

## **Major Changes in AIA 201 (1997 version)**

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This paper discusses six major changes in AIA 201 (1997 version). These changes include: 1) Increased design delegation to the Contractor, 2) Mutual Waiver of Consequential Damages 3) Change in Indemnity Provision 4) Broader definition of Hazardous Materials 5) Requirement of Mediation and 6) Changes to Insurance.

**Key words:** General Conditions, AIA 201

### **Introduction**

The American Institute of Architects (AIA) has revised many of their standard form contracts effective late 1997. Among them is AIA 201- General Conditions of the Contract for Construction. This document is the basis for much of the construction documentation in the industry. In addition to its widespread use, it is often a model used by others when drafting general conditions. It reflects the current trends in both industry and the law.

The new AIA 201-1997 version contains many major and minor changes from the 1987 version. Six major changes are: 1) increased design delegation to the contractor and the subcontractor, 2) mutual waiver of consequential damages between owner and contractor, 3) contractor indemnification of owner is limited to the extent of the contractor's own negligent acts; 4) a broader definition of the term "hazardous materials; 5) the requirement of mediation before arbitration is filed and 6) increased insurance requirements. These changes are discussed in this article.

### **Increased Design Delegation to the Contractor and Subcontractor**

AIA 201, §3.12.10 (1997 Version) states:

*The Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering unless such services are specifically required by the Contract Documents for a portion of the Work or unless the Contractor needs to provide such services in order to carry out the Contractor's responsibilities for construction means, methods, techniques, sequences and procedures. The Contractor shall not be required to provide professional services in violation of applicable law. If professional design services or certifications by a design professional related to systems, materials*

*or equipment are specifically required of the Contractor by the Contract Documents, the Owner and the Architect will specify all performance and design criteria that such services must satisfy. The Contractor shall cause such services or certifications to be provided by a properly licensed design professional, whose signature and seal shall appear on all drawings, calculations, specifications, certifications. Shop Drawings and the submittals prepared by such professional. Shop Drawings and other submittals related to the Work designed or certified by such professional, if prepared by others, shall bear such professional's approval when submitted to the Architect. The owner and the Architect shall be entitled to rely upon the adequacy, accuracy and completeness of the services, certifications or approvals performed by such design professional, provided the Owner and the Architect have specified to the Contractor all performance and design criteria that such services must satisfy. Pursuant to the Subparagraph 3.12.10, the Architect will review, approve or take other appropriate action on submittals only for the limited purpose of checking for conformance with information given and the design concept expressed in the Contract Documents. The Contractor shall not be responsible for the adequacy of the performance or design criteria required by the Contract Documents.*

Consistent with recent trends, this section of AIA 201 delegates design, and therefore the cost of design, of certain elements of the construction to the contractor and subcontractor. Prudent contractors will want to clarify exactly what design elements they are undertaking in a particular project, and to be aware they may be required to expend large sums for design of certain portions of the work.

The amount of design delegation to the contractor and subcontractors is getting so great there is some fear the contractor may come into conflict with State architect and engineering licensing laws. Certainly AIA 201 tries to prevent any conflict with state licensing laws by stating in section 3.12.10 "The Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering unless ... The Contractor shall not be required to provide professional services in violation of law. If professional design services or certifications by a design professional ... The Contractor shall cause such services or certifications to be provided by a properly licensed design professional...". This provision merely says the Contractor cannot do the design itself, but must pay licensed design professionals to perform the work necessary to comply with the contract documents.

A problem with the increased design delegation is the responsibility for design placed on unlicensed and untrained individuals, rather than those who possess state licenses. An example of what can go wrong is the Hyatt Regency Hotel walkway collapse in Kansas City, Mo. In 1981 114 people lost their lives and many were injured when the second and fourth floor walkways of the hotel collapsed. The original structural supports for the walkways had been changed at the suggestion of the steel fabricator. If the design in that case was the responsibility of the Architect, then the Owner would be responsible for it. However, if the design was the responsibility of the Contractor, the Owner would be shielded from liability unless an injured plaintiff could prove the Owner negligently hired the Contractor – not an easy task. This new

document makes it clear that much of the design work is the responsibility of the Contractor, and the Contractor must be aware of the risks it is undertaking when it is responsible for design.

Prudent contractors will carefully check their insurance. It is unlikely a Builder's Risk or Umbrella policy will cover claims and damages related to design work. Contractors may need to obtain errors and omissions insurance, similar to that purchased by architects and engineers. These policies will protect them from lawsuits related to defective design claims, claims which may arise years after the construction is completed.

Section 3.12.10 potentially requires the Contractor to provide and pay for design work in three different areas: 1) Design necessary "to carry out the Contractor's responsibilities for construction means, methods, techniques, sequences and procedures"; 2) Design "specifically required by the Contract Documents for a portion of the Work" AND related to systems, materials or equipment; and 3) Design "specifically required by the Contract Documents for a portion of the Work" and NOT related to systems, materials or equipment. While it is true the "Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering" or "to provide professional services in violation of applicable law" the provision requires the Contractor to pay for professional design services in the specified instances. This provision potentially requires the Contractor to incur large expenses for professional design services and to comply with all local law regulating design services.

The first category of design elements to be paid for by the Contractor are those necessary to carry out the Contractor's responsibilities for construction means, methods, techniques, sequences and procedures. This is not new, and contractors have historically been responsible for design costs associated with means and methods. None of these design elements need be reviewed by the Architect, though they, like all design elements, could be submitted to the architect for "the limited purpose of checking for conformance with information given and the design concept expressed in the Contract Documents". The wording does not specifically require the Contractor to have such design elements prepared by a licensed design professional, though a prudent contractor certainly would comply with all local law regulating design services.

The second category of design elements to be paid for by the Contractor are, "Design elements that are specifically required by the Contract Documents for a portion of the Work" AND related to systems, materials or equipment. This is the category of design discussed most extensively in the provision. For this category of design, and this category only, the Owner and the Architect will specify ALL performance and design criteria that such design services must satisfy. The contractor must have this work done by properly licensed design professionals, and the Owner and Architect shall have the right to rely upon the adequacy, accuracy and completeness of those services. While it is true the Owner and Architect must provide ALL performance and design criteria for this category of design expense, a broadly worded performance specification will require extensive detailed design, all at the contractor's expense.

The third category of design elements to be paid for by Contractor are design elements "specifically required by the Contract Documents for a portion of the Work" and NOT related to systems, materials or equipment. Exactly what design elements are in this category are not clear.

However, it appears that the provision envisions something here. If not, this provision could have been worded as follows:

“The Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering unless such services are specifically required by the Contract Documents for a portion of the Work ... If professional design services or certifications by a design professional are specifically required of the Contractor by the Contract Documents for a portion of the Work, the Owner and the Architect will specify all performance and design criteria that such services must satisfy.”

However, the provision does NOT say this, instead it says:

“The Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering unless such services are specifically required by the Contract Documents for a portion of the Work ... If professional design services or certifications by a design professional ***related to systems, materials or equipment*** are specifically required of the Contractor by the Contract Documents, the Owner and the Architect will specify all performance and design criteria that such services must satisfy. (emphasis added).”

Since courts are likely to favor an interpretation, which gives meaning to all provisions, instead of one that renders any provision meaningless, it is conceivable items that are not specifically related to systems, materials or equipment could be covered differently. [See *U.S. v. Lennox Metal Mfg. Co.*, 225 F.2d at 309), *Blake Constr. Co. v. U.S.*, 597 F.2d 1357 (Ct.Cl. 1979)].

Contractors must be aware they are accepting not only the costs of design, but the liability and risk the design will be adequate to perform the job. Should the design prove inadequate, the Contractor will be liable for damages associated with the inadequate design, including potential damage to third parties. Contractors need to be aware that they may need to purchase errors and omissions insurance, similar to that purchased by architects and engineers, to cover potential lawsuits which may not arise for years after construction has ended.

Contractors may think they are not responsible for damages related to inadequate design under the last sentence of the provision. This sentence reads the “Contractor shall not be responsible for the adequacy of the performance or design criteria required by the Contract Documents”. A court is likely to interpret this sentence as meaning the Contractor will not be responsible for those designs as being adequate to the overall purpose and construction of the project. If the contractor can show it built exactly according to the performance or design criteria outlined in the contract, and those criteria prove to be inadequate, then the Contractor bears no responsibility.

However, the Contractor will be responsible for performing all requirements of the contract adequately, including design work it is responsible for under the terms of the contract. If the design prepared by the Contractor (or the architect, engineer hired by the Contractor) is inadequate or fails, the Contractor will have breached the duties it assumed under the contract and be liable for damages. Also, since many design criteria may be broadly worded performance

specifications, the Contractor will be assuming the liability for the adequacy of its design to fit that broadly worded performance specification. The courts have historically found Contractor's liable for the costs and risks associated with broadly worded performance specifications.

For example the court in *Stuyvesant Dredging* said, "Design specifications explicitly state how the contract is to be performed and permit no deviations. Performance specifications, on the other hand, specify the results to be obtained, and leave it to the contractor to determine how the achieve those results." *Stuyvesant Dredging Co. v. U.S.*, 834 F.2d 1576 (Fed. Cir. 1987).

The extent a Contractor in a particular project must pay for design services will depend on the detail of the plans and specifications. Plans and specifications lacking detail or containing broad performance specifications will require the Contractor to expend large sums for design, and the Contractor will be accepting the risk of those designs. The architect or engineer hired by the Owner does not bear the risk of those designs. If the contract contains broadly worded performance specifications, the contractor will be responsible for preparing the design to comply with that specification. Performance specifications are those, which contain broad language stating merely how a particular project or part of a project is to perform. For example, a performance specification may state something like: "Provide air conditioning systems to cool a particular area to 72° when the outside temperature is 102° degrees and 80% humidity". This type of specification would require the contractor to determine what type of system to install. In the event the system designed by or for the contractor proved inadequate to cool to the required temperature, the Contractor would be responsible for damages.

Another area of potential conflict between the Owner/Architect and the Contractor may be the extent to which the Contractor responsible for design that may only be inferable from the Contract Documents. For example, assume the contract contains the following provision, a provision common in AIA contracts:

"The intent of the Contract Documents is to include all items necessary for the proper execution and completion of the Work by the Contractor...performance by the Contractor shall be required to the extent consist with the Contract Documents and reasonably inferable from them as being necessary to produce the indicated results."

Is this paragraph specific enough to engage 3.12.10? Does this mean the contractor is financially and legally responsible for all design "reasonably inferable... as being necessary to produce the indicated results"? Depending on the precedence given to the documents, it could be argued this is so. However, a better interpretation would be the Contractor is liable for all design specifically enumerated in the contract some place, even if in the form of a broadly worded performance specification.

The line of 3.12.10 which says, "If professional design services or certifications by a design professional related to systems, materials or equipment are specifically required of the Contractor by the Contract Documents, the Owner and the Architect will specify all performance and design criteria that such services must satisfy", bolsters the Contractors argument that it is not responsible for "inferable" design. Exactly what, if any, design may be required under a

broadly worded performance specification as versus design that is merely inferable from the Contracts Documents is not clear and will hopefully not prove to be a problem.

### **Mutual Waiver of Consequential Damages**

The second major change in AIA 201 (1997 version) is the waiver of consequential damages. Though the law relating to damages varies with state law, some general principles have emerged. In a broad sense, “damages” are what the losing party to a lawsuit will pay to the winning party. Several categories of damages are recognized.

The most common form of contract damages awarded is “general” damages. Other terms for general damages include “direct” or “actual” damages. The term “actual damages” is more often used in connection with tort liability, rather than contract liability. General damages are the immediate costs associated with breach of the contract or those, which arise naturally from the breach. General damages include items the parties could have reasonably foreseen when the contract was entered into. For example, should the Owner delay the construction, it is foreseeable the Contractor will have increased rental payments for the job shack located on the site. That rental would be an actual damage.

“Consequential” or “special” damages are those damages that are more remote than actual damages, or damages that may not naturally flow from the breach. A consequential or special damage may be one that arises because of some unique characteristic of the damaged party, rather than some general characteristic of all similarly damaged owners. For example an Owner may cause a delay in the construction, and during that delay the project manager dies in an unrelated car accident. The Contractor is forced to obtain the services of another project manager, but at a cost greatly in excess of the deceased project manager’s salary. This would likely be a consequential damage as it was not reasonably foreseeable that the first project manager would die and it would be difficult to obtain the services of another because of an overly tight market for professionals in the industry.

Of great concern to contractors was the case of *Perini Corporation v. Greate Bay Hotel & Casino, Inc.*, 129 N.J. 479, 610 A.2d 364 (1992). In this case the owner was awarded consequential damages in excess of \$14.5 million dollars for lost profit when a casino was not completed on-time. While lost profit might be an actual or direct damage, the unusually large amount in this cases is considered a consequential damage because of the unique characteristic of this owner, rather than owners in general.

The exact line between and direct and consequential damages is not clear and may vary with state law, and certainly depends on the specific facts of the case and the characteristics of damage. AIA 201 (1997 version) does provide some guidance. The provision specifically states the owner waives the following damages: rental expense, loss of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons. Damages waived by the contractor include: principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

Notice this provision does waive much of the damage and risk the contractor is accepting should its design work performed prove to be faulty. For example, assume a stairwell or walkway designed by the Contractor's licensed engineer employee proves to be faulty, collapses and kills the Owner. This would likely be a consequential damage waived by the provision. Note, however, this provision cannot waive the liability of third parties who may be injured. Should patrons of the Owner's establishment be injured, the Contractor will retain liability to those patrons. A Contractor should obtain insurance to protect it from such lawsuits.

The provision specifically retains the possibility of "direct liquidated damages". The term "direct liquidated damages" is not known in the case law and will hopefully not cause confusion to judges unfamiliar with the construction industry practice. In this sentence the term means that the liquidated damage provision must be an estimate of the direct damages only, no consequential damages.

The contractor must be careful the owner does not try to "hide" consequential damages in the direct liquidated damage clause. The direct liquidated damage clause must reflect an estimation of direct damages only, and should not contain any provisions for consequential damages.

The problem could arise because Judge-made law normally enforces liquidated damage clauses and makes no distinction between "direct" or "consequential" damages included in the provision. If the provision is an estimation of the *actual* damages, are not designed as a penalty, and are understood by the parties to be a provision for liquidated damages, the provision will be enforced. However, actual damages could include consequential damages. The inclusion of the term "direct" will hopefully prevent this from happening. Should the court or jury determine the liquidated damage provision contains consequential damages, the provision should not be enforced.

Enforcing a liquidated damage provision that contains consequential damages would be contrary to the spirit of the document. However, realistically, it is unlikely the contractor will dissect the direct liquidated damage provision at the time the contract is entered into, and judges may be unwilling to do so at the time of trial. Judges may be of the opinion the contractor should have negotiated the direct liquidated damage clause at the time the contract was signed, if it thought the direct liquidated damage clause actually contained hidden consequential damages.

### **Changed Indemnity Provision**

The third major change involves a change in the indemnity provision. Indemnity provisions have been the subjects of much dispute and negotiation. Historically the indemnity provision in AIA 201 stated "3.18.1..Contractor shall indemnify...the Owner, Architect...from and against claims, damages...arising out of our resulting from performance of the Work...*but only to the extent caused in whole or in part by negligent acts or omissions of the Contractor...*". This meant if the Contractor was 1% responsible for the claim or damage, the Contractor was 100% responsible for the damage.

The present provision reads “Contractor shall indemnify...the Owner, Architect...from and against claims, damages...arising out of our resulting from performance of the Work.... *but only to the extent caused by the negligent acts or omissions of the Contractor...*”. This modified provision states the Contractor will only be responsible for its own damages and the Owner and/or Architect will be responsible for their own damages. For example, if the Contractor is 1% responsible for the claim or injury, it will be responsible to pay for only 1% of the damage.

### **Broader Definition of Hazardous Materials**

The forth-major change in AIA 201 is a broader definition of hazardous materials. This provision was first introduced in 1987 and protected the Contractor from costs associated with the removal and containment of asbestos and PCB. Under the 1997 version, a hazardous material is more broadly defined as “a material or substance, including but not limited to asbestos and polychlorinated biphenyl (PCB), encountered on the site by the Contractor that presents the risk of bodily injury or death.” Under this definition any substance, which presents a risk of bodily injury or death, is a hazardous substance.

In the event hazardous materials are found the owner is required to indemnify the Contractor, Architect or subcontractor for claims or damages related to the hazardous substance, including removal, containment, and injury. This in effect puts the cost of alleviating the condition caused by hazardous material upon the Owner.

As with all risks and liabilities of the parties using AIA 201 (1997 version) the damages are limited by the Mutual Waiver of Consequential damages. Therefore, should the Contractor uncover a hazardous material and be delayed in the project, it is not likely it will be able to recover home office overhead or other consequential damages.

This is an area where Owners need to check their insurance coverage. Many property and liability policies do not contain provisions for removal, containment or damage related to pollution or pollutants. Pollutants are likely to include hazardous materials. Therefore a provision denying coverage for pollution is likely to deny coverage for anything related to hazardous wastes.

### **Requirement of Mediation**

The construction industry has long recognized the inefficiency of litigating disputes. Construction contracts have for some years contained mandatory arbitration clauses. These mandatory arbitration clauses have consistently been upheld in most jurisdictions. Upholding a mandatory arbitration clause prevents the parties from proceeding with litigation in a matter.

In a further attempt to reduce the cost of claims and conflict disputes, mediation is now required before arbitration or litigation is filed. Mediation is the use of a third party to help the parties voluntarily comes to a settlement of their dispute. The mediator does not decide if one party is right or wrong, but merely assists the parties in negotiating a settlement. In mediation the parties



retain more control over the outcome of the settlement and can fashion unique and appropriate remedies to conflicts. Arbitrators and judges are generally limited to damages.

Arbitrators, on the other hand, operate similar to judges and actually decide the case after evidence is presented. While it is true an arbitration is less formal than a court trial, the parties still give up a great deal of control over the outcome once the matter is placed in the arbitrators' hands. In addition the arbitrators are generally limited as to the scope and type of remedies they can employ. As with judges they are generally limited to monetary damages.

### **Changes to Insurance**

The types of insurance the Contractor needs to obtain has been increased. The builder's risk policy must now include "earthquake, flood, windstorm, test and start up."

In addition, a new type of insurance, "Project Management Protective Liability," (PMPL) is an optional insurance the Contractor can obtain. The Owner will pay for this insurance. This policy provides "primary protection of the Owner's, Contractor's and Architect's vicarious liability for construction operations under the Contract."

In other words, this policy provides insurance if a party is found to be vicariously liable for the acts of others. In general, a party with control over a person will be vicariously liable for all damages caused by that person. An employer is generally vicariously liable for the breaches of tort or contract committed by its employee in the course and scope of employment. The Owner will be vicariously liable for the breaches of the Architect, and the Contractor will be vicariously liable for the breaches of subcontractors.

There are two major advantages for the Contractor obtaining this policy. First, to the extent the policy covers a claim or damage, indemnity and subrogation are waived. Secondly, the Contractor will not be required to name the Owner as additional insured on its general liability coverage. Because the PMPL policy is separate from the Contractor's other insurance, conflicts between the Owner, Contractor and Insurance Company over coverage can be expected to decrease. Since this is a new form of policy however, Contractors and Owners will want to understand the exact scope of coverage before deciding the Owner should not be added as an additional named insured on the Contractor's Builders Risk or other insurance.

### **Summary**

This article has discussed some of the major changes in AIA 201 (1997 version). Many other changes have also been incorporated into it, changes not discussed here. It is likely specific state law will affect any interpretation of the document. Anyone using AIA 201 (1997 version) should have the document carefully reviewed by counsel to determine the exact nature of their rights and liabilities under this new form, as compared to the prior form, and in connection with a particular project.

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