DESIGN PROFESSIONAL CONSIDERATIONS - TERMINATION FOR CAUSE
ISSUES CONTRACTOR TERMINATION FOR CAUSE
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I. SCOPE NOTE
This article discusses a design professional's considerations arising from an owner's for-
cause termination of a general contractor, the design professional's potential liability associated
with the termination and the support a design professional can expect to provide to the owner in
ensuing litigation.

II. CONSTRUCTION ADMINISTRATION OBLIGATIONS

A. General

The design professional acts as the owner's agent at all times in his performance of his Construction Administration ("CA") duties. His primary CA role is to observe construction for conformity with his plans and specifications (together, the "Plans"). Because the Plans are part of the owner/contractor contract, he will also on occasion be called to perform a quasi-judicial role with respect to their interpretation. In that role, he is bound to a degree of impartiality to the owner and contractor. The tension between these two roles can impact the quantity and quality of the design professional's advice to the owner in regard to the issue of contractor termination, as well as result in potential liability.

While an architect's precise CA tasks will vary by project and contract, here is a good general list:

1. Ensure conformity of construction to Plans
2. Identify, communicate and reduce project risk
3. Identify and resolve construction issues as early as possible
4. Review shop drawings
5. Respond to contractor requests for information about Plans
6. Respond to contractor requests for changes in scope, time and payment
7. Observe and report to the owner on progress of construction
8. Supervise project closeout
9. Advise owner on question of contractor termination
In the performance of each of these tasks, the design professional can find himself coming into possession of information relevant to the owner's decision to terminate the contractor.

B. General Contractor's Project Role

The general contractor's project duties are far different than the design professional's CA role. N.C.G.S. § 87-1 defines a general contractor as "any person or firm or corporation who for a fixed price, commission, fee, or wage, undertakes to bid upon or to construct or who undertakes to superintend or manage, on his own behalf or for any person, firm, or corporation that is not licensed as a general contractor pursuant to this Article, the construction of any building, highway, public utilities, grading or any improvement or structure where the cost of the undertaking is thirty thousand dollars ($30,000) or more."

"Superintend or manage" is further defined by NC's administrative code as the actions taken by one who "is responsible for superintending or managing the entire construction project, and either contracts directly with subcontractors to perform the construction for the project or is compensated for superintending or managing the project based upon the cost of the project or the time taken to complete the project." 21 N.C. Admin. Code 12.0208.

Each owner/contractor agreement will further define the contractor's role from what is established statutorily. Two families of form documents in wide use in NC are those promulgated by the AIA (American Institute of Architects) and the AGC (Associated General Contractors of America). A contract from the AIA family of contracts is commonly referred to as an "AIA Contract", while an AGC contract is often said to be from the "ConsensusDOCS" family of contracts.

Under Section 3.3.1 of the AIA's A201 General Conditions ("A201"), the contractor is to "supervise and direct the Work, using the Contractor's best skill and attention," and "shall be solely responsible for, and have control over, construction means, methods, techniques, sequences and procedures and for coordinating all portions of the Work." The remainder of Article 3 specifies and amplifies this general definition.

The ConsensusDOCS 200 Standard Agreement and General Conditions Between Owner and Contractor (Where the Contract Price is a Lump Sum) (the "CD 200") from the AGC states that the contractor is "responsible for the supervision and coordination of the Work, including the construction means, methods, techniques, sequences and procedures utilized." (§ 3.1.2).

Taken cumulatively, a good list of a general contractor's project duties that can be gleaned from statute, the AIA Contracts and the ConsensusDOCS would include:
1. Supervise, coordinate and direct project construction in conformance with project Plans

2. Enter into subcontracts and agreements for the provision of labor and material to the project

3. Adhere to project cost and time requirements

Together, the design professional and contractor form a team that (all things being equal) should result in the successful completion of the project. When that does not happen, it is the design professional's responsibility to advise the owner so that he can take steps to mitigate the damage to the project. One of those steps is to terminate the contractor for cause and replace him with a new contractor to complete the project.

C. Design Professional's Quasi-judicial CA Role

As mentioned above, the design-professional sometimes assumes a quasi-judicial role with regard to contractual disputes between the owner and contractor. Some contracts contain specific provisions this regard. For example, the A201 requires the project architect to act as the Initial Decision Maker with respect to an owner's decision to terminate a contractor for cause, by certifying the existence of sufficient cause to justify the termination (A201, § 14.2.2).

In contrast, the CD200 contains no analogous provision, allowing the owner to terminate the contractor unilaterally. Nonetheless, despite having no contractual obligation to do so, it is difficult to imagine an architect properly discharging his CA duties without having significant impact on the owner's termination decision. Thus, although he may be working under an AGC ConsensusDOC, a design professional may find himself in the role of an advisor, and as such he should be cognizant of what that role entails.

Regardless of the existence of a specific contractual duty to act as an Initial Decision Maker, the design professional who is asked by the owner to participate in the decision to terminate a contractor should act as impartially as possible. For example, he should decline to assist the owner in a contextual termination for cause that is driven by some business consideration other than contractor non-performance. He should also carefully analyze the owner's basis for the termination from the perspective of the contract between the owner and contractor and the prevailing law.

D. Termination Considerations

The following are considerations for the design professional in any contractor termination analysis.
1. Materiality Requirement

A mere breach of contract is not a sufficient ground for the termination of a contract. The breach must be of a material term of the contract. The owner has the burden of proving this issue at trial by establishing that the contractor "failed to perform (or abide by) a material term of the contract." (NCPJI 502.00 CONTRACTS - ISSUE OF BREACH BY NON-PERFORMANCE)

To help the jury decide this issue, the judge will instruct the jurors that a "material term is one that is essential to the transaction, that is, a term which, if omitted or modified, would cause one of the parties to withhold assent or to bargain for a substantially different term," and that "(n)ot every term in a contract is material. A party's failure to (perform) a term that is not material is not a breach of the contract." (Id.)

There are several materiality factors upon which the jury will be instructed:

a) The subject matter and purpose of the contract;

b) The intentions of the parties;

c) The scope of performance reasonably expected by each party;

d) The prior dealings of the parties; and

e) Any custom, practice or usage so commonly known to other reasonable persons, in similar situations, that the parties knew or should have known of its existence. (Id.)

The determination of materiality is a critical consideration, for if the contractor can establish that the termination was premised upon a non-material breach, then he may have his own claim for damages to which the owner will be precluded from using the contractor's non-performance as a defense or as the basis for a counterclaim (D.W. Ward Const. Co., Inc. v. Adams, 90 N.C.App. 241, 244, 368 S.E.2d 31, 33 (N.C.App., 1988).

2. Contractor's Defense of Prevention

Even if the contractor's breach is clearly material, the design professional should advise the owner to take great care in carrying out the termination in a manner that would seem consistent and fair to the average person. If the owner jumps the gun or otherwise acts dubiously or inconsistently with a contractual termination provision, he may hand the contractor a prevention defense that the owner "knowingly and without justification prevented (hindered or made more costly)", the contractor's "performance of (or ability to abide by) the material
While the contractor bears the burden of proving that the owner prevented his performance, it is (by the plain language of this jury instruction) a very broad defense. Well-proven conduct by the owner that resulted in the prevention or hinderance or cost-enhancement of the contractor's work, could result in the judge instructing the jury that even non-compliance by the contractor of a material term does not constitute breach of the contract. (see Id.).

With that in mind, a savvy contractor (sensing that an owner is considering or has even already begun to institute a termination), might begin advising the owner (in writing) that he is hindering the contractor's work, preventing him from accomplishing it and otherwise driving his costs up. Likewise, an owner receiving a such a letter from a contractor he is considering (or in the process of) terminating should not "take the high road" and ignore it. The design professional should advise the owner to refute the contractors contentions as factually as possible.

Additionally, the design professional should advise the owner to follow the contractual letter of any procedural or notice requirements. For example, both the A201 and the CD200 contain specific cure periods that the owner should not violate, even in seemingly minor ways.

3. Any Repudiation By the General Contractor Must Be Clear

An owner can circumvent the materiality requirement (as well as a potential prevention defense) if he can obtain an explicit refusal to perform from the contractor which in itself constitutes a material breach of the contract by repudiation.

Repudiation has two requirements. First, at the moment of the contractor's repudiation the owner must be "ready, willing and able to perform his obligations as agreed and would have done so but for the repudiation by the defendant." (NCPJI 502.05 CONTRACTS - ISSUE OF BREACH BY REPUDIATION).

The second requirement of a repudiation is a clear expression by the contractor "by words or conduct" of a "positive, distinct, unequivocal and absolute refusal (or inability) to perform". (Id.) There are no specific or magic words to a sufficient repudiation, as long as it is delivered clearly and without equivocation.

Therefore, if an owner intends to rely upon a repudiation by the contractor as grounds for a termination, the design professional should advise him to confirm it with the contractor in a writing that includes:
a) A recounting of the contractor's inability or unwillingness to perform;

b) An assertion that the contractor has been fully paid for his past work; and

c) An assertion that the contractor will be paid for future work, but only if he actually does it.

4. The Existence of Contractual Grounds for Termination

a) General

The most common material breaches of a construction contract by general contractors are failure to timely complete the project, defective construction and cost overruns. The materiality of all three is generally not difficult to establish, as even the sketchiest of construction contracts will usually include a project duration, a description of the general contractor's scope of work and a price.

However, despite the materiality of the foregoing breaches, absent specific contractual language to the contrary, it is difficult for an owner to use them as grounds for a termination because each is primarily assessable only after the fact, and thus, after the damage is done. Most owners (rightfully) do not want to wait until the project is way behind schedule, dangerously defective and encumbered by liens to terminate an incompetent contractor. They want to be proactive and mitigate their potential damages by terminating the contractor and finding someone else to finish the project properly. In turn, the design professional's CA duties include the identification and reduction of project risk, as well as the resolution of construction issues as early as possible.

Unfortunately, because (by definition) the general contractor is "responsible for superintending or managing the entire construction project", it is very difficult to establish the precise moment (prior to the date called for in the contract for substantial completion) that his mismanagement has resulted in a material breach justifying termination. Despite running late, if the contractor continues to insist that he is capable of getting the project back on schedule, the owner runs the risk of a precipitous termination that will constitute a prevention of the contractor's performance.

b) Specific Termination Provisions

In order to resolve the foregoing problem, the AIA and CGC have termination provisions that are remarkably similar to each other. Both
define the following as breaches of the contractor's CA duties that justify a terminating the contract for cause:

1) A persistent or repeated failure to supply sufficient, skilled workers, material or equipment to the project to meet the schedule (the AIA does not mention equipment or the schedule);

2) A failure to promptly pay workers, subcontractors or material suppliers (the AIA does not include the word "promptly", but does state refer to the contractual terms in the contracts at issue);

3) A disregard of laws, ordinances, rules, regulations, or orders of a public authority having jurisdiction (AIA the requires that such disregard be "repeated"); or

4) Is otherwise is guilty of a material breach of the contract (AIA uses the word "substantial" instead of material). (see CD 200 11.2 and A201 14.2.1).

In a sense, what the AIA and AGC have done is to enumerate three categories of breach, the materiality of which the parties have arguably agreed to beforehand. A shorthand way to describe them would be: 1) Insufficient Labor/Material; 2) Financial Instability, and 3) Regulatory Non-conformity.

The fourth ground for termination promulgated by the AIA and AGC (being "otherwise guilty of a material breach of the contract") is a catch-all provision that does not add anything to the common law materiality requirement and is thus of not much use.

Therefore, the best practice for a design professional in assisting an owner in the consideration of a contractor termination, would be to catalogue and categorize each breach of the contractor's CA duties into one of the three enumerated breach categories, noting that the more numerous and significant the breaches are, the less likely it will be for the termination to be seen as pre-textual, and thus to constitute an act of prevention of the contractor's performance by the owner.

II. POTENTIAL LIABILITY OF DESIGN PROFESSIONAL ARISING FROM CONTRACTOR TERMINATION

A. General
If the termination of a general contractor results in litigation, the owner's measure of damages (assuming economic reasonableness) is the reasonable cost of labor and materials (and other costs) necessary to correct the work to bring the improvement into conformity with the requirements of the contract. (NCPJI 503.21 OWNER'S MEASURE OF RECOVERY FOR A CONTRACTOR'S PARTIAL BREACH OF A CONSTRUCTION CONTRACT). In other words, the necessary and reasonable costs the owner incurs finishing up the project ("Project Completion Costs") with a replacement contractor will form the basis of his damages.

Two things are generally true about Project Completion Costs. First, they are easy to prove. The replacement contractor testifies to the performance of the work and the invoices he tendered to the owner. The owner testifies that he paid the invoices, and the owner's attorney writes the total number on the chalkboard. Not much to it, and as long as there has not been a change in the scope of work, there is little the original contractor can offer in defense. Second, Project Completion Costs are almost always higher than the costs would have been for the original contractor to complete the project.

Therefore, a terminated general contractor is facing a big, easy to prove damage claim, which (not surprisingly) he is looking to lay off (as much as he can) on anybody else he can find. The most obvious target of this effort is the design professional.

B. Liability for Improper Termination

Prior to the late 70s, design professionals were protected by lack of contractual privity from liability arising from the owner's termination of a contractor. That changed with the line of NC holdings that allowed direct negligence claims by contractors against design professionals.

Typical of these cases was Davidson and Jones, Inc. v. New Hanover County, in which the Court held that "an architect in the absence of privity of contract may be sued by a general contractor or the subcontractors working on a construction project for economic loss foreseeably resulting from breach of an architect's common law duty of due care in the performance of his contract with the owner." 41 N.C.App. 661, 667, 255 S.E.2d 580, 584 (N.C.App., 1979).

Underpinning this trend toward expanded design professional liability is the judicial perception of an uneven relationship between contractor's and architects/engineers. "Altogether too much control over the contractor necessarily rests in the hands of the supervising architect for him not to be placed under a duty imposed by law to perform without negligence his functions as they affect the contractor. The power of the architect to stop the work alone is tantamount to a power of economic life or death over the contractor. It is only just that such authority, exercised in such a relationship, carry commensurate legal responsibility." Shoffner Industries, Inc. v. W. B. Lloyd Const. Co., 42 N.C.App. 259, 266, 257 S.E.2d 50, 55 (N.C.App., 1979).
A terminated contractor may argue that the project design professional's negligent determination (and related advice to the owner) of the grounds justifying his termination is a breach of the standard of care owed by the design professional to the contractor under Davidson and Shoffner. This claim would likely be viable regardless of the existence of a contractual certification requirement. Unless the design professional can prove that he played no role in the termination, than he is subject to a claim that whatever role he did play in the termination was performed negligently.

C. Available Defense--Lack of Direct Damages

While the trend since Davidson and Shoffner has been to expand the exposure of design professionals to contractor's claims, there have been a few cases that have pushed back somewhat. For example, in Kaleel Builders, Inc. v. Ashby, 161 N.C.App. 34 (N.C.App.,2003), the court drew a distinction between the direct negligence claims allowed by Davidson and the third-party claims filed by contractors seeking indemnity or contribution from design professionals for damage claims brought against them by owners and others.

Until Kaleel, contractors often used Davidson to bring design professionals into litigation against owners under a blended "indemnigence" theory that, essentially, said the owner has damages he claims I caused but are really your fault designer, and I've got damages that I know are your fault designer, so I'm just going to sue you for the whole thing without spending much time discerning between the two. The Kaleel Court effectively limited the contractor to the latter half this indemnigence equation, allowing only those direct damages that the contractor allegedly incurred as the proximate result of the designer's negligence.

When defending a claim against a design professional by a contractor seeking to pass off alleged Project Completion Costs under a theory of negligent termination, counsel should look hard at the manner in which the damages are pled. If they are not clearly direct, than a dismissal is possible. In Spearman v. Pender County Bd. of Educ., the dismissal of an architect from a mold class action case was upheld because the third-party plaintiff had impleaded the architect under Rule 14 rather than Rule 18. Rule 14 only allows claims against a third-party who "is or may be liable to him for all or part of the plaintiff's claim against him" (i.e., indemnity or contribution), while Rule 18 allows the assertion of an "original claim". 175 N.C.App. 410, 413 (N.C.App.,2006).

D. Summary Of Design Professional Considerations To Avoid Liability

When advising the owner on termination, a design professional should consider and advise the owner on the following:

1. Does the contract between the owner set out a termination procedure? If it does, it should be specifically and fully followed.
2. What does the owner contend as the basis of the termination? The basis must be material and specific contentions are better than general.

3. Does the owner's basis for termination conform with those set out in the contractual termination procedure? Insufficient Labor/Material, Financial Instability, and Regulatory Non-conformity are the bases set out in the A201 and CD200.

4. Even if there is no contractual termination provision, Insufficient Labor/Material, Financial Instability, and Regulatory Non-conformity still provide the strongest foundation for termination.

5. Has the design professional had any gaps in the performance of his CA duties that could have impacted the contractor's non-performance? For example, if the architect has been slow in approving contractor payment applications, this might have impact on the contractor's payments to its subcontractors.

6. Do the Plans have any errors or omissions that may have contributed to a construction defect that the owner interprets as a Regulatory non-conformity? If so, the contractor may have a defense under the Implied Warranty of the Suitability of the Plans and Specifications (a/k/a the Spearin Doctrine), under which the contractor is provided a defense to a construction defect claim if he can prove he complied with the plans provided to him by (or for) the owner, the plans were defective and the defective plans caused the construction defect.

III. LITIGATION SUPPORT

If contractor termination leads to litigation, a design professional (whether he likes it or not) is often called upon to provide litigation support in the four broad areas outlined below.

A. Document Custodian

In the performance of his CA duties, the design professional may find that he has the more accurate and complete documentary record of what transpired on the project. This is particularly true of those members of the design team who had reason to be on the project site consistently, like the geotechnical engineer. In establishing that a termination was justified, the design professional's files become a critical proof component.

With that in mind, the design professional should keep his project records complete and in good and logical order. He should also be cognizant that his written words (particularly emails) may well be evidence and should thus keep them as professional as possible. Any hint that he was biased against the
contractor may destroy the credibility of his advice to the owner regarding termination.

B. Fact Witness Testimony

In the conduct of their CA duties, design professionals (and their staff) become first-hand witnesses to the contractor's efforts to comply with the Plans and the construction documents. In the owner's presentation of proof of the contractor's actions and omissions justifying termination, the design professional's factual testimony may be the most critical element. To be ready to testify competently, he should be in the habit of making notes of critical conversations events, particularly when termination begins to look like a possibility.

C. Expert Witness Testimony

A design professional may well be called upon to give his expert testimony. In fact, the decision to terminate is arguably an opinion that would require his qualification as expert before the jury can hear it.

D. Mediation and Resolution Support

If the design professional has maintained his professionalism and impartiality throughout the underlying project, he may be an asset to both the owner and contractor in resolving the dispute without protracted litigation.