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Design and Construction Management Professional Reporter

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Inside this issue:

Note from the Editor

Donovan Hatem is pleased to present its Spring 2023 D&C Reporter. This past winter saw dramatic shifts in weather from day to day. Economic conditions have been equally unsettled and oftentimes defy prediction, but there is a wide array of public and private projects that occupy the industry.

This edition discusses recent cases on the statue of repose as it applies to design professionals in a variety of contexts, the economic loss doctrine, which can be used to bar certain claims for purely economic loss and largely impacts cases brought by parties with whom professionals are not in privity, successor liability of architects and assignment of design agreements.

These cases demonstrate that the law is constantly evolving and differs from state to state. That is why we continue to vigilantly monitor developments and keep our readers informed.

We hope you find these articles informative and helpful. If you have any questions or wish to discuss these articles or any issue impacting the design and construction industry, please reach out to us.

Best regards,

Steve Willig

The Assignment of a Design Agreement Must Be Carefully Drafted

By Gail Kelley

When contemplating entering into a design-build agreement for a Project, owners often contract with a design professional to provide various services for the Project before they enter into an agreement with the Design-Builder. Depending on what these services entail, the documents developed by the design professional may serve as the Basis of Design for the design-build agreement, or the Owner may assign the design professional's agreement, including the documents prepared under the agreement, to the Design-Builder. In this second case, failure to carefully draft the assignment provisions can lead to disputes over which party - the Owner or the Design-Builder - is liable for any alleged errors in the documents prepared under the agreement and consequently has the legal right to pursue professional liability claims against the design professional. The Connecticut Supreme Court's opinion in *Centerplan Construction v. City of Hartford*, 343 Conn. 368, 274 A.3d 51 highlights the problems that can arise when a contract does not clearly state the parties' intent with respect to the assignment.

The case involved a dispute over who was responsible for delays in construction of the Dunkin Donuts baseball stadium in Hartford, Connecticut. The dispositive issue in the appeal before the Court was whether the Project's Developer, DoNo Hartford, LLC (DoNo), and Design-Builder, Centerplan Construction Company, LLC (Centerplan) —"controlled" the architect and were therefore responsible for any errors and omissions in the stadium's design and thus any consequent delays. The Court concluded that the various agreements between the Owner (the City of Hartford) and DoNo and Centerplan (the plaintiffs) did not unambiguously establish who had legal control of the Architect during all relevant time periods and therefore remanded the case for a new trial.

THE VARIOUS AGREEMENTS

On August 29, 2014, the City entered into an agreement for the stadium's design with Pendulum Studios II, LLC, (the "Architect Agreement"). In February 2015, the City contracted with DoNo to serve as the developer for the stadium (the "Developer Agreement"); DoNo, in turn, contracted with Centerplan (the "Builder Agreement").

The Developer Agreement stated that DoNo would assume the City's rights and obligations under the Architect Agreement and that it was the parties' intention that DoNo "have complete control over the design and construction means and methods to be performed at the Project Facilities", subject to the City's approval. Likewise, the Builder Agreement provided that, subject to the City's rights with respect to direction or approvals of design, Centerplan would have "sole control and discretion over the design of the Project," including all aspects of management and administration of the design and construction of the Project.

In May 2015, the parties executed an assignment that assigned the Architect Agreement to the plaintiffs. It is this assignment that is one of the sources of dispute, as the City argued that the plaintiffs took control over the Architect (and assumed responsibility for any subsequent design errors) upon execution of the Developer Agreement and Builder

Agreement in February 2015. In contrast, the plaintiffs argued that they had no liability for any design errors and the May 2015 assignment was only a partial assignment as the recitals at the beginning of the Assignment noted that the design was complete by May 2015, leaving only construction administration services.

THE COURT'S RULING

The Court disagreed with both the City and the plaintiffs and held that the assignment unambiguously provided that the plaintiffs had legal control of the Architect and design upon execution of the Assignment, including responsibility for any design errors committed after that time. The Court noted that while the Architect might have completed certain parts of its design responsibilities, this did not alter the assignment language, which transferred all "representations, obligations, terms, and conditions" of the Architect Agreement —and control of and liability for the Architect—wholly to Centerplan. However, the Court held that the City retained responsibility for the Architect's errors and omissions until the execution of the Assignment, despite the language in the Developer and Builder agreements with respect to control over the Architect. The Court noted that while these two agreements were silent as to whether the parties intended for legal control of the Architect to be automatically assigned to the plaintiffs, the mere existence of the May 2015 assignment indicated that the transfer of control was conditioned on the parties entering into a separate assignment; that is, the Assignment would have been superfluous if the plaintiffs already had legal control of the Architect.

This did not completely resolve the parties' dispute with respect to control over the Architect, however. In December 2015, DoNo sent a notice of claim to the City, requesting a budget increase and time extension because of changes that the City and the baseball team had made to the design. To resolve DoNo's claim, DoNo and the City executed a term sheet that extended the substantial completion deadline, prevented any changes to the stadium's design without the City's consent, modified the liquidated damages provision in the Developer Agreement, and increased the contract amount. The extended substantial completion deadline was not attained, and on June 6, 2016, the City terminated both the Developer Agreement and the Builder Agreement.

In arguing over who was liable for design errors after execution of the term sheet, the plaintiffs claimed that the term sheet clearly and unambiguously gave the City exclusive control of the design. They pointed to the term sheet's provision that any new design changes to the Ballpark required the express written consent of the City and that such consent could be withheld in the City's sole and absolute discretion. The City, in turn, argued that the term sheet did not cede design control to the City as it did not allow the City to make changes to the design, it only allowed the City to withhold consent to changes sought by others. The City further argued that there was no reason for the plaintiffs to cede design control to the City, in light of the new substantial completion deadline in the term sheet.

The Court held that it was not unambiguous as a matter of law as to which party had legal responsibility for the Architect and the design under the term sheet. The Court noted that the language of the term sheet lent support to the City's interpretation that the plaintiffs retained control of the Architect and the design, as nothing in the term sheet explicitly provided that the plaintiffs ceded control back to the City, or that the City gained or received control. The Court also noted that the plaintiffs' December 2015 notices of claim complained that the City's delay in assigning the Architect Agreement meant the plaintiffs would be unable to finish the stadium on time, so it would be incongruous for the plaintiffs to transfer control back to the City.

However, the Court found that the plaintiffs' interpretation that the term sheet ceded legal control of the Architect and the design to the City was also reasonable. Specifically, the Court noted that under the Developer Agreement, change orders requested by the Developer were subject to the approval of the City and could be granted or denied in the City's sole discretion, but only if the change was a Material Change to the In Progress Project Plans. The term sheet, however, provided that the City must consent to any design changes, not just material changes. The use of this more expansive language suggests that, after the term sheet, the City gained additional control over the Architect and design. Given the circumstances leading to the term sheet—including the City's desire to achieve substantial completion by the revised deadline— the Court found that it is at least plausible, and perhaps logical, for the City to want greater control over the Architect and the design.

Finding that both parties' interpretations were reasonable, the Court remanded the case so that the trial court could determine who had legal responsibility for the Architect and the design from January 2016 (when the term sheet was executed) to June 2016 (when the Developer and Builder agreements were terminated).

FINAL THOUGHTS

While *Centerplan* dealt only with which party – the Owner or the Design-Builder – was liable for alleged errors and omissions in the Architect's design, transfer of a Design Agreement can also raise liability issues for the Design Professional. One such issue is exposure to professional

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liability claims from multiple claimants - e.g. Owner and Design-Builder – having divergent interests. During the period of time that its agreement is with the Owner, a Design Professional's duty of care is to the Owner. However, once the agreement is transferred to the Design-Builder, its duty of care is to the Design-Builder. The interests of the Owner and the Design-Builder may not be aligned and in providing services to the Design-Builder, the Design Professional may be required to find fault with services that it provided to the Owner. Furthermore, as the design process typically involves successive refinements to previous work, the Design Professional may be faced with potential liability to both the Owner and the Design-Builder for the same alleged errors or omissions.

In situations like this, the Design Professional should ensure that there is a properly drafted design transfer agreement that is signed by all relevant parties. The specific wording of the design transfer agreement will vary somewhat, depending on the project, but at a minimum, the Owner should assign all of its rights in the Design Agreement to the Design-Builder and the Design-Builder should agree to accept the assignment. The Owner should also agree to waive any claims it might have against the Design Professional relating to the Design Agreement. For its part, the Design Professional would need to waive any claims it might have against the Owner, including any claims for payment, other than those specifically listed. The Design Professional should also acknowledge that it is responsible to the Design-Builder for any negligent errors or omissions in its services, retroactive to the date its services commenced under the Design Agreement.

Massachusetts Superior Court Finds Injured Pedestrian's Claims Against Contractor Not Time-Barred, Despite Arising 6+ Years After Project Completion.

By Jena Richer

The Massachusetts Superior Court recently refused to dismiss a pedestrian's personal injury claim against a contractor, rejecting the contractor's argument that such claims should be time-barred under the Massachusetts

statute of repose in Lefta v. Signet Electronics, Inc., 2022 WL 16855617, at *1 (Mass. Sup. Ct.).

Lefta involved a pedestrian injured by a faulty door lock at a nursing home. Years before that incident, in October of 2010, the building owner for the nursing home entered into a $26.7M contract to construct an addition to an existing building ("the Project") with Pro Con Inc., as general contractor. In November of 2011, Pro Con subcontracted with Bristol Builders and Contractors, Inc. ("Bristol"). Pursuant to this subcontract, Bristol would be paid $750,000 to perform certain work including that associated with "doors and hardware." Specifically, this door-related work included installation of a particular model of electromagnetic door locks. Accordingly, sometime during 2012, Bristol installed approximately 25 Schlage electromagnetic locks for this Project. Bristol played no role in the electrical wiring of these locks, and the addition was substantially complete by August 2012.

In October 2014, Alfons Lefta was struck on the head by a falling metal component of an electromagnetic door lock while delivering medical supplies to the nursing home. Three years later, in August of 2017, Mr. Lefta and his wife and child ("the plaintiffs") filed a complaint for personal injuries and loss of spousal and parent consortium, respectively. The original complaint did not name Bristol as a defendant. Indeed, it was not until after Pro Con filed a third-party complaint in October of 2018 (naming Bristol as a third-party defendant in the action) that the plaintiffs named Bristol as a defendant through a second amended complaint in April of 2019. The issue brought before the Superior Court upon Bristol's motion for summary judgment was whether the causes of action brought in the second amended complaint are time-barred by the statute of repose (G.L. c. 260 § 2B). The Court found the claims are not barred and denied

Bristol's motion for summary judgment.

As applied to this case, the statute of repose precludes an "[a]ction of tort for damages arising out of any deficiency or neglect in the design, planning, construction, or general administration of an improvement to real property," unless it is commenced within six years of substantial completion of the improvement. G.L. c. 260 § 2B.

Thus, the issue before the Superior Court was two-fold: first, whether the Schlage electromagnetic locks fall within the purview of § 2B as "an improvement to real property," and second, whether Bristol's work likewise involved "the design, planning, construction or general administration" contemplated by the statute.

The Court first determined that the installation of the Schlage electromagnetic locks was indeed an "improvement." Though the text of § 2B did not define the term and the legislative history did not further elucidate its meaning, the Court looked at the Supreme Judicial Court's previous use of the word's dictionary definition: "a permanent addition to or betterment of real property that enhances its capital value and that involves the expenditure of labor or money and is designed to make the property more useful or valuable as distinguished from ordinary repairs." The Court had "little difficulty" in applying this definition to encompass the lock installation at issue.

It was then decided that no evidence had been put forth to substantiate that Bristol's services involved the requisite "design, planning, construction or general administration" to trigger 2B's protections. Specifically, the Court reasoned that section 2B protects "parties who render particularized services for the design and construction of particular improvements to particular pieces of real property." Two cases were particularly instructive in applying this distinction: Colomba v. Fulchini Plumbing, 58 Mass. App. Ct. 901 (2003), and the more recent Szulc v. Siciliano Plumbing & Heating, Inc., 99 Mass. App. Ct. 729 (2021).

Bristol, the Court reasoned, failed to provide any evidence that it did anything more than "merely install" the locks. Quite literally, the Court could only find one statement in Bristol's memorandum in support of its summary judgment motion that was relevant to this point. Unfortunately, that statement—"it is undisputed that the installation of the mag lock required some level of expertise to assemble and install"—lacked any citation, and the Court "could find no such evidence" upon its own review of the record. In light (at least one most favorable to the plaintiffs) of the fact that Bristol played no part in the electrical wiring of the locks after installation, the Court decided that a question of fact remained as to whether Bristol's services fell within those contemplated by section 2B and, accordingly, denied Bristol's motion for summary judgment.

Though the Court declined to apply the statute of repose to bar the claim, it is important to keep in mind the argument such was due to the lack of evidence to support the argument Bristol's work was in "design" or "construction." Thus, this case clearly outlines an analytical framework that contractors may use to oppose time-barred claims by injured persons in similar cases.

North Carolina Court Clarifies [1] Plaintiffs Have the Burden of Proving—not Pleading—That Their Claim Was Filed Within the Statute of Repose and [2] the Statute of Repose Commences on Substantial Completion for Each Contractor

In August 2022, the North Carolina Court of Appeals held that claims against an engineer and a subcontractor were improperly dismissed at the pleading stage where the plaintiff did not allege an act or date of substantial completion regarding the statute of repose in its complaint. *Gatson County Board of Education v. Shelco*, LLC, 877 S.E.2d 316 (N.C. Ct. App. 2022) concerned an action by the Gatson County Board of Education (the "Board") against Shelco, LLC (the "Contractor"), S&ME, Inc. (the "Engineer"), Boomerang Designs, P.A. (the "Architect"), and Campco Engineering, Inc. (the "Subcontractor") alleging that a retaining wall constructed as part of a high school construction project was defective. Construction of the retaining wall was completed in 2011, and the Board first became aware of the defects in 2012.

In May 2013, the Board, Contractor, and Architected signed a certificate of substantial completion whereby the

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Contractor and Architect represented that the entire project – including the retaining wall – was completed. The Engineer and Subcontractor did not sign the certificate. In 2018, the Board, Contractor, Engineer, Architect, and Subcontractor all signed a tolling agreement for the period of March 1, 2019, through September 15, 2020.

In November 2020, the Board commenced the action against all parties alleging that the retaining walls were defective. Each defendant moved to dismiss based on North Carolina's six-year statute of repose (Rule 12(b)(6)). The trial court granted the motion as to the claims against the Engineer and the Subcontractor, as neither party signed the certificate of substantial completion. The trial court denied the motion as to the claims against the Architect and Contractor, and ruled that the certificate of substantial completion, combined with the tolling agreement, established that the claims against the Contractor and the Architect were filed within the six-year statute of repose. The Board, Architect, and Contractor appealed.

North Carolina's statute of repose provides, "[n]o action to recover damages based upon or arising out of the defective or unsafe condition of an improvement to real property shall be brought more than six years from the later of [1] the specific last act or omission of the defendant giving rise to the cause of action or [2] substantial completion of the improvement . . . or specified area or portion thereof (in accordance with the contract[.]" *Gatson*, 877 S.E.2d at 319.

While the plaintiff has the ultimate burden of proving that a statute of repose does not defeat a claim, that burden does not apply at the pleading stage.

Unlike a motion for summary judgment which will take account of evidence, a Rule 12(b)(6) motion to dismiss is limited to a review of the allegations of the complaint. Therefore, such motion may succeed, in this context, only where a complaint on its face shows its claims are outside the statute of repose period.

On appeal in Gatson, the Subcontractor and Engineer argued that the Board's allegation that the retaining wall was completed in 2011 constituted the act of substantial completion under the statute of repose. The Court of Appeals emphasized that while North Carolina courts have not interpreted "substantial completion" with respect to a project that has several components, the plain language of the statute suggested that when a contractor completes its part of the project, the project is substantially complete as to that contractor. *See Lawrence v. General Panel*, 822 S.E.2d 800 (S.C. 2019).

Applying that standard to this case, the Court noted that the Board contracted with the Engineer not just to provide services relating to the retaining wall, but "to provide geotechnical engineering service for the Project." Further, the Board did not allege when the entire project was substantially completed, and the Engineer did not sign the certificate of substantial completion. Thus, the Court reasoned that there is no indication from the face of the complaint that the Engineer was responsible for a specific portion of the project work or that it completed this portion outside the statute of repose.

As to the Subcontractor, the Board alleged that Subcontractor was the civil engineering subcontractor to the Architect, whose services were not limited to the retaining wall. Just as the Engineer, the Subcontractor did not sign the certificate of substantial completion. Thus, there is no definitive allegation indicating that the Subcontractor's only work on the project was the retaining wall and that it completed this work outside the statute of repose.

This ruling demonstrates why it is important to ensure a dismissal motion has the proper foundation in the complaint upon which the Court can rule. In this instance, without sufficient allegations relating to the date of substantial completion, the motion could not succeed, and a summary judgment notion , at a later time upon submission of evidence, would have been a better course of action.

Federal Court in South Florida: Original Architect Liable for Design Flaws in Original Plans Despite Appointment of Successor Architect

By Allison K. Jones

The Unites States District Court for the Southern District Court of Florida issued an opinion in *Hotels of Deerfield, LLC et al. v. Studio 78, LLC et al.*, (2022 WL 731944 (S.D. Fla., Mar. 11, 2022) (Singhal, J.) holding a project's original architect responsible for design flaws in his drawings, even though he had been replaced by a successor architect. This was the case even though the building was constructed solely based on the successor architect's design and specifications.[1]

This case involved the design of a new $10 million Fairfield Inn & Suites Hotel ("Fairfield") project in Deerfield Beach, Florida. In 2017, Fairfield retained Studio 78, LLC to provide architectural and engineering services and serve as the Architect of Record for the project. Studio 78 submitted its preliminary architectural designs but, six months into the project, Fairfield was so dissatisfied with the design that it replaced Studio 78 with a new design team to complete the hotel's design. Construction was delayed and Fairfield filed suit against Studio 78 and its principal architect in early 2018, alleging Studio 78's design was untimely, incomplete, flawed, and did not meet Florida Building Code. Studio 78's plans were never completed or submitted for permitting. The successor architect redesigned the entire project from the beginning without using or relying on any of the previous design work from Studio 78. The hotel was ultimately built to the successor's drawings and specifications only and did not contain any of Studio 78's original design.

Studio 78's main defense in the litigation was Rule 61G1-18.002 of the Florida Administrative Code:

> (1) A successor registered architect seeking to reuse already sealed contract documents under the successor registered architect's seal must be able to document and produce upon request evidence that he has in fact recreated all the work done by the original registered architect. Further, the successor registered architect must take all professional and legal responsibility for the documents which he sealed and signed and can in no way exempt himself from such full responsibility.

All state architectural regulations and the National Council of Architectural Registration Boards require a subsequent architect to check, remeasure, and integrate all prior work into the successor architect's original submission and to keep written substantiation of the design process as if the architect had rethought and redrawn the entire design. The architect shall not seal drawings, specifications, reports or other professional work which was not prepared by or under the responsible control of the architect. States differ on what level of rework and redrawing is required of a successor architect, so strict attention must be paid to the applicable state's current regulations. To the extent a successor architect signs and seals original drawings prepared by a prior architect, those documents must be treated as though they are the successor architect's original work.

Despite the express language in the Florida regulation, purportedly transferring full professional responsibility and legal liability to the successor architect, the Florida Court in Hotels of Deerfield found that the prior architect was equally responsible for the plans he had drawn, and liability had not transferred with the transfer of the design responsibility. This was regardless of the fact that the drawings utilized, and the hotel that was constructed, in no way resembled the prior architect's design. Studio 78 and its principal eventually settled the case

Only a handful of states have specific regulations about successor design professionals[2], but caution must be employed to not rely solely on these regulations for protection against liability. Even with such a regulation, the Florida Court still found that the prior architect was liable for his design flaws. Each set of stamped or sealed drawings is considered each separate architect's copyrighted, original work.

The first and best line of defense is a well-drafted contract. That writing should spell out the liabilities and risks retained if a new architect is commissioned to replace the original on the project. These terms can be easily added to the AIA prime design contracts or any other base contracts that may be utilized.

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1. *This decision extends the ruling in an earlier Florida state case, Villanueva v. Reynolds, Smith and Hills, Inc., that held original engineers who were replaced by successor professionals were still liable for their design flaws on a project. Villanueva, 159 So. 3d 200 (Fla. Dist. Ct. App. 2015).*
2. *Note that some of these regulations occur in a state's or municipality's Building Code or Ordinances.*

The Economic Loss Doctrine's Relevance To Construction Cases And Recent Application In Arizona And North Carolina

By Jessica Scarbrough

INTRODUCTION

Understanding and calculating damages that may be recoverable is an essential element in any claim or lawsuit, as such informs on how to defend and how to work toward a resolution. This is especially relevant in construction litigation where damages can be large and accrue over a sustained period of time. Of equal import is knowing what is not recoverable. The economic loss doctrine ("ELD") is one limitation on recoverable damages that will often apply to construction cases. Its meaning and application are also in flux.

A majority of jurisdictions have adopted some form of the ELD; however, interpretation and application of the ELD vary widely. Case in point, the highest courts in both Arizona and North Carolina recently addressed the ELD and did so in distinct ways. This article serves to review and analyze the implications of the recent Arizona and North Carolina decisions, with special attention paid to how their holdings impact contractors and subcontractors for commercial construction projects.

WHAT IS THE ECONOMIC LOSS DOCTRINE?

There is no uniform definition, but broadly speaking the ELD is a prohibition of recovery in tort (i.e., a claim for negligence) for purely economic losses. Such losses are generally limited to a claim in contract. A threshold question when evaluating the applicability of the ELD is whether the alleged damages arose out of conduct that is fundamentally tortious or contractual in nature. Said differently, the ELD does not permit recovery from another's allegedly tortious conduct where the alleged damages are not for physical injury or property damage (in other words, injury to property or person is not considered economic loss). Consequently, economic losses (e.g., delay damages, cost to redesign, etc.) are not recoverable in most instances if there is no contractual privity.

While seemingly simple on its face, the ELD has been complicated by differing judicial interpretations in many states and modern project delivery methods which can blur the lines of contractual privity. Thus, an important baseline question, especially as it applies to construction and design professionals, is whether contractual privity exists with whoever is asserting the claim.

ARIZONA

Decided on May 23, 2022, by the Supreme Court of Arizona, *Cal-Am Properties Inc. v. Edais Engineering Inc.* held that design professionals are not liable to third-parties with whom there is no contractual privity for purely economic losses. *See generally Cal-Am Properties Inc. v. Edais Engineering Inc.*, 509 P.3d 386 (Ariz. 2022). Though never expressly stated in the opinion, the legal reasoning employed in the Cal-Am case rested on the principles of the ELD.

FACTS

Cal-Am Properties Inc. ("Cal-Am") was a developer of RV and mobile-home parks. In 2014, Cal-Am leased an RV resort in Arizona (the "Property"), intending to construct a banquet and concert hall on the premises (the "Project"). The owner of the Property funded, and Cal-Am managed. the Project. Cal-Am hired a contractor, VB Nickle, to design and construct the hall. VB Nickle hired Edais Engineering, Inc. ("Edais") as a subcontractor to survey the Property and mark the permitted location of the hall. Cal-Am and Edais did not have contractual privity. Edais conceded that it erred in placement of the markers for the location of the hall, and Cal-Am sued Edais for various claims, including negligence.

Edais successfully moved for summary judgment on the grounds that Cal-Am's damages were purely economic, and Edais did not owe a duty to Cal-Am. The Court of Appeals affirmed the trial court's decision and the Supreme Court of Arizona granted review to "reexamine" its holding from a 1984 case, *Donnelly Construction Company v. Oberg/Hunt/Gilleland*, that allowed design professionals to be held liable to third parties who suffered purely economic damages resulting from foreseeable harm following professional negligence. *See generally Donnelly Construction Company v. Oberg/Hunt/Gilleland*, 677 P.2d 1292 (Ariz. 1984).

CAL-AM DECISION

The Arizona Court summarized its prior holdings in *Donnelly* and explained that in a 2007 decision, *Gipson v. Kasey*, it held that Arizona courts should not consider foreseeability as a factor when making determinations of duty. *See generally Gipson v. Kasey*, 150 P.3d 228 (Ariz. 2007). The Court stated that its prior holdings in *Donnelly* had been repeatedly rejected since *Gipson*, but that, in rejecting *Donnelly*, it had not foreclosed the possibility that a duty may exist between design professionals and those not in privity with them.

Utilizing a post-*Gipson* framework, the Arizona Court explained that duties are based on special relationships or public policy. In Arizona, special relationships are what give rise to a duty in negligence and/or relationships recognized under contract law. The Court stated that a special relationship required a "preexisting, recognized relationship between the parties," and that was not present between Cal-Am and Edais simply because Cal-Am was the project owner and Edais a subcontractor who worked on the Project. Unequivocally, the Court wrote that "Arizona has yet to recognize the relationship between a design professional and an owner as a categorical special relationship. We decline to do so now."

Further, the Court held that "although liability for a joint undertaking may exist despite a lack of privity" between Cal-Am and Edais, that concept would require Edais' conduct to have been undertaken directly with or for Cal-Am. However, the Court explained that no such liability would exist where parts of an overall enterprise were organized by another entity. Ultimately, the Court held that because Edais' actions were with and for VB Nickle there was no special relationship between Cal-Am and Edais.

The Court also examined Arizona's public policy framework, similarly holding that public policy was not implicated as a result of Cal-Am suffering a purely economic injury. In Arizona, a duty based on public policy is created by state statutes and, to a lesser extent, the state's common law. For an Arizona statute to create a duty based on public policy, the plaintiff must be "within the class of persons to be protected by the statute," and the harm must be of the type "the statute sought to protect against."

The Court ruled that state statutes and administrative regulations governing qualification and minimum standards for design professionals did not support recognizing a special relationship. The purpose of the statutes and regulations governing design professionals was not to protect project owners like Cal-Am from economic harm, but rather, to protect the safety, health, and welfare of individuals who would enter the buildings and structures, by preventing injuries resulting from poor workmanship.

The Court concluded its decision, writing:

> Our holding does not render Cal-Am or similarly situated plaintiffs devoid of a remedy. In general, when a project owner is economically harmed due to a subcontractor's negligence, it 'is viewed just as a failure in the performance of [the subcontractor's obligations] to its contractual partner, not as a breach of duty in tort to...the owner of the project.' Restatement (Third) § 6 cmt. b. The remedies available to the project owner sound in contract, not tort. For example, in a case of a subcontractor's defective workmanship, as here, the project owner could sue the general contractor it hired for breach of contract and, perhaps the subcontractor for breach of contract as a third-party beneficiary... or obtain an assignment of liability from the contractor.

TAKEAWAYS FOR DESIGN PROFESSIONALS

The Court in Arizona has clarified design professionals' responsibilities toward other parties where there is no privity. However, it must be noted Arizona permits parties to contract out the ELD at the time they negotiate project contracts. Care must be taken in reviewing contracts to be sure this important protection is not impacted.

NORTH CAROLINA

North Carolina jurisprudence has taken a different approach to the ELD, finding that lack of contractual privity is immaterial to the application of the ELD. The Court in *Crescent University City Venture, LLC v. Trussway Manufacturing, Inc.*, 852 S.E.2d 98 (N.C. 2020), held that a negligence claim against a product manufacturer was precluded by the ELD, even though there was no contractual privity between the owner and manufacturer. This holding has since been distinguished by federal district court opinions and an additional North Carolina Supreme Court decision.

FACTS

Crescent University City Venture, LLC ("Crescent") was the owner and developer of an initiative to build and lease several student apartment buildings (the "Project") near the campus of the University of North Carolina at Charlotte (the "Property"). In 2012, Crescent entered into a contract with a general contractor to construct the Project. The general contractor entered into a variety of agreements with subcontractors to facilitate the construction, including a subcontract with Madison Construction Group, Inc. ("Madison"). Madison was responsible for the provision and installation of wood framing for the Project.

Madison executed a purchase order with Trussway Manufacturing, Inc. ("Trussway") for trusses. The purchase order included the Project specifications for the trusses needed and an express warranty. Construction was completed and ceilings thereafter began to crack and sag.

An investigation was conducted, and it was determined that there were "systemic and pervasive" floor-truss defects throughout the Project. Crescent and the general contractor disagreed on how to conduct repairs. As a result, Crescent developed a repair plan with the engineering firm it had hired to investigate the Project.

Litigation ensued among the general contractor, Crescent the general contractor's parent company and Trussway. Trussway filed a motion for summary judgment, alleging that Crescent's negligence claims against it were barred by the ELD. The Business Court agreed with Trussway, dismissing Crescent's negligence claim and applying the ELD "irrespective of the existence or lack of a contractual relationship between Crescent and Trussway".

CRESCENT DECISION

On appeal, the North Carolina Supreme Court began by stating that when applying the ELD, North Carolina courts have long refused to recognize breach of contract claims disguised as negligence claims Adopted by the Court in *N.C. State Ports Authority v. Lloyd A. Fry Roofing Co.*, the ELD bars recovery in tort by a plaintiff against a promisor for the simple failure to perform the contract, even if such failure was a result of negligence or lack of skill.

Analyzing and applying precedent from the U.S. Supreme Court, the North Carolina Supreme Court focused on the purpose of the ELD, citing *East River S.S. Corp. v. Transamerica Delaval, Inc.*, when writing that the ELD served to prevent contract law from drowning in a sea of tort. *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986).

Crescent argued that the application of the ELD hinged on the existence of a contract between parties; however, the North Carolina Court rejected that premise. Instead, it reasoned that Crescent's position was in conflict with the Court's decision in *Ports Authority*, highlighting that the decision was specific to the commercial-development context. The North Carolina Court found that:

> The lack of privity in the commercial context between a developer and a subcontractor, supplier, consultant, or other third party—the potential existence of which is readily known and assimilated in sophisticated construction contracts—is immaterial to the application of the economic loss rule.

The *Crescent* Court took care to differentiate and emphasize the importance of the commercial relationship(s) between the parties, citing policy considerations when applying the ELD to private residences and/or homeowners. The Court reasoned that there are different considerations between the type of entities involved, as homeowners are often less sophisticated or knowledgeable while investing in homes. However, given that Crescent, Trussway, and the other relevant entities were all sophisticated, commercial parties, the North Carolina Court took a different approach toward Crescent's negligence claim and held that the ELD applied.

The Court concluded by holding that, when there is a contract in existence that covers the injury complained of, the ELD bars tort claims seeking economic losses. Where a contract exists, plaintiffs like Crescent are required to look toward contractual remedies.

ADDITIONAL DECISIONS

Slip opinions from a federal district court applying North Carolina law and a subsequent North Carolina Supreme Court case have uniquely discussed and distinguished Crescent's holding.

NEW DUNN

Shortly after the Crescent decision, the United States District Court for the Eastern District of North Carolina issued a slip opinion in *New Dunn Hotel, LLC v. K2M Design, Inc.*, No.

5:20-CV-107-FL, 2021 WL 1910033, *1, (E.D. N.C. May 12, 2021). In this opinion, the District Court explained that, under North Carolina law and application of the ELD, a tort action does not lie against a party to a contract, and that it is contract law – not tort law – that defines the obligations and remedies of the parties in relevant circumstances. Stated differently, the District Court explained that the relevant inquiry is whether the plaintiff has a basis for recovery in contract or warranty. If they do, the ELD applies. If they do not, then the ELD is not applicable and will not limit plaintiffs' claims.

The District Court distinguished the *New Dunn* facts from Crescent by reasoning that, in Crescent, even if contractual privity did not exist between Crescent and Trussway, Crescent had contractual avenues for recovery for the claims brought under negligence. Mainly, Crescent could – as the North Carolina Supreme Court suggested – sue the general contractor and go down the line in that manner to recover its losses. However, in disavowing the application of the ELD in *New Dunn*, the District Court reasoned that the plaintiff did not have that bargained-for means of recovery. Utilizing that understanding, the District Court held that the ELD did not apply to the plaintiff in the *New Dunn* action because the contracts at issue did not address the claims the plaintiff had brought. Thus, the plaintiff had no remedy under contract law.

UNITED STATES FOR USE AND BENEFIT OF SCHNEIDER ELECTRIC

In *United States for use and benefit of Schneider Electric Building Americas, Inc. v. CBRE Heery, Inc.*, No. 5:20-CV-00257-BR, 2021 WL 5114653, *1 (E.D. N.C. July 26, 2021), the United States District Court for the Eastern District of North Carolina issued another slip opinion speaking to North Carolina's application of the ELD and the *Crescent* decision. In this matter, the District Court responded to arguments regarding both the application of North Carolina law and adherence to federal Circuit Court precedent.

The District Court rejected arguments that the ELD was applicable to a plaintiff who had some contract privity but where said contracts did not address the claims filed. The Court held that because the contracts did not account for the plaintiff's claims, the plaintiff otherwise lacked a basis for recovery in contract or warranty. Further, the District Court rejected arguments that the Crescent decision made a prior Fourth Circuit decision, *Ellis v. Louisiana-Pac. Corp.*, unviable. *See generally Ellis v. Louisiana-Pac. Corp.*, 699 F.3d 778 (4th Cir. 2012). To the contrary, the District Court held that both decisions were in accordance with the other, as Ellis had determined that the relevant ELD inquiry was whether the plaintiff had a basis for recovery in contract or warranty.

The District Court also commented on the narrowness of the Crescent holding, emphasizing that it was applicable only in commercial settings.

CUMMINGS

At the end of 2021, the North Carolina Supreme Court issued a decision in *Cummings v. Carroll*, where it touched on its prior holdings in Crescent. *See generally Cummings v. Carroll*, 866 S.E.2d 675, 686 (N.C. 2021). In the *Cummings* action, the North Carolina Court held that the ELD did not bar plaintiffs' claims of fraud, negligence, and negligent misrepresentation against various defendants where the alleged conduct underlying the claims at issue were not enumerated in the contracts. In finding that the ELD did not apply to plaintiffs' claims, the Court advanced two main justifications; i) the claims did not implicate the terms of the contracts between the parties, and ii) it was not a commercial transaction.

The Court wrote that because certain language was not incorporated into the contract that language could not serve as a basis for the application of the ELD. Specifically, the Court reasoned that important representations were omitted from the agreement. Thus, the defendant(s) had not been bound to the performance of the contract or the personal liability it would have otherwise contemplated. As such, the Court held that the defendants lacked the privity of contract necessary to support the invocation of the ELD.

The North Carolina Court dispatched arguments regarding *Crescent's* applicability to *Cummings* and similarly situated plaintiffs though, emphasizing that Crescent's holdings were only applicable to commercial transactions. That being said, its holding in *Cummings* supports the reasoning employed by the United States District Court for the Eastern District of North Carolina in its opinions regarding commercial transactions.

TAKEAWAYS FOR DESIGN PROFESSIONALS

North Carolina's application of the ELD appears to rest on contract formation and the terms within a contract's four corners. While *Cummings* discussed non-commercial transactions, its reasoning paralleled that of the United States District Court for the Eastern District of North Carolina slip opinions.

As such, the general rule in North Carolina is that if a contract or warranty of some kind specifically enumerates or contemplates the claims alleged in a complaint, the courts will apply the ELD and bar tort recovery for purely economic damages. However, in circumstances where the contracts are ill-formed, missing terms relevant to the claims, and/or non-existent, the courts may permit tort recovery for purely economic damages. Though not binding to North Carolina

state courts, the opinions from the United States District Court for the Eastern District of North Carolina raise concerns for design professionals. In *New Dunn, Schneider,* and in a subsequent matter, *Walbridge Aldinger LLC v. Cape Fear Engineering, Inc.*, the District Court permitted tort damages against design professionals. Further, *Schneider* reasoned that unless there is a contract that contemplates the alleged claims, parties are not barred from seeking tort damages. This is contrary to many other jurisdictions that bar tort recovery when a contract exists but provides courts with more nuance and aggrieved parties more flexibility.

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