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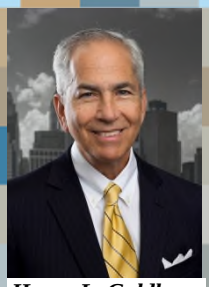
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Defective Design Specifications: Contractors Are Not Without Remedy

by: Henry L. Goldberg & Robert J. Fryman

As we have often discussed on these pages, in New York, the general rule is that without a contractual relationship between contractor and designer, a contractor's ability to bring a direct claim against a design professional is severely limited. This has historically been very frustrating for contractors and subcontractors alike when confronted with defective specifications, such as, for example, abusively applied "sole source" specifications. However, recent court decisions may now offer some inroads for contractors and subs, particularly where the claim of "defective specification" involves a design professional's active involvement in the construction phase of a project.

Given the law in New York requiring the need for a contractual relationship (which virtually never exists between a contractor and the owner's design professional), a contractor can only pursue contract claims if the contractor had a relationship with the design professional which amounted to the "functional equivalent" of a contractual relationship (privity of contract).

In order to establish the "functional equivalent of privity," the contractor would need to prove:

(1) the design professional knew or was aware that its plans or specifications would be used for a particular purpose by a known contractor;

(2) the known contractor relied upon the plans or specifications for that particular purpose; and

(3) conduct by the design professional evidencing their understanding that the contractor would rely on the plans and specifications.

These components of the functional equivalent concept had been well established. It is not sufficient that a design professional prepared a set of plans and specifications

upon which a contractor relied, bid upon and was awarded a project, to give rise to the "functional equivalent of privity."

However, a recent decision of a New York appellate court focused, instead, on a design professional's active involvement in the construction phase of a project, as opposed to its merely issuing plans and specifications containing a "negligent misrepresentation" (*i.e.* defective specification). The appellate court reinstated the contractor's claim, which had already been dismissed by a lower court.

Designer's Active Involvement

The case involved materials that were "sole source" specified in the bid package by the design professional. There was no "or equal" anticipated. As the contractor began installation of the specified materials, it noticed defects in the materials, which it promptly brought to the designer's attention.

The defects were investigated by the designer who assured the contractor that it had reviewed the manufacturer's processes and that its quality control measures were modified so that the materials would be free from defects. However, further deliveries also proved to be defective, resulting in damages to the contractor of the costs to remove and replace the defective materials, as well as delay damages. The contractor sued the designer directly, but the claim was dismissed under New York's general rule regarding the requirement of a contractual relationship between the parties.

The appellate court reinstated the claim, however, focusing not on the bid documents containing the "sole source" specification, but rather on the designer's active conduct during the construction phase of the project. In allowing the contractor's direct claim against the designer to proceed, the appellate court observed that while the designer conducted an investigation into the problems with the material at issue, it did not allow the contractor to participate, alleging the involvement of proprietary intellectual property in the manufacturing process. Moreover, the court found that after the designer concluded its unilateral investigation, it made direct affirmative representations to the contractor that the manufacturer's quality control measures were modified so that the materials would be free from defects.

The court found that the contractor reasonably relied on the designer's representations, noting that the contractor had no alternative but to accept same. The appellate court noted that an affidavit of the contractor indicated that without these representations by the designer, the contractor "would not have installed the second set of blocks without a written change order guaranteeing its payment, but instead would have chosen to breach the contract." As a result, the court found that the

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contractor's claim for negligent misrepresentation as to the suitability of the "sole source" specified material could proceed under a "functional equivalent of privity" basis.

MH&H Commentary

Recent cases demonstrate a willingness on the part of certain courts to understand the context in which such claims actually arise during the construction phase of a project. These courts have provided guidance on how to creatively address, with the right facts and circumstances, defective design problems.

Of course, claims against an owner for the defective design of its architect or engineer are not burdened by the lack of contractual relationship (privity of contract) since the contractor is, of course, "in contract" with the owner.

This becomes a bit more complicated with regard to defective specification claims of subcontractors, not in privity of contract with the owner. However, the same rules apply to subs as with contractor claims.

In any event, how much more satisfying (and fair) is it to hold the responsible party, the designer itself, responsible, not to mention to have "access" to its malpractice policy?

A single defective specification can wreak havoc with the profitability of a project. Claims against designers for defective specifications from other than their actual client, the owner, may increase in frequency in the future as the law evolves in this area. Also, this "functional equivalent" alternative theory may become even more significant as "design-build" project delivery increases in market share throughout the industry.

Any issues raised in this Alert may be addressed to Mr. Goldberg or Mr. Fryman who can be reached at: (516) 873-2000 or by email at hgoldberg@moritthock.com or rfryman@moritthock.com.

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