

Design-Build in North Carolina – is it Possible?

By Douglas P. Jeremiah, P.E., Esq.

Design and construction firms across the country are promoting the benefits of design-build project delivery as a way of providing faster project completion to the owner and at a lower cost than the traditional design-bid-build project delivery method. There are a number of economic factors increasing the demand for design-build. The increasing use of complex debt financing for construction projects is creating the need for more definite project budgets early in the process. Project delays for debt-financed projects can wreak financial havoc on project owners. Building components and systems are more often being designed by product suppliers and fabricators. Project claims, disputes, and litigation are increasing project costs. Lastly, the globalization of engineering and construction services is carrying the preference in other countries for design-build into the United States.

This article provides a broad overview of design-build in North Carolina. To properly engage in a design-build project is a complex undertaking. It is recommended that you consult with your attorney before initiating any plans to perform design-build services in North Carolina.

Engineering firms organized as professional corporations and professional limited liability companies (“PLLC”) in North Carolina are generally not allowed to provide construction services. The same applies to the professions of architecture, surveying, landscape architecture, soil science, and geology. The licensing statutes and regulations governing these professions do not explicitly prohibit providing of construction services. The wrinkle lies for these professionals desiring to provide professional services as a professional corporation or a PLLC, because those business entities must also comply with the North Carolina Professional Corporation Act (“PC Act”).

The PC Act requires that professional engineers, geologists, soil scientists, landscape architects, or architects own at least 2/3 of the professional corporation or PLLC. The remaining 1/3 may be owned by non-professionals, but they must be individuals employed by the professional corporation or PLLC. These ownership requirements would, therefore, prevent a construction contractor from buying or merging with an engineering professional corporation or PLLC to provide design-build services in North Carolina.

The PC Act does not allow a professional corporation or PLLC to offer non-professional services unless the non-professional services are “ancillary” to the professional services offered. Ancillary services are those services connected to and of the same nature as the professional service, but must be subordinate to the professional service. Construction services are not considered by the North Carolina Board of Examiners for Engineers and Surveyors (“Engineering Board”) to be ancillary. Thus, an engineering firm organized as a professional corporation or PLLC could not buy or merge with a general contractor (even assuming the professional ownership requirements

were complied with) to offer design-build services in North Carolina because it would not be authorized to offer construction services.

Corporations practicing professional engineering formed prior to June 5, 1969, however, are exempt from the PC Act and are not subject the ownership requirements and service limitations imposed by the PC Act. In addition, engineering entities other than a professional corporation or PLLC are not bound by the restrictions of the PC Act. A sole proprietor, general partnership, or limited partnership could theoretically be licensed to provide both engineering services and general contracting, and be able to offer sole-source design-build services. It should be noted, however, that these business entities offer less liability protection to their owners than the PLLC or professional corporation. Limited liability partnerships (“LLP”) generally offer the same protection as a limited liability company, but the Engineering Board would likely view an attempt to offer design-build services through an LLP as circumventing the PC Act. Also, the Engineering Board is likely to find that it is unlawful for a corporation to be a partner in a professional partnership unless the corporation satisfies the requirements of the PC Act. Therefore, a corporation may not circumvent the PC Act by joining into a partnership that will serve as the operating entity for engineering services.

There are ways engineers in a professional corporation or PLLC can participate in design-build projects in North Carolina. A general contractor may contract with the owner to provide design-build services. The general contractor can subcontract the design services to an engineer. Engineering firms organized as a professional corporation or PLLC are not able, however, to do the opposite – that is contract directly with the owner to provide design-build services and subcontract the construction services to a general contractor. This is because general contracting is regulated by its own statutes and licensing board. The North Carolina courts have held that the prime contractor itself, and not an employee or subcontractor, must hold a general contractor’s license, or the prime contract for construction will not be enforceable.

General contractors are not prohibited under the PC Act from offering professional engineering services as long as they are “reasonably necessary and connected” with general contracting. Thus, employees of a general contractor may provide design services in a design-build contract as long as they are licensed, professional engineers. Such general contractors, however, are prohibited from offering stand-alone design services – they are limited to offering design through design-build project delivery. General contractors offering such professional engineering services must file an application and register with the Engineering Board.

An engineering professional corporation or PLLC may be able to form a joint venture with a general contractor to furnish design-build services. Joint ventures are entities typically created for one project, usually by one or more general contractors. The North Carolina Licensing Board for General Contractors (“General Contracting Board”), however, requires that each entity in a joint venture be a licensed general contractor or that the joint venture itself be a licensed general contractor. Although the General Contracting Board allows an engineering firm to obtain a general contracting license, if

that firm is a professional corporation or PLLC, it is prohibited under the PC Act from offering general contracting services. It is unsettled as to whether an engineering professional corporation or PLLC could obtain its general contracting license but not provide general contracting services, thus meeting the requirements of the General Contracting Board for a joint venture and comply with the PC Act. The safest way for an engineering entity involved in a joint venture to offer design-build services would be for the joint venture itself to obtain a general contracting license.

In addition to the statutory and regulatory hurdles impeding the use of design-build in North Carolina, the engineering firm should take into the following issues into consideration when participating in a design-build joint venture. Will the engineering firm have to indemnify the surety as the general contractor typically is responsible for? Will the engineering firm bear the risk of project losses? Can the engineering firm control building code compliance and professional engineering standards on the project? If the joint venture is sued for professional liability, will the general contractor participate in any loss?

Engineers can also offer design-build services in North Carolina by forming a separate entity and that entity licensing as a general contractor. To obtain an unlimited general contractor's license, a corporation must demonstrate substantial net worth in an amount fixed by regulation. The general contracting entity could be a "related entity" to the engineering firm which would typically perform work in conjunction with the engineering firm. There should be a formalized relationship set up by the engineering firm with the related entity that documents their relationship, including, for example, how employees are shared and which entity's payroll they are on. For example, the owners of ABC Engineering could create ABC Contractors as a related entity. In this arrangement, an owner could contract directly with the ABC Contractors, which in turn could subcontract the design services to ABC Engineering. The two entities may have common ownership, but ABC Contracting cannot control ABC Engineering.

All of the above restrictions apply to public as well as private projects in North Carolina. State procurement laws of both design and construction services further complicate the use of design-build in North Carolina on public projects. Procurement of building design services for all state and local governments is based on qualifications without regard to cost. The design services must be contracted directly between the design professional and the owner. Furthermore, the design professional must be selected and the design must be completed before the project can be bid for construction. The procurement rules for most public projects limit project delivery methods to multi-prime, single prime, and construction management at risk. The main criterion for contractor selection is price, which is generally fixed and based on complete construction drawings and specifications.

State and local governments can, under limited circumstances, obtain authorization from the State Building Commission ("SBC") to use design-build project delivery method. The State Building Commission, an agency of the North Carolina Department of Administration, is responsible for developing procedures to direct and

guide the State of North Carolina's capital facilities development and management program. The authorization from SBC applies to single projects and must be specifically for: (1) use of special technology or equipment; (2) specialized or complex construction; or (3) fast-track schedule necessary to address judicial intervention or regulatory mandate. NCDOT is also authorized by statute to award up to three design-build contracts annually. NCDOT must make a determination that project delivery must be expedited and that it is not in the public interest to comply with the standard design and construction procurement procedures. Public project owners desiring to utilize design-build can also get their legislator to sponsor a local bill authorizing the use of design-build for a specific project.

These are some of the roadblocks that restrain the use of design-build in North Carolina. As design-build gains popularity and the North Carolina General Assembly becomes more comfortable with its use as a project-delivery method, restrictions on the use of design-build through the PC Act and through the state procurement statutes may be lessened. Until then, there are important considerations for engineers to take into account when deciding whether to participate in design-build, not the least of which are risk, liability, and capitalization.

Bio

Mr. Jeremiah practices construction law in the Raleigh office of Conner Gwyn Schenck PLLC, a construction law firm with offices in Raleigh and Greensboro. Mr. Jeremiah received his B.S. in Civil Engineering from Virginia Polytechnic Institute & State University. He received his J.D. from the University of North Carolina at Chapel Hill. Prior to law school, Mr. Jeremiah worked as a project development engineer with NCDOT in Raleigh. If you have a question or issue for a future column, please email Mr. Jeremiah at djeremiah@cgspllc.com.