Part I – Contract Law and Professional Liability
1.1 Introduction

Contract law is the legal framework within which parties may create their own rights and duties by agreement. This framework affords significant freedom to the contracting parties to determine the terms of their agreement and provides the parties with legal remedies for breach of their agreement so that the commercial efficiency of contracting is enhanced.

A contract is an agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law. Accordingly, the content of contracts between design professionals and their clients is often closely negotiated and is intended to record their expectations and constitute the ground rules for their relationship until each party's contractual undertaking is discharged. The contracting process, therefore, can be viewed as the first phase of project delivery and the resulting contract can be viewed as the foundation for each phase of service that follows.

This section provides a broad overview of the principles of contract law and professional liability. While general in nature, the information provided will help the design professional understand the importance of contracts in structuring commercial relationships and in providing remedies when contracting parties fail to fulfill their obligations to one another or when others are injured as a consequence of their acts or failures to act.

1.2 Essential Elements of a Contract

There are four essential elements that are required for a contract to be legally valid: mutual assent, consideration, legal capacity to contract, and a legally permissible objective. Each of these is briefly described in the following sections.

1.2.1 Mutual Assent

Mutual assent is present when two or more parties have agreed to something. This usually happens when one party makes an offer that is accepted by the other party. For example, a design professional's proposal, submitted in response to a client's request for proposal (RFP), is usually an offer that the client may accept to bind the professional. In legal terms, an offer creates the power in the offeree (the one to whom the offer was made) to form a contract by accepting the offer.

Usually, an offer must be accepted exactly as offered. A response, therefore, is often either a complete acceptance or a complete rejection of the offer. Frequently, however, a “rejection” may simply contain differing terms from the offer. In that case, the response is called a counteroffer. The party who originally made the offer has the power to accept or reject the counteroffer. Obviously, this dialogue frequently occurs in contract negotiations.

As a rule, an offer may be withdrawn at any time prior to acceptance by the other party. Sometimes offers are withdrawn according to their own terms (e.g., they are stated to be open for only 30 days) or simply due to the passage of a “reasonable” amount of time. This is to prevent old offers that were never formally rejected from being accepted at an inappropriate time. To avoid uncertainty, it is generally a good policy to place a time limit for acceptance of the offer in the offer itself.
1.2.2 Consideration

Consideration is that goal, motive, or benefit that leads the parties to enter into the contract. It involves a bargained-for exchange of something of legal value. For the design professional, consideration is usually money. A promise to give a gift, however, is generally unenforceable because the term “gift” implies that there is no exchange of something of legal value. One party gives, the other receives, and no exchange is involved.

Legal value, however, is not necessarily the same as commercial value. One party could agree to pay one dollar for a residence that had been appraised at $300,000. The single dollar would be valid consideration for the contract because it has legal value, even though the commercial value of the house is much greater.

Alternatively, parties can supply the necessary consideration to a contract by performing some act that they are under no legal obligation to perform or by ceasing some activity in which they are legally entitled to engage. Promises are also good consideration. A contract in which one party promises to perform services in exchange for the other party’s promise to pay is supported by valid consideration.

1.2.3 Legal Capacity to Contract

Each party to a contract must have the legal capacity to contract. Generally, that means that the parties must be of legal age (which varies from state to state) and reasonably able to understand the nature of what they are doing (e.g., not intoxicated or mentally incapacitated).

Legal capacity is not often a problem area with design and construction contracts. When it is an issue, the problem is usually to determine whether an individual or corporation was authorized to perform the services covered by the contract or whether the corporate officer or representative signing was properly empowered to sign such a contract on behalf of the corporation.

Since all states require that architects, engineers, and many other design professionals be licensed in the state before practicing there, a design professional who is not properly licensed may be denied access to the courts in the state to enforce a contract if that should ever be necessary. Therefore, to the extent that an unenforceable contract is no contract at all, proper state licensure is also a component of a party’s legal capacity to contract.

1.2.4 Legally Permitted Objective

A legally permissible objective is anything that is not contrary to a statute; that is, those laws enacted by local, state, or federal governments, or the common law, which is the general law developed over the years through court decisions. A contract that requires either party to perform an illegal act is unenforceable.

1.3 Express and Implied Contracts

Once made, a valid contract can be categorized as either express or implied. A contract is implied when a promise can be inferred from the conduct of the parties rather than from their express words. For example, if a client failed to execute and return a proposed contract to a design professional, but subsequently made one or more progress payments that were due to
the design professional in accordance with the terms of the contract, the law would probably infer the existence of a contract.

Express contracts arise when the parties write or speak the elements to which they have mutually assented. Contracts in the design and construction industry are usually express contracts. Not all express contracts are in writing, however. Oral contracts are express contracts and are, generally, legally enforceable. Some contracts, however, must be in writing to be enforceable. The laws that impose such a requirement are commonly referred to as “statutes of frauds.” Four types of contracts are generally required to be in writing. They include:

- Those in which one party agrees to assume responsibility for the debts of another party;
- Those in which an executor (one charged with carrying out the last will and testament of another) promises to pay the deceased’s debts out of his own (the executor’s own) funds;
- Those for the sale of land or any interest in land; and
- Those that cannot be performed within one year.

In addition to the above requirements, at least one state (California) requires that all contracts for architectural services or engineering services be in writing. In the absence of such requirements, however, there are no business or risk management advantages to oral contracts. An obvious problem with oral contracts is that their existence and terms are difficult to prove. Although parties may have the best of intentions, people move on to other assignments, and memories often fade. Even though a contract need not be in writing to be enforceable, executing written contracts is good policy and offers many benefits. A written contract provides objective, documented evidence of the agreement, unlike an oral contract, in which the terms are left to the subjective and possibly biased recollection of each party. Having contracts in writing provides an opportunity for each party to review those terms and make certain they are comfortable with their undertakings and obligations. In the event that a dispute cannot be resolved directly between the parties, a written contract provides a basis upon which some third party (e.g., judge or arbitrator) may resolve the dispute.

1.4 Prime Contracts and Subcontracts

Design and construction projects typically involve one or more tiers or hierarchies of contracts and contracting parties. For example, the contract between the project owner and design professional or project owner and contractor is referred to as a prime contract. The design professional may then be referred to as a prime design professional and the contractor as a prime contractor (or general contractor).

These “primes” may then subcontract certain portions of the services or work through subcontracts to independent consultants or subcontractors. The “subs” may, in turn, further subcontract the services or work to sub-subcontractors and so forth. While project owners typically seek to avoid contractual relationships with the prime professional’s consultants and prime contractor’s subcontractors, the prime contracts often include flow-down provisions designed to incorporate the terms and conditions of the prime contract into the terms and conditions of the lower tier subcontracts.

Due to the potential for conflicts over inconsistencies between prime contracts and
subcontracts, one prominent author has referred to subcontracting as the “Achilles' heel” of the design and construction process (see Sweet on Construction Law, 1997, 346). This potential for conflict points to the need for a comprehensive set of coordinated project contracts, such as the standard forms published by the AIA and EJCDC. These and other families of standard industry agreement forms are further described in Part II and many of the provisions contained in the AIA and EJCDC agreement forms are cited throughout this publication.

1.5 Contract Terms

In general, a contract term is any provision forming a part of the contract. Not all contract terms, however, are stated expressly. Terms that are not expressly stated by the parties, but are assumed to exist by the courts, are referred to as implied terms. For example, the law generally assumes a duty among parties to a contract to act in good faith and perform the contract fairly. This so-called “covenant of good faith and fair dealing” is viewed as so fundamental to the parties’ contractual undertaking that it need not be negotiated or expressed in the contract. Similarly, if not otherwise expressed, additional terms typically implied in a contract for design professional services include the design professional’s obligation to: (1) perform services with reasonable skill, care, and diligence; (2) perform services in accordance with applicable law; and (3) perform services in a reasonable time.

Other terms may be made a part of the parties’ contractual obligations through incorporation by reference provisions. As discussed above, the terms of a prime contract may be incorporated by reference and thus flowed-down into a subcontract agreement. Similarly, regulations, statutes, schedules, insurance, and other requirements may be incorporated by reference into a prime contract or subcontract. To avoid ambiguity, however, it is often preferable to incorporate the specific provisions that the parties intend to govern in the event of a dispute rather than to simply reference an entire prime contract or other lengthy document for incorporation.

1.6 Contract Interpretation

Contract interpretation is the process by which the courts or others determine what terms are implied in order to fill gaps or resolve conflicts in incomplete or imperfectly coordinated contracts. Courts will not look outside the contract to deliver terms of an agreement unless there is a gap or ambiguity in the contract itself. In interpreting the contract, courts (or, in some instances, arbitrators or design professionals acting as initial interpreters) try to respond to a gap by filling it with an objectively reasonable term or with their best understanding as to what the parties would have wished had they negotiated the term and expressed it in the contract. In other circumstances, rules of precedence reflecting industry practice are applied. The following are some of the basic rules used to aid in interpretation:

- The contract should be interpreted as a whole in order to give reasonable, lawful, and effective meaning to all of the terms.
In the event of a conflict, negotiated terms take precedence over standard terms or “boilerplate” language.

Specific terms govern over general terms. (For example, unless the contract provides otherwise: special conditions take precedence over general conditions; specifications take precedence over drawings; and large-scale details take precedence over smaller-scale drawings.)

Unless a different intention is expressed, general words are given their commonly accepted meaning and technical terms are given their normal technical meaning.

Express terms, course of dealings, and trade usage are weighted in that order.

Ambiguous terms (i.e., those susceptible to more than one reasonable meaning) are generally interpreted against the interests of the drafter.

1.7 Waiver

In some instances, one or both of the parties to a contract will waive a right that would otherwise be assumed to exist and that would be an implied term of the parties’ contract. Waiver is defined as a party’s voluntary relinquishment of a known right and may be express (in writing or orally) or, in some instances, inferred from circumstances.

Written contracts frequently include express waiver provisions such as those waiving the right to file a mechanic’s lien, waiving the right to a jury trial, or waiving the right to consequential damages. (See, AIA Document B101-2007, § 8.1.3 and EJCDC E-500, 2008 Edition, § 6.10.E.) Such waivers are part of the parties’ contractual exchange and, unless contrary to law, are enforceable.

Similarly, written contracts frequently include express “no waiver” provisions. These essentially state that the failure of either party to insist on the performance of the other party in a given instance will not be construed as a waiver with respect to any future performance. (See, EJCDC E-500, 2008 Edition, § 6.11.D.)

1.8 Contract Modification

A contract modification is any change that adds or deletes elements to the contract but leaves the general purpose intact. As a general rule, once made, a contract can be modified or changed orally or in writing. To avoid the problems associated with oral contracts as described in 1.3, most written contracts contain a provision prohibiting oral modification such as, “This agreement may be amended only by written instrument executed by both parties.” (See, also, AIA Document B101-2007, § 13.1 and EJCDC E-500, 2008 Edition, § 8.02.A.)

There are essentially two types of contract modifications or changes: a bilateral modification and a unilateral modification. As the names suggest, a bilateral modification is agreed to by both parties, whereas a unilateral modification may be ordered at the discretion of one of the parties.

An unusual feature of construction contracts is that they typically afford the project owner the right to unilaterally change the contract, provided that the change does not constitute a cardinal change (a change so substantial that the contractor’s performance constitutes a new undertaking). The project owner’s insistence on such a change would be a breach of the original contract.
1.9 Contract Discharge

Contract discharge means that the legal duty of one or both of the parties has been terminated. Most contracts are discharged when each party has performed to the satisfaction of the other party. Of course, a contract may be discharged, modified, or replaced if the parties so agree. A contract may also be discharged if it becomes impossible to perform due to circumstances or events beyond the control of the parties (e.g., the death or incapacity of one of the parties) or by operation of law (e.g., the bankruptcy of one of the parties).

Finally, in the event of a material breach of the contract by one party, the non-breaching party is generally excused from performing and can sue to recover damages. Not every material breach, however, results in immediate contract termination. Many contracts include an “opportunity to cure” provision providing the defaulting party with an opportunity to cure or correct the default within a certain amount of time following the other party's written notice to cure. (See, EJCDC E-500, 2008 Edition, § 6.05.B.1.c.)

1.10 Professional Liability

According to Black's Law Dictionary (Abridged Sixth Edition, 1991), when one has a liability, that person or entity is legally “responsible for a possible or actual loss, penalty, evil, expense, or burden.” Black’s also says that one who is liable is “bound in law and justice to do something which may be enforced by action.” For our purposes here, we will combine some frequently used concepts of liability into an informal working definition:

Professional liability consists of those obligations that are or will be legally enforceable and that arise out of the design professional’s performance of, or failure to perform, professional services.

Experience teaches that professional liability claims against design professionals are usually based in contract or in tort. The following sections briefly explore those sources of liability and how they potentially overlap.

1.10.1 Liability in Contract

Because contracts are promises that the law will enforce, it follows that the person or business entity to which the promise was made will be entitled to enforce the promise. When a valid contract is not performed substantially according to its terms, it is said to have been breached. Note that the failure must be substantial. Not every minor or merely technical deviation from the terms of a contract is considered to be a breach of contract. But if there is a substantial, unexcused deviation or failure to perform according to the terms of the contract, the breaching party will be liable under the law for that breach.

Sometimes, it is possible for someone who is not a party to a contract to sue for breach of that contract. This can happen when a contract was specifically intended to benefit a third party. Accordingly, those parties are called third-party beneficiaries and may have rights to sue under the contract. To avoid claims by third parties who are not specifically intended to
benefit from the contract, contracting parties often include a “no third-party beneficiaries” provision in their contracts. (See, AIA Document B101-2007, § 10.5 and EJCDC E-500, 2008 Edition, § 6.07.C.)

Finally, a party may be subrogated to the position of a contracting party, such as an insurer who has paid a claim or loss under its insurance policy. Unless the policy or contract of insurance provides for the waiver of this right, the concept of subrogation allows the insurer to “stand in the shoes” of its insured in pursuing recovery against responsible third parties. (See, Professional Liability and Pollution Incident Liability Insurance Policy, Member Companies of CNA Insurance, 2005, § VI.D, Subrogation, which reads, in part, “We hereby waive subrogation rights against your client to the extent that you had a written agreement to waive such rights prior to a claim or circumstance.”) In response to the likelihood of subrogation actions by insurers, many design and construction contracts include “waiver of subrogation” provisions. (See, AIA Document B101-2007, § 8.1.2 and EJCDC E-500, 2008 Edition, § 6.04.E.)

Third-party plaintiffs or claimants who are not third-party beneficiaries of the contract or who are not subrogated to the position of a contracting party are generally left to remedies available in tort.

1.10.2 Liability in Tort

Torts are civil wrongs, i.e., violations of the personal, business, or property interests of private citizens. When the interests of individuals or business entities are violated, they may sue the responsible party in court to remedy the injury.

Unlike contracts, where the parties to the contract are known, the number of people and entities to whom design professionals may be liable in tort is indefinite. Design professionals can expect to be liable under tort law to anyone to whom they owed a duty to act with reasonable professional skill and care, that is, non-negligently. This standard is referred to as the negligence standard or, alternatively, the professional standard of care.

Clearly, this standard can expand the express obligations assumed under a particular contract. Courts look to the terms of the contract as well as statutes, codes, standards, and other sources to determine the scope of the design professional’s undertaking. They also consider whether the specific circumstances of that undertaking suggest that it was reasonably foreseeable that a given claimant would be injured if the design professional did not act with due skill and care. If a court is convinced that the design professional should have been able to foresee that specific persons or classes of persons would be injured if there was substandard performance of professional services, then the design professional will probably be liable to those persons if such harm occurs.

When the criteria mentioned above are applied in actual situations, clients, members of the public who use or come in contact with construction projects, contractors, subcontractors, construction laborers, lenders, insurers, sureties, and others may be included in the list of those to whom the design professional might be liable. As a consequence, design professionals must develop the ability to assess the likelihood that someone could be harmed by their actions or inaction and should take steps to prevent or mitigate potential harm.

1.10.3 Misrepresentation

In recent years, misrepresentation, “an untrue statement of fact... or false representation” (Black's Law Dictionary, Abridged Sixth Edition, 1991) has become an increasingly important...
source of liability for design professionals. In contract law, a misrepresentation is any erroneous statement of fact made by one party that has the effect of inducing the other party into the contract. Generally, the effect of such misrepresentation is to make the contract voidable at the election of the representee, i.e., the party who relied on the representation. (See, also, 2.2.2 for a brief discussion on the “language of representation.”)

Similarly, the tort of negligent misrepresentation would be a viable claim for a third-party plaintiff who relied, to its detriment, on erroneous information or a misrepresentation provided by a design professional in association with the services performed on behalf of the client. An example would be the claim of a lender who, in extending a loan to the design professional’s client, relied to its detriment on erroneous information provided by the design professional.

To mitigate exposure to claims of negligent misrepresentation, design professionals are urged to describe any representation as a professional opinion limited to and based upon the design professional’s scope of services. Also, while a statement of opinion will generally not be construed as a statement of fact, a court is more likely to construe such an opinion as a statement of fact if the representor claims special knowledge or expertise. Accordingly, design professionals should not only qualify representations as professional opinions, but they should avoid any characterization of their professional opinions as “expert opinions” unless the opinion is based on facts within the professional’s knowledge and control.

### 1.1.1 Liability for Employees, Consultants, and Joint Venturers

Design professionals are, of course, liable for their own personal actions. They are also liable for the actions of others under specific circumstances. Those professionals who are employers are liable for the actions or failures to act of their employees, if such activity was within the normal course of the employee’s duties on behalf of the firm. This kind of vicarious liability (liability incurred via another person) is imposed due to the doctrine of respondeat superior. Loosely translated from the Latin, this means that the “master” should respond for the actions of the “servants.”

Design professionals are also liable for the professional acts and omissions of the consultants that they hire or those for whom the design professional takes responsibility by contract. As discussed in 1.4, the prime design professional normally contracts to provide a certain scope of services, some of which are then subcontracted to independent consultants. If these consultants breach their contracts, that failure might cause the prime to be in breach of the prime contract and become liable to the client. Similarly, actions of the consultants may injure others to whom the prime might also be liable.

Finally, design professionals are liable for the acts and omissions of their partners and joint venturers. A joint venture is essentially a partnership, but only for a specific, and usually limited, purpose. Although partnership agreements and joint venture agreements usually allocate responsibility and liability between the parties (it may be 50/50, 60/40, or some other combination), that allocation is internal only. To the rest of the world, the partners or joint venturers are, in essence, co-promisers and are “jointly and severally” liable. That means an injured party may recover the full scope of damages awarded by the trier of fact (e.g., court, arbitration panel) from either party or from both parties in any combination.
1.12 Types of Damages

There are essentially three categories of damages for which design professionals may be liable: 1) direct damages; 2) consequential damages; and 3) statutory damages.

Direct damages generally consist either of bodily injury to, or wrongful death of, a person or damage to property. The damages must be a direct result of the proscribed actions or a failure to act. Consequential damages do not directly or immediately result from particular actions or a failure to act—they depend on intervening circumstances. Nevertheless, they must be a reasonably foreseeable result of an activity. They can include economic losses, such as lost profit. Direct damages and consequential damages, together referred to as compensatory or actual damages, are intended to fully compensate an injured party for the injury sustained. They are not intended to compensate an injured party for more than its actual loss. Statutory damages are those that are prescribed by language in a statute. Statutory damages may be awarded regardless of whether a party actually suffers damages.

The damages for which an injured party can recover depend on the theory of liability on which the claim is based. Obviously, statutory damages are created by specific laws. For example, it is possible to recover statutory damages for violating the copyright of another person or business entity. If copyrighted material is improperly copied, the author will often be able to recover damages specified by law, whether or not there were any actual, provable damages caused by the copying.

Consequential damages are most closely associated with tort law. The public policy objective behind much of tort law is to promote public safety and to allocate fairly the costs of physical injuries and property damage among the parties who caused the damages.

When a negligent action or failure to act by a design professional results in the bodily injury or death of a person, the law is clear that victims may sue the design professional, regardless of whether there was a contract between them. Until approximately 40 years ago, the general rule under the economic loss doctrine was that one party could not sue another unless the two were parties to a contract (called privity of contract). Today, with some significant exceptions, privity of contract is not required for a person or business entity to sue a design professional for negligence. The same is true if the design professional’s negligence causes damages to the property of a person or business entity. Regardless of whether the parties had a contractual relationship, the design professional will be liable under tort law for such damages if found to be responsible.

The goal of contract law, on the other hand, is to promote commercial market efficiency. That is done in part by assuring parties that the risks and rewards, benefits and burdens that they negotiate in contracts will be respected and enforced. In other words, the parties allocate risks and rewards in their contracts, and the courts should protect their economic expectations. One manifestation of this policy is that consequential damages are not usually available for breach of contract. For a party to recover such damages for breach of contract, the wronged party would have to prove that the breaching party actually knew that such damages would occur as a result of the breach of contract.

The law of torts and the law of contracts, and the public policies underlying them, potentially overlap when so-called economic losses occur. Some courts have adopted an economic loss rule to preserve the distinctions between contract and tort remedies. Generally, this rule provides that a
party may not sue in tort for economic losses unless it has a contractual relationship with the
party being sued.

For example, a contractor who believes that a design professional under contract to the
client performed construction contract administration services negligently and thereby put the
contractor through unnecessary expense may want to sue the design professional for alleged
losses. In states with the economic loss rule, the contractor would not be permitted to do so.
That is because the contractor has no contractual relationship with the design professional
and there is no bodily injury or property damage involved, only loss of money, i.e., an
economic loss. If the contractor were allowed to sue the design professional in tort for such
damages, it would disrupt the allocation of risk that the client, design professional, and
contractor had negotiated in their contracts and could allow the contractor to achieve a better
result than it had otherwise been able to negotiate.

1.13 Defenses to Liability Claims

A number of defenses are available to design professionals faced with professional liability
claims, one or all of which may be applicable in any given case. A brief discussion of several
of the more common defenses follows.

1.13.1 Statutes of Limitations and Statutes of Repose

Statutes of limitations and statutes of repose have been enacted in most states. A statute
of limitations generally provides that once a legal claim accrues to a party, that party has a
specific period of time in which to sue. Accrual of a claim is usually that point where a party
has reasonable notice of the facts that would justify legal action against someone for damages.
It can be difficult to determine exactly when the period begins to run, and the number of years
allowed varies from state to state and from legal theory to legal theory. For example, in many
states a breach of contract claim must be made within six years of the date of the breach. A
claim for negligence, however, may only be available for three years from the date of discovery.

A statute of repose is similar to a statute of limitations, but its time period begins to run
upon the occurrence of some event, not necessarily a party’s notice of the facts constituting a
claim. Generally, under a statute of repose, all claims for negligence in the design and
construction of an improvement to real property must be made within a specified period of
years following the date the improvement was placed into service (the date of substantial
completion), regardless of when such negligence was first discovered. Such statutes recognize
that once a project has been completed for a certain span of years, factors such as
maintenance, occupancy and usage, and other reasons suggest that it is unfair to continue to
subject design and construction entities to claims for problems with the facility. (For state-
specific statutes, see NSPE’s State-By-State Summary of Liability Laws Affecting the Practice

Some standard agreement forms attempt to add some certainty to this area of the law by
providing a positive trigger to the running of the statutory period, whatever it might be. (See,
(See, AIA Document B101-2007, § 8.1.1.) Parties to a contract can, within reason, negotiate
a shorter or longer period for making claims than provided in the law. For example, a client and
design professional could agree that all claims by either party against the other must be made
within three years from the date of substantial completion of the project. (Statistically, following
substantial completion of a facility or other improvement to real estate, the majority of any claims
filed against design professionals occur within three years, and almost all such claims are filed
within six years.)

1.13.2 Comparative Negligence and Contributory Negligence

Comparative negligence is an alternative, in some respects, to the idea of joint and several
liability among joint tortfeasors (two or more parties liable in tort for the same injury). For those
states that use comparative negligence, the relative amount of each party’s negligence is measured
as a percentage of the damages incurred by the injured party. For example, if both the
construction contractor and the design professional jointly cause an injury to the project owner or a
third party, they could be held jointly and severally liable. That means that the design professional
might have to pay all of the injured party’s damages even if only one percent at fault. In states that
use comparative negligence concepts, if the design professional is found to be only one percent
liable, then he or she would only have to pay one percent of the damages, regardless of whether or
not the injured party could recover the other 99 percent from the contractor. Clearly, this is a more
equitable result from the perspective of the design professional.

Contributory negligence occurs when the party making the claim is partly responsible for its
own injury or damages. When this concept applies, the damages that the injured party can recover
are reduced by the percentage of that party’s own negligence. If the injured party’s contributory
negligence is substantial, recovery may be barred entirely. For example, in some states that use
contributory negligence, injured parties must be less than 50 percent negligent or they cannot
recover at all. Because of the potential harshness of such a result, the majority of states have
replaced contributory negligence acts or doctrines with comparative negligence.

1.13.3 Immunity

A design professional may enjoy immunity or be protected from claims under certain
circumstances. When the design professional acts as an agent of the client, effectively acting as
the client, there is often immunity from claims. The basis of this immunity is that the design
professional is a substitute for the client and any liability is the client’s and not that of the design
professional. An example of this would be a situation where the design professional acts on behalf
of a client during the bidding period and causes one of the bidders to be improperly precluded or
puts them to unjustified expense. If the bidder recovers from the client (the principal), the design
professional (the agent) will generally be immune from a separate suit from the bidder.

Another situation in which a design professional may be immune from suit is when the design
professional renders a decision in good faith when acting as an arbitrator or decider of disputes
between the project owner and contractor. This immunity is specifically provided for in the
standard form agreements of the AIA and EJCDC. It is also called for in the Construction Industry
Rules of the American Arbitration Association with respect to its construction arbitrators. Immunity
of this nature, often referred to as quasi-judicial immunity, is necessary if the design professional
is to perform services properly without fear of suit for defamation or interference with business
relationships.
1.13.4 Betterment

Betterment occurs when an injured party is compensated for more than its loss. Although it may be appropriate for a design professional to be financially responsible for damages caused by its negligent acts or omissions, the responsibility does not extend to improving the project or the client’s economic position compared to what it would have been if no such error or omission had occurred. For example, assume that an architect negligently omitted a requirement for railings in a stairwell of a public building. Accordingly, they were not part of the contractor’s construction price. When the omission is discovered, assume that the contractor will be given a change order for the cost of adding the missing handrails. If the client could recover from the architect for the full cost of the handrails, there would be betterment. The client would have received for free what it would have had to pay for if no error had been made. On the other hand, if the cost of the railings and associated labor increased from what they were at the time of bidding, or if remedial work was required in connection with the installation of the handrails, then it would be appropriate for the architect to be responsible for such additional costs since the client would never have incurred the costs but for the negligent error or omission.

1.13.5 Waiver and Estoppel

Waiver, as described in 1.7, is the voluntary and intentional giving up of a known right. For example, if a client knowingly agrees to accept less than full performance from a contractor, that would be a waiver of the right to enforce full compliance. That waiver might be made expressly in words or in writing, or it might be implied from the circumstances. Often, waivers are the result of negotiations in the settlement of claims.

Estoppel is similar to waiver, but with the following principal difference: waiver only requires action by one party while estoppel requires action by both parties. In essence, estoppel operates to stop someone from doing something that they would otherwise have the right to do. The reason both parties must be involved is that it requires the first party to take action on which the second party relies to its detriment. For example, if an engineer’s client tells the engineer that he need not visit the site on a particular day, which the engineer would have otherwise done, the client will be estopped from suing the engineer for not observing construction activity that would otherwise have been observed. Estoppel is based on equity and fairness principles and can be a valuable defense in a number of situations.

1.14 Effect of Form of Business Entity on Liability

Design professionals and their clients organize their businesses in a variety of different legal forms, including sole proprietorships, partnerships, corporations, and limited liability companies or limited liability partnerships. Each form has somewhat different implications for general business liability and professional liability risk management. Design professionals should consider these implications when establishing their practices and when contracting with their clients.

A note on pre-contract risk management is appropriate before proceeding further. Regardless of the form of a client’s business organization, the design professional should
recognize that professional services contracting results in a commercial transaction in which the
design professional effectively extends credit to the client for periods often exceeding 90 days.
Accordingly, credit checks of the client should be considered. Alternatively, if the client is a
governmental entity, the design professional should verify that money has been appropriated to pay
for the contemplated professional services.

1.14.1 Sole Proprietorships

Sole proprietorships are businesses owned by one person. There may or may not be any
employees (there may be just a sole practitioner). There is no legal distinction between the
business and personal assets of the sole proprietor. If the proprietor becomes liable for damages
due to either business or professional activities, all of the proprietor’s personal assets are
potentially available to satisfy the judgment. Note that only the assets of the proprietor are
available. If assets are placed in trust for the benefit of children, for example, or are titled in the
spouse’s name, then they usually are not the proprietor’s property and are not available to
creditors. Such transfers should be made as an integral part of long-range estate planning, with
appropriate advice of an attorney experienced in estate planning and succession issues.

1.14.2 Partnerships and Joint Ventures

Partnerships are formed when two or more people agree to undertake business activities
together. All partners are jointly and severally liable for obligations of the partnership. Generally,
all personal property of the partners is potentially available to satisfy judgments against the
partnership. In that sense, the situation is similar to that faced by sole proprietors. The main
difference is that not only can one’s own acts or failures to act place all personal assets at risk, but
one’s partner’s acts conducted in furtherance of the partnership business can also do so.

As noted in 1.11, a joint venture is a form of partnership which is created for a single purpose.
For example, two unrelated design professional firms who wish to form a partnership to perform
services on a particular project would traditionally form a joint venture. Similarly, a design
professional firm and a contractor could form a joint venture in connection with a design-build
project. As with a general partnership, however, each party is fully liable for the joint venture and
the other’s acts and omissions. The control of the joint venture and allocation of risk and reward is
usually addressed in a joint venture agreement. Both the AIA and EJCDC publish standard form
joint venture agreements. (See, AIA C801-1993 and EJCDC E-580, 2005 Edition.) A limited
liability partnership (LLP), as discussed below, is a recent alternative to a joint venture.

1.14.3 Corporations

Corporations are legal entities in and of themselves. That means that they are legally distinct
from the people who own and run them. Two typical types of corporations are professional
corporations and business corporations. Professional corporations (sometimes called professional
associations) are those in which all shares of ownership (or a minimum percentage) in the
corporation must be held by licensed professionals in the appropriate profession. For example,
generally, in a professional architectural corporation, all shares of stock must be owned by licensed
architects. Some states require the use of this type of corporation for those that provide
professional services to the public.
On the other hand, a business corporation can be owned by non-licensed persons. General business corporations are not allowed by all states to provide professional services. Even when they are so permitted, there is usually a requirement that at least a majority of the shares of ownership be owned by licensed design professionals. Both professional corporations and business corporations can be either “C” or “S” corporations. These designations are from the Internal Revenue Code and have principally to do with the tax status of the corporation and the shareholders. They have no effect on the liability exposure of the corporation.

In general, the owners of corporations are not personally liable for acts or failures to act by the corporation. They only stand to lose the value of the stock that they own in the corporation if a large claim or liability affects its worth. If the insurance and assets of the corporation are not adequate to satisfy its obligations, claimants generally have no right to pursue the personal assets of the individual shareholders.

This shield from personal liability is only available for general business liabilities, however, not for professional liability. Since only individuals are tested and licensed to practice as design professionals, those licensed individuals cannot escape liability for their personal actions or failures to act. A corporation may provide some increased protection compared to a partnership, however, because the actions of one shareholder do not place the personal assets of other, non-involved, shareholders at risk, as is the case with a partnership.

1.14.4 Limited Liability Companies and Limited Liability Partnerships

Limited liability companies and limited liability partnerships are fairly recent statutory creations in which the personal liability of the members or partners can be reduced while still maintaining some of the advantages of a general partnership, such as flow-through tax treatment.

A limited liability company (LLC) is a business entity that provides all members with protection from personal liability for company debts while allowing them to participate in management and control of the company. The personal liability shield of an LLC is broad, but as is the case with a corporate entity, an LLC will not shield individuals from liability caused by their own tortious action (negligence, professional malpractice). An LLC will, however, protect the other members of the LLC from liabilities caused by another member's tortious actions.

A limited liability partnership (LLP) is a general partnership in which partners are afforded protection from certain types of partnership liabilities. The types of liabilities from which an LLP partner is protected vary greatly from state to state, but generally LLP partners are not liable for the tortious actions (negligence, professional malpractice) of other partners. An LLP partner is not, however, protected from his own tortious actions or from other types of partnership liabilities. Unlike an LLC, an LLP may not protect a partner from personal liability for some debts of the partnership, such as those caused by a breach of contract.
1.15 Summary

To summarize the foregoing, design professionals should understand the following:

- Contract law allows contracting parties to create their own rights and duties by agreement and affords the parties legal remedies for breach. The essential elements of a valid contract are: (1) mutual assent; (2) consideration; (3) legal capacity to contract; and (4) legally permitted objective.

- Legally enforceable contracts may be written or oral, although it is always a good policy to execute a written agreement. Both written and oral contracts are called express contracts. When a contract can be inferred from the conduct of the parties, it is called an implied contract. Contract terms can also be express or implied. Implied contract terms are assumed to exist under the law, even though they are not spelled out within the contract.

- Contract modifications or changes usually require the consent of both parties. An unusual feature of construction contracts, however, is that they often allow the project owner to change the contract unilaterally, provided that the change is not a cardinal change, i.e., one so substantial as to constitute a new undertaking.

- Design professionals typically face two types of liability—liability in contract and liability in tort. When a party substantially fails to perform a contractual obligation, that party is considered to be in breach of the contract and will be liable for that breach. In contrast, torts are civil wrongs—that is, they involve violations of the personal, business, or property interests of private citizens. Thus, liability in tort is much more open-ended than liability in contract. Design professionals are liable not only for their own actions, but under some circumstances for those of their employees, consultants, and joint venturers.

- Design professionals may be held liable for three different types of damages: (1) direct damages; (2) consequential damages; and (3) statutory damages. Consequential damages are most often associated with tort law. Some states have adopted the economic loss rule, which does not allow a party to sue in tort for economic losses unless it has a contractual relationship with the party being sued. The purpose is to preserve the sanctity of contractual negotiations and agreements.

- Common defenses to liability claims against design professionals include statutes of limitations and statutes of repose, comparative negligence and contributory negligence, immunity, betterment, waiver, and estoppel.

- Different forms of business organization affect the liability exposure of design professionals and their clients. Professional liability is always personal, and there is no shield to liability for personal professional negligence. Nor is there any shield from business or professional liability for sole proprietors and partners in a partnership for damages that result from business and professional activities. In corporations, stockholders may have a shield to liability that results from another stockholder’s actions or failures to act that do not involve them personally. Limited liability companies (LLCs) and limited liability partnerships (LLPs) are fairly recent statutory creations in which the personal liability of the members or partners can be reduced while still maintaining some of the advantages of a general partnership.