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A National Survey of Construction Design Professional Liability Trends

I. History of Professional Liability Standard and Evolution of Tort Liability

There have been several recent important decisions by courts across the country that continue to expand liability for architects, structural engineers, geotechnical engineers, and other design professionals in construction. Courts in certain jurisdictions have eroded the boundaries of liability for design professionals. The trend is to further throw open the doors to non-contractual claims and expand the tort liability across several different fronts. This includes further erosion of the economic loss doctrine, pushing the boundary of damages to allow recovery without physical injury or actual physical damage, expanding the duty to safeguard public safety, contorting errors into misrepresentations, and other areas courts have increased potential liability. This is a trend we will likely see continue and expand to many jurisdictions across the country.

Professional Liability Standard

To understand the recent decisions by courts expanding liability of design professionals, it is important to understand the core concepts of such liability. While the law across jurisdictions differs on the extent to which a design professional may owe a duty of care to third parties, it is clear this is an evolving area of law. Professional liability essentially means liability for any legally enforceable obligations that arise out of the performance of, or failure to perform, professional services by the design professional. Such claims can be based in contract or tort.

As the California Supreme Court stated:

The services of experts are sought because of their special skill. They have a duty to exercise the ordinary skill and competence of members of their profession, and a failure to discharge that duty will subject them to liability for negligence. On the other hand, those who hire such persons are not justified in expecting infallibility but can expect only reasonable care and competence. They purchased service, not insurance.

Gagne v. Bertran, 43 Cal. 2d 481, 275 P.2d 15 (1954).

Courts have expanded liability in tort, where no contract is required between the claimant and the design professional. When based in tort, a claim is generally rooted in the theory that the design professional failed to exercise the degree and level of care that society reasonably expects a prudent and careful design professional under similar circumstances would exercise (the professional standard of care). In other words, design professionals must carry out their work as prudently and carefully as other reasonable design professionals would have under the same or similar circumstances. The standard is not perfection.

The standard of care for design professionals can evolve as courts deal with different facts. Unlike with a contract claim, design professionals potentially owe a duty to any third-party where it is reasonably foreseeable that they may suffer damage if the design professional fails to act with the appropriate skill and care.

Economic Loss Rule

It has long been the case that purely economic damages cannot be recovered based solely on negligence or some other tort theory. Instead, one must have a contract to recover such damages. To sue in tort, there much be some bodily injury or property damage. The economic loss rule recognizes the differences between contract and tort remedies. The economic loss doctrine is recognized, in some form or another, in most all states. However, in construction design cases, the courts have evolved their application of the economic loss doctrine.

Even though design professionals on a construction project typically contract with only one party, many parties rely upon the plans, specifications, and other work performed. Yet, these parties do not have the ability to recover where the economic loss doctrine is strictly applied. Courts around the country have applied the rule in different way as a result of this, and other, realities, and the law continues to evolve.

II. Courts Continue to Expand Liability for Construction Design Professionals

Courts around the country have recently issued decisions that expand liability of design professionals in tort in several directions.

Washington State

The Washington Supreme Court retooled, if not abandoned, the economic loss doctrine in 2010, with the creation of the independent duty doctrine. *See Eastwood v. Horse Harbor Found., Inc*., 170 Wn.2d 380 at 389, 241 P.3d 1256 (2010). The court gave little in the way of specific guidance regarding when the core concepts of the economic loss rule would hold. The boundaries between contract and tort have been blurry ever since. The independent duty doctrine allows a tort claim where a duty in tort exists independently from the terms of a contract.

Like many states, design professionals in Washington have a common law tort duty to exercise reasonable care.

In recent years, Washington courts have expanded professional liability under the independent duty doctrine and increased the scope of remedies available. *Donatelli v. D.R. Strong Consulting Engineers, Inc.*, 312 P.3d 620 (2013). Design professionals are now potentially liable in tort even though they contracted to disclaim liability for economic damages. This means that a party who is not content with the contract it made need only allege that it relied on the act or representation of the design professional, even if it contradicts the contractual language, and can thereby get around the contract and sue for negligence or negligent misrepresentation.

More recently, in 2016, the Washington Supreme Court further expanded tort liability for design professionals. The court held that the engineer owed a duty to take reasonable care to design the building so as not to present any safety risks. *See Pointe at Westport Harbor Homeowners' Ass'n v. Eng'rs Nw., Inc.*, 193 Wash. App. 695 (2016). "Where an engineer's design services ultimately result in the construction of an unsound structure, the engineer has breached his duty of care." *Id*. Thus, no actual personal injury or property damage was required. The damage was solely the cost to repair defective construction. "Even where such safety risks do not cause consequential damage to persons or property, the risk itself constitutes an injury within the class of harm contemplated by a design professional's duty of care." *Id*. The engineer "owed an independent duty to the developer and to members of the HOA, as holders of property interests in [the condominium], to take reasonable care to design a building that did not present safety risks to its residents or their property." *Id*.

After the *Pointe* decision, a design professional's ability to limit liability for purely economic damages resulting from alleged design defects is markedly limited. This marks a significant erosion of the economic loss rule in Washington and gives way for more aggressive tort theories for homeowner with construction defect claims.

New York

New York law follows the economic loss rule, with some narrow exceptions. However, recent a New York Appellate Court decision has expanded liability of design professionals, allowing tort claims without personal injury or property damage, essentially allowing third-parties to recover for alleged construction defects without a contractual relationship. That case is D*ormitory Authority of the State of New York v. Samson Construction Co. and Perkins Eastman Architects P.C.*, 2016 WL 820960 27 N.Y.S.3d 114 (N.Y. App. Div. 2016). The New York high court heard oral argument in January 2018 and is set to issue its decision.

In D*ormitory*, the court held that an architect can be liable for pure economic loss when violations of a professional duty to the public result in "catastrophic consequences." The Dormitory Authority of the State of New York (DASNY) hired an architect to design a laboratory for New York City. During the project, neighboring buildings suffered damage from vibration and settlement. DASNY sued the architect in contract and tort for a failure perform a sufficient site investigation and for a faulty foundation design.

The court held that "the 'economic loss' doctrine does not apply to negligence claims arising out of a violation of a professional duty." *Id*. at 118. The majority determined that because the project was "so affected with the public interest that the failure to perform competently can have catastrophic consequences," and that "a catastrophe does not necessarily have to be a sudden event." As a result, it said, the architectural firm may be subject to tort liability as well as contractual liability. The significance of the contractual relationship between the parties was not fully explained.

California

California courts have established exceptions to the economic loss doctrine related to design professionals, but generally a contractual relationship and/or bodily injury or actual property damage, is required in order for a third-party to sue. However, recent decisions signal further widening of the exception. An exception related to residential construction was established in *Beacon Residential Community Ass'n v. Skidmore, Ownings & Merrill LLP*, 59 Cal.4th 568 (2014), where the California Supreme Court held that architects have a duty to third-party purchasers to design a building free of defects. *Id*. at 581.

By this holding, the California Supreme Court has opened the door for design professional liability to third parties for purely economic damages even where there is no contractual relationship and no property damage or bodily injuries. The Court did so even though Skidmore's agreement expressly disclaimed the existence of any "third-party beneficiary of the obligations contained in the Agreement."

In refusing to permit the architects to rely on a lack of privity defense, the court noted that "[t]he declining significance of privity has found its way into construction law."

Subsequently, a California federal court relied on the *Beacon* holding and signaled expansion of this exception beyond the residential context. In *Apex Directional Drilling, LLC v. SHN Consulting Eng'rs & Geologists, Inc*., 2015 U.S. Dist. LEXIS 105537 (N.D. Cal. Aug. 11, 2015), the United States District Court for the Northern District of California held that an engineer could be held liable for professional negligence for purely economic loss on a non-residential project. In *Apex*, in bidding the job, a contractor relied on the engineer's geotechnical report. Actual soil conditions differed from what was identified in the report. The contractor sued the engineer for breach of professional duty and negligent misrepresentation. The court held that, a contractor performing work on a municipal project could sue an engineer in tort for purely economic loss. The design professional's argument that it does not owe a duty of care to a contractor is no more.

Georgia

Georgia joins the list of states further eroding the protection of the economic loss doctrine by allowing claimants to avoid its application through a negligent misrepresentation claim. The Georgia Court of Appeals in *Atlantic Geoscience, Inc. v. Phoenix Development and Land Investment, LLC*, 341 Ga. App. 81 (2017) held that a design professional can by sued for negligent misrepresentation. The case involved an environmental engineer hired by a developer, and the engineer's report identifying an encroachment by adjacent landowner, without recommending further investigation. the developer relied on the

report and bought the property. The encroachment was actually a landfill and the developer could not development the property as planned. The project fell apart as a result and the developer sued the engineer for professional negligence, a tort-based claim. The engineer argued that Georgia's economic loss rule which provides that "a contracting party who suffers purely economic losses must seek its remedy in contract and not in tort" and that without personal injury or actual damage to property, the tort claim should be barred.

The appellant court held that "Georgia permits the recovery of certain types of economic losses in an action, such as this, where the plaintiff alleges professional negligence resulting in a misrepresentation." And that, "[t]his rule can apply to claims for professional malpractice in cases asserting that a professional made a misrepresentation in the breach of his or her professional duties."

The Court of Appeals disagreed and held that the allegation of misrepresentation by the engineer in failing to disclose the landfill in its report was sufficient to make this a case of negligent misrepresentation, avoiding application of the economic loss doctrine to bar the claim.

Other States

Courts in other states have refused to apply the economic loss doctrine to bar tort claims against design professionals. This includes Delaware, Montana, Pennsylvania, and Rhode Island.

III. Some Boundaries Holding, But How Strong?

The economic loss doctrine has held strong in some states, but even in those jurisdictions, there is some indication this will weaken.

Maryland's Highest Court recently signaled the continuation of the economic loss doctrine in construction cases under certain circumstances, by holding that the economic loss doctrine precluded a contractor from bringing a tort action against the designers for its purely economic losses. *Balfour Beatty Infrastructure, Inc. v Rummel Klepper & Kahl, LLP*, 2017 WL 701441, 4 (Md 2017), involved a large government project and a contractor that sued an engineer it was not in contract with. The contractor alleged economic damages stemming from negligent misrepresentations and deficiencies in the design prepared by the engineer. The court stated that:

> [W]e think the complex web of contracts that typically undergirds a public construction project should govern because parties have sufficient opportunity to protect themselves (and anticipate their liability) in negotiating these contracts.

Id. at 11.

In the context of a complex construction project with many sophisticated contracting parties, and considered allocation of risk, the economic loss doctrine clearly will hold in Maryland. However, the court did not go so far as to say that contractors cannot, under any circumstances, hold designer professionals liable for economic losses. Further, a footnote in the decision indicates this decision may have limited applicability, in noting that "other considerations may apply" to private projects. Whether

this leaves the door open for the expansion of liability for design professional in smaller and/or private projects remains to be seen.

IV. Other Trends that May Increase Design Professional Claims

In addition to the continued expansion of liability of design professionals, other realities may result in an increase of such claims.

Current Claim Trends

In 2018 we continue to experience a booming economy. Strong economic times equals more construction cranes and busy contractors and design professionals. With these conditions, we always have potential for and increased number of technical errors in design work. This can be due to the increased number of projects worked on, and/or the staffing of projects with less-experienced employees.

While we continue to see claim frequency holding steady, the severity of claims is rising. The highest level of claims involves: architects, geotechnical engineers, and structural engineers. Condominiums continue to be the project-type with the most frequent claims, followed by schools and hospitals.

Wrap Policies

Wrap policies have been used more frequently in the recent past, which brings an increased focus on risk transfer outside the wrap. This means design entities, which are typically outside the wrap policy, are targeted, giving rise to creative theories of design liability and the potential for further erosion of protection for design professionals by the courts.