A MOUNTAIN PEAK VIEW OF THE LEGAL RISKS ASSOCIATED WITH IPD CONTRACTS

By Stephen A. Hilger

Integrated Project Delivery, or "IPD," is taking the construction world by storm. It is another attempt at solving an age old problem: picking the right players who will all function together as a team. IPD attempts to deal with team selection in a way which gets away from the "forced marriage" approach of traditional design-bid-build project delivery where many team members simply look out for themselves. Once the team is established, the new challenge is putting the team together with a suitable written IPD contract.

Fueled largely by technological innovations such as Building Information Modeling, or "BIM," construction project teams are looking for ways to enlist greater collaboration in the entire construction process with early participation, trust, communication, input and cooperation from all of the key players. IPD attempts to couple that cooperation with a dynamic shift in thinking from "risk-shifting" contracts to "risk-sharing" environments.

Construction is no different than so many industries these days in that factors such as business climate changes, the economy, technological advances, and so many other factors are both forcing and enabling changes in how business is being done. IPD is facilitating such a change.

Much has been written about IPD in terms of what it is and what its benefits are. The purpose of this article is not to revisit all of those considerations, but rather to focus on a few of the primary legal challenges facing IPD participants. Here are some sentiments often heard or expressed relating to IPD contracts and some insight on their legal implications:

1. IPD contracts are new business formats with no legal precedent

Almost every article or discussion dealing in some way with the legal aspects of IPD contracts raises the sentiment that IPD contracts have not been tested in court which then elevates the legal risk to the IPD participants. While it is true that as of this date there is little, if any, case authority dealing with the legal merits of IPD contracts, that does not tell the whole story.

The first challenge to this sentiment is determining whether IPD contracts really are new. Those of us who were around in the early 1980's and remember the "partnering" agreements that were circulating along with other contract documents will recognize some of the "fluff" language in IPD contracts inserted in an obvious effort to engender a spirit of cooperation. The language is really not all that new, but the same enforceability issues prevail. What is new about IPD contracts is that they have risen along with BIM technology. New technology, by itself, is not reason enough to avoid a project delivery method.

The first corollary to the "new" sentiment is whether "new" is the essential equivalent of "bad." Contracts which are new and untested give most of the legal community a pit in their stomach because there are no legal authorities or precedent to

turn to in order to provide assurances as to legal risk assessment. However, the lack of judicial precedent on a particular subject matter will give a skilled and savvy attorney a clear slate to educate the judicial community on what the language means or should mean. Further, even though there may not be a long line of cases that lawyers can read to find the meaning of specific clauses in IPD contracts, we are dealing with contract law and we have well over 100 years of well-defined rules of contract interpretation to fall back on. While there may not be a lot of judicial history on IPD contracts, this may turn the unwary away and will create opportunity for innovative thinkers. This, in and of itself, is therefore not enough of a reason to avoid IPD contracts.

2. IPD contracts create new and previously un-assumed risk

This sentiment is true, in part. It is often said, and it has been expressed often in writing, that the players in an IPD contract will be assuming risk which they are not accustomed to undertaking. This is true for any contractor or subcontractor who has never before signed a design-build contract. This is also true of the design community who generally has never before assumed any role in means and methods. These are discussed below. The contractors in an IPD environment run the risk of assuming some design responsibility, and at a very minimum, the contracts are usually set up to share financial risk of the project which could, to some extent, include design deficiencies. In addition, contractors may, depending on the language of the contract, absorb liability for the design which they contribute to, and they also absorb the liability for the design contributions of their subcontractors. While most commentators and proponents of IPD seem to think that the problems associated with design will be discovered through the use of BIM, the sleeping dragon may very well be the overreliance on computer models without enough human input. So, there are new risks. They need to be managed just as they were when the design-build delivery method came onto the scene.

3. Loss of the Spearin Doctrine

The "Spearin Doctrine" is a time honored rule which comes from the United States Supreme Court's decision in *U.S. v Spearin*, 248 U.S. 132 (1918) adopted in some form by most states, which stands for the proposition that a contractor under a traditional design-bid-build contract can rely on the basic notion that the plans and specifications provided by the owner's design team are buildable. Then, if the design documents were not buildable, or if what was designed did not work or function the way the designers or owners intended, the contractor was exonerated from liability as long as the contractor built the project in accordance with those contract documents. With the advent of design-build construction, this principle disappeared as contractors were contracting to provide the design services. With IPD, the lines between design and construction are definitely blurred. While not as clear as with design-build, the contracting community risks losing the Spearin Doctrine defense in an IPD setting depending upon how the IPD contract is drafted and what specific input or design liability the contractor has undertaken for itself or its subcontractors. The sentiment that a contractor would lose the Spearin Doctrine is therefore true, in part. This loss is somewhat mitigated by the fact that contractors have already been operating without this protection under the design-build model.

4. Sharing in means and methods

In design-build construction, designers do not absorb means and methods responsibility because in theory, design and construction are provided through a single contracting entity. That may change with IPD contracts. Designers will likely absorb some of the financial risks of mistakes in means and methods simply because of the sharing in the overall profitability of the project. However, what is new is that depending on how the IPD contracts are drafted, designers may also absorb some liability for means and methods decisions based on their input just as a contractor may absorb liability for design. Again, the IPD boundary limits between design versus construction are blurred.

5. Loss of the Economic Loss Doctrine

The Economic Loss Doctrine is alive and well and living in most state court jurisdictions. The Economic Loss Doctrine is a legal defense which is typically raised by contractors to eliminate broad categories of tort-based claims and generally stands for the proposition that if two parties are joined together by contract, and there is a breach, the courts will follow the contract remedies, not the tort remedies, in the absence of (1) personal injury, (2) third party property damage, or (3) facts giving rise to the breach of a legal duty owed independently of the contract. The Economic Loss Doctrine is not generally applied to designers because courts view their liability as arising out of both the contract and the professional relationship. With the blurring lines between design and construction, the IPD relationship may subject contractors to an increased risk of tort liability where previously there was little or none. This could be a significant risk which needs to be addressed in the contract, as well as with suitable insurance.

6. IPD contracts contain "fluff" language

"Fluff" language is "feel-good" language. Some of the new language in an IPD contract is designed to inspire cooperation among the team members. One often-stated criticism of the IPD contracts is that they contain this "go team go" type language. Examples from actual IPD contracts include "members shall act as a team," members "affirm their commitment," members agree to "pursue the Owner's objectives," "using principles of value design," "collaborating with all members of the design team," agreeing to make "reliable promises," "promissor shall accept the reasonable legal consequences," the IPD members will "be expected to reasonably share information and actually promote harmony, collaboration and cooperation," and the like. This type of language crept into the IPD contracts by and large by designers and to some extent contractors, not by lawyers.

If the allegation is that the contracts are loaded with "fluff" language, then the response is guilty as charged, but only in part. Many homegrown IPD contracts began with a traditional platform where the "fluff" language was edited into the document. This fluff does not make the contracts unenforceable, but it does make portions of the contract difficult to enforce. Further, addition of the fluff language may make the clear and non-fluff language difficult to enforce. Courts are required to look at a contract as a whole. If

the entire document is clear and unambiguous, then the job of determining the intent of the parties is not always difficult. However, when you add in the fluff language, where performance may be difficult to measure, a court will have more difficulty interpreting what used to be clear and unambiguous because, to consider the contract as a whole, the fluff language will necessarily be included. This means the uncertainty factor applies not only to the new fluff language, but also to the provisions which have developed time-honored meanings. Fluff language is therefore a legitimate concern.

Another concern with fluff language is that it may create an ambiguity in the contract, that is, it may create a condition where a particular term or clause is susceptible to two legitimate meanings. With a time-honored and clear family of documents, this is much less of a concern. The general rule is that an ambiguity will be construed against the party who drafted the contract. This well-intended fluff language may therefore provide some very real and unintended consequences.

Some of the fluff language may not be needed. What many people do not know is that most contracts, in most jurisdictions, carry an implied covenant of good faith and fair dealing, regardless of whether or not such language is written in the contract. Some, but not all, of the fluff language which seeks to create this obligation of good faith and fair dealing, could be eliminated because it is already implied by law.

The solution to the problem with fluff language is really simple: get rid of it. Fluff language in an IPD contract is not needed to be successful. The key is in fairly drafting the obligations of the parties using concise terms.

7. Insufficient insurance products

Because of the blurring lines between design and construction, there are very few insurance products currently on the market which adequately address the needs of an IPD project. In relatively short order, however, insurance companies will likely see IPD as an emerging market and will offer products that adequately cover IPD risks. The jury is still out on the cost. All IPD participants should discuss insurance with their agents to maximize coverage benefits.

8. Impact on licensing

Issues associated with licensing are seldom discussed when it comes to IPD contracts. Each state has its own professional licensing requirements. Depending on what state you are in, this could be a huge problem. If, because of the nature and level of participation, a participant in an IPD contract is required to be licensed under the laws of the state where the project is located and it turns out the party is not licensed, there could be dire implications.

For example, in many states, performing what the state legislation considers "design" work when the party is not licensed could have both civil and criminal consequences. In some states, operating without a license when you are required to be licensed may be a felony. On the civil side, operating without a license when you are required to be licensed could mean: (1) the IPD contract is void, not voidable, (2) the defaulting parties are not entitled to be paid, (3) the defaulting parties may have to give

back what they have already been paid, and (4) the defaulting party may forfeit any construction lien rights. Obviously, these are huge consequences.

These consequences are more likely to affect a contractor who is contributing to the design than a designer who may have it easier when it comes to licensing compliance. The IPD contract therefore must be carefully drafted so that either the contractor is merely contributing design suggestions to the design team and the design team has ultimate design responsibility similar to most submittal and value engineering procedures, or the contractor had better be certain that it meets the licensing regulations. This is particularly true where a contractor assumes responsibility for a delegated design. The IPD contract must be clear on who has first-party liability for design, who is the "person in responsible charge," and how all that meshes together in the continuum of cooperation versus responsibility.

9. Third-party liability for design

Another major issue which does not appear to be getting much air time is third-party liability for defective design. For example, what if a hotel pedestrian bridge, designed and built under an IPD contract, collapsed causing personal injury and property damage? Under a traditional approach, if the contractor built it in accordance with the plans, the contractor may not be liable. If the design was sound and it was simply not built correctly, the design team may be off the hook. Under IPD, with various contributions and cooperation in the design process, the blurring IPD lines of responsibility may mean that both contractor and the design team will share culpability. What is even more compelling is that there may be gaps in the insurance coverage, meaning that both the contractor and the design team will have risks not covered by current insurance products.

Along these lines, in any third party negligence suit for personal injury or property damage, the issue always arises as to what the standard of care is. With IPD contracts, this remains an unanswered question.

10. Agreements not to sue IPD members

Some notable IPD contract platforms have a process where IPD members may not sue each other. This was a noble and creative idea no doubt originating from the parties, not their lawyers. However noble, it may have questionable enforceability. If a state statute imposed a law preventing parties from suing each other, it may be an unconstitutional denial of access to the court systems. While the constitution does not play a large role in private contracts, the theories carry over. These provisions may be viewed as a waiver of rights in advance, which are generally unenforceable. Courts may find these clauses invalid as against public policy, which is the contract version of unconstitutional. Further, if you look closely at many of the "no sue" provisions, they directly conflict with the default provisions. Also, some states have laws indicating that a party may not be required to waive lien rights in advance. These IPD "no sue" clauses have the same material effect. There is also a question about the impact these clauses have on waivers of subrogation. Some of these problems may be partially solved by

placing a limitation or cap on damages, with a reasonable basis for the cap, coupled with a waiver of consequential damages.

Some courts will enforce these no suit clauses. Some will not. It will depend on what court a party is in, what the laws of the jurisdiction are, how the clauses are written, and even possibly what the judge had for breakfast.

11. Ownership of documents

The design team typically owns the design documents unless the contract states otherwise. With the blurring of the lines between design and construction, it may not be completely clear who the "design team" is. Ownership and all other intellectual property rights should therefore be described in terms of the party rather than the role the party plays.

12. Impact on indemnity clauses

Indemnity clauses must be closely examined in every contract. In a very general and oversimplified way, indemnity provisions can be divided into three groups: door number one where the indemnitor indemnifies the indemnitee for everything including the indemnitee's sole negligence, which is known as broad form indemnity; door number two is the same as door number one except the indemnitor is not responsible for the indemnitee's sole negligence; and door number three where each party is responsible for their share of comparative fault. In most states, door number one is illegal and unenforceable. Most owners and contractors use door number two. Many of the commercially available families of documents use door number three.

With IPD contracts, the indemnity of choice for most, door number two, is no longer available. This is in part due to the no suit clause. This will all require a major transition in thinking for contractors in particular. Like so many of these issues, this issue is far more complex than what can be said in a short and simple article. The indemnity obligations are definitely worthy of very close scrutiny.

13. Business form

Another issue to consider with the IPD delivery method is simply how the participants are going to be doing business from a legal structure point of view. There are many possibilities. A single business entity could be created where all the IPD participants own a portion of the new company and have all of their rights, duties and obligations to each other spelled out in a joint operating agreement. Another option is for the parties to sign one joint agreement with the owner. There are families of documents already in place such as the AIA C195-2008 creating a single purpose entity ("SPE"), the AIA C196-2008 creating an agreement between the SPE and the Owner, and the AIA C197-2008 creating an agreement between the SPE and non-SPE members. The ConsensusDOCS 300 is another platform, as are multiple other public and private homegrown agreements. You may also be able to secure a copy of the agreements used for various notable IPD projects. Other possibilities include multiparty agreements, joint ventures, and limited liability companies. The possibilities are limited only by the creativity of the parties putting the deal together.

A word of caution, however, is in order. All of the IPD participants should have a complete understanding of what the negotiated business deal is first, then pick the business form. That is a much better approach than picking the business form and then trying to fit the square peg in the round hole.

14. Public procurement considerations

Design-build construction was often unsuccessfully challenged in the public arena when it first arrived on the scene. Many public owners understand the limitations of using an IPD contract on a project that must be publicly bid. Until the procurement codes change, public owners are likely going to continue to use the traditional contracts and the traditional approaches; although the language of the contracts will likely include more of the cooperation language, even if the parties are legally separate. It will be interesting to see if public owners will attempt an IPD project utilizing the public bidding statutes under a tri-party agreement between the owner, the design team, and the lowest bidding contractor.

These are only a few of the mountain peak points dealt with in a very general sense. The intent of this article is not to advocate for or against IPD contracts, but rather to point out some of the issues which need to be considered. As with any mountain range, when you cross it, there will likely be more mountains and more peaks. A risk-reward evaluation of any IPD contract must start with what the negotiated deal is, then follow with how to formalize that negotiated deal in writing. The "risk-sharing" notion of an IPD contract has worked in the past, and it will work in the future.

On a final note, parts of an IPD are new, particularly due to the technological advances in BIM. Do not let that scare you away. People at one time thought the world was flat until pioneering sailors went over the edge and returned. Christopher Columbus sailed to the "New World" even though what became North America had been inhabited by Native Americans for over 10,000 years. While parts of IPD are new, most of the parts are not. If you evaluate your risk and draft your contracts accordingly, the success in an IPD project may be very rewarding.

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