Court Finds Subcontractor Liable For Ambiguity in Contract Documents

A CONTRACT MAXIM we often see applied in construction cases, *contra proferentum,* means that an ambiguity in a contract will be construed against the drafter. The idea is to discourage contracting parties from inserting vague clauses into contracts, consistent with the notion that the drafter of an ambiguous clause should bear the responsibility of any untoward effects. There is, however, an important caveat. When there is an obvious ambiguity in the bidding documents, bidders have a duty to clarify the matter before bidding. A recent federal appeals court illustrates the point.

In *Otis Elevator Company v. WG Yates & Sons Construction Company,* the firm WG Yates & Sons entered into a prime contract with the Huntsville-Madison County Airport Authority, in Alabama, to expand the latter's baggage claim area. The airport contracted separately with a design firm, Chapman Sisson, to serve as the architect for the project. WG Yates put the escalator work out for bids and awarded a subcontract to Otis Elevator.

The escalator bidders had the benefit of the contract documents before submitting their bids. However, those documents were unclear as to whether a dimension of 39.5 in. referred to the width of the escalator step tread or to the distance between the escalator handrails. Otis noticed this ambiguity before submitting its bid. However, rather than ask for clarification, it assumed the 39.5 in. applied to the distance between handrails and selected a 32 in. step width, noting this step width in its bid. Otis later submitted shop drawings indicating that it would install escalators with a 32 in. step width, and these drawings were approved by WG Yates and the architect. Otis did not include any disclaimer or other notice to call attention to the 32 in. step.

Upon discovering during a site visit that the elevator step width was 32 in. rather than 39.5 in., the architect issued a letter clarifying that the design intent was for the step width, not the distance between handrails, to be 39.5 in. The airport demanded that the escalators be replaced with escalators having a 39.5 in. step width. WG Yates and the airport eventually resolved the matter, the airport keeping all four of the 32 in. escalators that were in place (in exchange for a $100,000 credit) and receiving an additional escalator, this one with a 40 in. step width. Otis incurred almost $125,000 in additional work to accomplish this, and WG Yates incurred almost $600,000 in additional costs and in damages paid to the airport.

After a three-day bench trial to adjudicate the claims of Otis and WG Yates, the district court awarded Otis the costs of the additional escalator work, citing the *contra proferentum* concept. The trial court thought Otis should not have to bear responsibility for the added cost because (1) its shop drawings had been approved by WG Yates and the architect; (2) the architect made regular site visits and inspections during Otis's installation; and (3) multiple bidders included a 32 in. step width in their proposals, establishing that Otis's interpretation was reasonable.

WG Yates appealed, contending that Otis was not entitled to rely on its own interpretation of what was meant on the drawings. The primary issue on appeal was whether Otis, as a subcontractor bidding for work on a public project, had a duty to clarify an ambiguity in the bidding documents or could instead rely upon a reasonable interpretation of its own.

The appellate court ruled that Otis had a duty to seek clarification of the ambiguity. It cited testimony from Otis's estimator that he noticed the step width dimensions were "unclear" when he was preparing Otis's bid. By failing to say something about this lack of clarity, the court held, Otis assumed the risk if the architect had a different interpretation in mind. The court relied on federal precedent holding that subcontractors "are obligated to bring to the government's attention major discrepancies or errors which they detect in the specifications or drawings, or else fail to do so at their peril."

The court also found that the architect's review and approval of submittals was "not conducted for the purpose of determining the accuracy and completeness of other details such as dimensions and quantities." Moreover, the subcontract stated that any review and approval of Otis's submittals would not excuse Otis from performing its work in "strict accordance" with the contract documents. Finally, the court noted that both the architect and WG Yates included disclaimer language in their stamp approvals of Otis's submittals to the effect that Otis remained ultimately responsible for completing the work in accordance with the contract documents.

We do not often see cases in which an appeals court, in interpreting ambiguous specifications, relies in part upon the disclaimer contained in the architect's stamp (that is, "this review is only for general conformance with the design concept of the project and general compliance with…the contract documents"). The court appeared to follow the literal language of the stamp and did not accept Otis's argument that approval was tantamount to acceptance of the 32 in. step. Moreover, the fact that the architect made multiple site visits before noticing that the escalator steps were only 32 in. wide did not change the court's opinion.

We also do not often see candid testimony from estimators that they believed the bidding language to be unclear. Since bidders are not charged with finding "hidden" (that is, latent) ambiguities in the bidding documents, the appellate court might have come to a different conclusion if Otis's estimator had testified that he didn't notice the ambiguity or felt that a 39.5 in. step would have been an unreasonable contract interpretation. **CE**

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Do Contractors Face Liability for Providing Design Solutions?

ON THE BASIS of the Spearin doctrine (from the 1918 case *U.S. v. Spearin* [248 U.S. 132]), a body of case law has grown up holding that owners by implication warrant the adequacy of the designs they supply. As noted by Justice Louis Brandeis in *U.S. v. Spearin*, "[I]f a contractor is bound to build according to the plans and specifications prepared by the owner, a contractor will not be responsible for the consequences of defects in the plans and specifications." Few construction litigation cases are so black and white, however. Recently, a federal court considered whether the actions of a contractor in providing design solutions exposed it to liability when the structure failed.

The case *American Towers LLC v. BPI, Inc.,* grew out of a project to erect a cell tower. American Towers hired BPI as the general contractor on a project to construct the tower, the tower compound, and an access road leading up a hill to the tower. The contract required American Towers to provide BPI with "drawings, specifications," and "instructions." The contract required BPI to complete its work in "workmanlike manner and with the highest degree of skill and care exercised by reputable contractors performing the same or similar services." BPI would also be responsible for the "construction means, methods, techniques, sequences and procedures." If a problem was encountered, BPI was to stop work and notify American Towers. The latter was to provide BPI with instruction on how to proceed. BPI was also required to consult a geotechnical engineer during certain portions of the work.

During the project BPI encountered what it deemed a problem with American Towers' drawings. It stopped work and notified American Towers. However, instead of waiting for instructions, BPI proposed a design solution of its own, and American Towers ultimately approved it.

BPI did not consult a designer in developing its proposal, and American Towers approved the proposal without engaging a design engineer. One year later, the access road collapsed in a landslide, damaging surrounding property and leaving the tower and the compound inaccessible and useless. American Towers initiated litigation against BPI, alleging that the latter had breached its contract. American Towers and BPI both filed several motions for summary judgment, asking the court to resolve the legal issues prior to trial.

One of the more interesting legal issues for the court concerned BPI's motion arguing that American Towers was wholly responsible for the design of the project and that BPI was responsible only for constructing the project in accordance with American Towers' design. BPI alleged that it could not be responsible for the road collapse because the contract clearly called for the owner to develop the design. BPI was to carry out construction in accordance with that design. BPI further pointed to the contract provision requiring BPI to stop work and await design instructions as suggesting that it had no role (and no fault) in the design.

The court denied BPI's motion, holding that its argument "glosses over" the fact that BPI did more than wait for instructions; BPI proposed a design solution. Its actions in furnishing a design solution, coupled with "BPI's vow to complete its work using the 'highest degree of skill and care,'" meant that the contract may have imposed a requirement on BPI to consult a designer in developing its proposed solution.

BPI contended that, even if it had a responsibility to consult a designer in developing the solution it submitted to American Towers, the latter had a responsibility to consult a designer before approving the proposal. The court decided that American Towers was not necessarily required to consult a designer before approving BPI's proposal. The responsibility to consult a designer regarding the proposed solution did not belong solely to American Towers as a matter of law, but it might belong to BPI because of the high standard of care required.

American Towers argued that BPI breached the contract by failing to use a certain specified fill material. The court denied the motion, reasoning that American Towers' expert had not been sufficiently clear as to the content of the fill material to warrant summary judgment. American Towers also alleged that BPI breached the contract by failing to consult a geotechnical engineer during portions of the work. The court granted the motion, finding that the evidence was undisputed that BPI did not consult a geotechnical engineer but said that American Towers would have to prove causation at trial. American Towers would thus have to prove that BPI's failure to consult a design engineer actually caused the road to fail.

Sophisticated contractors and subcontractors frequently propose design solutions; in fact, they are at times required to do so as part of the requests for information. Contractors are well advised to ensure that such solutions are examined by the owner's design professionals to avoid blurring the lines of design liability. Moreover, most business owners are loath to resort to litigation. The court's decision here poignantly summed up this sentiment:

> When a construction project goes awry, the resulting civil litigation is often as jumbled as the marred structure. The parties usually dispute what caused the project to fail, and…[b]oth parties then present expert testimony tending to show…the culprit. Courts are ill equipped to resolve disputes between experts…and at the summary judgment stage, courts are not authorized to do so. So it should come as no surprise that the heavily factual dispute between the parties here must proceed to trial. **CE**

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Federal Agency Held Liable for Deficient Design In IDC Contract

MANY READERS are familiar with integrated project delivery, an approach that attempts to spread the risk and responsibility equally among all project participants. Through multiparty contracts involving the owner, the designer, and the contractor, the intention of this arrangement is to build a team-based approach to the design and construction phases of a project. Under an integrated design and construction (IDC) contract, the construction contractor is brought into a project early to analyze the design and provide guidance to the owner and its design team on changes it may wish to implement. A recent Civilian Board of Contract Appeals decision caught our attention.

The issues in dispute in *Kiewit-Turner v. Department of Veterans Affairs* arose from the design and construction of a medical center campus in Aurora, Colorado. In 2010 the Department of Veterans Affairs (VA) awarded a contract to Kiewit-Turner for preconstruction services on the facility with an option for the performance of construction services. At the time the VA hired Kiewit-Turner as the IDC contractor, however, the design was already 50 percent complete and all funding decisions had been made. The VA had established construction costs of $582 million. Kiewit-Turner advised the VA at many stages of the design that the design lacked coordination and completeness and was over budget and that value engineering suggestions were not being incorporated.

At the 65 percent design phase, Kiewit-Turner advised the VA that the design would cost $664 million to construct. The VA had also engaged another firm to prepare an independent estimate of the construction costs, and this came in at $677 million. The parties continued to discuss value engineering efforts that could be undertaken, along with other price reductions that could be achieved. Ultimately, the VA promised to have its design team produce a design that could be constructed for $582 million, and Kiewit-Turner promised to achieve a firm target price no higher than $604 million, provided it had 100 percent design drawings.

The design, however, was never adjusted, and the VA refused to adjust the firm target price of $604 million. The VA knew the design was over budget by approximately $200 million. The design team, the VA, and Kiewit-Turner met and developed cost-cutting measures of approximately $140 million. But after the meeting and unbeknownst to Kiewit-Turner, the VA directed its design team not to incorporate any design changes that would reduce costs or change the design. Kiewit-Turner began the construction under protest. Ultimately, the firm sought declaratory relief from the Civilian Board of Contract Appeals, seeking an order allowing it to stop work on the project because of the VA's material breach of the contract.

Three questions were posed to the board: Did the contract with Kiewit-Turner obligate the VA to provide a design that could be constructed for $582 million? Did the VA materially breach the contract by failing to provide a design that could be built for that price? Did such a breach entitle the contractor to stop work?

In a rather scathing written opinion, the board answered all three questions in the affirmative, beginning its analysis with the observation that the VA "did not use the IDC mechanism properly from the start." Indeed, an internal procurement review by the U.S. Army Corps of Engineers stated that because the design development had already reached a major milestone prior to the procurement of the IDC contractor, Kiewit-Turner was "unable to integrate with the designer to achieve best value." Moreover, the VA had never used the IDC method before, and the benefits of such a delivery method were unlikely to be recognized in view of the fact that, according to the agency's own assessment, the VA culture is "not comfortable with new approaches."

In answering the first question, the board found that the $582 million estimate was inextricably linked to and formed the basis of Kiewit-Turner's offer of a target price of $604 million. In evaluating whether the VA's actions constituted a material breach, the board literally counted the ways. It found that Kiewit-Turner was deprived of the benefit of working with a design to which the project could be constructed for the estimated cost. It also found that the VA failed to control its design team, delayed approval of the design, presented Kiewit-Turner with a design that was incomplete, failed to process change orders, failed to make timely payment, and drove up the costs of construction. Moreover, the board found that because the VA insisted that it would not redesign the project or seek additional funding, its breach could not be cured.

On the third question, whether Kiewit-Turner was entitled to stop work, the board found it compelling that Kiewit-Turner had continued to proceed with construction under strenuous protest to avoid being charged with default. The board found that under these circumstances, Kiewit-Turner was entitled to stop work. The board even cited an engineer's description of the VA team as the "least effective and most dysfunctional [VA] staff on any project that [he] had ever seen."

It has been reported that in the wake of this ruling the VA found additional funding to cover more than $150 million in delinquent payments to Kiewit-Turner and that Kiewit-Turner has resumed construction work on the project on a cost-reimbursable basis. The project, unfortunately, has also been the subject of an unflattering report from the U.S. Government Accountability Office and has been scrutinized by the Colorado legislature. **CE**

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Supreme Court Casts a Pall Over State Licensure Boards

MANY REGARD state engineering boards and the licensure process as promoting public policy. Indeed, by ensuring a level of competency and integrity within the profession, these entities safeguard the health, safety, and welfare of the public. In 1907 Wyoming became the first state to enact a professional engineering licensure law. Since then, every other state has developed its own board to regulate the licensure process, oversee continuing education requirements, and monitor enforcement. Vital to the profession, state licensing boards draw upon the commitment and expertise of well-regarded architects, professional engineers, and business owners to serve as members.

A recent decision from the nation's highest court, however, has called into question the ability of state boards to regulate their own professions. Last October, the high court agreed to hear a case concerning whether state boards, being composed primarily of "active market participants," could legitimately curb unregulated acts. The case *North Carolina State Board of Dental Examiners v. Federal Trade Commission* grew out of a dispute over teeth-whitening services.

Individuals who were not dentists were offering services for teeth whitening in malls, tanning salons, and elsewhere in North Carolina at rates significantly lower than those charged by dentists. When dentists complained to the North Carolina State Board of Dental Examiners about the unregulated practice, the board issued nearly 50 cease and desist letters. The letters were issued not only to those performing the service who were not dentists but also to the product manufacturers, mall owners, and property managers who leased space to them. Because the letters warned that the unlicensed practice of dentistry was a crime, those who were not dentists stopped offering the services. Under the North Carolina Dental Practice Act, however, teeth whitening is not specified as "the practice of dentistry." The nondentists then protested to the Federal Trade Commission (FTC).

The FTC filed an administrative complaint, alleging that the North Carolina board's concerted actions to exclude nondentists from the market of teeth whitening services constituted an unfair method of competition. Being an agency of the state for the regulation of the practice of dentistry, the board filed a motion to dismiss, arguing sovereign immunity. In other words, the board took the position that because it was an agency of the state, it was shielded from any legal action by the FTC. An administrative law judge, however, denied the board's motion to dismiss. The FTC sustained the ruling, reasoning that the board must be actively supervised by the state in order to enjoy the protections of immunity. The board comprised eight members, six of them practicing dentists, and it was not supervised by the state. The administrative law judge decided the case after a hearing on the merits and found that the board had unreasonably restrained trade in violation of antitrust laws. The FTC again sustained the rulings of the judge, and on appeal the Fourth Circuit Court of Appeals affirmed the FTC's rulings in all respects. The board then appealed to the U.S. Supreme Court, which agrees to hear only 2 percent of all cases submitted to it. Its decision was issued on February 25, affirming the Fourth Circuit Court of Appeals and FTC rulings.

The high court began its discussion by noting that federal antitrust laws are a central safeguard for the nation's "free market structures." It opined that a state board with active market participants cannot be shielded from anticompetition challenges unless it is acting pursuant to a clearly articulated state policy to displace competition and is actively supervised by the state.

Although the North Carolina State Board of Dental Examiners was empowered to regulate the practice of dentistry, there was no state policy on teeth whitening. Moreover, the board was not actively supervised by the state when it interpreted the statute to address teeth whitening and when it issued cease and desist letters. "[A]ctive market participants," held the court, "cannot be allowed to regulate their own markets free from antitrust accountability."

This decision has ramifications for the architecture and engineering community. Future challenges can be brought against any state licensing board whose acts are deemed to regulate conduct not clearly within its profession's defined scope of practice. Indeed, the National Society of Professional Engineers has publicly decried the decision as "weakening" the legal and regulatory enforcement mechanisms of state engineering licensure boards.

In an amicus brief submitted to the Supreme Court, the National Council of Examiners for Engineering and Surveying argued that the decision would add bureaucracy to licensing board decisions and would make it difficult for states to recruit qualified professionals to serve on boards. Justice Anthony M. Kennedy, in concert with a five-member majority, expressly rejected the notion that dedicated professionals would be discouraged from serving on boards because of the decision. "There is…a long tradition of citizens esteemed by their professional colleagues devoting time, energy, and talent to enhancing the dignity of their calling."

In any case the Supreme Court's holding evokes a statement by the economist Adam Smith in 1776 in *An Inquiry into the Nature and Causes of the Wealth of Nations:* "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." **CE**

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Withholding Retention: What Constitutes a Good Faith Dispute?

THOSE FAMILIAR with the flurry of activity at the end of projects appreciate the intense negotiating that ensues. From punch list to pending change orders to claims submission, obtaining final payment can be a grueling and drawn-out process. Among the more straightforward items to resolve, however, is the release of the final retention to the contractor. Once the owner is no longer exposed to mechanic's liens or deficiencies in the contractor's work, withholding the funds retained as security is no longer justified.

Many states have laws regulating when the retained funds must be released to a contractor and have statutory interest penalties that apply when the funds are unjustifiably paid late. This month we highlight an unusual case between a contractor and a public owner that was litigated over the course of a decade and turned in large part on whether the retained funds were properly withheld. Ultimately, the owner was ordered to pay the contractor more than $1.5 million in interest penalties for wrongfully holding on to retention monies for more than 10 years.

In *FTR International, Inc. v. Rio School District,* the disputes at issue arose from a school project in California. In 1999 a general contractor, FTR, submitted the winning bid to the Rio School District and was awarded a contract for $7.3 million. During construction, FTR submitted more than 150 proposed change orders based on the argument under the Spearin doctrine that the design was flawed. The district denied most of these orders on three grounds: (a) the work was within the original scope; (b) the amounts sought were excessive; and (c) the proposed change orders were not submitted in timely fashion. Pursuant to the contract, the district had retained close to 10 percent of the contract balance and was holding $676,436 at the time FTR completed its work, in June 2001. When construction was completed, FTR sought to obtain the balance due under the contract and the retained funds and submitted a delay and disruption claim. The district refused to make any payments. Instead, it withheld the balance due under the contract and the retained funds and paid nothing on the delay claim.

FTR sued the district and after (an inexplicable) 243 days of trial, the court found in favor of FTR. The court awarded FTR a total of more than $9.3 million, including damages for the balance due under the contract; extra work, delays, and disruptions caused by the district; statutory penalties; attorneys' fees; and prejudgment interest and costs. In making its award, the court enforced the following state statute, which addresses the prompt payment of retained funds to contractors:

> Within 60 days after the date of completion of the work of improvement, the retention withheld by the public entity shall be released. In the event of a dispute between the public entity and the original contractor, the public entity may withhold from the final payment an amount not to exceed 150 percent of the disputed amount.

That statute also allows a 2 percent per month statutory penalty for wrongful withholding, which the court assessed at $1.5 million. In the face of such a large award, it was hardly surprising that the district filed an appeal alleging that the trial court erred in awarding statutory penalties. The district asserted that because there was a "good faith" dispute, it was entitled to withhold the retained funds and avoid the penalties.

The appeals court began its analysis by setting forth the ultimate purpose of retention: to ensure that the owner has sufficient funds to complete or correct defective or unfinished work and to provide security against mechanic's liens. The court found that the district had no justification for retaining the funds. Instead, the district relied on FTR's affirmative claim as the "dispute" that the district believed entitled it to withhold all funds. The district asked the court to adopt legal precedent in California to the effect that as long as there is "any good faith dispute," the statutory penalty should not be assessed.

The appellate court expressly declined to follow that legal ruling and affirmed the trial court's ruling on the interest penalty. The court disagreed with the district's broad interpretation of "dispute" and reasoned that the purpose of ensuring the prompt release of the retained funds would not be served if "any dispute" justified withholding the sums retained. "Once the legitimate purpose for retaining the funds ends, the public entity must release the fund or suffer the statutory penalty."

Many readers are acquainted with the "golden rule" in business: the party who holds the "gold" (money) rules. When parties to a contract know that their disputes are headed to litigation, the "upstream" party is often tempted to use whatever leverage it has, including withholding retained funds, to help it in the claims process. By any objective measure, it is difficult to argue that the withholding was justified in the absence of any corrective work and merely because the contractor submitted a claim. It is particularly hard to see how this could be justified after more than 10 years.

As we often point out in this column, this type of heavy-handed dealing does not sit well with arbitrators, juries, or judges and can result in large damage awards, or "home runs," against the party exerting this control. Both the trial court and the appellate court noted that the district had "unclean hands," causing economic duress and hardship for the contractor simply to obtain an advantage. **CE**

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Recovering Attorney Fees Under AAA Arbitration

THE PHRASE "only the lawyers win" is commonly voiced by parties involved in litigation. It brings to mind the statement attributed to the French philosopher Voltaire to the effect that he was ruined on two occasions in his life, once when he lost a lawsuit and once when he won one.

The United Kingdom and much of Europe have tried to address this by requiring that the parties losing in litigation pay the reasonable attorney fees incurred by the prevailing parties. Things work differently in the United States. Under the "American rule," litigants compensate their own attorneys, regardless of the outcome, unless the statute or contract in question provides otherwise.

Because a fair number of construction disputes are resolved through the American Arbitration Association (AAA), readers should be mindful that making a demand for the award of attorney fees can unintentionally turn the American rule on its head; that is, making a request for attorney fees in the initial demand can trigger a fee award even when such relief is not permitted by contract or statute.

Rule 45 of the AAA Construction Industry Arbitration Rules permits an arbitrator to award a prevailing party's attorney fees if "all parties have requested such an award or it is authorized by law or their arbitration agreement." Recent cases in Tennessee, New Jersey, Missouri, and Illinois have enforced attorney fee awards even when parties retract their initial request for fees.

For example in *Lasco Inc. v. Inman Construction Corp., et al.,* the plaintiff, Lasco, filed a breach of contract suit against Inman. Inman moved to compel arbitration, and the parties agreed to submit their dispute to arbitration under the AAA. After the hearing, the arbitrators issued an award denying Lasco's claim in its entirety and awarding Inman $162,333 in attorney fees. Lasco then filed a motion to vacate the award, contending that the arbitrators exceeded their authority because attorney fees were not authorized by the contract. The trial court agreed and vacated the arbitrators' award with respect to attorney fees. Inman, however, took the issue to the Tennessee Court of Appeals.

The appellate court noted that both Lasco and Inman had requested an award of attorney fees in the arbitration. In particular, Lasco made a demand for these fees in its initial demand for arbitration and in its posthearing brief. Since both parties had requested an award of the fees in their initial pleadings, the court concluded that the arbitrators had not abused their discretionary authority and confirmed the award.

Similarly, in *City of Chesterfield v. Frederich Construction, Inc., et al.,* a state appeals court in Missouri confirmed an award under the AAA that included attorney fees, even though no contract provision or statute authorized such fees. The court held that the arbitrators had the authority to award the fees because the AAA rules had been incorporated into the contract.

The contract at issue provided that all disputes between the parties be subject to arbitration under the AAA Construction Industry Arbitration Rules. When disputes arose on the construction project, the contractor demanded arbitration and requested an award of attorney fees, as did the owner in its answer and counterclaim.

In the final award, the arbitrators found in favor of the contractor and awarded the contractor almost $280,000 for attorney fees. The arbitrators made the fee award even though there was no contractual provision, statutory authority, or "special circumstances" authorizing the award of the fees. The arbitrators stated nonetheless that they were justified in awarding fees simply because the AAA rules allow such an award if all parties request it. On review, the trial court confirmed the award. The court of appeals did the same, finding that by incorporating the AAA rules into their agreement, the parties made the rules as much a part of the contract as any other provision

An Illinois state appeals court case, *Spencer v. Ryland Group, Inc.,* involved a plaintiff seeking to vacate an award because the arbitrators, in contravention of the underlying contract, failed to award attorney fees. While the trial court dismissed the plaintiff's complaint, the decision was overturned on appeal. The appellate court found that the arbitrators had indeed abused their discretionary authority by failing to award the fees.

We wanted to bring this subject to the attention of our readers for several reasons. First, the cases demonstrate that arbitration rules governing a dispute can materially affect the relief available to parties. Consequently, while the "American rule" severely restricts the recovery of legal fees in court, AAA arbitration (along with other rules embodying similar language) broadens this remedy substantially. This can certainly help to defray the expense of pursuing a remedy against a contracting party.

But perhaps more important, the cases also demonstrate the importance of knowing what you are pleading in an arbitration demand. There is a tendency for parties to ask for attorney fees as a matter of course in their arbitration demands. What happens, however, if the party knows that its claim is open to severe challenges but, for tactical reasons, decides to pursue it anyway? By asking for recovery of its own legal fees, that party risks having to pay its adversary's legal fees if it loses, assuming that the adversary had the foresight to ask for reimbursement of legal fees. This necessarily requires the parties involved in arbitration to be mindful of the true merits of their positions before filing an arbitration demand. The sting of paying its adversary's legal fees on top of its own could indeed ruin a company. **CE**

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Rethinking the Spearin Doctrine?

THE U.S construction industry has long held that an owner impliedly warrants to contractors the suitability of the plans and specifications he or she furnishes during the bidding process. This principle, referred to as the Spearin doctrine, was originally formulated under the design/bid/build project delivery approach, by which the owner contracts directly with the designer for completed design documents and the general contractor has no involvement whatsoever in the design process.

As the industry has moved to such other delivery systems as design/build and construction manager at risk (CMAR), questions have been raised about the applicability of the Spearin doctrine. With CMAR, the owner still contracts with the designer to develop the full design. However, the general contractor (often called the CMAR) is under contract with the owner during the design stage, providing such preconstruction services as constructability and value engineering reviews. Some owners contend that this should preclude the CMAR from claiming that a design is defective.

This was the issue in *Coghlin Electrical Contractors, Inc. v. Gilbane Building Company.* The project involved the construction of a 320-bed psychiatric facility for Massachusetts's Division of Capital Asset Management and Maintenance. Gilbane Building Company served as the CMAR and engaged in typical preconstruction activities. Its electrical subcontractor contended, among other points, that the design was defective, and it filed a multimillion-dollar claim against Gilbane, which passed it through to the state.

When the state rejected the claim, Coghlin sued Gilbane, and Gilbane in turn sued the state, arguing that the state was legally responsible for damages caused by its design errors or omissions. The state moved to dismiss the case, alleging that because Gilbane had extensive planning and design oversight duties, it bore the risk of design problems raised by its subcontractors. The state further contended that Gilbane had the duty to indemnify the state for any claims, losses, or damages arising from the project.

The trial court framed the legal question as follows: does the CMAR agreement trump long-standing Spearin doctrine principles recognized by Massachusetts? The court termed the dispute a "case of first impression," meaning that it raised an issue that had not been previously considered in Massachusetts. It began its analysis by citing certain provisions of the CMAR contract, including the "extensive design review" responsibilities of Gilbane:

> The CM shall review, on a continuous basis, development of the drawings, specifications, or other design documents produced by the designer.... Review of the documents is to discover inconsistencies, errors, and omissions between and within design disciplines.... Without limitation, the CM shall review the design documents for clarity, consistency, constructability, maintainability/operability...

The court also cited the indemnification provision, which required Gilbane to "indemnify, defend . . . and hold harmless [the state] from any claims or damages," regardless of whether or not such claims, damages, or losses were caused in whole or in part by the state.

The court acknowledged that Massachusetts law favors contractors when the owner supplies erroneous or ambiguous plans and specifications. However, the court was influenced by the fact that, under a CMAR delivery model, Gilbane had more involvement in the early phases of the design. In this light, the court determined that traditional Spearin law did not apply and found that the allocation of risk for cost overruns was decidedly shifted to Gilbane.

Gilbane appealed the decision, arguing that the ruling, which shifted design risk to general contractors and abrogated Spearin, was flawed in that Gilbane was neither contractually responsible for the design nor responsible for hiring the designer. It contended that the court incorrectly construed the CMAR contract as a design/build contract.

The state argued that, under the CMAR delivery method, a contractor cannot simply pass along a subcontractor's claim stemming from the contractor's own contractual responsibilities. Because Gilbane was contractually required to continuously review design documents for clarity, consistency, and constructability and to maintain coordination, the state said the trial court got it right in dismissing Gilbane's suit.

The American Council of Engineering Companies and the local chapter of the American Institute of Architects filed briefs in support of the state, arguing that the rationale behind the Spearin doctrine—that is, the contractor's lack of control over the design—is inapplicable with CMAR contracts, in which general contractors are deeply involved during the development of the design. Further, they argued that the allocation of risk to the general contractor for design issues is fair because of the way in which the CMAR is compensated, a guaranteed maximum price being established after the contractor is under contract.

In the other corner, the Associated General Contractors of America argued that the CMAR delivery method does not and should not make general contractors guarantors of the design and that "design reviews" do not contractually delegate design responsibility to the general contractor. One brief argued that if the holding is affirmed and general contractors are held to be legally responsible for defects in designs they did not prepare, the CMAR delivery method will become obsolete in Massachusetts.

The ruling from the Massachusetts Appeals Court, which is expected this year, will have major consequences for the industry, particularly if the state's position is upheld. We will report on the decision as soon as it is rendered. **CE**

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Owner Awarded Liquidated Damages Following Termination for Convenience

AS DISCUSSED in earlier columns, a termination for convenience clause gives a party the right to end the contractual relationship on a "no fault" basis. The clause generally entitles the terminated party to submit a proposal to recoup its costs, and the remedies associated with a default termination (such as excess reprocurement costs) are not available to the terminating party. In fact, most veterans in the construction industry assume that a terminated party has no real liability once this clause has been invoked.

A recent case, however, may require a rethinking of this assumption. In *Old Colony Construction, LLC v. Town of Southington,* the Connecticut Supreme Court ruled that the termination for convenience clause did not absolve the contractor from paying liquidated damages for unexcused project delays.

The disputes stemmed from the replacement of a pump station in Southington, Connecticut. Old Colony Construction's contract with the town provided for liquidated damages in the daily amount of $400. The project was plagued with a variety of delays, and the parties disagreed over the responsibility for them. Southington ultimately terminated Old Colony for convenience 26 months after the contract's required completion date.

At the time of the termination, Old Colony had been paid $650,000 on its $915,000 contract. The firm sought an additional $1.3 million in unpaid costs and delay-related damages. When the claim was denied, Old Colony filed suit and the town counterclaimed, contending that it was entitled to offset liquidated damages for the entire 26 months.

The court concluded that Old Colony was entitled to $164,000 in damages relating to the termination for convenience. However, it also held that the town was entitled to $315,000 in liquidated damages and could offset that against the amount owed Old Colony. The net judgment was a payment to the town of approximately $150,000.

Old Colony appealed to the Connecticut Supreme Court, arguing that liquidated damages were not available as a remedy to the town once it made the decision to terminate for convenience. Further, it argued that liquidated damages were unavailable to the town because of the town's own hand in the delays, that is, faulty contract documents and late responses to submittals. Lastly, Old Colony argued that, even if liquidated damages could be recovered, the court could not apportion all 26 months of delay to it as the town should be responsible for the delays that it caused.

The Connecticut Supreme Court rejected all three arguments. First, it found that the termination for convenience provision expressly permitted the town to avail itself of remedies in addition to the convenience termination. The contract stated: "Upon seven days' written notice to [Old Colony] and [the project engineer], [the town] may, without cause and without prejudice to any other right or remedy of the town, elect to terminate the contract."

The court found it dispositive that the termination provision expressly and broadly reserved "any other right or remedy" of the town, which, in its view, included the assessment of liquidated damages. The court stated that "had the parties intended to limit the town to nondefault remedies, as Old Colony suggests, one would expect some sort of limiting language rather than such expansive terms."

It is significant that the court rejected Old Colony's supporting case law. The termination for convenience cases adduced by Old Colony generally involved owners trying to recover from the contractor for defective or incomplete work, and none involved the overturning of a liquidated damages assessment. The court supported its reasoning by noting that even if Old Colony was right and termination for convenience operated to stop the assessment of liquidated damages, "the town's claim for liquidated damages in the present case would not be impaired because its right to such damages arose as soon as the substantial completion date passed and continued to accrue until termination of the contract."

The court also rejected Old Colony's other defenses. It refused to be guided by the rule followed by a majority of jurisdictions to the effect that when delays are attributable to both parties, the liquidated damages clause is annulled. Instead, it held that in the absence of a formal extension of the contract date, the contractor was responsible for the delays. Moreover, Old Colony had not submitted a claim requesting time or costs associated with the town's delays, had not followed the strict written notice provisions of the contract, and did not argue that the town waived those notice of claim requirements.

This case is interesting from several perspectives. First, the court ruling gives no indication as to why the town did not terminate for default. After a two-year delay, the town appeared to have the contractual default remedy at its fingertips, but instead it chose termination for convenience. While such termination did not expose Old Colony to excess reprocurement costs, it may have lulled the firm into thinking that it was not at risk for liquidated damages. Finally, Old Colony might have itself to blame for the results. Had it presented a timely and proper claim for owner-caused delays, it might not have borne the full brunt of project delay even though the court held that liquidated damages were applicable in a termination for convenience situation. **CE**

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Court Establishes Test for Proving Architectural Copyright Infringement

DESPITE RECENT rulings by federal courts awarding significant amounts to design professionals who alleged copyright infringement, disputes of this type are rarely litigated. Indeed, proving copyright violations of creative work is a somewhat Herculean task. A recent decision, *Humphreys & Partners Architects, L.P., v. Lessard Design, Incorporated,* highlights the difficulties design professionals encounter in proving design infringement.

The plaintiff, Humphreys & Partners Architects (HPA), is a designer of multifamily residential buildings. In 2000 it designed a high-rise tower known as Grant Park, a 27-story condominium building. It registered the design as an architectural work, and the building, which has a dual-core layout with two separate elevator cores, was constructed in Minneapolis in 2004.

In 2008 the Penrose Group, a real estate developer, solicited design proposals for a high-rise apartment complex it wanted to build in McLean, Virginia. HPA submitted illustrations of its Minneapolis Grant Park design and met with Penrose. The latter subsequently met with a competing firm, Lessard Design, and provided it with HPA's Grant Park floor plan. Penrose expressed its desire to have a building that would feature dual elevator cores connected by a service corridor.

Twelve days later Lessard emailed Penrose a preliminary sketch of a design with two elevator cores. Penrose ultimately retained Lessard for the design work, and a 19-story building with three elevator cores connected by an unfinished hallway was constructed in 2012. Shortly thereafter HPA filed suit against Lessard, the former and current building owners, and the construction contractor, alleging copyright infringement.

The defendants asked the court to rule in their favor before trial, arguing that they did not copy the Grant Park design and that the two designs were not substantially similar. For its part, HPA alleged that the speed with which Lessard submitted its design after receiving the Grant Park design constituted direct evidence of copying. Furthermore, it pointed to nine similarities between the two designs, circumstantial evidence, it contended, of copying. It also alleged that the arrangement of the nine features was a copyright infringement as well.

The court saw no direct evidence of copying and ruled that the two designs were not extrinsically—that is, objectively—similar. Pointing out that the nine features in question, along with the arrangement of these features, were not even eligible for copyright protection, it cited the explanations given by the defendants' experts of how the sizes, footprints, floor plans, and exterior appearances of the two buildings differed. HPA appealed the decision to the U.S. Court of Appeals for the Fourth Circuit.

The appellate court began by outlining the standard set forth in the Architectural Works Copyright Protection Act. To establish a claim for copyright infringement, a plaintiff must prove that it owned a valid copyright and that the defendant copied the original elements of that work. A plaintiff can prove copying occurred through either direct or circumstantial evidence. Direct evidence of copying, the court noted, can take the form of admissions, witness accounts of the physical act of copying, and common errors in the works of a plaintiff and a defendant.

Where direct evidence is lacking, circumstantial evidence must include proof that the alleged infringer had access to the work and that the supposed copy is "substantially similar" to the author's original work. The appellate court then expressly held that, to prove substantial similarity, the plaintiff must show that the two works are both "extrinsically" and "intrinsically" similar. The former inquiry is objective and looks to "external criteria of the alleged copy and the protected elements of the architectural work." By contrast, the intrinsic inquiry "implicates the perspective of the...intended observer...and looks to the total concept and feel of the works."

HPA argued that there was direct evidence of copying because "rather than going through the normal iterative design process, Lessard had a preconceived solution to the design." The court, however, saw no direct evidence of copying. It also rejected HPA's argument that the overall form and composition of the works were similar. HPA's expert had opined that "the ideas and expression of ideas" in the two buildings were substantially similar and in doing so called attention to such factors as the floor plan, the exit circulation, the building size, and the "composition of major elements that make up the exterior expression of the buildings."

The court, however, relied on the opinions of the defendants' experts, who contended that the two buildings were not substantially similar in overall form and denied that the two designs "arrange spaces and elements in a substantially similar manner." Finally, the appellate court agreed with the lower court's analysis that even though the two designs shared nine features, individual design components or features cannot be protected under copyright laws.

Proving infringement is by no means simple, and litigating an infringement case is an uncertain proposition, to say nothing of the costs. **CE**

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State Court Upholds Spearin in CMAR Projects

THE HIGHLY anticipated ruling in *Coghlin Electrical Contractors, Inc. v. Gilbane Building Company* has now been issued, and (with some caveats) it permits a construction manager at risk (CMAR) to pursue an owner for design defects even if the CMAR was involved in the design process.

In the traditional design/bid/build world, an owner impliedly warrants to the contractor the suitability of its design documents under what is commonly known as the Spearin doctrine. The rationale is that, vis-à-vis the contractor, the owner exclusively controls the design. The contractor is therefore entitled to reasonably rely upon the sufficiency and completeness of the design when it bids on the project. While the Spearin doctrine is largely associated with design/bid/build, courts have also applied it to design/build projects. Consequently, if an owner furnishes a "bridging" design during procurement that contains errors and the designer/builder cannot reasonably detect these errors until after the contract is awarded, the designer/builder has a remedy against the owner for the consequences of the errors.

Spearin's applicability under the CMAR delivery method had not been the direct subject of any court case until *Coghlin*. The case arose from the construction of a psychiatric facility for Massachusetts's Division of Capital Asset Management and Maintenance. Gilbane Building Company served as the CMAR on the project. The state contracted separately with an architecture and engineering firm for the design. Although Gilbane's preconstruction activities included a review of the design documents, the contract stated that Gilbane did not assume any legal responsibility for the design.

During the project Gilbane's electrical subcontractor (Coghlin Electrical Contractors, Inc.) noted several design-related discrepancies, one being that the ceilings were designed so that 2 ft of space would be left to the bottom of the structural steel whereas 5 ft was required to accommodate the mechanical and electrical work. Coghlin sued Gilbane, and the latter sued the state on the grounds that the state breached its implied warranty that the plans and specifications were sufficient. The state successfully convinced the trial court that, as the CMAR, Gilbane assumed liability for the design. The trial court also found that Gilbane, by virtue of a broad indemnification clause, was obligated to defend the state from Coghlin's claims and to indemnify the state. The ruling set the stage for a high-profile appellate battle.

The Massachusetts Supreme Judicial Court started by evaluating the state statute authorizing CMAR delivery methods on public projects. It concluded that the legislature never "intended to abolish the owner's implied warranty and to require the CMAR to bear the entirety of the risk arising from design defects." The court acknowledged that, in contrast to design/bid/build contractors, CMARs may provide "consultation" regarding the design. Such consultation, however, did not mean that the CMAR had control over the design. Control remained with the owner: "The possibility that the CMAR may consult regarding the building design does not suggest that the CMAR should be the guarantor against all design defects, even those that a reasonable CMAR would not have been able to detect."

As a result, the court concluded that the owner still impliedly warrants the sufficiency of the design under a CMAR process. However, it noted that the scope of the warranty may be more limited than under design/bid/build. To prove the owner's breach of its implied warranty of the design, a CMAR must, according to the decision, show that it relied in good faith on the design in light of its own design responsibilities. "The CMAR's level of participation in the design phase…and the extent to which the contract delegates design responsibility to the CMAR may affect a fact finder's determination as to whether the CMAR's reliance was reasonable." What this means is that the CMAR's contractual duties with respect to the design will heavily influence the breadth of any implied warranty claim against the owner.

The Supreme Judicial Court next concluded that the contract did not contain an express disclaimer of the implied warranty. The provisions requiring Gilbane to "carefully study" and "carefully compare" all design-related documents, to "take field measurements and verify field conditions," and to review the design "on a continuous basis" were not enough to expressly abrogate the implied warranty. Finally, the court rejected the state's argument that it should be indemnified by Gilbane for Coghlin's design defect claims, finding that this would inappropriately absolve the state from its Spearin obligations.

The *Coghlin* decision shows careful thought and is generally in accord with how many in the construction industry have assessed Spearin's role on CMAR projects. The Spearin doctrine has always been based on the concept of "reasonable reliance." Such reliance for a design/bid/build contractor might be different from that for a CMAR. CMARs provide preconstruction services and typically review the owner's design for value engineering and constructability as it is being developed. Consequently, as the *Coghlin* court pointed out, the extent of a CMAR's preconstruction involvement should be a factor in whether the CMAR can raise a Spearin claim. By the same token, CMARs are not designers, and they should not be held responsible for design deficiencies that cannot reasonably be detected prior to construction. **CE**

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Is a Contractor's Duty to Continue Performance Absolute?

BECAUSE OF the frequency with which disputes arise on construction projects, most contracts require the contractor to continue work pending resolution of a dispute. In the federal arena, the standard "disputes" clause is generally considered to leave the contractor with little choice but to perform and seek damages later. This is true even in the face of directives or positions that seem unjust or are later determined to be legally incorrect. The U.S. Court of Federal Claims, however, recently ruled that this obligation is not absolute. A contractor may be justified in stopping work under certain circumstances.

In *Vanguard Construction, Inc., v. United States,* the contractor and plaintiff (Vanguard) entered into an indefinite delivery/indefinite quantity contract with the U.S. Air Force for roof replacement and repair work on buildings at Edwards Air Force Base, in California. The air force later issued a task order to Vanguard for replacing the roof of a particular building. As is the case with most government contracts, the contract incorporated the terms of the Federal Acquisition Regulation.

Vanguard demolished and removed the existing gravel roof, which also required it to remove a portion of a metal storage structure on top of the roof. It then notified the air force that a 60 ft section of the roof stem wall was missing. Vanguard's letter stated that "[t]he existing condition is incompatible with the specified roof system" and asked for direction on how to proceed, including a request for information on structural requirements for building a stem wall. It also requested information on any modifications to the storage building because the task order was silent on that issue.

The air force declared that the missing stem wall condition had been visible prior to the roof demolition and should have been accounted for in Vanguard's original proposal. There was no response, however, to Vanguard's request for information. Vanguard denied that the condition had been visible prior to demolition and reiterated its request for direction on structural and other issues pertaining to the design and construction of the new portion of the stem wall. The air force never provided the information sought by Vanguard, maintaining that the problem was within the scope of the original task order.

Vanguard installed approximately 85 to 90 percent of the new roof, leaving undone the part near the missing stem wall, which it continued to maintain was incompatible with the roofing system being installed. The firm eventually demobilized from the project site, claiming that there was no more work that could be completed.

The air force notified Vanguard that it considered the firm to be in default and terminated the task order. The notice cited Vanguard's failure to comply with its duty to proceed with performance pending resolution, as required by the contract's disputes clause.

Vanguard filed suit to challenge the termination for default and requested that the default termination be converted into a termination for convenience. It contended that its failure to complete the roof was justified by the government's refusal to provide responses to its requests for information. The government filed a motion for summary judgment arguing that, as a matter of law, the termination for default was justified because the contractor's duty to proceed with performance was absolute pursuant to the disputes clause.

Vanguard countered that completion of the roof was not possible once the latent defect in the existing stem wall or parapet along the perimeter of the roof was discovered. The government argued that the contract allocated to Vanguard the risk of dealing with latent or unanticipated site conditions. It further contended that the burden of devising a solution to the problem lay exclusively with Vanguard without technical input or design assistance from the government.

The court denied the government's motion for summary judgment, holding that, although the Federal Acquisition Regulation appears to unconditionally require a contractor to "proceed diligently with performance" while a dispute awaits resolution, a contractor is not always obligated to continue. Citing case law precedents, the court concluded that a contractor's duty to continue performance may be annulled if the government refuses to provide design information critical to the contractor. The court held that, to make a determination before trial, it would need to determine whether the missing stem wall was visible prior to demolition and whether Vanguard truly needed information from the government to complete the roof near the missing stem wall.

We have often reported in this column on decisions that reaffirm a federal contractor's obligation to continue working during a dispute. Courts and boards have recognized only three scenarios negating this obligation: (1) the specifications are so defective that work cannot continue without assured failure; (2) the contractor cannot proceed until it receives a response to a clarification request, or (3) the government materially breaches the contract.

It is unclear why the government chose not to respond to the contractor's requests for information. It may be that it thought that by answering it would somehow concede liability or waive its right to allege that Vanguard missed the defects in its prebid inspections. Whatever the reason, the court was not inclined to place the blame on the contractor at this early stage in the litigation, and the government was rebuffed on what it probably viewed as a slam dunk in its reliance on the disputes clause. **CE**

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