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**DESIGN PROFESSIONAL LIABILITY
TO THE SURETY**

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I. INTRODUCTION

After default is declared, the contractor terminated, and the investigation completed, the performance surety is frequently faced with claims based on two basic scenarios: (1) the work is not nearly as complete as it should have been, and, (2) the quality of the work is not as required by the contract documents. While such complaints and claims may result from an obligee's understandable desire to improve the quality of the construction project, it is also frequently the case that in fact, the bonded principal has been overpaid for shoddy work.

In such cases the surety may have the ability to recover all or some portion of its loss from the design professional. In today's construction environment, architects and engineers are increasingly called upon to referee disputes between owners and contractors and subcontractors, and to certify to owners that pay applications from contractors are in fact appropriate. When errors of judgment are made, and the contractor receives payment to which it was not entitled, is a design professional liable to the surety for the resulting loss? This paper examines the current state of the law in this regard in the southeast.

II. BARRIER TO RECOVERY – DEFENSE BASED UPON LACK OF PRIVITY

The surety rarely, if ever, has privity of contract with the architect or engineer on a project. On most projects, design professionals enter into contracts either with the owner or general contractor. Under such typical scenarios, the surety has no direct *contractual* cause of action against an architect or engineer for economic loss and damage that result from the design professional's failure to properly perform his or her obligations. Causes of action must be based on tort theories, such as negligence, which can often make recovery against design professionals more difficult.

A. Common Law Rule

Historically, liability of a design professional was limited to the parties with whom the design professional contracted through the legal doctrine known as privity. Economic losses generally were not recoverable in tort actions such as negligence unless the plaintiff suffered personal injury or property damage. For many years, the doctrine provided such effective protection that malpractice insurance for design professionals was rarely considered a necessity.

Although a growing number of courts have permitted negligence actions by contractors and sureties against design professionals for purely economic damages,

there are several policy reasons that are often offered in support of the economic loss limitation in tort claims:¹

- (1) The contracting parties, usually the owner and the design professional, are more assured of the enforceability of the benefits and burdens of the agreement that they negotiated. Therefore, a contractor or surety's attempts to obtain benefits by a tort claim, that could not have been obtained through contract negotiations or in a contract action, may be defeated;
- (2) There is less chance that the design professional will be placed in a position where there is a conflict of interest. Because the design professional is charged with the responsibility of trying to safeguard the owner against deficient and non-conforming work, the design professional's liability to the contractor, and perhaps the surety, should be limited; and
- (3) The economic damage limitation may minimize the potential for disproportionate damages. Consequential damages that are not contemplated by the parties at the time they enter their contract generally are not recoverable in a contract claim. However, all damages resulting from negligence, including consequential damages, may be sought in a claim based on a tort theory.

Although there were considerable differences in the laws from state to state, there was a general recognition among most jurisdictions that economic loss claims were subject to considerations that were different from bodily injury and property damage claims. Thus, most courts refused to recognize claims for purely economic damages where there was no contractual privity between the parties. Courts reasoned that "the line between physical injury to property and economic loss reflects the line of demarcation between tort theory and contract theory."²

B. Exceptions to the Common Law Rule

The jurisdictions that reject the economic loss rule and the requirement of privity generally rely on either the foreseeability of damages caused by the design professional or a misrepresentation theory expressed by Section 552 of the Restatement (Second) of Torts.

¹ Architect and Engineer Liability: Claims Against Design Professionals, (Third Edition), Sido, Kevin R., Aspen Publishers, Inc. 2006.

² *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

1. Foreseeability of Damages

One of the leading cases in which a court has imposed liability on a design professional for negligence where there was no privity is *United States v. Rogers & Rogers*.³ There, the court listed the following considerations for determining whether such liability exists:

- (a) The extent to which the transaction was intended to affect the third party;
- (b) The foreseeability of harm to the third party;
- (c) The degree of certainty that the third party suffered injury;
- (d) The closeness of the connection between the design professional's conduct and the third party's injury;
- (e) The moral blame attached to the design professional's conduct; and
- (f) The policy of preventing future harm.

The court's decision in *Rogers* was based in large part on the extensive power of the architect on that project.⁴ The court stated:

The power of the architect to stop the work alone is tantamount to a power of economic life or death over the contractor. It is only just that such authority, exercised in such a relationship, carry commensurate legal responsibility.⁵

It is important to note, however, that architects' responsibilities under standard AIA contracts have been greatly limited since the *Rogers* decision was issued.⁶

Another leading case is *A.R. Moyer, Inc. v. Graham*.⁷ There, the Florida Supreme Court considered whether a general contractor could assert a negligence claim against a supervising architect. The court held that:

³ 161 F.Supp. 132 (S.D. Cal. 1958).

⁴ Design Professionals' Liability for Negligent Design and Project Management, Martha Crandall Coleman, (Unpublished paper submitted at the ABA/TIPS Fidelity & Surety Law Committee annual midwinter meeting in New York, New York on January 24, 1997).

⁵ *Rogers*, 161 F.Supp. at 136.

⁶ See Fn. 4.

⁷ 285 So. 2d 397 (Fla. 1973).

a 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.⁸

Although the Florida Supreme Court later limited the *Moyer* decision to the facts of that case, other jurisdictions have continued to follow the rationale and holding of the case. The jurisdictions that have followed the *Rogers* and *Moyer* decisions have focused primarily on two concepts which both of these decisions addressed:

- (a) The professional nature of work that architects and engineers perform; and
- (b) The foreseeability of harm from the design professional's negligence.⁹

2. Restatement of Torts (Second) § 552

Several states have recognized a negligence action against design professionals based upon Section 552 of the Restatement (Second) of Torts which states, in part:

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

See, e.g., *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 677 P.2d 1292 (Ariz. 1984); *Malta Constr. Co. v. Henningson, Durham & Richardson, Inc.*, 694 F.Supp. 902 (N.D. Ga. 1988); *Wood Bros. Constr. Co. v. Simons-Eastern Co.*, 389 S.E.2d 19 (N.C. Ct. App. 1980).

⁸ *Id.* at 402.

⁹ See Fn. 4 at p. 4.

C. Survey of Southern Jurisdictions

Jurisdictions vary as to their approach to negligence claims against design professionals and their requirements for privity to recover economic damages. Some states firmly hold to the strict requirement for privity and do not allow anyone other than the client to assert a negligence claim against a design professional. Others have recognized negligence actions based upon one of the rationales discussed above.

Privity Required for Claims Against Design Professionals

(1) Florida

The Florida appellate courts have restricted tort liability for economic damages. In *AFM Corp. v. Southern Bell Tel. & Tel. Co.*,¹⁰ the Florida Supreme Court adopted the economic loss rule with regard to services, but in doing so did not specifically overrule the *Moyer* decision discussed above. Later, in *Casa Clara Condominium Assoc., Inc. v. Charley Toppino and Sons, Inc.*,¹¹ the same court limited *Moyer* to its facts.¹² Then the court held that the nexus between an owner and an engineering consultant hired by the architect was not sufficiently close to permit a tort claim against the engineering consultant.¹³ Finally, in 1996, the Florida appellate courts held that a general contractor may not maintain a negligence action against an architect with whom the general contractor has no privity.¹⁴ In *D.I.C.*, the court affirmed the trial court without any discussion of the privity issue, but the dissent argued that the contractor should have been able to maintain the claim pursuant to *Moyer*.

(2) Texas

Texas courts have held that design professionals can be sued for negligence only by the person or entity with whom the design professional has contracted.¹⁵

¹⁰ 515 So. 2d 180 (Fla. 1987).

¹¹ 620 So. 2d 1244 (Fla. 1993).

¹² See also *Spancrete Inc. v. Ronald E. Frazier & Assocs.*, 630 So. 2d 1197 (Fla. Dist. Ct. App. 1994).

¹³ *City of Tampa v. Thornton Tomasetti, P.C.*, 646 So. 2d 279 (Fla. Dist. Ct. App. 1994).

¹⁴ *D.I.C. Commercial Constr. Corp. v. Broward County*, 668 So. 2d 697 (Fla. Dist. Ct. App. 1996).

¹⁵ *Bernard Johnson, Inc. v. Continental Constructors, Inc.*, 630 S.W.2d 365 (Tex. Ct. App. 1982).

Privity Not Required to Assert Claims Against Design Professional

(1) Alabama

The Supreme Court of Alabama has held that a contractor is entitled to recover from an architect delay damages that arose from the architect's defective plans.¹⁶ In the *Berkel* case, an architect approved the installation of piles with a grout mixture that differed from that originally specified. After the 87 piles were installed, a load test confirmed that the substitute grout mixture was inadequate. The subcontractor that performed the work sued the architect for the cost of replacing the piles. The Supreme Court held that the subcontractor was entitled to argue that it reasonably relied on the architect's on-site activities, as described under the contract with the owner, and that the architect also had an independent duty to the subcontractor based upon the architect's actions at the project site. The Court held:

In deciding whether to impose a duty in a construction context, the trial court should analyze six factors: (1) the extent to which the transaction was intended to effect that other person; (2) the foreseeability of harm to him; (3) the degree of certainty that he suffered injury; (4) the closeness of the connection between the defendant's conduct and the injuries; (5) the moral blame attached to such conduct; and (6) the policy of preventing future harm.¹⁷

(2) Georgia

In *Robert & Co. Assocs. v. Rhodes-Haverty Partnership*,¹⁸ the Georgia Supreme Court held that a negligent engineer may be liable to a purchaser where the engineer knows that the prospective purchaser may rely on a report prepared by the engineer. The court based its decision on the foreseeability of the of the purchaser relying on the report. Georgia courts have also upheld liability under Section 552 of the Restatement (Second) of Torts for the negligent supply of false information when the third party justifiably relied on the information, but the court rejected a claim for liability based upon failure to supervise.¹⁹

¹⁶ *Berkel & Co. Contractors, Inc. v. Providence Hosp.*, 454 So. 2d 496 (Ala. 1984).

¹⁷ *Id.* at 502-03.

¹⁸ 300 S.E.2d. 503 (Ga. 1983).

¹⁹ *Malta Constr. Co. v. Henningson, Durham and Richardson, Inc.*, 694 F.Supp. 902 (N.D. Ga. 1988); *Wood Bros. Constr. Co. v. Simons-Eastern Co.*, 389 S.E.2d 382 (Ga. Ct. App. 1989).

(3) Louisiana

The Louisiana Court of Appeals has held that “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 architects’ expertise in providing adequate supervision, plans and specifications.”²⁰ Later, the same court applied the *Rogers* test to affirm an action against a design professional.²¹ See also comprehensive discussion below of *Calandra Development, Inc. v. R.M. Butler Contractors, Inc.*, Fn. 31 below, and *American Fidelity Fire Ins. Co. v. Pavia-Byrne Eng’n Corp.*, Fn. 32 below.

(4) Mississippi

Under Mississippi law, for a contractor to recover from a design professional on a tort claim, the contractor must show a breach by the design professional of its contract with the owner.²² See also comprehensive discussion below of *State ex rel. National Surety Corp. v. Mulvaney*, 72 So. 2d 424 (Miss. 1954).

(5) Tennessee

Tennessee courts have allowed negligence claims against design professionals under Section 552 of the Restatement (Second) of Torts where there is no privity between the plaintiff and the design professional.²³

III. LIABILITY OF THE DESIGN PROFESSIONAL TO THE SURETY

Subrogation substitutes the surety for an obligee or principal and creates in the surety the same rights as the obligee or principal before the surety discharges its obligations under its bonds. After payment of a loss, the surety is subrogated to the rights of the party whose loss was paid. In most cases this party is the owner, but the surety may also be subrogated to the rights of general contractors, subcontractors, suppliers, and others. As successor to those rights, the subrogated surety may proceed against other parties, such as architects and engineers, who may be liable for the loss that triggered liability for the surety.

²⁰ *Standard Roofing Co. v. Elliot Constr. Co.*, 535 So. 2d 870, 880 (La. Ct. App. 1988), writ denied, 537 So. 2d 1166 (La. 1989); See also *Gurtler, Hebert & Co. v. Weyland Machine Shop*, 405 So. 2d 660 (La. Ct. App. 1981).

²¹ *Colbert v. B.F. Carvin Constr. Co.*, 600 So. 2d 719 (La. Ct. App. 1992); writ denied, 604 So. 2d 1309 (La. 1992).

²² *Bagwell Coating, Inc. v. Middle South Energy, Inc.*, 797 F.2d 1298 (5th Cir. 1986).

²³ *John Martin Co. v. Morse/Diesel, Inc.*, 819 S.W.2d 428 (Tenn. 1991).

A. Premature Release of Retainage

Building contracts usually stipulate that the owner will retain a percentage of the contract balance until the principal's work is approved by the architect or engineer and the owner accepts the project. The retainage provides an incentive to the contractor to complete the contract to the satisfaction of the owner. Satisfactory completion usually requires that the general contractor pay all of its subcontractors and suppliers. Sureties are exposed to liability when the design professional authorizes retainage to be released to the principal and the principal has failed to pay in full its subcontractors and suppliers.

One of the leading cases that establishes liability of the design professional to the surety is *State ex rel. National Surety Corp. v. Mulvaney*.²⁴ There, the surety claimed that the architect negligently authorized the release of retainage to the contractor, thereby depriving the surety of funds that could have been used to complete the project. The architect had contractually agreed to supervise the construction of the building and to issue a certificate of completion authorizing the owner to release the retainage after final inspection and acceptance of the work. As the project neared completion, the architect had approved the disbursement of approximately 85% of the total contract price – the remainder was withheld for final payment. After the architect inspected the project, he advised the owner that the project was complete, with the exception of \$2,800 in punch list items, and the architect approved the release of all but \$2,800. The principal then advised the surety that he would be unable to pay more than \$17,000 in unpaid invoices for labor and materials.

The surety paid the unpaid subcontractors and suppliers and then obtained a written assignment of the claimants' rights against the principal. The surety then sued the architect for improperly authorizing the release of the retainage.

The Mississippi Supreme Court held that the retainage was for the mutual benefit of the owner and the surety and that the surety was entitled to recover the full amount of the retainage that the architect negligently released. Although the court did not discuss the absence of contractual privity, it held that:

[a] contractual relation between the architect and the surety was not a requisite to the existence of this duty. It arose out of the general contractual arrangements which contained mutually interdependent rights and obligations.²⁵

The *Mulvaney* court found that a design professional's liability can arise from either (1) express contractual language creating a duty, or (2) an undertaking by the design professional to perform services that may result in loss to the surety.

²⁴ 72 So. 2d 424 (Miss. 1954).

²⁵ 72 So. 2d at 431.

Similarly, in *Peerless Ins. Co. v. Cerny & Associates, Inc.*,²⁶ a federal court in Minnesota held that the agreement between the contractor and owner, as well as the bond furnished by the surety, subrogated the surety to the owner's rights against the architect for losses caused by the architect's negligence. The court stated:

[The] 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.²⁷

Privity of contract was not required because, the court reasoned:

[the] defendant-architect undertook the performance of professional conduct, which, if negligently performed, would obviously cause loss to the Owner and/or the plaintiff-surety. Under such circumstances, the law imposes upon the defendant a duty to exercise due care and avoid such loss. .

²⁸

B. Improper Certification of Progress Payments

Design professionals routinely certify the contractor's requests for progress payments. The purpose of the certification is to confirm that the contractor has not billed for more work than it has actually performed. If the design professional approves draw requests and allows the owner to prematurely release contract funds and overpay the defaulted contractor, then the overpayment may result in loss to the surety because the surety will be deprived of funds that could be used to complete the project.

In *Westerbold v. Carroll*,²⁹ an indemnitor of the surety sued the project architect for negligently failing to inspect the contractor's work and falsely certifying the value of the work performed and materials supplied by the contractor. After the trial court dismissed the claim, the Supreme Court of Missouri reversed the trial court, and in doing so analyzed the surety's rights to which the indemnitor was subrogated. The court followed *Mulvaney* and after thoroughly analyzing and rejecting the architect's privity defense, held that the retainage provision of the contract was for the benefit of the surety as well as the owner, and that in issuing the bond, the surety relied upon the inspection, supervision, and payment provisions of the contract.

²⁶ 199 F.Supp. 951 (D. Minn. 1961).

²⁷ *Id.* at 955.

²⁸ *Id.*

²⁹ 419 S.W.2d 73 (Mo. 1967).

Although the *Westerbold* court acknowledged that the architect and surety were not in privity, the relationship was so close “as to approach that of privity.”³⁰ The court reasoned that the architect knew of the surety’s involvement in the project and knew that the surety would likely be damaged by the improper certification of the contractor’s pay requests.

C. Negligent Inspection of Contractor’s Work

Courts have allowed sureties to sue design professionals for the negligent inspection of a contractor’s work. In *Calandra Development, Inc. v. R.M. Butler Contractors, Inc.*,³¹ a surety sued an engineer who was charged with supervising the design and construction of a subdivision for failing to adequately inspect the work in progress, failing to make a sufficient number of inspections, failing to be present when defective work was performed, and authorizing payment for defective work. The surety alleged that the bond was issued based upon the contract provision that required engineering supervision of the work. The surety also claimed that the engineer was aware of the surety’s reliance and owed the surety an independent duty, separate and apart from the duty owed to the owner, to adequately supervise the work to insure that the work was performed in conformance with the plans and specifications. The court held that the contract between the owner and contractor created duties for the engineer to the surety.

In *American Fidelity Fire Ins. Co. v. Pavia-Byrne Eng’n Corp.*,³² a surety successfully sued an engineer for failing to properly inspect the contractor’s work in accordance with the engineer’s contract with the owner and to properly calculate the estimated value of the completed work. The Louisiana Court of Appeals held that the engineer owed the same degree of care to both the owner and the surety by virtue of the engineer’s contract with the owner. The contract gave the engineer final authority over all disputes between the owner and contractor involving the quality of the work and the compensation for that work. The court held that the specific contract clause, combined with information obtained by the engineer during construction, required the engineer to verify facts that would have enable the owner to withhold payment of contract funds which could have been used to complete the project.

D. Failure to Require Correction of Defective Work

In *U.R.S. Co. v. Gulfport-Biloxi Regional Airport Auth.*,³³ an architect was found liable to the surety for negligently failing to require the contractor to correct defective

³⁰ *Id.* at 78.

³¹ 249 So. 2d 254 (Ct. App. La. 1971).

³² 393 So. 2d 830 (Ct. App. La. 1981).

³³ 544 So. 2d 824 (Miss. 1989).

work despite provisions in the architect's contract with the owner which stated that the architect was not responsible for the construction means, methods, techniques, sequences, or procedures. The surety recovered its cost of correcting the defective work.

IV. CONCLUSION

A compelling argument can be made that the design professional's duties extend directly to the surety, without regard to traditional concepts of privity and limitations imposed by the economic loss rule. Equally compelling arguments can be made by design professionals depending upon the facts of the case and applicable law in a given jurisdiction. As the law continues to evolve, the surety would be well advised to examine the role of the design professional in the planning and administration of any problematic project.