

Newsflash! Absence of Privity as a Defense to Claims against Design Professionals Practicing in New York

By Roy Schwartz and Matthew Dials

Terms and conditions within design consultants' agreements have greater meaning than just scope of work and fees. When drafting and negotiating agreements, design consultants should pay close attention to whether the contract provides third-party beneficiary rights, incorporates a prime or master agreement, or includes other provisions which may increase their liability if a claim arises.

In a recent District Court decision, *Stapleton v. Pavilion Building Installations Systems, Ltd.*, 09-CV-934S, 2017 WL 431801 (W.D.N.Y. Feb. 1, 2017) the Court relied on the legal principle of privity, i.e., the connection that exists between contracting parties, to determine a plaintiff's inability to assert claims against the design professionals.

The District Court's rationale included the following.

- (1) Privity (or its functional equivalent) is required to successfully assert a breach of contract claim;
- (2) Under the economic loss doctrine, a plaintiff may not assert a negligence claim against a design professional for purely economic losses unless the plaintiff and the design professional are in privity (or its functional equivalent); and



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- (3) Negligent misrepresentation claims against a design professional will be invalid unless privity exists or a relationship so close that it approaches that of privity.

In *Stapleton*, the Plaintiff retained Pavilion Building Installations Systems (“Pavilion”) to design, manufacture, and erect a permanent, lightweight building (“Project”) at its facility under a master agreement (“Master Agreement”). In turn, Pavilion retained an engineer-of-record who was responsible for reviewing engineering drawings to ensure they complied with the applicable New York State code. Pavilion also retained a second engineering firm to review the engineering design. Both engineering firms (collectively the “Design Professionals”) were retained as independent contractors through oral agreements and were paid directly by Pavilion. No written contracts existed between Plaintiff and the Design Professionals.

After the Project’s completion, Plaintiff allegedly became aware of significant flaws as evidenced by cracking and also tears in the Project’s fabric covering. Plaintiff sued Pavilion, the Design Professionals, and others. Plaintiff alleged that the Design Professionals breached the Master Agreement and were professionally negligent. The Design Professionals moved for summary judgment to dismiss all of Plaintiff’s claims on the basis of lack of privity.

1. *Breach of Contract Claim.*

Under New York law, a breach of contract claim requires (1) the existence of a contract; (2) performance of the contract by one party; (3) breach by the other party; and (4) resulting damages. Plaintiff argued that the Design Professionals were responsible for complying with the Master Agreement’s terms, which defined “Contractor” as including “any applicable subcontractors.” While the Master Agreement referenced subcontractors, the Design Professionals only had oral agreements with Pavilion, and there was no evidence of any intention to incorporate the Master Agreement’s terms into their subcontract. Absent a contractual relationship or another functional equivalent of privity, there can be no contractual remedy. The Design Professionals were deemed not in privity with the Plaintiff.

The Court recited that Plaintiff could theoretically be a third-party beneficiary to Pavilion’s subcontract with the Design Professionals, which would entitle Plaintiff to assert a breach of contract claim. However, there was no evidence of a third-party beneficiary relationship because there was no proof or claim that the subcontract identified Plaintiff, or that the Master Agreement’s terms were incorporated into the subcontract. Moreover, Plaintiff failed to allege a third-party beneficiary theory within its pleadings, and this theory could not be raised for the first time within opposition to a summary judgment motion.

2. *Professional Negligence and Negligent Misrepresentation Claims.*

Plaintiff also filed a professional negligence claim against the Design Professionals. However, New York’s economic loss doctrine generally bars recovery in tort for purely economic losses caused by a defendant’s negligence. In determining whether the economic loss doctrine applies, the court must consider the nature of the defect, the injury, the manner in which it occurred, and the damages sought. A key consideration is whether the requested damages

are for a product's failure to perform its intended purpose, as opposed to damages that resulted from the defective product; recovery in tort for failure to perform the intended purpose is barred by the economic loss doctrine, leaving a plaintiff to contractual remedies. The Court also cited that the economic loss doctrine is inapplicable where a plaintiff is in privity with an architect or engineer. Because Plaintiff only sought damages to the Project's structure (resulting from faulty design or construction), and given the absence of privity, the economic loss doctrine barred professional negligence claims against the Design Professionals.

The Court also discussed considerations for proving an exception to the economic loss doctrine, *i.e.*, where parties have privity of contract, and the plaintiff suffers damages due to the defendant's negligent misrepresentations. Because plaintiff could not prove privity (or its functional equivalent), the Court found the claim inapplicable. The Court also recited requirements for proving privity's functional equivalent:

- (1) An awareness that the Design Professional's services were to be used for a particular purpose;
- (2) Reliance by a known party in furtherance of that purpose (*e.g.*, if the Plaintiff relied upon the Design Professional's services in furthering its project); and
- (3) Some conduct by the Design Professionals linking them to the known party and evincing the Design Professionals' understanding of their reliance (*e.g.*, if the Design Professionals' subcontract referenced the Plaintiff and there was evidence that the Design Professionals knew that their work would be relied upon by the Plaintiff).

These three criteria, taken together, required Plaintiff to demonstrate circumstances of a close relationship premised on knowing reliance. As the Design Professionals and Plaintiff lacked any close relationship between them, the negligent misrepresentation claim would also fail.

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