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**ANALYZING, COMPARING AND CONTRASTING THE MOST
MISUNDERSTOOD AIA CONTRACT PROVISIONS UNDER
THE AIA A101 AND AIA A201 CONTRACT DOCUMENTS**

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In spite of the herculean efforts of the various and numerous parties involved in the construction industry, there remain many irreconcilable conflicts between common documents used in the industry. This is due, in part, to the respective bias of the industry members and their respective preferences for the use of documents which further their own interests.

The American Institute of Architects (“AIA”) has attempted to cure these conflicts by carefully coordinating their construction documents and by attempting to balance the interests of the parties of a construction project, paying particular attention to the legal positions, rights and responsibilities to the various tiers of relationships.

I. The AIA General Documents:

The AIA contract documents define the roles, duties and responsibilities of the various parties. For the purposes of this discussion the focus will be on what is referred to by the AIA as the Conventional A201 Family of Documents, and most particularly the Standard Form Agreements between the Owner and Architect and between the Owner and the Contractor.¹ The Standard Form Agreement between the Architect and the Owner is the AIA B101-2007. The AIA A101-2007 Contract is a common contract between the Owner and Contractor. The AIA A101-2007 Contract, in Article 1, incorporates the “Conditions of the Contract (General, Supplementary and other Conditions) Drawings, Specifications, Addenda...” and further enumerates the Contract Documents as including AIA A201-2007 General Conditions in Article 9.1.2. While the Contracts between the Owner and Architect and the Owner and Contractor are separate agreements, there is interplay between the agreements. In paragraph 6.1 of the AIA A101-2007 Contract, the Architect is designated as the “Initial Decision Maker” as defined in the AIA A201-2007 General Conditions.

a. A101- 2007 Owner and Contractor

In several paragraphs the General Conditions address the role of the Architect on the project, including most notably Article 4 titled “Architect”.² Paragraph § 4.2.1 provides that the

¹ The AIA Contract Documents were most recently revised in 2007. As the AIA "retired" the 1997 version of the AIA documents on May 31, 2009, unless otherwise noted all AIA documents referenced will be the 2007 version of the documents.

² In the A201-2007 the drafters changed the title of Article 4 from “Contract Administration” to Architect.

Architect will provide contract administration and serve as the Owner's representative during construction until the "Architect issues the final Certificate for Payment." The Architect is also designated, in the A201-2007 General Conditions, as the point of contact between the Owner and the Contractor.³ Further in paragraph §4.2.2, the General Conditions provide that the Architect will visit the project

"at intervals appropriate to the stage of construction, or as otherwise agreed with the Owner to become generally familiar with the progress and quality of the portion of the Work completed to determine in general if the Work observed is being performed in a manner indicating that the Work, when fully completed, will be in accordance with the Contract Documents."

The General Conditions also give the Architect the authority to reject non-confirming work.⁴ Further, the General Conditions provide that the Architect will review the Contractor's submittals for the limited purpose of checking for conformance with the Contract Documents,⁵ will prepare Change Orders,⁶ will investigate, make determinations and recommendations regarding concealed or unknown conditions,⁷ will conduct inspections to determine the dates of substantial and final completion, and issue the Certificate of Substantial Completion,⁸ will interpret written requests for interpretation of the requirements of the Contract Documents and performance under them, and will respond to requests for information regarding the Contract Documents.⁹

AIA A201-2007 also clearly states that the Agreement only creates a contract between the Owner and the Contractor and does not create relationships between other parties including the Architect. The Architect is, however, "entitled to performance and enforcement" of the Contract provisions intended to facilitate the Architect's duties.¹⁰ The General Conditions further note that while the Architect is not responsible for the non-conforming work by the Contractor, the Contractor is not relieved of its obligations to "perform the Work in accordance with the Contract Documents" because of the activities of Architect.¹¹

b. B101 – 2007 Owner and Architect

While A101-2007 and A201-2007 define the contractual relationship between the Owner and the Contractor, AIA B101-2007 is the Standard Form of Agreement between the Owner

³ AIA A-201-2007 §4.2.4

⁴ See AIA A-201-2007 §4.2.6

⁵ AIA A201-2007 §4.2.7

⁶ AIA A201-2007 §4.2.8

⁷ AIA A201-2007 §4.2.8

⁸ AIA A201-2007 §4.2.9

⁹ AIA A201-2007 §4.2.11 and §4.2.14

¹⁰ See AIA A201-2007 §1.1.2

¹¹ AIA A201-2007 §1.1.2 and §3.1.3

and the Architect and serves as the counterpart defining the Architect's duties to the Owner.¹² Article 3 of B101-2007 outlines the basic services the Architect is to provide, and including "usual and customary structural, mechanical, and electrical engineering services." Article 3 divides the Architect's services into those performed in three different phases: Schematic Design Phase, Design Development Phase, Construction Documents Phase, Bidding or Negotiation Phase, and Construction Phase. Similar to those duties and abilities that the Owner advises the Contractor to expect from the Architect in the A201-2007 General Conditions, among the services the Architect is to provide under the B101-2007 Agreement are:

- To advise and consult the Owner during the construction phase;¹³
- To visit the site at appropriate intervals to become generally familiar with the progress and quality of the work and whether the work, when completed, will be in accordance with the contract documents;¹⁴
- The authority to reject non-conforming work or require inspection and testing of the work;¹⁵
- To interpret the Contract Documents for the Owner and Contractor;¹⁶
- To review and certify amounts due to the Contractor;¹⁷
- To review and approve Contractor's submittals;¹⁸
- To respond to requests for information from the Contractor;¹⁹
- To prepare change orders for the Owner's Approval;²⁰
- To conduct inspections to determine the dates of Substantial Completion and final completion.²¹

While the B101-2007 is an agreement between the Owner and the Architect and the A101-2007 & A201-2007 comprise an agreement between the Owner and the Contractor, read together the Agreements define the responsibilities, authorities and protections between those parties on a construction project. All three Agreements repeatedly advise that the Architect is not responsible for the Contractor's work, or the means and methods used by the Contractor to perform its work. Under these Agreements, the Architect does have responsibilities to the Owner to visit the site and verify that, when completed, the work will conform to the contract

¹²The Commentary to the AIA B101-2007 notes that "B101 is the flagship 2007 owner-architect agreement upon which the other 2007 owner-architect agreements are based." There are three other AIA owner-architect agreements. B103 for a Large or Complex Project, B104 for a Project of Limited Scope, and B105 for a Residential or Small Commercial Project.

¹³ §3.6.1.2

¹⁴ §3.6.1.2

¹⁵ §3.6.2.2

¹⁶ §3.6.2.3

¹⁷ §3.6.3.1

¹⁸ §3.6.4.1

¹⁹ §3.6.4.4

²⁰ §3.6.5.1

²¹ §3.6.6.1

documents.²² If the Architect believes that is not the case, the Architect can reject payments to the Contractor or even rescind previously approved pay applications.²³

These duties provide the Owner with protections to ensure the proper performance of the Work by the Contractor. If the Contractor performs defective or non-conforming Work, the duties of the Architect should help identify non-conforming or defective work when it is performed rather than later in the process. The Contractor is provided clarity on where to direct questions and from whom directives will come. At the same time, the Contractor's Surety benefits from the Architect's performance of its duties to the Owner where the Architect identifies problems with the Work and directs the Owner to withhold payment until the Work conforms to the Contract Documents. This can either help prevent a claim against the Contractor's performance bond by addressing the issue as it arises, or can reduce the amount of the claim against the bond by limiting the amount of Work to be remediated.

II. Difficult Provisions In The AIA Contract Documents

While the AIA contract documents help provide an integrated set of documents to reduce conflict and questions during the construction process, many of the provisions still generate questions or confusion between the parties, and often have an impact upon the sureties.

a. The Indemnification Clause

Under the A201-2007 General Conditions the Contractor agrees to indemnify the Owner, the Architect and their agents and employees for claims, damages, expenses and attorneys' fees pertaining to injuries to persons or damage arising from the performance of the Work. This is set out in paragraph §3.18.1 of the A201-2007 General Conditions. While the paragraph limits the claims to those arising from the negligence of the Contractor, its subcontractors and agents, the Contractor agrees that it will indemnify the Owner and Architect even if the Owner and Architect in part caused the harm.

The enforceability of these provisions in the prior versions of the A201 General Conditions has often been a source of litigation. Generally, it is a matter of state law. Some states have recognized the enforceability of these clauses as written, others have struck the provision to the extent that Contractor is required to indemnify the Owner and its agents for its own negligence.²⁴ In enforcing this provision many Courts have noted that the indemnification is limited to the negligence of the Contractor and essentially serves as creating a comparative fault provision.²⁵

²² e.g. A201-2007 - §4.22, §4.23, §4.26; §9.5.1, B101-2007 §3.6.12

²³ A201-2007 §9.5.1

²⁴ See *Certain London Market Insurance v. Penn National Mutual Casualty Insurance*, 269 F. Supp. 2d 722 (N.D. Miss. 2003).

²⁵ *MT Builders, L.L.C. v. Fisher Roofing, Inc.* 197 P.3d 758 (Ariz. App. 2008) citing *East-Harding, Inc. v. Horace A. Piazza & Assocs.*, 80 Ark.App. 143, 91 S.W.3d 547, 551 (2002); *Hagerman Constr. Corp. v. Long Elec. Co.*, 741 N.E.2d 390, 392-95 (Ind.Ct.App.2000); *MSI Constr. Managers, Inc. v. Corvo Iron Works, Inc.*, 208 Mich.App. 340, 527 N.W.2d 79, 81 (1995); *Braegelmann v. Horizon Dev. Co.*, 371 N.W.2d 644, 646-47 (Minn.Ct.App.1985);

b. The Decisions to Withhold Certification Clause

As noted above, Paragraph §9.5.1 of A201-2007 permits the Architect to withhold certification for payment if the Work, when completed, will not comport to the Contract Documents. The decision to withhold payment of contract funds by the Architect will often determine whether the Contractor is financially able to perform the work and the amounts of the contract funds that remain for the Surety to perform the work if it is forced to complete or remediate the project. Whether the decision by the Architect to withhold certification for payment is a right or a duty is significant to both the Surety and to the Owner. The language in A201-2007 appears to make the withholding of the payment by the Architect, in whole or in part, permissive if the Architect cannot certify that the amount requested is properly due.²⁶

Dovetailing with the provisions of A201, under B101-2007 the Architect “shall review and certify” the pay applications of the Contractor and those certifications are to be based upon the Architect’s duty to the Owner to visit the site and determine if the progress and quality of the Work indicates that when complete it “will be in accordance with the Contract Documents.” B101-2007 paragraph §3.6.2.2 also gives the Architect the authority to reject non-conforming work. The question arises on whether the contract provisions regarding withholding of the certification of payment create a duty on the Architect to do so or simply grants the Architect the authority. The very language of B101-2007 creates a duty to become familiar with the work, but does not require exhaustive inspections. When nonconforming work, or deviations from the construction schedule, become known to the Architect then the Architect must advise the Owner.²⁷ While the Architect can approve minor changes to the Work in the Contract Documents, the commentary to B101-2007 indicates that the Architect does not have the authority to accept non-conforming work.²⁸ While A201-2007 appears only to grant the Architect the right to withhold payment for non-conforming work, if the Owner and the Architect have adopted the B101-2007 Agreement, then the Architect has a duty to withhold payment for non-conforming work unless the Owner agrees to accept the non-conforming work. As will be discussed later, this has the potential to become a significant issue where the relationship between the Owner and the Architect is based upon a non-AIA Agreement.

c. Waivers of Subrogation Clause

Under Paragraph §11.3.7 of AIA A201-2007 General Conditions, the Owner and the Contractor waive all rights against each other and certain other parties, including the Architect, for damages caused by fire or other causes to the extent they are covered by insurance. The parties also agree to have the Architect, its consultants, their agents, subcontractors, etc. agree to waive subrogation from them as well. While the parties agree to waive subrogation to

Nusbaum v. Kansas City, 100 S.W.3d 101, 105-07 (Mo.2003); *Dillard v. Shaughnessy, Fickel & Scott Architects, Inc.*, 884 S.W.2d 722, 724-25 (Mo.Ct.App.1994) (applying Kansas law); *Mautz v. J.P. Patti Co.*, 298 N.J.Super. 13, 688 A.2d 1088, 1092-93 (App.Div.1997); *Greer v. City of Philadelphia*, 568 Pa. 244, 795 A.2d 376, 379-82 (2002); *Brown v. Boyer-Washington Blvd. Assocs.*, 856 P.2d 352, 354-55 (Utah 1993).

²⁶ §9.5.1

²⁷ AIA B101-2007 §3.6.2.1

²⁸ See AIA A201-2007 §7.4 and commentary to B101§3.6.2.2

the extent the damages are covered by insurance, the paragraph further notes that the waiver of subrogation is effective even if that party has the duty to indemnify the other, regardless of who paid the premium on the insurance, and regardless of whether the party had an insurable interest in the property or not.

Similarly, the Owner and the Architect also agree in the B101-2007 Agreement to waive subrogation to the extent that damages are covered by property insurance.²⁹ This waiver of subrogation, however, does not waive the rights to the proceeds of any insurance provided for under the A201-2007 General Conditions.

Questions have arisen with respect to this section regarding amounts owed to third parties and what happens when the party responsible for insurance does not procure the required insurance. In reviewing the interplay between the two sections, one court noted:

A reasonable interpretation of the indemnification clause that is in harmony with the insurance procurement requirement and the waiver of subrogation clause is that the indemnification clause refers to compensation and liability for losses *not* covered by the property insurance policy, that is, compensation and liability to third parties.

Nodaway Valley Bank v. E.L. Crawford Constr., Inc., 126 S.W.3d 820, 829 (Mo. Ct. App. 2004).

In the case of *Jalapenos, LLC v. GRC General Contractor, Inc*, the Court found that where the Owner was to have provided the required insurance and did not, the Contractor was not required to provide indemnification for damages that would have been covered by the insurance.³⁰

d. Claims for Consequential Damages Clause

In the A201-2007 General Conditions and in the B101-2007 Standard Form Agreement, the Owner and Contractor and the Owner and Architect respectively, agree to waive claims for consequential damages.³¹ This is an attempt to limit the damages to those directly arising from the breach of the contract rather than damages such as lost profits, additional construction loan interest, additional rent paid by the Owner, and additional principal office expenses for the Contractor. In the A201-2007 document, the waiver of consequential damages provision specifically notes that it does not preclude the assessment of liquidated damages. Thus, while a project Owner might not incur lost profits, increased interest, or other

²⁹ AIA B101-2007 § 8.1.2

³⁰ *Jalapenos, LLC v. GRC General Contractor, Inc.* 939 A.2d 925 Pa.Super.,2007

"A101-2007 and A201-2007 [the standard contract forms] intentionally make provision for property damage and all risk insurance coverage to be provided by [the owner], all parties waive subrogation for the all risk property damage insurance provided by [the owner] and the only responsibilities of the contractors, if any, are for liability insurance to cover claims by third parties. Such provision is an appropriate allocation of risk and responsibilities and makes certain the obligation of the various parties under such contract documents to provide insurance."

³¹ See AIA A201-2007 §15.1.16 and AIA B101-2007§8.1.3

consequential damages as a result of the breach it will still be entitled to liquidated damages from the Contractor for the Contractor's breach.

There arises a question, however, regarding whether the Owner can recover other consequential damages such as its attorney's fees resulting from a breach by the Contractor. While the parties have waived consequential damages, which would include attorney's fees defending claims from other parties, the Owner is still entitled to be indemnified by the Contractor for claims arising from the Work. Thus, even though the expenses related to its attorney's fees in its defense related to those claims would be consequential damages, the Owner remains entitled to indemnification under the terms of the A201-2007 General Conditions.

A question also arises as to the interplay of the waiver of consequential damages and the provision in A201-2007 paragraph §13.4.1 which provides that the duties and obligations in the contract are not a limitation on the obligations, rights and remedies available by law.³² One unpublished Texas decision addressed this question related to a slightly modified paragraph 13.4.1 and held that the release of consequential damages was effective, and that the Owner was not entitled to recover any damages beyond the difference in the original contract amount and the cost to complete the project.³³

III. Modification of AIA Forms or Use of Non-AIA Forms

While the integrated nature of the AIA documents is intended to provide a coordinated approach to the relationships and duties between the various parties on the construction contract, the wheels fall off if the parties modify their AIA construction documents, or, more importantly, if one of the parties use a non-AIA document. Recognizing the potential for problems when non-AIA documents are used in combination with the AIA documents, the drafters of the AIA documents included in the General Information section of the AIA Document A201-2007 instructions, at page 2, the following warning:

Use of Non-AIA Forms. If a combination of AIA documents is to be used, particular care must be taken to achieve consistency of language and intent among documents.³⁴

a. Fast Track Provisions

While the AIA A101-2007 and A201-2007 Agreements do not contain a "fast track" provision, often such provisions are inserted into the contracts. So called fast track provisions allow for work to begin on certain portions of a project while the design work on other portions is still in

³² See *Stonehill-PRM WC I, L.P. v. Chasco Constructors, Ltd.* No. 03-08-00494-CV, Not Reported in S.W.3d, 2009 WL 349136, (Tex. Ct. App. Feb. 11, 2009).

³³ *Stonehill-PRM WC I, L.P. v. Chasco Constructors, Ltd.* Not Reported in S.W.3d, 2009 WL 349136.

³⁴ Courts have recognized the significance of this warning when faced with other issues where an AIA document is modified. See *MPACT Constr. Group, LLC v. Superior Concrete Constructors, Inc.*, 785 NE.2d 632, 640 FN 11 (Ind. Ct. App. 2003).

process.³⁵ While this provides the opportunity for construction of the project to get underway sooner, and perhaps finish sooner than if it were fully designed before the contracts are bid, fast track provisions create risk that the design and contract specifications can change after the Contractor and Owner enter into their contract. By their nature, "fast track" projects require additional contingencies, including time and money, which must be accounted for in the bidding process. To ensure that all parties are fully informed, a design/build agreement will generally denote that the project is "fast track." These provisions are frequently misunderstood by the parties as to which party, the Owner or the Contractor, bears the risk of increased costs and delays in construction. Generally, the provisions put the risk on the Contractor, which can then lead to claims against the Performance Bond. Great consideration must be taken then by the Contractor in agreeing to perform work on a "fast track" project.

b. Use of Non-AIA Forms

The dilemma is best illustrated by the following hypothetical example:

- 1) The Owner and Contractor enter into AIA A101-2007 General Contract incorporating the AIA 201-2007 General Conditions.
- 2) The AIA A101-2007 / AIA A201-2007 General Contract requires that the Owner retain a licensed Architect with design and contract administration duties.
- 3) The Owner enters into a Non-AIA agreement with an Architect which allows for an Architect representative but is, otherwise, silent regarding the Architect's responsibilities for review and approval of submittals.
- 4) The full design and contract administration are performed by the Architect's representative.
- 5) The Contractor transmits submittals to the Architect representative who takes no action whatsoever, and the Contractor proceeds to construct the building in accordance with the shop drawings and technical data submitted.
- 6) The building, as constructed, violates building codes as well as plans and specifications.
- 7) The Architect representative fails to detect the construction defects and certifies all of the Contractor's payment applications.
- 8) The Owner, being advised by others of the construction defects, terminates the Contractor and makes a performance bond claim to the Contractor's Surety which executed an AIA-312 Performance Bond.

While the facts in the above scenario would still result in many questions, the absence of the AIA B101-2007 agreement between the Owner and the Architect complicates matters. Although the AIA A201-2007 General Conditions give the Architect certain rights and responsibilities, the A201 does not constitute an agreement from the Architect to undertake

³⁵ See *Georgia Power Co. v. Georgia Public Serv. Comm'n*, 396 S.E.2d 562, 574 (Ga. Ct. App. 1990).

such responsibilities. In the above scenario, the Surety is likely faced with a significant potential loss. The Owner is entitled to have the Work performed under the terms of its Contract with the Contractor. As the building does not meet the plans, specifications and building codes, the Owner seeks to have the Surety perform under the terms of the performance bond to remedy the issues with the building. Under this scenario substantial remediation of the project work could be expected.

The central question is whether the Surety's obligation arose under the terms of the Bond. Under the AIA A312 performance bond, the Surety's rights don't arise until there is a default by the Contractor and the Owner is not in default. Improper payments made to the Contractor for deficient or defective work performed could constitute a breach of the bonded contract and an Owner default under the terms of the AIA A312 Performance Bond. Under the A-201 General Conditions, the Contractor must present its submittals, pay applications and requests for information to the Architect. Here, the Contractor submitted its pay applications to the Architect, who signed off on them, and the Owner issued payment. The Surety is likely to take the position that its obligation either did not arise under the terms of the bond, or that its obligations are either fully discharged or discharged to the extent that the Surety was prejudiced by the Owner's improper payment to the Contractor.³⁶ Because the contract funds are considered collateral to be used by the Surety in the event of a default, the improper payment of those funds caused prejudice or damage to the Surety where there was a default and the Surety was called upon to perform. As the Architect signed the pay applications authorizing payment for the non-conforming work, the Owner impaired the Surety's rights.

Additionally, because the Architect remained silent as to the submittals, the Surety is likely to assert that the Owner accepted the submittals and cannot now claim that the Contractor did not construct the building according to the plans and specifications. The Owner and Architect should be expected to assert that under the General Conditions, the Contractor is responsible for the means and methods used in the construction, and that any deficiencies are the responsibility of the Contractor.

Since its contract is silent as to its responsibilities for inspections and submittals, the Architect will assert that the Contractor bears the responsibility for any defects on the project, and that the Architect has performed its contractual duties. While the A101-2007 /A201-2007 Agreement between the Owner and the Architect granted the Architect certain rights, the Architect was not a party to that Agreement and is not bound by it. Instead the Architect's duties are found in its contract with the Owner, which does not set forth those duties. To the extent that the contract is silent as to the duties of the Architect in the construction management, the Owner, and perhaps the Surety, may also seek to proceed against the Architect in tort for its negligent performance in approving the improper payments and deficient construction.³⁷

³⁶ See *Cont'l. Ins. Co. v. City of Virginia Beach*, 908 F. Supp. 341, 347-348 (E.D. Va 1995); and *Pennsylvania Nat. Mut. Cas. Ins. Co. v. City of Pine Bluff*, 354 F.3d 945 (8th Cir. 2004).

³⁷ See Christopher R. Ward and Nicholas Hyslop, *Right of the Surety to Pursue Claims Against Third Parties*, in A.B.A., *The Law of Performance Bonds Second Edition*, 351, 361-374 (Lawrence R. Moelmann, John T. Harris, Kevin Lybeck eds., 2009).

IV. Case Study - The Hotel from Hell

Difficulties arise when non-AIA forms are utilized along with the AIA forms, a recent project in Florida is illustrative of the difficulties that arise when non-AIA forms are utilized along with the AIA forms. The allegations in that case read like the fact section of a law school exam question and involved numerous other issues not included in this summary. The legal controversy arose from a construction project for a hotel in Florida. On or about January 6, 2006, the Contractor entered into an AIA A101-1987 Contract with the Owner to construct a hotel of \$2.702 million.³⁸ The Hotel Project Contract required the Contractor to provide a Performance Bond and a Payment Bond. Four days later on January 10, 2006, the Contractor and Owner entered into a separate contract for the site work portion of the project ("The Site Work Project"), including the footers for the structural steel, which was originally contained in the Contract. The Site Work Contract was for an amount of Two Hundred Sixty-Eight Thousand Twenty-Six Dollars and no/100 (\$268,026.00) and did not require the Contractor to have bonds.

After work began on the Site Work Project, Contractor applied for Performance and Payment bonds on the Hotel Project and the bonds issued in June of 2006. The Bonds were each for the penal sum of \$2.434 million. After the issuance of the bonds, Contractor began construction on the Project.

After work on the Project began, the Contractor was unable to secure the proper licenses in Florida, which precluded the Contractor from continuing to perform work under the contract for the Project. In July 10, 2007, work on the Project ceased due to the Contractor's failure to have the proper Florida license. Based upon the lack of a proper Florida license, the Owner and its bank refused to make additional contract payments to the Contractor. On July 13, 2007, the Owner advised the Surety that certain subcontractors or material suppliers on the Project had not been paid for work or materials provided in connection with the Project. The Owner also raised concerns about defective construction as well as water damage and mold problems inside the building caused by Contractor's failure to protect the building from water intrusion when The Contractor ceased work on the Project.

In August 2007 the Owner sent the Contractor and the Surety a notice of default on the Project, and the Surety began an investigation of the potential claims against the Performance and Payment Bonds. Based upon its investigation the Surety demanded that the Indemnitors of the Contractor post collateral with the Surety.

As the Contractor was unable to complete the Project without the proper licensure, the Contractor proposed an amendment to the Contract (hereafter, the "First Amendment"). The First Amendment specified that work under the Contract would be completed by another company which was essentially an alter-ego of the Contractor and had the proper license. ("Substitute Contractor") As a condition to accepting the First Amendment, the Project Owner and its lender required that the Surety (i) consent to the First Amendment to the contract and (ii) add Substitute Contractor as a new bond principal and the Project Owner's lender as a co-obligee by issuing riders to the Bonds.

³⁸ Another issue that presented in the case related to allegations by the Contractor of a kickback scheme between it and the Owner in which the actual contract amount was \$2.1 million.

After extensive negotiations, including the execution of additional agreements between the Surety and the Indemnitors, the Surety agreed to issue two riders to the Bonds which added Substitute Contractor as a principal and the Project Owner's lender as a co-obligee. Once the Agreements were signed, the Substitute Contractor began work to complete the Project.

Despite requirements in the First Amendment to the Contract that the Substitute Contractor remedy portions of the Work that had been identified as defective.

In July, 2008, the Owner sent a letter to the Contractor³⁹ declaring it to be in default of the First Amended Contract, terminating the First Amended Contract and directing the Contractor to vacate the project within five (5) days. The Owner cited the failure to complete the Project by the date specified in the First Amended Contract, defective workmanship and materials, failure to account for progress payments, failure to keep the proper bond in place, and failure to keep the job free of liens as reasons to terminate the contract. Shortly thereafter, the Owner sent a letter to the Surety filing a claim against the Performance Bond and demanding that the Surety complete the bonded project under the terms of the Performance Bond.

During the Surety's investigation several issues with nonconforming work and defective plans and specifications became apparent. Many of these issues resulted in structural problems with the hotel steel framing and foundation and the supporting retaining wall, others issues pertained to support of the exterior brickwork, water intrusion resulting in water damage to the Hotel project and other property and mold. The project also failed to meet the applicable codes including the requirements of the Americans with Disabilities Act.⁴⁰ Some of these deficiencies were apparent to the Architect during the construction, while others the Architect indicated were not observed. Despite the construction that obviously did not comport with the plans and specifications, all but one of the pay applications were approved and the Contractor was paid for work performed.

The Surety took the position that its obligations under the terms of the Performance Bond may not have arisen based upon the actions of the Project Owner and its agents, the Architect and the structural and civil engineers on the project. In order to arrange for the completion of the project while the parties continued to review the matter, the Surety entered into an agreement with the Project Owner and its lender, under a full reservation of its rights. Under the agreement, the Surety paid the Project Owner a sum for the completion of the project under a Loan Receipt Agreement. If it was determined that the Surety should make payment to the Project Owner for the completion of the project, then the sum paid would be applied to that amount. If it was determined that that the Surety's obligations under the Bond did not arise, then the Project Owner was required to repay the Surety the funds loaned. Work resumed on the project and was completed at the end of October 2009 according to a remediation plan designed by the Project Owner's experts to bring the Hotel to the point of being able to obtain a certificate of occupancy.

³⁹ The letter was addressed to the Contractor, though the Substitute Contractor had assumed the contract. This was a potential issue in the case that was considered minor as the two companies had shared ownership, utilized the same labor and supervisors.

⁴⁰ 42 USC §12102 et seq.

Litigation arose between the Surety and the Contractor's Indemnitors over the failure to post collateral. The Contractor filed a Third-Party Complaint against the Owner and individual members of the Owner, which was an LLC, alleging breach of contract and conspiracy.

After the July 2008 declaration of default, the Surety also added counts to the litigation against the Indemnitors of Substitute Contractor for breach of the second indemnity agreement. Based upon the alleged construction defects raised by the Project Owner, the Surety, the Contractor and the Substitute Contractor filed additional counts against the insurance companies that issued the Commercial General Liability Policies ("CGL") on behalf of the Contractor, and against the subcontractors that performed the work the Owner's inspectors and remediation engineers alleged was defective. Additionally, the Surety sued the Architect, the structural and civil engineers, alleging negligent misrepresentations, negligent plans and specifications, and negligent approval of payment of contract funds for defective or non-conforming work.

The Surety and the Owner later settled the Performance Bond Claim and the Owner assigned the Surety its rights against all parties related to the project, including the design professionals. The Surety then asserted the Owner's rights against the design professionals in the litigation.

While the agreement between the Owner and the Contractor utilized the AIA A101-1987 and A201-1987 forms, the agreement between the Owner and the Architect was a four page non-AIA document. Two paragraphs of the agreement between the Owner and Architect related to the Architect's duties in the construction phase of the project. These provided that the Architect would provide a minimum number of site observation visits to "keep the Owner informed about the progress and quality of the portion of the Work completed" and that the Architect would "endeavor to guard the Owner against defects and deficiencies in the Work." The Architect was also to certify the amounts due to the Contractor.⁴¹ The Surety asserted that the Architect breached the terms of its Agreement by approving payment for work that the Architect knew did not comport to the plans and specifications, or which the Architect did not view. By not stopping payment until the Contractor remedied the issues, the Architect allowed the depletion of the contract funds and the construction of additional Work that it knew or easily could have known was defective. The Architect took the position that it was not required to

⁴¹ The Actual text of the two paragraphs in the Agreement was:

The Architect will provide a minimum of nine (9) site observation visits to 1) become generally familiar with and to keep the Owner informed about the progress and quality of the portion of the Work completed 2) to endeavor to guard the Owner against defects and deficiencies in the work, and 3) to determine in general if the Work is being performed in a manner indicating that the Work, when fully completed, will be in accordance with the Contract Documents. The Architect shall not be responsible for the Contractor's failure to perform the Work in accordance with the requirements of the Contract Documents.

The Architect shall review and certify the amounts due the Contractor and shall issue certificates in such amounts, however, the Architect shall not be required to make exhaustive or continuous on-site inspections to check the quality of the Work. The architect shall conduct observations to determine the date or dates of Substantial Completion and the date of final completion, shall receive from the Contractor and forward to the Owner, for the owner's review and records, written warranties and related documents required by the Contract Documents, and shall issue a final Certificate of Payment based on the final inspection indicating the Work complies with the requirements of the Contract Documents.

perform site inspections, nor to decline to certify payment applications, but rather to observe the general condition of the work and "endeavor to guard" the Owner.⁴² The Architect took the position that by advising the Owner of the problems it observed and by telling the Contractor that certain corrections to the Work needed to be made, that the Architect had fulfilled its contractual duties.

While granting authority to withhold payments to the Contractor under the Contract between the Owner and Contractor, the Architect was not specifically given that right or responsibility under the Agreement between the Owner and the Architect. The Surety, as assignee of the Owner, asserted that such actions were part of the "endeavor to guard" language and part of the Architect's general professional duties as well.

While the Agreement gave the Architect an argument that its duties were not all of those enumerated in the AIA documents, it also lacked some of the provisions that would normally protect the Architect. The Architect's Agreement also did not contain a waiver of consequential damages. While the Surety as assignee of the Owner, still had to address with the economic loss doctrine, there was no contractual provision preventing the Surety as assignee of the Owner from seeking to recover the Owner's lost profits, additional interest, and the Owner's attorney's fees and costs from the Architect for the damages arising from the Architect's improper certification of pay applications and failure to either properly inspect the work or advise the Owner of construction deficiencies.

The failure to use the AIA contract between the Owner and the Architect left open many questions regarding the duties and responsibilities between the parties. If the Architect did not have the duty to withhold payment for the defective work, then the Owner and the Surety would have to bear the loss for the improper payments to the Contractor. If, however, the Architect was found to have a responsibility to the Owner not to recommend payment for the non-conforming work, or that the Architect breached its duty to become generally familiar with the work and endeavor to protect the Owner, then the Architect faced the potential for the significant consequential damages suffered by the Owner.

Conclusion

While the AIA forms help reduce confusion as to the contractual rights and responsibilities of the various parties to a construction contract, certain clauses still generate confusion or are often misunderstood. Further, when non-AIA forms are utilized in conjunction with AIA forms, the possibilities for significant issues arise. It is critical, therefore, that the parties be aware of the interplay of the various Agreements on their construction projects.

⁴² Several cases have considered the "endeavor to guard" language in non-AIA contracts between the Owner and Architect. See *Mayberry Cafe, Inc. v. Glenmark Constr. Co., Inc.*, 879 N.E.2d 1162, (Ind. Ct. App. 2008) (Architect not liable for certifying payment applications for deficient work); *Liberty Mut. v. N. Picco & Sons*, No. 05 Civ. 217 (SCR), 2008 WL 190310 (S.D.N.Y. Jan. 16, 2008) (Architect's notification to the Owner of water infiltration and possibility of mold was sufficient to "endeavor to guard").

Biography of Thomas E. Crafton

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Thomas E. Crafton is a founding shareholder of Alber Crafton, PSC practicing primarily in the Louisville, Kentucky office. His practice focuses on fidelity and surety law, construction law, and commercial litigation. Thomas E. Crafton received his B.S. in 1972 from Western Kentucky University. He then attended the University Of Kentucky College Of Law and later received his J.D. from the Indiana University School of Law in Indianapolis.

Tom grew up in a construction family where he gained hands-on knowledge of residential and light commercial construction. Upon graduating from Western Kentucky, Tom began a career in the insurance industry where his primary emphasis was on construction-related damages and coverages. As a property and casualty claims adjuster, he attended construction school and developed skills as a construction damage estimator. As a contract surety claims supervisor and later as Assistant Vice President of two major sureties, he personally handled, supervised and offered litigation assistance in construction disputes of every conceivable nature, size and complexity.

Tom is licensed to practice in Kentucky and Ohio. He is admitted in U.S. District Court, Eastern and Western Districts of Kentucky, and Northern District of Florida and in the United States Courts of Appeals for the Sixth Circuit and Eleventh Circuit. Tom is a member of the American Bar Association, the American Bar Association Forum on the Construction Industry, the Fidelity & Surety Law Committee of the Tort and Insurance Practice Section of the American Bar (former Kentucky State Committee Chair), the Surety Claims Institute, the National Bond Claims Association, Northeast Surety and Fidelity Claims Conference, and Eastern Bond Claims Review.

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From 1996 to 1999, he served as an associate attorney working with his father at the law firm of Lanak & Hanna, P.C. in Santa Ana, California. In January 2000, he joined American Contractors Indemnity Company (ACIC) as the Director of Claims, and later that year he also assumed the position of Vice President. In 2002, he was given an additional position of General Counsel.

When HCC Insurance Holdings, Inc. acquired ACIC and formed HCC Surety Group, he was promoted to his present position, Senior Vice President – Claims. He currently manages and is responsible for HCC Surety Group's claims, subrogation and collateral departments. He also is responsible for HCC Credit's domestic and international trade credit insurance claims.

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