Construction Tool Box: Construction Laws, Cases, Notes and Alerts

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INTRODUCTION

Winter and the holidays have rolled around, and this month's issue stuffs many interesting decisions in the stocking. There are several decisions concerning construction defect claims, including two reaching contrary conclusions on whether a contractor's CGL coverage may apply to defect claims.

- The Editor

INDEX OF TOPICS COVERED

NATIONAL FOCUS

MILLER ACT SUPERSEDES CONTRACT TERMS

HPS Mechanical Inc. v. JMR Construction Corp., 2014 U.S. Dist. Lexis 105888 (N.D. California August 1, 2014).

The subcontractor filed claims against the contractor and its Miller Act surety for denied change orders. The contractor and surety argued that the subcontract language denied liability as well as liability under the Miller Act. The Court first observed that the liability of Miller Act sureties is defined by the liability of the underlying contract. Courts will look to the subcontract terms to determine the "measure of recovery." However, the courts have distinguished provisions that determine the measure of recovery from those that affect the timing or right of recovery under the Miller Act. In the latter case, enforcement of terms that negate Miller Act liability is contrary to the statute. The contract relied upon by the contractor and surety would in effect preclude Miller Act recovery if the Corps of Engineers had sole authority to determine entitlement to a change order. Such a contract provision would negate a right of recovery under the Miller Act and thus be superseded by the terms of the statute. The Court eventually found that the subcontractor was entitled to recover approximately $332,000 for which the contractor and its surety were liable. The main point of this case is that contracts may adjust or define the measure of recovery, but contract terms cannot deny a right to recovery or alter time deadlines specified in the Miller Act.

NATIONAL FOCUS

CONTRACT SPECIFICATIONS – CONTRACTOR'S RELIANCE

U.S. F/U/B/O BFF Waterproofing LLC v. The Ross Group Construction Corp., 2014 U.S. Dist. Lexis 93064 (N.D. Oklahoma July 9, 2014).

A subcontract provided that joint sealant work on a runway would involve more existing joints than new pavement, and the subcontract defined the width of existing joints by the variable "W" which became the issue in dispute. The subcontractor claimed it was entitled to additional compensation for costs incurred sealing joints in excess of 5/8 of an inch because, in its view, the subcontract defined "W" as a maximum width of 5/8 inches. The contractor argued that the subcontractor was required to seal all existing joints, and that the variable "W" was undefined and could represent any width. The Court ruled that the subcontractor was entitled to rely on the plans and specifications and that, at least in part, width had been defined as a maximum width of 5/8 inches on one of the specification sheets.

Although there was some ambiguity in the contract, the Court ruled that it must be construed in favor of the subcontractor, and the contract seemed to specify maximum width of 5/8 inches. The subcontractor was therefore entitled to recover extra costs of sealing joints in excess of that measurement.

CALIFORNIA

CONSTRUCTION DEFECT COVERAGE – SIR RETENTION

Evanston Insurance Co. v North American Capacity Insurance Co., 2014 WL 3362258 (E.D. Cal. July 8, 2014).

The insured faced multiple lawsuits brought by owners of several hundred single family homes located in developments in California. The developer tendered the claims to two insurance companies under separate CGL policies. One carrier agreed to defend the underlying actions, however North American denied coverage on grounds that the insured had not first satisfied a $10,000 SIR retention for each home at issue. The other insurance company opposed this calculation, arguing that computing the SIR on a per home basis (as opposed to each underlying suit) was unlawful. Under North American's interpretation, their policy would not kick in until some $4.5 Million was spent on the insured's defense ($10,000 SIR times approximately 450 homes).

The court agreed with North American concluding that a per claim SIR implicitly recognizes that multiple claims may arise from a single occurrence. The Court concluded that the insured could not have reasonably believed that the SIR applied only one time to an entire suit regardless of the number of claims or homes involved. The Court reasoned that, for example, the plaintiffs could have each filed individually rather than as a group. The Court concluded that the only reasonable interpretation was that the SIR applied on a per-home and not a per-suit basis.

CALIFORNIA

CONSTRUCTION DEFECT – TIMELINESS OF CLAIMS

St. Paul Fire & Marine Insurance Co. v. Centex Homes, 2014 WL 5013062 (C.D. Cal. October 7, 2014)

Homeowners in a California development sued Centex Homes on February 13, 2014 alleging construction defects. Centex tendered the underlying action to three different insurance companies under various additional insured provisions. Apparently, the insurers preliminarily agreed to defend Centex, subject to reservations of rights and the right to retain counsel. However, a dispute arose over the appointment of counsel, and the insurance companies filed a declaratory judgment action on May 29, 2014. The insurance companies alleged that Centex refused appointed counsel, demanded to be defended by independent counsel, and the insurance companies asserted claims for declaratory relief, breach of contract, and "equitable reimbursement".

Centex moved to dismiss the declaratory judgment action arguing that it was not "ripe", and that there was no justiciable controversy when the complaint was filed. Centex argued that the insurance companies filed suit before they had even sent Centex reservation of rights letters, and before Centex had the chance to respond to the insurance companies' requests for cooperation and appointment of counsel.

The Court essentially agreed with Centex and dismissed the case. The insurance companies sent reservation of rights letters on June 13, 2014, the same day they filed the action. The insurance companies sent reservation of rights letters under other policies June 18, 2014, five days after the complaint was filed. One of the companies did not send either letter before bringing suit. As a

result, the Court concluded that Centex could not have refused to cooperate, refused choice of counsel, or breached any policy obligations because the demands for same either had not yet been made or were made just after the lawsuit was filed.

With respect to the equitable reimbursement claim, the Court ruled that the insurance companies failed to allege that they had agreed to immediately defend Centex in the underlying action in its "entirety", or had paid to defend claims against Centex that were not potentially covered claims. Therefore the equitable reimbursement claim was not properly pleaded, and did not fit given the facts of the case.

CALIFORNIA

NOTICE OF CLAIM

Alterra Excess & Surplus Insurance Co. v. Gotama Building Engineers Inc., No. 2:14-cv-02969, 2014 WL 3866093 (C.D. Cal. July 24, 2014).

This case arose from plumbing and mechanical-engineering work Gotama consulted on for an architectural firm, DLR Group. The owner notified DLR that certain plumbing and mechanical-design deficiencies needed to be corrected. DLR sent Gotama a letter on April 24, 2013 informing it of the problems.

The owner eventually sued DLR group alleging breach of contract and negligence. DLR sought indemnity and contribution from Gotama. Gotama then filed a coverage claim. Alterra argued that Gotama's policy required it to tell the insurer about the claims no later than 60 days after its coverage expired June 1, 2013. Gotama countered that DLR Group's April 24, 2013 letter did not constitute a "claim" that triggered the policy's 60-day limitations period.

The Court found that Gotama was not entitled to defense coverage or indemnification because it waited too long to inform Alterra of the claim against it. The Court noted that Gotama did not tell Alterra about the claim until nearly seven months after coverage lapsed, even though the policy required notice within 60 days of its expiration

KANSAS

BOND CLAIMS

Dun-Par Engineered Form Co. v. Vanum Construction Co., 49 Kan. App. 2d 347 (2013).

This case involved work at Fort Riley Army base where Vanum worked as a subcontractor. Dun-Par was hired by one of Vanum's subcontractors, making Dun-Par a sub-subcontractor to Vanum. Because this was a federal job, the general contractor was required to provide a bond, and under the Miller Act, the bond only provided protection down to the sub-contractor level. The general contractor then required its subcontractors to obtain a bond, but Vanum's bond only provided bond coverage for entities that contracted with Vanum. The issue in this case concerned whether Dun-Par, as a sub-subcontractor to Vanum, was a lawful claimant under the bond. The bond defined "claimant" as an entity having a direct contract with the principal, or having valid lien rights which could be asserted.

The trial court found that Dun-Par did have lien rights under state law, even if a lien could not be filed on the federal project. However, the appellate court reversed, and held that a claimant within the language of the bond had to be an entity having a direct contract with the principal, or an entity having valid lien rights which may be asserted in the jurisdiction where the project was located. Since the project was located within the Fort Riley Military Reservation, and because federal law prohibits lien rights for contractors and subcontractors who work on federal land or buildings, the sub-subcontractor Dun-Par did not have valid lien rights and therefore did not meet the definition of a lawful claimant under the bond.

OHIO

CGL POLICY DOES NOT COVER DEFECTIVE CONSTRUCTION

Reggie Construction Ltd. v. Westfield Insurance Co., 2014 WL 4291584 (Ohio Ct. App. September 2, 2014).

Homeowners sued their contractor for mold and water-related defects, and Westfield Insurance refused to defend and indemnify the contractor against the claim. The trial court and appeal court ruled in favor of the insurance company that the construction defect claim was not an occurrence or accident within the meaning of the policy as "an event proceeding from an unexpected happening or unknown cause". The claims were the result of "predictable consequences" of defective construction which the contractor could have foreseen and controlled during the building process. Therefore, defective construction and resulting damages were not a "sudden and accidental" occurrence within the policy definition.

PENNSYLVANIA

CGL POLICY DOES COVER DEFECTIVE CONSTRUCTION

Indalex Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA, 2013 Pa. Super 311 (2013).

In this case, the insured (Indalex) manufactured windows and doors. Lawsuits were filed against Indalex alleging that Indalex's products were defective resulting in water leakage that caused physical damage, such as mold and cracked walls, and personal injury. The trial court ruled in line with prior Pennsylvania decisions holding that defective construction cannot be a covered occurrence because it is not "accidental".

The Superior Court held on appeal that the underlying complaints against Indalex triggered coverage because they alleged tort claims that the Court could not conclude "[were] outside the scope of coverage." The Court held that coverage under the CGL policy was triggered "[b]ecause the underlying complaints alleged defective products resulting in property loss, to property other than the Appellants' products, and personal injury", and concluded there was an alleged covered occurrence.

PENNSYLVANIA

PERFORMANCE BOND REQUIRED CLEAR NOTICE OF DEFAULT

Milton Regional Sewer Authority v. Travelers Casualty & Surety Co. of America, 2014 U.S.Dist. LEXIS 85557 (M.D. Pa. June 24, 2014).

Milton Regional Sewer Authority ("MRSA") sought recovery under a performance bond furnished by Travelers on a wastewater treatment plant. Travelers claimed that MRSA failed to meet conditions precedent to a claim on the bond, including failure to give proper notice and also give the contractor the opportunity to cure. The contractor's work was suspended on January 20, 2012. On February 20, 2012, MRSA sent the contractor a letter stating it intended to declare the contractor in default with a copy to Travelers. Although the contractor agreed to cure, MRSA claimed in a February 28, 2012 letter that it was declaring the contractor in default and terminating the contract for cause.

Travelers asserted that MRSA failed to notify the contractor that it was considering declaring a default and then within 15 days arrange a conference with the contractor and surety. MRSA contended it met these requirements by its January 20th letter, but Travelers argued that it was the February 20th letter that constituted notice of an intent to terminate, no required conference followed that letter, there was no opportunity to cure, and therefore MRSA failed to meet conditions precedent to recovery on the bond.

The Court agreed with Travelers noting that the January 20th letter was only a directive to suspend work and not proper "default notice" under the bond. Suspending work did not constitute notice to the contractor and surety that the owner was declaring a default. This case reinforces the principle that it is important to closely review the terms of payment and performance bonds with respect to notice, timing, content, language, copies, service, etc. if the intent or result is to eventually make a claim on the bond.

TENNESSEE

PROMPT PAYMENT ACT

Eagle Supply and Manufacturing Co. v. Bechtel Jacobs Co., LLC, 2014 U.S.Dist. LEXIS 75287 (E.D. Tenn. June 3, 2014).

Subcontractor Eagle Supply and Contractor Bechtel Jacobs had a contract dispute on a decontamination and demolition project for the U.S. Department of Energy. Eagle claimed that Bechtel improperly held retainage in violation of the Tennessee Prompt Payment Act. The Act applies to "private contracts" and all construction contracts in the State of Tennessee. Bechtel claimed that, because the work was for the federal government, the subcontract was a federal, not a private, contract.

The Court rejected Bechtel's defense because the Department of Energy was not a party to the subcontract. Simply because this was a federal project did not mean that subcontracts with third parties were not in a private context. The Court therefore denied Bechtel's motion to dismiss the claim under the Prompt Payment Act.

TEXAS

ECONOMIC LOSS DOCTRINE BARS CLAIM AGAINST ARCHITECT

LAN/STV JV v. Martin K. Eby Construction Co., Inc., 2014 Tex. LEXIS 509 (June 20, 2014)

In this case, the Texas Supreme Court reversed an appellate court judgment that allowed a contractor to recover $2.25 Million against a project architect. The contractor charged the architect with negligent work on a light rail transit line in Dallas, TX. The contractor claimed that plans and specifications were full of errors and had to be corrected. The contractor filed a tort claim against the architect, and the architect defended on the basis of the economic loss doctrine which holds there is no liability in tort for economic loss caused by negligence in performance or negotiation of a contract between the parties. The issue here was the extent to which this doctrine would apply to "contractual strangers" since the contractor and architect had no actual contract between them.

The Court noted a wide split of authority and opinion across the country on this issue but eventually concluded that the economic loss doctrine did bar this tort claim against the architect. If the architect is contractually liable to the owner for defects in the plans, and the owner in turn has the same liability to the contractor, the contractor in theory is protected. The availability of construction contract remedies precludes a tort recovery in this general situation, and the economic loss doctrine barred the contractor's tort or "extra-contractual" claim against the architect.

As noted by the Court, there is a wide split and divergence of opinion on this scenario across the country on whether the economic loss doctrine applies to bar or limit claims between parties not in privity of contract.

WASHINGTON

CHANGE ORDER PROCEDURE

Top Line Builders, Inc. v. Bovenkamp, 2014 Wash. App., 320 P.3d 130 (Wash. Ct. App. 2014).

This case involved the construction of a custom "prototype" residence by Top Line Builders, Inc. for the Bovenkamps for purpose of meeting LEED gold-certification standards. The contract required written and signed change orders. Ultimately, the Bovenkamps did not pay Top Line, and Top Line filed a construction lien on the property and a lawsuit to foreclose the lien. However, the contract required written and signed change orders, although the parties never executed any written change orders or submitted any change orders to the project lender, U.S. Bank. U.S. Bank acknowledged that Top Line's lien had priority for the base scope of work, but argued that changed work was subordinate to U.S. Bank's interest because the contract's written change order requirements were the sole means for increasing the contract price for purposes of the lien statute.

The trial court found that Top Line's claim for both the base scope work and extra work were secured by its construction lien. The Court of Appeals affirmed the trial court's ruling, holding that the parties' conduct in discussing and processing the changes had resulted in a mutual waiver of the contract's formal change order provisions.