of Consequential Damages: "The Design Professional and the Owner waive consequential damages, including but not limited to, damages for loss of profits, loss of revenues, loss of business and of business opportunities, reduced rental or market values, increased insurance costs, increased energy, water and other operational costs, unrealized tax incentives, credits, deductions and/or rebates, for claims, disputes or other matters in question arising out of or relating to this Agreement. The Owner and the Design Professional agree to require a similar provision in all contracts with contractors, subcontractors, subconsultants, vendors, and other entities involved in this Project to carry out the intent of this provision."

Sample Contract Clause for Waiver of Subrogation: "The Design Professional and Owner waive all rights against each other and against the contractors, consultants and employees of the other for damages to the extent that the damages sustained by either the Design Professional or the Owner are covered by property insurance."

Sample Contract Clause for Limitation of Remedy: "To the fullest extent permitted by law, the total liability in the aggregate, of Design Professional and Design Professional's officers, directors, employees, agents, and independent professional associates, and any of them, to Owner and any one claiming by, through or under Owner, for any and all injuries, claims, losses, expenses, or damages whatsoever arising out of or in any way related to Design Professional's services, the project, or this Agreement, from any cause or causes whatsoever, including but not limited to, the negligence, errors, omissions, strict liability, breach of contract, misrepresentation, or breach of warranty of Design Professional or Design Professional's officers, directors, employees, agents or independent professional associates, or any of them, shall not exceed the total compensation received by Design Professional under this Agreement."

Business/Practice Risks

As mentioned above, there are all kinds of financial incentives and potential benefits for Owners. One notable incentive is the Energy Improvement and Extension Act of 2008 that extended the Energy Act of 2005 until December 2013. This Act relates to tax deductions available to certain commercial owners, leases of commercial buildings for private properties and which are assignable to the primary designer for public properties. The Act states for public property the allocation of the deduction can be made by the "person primarily responsible for designing the property in lieu of the Owner of such property".

This Act relates to the Internal Revenue Code section 179D and allows for a tax deduction for part or all of the costs of energy-efficient commercial buildings. We will not list the qualification requirements, but will summarize the impact of the Act and its importance. The Act provides a tax deduction of up to $1.80 per square foot of building investments that achieve specified energy costs reductions beyond ASHRAE 90.1-2001. Specifically, deductions of up to .60 cents per square foot are available for three types of building systems, 1) lighting (including lighting controls); 2) HVAC; and 3) building envelope, including the roof, walls, windows doors and floor/foundation.

Because public entities are excluded from taking this benefit, many design professionals of public projects are taking advantage of this tax deduction and approaching their public owners to assign the tax deduction to their firm. Again, we recommend discussing with the Owner to understand if these energy requirements meet the Owner's project program. If the Owner is a public entity, discuss with your Owner and if approved, include the following clause in your contract taking assignment of this tax deduction;

Sample Contract Clause: "If the Owner's Project per the Owner's program requirements qualify the Project for tax deductions and or tax credits and the Owner cannot or will not use these tax deductions or tax credits, the Owner assigns such deductions and or credits to the Architect and will assist the Architect by signing documents needed for the Architect to claim such deductions and/or credits."

Is Your Risk Management Toolkit Green and Sustainable?

Whether you are a design professional who participated in the first Earth Day celebration on April 22, 1970, or a recent graduate pursuing professional architecture or engineering licensure, you may share the same enthusiasm and commitment to save our environment as Gaylord Nelson did 40 years ago when he organized that first Earth Day celebration to summon public support for a green and sustainable environment. Millions of people have embraced the environmental movement and have taken public, political, legislative and personal actions to enhance our quality of life on this planet.

It is not a surprise that design professionals are leading the G/S charge through the design and construction process. After all, design professionals like to be involved and are problem solvers by nature. While design professionals might be tempted to expand their scope of services, especially on G/S projects, it is important to stay focused on professional consulting services. Leave the training, maintenance and operations to the installers, manufacturers and owners.

Because design professionals have access to more new products, tools and technologies for G/S design, it is now most important that they reach deep down into the risk management toolkit throughout the design and construction process. The development of a written project program outlining all parties' expectations and responsibilities, explanation and assessment of financial expectations, coordination of documents throughout the design and construction process, and articulate and decisive contract language are critical tools for successful execution of risk management procedures on G/S projects.

Significant Change in Colorado Law Impacts Traditional Coverage Interpretation of Commercial General Liability Insurance Policies

By Peter C. Lenart, Esq.

RECENT SUBSTANTIVE CHANGES TO COLORADO LAW have significantly impacted the dynamics of construction defect claims, coverage and litigation in the state. The Colorado legislature and Governor William Ritter enacted House Bill 10-1394 into law on May 21, 2010. The legislation is entitled "Concerning Commercial Liability Insurance Policies Issued to Construction Professionals." The law not only took immediate effect from the date of its signing, but it also has retroactive application.

Traditional Commercial General Liability ("CGL") Policies, the type which most contractors and construction professionals hold to cover damage resulting from negligent work, require property damage to exist on a property other than the construction site in order to trigger an "occurrence" or "accident" for negligently performed construction work. For example, under traditional insurance practice, an improperly installed drainage system which flooded the project in question would not be entitled to CGL coverage. However, if the flooding impacted an adjacent home or business, the damage to the adjacent property would satisfy the damage to property requirement. The requirement of property damage as a condition of coverage has long spawned litigation over this requirement in an effort to bring a CGL Policy to the table for settlement. The recent change to Colorado law imposes a more relaxed standard which will result in coverage being available much more frequently under CGL policies.

The new Colorado law requires that CGL Policies be interpreted under a presumption that any property damage caused by a contractor, including damage to the work done by a contractor, is an "accident", thus triggering coverage under a CGL Policy. The new law makes it unnecessary for there to be damage to a neighboring property in order to bring about coverage under a CGL Policy. This change makes it more likely that negligent or unsatisfactory construction work will be pursued by Project owners.

While this law primarily affects various builders and trades professionals, it may also require a review of CGL Policies purchased by design professionals who act as project

manager or who undertake project work in a design/build capacity in Colorado. Accordingly, architects, engineers, and surveyors who work in Colorado should revisit their CGL Policies with their brokers to make certain that adequate coverage is in place. While the new law is in the process of being appealed, that is a lengthy process which will likely involve several court rulings.

Despite the fact that CGL Policy premiums for companies performing design and construction work in Colorado will undoubtedly increase markedly in light of the State's legislature broadening applicability of CGL Policy coverage, having adequate insurance available is now increasingly important. Plaintiff firms are guaranteed to pursue a wider spectrum of claims against entitles involved in a construction project in light of the new law.

The broader spectrum of claims will result in the greater likelihood of litigation, and this is yet another reason for companies doing business in Colorado to work with their broker to make certain that issues of adequate policy coverage, premium amounts, and deductible amounts are considered in a balanced and detailed fashion. Construction professionals doing business in Colorado should also discuss the implications of the new law with their corporate counsel or business law attorney so that there is a solid understanding at a company's management level on how the new law effects a company's risk management and loss prevention objectives, as well as the risk and potential exposure for Projects undertaken in Colorado.

Colorado Court of Appeals Recognizes Economic Loss Rule as Defense to Contractor's Fraud Claims Against Engineer

By Daniel C. Poteet, Esq.

HAMON CONTRACTORS, INC. V. CARTER & BURGESS, INC., AND CRAIG KITZMAN, 2009 WL 1152160 (Colo.App.), the Colorado Court of Appeals, Div. VII ("Court") was a case in which the disputes arose out of a Denver, Colorado project involving the installation of drainage pipe underneath a roadway. The contractor asserted claims for several hundred thousand dollars against the city, the assistant city engineer, and the Engineer based on cost increases and liquidated damages assessed against the contractor during the course of the project. The Court applied the Economic Loss Rule to shield a municipal owner's project administration engineer (the "Engineer") from a contractor's post-contractual fraud claims and claims of deliberate concealment and/or misrepresentation.[1] The Court further ruled that the Engineer had no independent duty to inform the contractor of design flaws during the project's bidding phase.

The contractor's claims against the Engineer were twofold. The contractor asserted claims of fraudulent misrepresentation arising after the city and contractor executed their contract, alleging that the Engineer knew defects in the project plans caused delays. Secondly, the contractor asserted negligence and negligent misrepresentation claims against the Engineer for failing to warn the contractor of the alleged project design defects during the bidding phase, prior to the contractor's execution of its contract with the city.

The Court found that the Economic Loss Rule barred the contractor's post-contractual fraud claims, rejecting the contractor's argument that the Economic Loss Rule applied only to certain types of torts. The Court reasoned that, because the duties the Engineer allegedly violated arose out of only the contractor's contractual relationship with the city, the Economic Loss Rule barred

[1] The Colorado Court refers in this case to the "Economic Loss Rule." The Economic Loss Rule is similar to the "Economic Loss Doctrine," as it is referred to in Massachusetts Courts. Jurisdictions that recognize the Economic Loss Rule or Economic Loss Rule typically use one of the two foregoing terms to refer to the same legal rule, subject to differences in whether, how, and to what extent a particular jurisdiction enforces the rule.

torts claims based on those duties. In making this determination, the Court considered, first, whether the relief sought in tort is the same as the contractual relief sought; second, whether there is a recognized common law duty of care; and third, whether the tort duty differs in any way from the contractual duty.

Regarding the first factor, the Court found that any obstacle to the contractor's recovery of its damages from the city would turn on adequacy of proof, not the nature of the action. The second factor tilted in the Engineer's favor because the Court found any obligations as to the information at issue existed only because of the parties' interrelated contracts. Finally, the Court found that the tort duty alleged by the contractor did not differ from the contractual duties of the Engineer. Accordingly, the Court found that there were no extra-contractual duties relative to the alleged post-contractual fraudulent conduct, and thus the Economic Loss Rule barred the fraud claims against the Engineer.

The Court also dismissed the pre-contract negligence claims against the Engineer on the grounds that the claims alleged only "nonfeasance" by the Engineer. Under Colorado Law, to substantiate a "nonfeasance" claim, there must also be an allegation of a special relationship between the parties. Here, the Court found that the contractor did not adequately allege the existence of any special relationship.

This case will benefit design professionals because it clarifies that, under Colorado law, the Economic Loss Rule will be based on the nature of damages alleged in conjunction with the source of the duties allegedly violated. The Court rejected the potentially more restrictive view of the Economic Loss Rule that, if applied, would have narrowed the Rule by excluding certain tort-based claims from its application.

Hawaii Appellate Court Confirms That a Construction Defect Claim Does Not Constitute an Occurence Under a Commercial General Liability Policy

By Amanda Sirk, Esq.

A HAWAII APPELLATE COURT RECENTLY CONFIRMED that a construction defect claim does not constitute an "occurrence" under a Commercial General Liability (CGL) policy. Specifically, the appellate court in Group Builders, Inc. v. Admiral Ins. Co., 123 Hawaii 142, 231 P.3d 67 (2010) held that faulty construction work by a subcontractor on a hotel construction project did not constitute an occurrence under a CGL policy.

In August 1999, Hilton Hotels Corporation, the parent company of the Hilton Hawaiian Village, LLC (collectively "Hilton"), retained Hawaiian Dredging as the general contractor for the construction of a new hotel tower known as the "Kalia Tower" (the "Tower") as part of the Hilton Hawaiian Village in Waikiki, Honolulu, Hawaii. Hawaiian Dredging retained Group Builders to install an exterior insulation finishing system and sealant, spray-applied fireproofing, building insulation, and metal wall framing on the Tower.

In May 2001, after construction of the Tower had been completed, Hilton opened the Tower guest rooms to the public. In mid-2002, extensive mold growth was discovered in the Tower guest rooms. In July 2002, Hilton closed the Tower guest rooms for remediation. An investigation revealed numerous defects in the design and construction of the Tower which contributed to or caused the mold growth.

In 2003, Hilton filed suit against numerous defendants involved in the design and construction of the Tower including Group Builders. In its Complaint against Group Builders, Hilton alleged five causes of action: (1) breach of contract; (2) breach of the covenant of good faith and fair dealing; (3) negligence; (4) breach of express and implied warranties; and (5) negligent misrepresentation.

Group Builders' CGL coverage was provided by the following insurers:

- Tradewind: October 1, 1999 to October 1, 2000;
- Admiral Insurance Co. ("Admiral"): October 1, 2000 to December 1, 2000; and
- After December 1, 2000, Group Builders maintained several insurance policies with Zurich American Insurance Co. ("Zurich"), and Fireman's Fund Insurance Co. of Hawaii, Inc. ("Fireman's Fund").

After Group Builders notified Admiral of the lawsuit, Admiral refused to defend, indemnify or otherwise provided insurance coverage to Group Builders for the claims asserted in Hilton's lawsuit. Hilton settled its claims with Group Builders, Tradewind, Zurich, and Fireman's Fund. In connection with the settlement, Group Builders assigned its claims against Admiral to Tradewind.

In December 2005, Tradewind and other CGL insurer entities (collectively the "Plaintiffs") filed a Complaint against Admiral for its refusal to defend, indemnify, or otherwise provide insurance coverage to Group Builders for the claims asserted in Hilton's lawsuit. In June 2008, Admiral filed a "Motion for Partial Summary Judgment Re: No Duty to Indemnify". The circuit court granted Admiral's Motion. The circuit court held that "because there is no genuine issue of material fact that any property damage as a result of an occurrence took place at Kalia Tower Project during the Admiral Policy period, which is required for coverage under Admiral's Policy, Admiral's [Motion] is granted."

The Plaintiffs filed an Interlocutory Appeal of the Order granting Admiral's Motion for Partial Summary Judgment, and Stay of the proceedings pending the appeal. The Plaintiffs argued that the circuit court erroneously concluded that there was no evidence of property damage caused by an occurrence during Admiral's policy period.

The appeals court noted that Admiral's CGL policy obligates Admiral to pay "those sums that the insured [Group Builders] becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." The appeals court further noted that the mold damage and resulting loss of use of the Tower qualified as "property damage" under Admiral's CGL policy. However, the appeals court stated that the issue is whether the "property damage" to the Tower was caused by an "occurrence" during the Admiral policy period. In Hilton's Complaint, Hilton identified the primary causes and contributing factors of the mold damage and Tower closure as: "material defects in the design and construction" of the Tower. The appeals court stated that the issue is whether alleged faulty construction work, giving rise to contractual claims, constitutes an "occurrence" under a CGL policy.

Admiral's CGL policy defines "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The appeals court held that construction defect claims do not constitute an "occurrence" under a CGL policy. Accordingly, breach of contract claims based on allegations of poor work performance, and tort-based claims, derivatives of this type of breach of contract claim, are also not covered under CGL policies.

In affirming the circuit court, the appellate court cited to WDC Venture v. Hartford Accident & Indemnity Co., 938 F. Supp. 671 (D. Hawaii 1996) which provides that the Plaintiff's tort and contract claims that arise from the contractual relationship, are outside the scope of the CGL policy. The circuit court also reasoned that permitting contractual claims under a CGL policy would violate public policy since it would not make sense for a policy to cover a willful and wanton breach of contract claim, as doing so would render the contract meaningless and "invite such misbehavior."

Additionally, the appellate court cited to Burlington Insurance

Co. v. Oceanic Design & Construction Inc., 383 F.3d 940, 943 (9th Cir. 2004) which provides that a homeowners' allegations of negligence against a contractor "cannot be read to constitute an occurrence under Hawaii law." The circuit court observed that "[a]llowing recovery for disputes between parties in a contractual relationship over the quality of work performed would convert this CGL policy into a professional liability policy or a performance bond." The circuit court further reasoned that because the allegations were ancillary to the breach of contract claim, they could not "state a separate independent cause of action for negligence."

In addressing the issue, the appellate court noted that the Hawaii Supreme Court has held that where an underlying complaint alleges an intentional breach of contract, there is no occurrence that triggers an insurer's duty to defend under a standard CGL policy. The Hawaii Supreme Court has further stated tort recovery is not allowed in the absence of conduct that (1) violates a duty that is independently recognized by principles of tort law and (2) transcends the breach of contract. The Hawaii Supreme Court has also cautioned of the need to examine carefully a complaint to "ensure that plaintiffs could not, through artful pleading, bootstrap the availability of insurance coverage under an insured defendant's policy by purporting to state a claim for negligence based on facts that, in reality, reflected manifestly intentional, rather than negligent conduct."

In applying these principles, the appellate court concluded that the line of federal cases applying Hawaii law follow the "majority position" that claims of poor workmanship, standing alone, are not occurrences that trigger coverage under CGL policies. In contrast, a minority of jurisdictions has held that the damage resulting from faulty workmanship is an accident, and thus, a covered occurrence, so long as the insured did not intend the resulting damage.

The appellate court's decision is a significant victory for CGL carriers allowing CLG carriers to reject coverage for claims for defective construction. However, the decision is negative for design professionals who may be one of the few parties in a lawsuit who are perceived to have "deep pockets" only because the design professional has insurance coverage.

Economic Loss Rule: A Viable Defense in Colorado for Design Professionals

By Marisa Skoglind, Esq.

THE COLORADO DISTRICT COURT RECENTLY APPLIED the Economic Loss Rule ("ELR") in granting summary judgment for a Colorado land planner as to negligence claims arising from professional services it provided to a developer. In Stan Clauson Associates, Inc. v. Coleman Brothers Construction, LLC et al., Colorado District Court Case No. P09CV53, the Court entered an order on Plaintiff's Motion for Summary Judgment Based on Economic Loss Rule holding, that, "there is no recognized common law duty of a land planner to a developer," and that negligence claims for damages against the land planner were barred by the ELR. [1]

The plaintiff, Stan Clauson Associates, Inc. ("Clauson"), a land planner in Aspen, Colorado, was retained by the defendant, Coleman Brothers Construction, LLC ("Coleman"), real estate developer, to provide land planning services in connection with Coleman's development plans for two pieces of property. Coleman and Clauson entered into two contracts with respect to those services. Notably, the first of the two contracts provided in writing that:

[1] The Colorado Court refers in this case to the "Economic Loss Rule." The Economic Loss Rule is similar to the "Economic Loss Doctrine," as it is referred to in other jurisdictions. The definition of the terms Economic Loss Rule and Economic Loss Doctrine differ by jurisdiction with respect to the ways in which the same general legal concept is applied and enforced.

> . . . [T]he outcome of any land use process is by no means certain. Our sole obligation is to make a good faith effort to present the project in the application and hearing process in a manner that is responsive to the code and other identified issues. No warranty is expressed or implied as to the acceptance of any project proposal in the land use approval process.

Clauson and Coleman subsequently entered into a second, oral contract for the development of a separate property, known as the "Emma Property", in which the parties agreed that the terms would replicate those in that contract. In performing its land planning services, Clauson stated in a letter to Coleman that the Emma Property "could possibly be subdivided into +/- 12 lots."

Coleman subsequently failed to timely pay Clauson's bills and, eventually, along with the other defendants, Coleman Ranch, LLC and Crown Mountain Plaza, LLC, executed a promissory note in which all three parties agreed to be jointly and severally liable for payment to Clauson. Id. Approximately one month later, Coleman's request for development rights for the Emma Property was denied, and the defendants ceased all payments to Clauson.

After Clauson filed its lawsuit asserting claims for breach of promissory note, breach of contract, and unjust enrichment, Coleman and Coleman Ranch, LLC filed counterclaims against Clauson, and a third party complaint against Dan Coleman ("D. Coleman"). D. Coleman then filed a third party claim against Clauson (Coleman, Coleman Ranch, LLC, and D. Coleman are collectively referred to as "Coleman Defendants"). The Coleman Defendants alleged that Clauson breached its duty of care and competency and, therefore, was negligent in issuing its letter with respect to the likelihood that Coleman would be granted property development rights for the Emma Property.

Clauson moved for summary judgment on the Coleman Defendants' negligence claims, asserting the ELR as a bar to those claims. The Coleman Defendants responded that the ELR did not apply because Clauson is a professional, and that Clauson's duty to exercise due care was not encompassed in the agreements with Coleman.

In addressing the ELR under Colorado law, the Court stated that "[t]he economic loss rule, in general, provides that 'a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law.'" (Quoting Town of Alma v. Azco Construction, Inc., 10 P.3d 1256, 1264 (Colo. 2000)). The Court continued that, while a breach of a duty arising independently from a contract duty may support a tort action, "[t]he economic loss rule indicates that where economic damages only are claimed and the relationship between the parties is based on a contract, the duties owed from one contracting party to the other are limited to the contractual duties unless there is a recognized common law duty of care in tort."

The Court articulated that the ELR is supported by the policy of enforcing expectancy interests of contracting parties to enable them to allocate risks within the contract through the bargaining process, knowing that they will not be able to recover economic damages in tort. The Court ultimately determined that: (1) the Coleman Defendants' pursuit of solely economic damages warranted the application of the ELR; (2) there is no recognized common law duty of care owed by a land planner to anyone; and, therefore, (3) there is no common law duty of care to compare to Clauson's contractual obligations to Coleman. Specifically, the Court concluded that, "there is no recognized common law duty for a land planner to exercise care and competence is [sic] providing services to clients and all the factors favor a finding that the economic loss rule bars the Coleman defendants' claims of negligence."

In so doing, the Colorado District Court has bolstered the state of the ELR in Colorado, particularly with respect to services rendered by design professionals. Thus, the ELR remains a viable defense in Colorado for design professionals, and serves an important function in maintaining a distinction between contract and tort law.

Colorado Court Bars Limitation of Liability Provisions for Design Professionals

By Justin Jagher, Esq.

A COLORADO STATE DISTRICT COURT ("COURT") RECENTLY INTERPRETED a newly-enacted Colorado statute (The Homeowners Protection Act of 2007) to prohibit limitation of liability clauses in design professional agreements. Although adverse to design professionals, it is unclear if other courts will follow the Court's lead and similarly narrow the efficacy of these limitation of liability clauses.

Terracon Consultants, Inc. ("Terracon"), an engineering firm, entered into three written contracts with Gallery Homes ("Gallery"), a property developer, to provide certain engineering and testing services for a housing subdivision. Each agreement contained a limitation of liability provision for all claims arising out of Terracon's services to be provided for the project. Following commencement of litigation arising out of the project, Terracon moved for partial summary judgment based upon its contractual limitation of liability provision. Terracon argued that its contracts were the result of negotiations between the contracting parties, and that there was no reason not to enforce the parties' agreement. Terracon argued further that The Homeowners Protection Act of 2007 was intended to limit liability to protect individual homeowners, not sophisticated parties of equal standing.

The Court denied Terracon's motion based upon its interpretation of The Homeowner Protection Act of 2007 that, it held, voids any contractual provisions that attempt to limit or reduce the rights or remedies of Colorado residential homeowners. C.R.S. 13-20-806 (7) (a) provides, in relevant part:

> In order to preserve Colorado residential property owners' legal rights and remedies, in any civil action or arbitration proceeding described in section 13-20-802.5 (1), any express waiver of, or limitation on, the legal rights, remedies, or damages provided by the "Construction Defect Action Reform Act", this part 8, or provided by the "Colorado Consumer Protection Act", article 1 of title 6, C.R.S., as described in this section, or on the ability to enforce such legal rights, remedies, or damages within the time provided by applicable statutes of limitation or repose are void as against public policy.

In light of the foregoing, the Court held that the limitation of liability provisions in all of Terracon's agreements with Gallery were unenforceable on the grounds that "[t]he plain language of the Statute does not state that only current homeowners may enforce it." Rather, the Court reasoned that:

> [i]f the intent of the statute, as argued by Terracon, is to preserve the legal rights and remedies of homeowners, allowing design professionals such as Terracon to limit their liability to a general contractor or developer in a third party claim in which the homeowner is the Plaintiff, would limit the homeowner's ability to fully recover their damages.

In essence, the Court determined that, to enforce the limitation provision would result in fewer available resources from which the residential homeowners could recover. However, in attempting to preserve the "pot of money" for potential homeowners, the Court appears to have extended its interpretation of the statute beyond its express terms. Had the intent of the statute been to preclude all provisions that limit liability, including those between design and construction professionals, or other sophisticated parties, in favor of future residential landowners, it should have expressly incorporated that language in the statute.

The affect of this ruling will be detrimental on design professionals practicing in Colorado. Although this is only one court's interpretation of the statute, it is likely that other courts will follow suit. Until this issue has been addressed by the Colorado Supreme Court, and it has had an opportunity to ultimately determine the efficacy of limitation of liability provisions in this context, a valuable contractual defense may no longer be available.

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