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Proliferating Chinks in the Armor

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You may have noticed that lawyers seem to live in dread of leaving any stone unturned. In drafting a will a lawyer isn't content to say "I leave all my worldly goods, etc.," but instead says something like "I hereby leave, devise, bequeath, bestow ..." This arcane verbal overkill results from concern that one of those words might convey something ever so slightly different from "leave," and so the lawyer includes them all, just in case. Lawyers are trained, by education and experience, to look for all possible options, all potential risks and opportunities.

In litigation, the ingenuity of lawyers in finding opportunities to further their clients' interests has caused consistent expansion of liability. Except for the occasional legislative intervention with a cap on damages or the like, the trend in law has been toward more potential litigation targets and more theories of liability. While it is undoubtedly a tribute to the cleverness and efficacy of the legal profession, and we are driven to it by our clients' desires, it is beyond question that this trend increases the risks, and therefore the costs, of doing business in general, and of construction in particular.

In the construction context, the impulse to find all possible targets and theories has led to what the U.S. Supreme Court has described as "more or less inevitable" efforts of plaintiffs' lawyers to transform ordinary contract claims into tort claims, which broadens the range of targets and, potentially, the available damages.

In the classic construction project arrangement, an owner employs an architect or engineer to prepare the design plans and specifications. The architect often enlists consulting engineers of one variety or another. Once the design is ready, the owner hires a contractor to construct the project, and he may also hire a construction manager. In this arrangement, typically, no contract exists between the contractor and either the designers or the CM, and this has traditionally been held to bar claims against the designers and the CM by the contractor. It also limits a contractor's recovery to contract damages, which are somewhat more limited than damages in a tort (negligence) action.

There is logic in this rule. Orderly society requires certain disincentives to harmful conduct, and the law provides them in the form of tort actions, in which a wronged party can obtain compensation for violation of societal duties - fraud, slander, personal injury caused by negligence or deliberate attack, etc. Claims between parties involved in a construction project, however, represent what courts classify as "economic loss." In economic transactions parties are free to allocate risks and benefits through binding agreements, and courts traditionally have decreed that parties should live by the bargains they strike. In other words, courts will enforce the parties' contractual obligations but will impose no additional duties by law for the general benefit of society.

The contractor is not without remedy, of course, because he can proceed against the owner, who becomes responsible for the plans and specifications and for the actions of the owner's agents, the designers and the construction manager. But for a variety of reasons - the owner may be insolvent, the contractor may want to preserve a relationship with the owner, the contract may constrain

recovery in some way, or the lawyer simply wants to include all targets - a contractor often prefers to sue the designer or CM directly.

The barrier protecting designers and CMs from claims by contractors is gradually being undermined. In a growing number of jurisdictions courts now recognize a tort action based upon "information negligently supplied for the guidance of others." The legal tome that summarizes common law as it evolves, the Restatement (Second) of Torts, describes this cause of action in section 552:

> One who, in the course of his business, profession or employment ... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

The tort turns on false information, but many functions in construction involve exchange of "information." It is not hard to see how designers and construction managers could be found liable for negligence in "obtaining or communicating" the information they provide to a contractor.

Many jurisdictions, even some that recognize the tort, resist this avenue of recovery in economic loss cases where the parties are governed by contracts. Virginia, for example, insists on contractual privity, i.e. a direct contractual relation between the parties, before an action for economic loss can be maintained. New York, Washington, Connecticut, and other states also have held the line.

But in the last ten years, suits by contractors or subcontractors against construction managers or designers have increasingly been permitted. In a Kentucky case in April of last year, the court allowed a contractor to sue a construction manager under section 552 for negligent "supervision, collection and distribution of information and directions it provided for guidance." In December of last year, a Pennsylvania federal court permitted a contractor, who had been sued by the municipal owner, to cross claim against the owner's engineer for defective plans.

Even in a jurisdiction that had heretofore been firm in requiring privity, weaknesses are appearing. A Maryland appeals court recently held that an accountant can be liable for economic loss under a negligent representation theory where, although there is no contract between the accountant and the plaintiff, the relationship between them "approaches privity." An example of such a relationship would be where a report was to be used for a particular purpose, and the accountant knew and understood how a third party was going to rely on it. It won't take long for contractors' lawyers to pour through this gap in the wall.

Even subcontractors, who don't have direct contractual relationships even with the owner, can nevertheless penetrate to the designer on this theory. In Oklahoma last year and in South Carolina in March of this year, courts have permitted subcontractors to sue architects directly for negligence in failing to properly insure that the contractor paid the subcontractors or had a payment bond in place.

Because the law imposes the liability in these cases, one can't easily protect against it by contract. A provision in the contract with the owner that required the owner to indemnify the designer or CM for liability to such third parties would likely be effective protection, but getting any owner to agree to that responsibility is another matter.

At the least, designers and construction managers should manage their risk of exposure to liability through careful risk assessment and protection, including client selection, proper scope of work, and adequate fees for the liability assumed. It might be worth a phone call to your legal counsel to check your jurisdiction's law.

These defenses cost time and money, of course, but remember, it's not paranoia if there's really someone chasing you.

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