Construction Toolbox: Construction Laws, Cases, Notes and Alerts

A Production of The Harmonie Group
Construction Law Committee

(Find in the www.harmonie.org Resource Center)

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Dear Reader:

This preface will focus on the resources prepared by The Harmonie Group Construction Committee that are available on the website www.harmonie.org:

- Construction Accident Investigation Checklist
- Compendium of Construction Laws (State by State)
- Digest of Primary Construction Contract Clauses
- "Construction Tool Box" notes and comments on recent cases and topics published three times a year
- Annual Seminar Presentation Booklets.

We are also hosting and presenting Construction Claims Conferences in Dallas on June 22, 2016 and Atlanta on August 3, 2016. Check the website or contact the Harmonie Group for more details and information on attending.

- The Editor

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NATIONAL FOCUS

CHANGE ORDER COSTS

Appeal of: BAE Systems San Francisco Ship Repair, 2016 ASBCA No. 58809 (January 11, 2016).

BAE Systems was a general contractor to clean and repair a U.S. Army vessel. Just before contract completion, the government issued a contract modification for additional work for a price of $96,157.00. After completing the work, BAE submitted a claim for $381,258.00. The contracting officer denied the additional costs, and the Board of Contract Appeals had to decide additional compensation.

The Board did not accept the government estimate since the actual work performed was more complicated because the contract modifications came late in the project work cycle. The Board also believed that the contracting officer could have minimized the disruption and decreased the cost by issuing the change order earlier. The Board ruled that BAE was entitled to most of the costs alleged as an equitable adjustment.

NATIONAL FOCUS

FALSE CLAIMS ACT DAMAGES LIMITED TO ACTUAL LOSS

U.S. ex rel. Wall v. Circle C Construction, LLC, 2016 U.S. App. LEXIS 1871 (6th Circuit February 4, 2016).

Circle C built several warehouses at Fort Campbell, but it turns out its electrical subcontractor underpaid its electricians by a few dollars an hour which rendered "false" Circle C's "compliance", making the contractor liable to the government under the False Claims Act. The government argued that it should not have to pay for ANY of the electrical work, worth approximately $260,000.00, because it would have suspended payment if it had known about the ongoing underpayments. The District Court agreed, applied the electrical subcontractor's pay total times three, and awarded over $750,000.00 in damages. However, this decision was reversed on appeal because there was no basis to agree with the government's assertion that all electrical work on the project was essentially without value merely because of the hourly wage under payments. Overall, there was no alleged defect in the electrical work done on the project.

The actual damages were only about $9,916.00 in pay differential, and the Appellate Court multiplied that by three, subtracted money the subcontractor already paid, and the award was just $15,000.00. The Court did say that this "difference in value" approach might have been applied differently if there was a bona fide claim that electrical work was defective, or there was some other falsehood or dishonesty involved with respect to the claim. However, the real wrong here was a relatively minor hourly wage underpayment, and that could be resolved at a much lower sum in "damages" than awarded by the District Court.

NATIONAL FOCUS

"SEVERIN DOCTRINE"

Turner Construction Co. v. Smithsonian Institution, 2015 CIVBCA LEXIS 384 (October 30, 2015).

The "Severin Doctrine" relieves the government from responsibility for a subcontractor's claim unless the prime contractor is also responsible and liable to pay the subcontractor. In this case, the "Severin Doctrine" was not operative because the contract left open the possibility of prime contractor liability to subcontractors.

Turner Construction provided design and construction services to the Smithsonian Institution and sought approximately $14.5 Million, with about half the amount paying for pass through claims of subcontractors. The Smithsonian argued that the prime contract precluded the claims, but the Board of Contract Appeals held that not all subcontractor claims were potentially barred, and that the claims themselves would have to be reviewed to make a determination. The Smithsonian also argued that the subs released all claims against Turner but it was determined that the Releases and similar documentation were intended to protect Turner Construction from independent liability to the subcontractors, but did not bar the subcontractors from submitting claims. In fact, the Board of Contract Appeals held that the contract required Turner Construction to pursue subcontractor claims and pay any recovery it received to the subcontractors, which is essentially the opposite of where the "Severin Doctrine" might conceptually apply.

CALIFORNIA

CHOICE OF LAW PROVISION

Vita Planning amd Landscape Architecture, Inc. v. HKS Architects, Inc., 2015 Cal. App. LEXIS 832 (September 25, 2015).

HKS provided architectural services for a hotel in California, and used a California firm, Vita, to perform landscape design. Vita eventually filed a complaint against HKS for almost $400,000.00 for work performed but not compensated. Vita sued in California, but HKS moved to enforce a Texas forum selection clause contained in the Prime Agreement with the project owner which it claimed was incorporated into the downslope contract with Vita. The Trial Court ruled that the Texas choice of law clause was enforceable because HKS and Vita were two different design professionals, and not contractor and subcontractor, and therefore California Civil Code of Procedure § 410.42 did not apply which bars out of state contractors forcing California subcontractors to litigate contract disputes out of state.

On appeal, however, Vita was able to define itself as a subcontractor and HKS as a general contractor so that § 410.42 applied and therefore the forum selection clause was not enforceable. The core of the dispute in reality was that there was a pay-if-paid clause in the main agreement between HKS and the owner, and pay-if-paid clauses are enforceable in Texas, but not in California. Therefore, determining whether Texas or California law applied was critical to the entire payment dispute and process.

Vita argued that enforcing the forum selection clause would violate California public policy and that the statute barred the clause, and the Appeal Court agreed. The statute did not specifically define the

terms "contractor" and "subcontractor", and the Appeal Court ruled that these terms were not limited only to builders, and did not exclude an architect or other design professional in the construction trade working on a construction contract who "subcontracts" out a portion of the work. The Court further ruled that the statute was intended to protect California subcontractors and give them the benefit of California laws such as prompt pay laws. Apparently, there are some two dozen states that have similar statutes voiding forum selection clauses that force litigation outside of the state where the project is located. The Court concluded that § 410.42 applied, Vita did not have to take its claim to Texas, presumably California law applied and would also render unenforceable the pay-if-paid clause.

CALIFORNIA

"EICHLEAY FORMULA" FOR OVERHEAD COST RECOVERY

JMR Construction Corp. v. Environmental Assessment Remediation Management Inc., 2015 Cal. App. LEXIS 1172 (December 30, 2015).

JMR, the general contractor, sought damages for extended overhead costs from the Corps of Engineers, and a trial court awarded JMR approximately $400,000.00 based on application of the "Eichleay" formula. On appeal, the argument was that the courts erred in applying the Eichleay formula but the Court of Appeal in California disagreed.

Under the "Eichleay" formula for overreach for a defined contract period it multiplies total overhead costs by the ratio of delayed contract billings to total billings. This number, the allowable contract overhead, is divided by the days of performance to get a daily contract overhead rate and that daily rate is then multiplied by the number of days of government or owner caused delay. This calculation is often applied on federal public works projects, but it had never been approved by the California Courts. JMR argued that the formula was valid and it would be typical for a contractor to seek delay damages from a sub. JMR also pointed out the formula is frequently used at the trial court level and in construction arbitrations. Application of the Eichleay formula requires that there is a government or owner-caused delay, the contractor as a result was on standby, and the contractor was unable to take on other work because of the delay and standby status of equipment and personnel.

INDIANA

ECONOMIC LOSS DOCTRINE – POSSIBLE EXCEPTION

City of Whiting v. Whitney, Bailey, Cox & Magnani, LLC, 2015 U.S. Dist. LEXIS 150229 (N.D. Indiana, November 5, 2015).

Whiting sued the contractor because of a failed retaining wall that was part of a waterfront project. The City alleged the wall caused extensive damage to city property, including a pavilion, gazebo, and fishing pier. The City alleged damages of more than $1.3 Million in delays and repairs. The City sought to recover from the engineer even though it did not have contractual privity with the engineer.

The "economic loss" rule generally precludes liability for purely economic loss in tort for negligence where there is a contract which governs the work in question. The Court ruled that an

exception to this rule might apply here where the alleged construction defect causes personal injury or damage to property other than to the product or service itself. In short, the City argued that there was damage to both its project and other property not directly linked to or part of the construction project itself.

The contractor argued that all of this other property was part of or within the construction project, but as a matter of pleading on an initial motion, the Court ruled that the City might state a claim for negligence with respect to damage that was beyond or not strictly speaking part of the construction project or Zone, itself and therefore potentially outside of the "economic loss rule".

PENNSYLVANIA

LATENT CONSTRUCTION DEFECTS NOT COVERED

Reginella Construction Co. v. State Farm Fire & Casualty Co.,2016 WL 454313 (W.D. Pa. February 5, 2016).

Mr. Eck bought a house built by Reginella in Pennsylvania in 2005, and several years later in 2012 noticed problems with the floors on the second story of the house. The customer eventually alleged that the contractor used faulty materials and substandard construction which caused bulging floors and other structural problems. State Farm insured the contractor during the policy period in which the house was built (2004-2006). The policy covered property damage caused by an occurrence during the policy period.

The customer sued Reginella, who tendered the case for defense and indemnification to State Farm, and State Farm rejected the tender on the primary basis that the alleged construction defects were not discovered until 2012. Therefore, State Farm argued that there was no "occurrence" as specified in its policy within the policy period. Eventually, the insured sued State Farm in 2015 for breach of contract, bad faith, unreimbursed attorneys' fees, punitive damages and other costs. The District Court in Pennsylvania agreed with State Farm's principal position and granted the insurer's motion to dismiss. The triggering "occurrence", the Court found, took place after State Farm's policy expired.

The Court admitted that the cause of the damage, the allegedly defective construction, arguably occurred within State Farm's coverage period, but cause of injury is not necessarily determinative of the date an insurance policy is triggered unless specifically required by the language of the policy. The Court ruled that State Farm's coverage denial was based on a consistent reading of the insurance policy, and was legally proper with respect to coverage under occurrence-based policies.

This case is interesting, because, generally, in construction defect litigation the defect occurs at the time of defective construction during the contractor's actual physical work. Typically, the active negligence of the contractor is held to be the defect, which occurs at the time of construction. For example, cases dealing with the statute of limitations have consistently held that the statute begins to run on constructions defects from completion of the contractor's actual physical work, and not when defects are discovered or first observed.

In this case, the Court seems to be saying that under the policy manifestation of injury was the occurrence, and that did not arise until 2012 regardless of the fact that the alleged defective construction took place back in 2004-2006 during State Farm's policy period.

The Court held that there was no coverage under the State Farm 2004-2006 policy even though it was an occurrence-based policy, although the reasoning is more attuned to a claims-made policy, i.e., no visible damage and claim made until 2012.

- The Editor

MISSISSIPPI

ARBITRATION CLAUSE

New Orleans Glass Co. v. Roy Anderson Corp., 2015 U.S. App. LEXIS 21026 (5th Circuit, December 1, 2015).

A developer of a condominium resort project started an arbitration proceeding against the general contractor. The contractor then filed third party demands for arbitration against several of its subs who refused to arbitrate. The contractor moved to compel arbitration which was denied, but this decision was reversed on appeal.

The contractor argued that the subcontractors were bound to arbitrate under a provision in the subcontract that provided, if the contractor had a claim or dispute involving the subject matter with a third party, the subcontractor had to assert any claims and defenses in the same forum and same proceeding which had jurisdiction over the dispute between the contractor and third party, which in this case was the developer/owner. This contract language contained no provision limiting the application or definition of a particular party and based on this language the subcontractors were bound to arbitrate as part of the primary arbitration between the developer and contractor. The subcontractors' claims and defenses involved the same overall subject matter as the contractor's claims/dispute with the owner/developer.

VIRGINIA
ENGINEER LIABILITY FOR DESIGN DEFECT

William H. Gordon Associates, Inc. v. Heritage Fellowship, 2016 Va. LEXIS 11 (February 12, 2016).

Gordon designed a rain tank system installed by general contractor W&J. Eventually the tank and parking lot above it collapsed. The courts ruled that negligence on the part of the engineering firm was the sole proximate cause of the tank collapse, and Gordon had a duty to repay remediation costs. The evidence indicated that the contractor substantially complied with the engineering plans, and there was evidence that negligent design caused the tank failure.

The contracts did not shift design liability to the general contractor. Since the contractor complied with the engineer's design, it was not liable for remediation. It should be noted that this case is an offshoot of the "Spearin" doctrine to the effect that a contractor who builds in accordance with plans

and specifications is entitled to be paid, and is not liable for defects, even if the plans may turn out to be erroneous or defective.

WASHINGTON

DIFFERING SITE CONDITIONS – CONTRACT SILENCE

King County v. Vinci Construction Grands Projects, 2015 Wash. App. LEXIS 2735 (November 9, 2015).

Kings County Washington hired a joint venture for a major expansion of its waste water treatment system, including tunneling work. The joint venture alleged the County breached the contract by refusing to grant change orders and time extensions for differing site conditions. A jury awarded the joint venture $26 Million in damages on some of its claims, but dismissed a differing site condition claim based on the soils. On appeal, this decision was affirmed.

The joint venture tried to argue there was a Type I differing site condition, however the appellate court held that the contract documents did not specifically indicate the frequency of transitions between differing soil types. The contract documents contain no baseline for expected number of changes or transition in soil composition. The contract documents contained no express or implicit indication as to the number of soil transitions, and "silence" does not support a differing site condition claim. A differing site condition claim cannot exist where the plans and specifications are essentially silent about the alleged unforeseen condition. Under Washington law, there is no claim for a differing site condition where the contract either disclaims liability for subsurface conditions, or gives no information regarding the subsurface conditions.

WISCONSIN

CONTRACT FORMATION-NO OFFER OR ACCEPTANCE

CG Schmidt, Inc. v. Permasteelisa North America, 2015 U.S. Dist. LEXIS 144184 (E.D. Wisconsin, October 23, 2015).

The general contractor sued the subcontractor after the sub walked away from a $52 Million office building construction project in Milwaukee, Wisconsin. What transpired was a 14 month exchange between the parties that included an initial bid, revised bids, letters of intent, a preliminary schedule and cost breakout, an updated bid proposal, but never an actual signed contract. The subcontractor never signed the proposed subcontract, and the District Court granted the subcontractor's motion for summary judgment and dismissed the claim on grounds that no contract ever came into existence.

The Court ruled that the documentation assumed and stated an intent to enter into a formal written agreement, and that with all of the negotiating and documentation being exchanged, the indications were that the parties did not consider themselves bound by any agreement. The Court ruled that the parties were "working toward" a signed contract, but the bid itself also stated that a signed subcontract would be required. The Court also reviewed the parties' conduct which contained extensive negotiations and discussions over price and other numerous subcontract terms which all negated the existence of a final or agreed upon agreement.