

# THE ARCHITECT AS A SOURCE OF SALVAGE

*Ann T. Hester  
James D. Ferrucci*

## **I. Introduction**

Architects and other design professionals typically perform functions in the construction process which can be of critical importance to the surety. Among other things, they prepare project plans and specifications, certify payments to the contractor, review shop drawings, inspect or supervise the contractor's work, rule on claims for extras and change orders, authorize the release of retainage, and generally make decisions and recommendations throughout the course of the project.<sup>1</sup> An architect who improperly performs his duties can cause loss to the surety, and the surety may have a right to recover those losses from the design professional.<sup>2</sup>

## **II. Privity and the Economic Loss Doctrine**

The requirement of privity of contract and the economic loss doctrine both impose a limitation on scope of the design professional's liability. Nevertheless they are separate issues, as the nature of the limitation is different for each. They are considered together here, however, because both involve the intersection of contract and tort theories and analyses<sup>3</sup> and judicial opinions frequently blur the distinction leading to unnecessary confusion.<sup>4</sup>

When applied, the requirement of privity limits the right to sue the architect to the party which entered into the contract for the architect's services — typically the project owner. The premise is that the architect owes a duty of care and competence only to the party to whom he voluntarily undertook the obligation of performing his services. Privity is essentially a matter of standing; it raises the question of who may complain when the architect negligently performs his contract.

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<sup>1</sup> When a design professional other than the architect — such as the project engineer — performs those functions, that design professional may also be a source of salvage and will be held liable on the same basis and to the same extent as the architect. Therefore the statements and analyses herein are applicable to other design professionals who perform the role traditionally played by the architect.

<sup>2</sup> See *SME Indus., Inc. v. Thompson, Ventulett, Stainback & Associates, Inc.*, 28 P.3d 669, 680-84; see also Martha Crandall Coleman, *Liability of Design Professional for Negligent Design and Project Management*, 33 TORTS & INS. L.J. 923 (1998); Michael L. Chapman, *The Liability of Design Professionals to the Surety*, 20 FORUM 591 (1985).

<sup>3</sup> See Coleman, *supra* note 2, at 923-24.

<sup>4</sup> See, *infra*, text accompanying notes 54-55.

The economic loss doctrine, on the other hand, limits the type of damages for which the architect may held liable for his negligence to physical injury to person or property. Whether the party suing is or is not in privity, purely economic losses — such as loss of profits or increased costs of performance — are not recoverable. The premise is that economic losses are to be redressed under contract law, not tort law.

#### A. THE PRIVITY ISSUE — TO WHOM IS A DUTY OWED?

Design professionals typically enter contracts with the project owner, not the contractor or the surety. Therefore usually neither the contractor nor its surety has privity of contract with the architect and has no basis for asserting a breach of contract claim against the architect who fails properly to perform his obligations. If the architect's failure constitutes negligence, however, may not the contractor or the surety invoke tort law and sue the architect for the damages caused by his negligence? It is just an expansion of the scope of the design professional's liability to third parties which the privity requirement forbids. Even tort law requires some connection between the injured party and the putative tortfeasor. The injured party must prove, not only that the tortfeasor failed to adhere to a required standard of care, but that the tortfeasor owed to the injured party a duty of adhering to that standard.<sup>5</sup> Under the privity requirement, the design professional owes a duty of care only to the party who contracted for his services and not to others even though they may be affected by the performance of those services.<sup>6</sup> As stated *Crow-Crimmins – Wolff & Munier v. County of Westchester*, “without privity of contract, there is no duty owed to the subcontractor by the architect and the subcontractor is barred from bringing a direct suit for damages.”<sup>7</sup>

The rationale for restricting a professional's liability for negligence to his clients was stated by Judge Cardozo in *Ultramares Corporation v. Touche*<sup>8</sup> as follows:

If liability for negligence exists, a thoughtless slip or blunder ... may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on those terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.<sup>9</sup>

Although Judge Cardozo was adjudicating a negligence claim against an accountant, proponents of privity believe that his concerns apply equally to such a claim against a design professional.<sup>10</sup>

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<sup>5</sup> See, e.g., *Linde Enters., Inc. v. Hazelton City Auth.*, 602 A.2d 897, 899 (Pa. Super. Ct. 1992).

<sup>6</sup> See, e.g., *id.*; *Essex v. Ryan*, 446 N.E.2d 368, 370 (Ind. Ct. App. 1983).

<sup>7</sup> 455 N.Y.S.2d 390, 391 (N.Y. App. Div. 1982); see also, *Linde Enters., Inc.*, 602 A.2d at 899.

<sup>8</sup> 174 N.E. 441 (N.Y. 1931).

<sup>9</sup> *Id.* at 444.

<sup>10</sup> See, e.g. *Widett v. United States Fid. & Guar. Co.* 815 F.2d 885, 886 (2d Cir. 1987); *Essex v. Ryan*, 446 N.E.2d at 373.

Nevertheless, the privity requirement has been abandoned or relaxed. In many jurisdictions, and the architect may be held liable for his negligence to third parties such as the contractor or the surety.<sup>11</sup> The seminal case which imposes liability upon a design professional for negligence absent privity is *United States v. Rogers & Rogers*.<sup>12</sup> In that case, the court set forth the following factors for determining whether such liability exists:

- (1) The extent to which the transaction was intended to affect the third party;
- (2) The foreseeability of harm to the third party;
- (3) The degree of certainty that the third party suffered injury;
- (4) The closeness of the connection between the design professional's conduct and the third party's injury;
- (5) The moral blame attached to the design professional's conduct;  
and
- (6) The policy of preventing future harm.<sup>13</sup>

Whether, and the extent to which, a design professional may be held liable for negligence to a third party with whom it has no privity, such as the surety, depends on the law of the particular jurisdiction. While the applicable law varies from state to state, courts have generally taken one of the following approaches with respect to making that determination.

### **1. The "Strict Privity" Approach**

Despite the liberalizing trend, courts in some states continue firmly to hold to the "strict privity" requirement and therefore do not allow a negligence claim against a design professional by someone other than his client. In *Linde Enterprises, Inc. v. Hazelton City Auth.*,<sup>14</sup> for example, a construction contractor claimed that cost overruns were due to faulty specifications and negligent supervision by the engineering firm hired by the owner. The court affirmed judgment in favor of the engineering firm because "Pennsylvania courts have long held that privity between parties is required to maintain an action for professional negligence."<sup>15</sup> The court noted that a negligence claim must fail if it is based on circumstances for which the law imposes no duty of care on the defendant and that absent privity, the engineering firm owed no duty of care to the contractor.<sup>16</sup>

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<sup>11</sup> Recent statutes in some jurisdictions condition the maintenance of a professional malpractice action upon the submission of a certification of merit by a licensed professional. See *infra* Part V.

<sup>12</sup> 161 F. Supp. 132 (S.D. Cal. 1958)

<sup>13</sup> *Id.* At 135.

<sup>14</sup> 602 A.2d 897 (Pa. Super. Ct. 1992).

<sup>15</sup> *Id.* at 899 (quoting *Hartford Accident & Indem. Co. v. Parente Randolph*, 642 F. Supp. 38, 40 (M.D. Pa. 1985).

<sup>16</sup> *Id.* Courts in some other jurisdictions also continue to impose the strict privity requirement. See *Essex v. Ryan*, 446 N.E.2d 368 (Ind. Ct. App. 1983) (Indiana); *John Day Co. v. Alvine & Assocs., Inc.*, 510 N.W.2d 462 (Neb. Ct.

## 2. The “Near Privity” Approach

The minimum loosening of the privity requirement has been referred to as the “near privity” approach.<sup>17</sup> The decision of the New York Court of Appeals in *Ossining Union Free School District v. Anderson LaRocca Anderson*,<sup>18</sup> illustrates that approach. There, the school district sued consulting engineers hired by the district’s architects for costs resulting from the consulting engineers’ negligence in preparing a report as to the structural soundness of a school building. The action had been dismissed below on strict privity grounds.<sup>19</sup> Finding that standard erroneous, the Court of Appeals stated that “[t]he long-standing rule is that recovery may be had for pecuniary loss arising from negligent misrepresentation where there is actual privity of contract between the parties or a *relationship so close as to approach that of privity*.”<sup>20</sup> Reversing the dismissal, the court found that the district had alleged facts sufficient to show such a relationship upon the following criteria:

- (1) the defendant’s “awareness that [its] reports were to be used for a particular purpose or purposes;
- (2) “reliance by a known party or parties in furtherance of that purpose; and
- (3) “some conduct by the defendants linking them to the party or parties and evincing defendant’s understanding of their reliance.”<sup>21</sup>

Applying those criteria in *IT Corp. v. Ecology & Environmental Engineering, P.C.*,<sup>22</sup> however, the court found that the contractor that had relied to its detriment on the engineering firm’s bid documents did not have a relationship with the engineering firm that approached privity.

## 3. The Restatement Approach — A “Middle Ground”

Section 552 of the Restatement (Second) of Torts,<sup>23</sup> entitled "Information Negligently Supplied for the Guidance of Others," represents a more relaxed standard than the "near privity"

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App. 1993) (Nebraska); *Widett v. United States Fid. & Guar. Co.*, 815 F.2d 885 (2d. 1987) (New York); *Bernard Johnson, Inc. v. Cont'l Constructors, Inc.*, 630 S.W.2d 365 (Tex. App. 1982).

<sup>17</sup> See Jerome M. Joseph, *Sureties' Claims for Negligence Against Accountants, Design Professionals, and Lenders*, 24 THE BRIEF 16, 17 (1995) (applied in the context of negligence claim against an accountant).

<sup>18</sup> 539 N.E.2d 91 (N.Y. 1989).

<sup>19</sup> *Id.* at 94.

<sup>20</sup> *Id.* (emphasis added).

<sup>21</sup> *Id.* at 95; see also *Westerhold v. Carroll*, 419 S.W.2d 73, 78-79 (Mo. 1967) (expressly adopting New York’s ‘approaching-privity’ test); cf. *McElvy, Jennewein, Stefany, Howard, Inc. v. Arlington Elec., Inc.*, 582 So. 2d 47, 50 (Fla. Dist. Ct. App. 1991) (architect not liable to subcontractor for negligent advice given to owner because there was insufficient nexus).

<sup>22</sup> 713 N.Y.S.2d 633, 636 (N.Y. App. Div. 2000).

<sup>23</sup> RESTATEMENT (SECOND) OF TORTS § 552 (1977).

rule. Essentially, it constitutes a "middle ground" between requiring strict privity and requiring no privity. Section 522 provides in pertinent part:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, 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.

(2) Except as stated in subsection (3), the liability stated in subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.<sup>24</sup>

The intended application of section 552 in the construction context was explained by the following illustration appended to that section:

The City of A is about to ask for bids for work on a sewer tunnel. It hires B Company, a firm of engineers, to make boring tests and provide a report showing the rock and soil conditions to be encountered. It notifies B Company that the report will be made available to bidders as a basis for their bids in doing the work. Without knowing the identity of any of the contractors bidding on the work, B Company negligently prepares and delivers to the City an inaccurate report containing false and misleading information. On the basis of the report D, a subcontractor, contracts with C to a part of the work. By reason of the inaccuracy of the report, C and D suffer pecuniary loss in performing their contracts. B Company is subject to liability C and to D.<sup>25</sup>

Thus, the Restatement allows for recovery, not only by those parties whom the design professional intends to influence directly, but also by those parties whom the design professional knows his client (the owner) intends to influence. Further, the injured party need not be in privity with the client so long as the design professional has reason to know that the client will pass on the information to that party.

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<sup>24</sup>. *Id.*

<sup>25</sup> *Id.* illus. 9.

In *Robert & Co. Associates v. Rhodes-Haverty Partnership*,<sup>26</sup> the Georgia Supreme Court invoked section 552 to hold a firm of architects and engineers liable for negligence in preparing a report of a building inspection that was furnished to prospective purchasers of the building. The plaintiff, who had not contracted with the firm for the report, relied it upon in deciding to purchase the building. The report failed to disclose the existence of cracks in the exterior masonry which required a substantial expenditure to repair. The court held that even in the absence of privity, the firm had a duty of reasonable care and competence to the purchaser and could be held liable for an economic loss under the circumstances set out in section 552.<sup>27</sup>

Section 552, however, is limited to supplying “false information for the guidance of others” and does not apply to negligence generally. In *Donnelly Construction Co. v. Oberg/Hunt/Gilleland*,<sup>28</sup> for example, the plaintiff contractor<sup>29</sup> sought to recover increased costs of construction caused by the defendant architect’s plans and specifications which were substantially in error. The contractor asserted claims for general negligence and negligent misrepresentation. The architect defended on the ground that the contractor was not in privity. Rejecting the defense, the Arizona Supreme Court relied on section 552 only in upholding the negligent misrepresentation claim.<sup>30</sup> The court allowed the general negligence claim on the ground that it was foreseeable that erroneous plans and specifications would increase costs.<sup>31</sup> In *Malta Construction Co. v. Henningson, Durham & Richardson, Inc.*,<sup>32</sup> the court did not specifically cite section. 552; however, it allowed the contractor’s claim against the engineer for delays caused by defective plans and drawings pursuant to an exception to the strict privity requirement under which one who supplies information during the course of his business owes a duty of reasonable care to a foreseeable third party.<sup>33</sup> The court did not uphold that part of the claim based on the architect’s alleged negligent review of shop drawings because that conduct fell outside of the scope of the exception.<sup>34</sup>

Moreover, at least one court has said that the result called for in illustration 9 should not obtain when instructions to bidders specifically warn bidders not to rely on the report. In *David Pflumm Paving & Excavating v. Foundation Services Co.*,<sup>35</sup> the excavation subcontractor sought to recover the cost of removing unexpected rock. It sued the firm that performed the subsurface

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<sup>26</sup> 300 S.E.2d 503 (Ga. 1983).

<sup>27</sup> *Id.* at 681-82 (“the best rule for resolution of this type of dispute is the one enunciated in the *Restatement of Torts 2d*, § 552”). Sec. 552 was also relied on to hold design professionals liable to non-parties in *Gulf Contracting v. Bibb County*, 795 F.2d 980, 982 (11th Cir. 1986).

<sup>28</sup> 677 P.2d 1292 (Ariz.).

<sup>29</sup> For the purposes of analyzing the design professional’s liability to non-parties, the contractor and the surety stand in equivalent positions: neither is typically in contract with the design professional. Hence the same principles should apply to both. Jerome M. Joseph, *Sureties’ Claims for Negligence Against Accountants, Design Professionals, and Lenders*, 24 THE BRIEF 16, 20-21 (1995).

<sup>30</sup> *Id.* at 11296-97.

<sup>31</sup> *Id.* at 1295-96. See also, *infra* Part I.D.

<sup>32</sup> 694 F. Supp. 902 (N.D. Ga. 1988).

<sup>33</sup> *Id.* at 906-07.

<sup>34</sup> *Id.* at 907; cf. *Wood Bros. Constr.Co. v. Simons-Eastern Co.*, 389 S.E. 2d 19 (N.C. Ct. App. 1980) (affirming summary judgment for architect on contractor’s claim for negligent supervision because *Robert & Co. Associates*, 300 S.E.2d at 681-82 established an exception to the privity requirement for only negligent misrepresentation).

<sup>35</sup> 816 A.2d 1164 (Pa. Super. Ct. 2003).

testing and issued a report and the architectural firm which used the report in preparing the specifications. Among other arguments, the subcontractor relied on section 552, noting that illustration 9 imposed liability when an engineering report was to be made available to, and expected to be used by, bidders. Affirming summary judgment against the subcontractor, the court distinguished illustration 9 on the basis of provisions in the instructions to bidders which expressly provided that data concerning subsurface material was obtained for the architect's use, that the accuracy of the data was not guaranteed, that the data did not constitute part of the contract documents, that the contractor must assume all risk in excavating, and that the bidder was not be entitled to rely on the data.<sup>36</sup>

#### 4. The "Foreseeable User" Approach

The most liberal relaxation of the privity requirement permits a non-client to recover for negligence if the injury was foreseeable. The decision of the Supreme Court of South Dakota in *Mid-Western Electric, Inc. v. DeWild Grant Reckert & Associates, Inc.*,<sup>37</sup> illustrates that approach. The court there held that an electrical subcontractor had a cause of action against the project engineer for negligence. Because it was foreseeable that the subcontractor could be injured by the engineer's negligence, the engineer owed a concomitant duty of care to the subcontractor even though there was no privity of contract.<sup>38</sup> In reaching that conclusion, the court noted that "[t]oday the majority of jurisdictions that have examined this question allow a cause of action against an architect or engineer for economic damages if a party was foreseeably harmed by the professional's negligence."<sup>39</sup>

One commentator has rightly noted that some cases have not required privity on the ground of "professional standards of practice" — "the architect or engineer owes a duty to his client but also has a responsibility to others because of the professional character of his or her work."<sup>40</sup> As was also observed, the rationale for doing so was the foreseeability of reliance by, and harm to, parties not in privity with the design professional.<sup>41</sup> That analysis has been applied to permit the surety to recover from the architect in the absence of privity.<sup>42</sup>

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<sup>36</sup> *Id.* at 1166-66, 1170-71. The court also held that under Pennsylvania law, section 552 permits recovery only "where the plaintiff has suffered losses in addition to his economic loss." *Id.* at 1168. *But see Borough v. Landsdowne v. Severson Env'tl Servs., Inc.*, 2000 U.S. Dist. LEXIS 18732, C.A. No. 99-3781 (E.D. Pa. Dec. 12, 2000) (permitting recovery for purely economic loss by subcontractor against architect for defective plans under section 552 without discussion of instructions for bidders).

<sup>37</sup> 500 N.W.2d 250 (S.D. 1993).

<sup>38</sup> *Id.* at 254. *See also Huber, Hunt & Nichols, Inc. v. Moore*, 136 Cal. Rptr. 603, 617 (Cal. Ct. App. 1977) ("Foreseeability and proximate cause now supplant the former requirement of privity of contract"); *A.R. Moyer, Inc. v. Graham*, 285 So. 2d 397, 402 (Fla. 1973) (general contractor "who may foreseeably be injured or sustained an economic loss proximately caused by the negligent performance of a contractual duty of an architect has a cause of action against the alleged negligent architect, notwithstanding the absence of privity"); *Walder Pump & Equip. Co. v. Orr-Schelen-Mayeron & Assocs., Inc.*, 386 N.W. 2d 375 (Minn. Ct. App. 1986).

<sup>39</sup> *Mid-Western Elec.*, 500 N.W.2d at 253.

<sup>40</sup> Coleman, *supra* note 2, at 927-28 (discussing *A.E. Inv. Corp. v. Link Builders, Inc.*, 214 N.W.2d 764 (Wis. 1974)).

<sup>41</sup> *Id.* at 928.

<sup>42</sup> *See, e.g., Peerless Ins. Co. v. Cerny & Assocs., Inc.*, 199 F. Supp. 951 (D. Minn. 1961), discussed, *infra*, Part IV.

Finally, some courts have adopted the *Rogers & Rogers* test described above, which is a hybrid between the Restatement rule and a pure foreseeability approach.<sup>43</sup>

## **B. THE ECONOMIC LOSS DOCTRINE — WHAT KIND OF DAMAGES ARE RECOVERABLE?**

The “economic loss doctrine” has traditionally barred negligence claims against design professionals for purely economic losses by both those in privity and those not in privity with the professional.<sup>44</sup> The crux of the doctrine is not privity but the premise that economic interests are protected, if at all, by contract principles, rather than tort principles.<sup>45</sup> An “economic loss” is the loss of an expectancy interest created by contract. Thus, economic losses include the diminution in value of an item due to its defective nature, the cost to repair the defect and the consequent loss of profits.<sup>46</sup> Economic loss has also been defined as damages for inadequate value, repair and replacement costs, lost profits, increased cost of performing work and the additional cost of completing work due to delays or disruptions.<sup>47</sup>

In *SME Industries, Inc. v. Thompson, Ventulett, Stainback & Associates*,<sup>48</sup> the Utah Supreme Court applied the economic loss doctrine to affirm a summary judgment against a structural steel subcontractor seeking to recover from the architect and other design professionals the delay damages and other economic losses alleged to have been caused by the designers’ negligence in preparing the plans and specifications and administering the contract.<sup>49</sup> That court explained the economic loss doctrine and the importance of applying it in the construction setting as follows:

The economic loss rule is a judicially created doctrine that marks the fundamental boundary between contract law, which protects expectancy interests created through agreement between the parties, and tort law, which protects individuals and their property from physical harm by imposing a duty of reasonable care. Simply put, the economic loss rule holds that “economic damages are not recoverable in negligence absent physical property damage or bodily injury.”

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<sup>43</sup> See, e.g., *Berkel & Co. Contractors, Inc., v. Providence Hosp.*, 454 So. 2d 496 (Ala. 1984); *Colbert v. B.F. Carvin Constr. Co.*, 600 So. 2d 719 (La. Ct. App. 1992).

<sup>44</sup> See, e.g., *Carlson v. Sharp*, 994 P.2d 851 (Wash. Ct. App. 1999) (applying economic loss doctrine to a developer who was in privity with engineer); Coleman, *supra* note 2, at 934 (citing Sidney R. Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C.L. Rev. 891, 895 (1989)).

<sup>45</sup> Coleman at 934.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* (citing Murray H. Wright and Edward E. Nicholas, III, *The Collision of Tort and Contract in the Construction Industry*, 21 U. RICH. L. REV. 457 (1987)).

<sup>48</sup> 28 P.3d 669 (Utah 2001).

<sup>49</sup> *Id.* at 682.

... [R]elief for defeated economic expectations under a design or construction contract ... [is] to come from the contract itself, not from third parties.... [T]o conclude otherwise would essentially impose the plaintiffs' "economic expectations upon parties whom the plaintiffs did not know and with whom they did not deal and upon contracts to which they were not a party."

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... [A]ll parties to a construction project ... resort to contracts and contract law to protect their economic expectations. Indeed, this is particularly true with contractors and subcontractors whose fees are founded upon their "expected liability exposure as bargained and provided for in their contracts." Protection against economic losses caused by another's failure to properly perform, including an architect or design professional, is but one provision a contractor, subcontractor, or sub-subcontractor may require in striking his or her bargain. Accordingly, contractors' negligence claims against architects ... are ... the types of commercial situations to which the economic loss rule was meant to apply.<sup>50</sup>

The concern, in the words of the Illinois Supreme Court, is that "tort law would, if allowed to develop unchecked, eventually envelop contract law."<sup>51</sup> A second rationale for the economic loss rule has also been advanced. In *David Pflumm Paving & Excavating, Inc. v. Foundation Services Co.*,<sup>52</sup> the court denied a subcontractor's negligence claim against entities providing architectural and engineering services to the owner on the ground that only economic loss was sustained. The court explained by quoting as follows from a prior decision in non-construction case:

"[N]egligent harm to economic advantage alone is too remote for recovery under a negligence theory. The reason a plaintiff cannot recover stems from the fact that the negligent actor has no knowledge of the contract or prospective relation and thus has no reason to foresee any harm to the plaintiff's interest.

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"... [A]llowance of a cause of action for negligent interference with economic advantage would create an undue burden upon industrial

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<sup>50</sup> *Id.* at 680-81 (citations omitted) (first and second quotations from *American Towers Owners Ass'n, Inc. v. CCI Mech., Inc.*, 930 P.2d 1182, 1189, 1192 (Utah 1996), third quotation from *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P.2d 986, 992 (Wash. 1994) (en banc)).

<sup>51</sup> *Fireman's Fund Ins. Co. v. SEC Donohue, Inc.*, 679 N.E.2d 1197, 1199 (Ill. 1997) (quoting *Congregation of the Passion, Holy Cross Province v. Touche Ross & Co.*, 636 N.E.2d 503, 513 (Ill. 1994) and applying the economic loss rule to bar a claim against an engineering firm).

<sup>52</sup> 816 A.2d 1164 (Pa. Super. Ct. 2003).

freedom of action and would create a disproportion between the large amount of damages that might be recovered and the extent of the defendant's fault. To allow a cause of action for negligent cause of purely economic loss would be to open the door to every person in the economic chain of the negligent person or business to bring a cause of action. Such an outstanding burden is clearly inappropriate and a danger to our economic system."<sup>53</sup>

The "too-remote" reasoning, however, raises the privity issue and thereby confuses the analysis. Indeed, in the *David Pflumm* case, the court includes section 552 of the Restatement in its economic loss discussion, noting that "while Section 552 applies in Pennsylvania, it applies only in cases where the plaintiff alleges loss that is not solely economic."<sup>54</sup> While perhaps understandable, this mixing of apples and oranges is responsible for much of the opaqueness with which these issues can be shrouded. In Illinois, one of three express exceptions to the economic loss rule is that the plaintiff may recover economic losses in tort "where the plaintiff's damages are proximately caused by a negligent misrepresentation by a defendant in the business of supplying information for the guidance of others in their business transactions."<sup>55</sup> That exception is very similar in substance to section 552 and is designed to limit the scope of the persons to whom the actor may be liable, not the nature of the damages for which he may be liable. The Illinois court went to hold that architects and engineers were not primarily in the business of supplying information for the guidance of others and therefore claims against them for economic loss did not come within the exception. The court reasoned that the information provided by architects and engineers — in contrast to attorneys and accountants — is incidental to structure which is the focus and ultimate result of their work.

As to the continuing viability of the economic loss rule, one commentator has concluded that "[a] very discernable trend appears to exist in many other jurisdictions toward eroding and 'knocking down the Berlin Wall' of the economic loss doctrine."<sup>56</sup> Although many jurisdictions continue to preclude recovery against design professional when the professional's negligence

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<sup>53</sup> *Id.* at 1168-69 (quoting *Aikens v. Baltimore & Ohio R.R. Co.*, 501 A.2d 277, 279) (citations omitted in original).

<sup>54</sup> *Id.* at 1168.

<sup>55</sup> *Fireman's Fund Ins. Co.*, 679 N.E.2d at 1199-1200.

<sup>56</sup> Daniel E. Toomey and April Rich, *Design Professionals Liability to Third Parties for Negligence*, in *WHEN THE WALLS COME TUMBLING DOWN – WHO PAYS? ANALYSIS AND ADVOCACY OF POST-CONSTRUCTION DISPUTES* (January 23, 1992)(unpublished paper, Forum Comm. on the Constr. Indus. and the Fid. & Surety Law Comm.).

results in purely economic losses,<sup>57</sup> other jurisdictions have rejected the doctrine and allowed such recovery.<sup>58</sup>

### **III. Subrogation – Getting Around the Privity Problem and Economic Loss Prohibition**

When applicable, the contractual privity requirement bars recovery on a tort basis from a design professional. Even under approaches which loosen the strict privity requirement to some degree, the design professional's negligence liability will be limited to persons or entities who are in circumstances which fall within the parameters of the relaxed standard. The project owner, however, is typically in privity with the architect and other design professionals and thus may sue the architect directly for breach of contract without the necessity of resorting to tort law. Where the owner is the obligee and the surety has completed the project or otherwise discharged the obligations of the principal to the obligee, it should succeed to the owner's contract claim against the architect by operation of law under the doctrine of subrogation and thereby avoid any privity issue.<sup>59</sup> Because subrogation is an equitable doctrine governed by equitable principles, the surety may not be able to recover as subrogee against third parties unless the balance of the equities favor the surety or the third party has a contractual obligation to the obligee.<sup>60</sup> It has been held, however, that the surety which has been subrogated to the owner's claim against the design professional prevails under either test. As between the surety and the negligent architect, the surety is the innocent party and therefore has the superior equity.<sup>61</sup> Clearly, the architect has a contractual obligation to the obligee to

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<sup>57</sup> See, e.g. *SME Industries, Inc.*, 28 P.3d at 682; *Carlson*, 994 P.2d at 854; *Fireman's Fund Ins. Co.* 679 N.E.2d at 1201-02; *Gerald M. Moore & Sons, Inc. v. Drewry*, 467 S.E. 2d 811 (Va. 1996); *2314 Lincoln Park West Condominium Ass'n v. Mann, Gin, Ebel & Frazier, Ltd.*, 555 N.E. 2d 346 (Ill. 1990); *Floor Craft Floor Covering, Inc. v. Parma Community Gen. Hosp. Ass'n*, 560 N.E. 2d 206 (Ohio 1990); *D.I.C. Commercial Constr. Corp. v. Broward County*, 668 So. 2d 697 (Fla. Dist. Ct. App. 1996); *National Steel Erection, Inc. v. J.A. Jones Constr. Co.*, 899 F. Supp. 268 (N.D.W. Va. 1995); *Fleischer v. Hellmuth, Obata & Kassabaum, Inc.*, 870 S.W. 2d 832 (Mo. Ct. App. 1993); *Long Island Lighting Co. v. Stone & Webster Eng'g Corp.*, 839 F. Supp. 183 (E.D.N.Y. 1993); *In re PharMor, Inc. Securities Litigation*, 892 F. Supp. 676 (W.D. Pa. 1995); *Linde Enters, Inc. v. Hazelton City Auth.*, 602A. 2d 897 (Pa. Super. Ct. 1992); *Maack v. Resource Design & Constr., Inc.*, 875 P.2d 570 (Utah Ct. App. 1994); *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P. 2d 986 (Wash. 1994).

<sup>58</sup> See, e.g. *E. Steel Constructors, Inc. v. Old Republic Sur. Co.*, 549 S.E.2d 266 (W. Va. 2001); *Jim's Excavating Service, Inc. v. HKM Assocs.*, 878 P.2d 248 (Mont. 1994); *Valley Farmers' Elevator v. Lindsay Bros. Co.*, 380 N.W. 2D 874 (Minn. Ct. App. 1986), *aff'd*, 398 N.W. 2d 553 (Minn. 1987); *Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc.*, 463 S.E. 2d 85 (S.C. 1995); *A.R. Moyer, Inc. v. Graham*, 285 So. 2d 397 (Fla. 1973); *Conforti & Eisele, Inc. v. John Morris Assocs.*, 418 A.2d 1290 (N.J. Super. Ct. Law Div. 1980); *aff'd*, 489 A.2d 1233 (N.J. Super. Ct. App. Div. 1985); *Quail Hollow East Condominium Ass'n v. Donald J. Scholz Co.*, 268 S.E. 2d 12 (N.C. Ct. App.), *review denied*, 273 S.E. 2d 454 (N.C. 1980).

<sup>59</sup> See, e.g., *Unity Tel. Co. v. Design Serv. Co., Ind.*, 201 A.2d 177, 181 (D. Me. 1964). For a detailed discussion and analysis of the surety's subrogation rights, see George J. Bachrach and John V. Burch, *The Surety's Subrogation Rights*, in THE LAW OF SURETYSHIP § 26-1 (Edward G. Gallagher, ed. 1993), Tort Trial and Ins. Practice Section, American Bar Ass'n. For a comprehensive listing of reported cases concerning the surety's subrogation rights, see THE SUBROGATION DATABASE: CASES CONCERNING THE SUBROGATION RIGHTS OF THE CONTRACT BOND SURETY (George J. Bachrach, ed. 1995), Tort Trial and Ins. Practice Section, American Bar Ass'n.

<sup>60</sup> *Id.* at 180-181.

<sup>61</sup> *Id.*

perform his services with the exercise of reasonable care, and therefore may be held liable to the subrogated surety when the architect breaches that obligation by performing negligently.<sup>62</sup>

Subrogation should also operate to overcome the prohibition of the economic loss doctrine. That rule precludes the recovery of purely economic losses when the asserted liability is based on negligence or other tort cause of action. It does not apply to breach of contract claims because the rationale of that doctrine is that contract law should govern claims for economic loss. Thus, when the performing surety is subrogated to the obligee's contract claim against the architect, the surety should be able to avoid, not only the privity requirement, but the economic loss prohibition as well.<sup>63</sup>

#### **IV. Claims by Sureties**

A design professional's negligence may lead to losses for the surety in many situations such as when the professional improperly certifies progress payments, prematurely releases retainage, or makes errors in project administration or supervision.<sup>64</sup> Consequently, there have been numerous decisions involving a surety's claim against an architect or engineer for negligence. While a survey of all such cases is beyond the scope of this paper,<sup>65</sup> there follows a brief discussion of some of the more notable cases involving sureties.

The landmark case establishing the design professional's liability to the surety is *State v. Mulvaney*<sup>66</sup> in which the court upheld a surety's right to bring a negligence claim against an architect for negligently approving the release of retainage. The court awarded the surety the amount of retainage which was negligently released.<sup>67</sup> With respect to the privity issue, the court stated: "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."<sup>68</sup>

In *Peerless Ins. Co. v. Cerny & Assocs., Inc.*<sup>69</sup> a surety sued an architect for negligently certifying payment of \$100,644.20 to the contractor. The court held that the surety was subrogated to the owner's rights against the architect and found that the architect's negligence was the sole proximate cause of the surety's loss. The court went on to say that:

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<sup>62</sup> *Id.* at 181.

<sup>63</sup> See Coleman, *supra* note 2, at 943.

<sup>64</sup> For a review and analysis of commonly encountered situations where the negligence of a design professional can lead to losses for the surety, see Chapman, *supra* note 2, at 591-93.

<sup>65</sup> For a comprehensive survey of cases involving claims by sureties and contractors against design professionals for negligence, see Thomas J. Burnside and Melissa Weeden, *Claims and Defenses of Contractor Surety Because of Architect/Engineer's Acts or Omissions*, (October 24-25, 1996) (unpublished paper, 7th Annual Northeast Surety & Fid. Claims Conference).

<sup>66</sup> 72 So. 2d 424 (Miss. 1954).

<sup>67</sup> *Id.* at 433.

<sup>68</sup> *Id.* at 431.

<sup>69</sup> 199 F. Supp. 951 (D.C. Minn. 1961).

[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.<sup>70</sup>

In *Calandro Dev., Inc. v. R.M. Butler Contractors, Inc.*,<sup>71</sup> the court, in 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 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 reasoned as follows:

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."<sup>72</sup>

Importantly, 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."<sup>73</sup>

In *Aetna Ins. Co. v. Hellmuth, Obata & Kassabaum, Inc.*,<sup>74</sup> the court allowed the surety to recover for losses sustained by reason of an architect's negligent supervision of construction when the architect was obligated by contract to supervise the construction. In that case, the contractor was in financial difficulty and 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 was forced to provide financial assistance to the contractor and to pay certain claims of subcontractors and suppliers. The surety alleged that the architect was negligent because it made no effort to ascertain how the contractor was allocating its progress payments even after being put on notice that subcontractors and suppliers were not being paid. The court adopted a general negligence standard and therefore rejected the architect's lack-of-privity defense.

In *U.R.S. Co., Inc. v. Gulfport-Biloxi Regional Airport Auth.*,<sup>75</sup> an architect was held liable to the surety for negligently failing to require correction of defective work despite provisions in the architect's contract with the owner which declared that the architect was not responsible for construction means, techniques, sequences or procedures. The surety was awarded as damages the cost of correcting the defective work.

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<sup>70</sup> *Id.* at 955.

<sup>71</sup> 249 So. 2d 254 (La. Ct. App. 1971).

<sup>72</sup> *Id.* at 265.

<sup>73</sup> *Id.*

<sup>74</sup> 392 F. 2d 472 (8<sup>TH</sup> Cir. 1968).

<sup>75</sup> 544 So. 2d 824 (Miss. 1989).

In *Standard Roofing Co. of New Orleans v. Elliot Constr. Co., Inc.*,<sup>76</sup> a case involving a subcontractor's negligence claim against an architect, the court recognized that a design professional may be liable to a foreseeable third party and said:

An architect is deemed to know that his services are for the protection of the owner's interest, as well as the protection of other third parties who have no supervisory power whatsoever and must rely on the architect's expertise in providing adequate supervision, plans and specifications.<sup>77</sup>

## V. Statutory Preconditions

As a part of the recent "tort reform" movement, some states have enacted statutes which condition the maintenance of a professional malpractice action upon the submission of a certification by a licensed professional that the claim has merit. Although apparently motivated by a desire to reduce medical malpractice actions, such statutes include architects and engineers either by express reference or by language so broad as to necessarily include them.<sup>78</sup>

As example, the statute in Maryland<sup>79</sup> provides that a civil action "based on the licensed professional's alleged negligent act or omission in rendering professional services ... for others"<sup>80</sup> "shall be dismissed, without prejudice, if the claimant fails to file a certificate of a qualified expert with the court"<sup>81</sup> which attests "that the licensed professional against whom the claim is filed failed to meet an applicable standard of professional care."<sup>82</sup> The certificate must be filed within 90 days after the action is filed<sup>83</sup> and must be served on all parties.<sup>84</sup> The statutory definition of "licensed professional" includes licensed architects, landscape architects, and engineers.<sup>85</sup> Other states which have similar statutes include Arizona,<sup>86</sup> Georgia,<sup>87</sup> Minnesota,<sup>88</sup> and New Jersey.<sup>89</sup>

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<sup>76</sup> 535 So. 2d 870 (La. Ct. App. 1988).

<sup>77</sup> *Id.* at 880. 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 a surety's indemnitor to sue an architect for negligently certifying the amount of work completed and materials furnished for the project).

<sup>78</sup> In addition, there are states which have enacted very short statutes of limitations for professional malpractice claims. See, e.g., KY. REV. STAT. 413.245 (2004).

<sup>79</sup> MD. CODE ANN., CTS. & JUD. PROC. §§ 3-2C-01 — 02 (2003).

<sup>80</sup> *Id.* § 3-2C-01(b).

<sup>81</sup> *Id.* § 3-2C-02(a)(1).

<sup>82</sup> *Id.* § 3-2C-02(a)(2)(i).

<sup>83</sup> *Id.* § 3-2C-02(a)(2)(ii).

<sup>84</sup> *Id.* § 3-2C-02(a)(2)(iii).

<sup>85</sup> *Id.* § 3-2C-01(c).

## VI. Conclusion

The architect and other design professionals can be an important source of salvage for the surety when their negligence causes or increases the surety's loss. The interplay between contract law and tort law, which so often arises when the surety sues the architect, can be problematical. Despite liberalizing trends, either the requirement of contractual privity or the economic loss rule or both may bar recovery when the surety, which is not a party to the architect's contract, seeks to recover for the economic loss caused by the architect's negligence. The subrogation rights of the performing surety, however, is a powerful tool and should enable the surety to overcome those hurdles. Even so, the surety and its counsel must take to comply with any statutory preconditions to, or limitations upon, malpractice actions against professionals.

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<sup>86</sup> ARIZ. REV. STAT. § 12-2602 (2004).

<sup>87</sup> GA. CODE ANN. § 9-11-9.1.

<sup>88</sup> MINN. STAT. § 544.42 (2003)

<sup>89</sup> N.J. STAT. § 2A:53A-27 (2004). As that statute applies only to claims for damages "for personal injuries, wrongful death or property damages," it may not apply to claims for purely economic loss. See *Couri v. Gardner*, 801 A.2d 1134, 1138 (N.J. 2002) (holding that a claim for the fee which the plaintiff paid to the defendant psychiatrist for a report prematurely disclosed by the defendant did not constitute "damages for personal injuries, wrongful death or property damage"). Nevertheless, because no court has yet considered the applicability of the statute to economic losses caused by the negligence of a design professional and because the penalty for non-compliance is ordinarily dismissal of the complaint *with* prejudice, the better practice would be to obtain and file the affidavit of merit.