I. Federal Design-Build Contracting

A. Authority – Clinger-Cohen Act of 1996, 41 U.S.C. § 235m, authorizes federal agencies to use design-build procurement. Each agency may have its own design-build criteria and procedures.

B. Bidding Process – Two-Phase Selection Procedure

1. Phase I – During the first phase, the agency does not consider cost in evaluating proposals.
   a) The agency prepares a scope of work that will be included in the solicitation. The scope of work must be sufficiently detailed so that bidders may determine the information required by the agencies in evaluating the proposals.
   b) During this phase, the agency considers the following factors when evaluating proposals:
      (1) Experience and technical competence,
      (2) Ability to perform, and
      (3) Past performance.

2. Phase II – Generally, the top five bidders from Phase I are selected to progress to Phase II.
   a) Bidders submit technical and pricing proposals.
   b) Best value
      (1) The agency’s goal is to achieve the best value for the project. Under the “best value” rubric, the agency does not have to choose the lowest bid.
      (2) If the agency determines that it will award the contract to a bidder who has not submitted the lowest cost or is not the most technically qualified, the government must engage in a “tradeoff process” which requires that the solicitation clearly list all evaluation factors that will affect contract performance, along with their relative importance.
The agency may also employ the “lowest price technically acceptable” approach. This approach is deemed acceptable when “best value” will result from selection of a technically acceptable proposal with the lowest price. The solicitation must specify which evaluation factors will establish acceptability.

II. State Design-Build Contracting

A. Currently, 42 states have authorized the use of design-build contracting for various types of projects. Only Alabama, Arkansas, Georgia, Indiana, Iowa, North Dakota, Rhode Island and Wyoming have not authorized the use of design-build.

B. California

1. California Government Code §§ 13332.19 and 14661, enacted in 1998, establish comprehensive design-build procedures for public works procurements. The state is authorized to use design-build procurement under the following conditions:

   a) There is legislative approval for the use of design-build on a particular project.

   b) The agency must prepare a program setting forth the scope of the project.

   c) The agency must establish a competitive prequalification and selection process. The following are the sole criteria that may be considered for prequalification:

      (1) Possession of required licenses.

      (2) Experience on similar projects.

      (3) Proposed project management plan demonstrating the ability of the design-builder to complete the project.

      (4) Financial, bonding and insurance information.

      (5) Evidence that the design-builder has not had a surety company finish work on any project within the last five years.

      (6) Information pertaining to OSHA violations, construction/design claims totaling more than $500,000, violations as an employer of federal or state law, convictions of submitting false claims in the last five years, and violations of Contractor’s State License Law.
(7) A declaration from the design-builder that it will comply with all other provisions of law applicable to the project.

d) The agency must select the design-builder according to one of the following methods:

(1) Selection based on performance, price, and other criteria set forth in the solicitation for proposals. The agency establishes technical criteria and methodology, including price, to evaluate proposals and includes these criteria in the request for proposal (RFP). The contract will be awarded to the proposal that is deemed to provide the best value in meeting the agency’s and the project’s objectives. This method is available for projects with approved budgets of $10 million or more.

(2) Selection based on performance, price, and other criteria set forth in the solicitation for proposals. The criteria employed in this method include, but are not limited to proposed design approach, life-cycle costs, project features and functions. The criteria must appear in the RFP. The contract shall be awarded to the proposal that offers the best value for the lowest price. This method is available for projects with approved budgets of $10 million or more.

(3) Design-build competition based upon program requirements and detailed scope of work. The contract shall be awarded to the lowest, responsible bid. This method may be used for projects with approved budgets of $250,000 or more.

e) Design-builder must comply with the Subletting and Subcontracting Fair Practices Act.

(1) Compliance with the statute can be problematic in design-build projects given that both the number and type of subcontractors are often unknown at the time of bidding.

(2) The state may identify the types of subcontractors by license classification that will be listed by the design-builder in the bid. The state will not identify more than five types of subcontractors.

(3) The design-builder may identify two subcontractor license classifications in addition to the five license classifications identified by the state.

(4) All subcontractors listed by the design-builder at the time of bid shall be afforded all of the protections of the Subletting and Subcontracting Fair Practices Act.

(5) All subcontracts that were not listed in the bid shall be competitively bid and awarded to the lowest responsive and responsible bidder.
f) The design-builder must be properly bonded.

2. University of California is authorized to employ design-build.

3. California State Universities are authorized to employ design-build.

4. Community College Districts are authorized to employ design-build.

5. School Districts have been authorized to employ design-build contracting.

6. Transit Operators have been authorized to employ design-build contracting.

7. Counties – The following counties have been authorized to employ design-build contracting:
   a) Alameda
   b) Contra Costa
   c) Sacramento
   d) Santa Clara
   e) Solano
   f) Sonoma
   g) Tulare

8. Charter cities may employ design-build contracting.

9. Recent legislation
   (a) SB 1759, enacted 9/26/2002, authorizes the cities of Brentwood, Hesperia, Vacaville and Woodland to enter into design-build contracts.
   (b) AB 1000, enacted 9/17/2002, authorizes community college districts to enter into design-build contracts.

III. Valuation – Design-builders are generally asked to formulate a bid price based on incomplete and imprecise concepts and designs.

A. Lump Sum/Fixed Fee

1. Under this pricing method, the owner knows what the project will cost very early in the construction process, which enables the owner to arrange funding and make other plans.
2. Owners often end up paying a premium to mitigate the contingencies faced by the design-builder that result from the incomplete nature of the project design at the time of bidding.

B. Cost-Plus/Guaranteed Maximum Price (GMP)

1. This method affords the owner and design-builder more flexibility and allows for much more input by the owner.

2. Any costs savings may be obviated by contingencies included by the design-builder in the GMP or deficiencies in the scope of the project definition.

3. This method allows owners to provide design-builders with incentives, in the form of a share in any cost savings, to finish the project ahead of schedule.

IV. Standard of Care

A. Traditional Risk Allocation – Traditionally, the parties to a design-bid-build project were held to the following standards:

1. Architects/Design Professionals – Liable to owner if shown to be negligent unless the design professional agrees to be held to a higher standard or warrants his work.

2. Contractors – Must build in compliance with the drawings and specifications. No liability for design problems.

3. Owners – Responsible for design defects through the implied warranty that attaches to the designs. See U.S. v. Spearin, 248 U.S. 132 (1918). Owners may also be liable to contractors for extra costs that result from design problems.

B. Design-Build Risk Allocation

1. The design-builder unites the performance and design standards of care that were traditionally divided among the owner, design professional and contractor.

2. Under a design-build contract, the design-builder assumes the responsibility of design, thereby relieving the owner of any liability under Spearin. However, if the owner supplies design-related information that is to be incorporated into the design or used in the bidding process, the owner may be held to have impliedly warranted that information.
V. Insurance

A. On design-bid-build projects, the parties generally carry the following insurance policies:


2. Architects/Design Professionals – Generally, coverage similar to the contractor with the addition of Professional Liability or Errors and Omissions (E&O) coverage.

B. The traditional method of insuring and bonding projects is not a viable option for design-build projects since the conventional methods do not address the particular risks that are inherent to the design-build process.

1. CGL policies leave design-builders with inadequate coverage because they contain exclusions for the following types of liability:

   a) Contractual liability – There would be no coverage where the contractor agrees to indemnify the design professional.

   b) Professional liability – There would be no coverage for liability arising from the design-builder’s design activities.

   c) Provide no coverage for damage to the contractor’s own work.

   d) Provide no coverage for increased completion costs, repair costs or consequential damages that result from a design error or omission.

2. Professional liability policies also do not provide a perfect solution for the design-builder.

   a) Generally, professional liability policies are claims-made policies, meaning a claim must be made during the policy period in order to be covered. Most design professionals carry job-specific, professional liability coverage only for the duration of the project. Often, claims for design-related liability will surface after the policy has expired leaving the design-builder without coverage. In order to more effectively utilize professional liability insurance and obviate the claims-made nature of the policies, design-builders should take the following actions in regard to their own and their design-builder partners’ policies:

      (1) Carefully examine the policies.

      (2) Require all members of the design-build team to obtain professional liability insurance for a specified number of years after completion of the project.
(3) Periodically ascertain that all members of the design-build team are maintaining coverage.

b) Often, design-builders will subcontract the design elements of the project. While the subcontracts usually require the subcontractors to carry professional liability insurance, reliance by the design-builder on a subcontractor’s insurance can often prove to be a mistake:

(1) The subcontractor may be uninsured or underinsured.

(2) The subcontractor may carry a policy that covers its entire practice rather than a job-specific policy. As such, the policy limits may be exhausted by other jobs in which the subcontractor is involved.

(3) Professional liability policies usually will not cover liability arising from either the design-builder’s own errors and omissions or the design-builder’s vicarious liability for managing the subcontractor.

C. Insurance Products That are Suited to Design-Build Projects – Given the inadequacy of more traditional insurance products and the growing number of design-build projects, insurers are developing new products specifically tailored to the risks associated with design-build projects.

1. Design-Build Professional Liability Insurance

   a) This form of coverage is not standardized so design-builders should compare policies from various insurers. Design-builders should negotiate terms that will provide the greatest amount of protection:

   (1) This should be the design-builder’s primary policy so that coverage is not contingent upon the exhaustion of other insurance policies.

   (2) Define the terms “design services” or “professional services” broadly so as to encompass all activities that design-builders perform.

   (3) Eliminate any provisions that exclude coverage for the methods, ways, means, systems, processes and safety duties of the design-builder.

   b) This form of insurance limits coverage to liability arising from professional negligence. Therefore, it does not provide coverage for liability stemming from warranty/guarantee or other contractual provisions that raise the standard of care.
c) There is also no coverage provided for liability based on faulty workmanship or failure to properly execute the design. In order to compensate for this, design-builders have to closely monitor quality control and hold subcontractors responsible for their faulty work.

d) Opt for a project-specific policy rather than a practice policy because project-specific policies offer the following advantages:

(1) Coverage may be broader.

(2) Ability to obtain extended period of coverage to address post-completion claims.

(3) Projects covered by the policy will be excluded from the practice coverage, thereby lowering the premium for the practice policy. This is advantageous for design professionals because owners often pay for the project-specific policy.

2. Owners/Contractors Protective Errors and Omissions Insurance

a) Owner

(1) This policy operates as a supplement to Professional Liability coverage. Provides coverage over the greater of the design-builder’s professional liability limits or the negotiated self-insurance retention.

(2) First party coverage

b) Contractor – Two forms of coverage available

(1) Coverage for damages that the design-builder is legally obligated to pay because of the professional negligence of the design-builder or its design subconsultant.

(a) Third party coverage.

(b) Usually has a deductible.

(2) Coverage for claims arising out of professional negligence of project architect/engineer.

(a) This policy operates as a supplement to Professional Liability coverage - Provides coverage over the greater of the design-builder’s professional liability limits or the negotiated self-insurance retention.

(b) First party coverage.
VI. Bonding

A. In the past, performance bonds for design-build projects were generally difficult to obtain. However, given that design-build projects are becoming more common, sureties are beginning to offer bonds tailored to the risks associated with design-build projects.

B. Design-build performance bonds cover design-related risks. In order to minimize their risks, sureties will often bond only those contractors with previous design-build experience. Additionally, sureties commonly require the design-builder to carry design-build liability insurance.

VII. Warranties/Performance Guarantees

A. Express Warranty

1. Contractors on design-bid-build contracts generally warrant their work for one year. However, design-build warranties may run for longer periods of time.

2. The warranty in AGC Standard Design-Build Contract Doc. 410 states:

   The Design-Builder warrants that all material and equipment furnished under the Construction Phase of the Agreement will be new unless otherwise specified, of good quality, in conformance with the Contract Documents, and free from defective workmanship and materials. Warranties shall commence on the Date of Substantial Completion of the Work or of a designated portion. The Design-Builder agrees to correct all construction performed under this Agreement which is defective in workmanship or materials within a period of one year from the Date of Substantial Completion or for such longer periods of time as may be set forth with respect to specific warranties required by the Contract Documents.

3. Breach of express warranty is the most common legal theory used by owners in actions against design-builders. It is especially easy for owners to assert such a claim within the context of objective performance specifications.

B. Implied Warranty – The design-builder can be found to have warranted the fitness of the project to serve the purpose for which it was intended.

C. Uniform Commercial Code

There is no uniform rule about the applicability of the UCC to construction services contracts. Some courts have refused to apply the UCC while others have applied the UCC by analogy. Still other courts have applied the UCC if the supply of goods represents the primary purpose of the contract or if the parties behaved as if the contract were one for the sale of goods with incidental services.
In Omaha Pollution Control Corp. v. Carver Greenfield Corp., 413 F. Supp. 1069 (D.Neb 1976), the court held that a contract for the design and construction of a sewage processing plant was a contract for the sale of a product. As such, the court ruled that the design-builder was liable for breaches of the UCC’s implied warranties of fitness and merchantability.

D. Defenses to Warranty Claims

1. Impossibility

   a) This defense does not generally offer an effective means for design-builders to avoid liability for breaches of express warranties.

   b) Several courts have found that design-builders have assumed the risk of impossibility.

   (1) In Colorado-Ute Electric Ass’n v. Envirotech, 524 F. Supp. 1152 (D.Colo. 1981), a contract to design and install a portion of an electric power plant contained performance guarantees requiring the design-builder to provide a unit that complied with state air quality standards. When the plant did not achieve those standards, the owner brought suit against the design-builder, which raised the defense of impossibility. The court rejected the design-builder’s defense, holding that it assumed the risk of impossibility by expressly warranting that it could build a compliant unit.

   (2) Similarly, in Aleutian Constructors v. United States, 24 Cl. Ct. 372 (1991), a contractor building a hangar and dormitory for the Air Force obtained the government’s permission to alter the roof design. When the roof was damaged by high winds, the contractor sued the government to obtain the costs of repair, claiming impossibility and defective design. The court rejected the contractor’s claim, holding that the contractor “created its own misfortune” and thereby assumed the risk of impossibility.

2. Owner Involvement

   a) Defective Information - If an owner provides information to the design-builder that is to be used in designing and building the project, the information will generally be considered to be warranted in the same manner as owner-provided information is in design-bid-build projects (Spearin doctrine).

   (1) The practice of providing such information is referred to as bridging.
(2) The use of bridging can destroy the advantage to an owner of having a single point of responsibility that is provided by design-build contracts.

(3) In M.A. Mortenson Co., ASBCA No. 39978, 93-3 BCA ¶ 26,189 (June 30, 1993), the Army Corps of Engineers (COE) supplied design criteria for a medical facility project. The COE informed bidders that the information could be used to prepare their bids. The contractor that was awarded the contract used the quantities for concrete and rebar contained in the COE design criteria to price its bid. When the final design was approved, the contractor submitted a claim for an equitable adjustment for increased quantities of concrete and rebar required to achieve the final design. The COE denied the claim on the grounds that the contractor had assumed the risk that extra quantities of materials might be required to complete the project since the contractor had entered into a fixed-price, design-build contract. The Armed Services Board of Contract Appeals, however, ruled in favor of the contractor, holding that the COE had not indicated that the contractors were to use the information that the COE had provided at the contractors’ risk. As such, the contractor was entitled to recover the costs of the additional concrete and rebar.

b) Interference - In Armour & Co. v. Scott, 360 F. Supp. 319 (W.D. Pa. 1972), the court found that the owner became so involved in the design process of a design-build project that it became a de facto partner of the design-builder. The owner modified the electrical and mechanical systems and increased the size of the plant. The owner and the design-builder sued one another in an attempt to recover the increased costs of constructing the plant. The court ruled that the owner’s conduct amounted to breach of contract. Since the court found that the design-builder also breached the contract, the court held that it was impossible to determine which party was responsible for the increased cost of construction. Consequently, the court did not award damages to either party.

E. Drafting to Avoid Warranty Problems

1. In drafting performance guarantees, the drafters must ensure that the contract clearly spells out the performance that the owner requires in order to create an enforceable guarantee. The design-builder also has an interest in making sure that the performance guarantees are clear and unambiguous in order to prevent the inference or implication of other guarantees.

a) Output and Consumption Guarantees – These forms of guarantees identify what owners expect from a portion of a project or from an entire project. As such, they should be as detailed as
possible. Examples of projects where a particular level of performance is important include refineries, electric power plants, waste-water treatment plants, and paper mills.

b) Compliance Guarantees – Compliance guarantees should not only state that the project must comply with all relevant laws and permits but should also ensure that the project will operate in compliance with the owner’s agreements with third parties concerning essential facility operations.

c) Completion Guarantees – These forms of guarantees should be treated differently in the design-build context than they are in the traditional design-bid-build context. As such, rather than being based on substantial completion, the design-build completion guarantee should define completion as the point in time when the project is able to perform according to its intended purpose.

2. Testing – The contract should also establish the method of determining whether the guarantees have been satisfied. As in the drafting of the guarantees, the testing provisions should be as specific as possible and should include the following determinations: who is to perform the tests, what standards should govern the testing, and the timing and duration of the testing.

3. Remedies – The design-build contract should expressly set out the remedy in the case of breach of warranty.

a) Reperformance

(1) For performance guarantees pertaining to discrete portions of a project, reperformance may provide the optimal remedy.

(2) However, in cases involving the guarantee of an entire project, reperformance may not be the most effective and efficient remedy. For example, the design-builder, through reperformance, may have to shoulder a burden that is wholly out of proportion to the owner’s injury.

b) Liquidated Damages – The typical design-build liquidated damage provision allows the contractor to attempt to repair with an option to cease the repair attempts and pay the liquidated damages.

4. Disclaimer/Waiver/Limitation of Liability

a) The inclusion of a detailed and explicit disclaimer may shield the design-builder from any liability for warranties that may be implied by courts.
b) The disclaimer should also contain a waiver by the owner of all other guarantees/warranties that were not expressly agreed to by the parties.

c) Reference to the applicable state law will be necessary to determine the validity of such provisions.

d) In California, such provisions will be upheld if they clearly and specifically shift the risk to the other party. See Wunderlich v. State, 65 Cal. 2d 777 (1967).

e) California Civil Code § 2782.5 allows parties to allocate, release, liquidate, exclude or limit any liability for design defects or of the promisee to the promisor arising out of or relating to the construction contract.

5. Insurance designed to address contractor's liability for breaches of performance guarantees.

a) Delayed Completion Insurance – Provides coverage for losses caused by one of the risks enumerated in the builder's risk policy.

b) Efficacy Insurance - Provides protection if the project does not meet the performance specifications. Some policies provide coverage for the owner's economic damage that result from the project's failure to perform.