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Indecent Exposure: The Erosion of Privity and Expanding Design Professional Liability

I. The Common-Law Rule and Requirement of Privity

At common law, a design professional's liability was limited to those parties with whom the design professional had a contract – claims by against design professionals brought by unrelated third parties with no contractual relationship with the design professional were barred in their entirety, whether such claims sounded in tort or contract (such as under a third-party beneficiary theory). To illustrate, while under the common law rule a design professional retained by a developer could face liability to the developer for breach of contract (or professional negligence) for the negligent preparation of design drawings, that design professional's liability was necessarily predicated upon the existence of contractual privity with the developer. Unrelated third parties not in contractual privity with the design professional – such as contractors who relied upon an architect's drawings when bidding a project, or homeowners injured as a result of an architect's allegedly deficient designs – could not state a claim against the design professional, as under the common law rule, the design professional had no duty of care to those parties, and those parties were not third-party beneficiaries to the design professional's contract.

Over the last several decades, courts around the country have weighed in on the issue, and most have protected the common-law doctrine requiring privity of contract. In *SME Industries, Inc. v. Thomason, Ventulett, Stainback and Associates, Inc.*, the Supreme Court of Utah affirmed the dismissal of a subcontractor's claims against a design professional, holding that the subcontractor could not get around the common-law requirement of privity by asserting a claim for negligent misrepresentation. 28 P.3d 669, 682 (Ut. 2001). The Supreme Courts of other states, such as Virginia and Washington, have decided the issue in similar fashion, and have upheld the dismissal of claims against design professionals brought by parties without privity of contract. *See Blake Construction Co. v. Alley*, 353 S.E.2d 724, 727 (Va. 1987); *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P.2d 986, 993 (Wa. 1994)

Over the last decade, however, a movement toward eroding the common law requirement of privity has begun, and courts are becoming increasingly amenable to allowing claims by unrelated third parties against design professionals to move forward. The most significant case to abolish the long-standing requirement of privity was the Supreme Court of California's recent decision in *Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP*, 327 P.2d 850 (2014). Should this trend continue, design professionals will likely face significantly increased exposure, as eliminating the common law requirement of privity of contract will expose design professionals to claims from unrelated third parties (parties with whom the design professional may have had no interaction, or authority to supervise). Additionally, eliminating the common-law requirement of privity will limit the design professional's ability to manage his or her risk through careful contract drafting and negotiation.

II. *Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP*

Less than four years ago, in a case of first impression, the Supreme Court of California completely upended the common-law requirement of privity, holding that an architect owed a duty to condominium unit owners. *Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP*, 327 P.2d 850 (2014). While *Beacon* is not the first recent decision to reject the common-law rule, it was one of the highest profile, as it came from the Supreme Court of California, and thus may herald a coming sea-change in the law.

Beacon – Rejection of the Common-Law Rule

In *Beacon*, a homeowners' association sued a developer and two architectural firms for alleged construction defects. 327 P.2d at 852-53. The two architectural firms were responsible for the principal design, both were also actively-involved during construction – both design professionals were involved in altering designs in the field, inspecting the work of the developer's subcontractors, and making recommendations to the developer to reject non-conforming work. *Id.* at 860. The developer offered units in the property for rent for two years after substantial completion, at which point the property was converted into condominium ownership. *Id.* at 852. Following transition of the property, the Homeowners' Association made complaints of water infiltration, structural cracks, and excessive solar heat gain, which it attributed to design deficiencies. *Id.* at 853.

The trial court granted a demurrer in favor of the design professionals, holding that as the scope of the design professionals' work on the project was merely to make recommendations to the developer, the design professionals owed no duty of care to future homeowners with whom there was no privity of contract. *Id.* at 853. The Court of Appeal reversed, holding the design professionals owed a common-law duty of care to the homeowners, and further held that California's Right to Repair Act, Ca. Civ. Code § 895 *et seq.*, demonstrated a legislative intent to impose a duty of care to future homeowners upon design professionals. *Id.*

Noting that "[t]he declining significance of privity has found its way into construction law," the Supreme Court of California swept away the requirement entirely, affirmed the Court

of Appeal, and established a new bright-line rule that greatly expanded the scope of exposure to design professionals operating in California. *Id.* at 854. Under the Supreme Court of California's holding in *Beacon*, the principal architect on a residential project owes a duty of care to future homeowners, even in situations where the architect does not take part in construction or exercise ultimate control over construction. *Id.* at 852.

Rejecting the design professionals' arguments that the absence of privity of contract foreclosed any duty to future homeowners, the Court held the design professionals indeed had a duty of care to the homeowners, as the their design drawings were intended to benefit those homeowners, and that it was foreseeable to the design professionals that plaintiffs would comprise the limited class of individuals harmed by the design professionals' work. *Id.* at 862. Significantly, the Supreme Court of California did not look to California's Right to Repair Act (as the Court of Appeal did) to find a legislative intent to demonstrate such a duty – according to the Supreme Court, the design professionals' duty to the future homeowners always existed – it was simply the common-law requirement of privity of contract (which the Court discarded) that had previously shielded design professionals from such claims (but would no longer).

Ultimately, under the Supreme Court of California's decision in *Beacon*, design professionals owe a duty of care to future homeowners, even in the absence of privity of contract, thus greatly increasing the exposure of design professionals.[1]

Other Jurisdictions and Cases Decided After *Beacon*

There is no indication (yet) that the Supreme Court of California's holding in *Beacon* will be adopted wholesale by other jurisdictions; since it was issued, no reported decision has cited *Beacon* for its central proposition. Troublingly, however, other courts – even in jurisdictions generally regarded as conservative, defense-oriented venues – have issued decisions with language that is uncomfortably close to the Supreme Court of California's decision in *Beacon*. Even courts in Texas – Texas, of all jurisdictions – seem to be open to eroding the common law rule and are showing a willingness to allow claims against design professionals by parties with no contractual relationship to the design professional.

Texas – *Black + Vernooy Architects v. Smith*

Around the time the Supreme Court of California issued its groundbreaking decision in *Beacon*, a Texas Court of Appeals held that an architect held no duty to a homeowner injured by the architect's design, and thus absent a contract between the architect and homeowner, the homeowner could not state a claim against the architect, suggesting that given the right set of facts, Courts in Texas might be open to eroding the common-law requirement of privity. *Black + Vernooy Architects v. Smith*, 346 S.W.3d 877 (Tex. Ct. Appeal, 2011).

In *Black + Vernooy*, plaintiffs asserted claims against an architect after sustaining serious injuries in a balcony collapse. *Id.* at 879. The trial court allowed plaintiffs' claims to go forward, and the architect was held responsible for a small fraction of the resulting jury verdict. *Id.* at

[1] It is worth noting that the Court's holding in Beacon is limited to design professionals serving as the principal architect on a project; presumably, subconsultants (or other design professionals who are subordinate to the architect of record) would have no such duty of care. *See Beacon*, 327 P.3d at 852.

880. The Court of Appeals reversed the trial court, holding that the architect had no common law duty to plaintiffs, and that plaintiffs were not third-party beneficiaries to the architect's contract with the owner. *Id.* at 884-86. Even in foreclosing the plaintiffs' claim against the architect, however, the Court of Appeals left an opening for future courts to find an exception to the common law rule, and to allow such claims to go forward. Specifically, the Court noted that the architect's contract with the owner explicitly stated that the architect had no control over the means or methods of the work, and that the contract specifically disavowed any intention to create any obligations toward third-party beneficiaries. *Id.* at 883-84. While noting that the architect was contractually obligated to report to the owner on the progress of construction, determine if the construction conformed to the contract documents, and even authorized the architect to inspect the work and reject any work that was deficient, the Court of Appeals nevertheless declined to "transform and extend the contractual duty owed to [the owner] into a common law duty owed to [the plaintiff]," an extension of law described by the Court of Appeals as "something that has never been done in the history of Texas jurisprudence." *Id.* at 881. Nevertheless, the Court of Appeals' decision left open the possibility that – under the right set of facts, such as when a design professional has the contractual authority to control a contractor's work – an injured plaintiff may be considered a third-party beneficiary to the architect's contract with the owner, thus giving rise to a contractual duty on the design professional's part. *Id.* at 891-92.

Texas – *Lan/STV v. Martin K. Elby Const. Co.*

Three years after the Texas Court of Appeals' decision in *Black + Vernooy*, however (and around the time the Supreme Court of California was issuing its decision in *Beacon*), the Supreme Court of Texas bolstered the common-law rule by reversing a jury verdict in favor of a contractor that had sought delay damages against an architect. *Lan/STV v. Martin K. Eby Construction Company, Inc.*, 435 S.W.3d 234 (Tex. 2014). While in *Lan/STV* the Supreme Court of Texas did not overturn the rule enunciated in *Black + Vernooy*, its decision may be an indication that – in Texas, at least – the trend toward abrogating the common-law requirement of privity has its limits, and that Courts may be unwilling to upend it in the manner of the Supreme Court of California in *Beacon*.

In *Lan/STV*, a contractor had bid (and had been awarded) a project with a public entity based upon the public entity's architect's designs. *Lan/STV v. Martin K. Eby Construction Company, Inc.*, 435 S.W.3d 234, 236 (Tex. 2014). The contractor alleged that during construction the architect's drawings were found to be replete with errors that necessitated the revision of approximately 80% of the architect's work, thereby causing the contractor to incur nearly $14 million in delay damages. *Id.* at 236-37. Despite the lack of contractual privity between the contractor and the architect, the trial court allowed the contractor's claim for negligent misrepresentation to go to the jury, resulting in a verdict in the contractor's favor. *Id.* at 237. After the Court of Appeals affirmed the trial court, the architect petitioned the Supreme Court of Texas for review, arguing that the contractor's claim was barred by the economic loss rule. *Id.*

Reversing the Court of Appeals, the Supreme Court of Texas noted that the economic loss rule precluded liability in tort for economic losses caused by the negligence of a party in its performance of a contract. *Id.* at 238. While noting that prior cases in Texas had carved out an exception to the economic loss rule for claims against other professionals, including attorneys, the Supreme Court of Texas declined to extend this exception to construction cases, and held

that absent privity of contract, the contractor had no claim against the architect for economic losses caused by the architect's work. *Id.* at 249-50.

Arizona – *Flagstaff Affordable Housing Limited Partnership v. Design Alliance, Inc.*

In 2010 (several years prior to the Supreme Court of California's decision in *Beacon*), the Arizona Supreme Court reaffirmed a prior Arizona case holding that design professionals owed duties to parties without privity of contract but relying upon the design professional's work (such as contractors), as well as for foreseeable injuries to foreseeable victims proximately caused by design professionals' negligence. *Flagstaff Affordable Housing Limited Partnership v. Design Alliance, Inc.*, 223 P.3d 664, 672-73 (Ariz. 2010) (citing *Donnelly Const. Co. v. Oberg/Hunt/Gilleland*, 677 P.2d 1292 (Az. 1984). Further, in *Flagstaff*, the Arizona Supreme Court held that while a lack of privity would not protect design professionals from claims by third-parties, any damages claimed by parties who were in privity of contract with a design professional would be limited to contractual remedies, under the economic loss rule. *Flagstaff*, 223 P.3d at 672.

III. The Implications of *Beacon* – What Does the Future Hold?

The California Supreme Court's decision in *Beacon* was groundbreaking not because it has established a significant following, or because jurisdictions around the country have accepted it wholeheartedly – it was groundbreaking by the ease in which the Court was able to sweep aside decades of precedent and establish a duty on the part of design professionals in the complete absence of contractual privity. With Texas and California (unsurprisingly) at opposite ends of the spectrum, courts around the country have come out somewhere in between, and have been finding various nuanced ways to get around the common-law requirement of privity.

Nevertheless, the Supreme Court of California's decision in *Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP* and the Texas Court of Appeals' decision in *Black + Vernooy Architects v. Smith* may herald a sea change in the law, and serve as an ominous warning to design professionals that the common law requirement of privity is in the process of being discarded, in favor of various theories that would expose design professionals to claims by unrelated parties, even in the absence of contractual privity.