SURETY TODAY PRESENTATION

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Baltimore, MD
May 13, 2019

THE SURETY'S CLAIMS AGAINST THE PROJECT ARCHITECT

Architects play a critical role in the construction process. They are typically retained by the project owner to develop a plan for the project, design what the project will look like, assemble the design team including civil, mechanical, structural and geotechnical engineers, investigate the project site and subsurface conditions, develop the drawings and specifications, specify equipment and materials, assist the owner with bidding and evaluating bids, and assist the owner with drafting contracts. Once the project is awarded to a general contractor, architects are typically involved with reviewing/vetting subcontractors, reviewing and approving submittals and shop drawings, responding to requests for information, developing any contract document addenda, reviewing change orders, reviewing claims, inspecting the work as it is being constructed, certifying payments, certifying level of completion, certifying substantial completion, preparing punchlists and certifying final completion and release of retainage.

Depending on the contractual agreements between the owner and architect on a given project, the architect may be more or less involved at each step of the process. Sometimes owners are more sophisticated and handle some aspects in-house and sometimes owners hire construction managers to handle construction aspects. When you are considering a claim against an architect it is important, as an initial matter, to determine what the architects agreed upon scope of work was and what obligations the architect agreed to perform for the owner. While the contract documents between the owner and general contractor may refer to a number of architect duties, the agreement between the architect and owner may not have included all of those duties and the architect consequently was not performing some of those duties. Just be mindful that there can be a difference between what the contact documents say and what actually occurred in practice.

Because of the critical role that an architect typically plays in most construction projects, there are fertile grounds for an architect to create a potential claim. For example:

1. Failure to accurately investigate and describe the site conditions, including underground conditions
2. Improper specification of equipment, materials, systems
3. Improper certification of payments
4. Improper certification of the level of completion
5. Improper certification of the quality of the work in place
6. Failure to perform tests and inspections – strength of concrete, soil compaction
7. Failure to properly inspect the work during construction to make sure that it conforms to the plans and specifications and that there are no defects
8. Bad design
9. Delays in approving changes, payments, responding to RFI's

10. Over inspecting
11. Improper release of retainage

Of course, there are many, many more potential grounds for a claim against an architect. Today we will be discussing the nature of claims against architects, bars and impediments to such claims, practical issues to consider and finally we will discuss some representative cases where the surety has successfully sued the project architect.

Some Practical Considerations

As an initial matter, one impediment or condition precedent to asserting a claim against an architect may be the requirement for a "certificate of merit." In Maryland, Pennsylvania, Texas and Georgia for example before a lawsuit can be filed against an architect the plaintiff must obtain a certification from an expert that the architect failed to meet the standard of care. In these states, if a plaintiff fails to obtain a certificate of merit before filing suit the case can be dismissed. If that dismissal occurs on the eve of the expiration of the statute of limitations, that could be the end of the case. As a practical matter, if you are planning to sue an architect you will need an expert to meet your burden of proof and establish what the standard of care was and how it was breached in any event, and this should be done before suit is filed. Thus, the certificate of merit is not too much of a burden; it is designed to weed out frivolous and unfounded claims.

Other practical considerations when considering a suit against an architect is the fact that not all architects are deep pockets. A typical architectural practice will have very little of value – they may have some desks, computers and software, but they are typically not capital rich businesses. Of course, the large national and international architectural firms are a different story. In addition, in many cases, architects are under-insured compared to the potential harm that can be caused. In some instances, architects can have large self-insured retentions that must be satisfied before the insurance kicks in. I have seen these as large as $500K and the architects could not meet that amount. Finally, architect professional liability policies are typically self-liquidating, which means that the costs of defense will erode and deplete the coverage amount. You could easily find that a million-dollar policy could be cut in half after a long drawn-out litigation.

When considering a suit against an architect careful consideration must be given to the type of claim that can be submitted. In the vast majority of situations, the surety is not in direct privity with the architect; which is to say that the architect and surety do not have a contract with one another. Without a direct contract between the surety and architect, the surety could not typically sue the architect for breach of contract. Further, in some states in the absence of privity of contract, the surety could not sue the architect in tort either. In other states, privity is not a bar to a tort claim by the surety against an architect and in still other states there is a middle ground regarding suits by sureties against architects in the absence of privity. We will begin by taking a look at a surety's breach of contract claim against an architect and then we will focus on the issue of privity.

Breach of Contract Claims

It would seem to be common sense that if you are not a party to a contract you cannot file suit against the party to the contract for breach of that contract. However, there are some work-arounds to effectively reach the same result. First, most jurisdictions recognize the right of a "third party beneficiary" to bring suit for breach of a contract to which it was an intended beneficiary. A third party beneficiary arises when two parties enter into an agreement with the intent to confer a direct benefit on a third party. In this situation a duty arises from the contracting parties to the intended beneficiary that will allow the beneficiary to sue on the contract even though it is not a signatory to the contract. The key is that the third party must be either specifically identified or part of a class of persons specifically intended to be a beneficiary of the contractual undertaking. The best example of a third party beneficiary in the surety world is the claimant on a payment bond. The payment bond is expressly intended to be for the benefit of the class of persons who provide work, labor or materials to the project. It is not enough to merely benefit from another party's contract; the parties to the contract have to intend to benefit the third party to create a third party beneficiary.

Another way to assert a breach of contract claim against an architect is to obtain assignment rights from the party that is in contract with the architect. So, when the surety is resolving a claim with the owner it can obtain the owner's assignment of its rights to pursue the architect as assignee for breach of the contract between the owner and architect. Some commentators on this approach have observed that there may be a few jurisdictions that restrict or limit the right of taking an assignment of a chose in action or an assignment against a professional. So, you would need to check the particular jurisdiction.

Of course, if the surety has performed under the performance bond and completed the project for the owner, the surety will be subrogated to all of the rights and claims of the owner, including the right to assert breach of contract claims against the architect for the damages incurred by the surety in completing the project.

As with any claim in general there may be challenges or defenses that an architect can assert against a breach of contract claim. For example, there may be limitations of the architect's duties or scope, which can limit the claim. There may be disclaimers in the plans and specifications that limit the architect's exposure. In addition, there may be waivers of damages or limitations of damages. Some architects attempt to limit their damages to the amount of compensation they have been paid. The net effect of such provisions is that the claim against the architect may not be as robust as the surety would hope, but the surety is bound to the contract terms in the same way as the owner.

Even with such limitations in contracts, some jurisdictions look beyond the contract provisions and impose duties or limit the effect of such provisions. In one case, the Fifth Circuit Court of Appeals held that the owner and design professional could not bargain away the design professional's potential duty to a surety that would step into the shoes of the owner under the doctrine of equitable subrogation. *Lyndon Prop. Ins. Co. v. Duke Levy & Assoc., LLC,* 475 F.3d 268, 270-71 (5th Cir. 2007). In another case out of Alabama, the Court observed that an architect cannot close its eyes on the site and refuse to engage in any inspection procedure whatsoever and then disclaim liability for the costs of defects. *Watson, Watson, Rutland Architects, Inc. v. Montgomery County Board of Education*, 559 So.2d 168, 174 (Ala. 1990). Finally, in a Mississippi

case, the court observed that an architect certifying payments despite direct knowledge of construction problems could not delegate its duty to exercise ordinary professional skill and competence. Thus, even in the face of contractual limitations, some jurisdictions will still impose a contractual duty on the architect.

Negligence Claims

Sometimes a direct contract action is not sufficient. One of the parties could be insolvent or bankrupt, the contractual terms may not be favorable as we just discussed, the owner may want to preserve its good relationship with the architect and refuse any assignment, etc. In such circumstances the surety may wish to consider a claim for professional negligence directly against the architect. To establish a claim for negligence, the surety must prove the following elements:

1. That the Defendant architect owed a duty to the Plaintiff, surety;
2. That the architect breached that duty;
3. That the surety suffered injury or loss; and
4. That the surety's injury proximately resulted from the architect's breach of the duty.

W. Page Keeton, et al., PROSSER & KEETON ON THE LAW OF TORTS, §30 at p. 164-65 (5th ed. 1984).

The key issue with a claim for negligence by a surety against an architect is whether the architect owes a duty of care to a surety. In general, a design professional, such as an architect or engineer, owes a duty to their client to exercise their skill, judgment, ability and taste reasonably, in the same manner that a prudent design professional similarly situated would have performed.

Strict Privity

However, in some states like Maryland, the courts have held that an architect does not owe a duty to any party that the architect is not in direct privity of contract with. This is known as the strict privity approach. Under strict privity a surety could not file a direct suit for negligence against an architect that the surety was not in contract with. The strict privity jurisdictions adhere to this approach in part to safeguard the distinction between contract law and tort law. The common refrain is that the court does not wish to see the law of contract drown in a sea of torts. Courts have also noted that it is not fair or just to subject a design professional to indeterminate liability to indeterminate claimants.

Gradually, over time, many jurisdictions have moved away from strict privity. Other courts have created exceptions to privity. Thus, in cases where there is property damage or personal injury caused by the negligent party, privity is not required. In Maryland, the court recognized an exception for the imminent risk of personal injury and/or property damage. In the Maryland case, certain parts of a condominium building were designed to meet the applicable fire code. The court held that the condominium association could sue the architect for the cost of repairing the negligently designed areas to prevent potential injuries.

Foreseeability

Some jurisdictions have abandoned privity entirely and will permit a non-client to recover for negligence directly if the resulting injury or loss was foreseeable. Some courts have adopted this approach because they assert that a design professional owes a duty to his client, but also has a responsibility to others because of the professional character of his or her work. The requirements of foreseeability, reliance and harm are believed to be sufficient requirements to limit the exposure of the design professional.

Restatement Approach

Still other jurisdictions follow a modified approach under the Restatement. The Restatement (Second) of Torts entitled information negligently supplied for the guidance of others represents a more relaxed standard than strict privity. Under section 522, an architect, who in the course of employment in their profession for which payment is expected, supplies false information for the guidance of others is subject to liability for damage caused by the justifiable reliance upon the information if there is a failure to exercise reasonable care or competence in obtaining or communicating the information, where the party suffering the loss was one of a limited group of persons for whose benefit the architect intended to provide guidance or knows that the recipient intends to supply to such others and that the architect intends the information to influence or knows that the recipient so intends.

Thus, the Restatement allows for recovery, not only by those parties to whom the architect intends to influence directly, i.e. the client, but also by those whom the architect knows his client intends to influence. There is no requirement for privity between the injured party and the architect's client as long as the architect has reason to know that the client will pass on the information.

Economic Loss Rule

Also lurking out there in many jurisdictions as a potential impediment to a direct claim against the architect by a surety is the Economic Loss Rule. Essentially the doctrine is based on the idea that purely economic interests are protected by contract principles rather than tort principles. An economic loss is the loss of an expectancy interest created by contract. Thus, such damages as diminution in value, cost to repair, lost profit, cost of completing work due to delays or impacts. Under the doctrine a person who suffers only economic damages through the failure of another person to exercise reasonable care has no tort cause of action against the person that caused the damage.

The doctrine rests on the assumption that tort law implements policies of compensation, deterrence, loss distribution and fairness, primarily designed to redress personal injury and physical damage to property. While the assumption under contract law is that it is designed to redress loss of expectations that arise from the failure to provide bargained for promises. Where parties are free to allocate risk by contract, contract law should govern instead of tort law. While similar to privity, the Economic Loss Rule is distinct and could apply in a particular jurisdiction to bar a surety's claim.

Surety vs. Architect Cases

Now let's take a quick look at some cases where the surety successfully brought claims against architects.[1]

The first case is *State v. Mulvaney*, 72 So. 2d 424 (Miss. 1954). In *Mulvaney* the court recognized the surety's right to sue an architect for negligence arising out of the architect's improper approval of the release of retainage. The surety was awarded as damages, the amount of retainage that was negligently released. In making its ruling, the court observed that the architect prepared the contract on a form provided by him, and he knew its provisions with reference to the retainage and the purpose thereof. The architect was charged with knowledge of the law which imposed upon the surety, in the event of the default of the contractor, the obligation to pay labor and material bills. The bond by its terms incorporated therein the contract. The Court stated, "[t]he architect knew, or should have known, when he authorized the release of the . . . retainage that the surety would be deprived of the protection thereof in event of default on the part of the contractor in completing the structure and paying outstanding bills for labor and material. The Court concluded, "[a] contractual relationship between the architect and surety was not requisite to the existence of this duty. It arose out of the general contractual arrangements which contained mutually interdependent rights and obligations."

The next case is *Peerless Ins. Co. v. Cerny & Assocs., Inc.*, 199 F. Supp. 951 (D.C. Minn. 1961). In *Peerless*, the surety filed suit against an architect asserting that the architect was negligent in issuing the required monthly certified and approved estimates of the work performed during the preceding month, which resulted in improper payments to the bonded principal. The court ruled that through its right of equitable subrogation, the surety was subrogated to the owner's claims against the architect. The Court found that the architect's negligence in certifying the payment was the cause of the surety's loss. The Court observed:

> [p]rivity of contract between plaintiff and defendant was not a prerequisite to the existence of the defendant-architect's duty in the foregoing respect, for the reason that said architect's duty to protect the Owner and the subrogated surety arose out of the general and mutual contractual arrangements which included resulting independent rights and obligations.

In *Calendro Dev., Inc. v. R.M. Butler Contractors, Inc.*, 249 So. 2d 254 (La. Ct. App. 1971), the court held that a surety could assert a cause of action against an architect or engineer for failing to adequately inspect work in progress, authorizing payments for

[1] The author gratefully acknowledges the work in identifying these cases of J. Ferrucci and A. Hester in their unpublished manuscript, *The Architect As A Source Of Salvage*, presented at the 15th Annual Northeast Surety & Fidelity Claims Conf., New Jersey (Sept. 2004).

defective work, failing to recommend that the owner withhold sufficient funds to correct defects, and neglecting to halt work until defects were corrected. The court stated:

> An engineer or architect must be deemed and held to know that his services are for the protection, not only of the interests of the owner, but also the surety on the contractor's bond . . . We are also of the view that the nature of the relationship between surety and engineer is tantamount to one of privity."

Id., 249 So. 2d at 265.

The *Calandro* court also held that "the degree of care owed by an engineer to a surety is the same as that owed to the owner." *Id.*

In *Aetna Ins. Co. v. Hellmuth Obata & Kassabaum, Inc.*, 392 F.2d 472 (8th Cir. 1968), the surety was permitted to recover its losses incurred as a result of an architect's negligent supervision of construction. In *Aetna*, the contractor was using progress payments to pay judgments resulting from other projects, rather than to pay its subcontractors and suppliers on the bonded project. The surety provided financing to the contractor and to satisfied claims of subcontractors and suppliers. The surety asserted in its suit against the architect that the architect was negligent in failing to determine how the contractor was utilizing the progress payments. The architect was put on notice that subcontractors and suppliers were not being paid, but did nothing to ensure the payments were being properly utilized. The court adopted a general negligence standard and in so doing rejected the architect's privity defense.

In *U.R.S. Co., Inc. v. Gulfport-Biloxi Regional Airport Auth.*, 544 So. 2d 824 (Miss. 1989), the architect was hired by the owner to design a new airport terminal building. As part of the architect/owner contract, the architect agreed to provide a full-time resident inspector for administration of the construction contract. *Id.*, 544 So. 2d at 824. The architect/owner contract also contained several exculpatory provisions purporting to insulate the architect from liability for actions of the contractor. The Court held that "[a]n architect is required to exercise ordinary professional skills and diligence and such duty is non-delegable." *Id.* at 827. During construction the architect received information on several occasions that the roof work being performed was defective, but the architect did nothing to address the issues. Ultimately, the project architect was found liable to the surety for negligently failing to require correction of defective work and the surety was awarded the cost of correcting the defective work as the measure of its damages.

The surety also had success against the design professional in the following cases: *City of Houma, La. v. Indus. Pipe Serv., Inc.*, 884 F.2d 886 (5th Cir. 1989) (engineer certified inaccurate or deficient records purporting to verify contractor's compliance with specifications); *Unity Tel. Co. v. Design Serv. Co., Inc.*, 201 A.2d 177 (D. Me. 1964); *Designed Ventures, Inc. v. Hous. Auth. of Newport*, 132 B.R. 677 (Bankr. D.R.I. 1991)

(architect improperly monitored contractor's performance and negligently authorized release of retainage); *American Fid. Fire Ins. Co. v. Pavia-Byrne Eng'g Corp.*, 393 So. 2d 830 (La. Ct. App. 1981) (improper authorization of release of retainage); *Westerhold v. Carroll*, 419 S.W. 2d 73 (Mo. 1967) (upholding right of surety's indemnitor to sue an architect for negligently certifying the amount of work completed and materials furnished for the project).

Suggested resources:

1. *The Architect As A Source Of Salvage*, A. Hester, J. Ferrucci, 15th Annual Northeast Surety & Fidelity Claims Conf., New Jersey (Sept. 2004)

2. Jerome J. Joseph, *Sureties' Claims For Negligence*, 24 Brief 16, 20 (ABA Winter Brief 1995)

3. Lloyd N. Shields, *Surety's Claims Against Design Professionals*, presented ABA/TIPS, FSLC – Mid-Winter Program (Jan. 2012)

4. Martha Crandell Coleman, *Design Professionals Liability For Negligent Design And Project Management*, ABA/TIPS/FSLC – Mid-Winter Program (Jan. 1997)

5. Robert R. Warchola, *Ignorance Is No Excuse: Acceptance By Owner, By Owner's Agent Or By Failure To Inspect As A Bar To Performance Claims*, 8th Annual Northeast Surety & Fidelity Claims Conf., New Jersey (Nov. 6, 1997)

6. The Contract Bond Surety's Subrogation Rights (G. Bachrach, J. Ferrucci, D. Bartlett editors), Christopher Ward, Lawrence Moelmann, Ch. 16 - *The Surety's Subrogation Rights Against Third Parties*, ABA/TIPS/FSLC (2013).

7. The Law Of Performance Bonds (G. Weinstein, K. Zanotta editors), C. Reid, J. Yi, G. Stuck, D. Stryjewski, Ch. 7 - *Right Of The Surety To Pursue Claims Against Third Parties*, ABA/TIPS/FSLC (2018)

8. Michael L. Chapman, *Liability of Design Professionals To The Surety*, 20 Forum 591 (1985)