



## **Construction Toolbox: Construction Laws, Cases, Notes and Alerts**

**A Production of The Harmonie Group  
Construction Law Committee**

**(Find in the [www.harmonie.org](http://www.harmonie.org) Resource Center)**

**Vol. VI No. I (April 2017)**

This edition includes a new decision from California finding no coverage for construction defects under a contractor's CGL liability policy. Readers of this digest will note frequent, and inconsistent, cases nationwide on this topic during the past several months. This point, and others, will be discussed at upcoming Harmonie Construction Committee presentations in Dallas on June 28, 2017, Denver on July 19, 2017, and Atlanta on August 9, 2017. Scheduled presentation topics include:

- Construction defects and contractor CGL coverage
- Construction accident checklist
- Update on Canadian construction law
- Reptile Theory Strategy and witness preparation
- Waivers of consequential damages
- Waivers of subrogation
- Expert witness selection and communication

Check the Harmonie website or contact Harmonie for details. CE credits will be available.

- The Editor

## TABLE OF CONTENTS

|   |    |
|---|----|
| Arbitration Award Ambiguity.....                              | 10 |
| Arbitration Award Vacated .....                               | 8  |
| Construction Surety’s Settlement Not “Bad Faith” .....        | 6  |
| Differing Site Conditions – Type 1 .....                      | 4  |
| Direct or Consequential Damages.....                          | 7  |
| Hazardous Material Waste and Removal .....                    | 3  |
| No CGL Coverage for Construction Defect .....                 | 5  |
| No Damages for Delay Clause Rejected .....                    | 9  |
| Order of Precedence Clause.....                               | 3  |
| Release – Latent Defects.....                                 | 6  |
| Requirements Contracts.....                                   | 4  |
| Safety Breach Material Violation Justifying Termination ..... | 9  |

**NATIONAL FOCUS**  
**HAZARDOUS MATERIAL WASTE AND REMOVAL**

Appeal of: South Bay Boiler Repair, Inc., 2017 ASBCA No. 59281 LEXIS 25 (January 19, 2017).

South Bay Boiler appealed the U.S. Navy's denial of a \$900,000 request for an equitable adjustment claiming that the Navy violated a statute which obligates the government to identify hazardous waste required to be removed by the contractor. The Armed Services Board of Contract Appeals (ASBCA) denied the appeal, ruling that the contract language put South Bay on notice of the presence of toxic heavy metals in the paint.

The Board argued that the contract language expressly placed the contractor on notice that the paint may contain heavy metals, and that the statute requires the government to identify types/amounts of hazardous wastes, not hazardous products. Because this was a fixed price contract, South Bay bore the risk of estimating its cost of performance and must assume any unexpected costs. It was also questionable what additional costs the contractor incurred because the claim was for the excess cost of meeting OSHA health regulations during paint removal operations, which regulatory work practices were needed regardless of how the paint was removed (by blasting or abrasion).

**NATIONAL FOCUS**  
**ORDER OF PRECEDENCE CLAUSE**

Appeals of A.T.I. Tacose S.C.A.R.L., 2017 ASBCA LEXIS 1 (January 4, 2017).

The U.S. Navy awarded a design/build contract to Tacose to construct a dormitory at an airbase in Italy. The government denied two claims for additional compensation for work the contractor claimed to be added to the contract, and the government's position was upheld by the Board of Contract Appeals.

One issue involved whether individual room speakers had to be installed in all 144 sleeping rooms in the dormitory as opposed to one audio speaker in each of the 36 quad module room groupings. Tacose relied upon a contract drawing depicting a speaker only in each common room and none in the sleeping rooms. However, the contract incorporated Department of Defense (DOD) facilities criteria which expressly required speakers in each sleeping room. The "order of precedence" clause in the contract specified that DOD criteria were incorporated and took precedence over individual contract drawings, and in the case of conflicts, the DOD specs controlled. The government argued that several separate contract provisions made it clear that the contract specifications as incorporated governed over the drawings, and the Board ruled that Tacose should have known it could not rely only upon the one drawing.

Another issue was a claim that the government constructively changed the contract by adding requirements concerning perimeter insulation and ground floor slab insulation. However, the technical specs required the contractor to follow applicable Italian and European codes and standards for each product and installation, and placed the responsibility on Tacose to design the dormitory in

accordance with all applicable standards and requirements. Thus, a claim for additional costs for the insulation work was denied.

**NATIONAL FOCUS**  
**DIFFERING SITE CONDITIONS – TYPE I**

ASI Constructors, Inc. v. U.S., 2016 U.S. Ct. Fed. Cl. LEXIS 1915 (December 20, 2016).

ASI Constructors filed a claim against the U.S. Army Corp of Engineers for damages for alleged breach of contract on a dam construction project in Oklahoma. ASI sought a \$6.7 Million equitable adjustment based on Type I differing site conditions which allegedly differed from the contract documentation. ASI allegedly encountered two differing site conditions described as pervasively fissured rock, and flowing water where the contract documents indicated perched water without active flow.

ASI cited several passages from the contract documents that the rock would be “tightly closed” and “impermeable”. The Corps countered that the language only provided qualified opinion based upon the geotechnical data, and not affirmative representations of the underground site conditions. The Corps also argued that the contract language specifically warned about local variations and characteristics in the subsurface materials that may be anticipated.

The Court denied the government’s motion to dismiss. ASI alleged that the contract documents as a whole contained certain representations about the subsurface conditions, and there was dispute about whether the conditions were pervasive or merely “local variations”. The Court believed that expert testimony would likely be required to determine and interpret both the contract language and the underground conditions encountered. The government’s reliance on general language regarding site conditions and the potential existence of variations was premature, and the government’s motion to dismiss the Type I differing site conditions claim was denied.

**NATIONAL FOCUS**  
**REQUIREMENTS CONTRACTS**

Certified Construction Co. of Kentucky, LLC v. United States, 2016 U.S. Ct. Fed. Cl. LEXIS 1594 (October 31, 2016).

Certified Construction alleged it had three contracts with the U.S. Army which granted it exclusive rights to perform asphalt and concrete pavement work at Ft. Knox, Kentucky. The government allegedly hired other contractors to perform such work, and Certified Construction claimed damages for 2006 - 2009. The Army asserted that work performed by other contractors fell outside the scope of Certified Construction’s contracts.

A requirements contract is one in which the government agrees to fill all its actual requirements for specified supplies or services during the contract period by purchasing from the awardee, who agrees to provide them at an agreed price. The essence of a requirements contract is exclusivity.

The Army argued that Certified Construction’s contract did not preclude other contractors performing asphalt and paving work that was “incidental” to other contracts. Certified Construction argued that it retained exclusive rights to perform concrete placement, asphalt pavement, and pavement marking, that was not “incidental” to other construction work.

The Court of Federal Claims essentially agreed with Certified Construction that the contracts were intended to form an enforceable requirements contract. The Court ruled that Certified Construction had the right to perform all such work, as long as paving was the dominant part of the work, and not merely “incidental” to another contract. What work, costs, prices, and profits were “dominant” and direct, as opposed to “incidental” and secondary, was left for trial and other future proceedings.

**CALIFORNIA**  
**NO CGL COVERAGE FOR CONSTRUCTION DEFECT**

Navigators Specialty Insurance Company v. Moorefield Construction, Inc., 6 Cal. App. 5<sup>th</sup> 1258 (December 27, 2016).

California recently adhered to decisions and logic rejecting CGL coverage for construction defects on the essential premise that installing defective construction is not a covered “accident” or “occurrence”. In this case, Navigators issued CGL policies to Moorefield Construction. A building owner sued Moorefield on claims of failed flooring. Navigators accepted Moorefield’s tender of defense of the complaint subject to a reservation of rights. The litigation eventually settled with Navigators contributing its policy limits of \$1 Million towards the settlement. In the meantime, Navigators filed a declaratory judgment action seeking to declare they had no duty to defend or indemnify Moorefield. One of the essential arguments was whether failure of the flooring was a covered occurrence because it was not the result of an “accident”.

After a bench trial, the Trial Court found there was no covered occurrence because Moorefield had directed the flooring subcontractor to install the flooring despite knowledge that moisture vapor emissions from the concrete slab exceeded specifications. The Trial Court also held that Moorefield had not met its burden of proving what portion, if any, of the \$1 Million paid by Navigators constituting “damages”, and what portion may have fallen within supplementary payment provisions of the policies. Moorefield appealed on two primary issues: first with respect to coverage, and the other relating to the supplementary payment provisions.

With respect to the first question, the Appellate Court held that under California law an accident does not occur when an insured performs a deliberate act unless some additional, unexpected, unforeseen happening occurs that results in damages. The Court agreed that the conduct here was not an accident, but rather a deliberate decision to install flooring despite knowledge that the moisture vapor emission rate from concrete slab exceeded specifications. In short, the damage was not produced by an additional, unexpected, independent, and unforeseen event. Navigators thereby had no duty to indemnify Moorefield and was entitled to recoup that portion of the \$1 Million settlement payment attributable to “damages”.

This decision and analysis is consistent with others across the country which have held that defective construction, even if it results in unexpected consequences, is not a covered accidental occurrence because it is a deliberate, albeit misguided act. Other courts however, have focused on the result/outcome and have found coverage, in whole or in part, for construction defects under an analysis that an unexpected or unattended outcome may qualify as a covered accidental occurrence.

With respect to the second question on appeal, the Appellate Court reversed the Trial Court and held that the supplemental payments provision in the CGL policy would cover awarded attorneys’ fees which were taxable as costs against the insured. Supplementary payments are tied to the insurers’ duty to defend, not the insurers’ duty to indemnify. Here, Navigators had a duty to defend Moorefield at the time of the settlement because there was potential for coverage for the flooring failure. Although the Trial Court eventually found that Navigators had no duty to defend, the finding was not “retroactive” back to the time of the settlement. As a result, Moorefield had to reimburse Navigator’s for that portion of the \$1 Million settlement payment attributable to damages, with the case remanded back to the Trial Court to

determine what part of the \$1 Million settlement payment could be apportioned to damages as opposed to attorneys' fees and costs of suit.

As stated, this case falls within a number of cases within the country which have declined to cover construction defects under CGL policies under the theory there is no covered "accident or occurrence". Other cases have also held that construction defects do not fall within covered "damages" under CGL policies. This case also indicates that, even if no coverage may eventually be found, there may nonetheless be a duty to defend at least up to and including that point where no coverage is determined to exist.

- The Editor

## **MARYLAND**

### **RELEASE – LATENT DEFECTS**

Skanska USA Building, Inc. v. Long Masonry, Inc., 2017 U.S. Dist. LEXIS 5885 (D.Md. January 1, 2017)

Skanska was the Construction Manager on a project to build a new research facility at Johns Hopkins University. Long was the masonry subcontractor. More than five years after substantial completion, twenty rows of brick façade fell from the building, and Long refused to pay remediation costs, or to indemnify Skanska for the cost. Long argued that the claim was barred by Maryland's three year statute of limitations, and by a release/accord and satisfaction agreement the parties executed in 2011. An engineer opined that the cause of the façade collapse was a number of alleged deficiencies related to Long's masonry work involving joints, spacing, veneer anchors, etc. Long initially argued that the contract claim was time barred by the three year statute of limitations because Skanska knew of the alleged breach back in 2009. However, the latest expert report appeared to raise "new and distinct" issues, and therefore there were issues of material fact as to whether the 2013 wall collapse was caused by defects known or unknown in 2009.

There was a prior settlement agreement and release which Long also argued resolved all issues with Skanska with respect to the project. However, the agreement had several exceptions, including one for latent defects not yet identified as of the date of the agreement. The Court ruled there were issues of fact as to whether the collapse was caused by defects that were latent and unidentifiable when the parties signed the release, or not. Therefore, Long's motion to dismiss was denied.

- The Editor

## **MICHIGAN**

### **CONSTRUCTION SURETY'S SETTLEMENT NOT "BAD FAITH"**

Great American Insurance Co. v. E.L. Bailey & Co., Inc., 2016 U.S. App. LEXIS 20018 (6<sup>TH</sup> Circuit, November 7, 2016)

Bailey was general contractor on a prison construction project in Ypsilanti, Michigan (one of my favorite city names of all time). Great American held the performance bond which did assign to Great American the right to settle project-related claims. As a result of a dispute, the State withheld \$411,000 in liquidated damages (\$1,000/day). Naturally, the State and Bailey sued each other in the Michigan Court of Claims. A settlement was reached where the State released Bailey's claims in exchange for paying Great American

\$358,000.00 in final payment on the construction contract. Bailey contended that Great American's settlement of its claims against the State was in "bad faith".

It is interesting that there was an initial dispute regarding the standard for "bad faith" under Michigan Law. Bailey argued that bad faith arose where an insurer is motivated by "selfish purpose" and a desire to protect its own interest at the expense of the insured. The Court questioned this analysis given the fact that suretyship is a three way contractual relationship, and not merely an insurer-insured relationship. The Court noted that the settlement appeared to be legitimate, and that Great American had secured a significant payment, which was in fact more than a mediator's recommendation.

Bailey was also upset that Great American and the State failed to disclose the settlement agreement until the very last day. The Court noted that "concealment" may be a factor in determining bad faith, but here the contractor had warning that Great American would control the claims against the State, and also forfeited its right to control its claim by failing to provide security/collateral as the surety requested.

Bailey also argued against the settlement contending that, under Michigan Law, liquidated damages are not enforceable if parties are mutually responsible for project delays. Bailey specifically blamed most of the delay on the State's architect/engineer who allegedly designed a flawed power source for the building. In fact, earlier in the dispute, a mediator had apportioned blame for the delay to both parties with roughly two-thirds to the contractor and one third to the State. However, the Court adhered to Michigan Law which apparently states that, if delay is due to the fault of both parties, the Court does not attempt to apportion liquidated damages. In short, the Court ruled that Bailey was disagreeing with the monetary amount of the settlement, which is not bad faith.

Another interesting side note which may have detracted from the bad faith argument is that the contractor did not allege "bad faith" against Great American when it used settlement proceeds to resolve outstanding claims and liens from Bailey's suppliers and subcontractors.

This is an interesting case interpreting and applying "bad faith" in a surety/construction context. The performance bond gave Great American the right to control settlement. The surety had apparently offered to put the dispute and settlement negotiations back into the contractor's hands if it posted sufficient collateral/security, which the contractor apparently declined to do. It was also somewhat hypocritical for the contractor to claim that the initial, overall settlement was in bad faith, but that various payments to its suppliers and subcontractors from the settlement proceeds were not also tainted or in bad faith.

The bad faith claim was also most likely deflected by the fact that a settlement of \$358,000.00 out of the \$411,000.00 which the State withheld represented a very substantial payment in terms of the dollars and percent of funds in dispute. It was clearly not a minimal settlement or grossly unfavorable to the contractor.

- The Editor

## **PENNSYLVANIA**

### **DIRECT OR CONSEQUENTIAL DAMAGES**

Jay Jala, LLC v. DDG Construction, Inc., 2016 U.S. Dist. LEXIS 150969 (E.D. Pa. November 1, 2016).

DDG Construction agreed to construct a motel for Jay Jala, but did not complete the work, and left the project in December 2014. Jay Jala terminated the contract, completed the motel on its own in 2015, and

then sought damages from DDG. However, the construction contract contained a waiver of consequential damages, and the court had to scrutinize in detail several issues and distinctions between direct versus consequential damages. The contract barred recovery for damages incurred by the owner for rental expenses, loss of use, income, profit, financing, business, reputation, and lost productivity. The basic framework the court adopted was to ask whether the claimed damages represented a loss in value from deficient contractual performance, or were collateral costs and losses.

One item was a project completion fee for supervision of the project after DDG's default. The Court interpreted this as seeking reimbursement for owner overhead costs for the time period during which the owner essentially served as its own contractor, and allowed this item of approximately \$12,000.00 per month as an item of "direct" damages.

With respect to additional bank interest paid because of delay, the Court also allowed this item as direct damages because of the importance of time to the contract. Interest on the loan to construct a building was an integral part of contract performance - construction of the building - which was delayed. In essence, the owner was entitled to recover as direct damages the "cost" of additional time needed to complete the project, such as the additional bank interest.

Likewise, the Court indicated that monthly utility expenses might be recoverable because the contract held the contractor liable to pay for the utility bills until the building was complete, and this expense was assumed by the owner during the delayed period of time to complete.

However, many other types of damages such as lost income, insurance, advertising, fixtures and equipment were deemed "consequential" and not recoverable because of the waiver clause. The Court also disallowed the extra cost to store furniture, fixtures and equipment due to delayed construction.

### **RHODE ISLAND ARBITRATION AWARD VACATED**

Nappa Construction Management, LLC v. Caroline Flynn, et al., 2017 R.I. LEXIS 13 (January 23, 2017).

Nappa contracted to construct an automobile repair facility. Under the contract, the owner could terminate for cause or for convenience without cause. However, in this case it was the contractor who supposedly terminated the contract due to non-payment. The issue was defective foundation and cement flooring work. The contractor invoiced for expenses that included the disputed charges, the owner refused to pay, and the contractor then charged the owner with breach of contract and terminated the contract.

The arbitrator noted that the owner's stop work order, although compliant with the contract, was not satisfactory to address the problem. On the other hand, the contractor acted badly in invoicing for work which was acknowledged to be deficient. The arbitrator ruled that neither party's action rose to the level of a breach of contract, and that resulted in the appeal from the arbitration award. The arbitrator invoked the contract's termination for convenience clause which would hold neither party in breach and entitle the contractor to the fair and reasonable value of work performed.

On appeal, the Supreme Court of Rhode Island noted that the termination for convenience clause only ran in favor of the owner. The Court ruled that the arbitrator employed a fiction that the owner terminated for convenience, and while an arbitrator may construe ambiguous contract language, the

arbitrator has no authority to add or modify contract provisions. Therefore, the arbitration award was vacated due to over-reaching on the part of the arbitrator.

It is notable that two dissenting judges would have affirmed the award because an arbitrator can resolve disputes based on provisions within the contract, and here the arbitrator did not expand on the contract language.

In essence, the court ruled that by converting a default termination by the owner into a termination for convenience, the arbitrator's decision veered away from the reality of the underlying dispute AND the language in the agreement.

## **TENNESSEE**

### **SAFETY BREACH A MATERIAL VIOLATION JUSTIFYING TERMINATION**

M&M Electrical Contractor, Inc. v. Cumberland Electric Membership Corp., 2016 Tenn. App. LEXIS 842 (November 4, 2016).

Cumberland Electric hired M&M Electrical to work on power lines which were going to remain energized during the work. M&M was moving powered electric lines by raising them in the air with bucket trucks. Upon observing that M&M's trucks were not grounded as required for performing such electrical "hotwork", Cumberland terminated the contract. The Trial Court ruled that M&M's failure to follow contractual safety rules constituted a material breach and dismissed M&M's claim for lost profits. The Court ruled that the termination was proper pursuant to contractual provisions allowing the owner to stop the contractor's work immediately for violation of safety requirements. M&M appealed that the alleged breach was not material, but the decision of the Trial Court was affirmed on appeal.

The Appellate Court ruled that M&M's failure to ground the trucks could have resulted in serious death or injury to workers, supervisors, or the public. The Court ruled that Cumberland was not obliged to wait until a disaster happened and someone was injured or killed due to the failure to ground the trucks. Cumberland also argued it had provided sufficient contractual notice to M&M to address the safety problems.

It is notable that M&M had been working on the project for several months in a similar fashion (using ungrounded trucks) without objection from the owner or a stop work direction. However, with respect to the personal safety issues, it does not appear that the concept of waiver or "past practice" was seriously argued in this instance.

## **TEXAS**

### **"NO DAMAGES FOR DELAY" CLAUSE REJECTED**

The Port of Houston Authority of Harris County, Texas v. Zachry Construction Corp., 2016 Tex. App. LEXIS 13306 (December 15, 2016).

The project owner, the Port Authority, initially refused to approve Zachry's original "in the dry" project design on a wharf construction project. The contractor was instead forced to use an alternative "in the wet" design. The contractor asserted that the Port Authority owed it damages for increased costs to perform, and a refund of liquidated damages that were withheld. A Trial Court awarded Zachry a total of almost \$20 Million in damages and costs. The Port Authority cited stringent Texas law upholding "no

damages for delay” clauses. Zachry argued that the Port Authority had essentially dictated the means and methods of the work, thereby voiding the “no damages for delay” clause.

This case has a lengthy history in the Texas courts, but the final decision essentially held that the contractor should have had sole control over its means and methods of work which were usurped by the Port Authority’s direction of the work. One common law exception to a “no damages for delay” clause is where wrongful conduct occurs that involves active interference, or arbitrary and capricious acts. Here, a jury had concluded that the delay damages resulted from the Port Authority’s conduct, interference, bad faith, and fraud. Hence, the “no damages for delay” provision was held to be invalidated.

The Court also ruled that, even though the contractor was required to submit its design and safety submittals, the Port Authority had no right to change or dictate them. The contractor was held to have the sole right to control the means and methods of its work, and since the Port Authority interfered, the “no damages for delay” clause was held avoided.

### **TEXAS ARBITRATION AWARD AMBIGUITY**

Eaton Commercial, L.P. v. Paradigm Hotel SA Riverwalk, L.P., 2016 Tex. App. LEXIS 10786 (October 5, 2016).

Paradigm Hotel hired Eaton Commercial to build a hotel in San Antonio, Texas based upon a cost plus fee arrangement for a guaranteed maximum price (“GMP”). Disagreement ensued with respect to the contract amount and the GMP, and an arbitrator awarded Eaton an adjustment to GMP of \$769,553.00. Eaton argued that the arbitration award was unclear for failure to specify the actual final contract amount upon which the adjustment should be applied. The trial court confirmed the arbitration award, but on appeal that decision was reversed and remanded back to the trial court, and eventually back to the arbitrator.

The arbitration award failed to state what the contract amount was, to what contract amount the GMP adjustment should be applied, and therefore how much more was owed to Eaton on top of contract amounts already paid or awarded. The reasoning in the award also seemed to imply that the award was not a GMP adjustment but rather compensation for actual additional costs incurred by Eaton, which should have been added to the contract cost, and not an adjustment to the GMP. The Appellate Court argued that this was not a situation where the Court was modifying or changing an award, but remanded the case back to the Trial Court with instructions to remand the case back to the arbitrator for clarification.

Typically, federal and state arbitration statutes permit courts to confirm or vacate arbitration awards. However, the courts at times create other “options” such as in this case if the arbitration award is deemed ambiguous or questionable, the courts may remand the proceeding back to the arbitration forum for clarification, explanation, or additional computations.