Construction Toolbox: Construction Laws, Cases, Notes and Alerts

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Dear Reader:

This issue covers cases dealing with common construction contract and liability issues such as differing site conditions, pay-if-paid clauses, and the economic loss doctrine. We also cover more esoteric and non-traditional topics such as the False Claims Act, fraud, and whether prospective building occupants/tenants have standing to sue the contractor. The challenge of construction law is that it encompasses both the usual construction issues and novel ones as well.

- The Editor

ALPHABETICAL BY TITLE

NATIONAL FOCUS

FALSE CLAIMS ACT REQUIRES A MATERIAL FALSEHOOD

U.S. ex rel. Kevin Thomas v. Black & Veatch Special Projects Corp., 2016 U.S. App. LEXIS 7343 (10th Circuit, April, 22, 2016).

This case involved an electrical power project in Afghanistan. The plaintiffs argued that the contractor falsely certified compliance with the contract after "altering documents" to fraudulently obtain work permits and visas for employees from the Afghan government. The Court ruled, however, that there was no material violation of the False Claims Act.

The Court noted that under the FCA there is a "materiality requirement" whereby a false statement or certification is material that leads the government to make a payment it might not otherwise have made. The requirement demands a showing that the government may not have paid a claim or an invoice if it had not been deceived by an alleged falsehood. Other Circuits have read similar requirements into the Act, holding that an alleged violation must be material because it was in some manner directly linked to the contract's purpose and would be relevant to the government's disbursement decision.

In this case, the contract was to produce electrical power in Afghanistan. The alleged "falsehood" with respect to the work permits and visas did not materially affect that essential contract purpose. For example, there was no indication that there was any contractual requirement upon the contractor to obtain work permits and visas. There was no allegation that the work permits and visas had anything to do with a performance or payment requirement. There was also no allegation that the contractor provided deficient work. Under the FCA, materiality requires a false claim for payment and proof of the claim having influence or impact on whether payment is made by the government. In this case it was not alleged that any of the alleged problems with the work permits and visas would have had any effect on the progress of the work, quality of the work, or the government's payment decision.

NATIONAL FOCUS

ARCHITECTURAL AND ENGINEERING SERVICES

Matter of: Tridentis LLC, 2016 U.S. Comp. Gen. B-412539 (March 18, 2016).

The U.S. Army Corps of Engineers used the Brooks Act to select bidders on a design project for boats, floating structures, and other naval equipment. The Act allows a federal agency to procure architectural and engineering ("A/E") services by selecting three bidders based solely on technical qualifications, then bargaining with the selected parties for a reasonable project price. *See*, 40 U.S.C. §§ 1101 to 1104. The Brooks Act is usually used for land-based construction projects, and one contractor brought a claim to the Comptroller General protesting the Corps's use of the Act for naval architecture and marine engineering. The contractor argued that Congress intended the Act solely for stationary building projects on land, and claimed that the Corps consequently should have allowed bidders to directly compete on price under the F.A.R. Regulations.

The Comptroller rejected the contractor's claim. Although the Brooks Act's legislative history did not mention "naval" or "marine" projects, the statute does not expressly limit its application to land projects. The Comptroller concluded that the Act's broad definitions of A/E services encompassed the work required by the Corps for this contract. The government said the services required by the Corps fell within the enumerated tasks, and argued that if Congress intended to limit the Act only to stationary land-based projects, then it would not have included a separate "real property" category.

NATIONAL FOCUS

BID EVALUATION

Matter of: Addvetco, Inc., 2016 U.S. Comp. Gen. B-412702; B-412702.2 (May 3, 2016).

The Comptroller General denied a contractor's challenge to the VA's selection of a more expensive offer in a three-factor best value bidding process. The factors were technical capability, past performance (equally important), and price (least important). Addvetco, Inc. protested the bid award for a hospital floor reconstruction project on several grounds, including that its technical capability rating was too low, and that the winning contractor's bid was not worth the $600,000 difference in price.

The Comptroller held that the VA's ratings on both contractors' technical capability were reasonable. Under the "construction approach" subfactor, for example, Addvetco's rating suffered because the contractor's schedule planned for more "off-shift" construction than called for by the VA's solicitation for the project. The Comptroller would not question the agency's conclusion, because of the "impact this project has on patient care." The Comptroller concluded that the VA reasonably determined that the other bid provided the best value at the least risk.

ALABAMA

CONTRACT AMBIGUITY

Otis Elevator Co. v. W.G. Yates & Sons Constr. Co., 2016 U.S. Dist. Lexis 26748 (N.D. Ala. March 3, 2016).

A subcontractor was liable for more than $400,000 in damages after making a reasonable but "unilateral" interpretation of an ambiguity. The project's drawings had marks indicating 39.5-inch wide escalator steps. Because standard escalator treads come in 24, 32, and 40 inch sizes, the subcontractor interpreted the drawings to require 32-inch treads, with the extra 7.5 inches in width allotted for handrails. Multiple project bidders included that same interpretation in their proposals, also without asking for clarification. The project owner only objected to the subcontractor's interpretation when the escalator was almost completely installed. The general contractor and project designer both contended that the project called for a 40-inch "nominal step width," as approximated in the drawings.

In 2013, an Alabama District Court awarded the subcontractor nearly $400,000 in damages after a three-day bench trial on the subcontractor's breach of contract claim and the general contractor's counterclaim. *See*, Otis Elevator Co. v. W.G. Yates & Sons Constr. Co., 2013 U.S. Dist. Lexis 111039 (N.D. Ala. 2013). The court held that because the ambiguity was latent, and other bidders made the same interpretation, the subcontractor acted reasonably and thus was not in breach of contract.

The Eleventh Circuit reversed on appeal. The court held that a subcontractor cannot recover based on a reasonable interpretation of an ambiguity, if that party "… is subjectively aware of that ambiguity when bidding on the construction contract and fails to clarify that ambiguity by inquiring of the contractor." The subcontractor failed to clarify, so it "bore the risk that [the contractor] would adopt a different, reasonable interpretation." On remand, the District Court held on motion for summary judgment that the subcontractor was liable to the general contractor for $415,000. The Court concluded that the Eleventh Circuit's decision was a "mandate" establishing that the subcontractor was the breaching party.

LOUISIANA

BUILDING OCCUPANTS AS PLAINTIFFS

D L Star LLC v. Royal Seal Construction, Inc., 2016 U.S. Dist. LEXIS 44738 (W.D. La. March 31, 2016).

Two projected building occupants claimed they were "third party beneficiaries" to the construction contract and were therefore entitled to lost profits because of construction delay. The courts consider three criteria when determining third-party beneficiary status: (1) the inclusion of the third-party is clear; (2) the intended benefit to that party is clear; and (3) the benefit to the third-party is not a mere incident to performance of the contract between the actual parties. Here, the plaintiffs did not satisfy any of the above criteria.

Here, the intent to benefit the projected building occupants was not included or listed in the contract documents. In fact, the contract documents contained a disclaimer that they did not create a contractual relationship between persons other than the property owner and the contractor.

The contract also contained no information detailing an intent to benefit the eventual building occupants. The Court ruled that the projected building occupants failed to prove that the contract intended to convey a clear benefit to them.

Finally, the Court ruled that not every promise or performance which may be advantageous to a third person creates an actionable right. In this case, the contractor's only obligation was to the property owner who might then use or lease the building space, but the contractor was not directly conferring a benefit on the third-parties.

MICHIGAN

BOND CLAIM NOTICE

Wyandotte Electric Supply Co. v. Electrical Tech. Systems, Inc., 2016 Mich. Lexis 845 (May 3, 2016).

Actual notice was not required for a subcontractor to comply with the state's little Miller Act, if the subcontractor sent proper notice to the general contractor on time and via certified mail. Wyandotte Electric, a second-tier subcontractor, filed a recovery claim with the general contractor's bond surety after the intermediate subcontractor. The surety denied liability because the general contractor claimed that it had not received notice within 30 days of the start of Wyandotte's work, as required by Michigan's Public Works Bond Act (PWBA).

The Supreme Court cited a plain reading of the PWBA: that notice "shall be served by mailing the same by certified mail, postage prepaid, in an envelope addressed to the principal contractor, the governmental unit involved, at any place which said parties maintain a business or residence." The court declined to read an actual notice requirement into the statute. Because Wyandotte complied with the PWBA, the court held that the subcontractor stated a valid bond claim.

The court also concluded that Wyandotte could sue on the general contractor's bond for claims arising from two provisions in its agreement with the subcontractor: (1) "time-price differential" charges for past-due invoices, and (2) one-third of unpaid attorney fees. The general contractor and its surety argued that they were not liable for these charges because they were not in privity with Wyandotte, but the Supreme Court held that privity is not required under the PWBA.

MISSOURI

PAY-IF-PAID CLAUSE

Zahner Co. v. McGowan Builders, Inc., 2016 Mo. App. LEXIS 529 (May 24, 2016).

McGowan hired Zahner to provide exterior metal paneling on a hotel construction project in New York City. Zahner filed a mechanics' lien for approximately $350,000. McGowan's defense centered on what it called a pay-if-paid subcontract provision that excused its non-payment. The Trial Court ruled that the provision did not create an unambiguous condition precedent of payment from the owner, and refused to let McGowan argue its theory. However, the Appellate Court agreed that the subcontract section was a pay-if-paid provision and not merely a pay-when-paid provision.

A pay-when –paid clause merely sets the time when the contractor must pay, but it does not fully shift the risk of non-payment from the owner or funding source. A valid pay-if-paid provision sets a condition precedent to the contractor's payment obligation to the subcontractor. The language here stated that McGowan was not responsible to make payment "unless and until" McGowan received payment from the owner. The Appellate Court ruled that the language of "unless and until" unambiguously conditioned McGowan's payment obligation to the subcontractor upon receipt of payment from the project owner, and thus the Trial Court's ruling was in error.

This case repeats the proposition that, unless a clause unambiguously and completely shifts the risk of non-payment from the contractor, it will be interpreted merely as a pay-when-paid clause and will not absolve the duty to pay a subcontractor.

PENNSYLVANIA

LIQUIDATED DAMAGES

Merrill Iron & Steel, Inc. v. Blaine Constr. Corp., 2016 U.S. Dist. Lexis 21929 (W. D. Pa. Feb 23, 2016).

A fabricated steel subcontractor's purchase order with a general contractor provided for a maximum of $150,000 in liquidated damages for delays caused by the subcontractor's failure to perform "successful completion of the Complete delivery." After allegations arose that the fabricated steel delivered by the subcontractor was deficient, third parties brought claims against the general contractor

for performing work that did not comply with the project's tolerance requirements. *See*, Merrill Iron & Steel, Inc. v. Blaine Constr. Corp., 2014 U.S. Dist. Lexis 89932 (W. D. Pa. July 2, 2014). In the present action, the District Court addressed the question whether the P.O.'s liquidated damages section – Article 5 – limited the subcontractor's liability for all damages related to delays. The court concluded that it did not.

The general contractor argued that Article 5 only applied to late delivery of steel, not to timely delivery of deficient steel. The contractor cited other P.O. sections in support of this contention. The court agreed that these clauses, coupled with a plain reading of Article 5, limited application of the liquidated damages section solely to timeliness of delivery, not delivery of deficient steel. The subcontractor's motion for summary judgment was therefore denied.

PENNSYLVANIA

ECONOMIC LOSS DOCTRINE

Elliot-Lewis Corp. v. Skanska USA Building, Inc., 2016 U.S. Dist. Lexis 59406 (E.D. Pa. May 4, 2016).

A narrow exception to the rule barring negligence claims for purely economic loss did not apply to a Pennsylvania HVAC consultant who provided inaccurate flow data after being hired to "balance" a flooded air conditioning system. The Restatement (Second) of Torts § 552 provides that a party "… who supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss …." Pennsylvania adopted § 552 in Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270 (Pa. 2002). There, the Supreme Court held that a claim against an architect was not barred by the economic loss rule. The court concluded that § 552 applies to "… cases where information is negligently supplied by one in the business of supplying information, such as an architect or design professional." Pennsylvania further defined "design professional" as a person who is "paid a fee for using his or her skills and training to provide information that is relied on by others."

For the District Court in Elliot-Lewis, the critical issue was whether the HVAC contractor provided information in the same manner as a "design professional." The District Court held that the HVAC contractor was not an architect or design professional, it was not in the business of "supplying information," and it did not supply information before the project commenced but was hired to troubleshoot an error in the initial design. The Elliot-Lewis ruling does not strictly limit § 552's application to architects and design professionals, but it does preclude claims against parties who provide information only as an "ancillary" aspect of a hired service or supplied product.

PENNSLYVANIA

FRAUD – DUTY TO DISCLOSE

Slippery Rock Area School District v. Tremco, Inc., 2016 U.S. Dist. Lexis 75403 (W.D. Pa. June 9, 2016.

The School District sued Tremco for allegedly installing inferior roofing materials. The District Court dismissed claims of fraudulent concealment and negligence. Key to a fraudulent concealment claim is that the defendant be under a duty to the other party to disclose the matter in question. The Court held there was no duty to speak because of a fiduciary or other similar relationship of trust and confidence between the School District and the contractor – they were simply contracting parties. The Court also ruled that a failure to disclose must be "extreme", and here any alleged failure to disclose was not extreme

but generally fell within the categories of product description and classification. The Court therefore granted defendant's motion to dismiss the fraudulent concealment claim.

The Court also dismissed the negligence claim based on the economic loss doctrine. The plaintiff attempted to invoke an exception to the rule claiming that the defendant had provided professional services and information intended to be relied upon, but the Court held that this exception is typically reserved for architects and engineers who are in the business of supplying information. Applying it to manufacturers or suppliers of a product was too broad an application. See the Elliot-Lewis case above.

SOUTH DAKOTA

LIMITATION OF LIABILITY

Highwater Inc. v. Northwest Pipe Co., 2016 U.S. App. Lexis 28129 (W.D. S.D. March 1, 2016).

A District Court would not abrogate "harsh" contractual remedy limitations that heavily favored a supplier after it breached a sales agreement. A general contractor purchased $800,000 worth of steel pipe from the supplier for a construction project in Rapid City, South Dakota. The supplier made delivery, but more than half of the pipe did not meet specifications. The District Court agreed with the general contractor that the supplier's delivery of non-compliant pipe was a breach of contract and a breach of express warranty. The general contractor's only recourse under the warranty was to rely on the supplier to "repair, replace, or refund the purchase price of, at Seller's option, any article of goods."

Other language in the contract expressly limited the general contractor's remedies beyond replacement of the pipe. The contract described the warranties as the supplier's "sole warranties." The general contractor's "exclusive and sole remedy" in a claim for damages as to goods delivered must have been less than the purchase price of the goods which gave rise to the claim. The contract also proscribed incidental or consequential damages. The general contractor argued that the warranty remedy limitation and the damages limitation were unconscionable.

The District Court agreed that the provisions did "strongly favor" the supplier, and noted that "[i]f this was a consumer contract presented on a nonnegotiable basis, it would be unconscionable." But the court emphasized that the general contractor was a sophisticated commercial entity. The contractor had two weeks to review the supplier's proposed contract, and it could have bought pipe from a different supplier.

TEXAS

CONTRACT BREACH

Pelco Construction Company v. Chambers County, Texas, 2016 Tex. App. LEXIS 5047 (May 12, 2016).

Chambers County contracted with Pelco to rebuild a fire house. Pelco was eventually ordered to stop work because FEMA had not approved the spending. The project never really resumed and Pelco filed suit to recover amounts owed for work already completed. The Trial Court granted summary judgment against Pelco and awarded $400,000 in damages to the County. However, on appeal, this decision was reversed and remanded for a new trial.

During the work, Pelco had submitted invoices to the County from which 10% retainage was withheld. The County had three arguments why withholding the 10% did not breach the contract, all three of which were rejected by the Appellate Court.

The County claimed it was obligated to pay only the amount certified by the project architect, however the contract made the architect the owner's representative and not a separate payment referee. The County argued that the contract permitted withholding retainage funds, but the Court held that none of the cited provisions permitted retainage. The County argued that the contract permitted withholding for defective work, but the architect had never sent notice of defective work either within the contract's notice period or thereafter.

The County further argued that Pelco failed to follow the contract resolution procedure, but the Appellate Court noted that the architect had not provided notice of any defects or reasons for non-payment.

TEXAS

DESIGN DEFECT LIABILITY

Dallas/Fort Worth International Airport Board v. INET Airport Systems, 2016 U.S. App. LEXIS 6646 (5th Circuit April 12, 2016).

In a surprising departure from Texas law, the Fifth Circuit held that both the project owner and contractor may have breached the parties' contract by failing to cooperate on a fix for the owner's defective design. The project involved installation of rooftop heating-cooling units at Dallas/Fort Worth airport. The contractor notified the airport board after its discovery that the rooftop units may not have functioned properly in conjunction with the airport's piping system. Subsequent deliberations resulted in two proposals for preventing post-installation defects with the new units, but the parties could not come to an agreement on how to proceed. The contractor missed its deadline, and both parties took the matter to court accusing the other of breaching the project contract. The District Court decided against the airport on summary judgment, and held that the contract put the risk of design defects on the airport as owner. *See,* Dallas/Fort Worth Int'l Airport Bd. v. INET Airport Sys., 2015 U.S. Dist. LEXIS 40704 (N.D. Tex. March 30, 2015).

The Fifth Circuit reversed and remanded. Although it was undisputed that the designs were defective, the appeals court said there was no explicit language in the contract placing the onus on the owner for design defects. The Court decided that the contract allocated risk to both parties, and held there was a question of fact as to which party was ultimately liable under the contract after the design defect was discovered. The contractor argued that the airport breached by failing to issue a change order as required in the contract. The airport claimed that the contractor breached by turning down a proposal and offering another that would have cost the airport an additional $60,000. The Fifth Circuit concluded that the airport *did not* have unilateral power as project owner to revise the plans and specifications.

WEST VIRGINIA

DIFFERING SITE CONDITIONS – TYPE 1

J.F. Allen Corp. v. The Sanitary Board of the City of Charleston, W.V., 2016 W. Va. LEXIS 204 (April 7, 2016).

A contractor could collect additional compensation from a municipal utility board for construction delays caused by unwarned-of utility lines. The $5.5 Million project called for the replacement of sewers and manholes in Charleston, West Virginia. The contractor's work led to 122 incidents of damage to underground utility lines and structures, that were marked incorrectly – or not marked at all – on the construction plans. After the municipal board refused to cover the contractor's additional costs, a circuit court dismissed the contractor's claim for damages. The court held that "… liability with respect to Underground Facilities was contemplated by the parties at the time of contracting and was allocated to [contractor], not [board]."

The West Virginia Supreme Court of Appeals reversed. The Court held that the contract affirmatively required the board to mark utility structures and additionally allowed for the contractor to request price adjustments for added costs caused by the board's failure to mark accurately. The Supreme Court of Appeals also ruled that the lower court erred in its holding that the contractor was barred from bringing the claim because it accepted final payment on the contract without making a formal written request for additional compensation. The Appellate Court held that the board likely had actual notice of the utility incidents – a sufficient substitute for written notice – because the board's on-site representative had documented all 122 events as they occurred.