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# Pacific Northwest DESIGN PROFESSIONAL LEGAL UPDATE

Washington Oregon Alaska Idaho

OCTOBER 2007

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## INCREASED EMPHASIS ON PROCUREMENT FRAUD PROSECUTION

The federal government spends hundreds of billion dollars annually to purchase goods and services from corporations and non-governmental agencies. Several recent and highly publicized scandals involving contractors and procurement officers have prompted lawmakers on Capitol Hill and law enforcement nationwide to focus on prevention, detection and punishment of procurement fraud. In order to avoid being blindsided by the new legislation and initiatives being rolled out, companies contracting with the federal government need to implement measures and programs to ensure compliance with the law.

Federal law enforcement officials rely on several criminal and civil statutes to charge contractors for schemes involving conflicts of interest, defective pricing, bid-rigging, product substitution, accounting and grant fraud, misuse of classified or other sensitive information, and other ethical breaches. Criminal statues include 18 U.S.C. § 287 (false claims), 18 U.S.C. § 1031 (Major Fraud Act), 18 U.S.C. § 1001,

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## I-35 Bridge Collapse Underscores National Infrastructure Needs

In the wake of the I-35 bridge collapse in Minneapolis on August 1, 2007, the nation's attention has been focused on what design professionals and the professional societies that represent them have been telling local, state and federal lawmakers for years: restoring our nation's infrastructure must be a priority at every level of government. Although the cause of the bridge failure is unknown at this time, the tragedy is a clear example that our nation's infrastructure is deteriorated and lawmakers have taken their eye off the ball. Despite increased funding for post-9/11 national security measures, we have failed to adequately fund the much needed repair and replacement of our nation's roads, bridges, dams, water and wastewater systems, and schools.

The 2005 Report Card for America's Infrastructure[1] (Report Card) published by the American Society of Civil Engineers (ASCE) gave our nation's infrastructure an overall grade of D. Our nation's infrastructure received a grade of D+ on the 2001 Report Card, so there has been little to no improvement despite efforts by engineering groups to bring this issue to the attention of lawmakers at every level. ASCE's Report Card rates fifteen infrastructure categories, including aviation, bridges, dams, drinking water, energy, hazardous waste, navigable waterways, public parks and recreation, rail, roads, schools, security, solid waste, transit, and wastewater. ASCE estimates that $1.6 trillion is needed over a 5 year period to bring the nation's infrastructure to a good condition, or an overall grade of B.

The American Council of Engineering Companies (ACEC) has joined ASCE in urging lawmakers to

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## INFRASTRUCTURE NEEDS (cont'd)

focus on our nation's aging infrastructure. ACEC

Reports out of Minneapolis immediately after the I-35 bridge collapse focused on the fact that a 2005 study of the bridge concluded that it was "structurally deficient."[4] However, experts were quick to point out that "structurally deficient" bridges aren't necessarily unsafe; they just do not have all of the factors of safety that highway departments and engineers, conservative by nature, might want them to have.

In an August 3, 2007 letter to Washington Governor Christine Gregoire, the Interim Secretary of the Washington State Department of Transportation, Paula J. Hammond, P.E., wrote "[b]eing structurally deficient does not imply that [a] bridge is in danger of collapse or unsafe to the traveling public." Instead, the label "means that a bridge requires repair or replacement of a certain component . . . [i]f the condition is such that it no longer is able to carry its intended traffic loads it may be weight restricted."

The 2007 Annual Bridge Update prepared by WSDOT for inclusion in its annual Gray Notebook reports that out of a total of 7,000 bridges, there are 122 bridges on the state highway system and 240 bridges on the city and county road systems that are "structurally deficient." These numbers seem to be in line with the rest of the nation, including Idaho and Oregon.

According to the ASCE Report Card, 1 in 4 of our nation's 600,000 federally funded bridges is deficient or functionally obsolete. More alarming than that statistic is the fact that the Report Card gave our nation's bridges a grade of C, whereas dams, roads, schools, drinking water and wastewater systems all received grades of D or D-. According to the Report Card, 26% of Washington's bridge are structurally deficient or obsolete, 60% of Washington's schools have at least one inadequate building and 74% have at least one unsatisfactory environmental condition. Similarly, the Report Card says that nearly $7 billion is needed to address Washington's water and wastewater infrastructure needs.

In light of the I-35 bridge failure in Minneapolis, after years of neglect, political will and federal funding appear to be in-line with addressing our nation's infrastructure needs. Design professionals should capitalize on the opportunity to address these needs before lawmakers' short attention spans shift elsewhere. However, care should be taken to ensure that multiple infrastructure needs, above and below ground, transportation and non-transportation related, are addressed and that available funding is not directed entirely toward repairing and replacing structurally deficient and functionally obsolete bridges.

1. http://www.asce.org/ reportcard/2005
2. http://www.acec.org
3. http://www.transportation1.org/tif5report
4. Pat Doyle, *What Caused It? Cracking, Vibration May Have Led to Collapse*, IDAHO STATESMAN, Aug. 3, 2007, at Main 13.
5. Greg Gordon, *More Than 1 in 4 Federally Funded Bridges Need Replacing*, IDAHO STATESMAN, Aug. 3, 2007, at Main 13.

## PROCUREMENT FRAUD (cont'd)

(fraud and false statement provisions), 18 U.S.C. § 201 (bribery), 18 U.S.C. § 371 (conspiracy), and 41 U.S.C. § 423 (Procurement Integrity Act).

Under 31 U.S.C. § 3729, the False Claims Act, the government can seek treble damages and other monetary penalties against contractors who knowingly submit or cause to be submitted a false or fraudulent claim to the federal government.

Under the Act's *qui tam* enforcement provision, private citizens can file a sealed complaint against government contractors and receive a percentage of the money recovered by the government. The National Procurement Fraud Task Force ("Task Force"), created in October 2006, assumed the FBI's role in investigating procurement fraud so that the FBI can direct its efforts on national security and terrorism-

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## PROCUREMENT FRAUD (cont'd)

related crimes post-9/11.

To increase transparency and accountability in federal contracting and to protect the integrity of the acquisition workforce, Congress has stepped up its oversight efforts regarding procurement fraud. These efforts include introducing several pieces of legislation and calling major players, such as former Defense Secretary Donald Rumsfeld, to appear before and answer to investigative committees.

The Executive Branch Reform Act of 2007, H.R. 984, was introduced this past February and would amend the Ethics in Government Act of 1978. Among other measures, the proposed legislation establishes cooling-off periods during which former federal agency contracting staff cannot accept rewards, inappropriate compensation or any compensation for legal or lobbying work performed on behalf of a government contractor. It also proposes a cooling-off period before a former employee, lobbyist or attorney for a contractor can participate in the award or administration of a contract to that contractor.

This past March, the House passed the Accountability in Contracting Act, H.R. 1362, which extends the cooling-off period during which former contracting officials are banned from taking jobs with contractors they previously supervised, and establishes a similar cooling-off period during which procurement officials are barred from awarding or overseeing contracts involving a former employer.

Finally, a proposed amendment to the Federal Acquisition Regulation ("FAR") was recently circulated for comment. The amendment would require contractors receiving federal contracts worth more than $5 million and taking longer than 120 days to perform to: (1) implement a written code of ethics and business conduct; (2) establish a compliance training program; (3) establish an internal control system; and (4) display fraud hotline posters produced by the DOJ's Office of the Inspector General.

Corporations that contract with the federal government must make fighting procurement fraud a top priority. The risk of civil and criminal penalties, loss of business opportunities, debarment-related penalties, and damage to the company's reputation and goodwill, are simply too great to avoid addressing this issue head on.

There are several steps that an organization can take to ensure that its employees comply with the law, **the most important of which is establishing a compliance program.** An effective compliance program is one that not only provides conduct guideposts, but also establishes a process for investigating possible violations and promptly remedying violations.

To that end, a company should implement a program that:

(1) ensures transparent procurement and compliance standards and expectations;

(2) educates the company's agents, employees and consultants about what activities and actions violate the existing laws and regulations, as well as the company's policies and code of ethics and conduct;

(3) identifies red flags that signal others' misconduct;

(4) clearly establishes that individuals are responsible for reporting suspicious activity;

(5) identifies proper reporting channels; and most importantly,

(6) establishes clear expectations regarding confidentiality and opportunities for feedback once an employee makes a report following the company's established protocol.

Additionally, an organization must foster top down leadership, speak with a constant and consistent voice when it comes to communicating its core values, routinely review and update procurement operations and compliance and ethics policies, and conduct regular self-audits of procurement controls and procedures.

# RESIDENTIAL CONSTRUCTION DEFECT LITIGATION

**An epidemic**

There is an epidemic of construction defect litigation in Washington. Recent legislative changes have not stemmed the flood of claims and the frantic pace of multi-family housing construction means more claims will follow.

In a construction defect lawsuit filed last week, a Condominium Owner's Association sued a Developer/General Contractor, alleging a wide range of construction defects. The Developer, in turn, sued 12 subcontractors and 4 design firms, seeking contribution. Each of these parties will undoubtedly have some form of insurance. What is less clear is whether the parties have coverage for the alleged defects.

**The fog of insurance coverage**

One would think by now the industry would understand what insurance coverage exists for construction defects. Unfortunately, this is not the case. Insurers have consistently taken the position that Comprehensive General Liability Policies (CGL) do not cover contractor errors in workmanship that lead to damage to a residence.

In August 2007, the Supreme Court of Texas held that a contractor's CGL policy covered a homeowner's claim that the defective construction of a foundation had damaged the house frame and its finishes. *Lamar Homes v. Mid-Continental Casualty Company*, 2007 Tex. Lexis 797, 50 Tex. Sup. J. 1162 (August 31, 2007). Courts around the country are split on this insurance coverage issue.

When the contractor or developer is uninsured or underinsured for a construction defect, the likelihood of a claim against the design professional, with his or her professional liability insurance, increases. Everyone likes a deep pocket.

**Practical Risk Management Suggestions**

If your firm is involved in multi-family residential construction, ask yourself these basic questions:

**Make sure your Professional Liability Policy provides coverage for multi-family residential work.**

Some carriers either exclude coverage for multi-family design work or limit coverage to a percentage of annual billings. Be forthright in describing the nature and extent of your multi-family design work at renewal time and keep your carrier informed as to the nature and extent of this work as the policy term progresses.

**Have your insurance broker or counsel review the owner, developer and general contractor's CGL coverage or Builder's Risk coverage.**

The most significant risk you face in multi-family construction is a claim by a client for contribution after the client is sued for construction defects. Meaningful insurance coverage for your client is your first line of protection. "All Risk" Builder's Risk coverage can also provide some protection for damage to the project caused by defective work during construction. Become educated on what this insurance really covers.

**Be sure all subcontractors are insured and contractually required to fix or pay for defective work.**

Many construction defect claims arise out of defective work by subcontractors. Subs are having difficulties obtaining meaningful CGL coverage for residential construction. On larger projects, developers, general contractors and subcontractors may be covered by a single project specific policy purchased by the owner (known as an OCIP). These policies are complex and should be reviewed by your broker or by counsel.

**Know your client.**

What is the track record of the developer from prior projects? Is there a history of claims? Is the developer adequately capitalized to handle claims?

Will you be contracting with a project-specific en-

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## RESIDENTIAL CONSTRUCTION DEFECT LITIGATION (cont'd)

tity (generally an LLC) that will go out of business when the project is turned over to a homeowners' association? Will the principals in the project-specific entity personally guarantee your contract?

**Develop your scope of work with due regard for foreseeable risks.**

Will you be allowed to develop a design that incorporates current state-of-the-art features to address proper weather protection?

Have you identified foreseeable problem areas like unstable soils, steep slopes, excessive ground water, lack of roof overhangs, unprotected flat decks?

Who will be on the design team and will other design team members be able to deliver their responsibilities for a quality design? Are they adequately insured?

Will you be responsible for coordinating and integrating all design elements?

What will be your responsibilities for obtaining necessary permits?

Will there be a waterproofing or building envelope consultant, and if so, will this entity be under contract to you or to the developer? Will you be allowed to select or approve the waterproofing consultant? Will the waterproofing consultant monitor construction? Is the waterproofing consultant adequately insured?

What will be your role during the course of construction? Will you review and approve shop drawings? Will you make periodic inspections of the work? Will you be attend weekly job site meetings during construction?

Will you be afforded the opportunity to develop a punch list of construction issues at substantial completion and will you be assigned the role of reviewing completion of punch list items prior to final completion and the sale of any units?

Is the construction timeline for your work reasonable?

Will you be allowed to recommend and to approve all building elements that could affect quality, such as windows, doors, roofing systems and waterproofing?

**Coordinate your work with others.**

Will the developer retain a separate Construction Manager? If so, what will be the division of responsibilities between you and the Construction Manager? Will the Construction Manager play any role in design? Is the division of labor between you and the Construction Manager adequately documented?

If other design firms have separate contracts with the developer, are those contracts uniform and integrated with regard to scope of work, risk allocation and dispute resolution?

Will there be design-build elements in the project delivery such as HVAC, elevators, fire suppression, electrical, plumbing? If so, will you review and comment on design-build submittals? Will those submitting design-build plans be required to carry professional liability insurance?

How will change order requests be handled?

How will submittals be logged, reviewed and approved?

**Know the general contractor.**

Will you be assisting the owner in selecting a general contractor?

If the owner is the general contractor, is the owner up to this task? Does the owner have a track record for constructing projects of comparable scope?

Is there a construction contract between the owner and the general contractor? Will you be allowed to comment on the contract form?

Will the owner require that the general contractor have written contracts with all subcontractors and will the risk allocations of the prime contract flow to the subcontracts? Will the owner approve all

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## RESIDENTIAL CONSTRUCTION DEFECT LITIGATION (cont'd)

subcontracts?

**Get paid.**

Does the owner have the funding to pay for design services, especially prior to the construction loan?

Do you have adequate copyright protection for the conceptual design you prepare in case the owner terminates your services before you finalize construction documents?

Does the owner have a funding commitment? Does the building need to be pre-sold before funds will be released by the lender?

Do you have the right under your contract to request assurances about funding throughout the project? Does your contract allow you to stop work if you are not being paid?

Have you discussed your lien rights with the owner?

**Understand your insurance.**

How will the project be insured?

Do you have professional liability coverage for condo work? Is your coverage adequate for the foreseeable risks?

Will the owner provide an OCIP that covers design services? Is your professional liability policy at risk before the OCIP comes into play? Are you responsible for a high deductible under the OCIP?

Is the OCIP policy large enough to cover foreseeable claims?

Is there a waiver of subrogation within the OCIP?

Will the owner and designers be "Additional Insureds" under the general contractor's CGL policy?

Who will carry Builder's Risk coverage during the course of construction? Will the Builder's Risk coverage be on an "All Risk" form?

**Understand your contract.**

Do you have a signed design professional contract in place before commencing any work?

Does your design services agreement address all of the risk issues listed above?

Have you asked your professional liability insurance broker, carrier or your attorney to review your proposed contract?

If your role or scope changes, will your contract be amended?

Are all indemnity obligations imposed on you in the design services agreement limited to incidents of professional negligence?

Can you obtain a meaningful limitation of liability clause in your contract?

Is there a waiver of consequential damages?

Are you satisfied with the disputes resolution provisions in the contract, including prevailing party attorney's fee clauses?

Are you protected against the unauthorized re-use of your documents for other projects?

Can you obtain a waiver of subrogation clause from the owner? Can the owner include a waiver of subrogation clause in the Condo Declarations, binding the Homeowner's Association and Unit Owners?

This checklist is just one method of managing risk on residential construction projects. Many professional liability carriers also provide sample risk management checklists for their insureds. The AIA Trust has published a "Risk Management Recommendations for Condominium Projects" and a "Condo Project Evaluation Form."

Design firms doing multi-family residential design work should carefully consider the issues highlighted here, designate appropriate lead principals to approve any condominium assignments, and prepare a "go/no go" evaluation form to manage the intake process for new work in this area.

For more articles of interest to architects and engineers, go to www.skellengerbender.com.