

Subcontractor Allowed to Sue Designer/Builder's Architect for Negligence

CONTRACTORS HAVE often attempted to sue design professionals for losses that they attribute to substandard design documents. These lawsuits are frequently barred by the economic loss rule, which precludes one party from suing another for purely financial losses when the parties are not in privity of contract. However, not all states recognize the economic loss rule, as seen in the recent California decision *U.S. Bilbro Constr. Co., Inc. v. Bilbro Constr. Co., Inc.*

The dispute concerned a \$7.3-million design/build contract awarded to Bilbro Construction to renovate a facility for the Naval Facilities Engineering Command in Monterey, California. Bilbro engaged Ferguson Pape Baldwin Architects (FPBA) to serve as the designer of record and to provide all of the architectural design services. FPBA's design team included an acoustic sub-consultant (Sparling). Bilbro retained Alpha Mechanical as a mechanical, electrical, and plumbing (MEP) design/build subcontractor, with Alpha in turn subcontracting the MEP design to Shadpour Consulting Engineers.

Alpha's MEP design was reviewed by Bilbro, FPBA, and Sparling at the 35, 75, and 100 percent design completion levels. Alpha stated that it regularly received direct communications during design development from Sparling and FPBA, including comments, changes, and revisions. As an example, Sparling raised some concerns about anticipated noise levels in eight rooms and made several recommendations to Alpha and Shadpour that were implemented.

After Alpha completed its work, the navy noted that 23 rooms (unrelated to the 8 previously addressed) exceeded its noise level requirements, and this was attributed to fans and air-handling units in the heating, ventilation, and air-conditioning system. None of the 23 rooms had been singled out as a po-

tential problem by Bilbro, FPBA, or Sparling during their review.

At this point Bilbro, FPBA, and Sparling made several suggestions to Alpha on how to reduce the noise levels, and Alpha purchased and installed new equipment as a result. These modifications did not effectively reduce the noise levels, and the navy refused to accept the project. Although Alpha had developed a solution, it was never implemented because Bilbro terminated Alpha for default and withheld \$323,000 from its payments.

Bilbro sued Alpha, seeking damages for its failure to achieve noise levels that satisfied project requirements. Alpha countersued Bilbro, FPBA, and Sparling for approximately \$1.1 million and also sued Shadpour for indemnity. Alpha alleged that FPBA and Sparling were negligent in that, among other lapses, they had failed to meet the applicable due standard of care, to properly inspect Alpha's design prior to their approvals, to detect problems with the designs before the work was completed, and to provide proper and effective solutions to address the noise levels. Both FPBA and Sparling filed motions to dismiss Alpha's claims based on the economic loss rule in the absence of a contractual relationship.

The court denied FPBA's motion to dismiss. While agreeing that there was no contractual privity, it concluded that FPBA and Alpha had a "special relationship" that gave rise to a legal duty of care. Under California law, the determination of a "special relationship" requires the balancing of several factors, including the extent to which the defendant's actions were intended to affect the plaintiff, the foreseeability of harm to the plaintiff, the degree of certainty that the plaintiff suffered injury, and the closeness of the connection between the defendant's conduct and the injury suffered.

Alpha convinced the court that these factors existed by arguing that FPBA, as the designer of record, was actively involved in the MEP design process, having made comments, suggestions, and revisions during the design review process. Alpha also argued that potential noise issues were discussed and that FPBA "proposed several recommendations to address the anticipated noise issue...with Alpha implementing their recommendations." The court agreed and also concluded that Alpha's subcontract required it to perform its MEP work in accordance with FPBA's plans and specifications and that there were no facts showing that Alpha had deviated from FPBA's approved plans.

While FPBA was not dismissed from the case, Sparling was; the court concluded that no special relationship existed between Alpha and Sparling. Although Sparling gave Alpha "suggestions" and was actively involved in reviewing the MEP design, the court found that Alpha was not required to implement Sparling's suggestions.

While there are a number of other California cases that address the application of the economic loss rule and the creation of "special relationships," this decision is significant given the design/build nature of the project. The facts in the case given here are as alleged by Alpha and have not been proved at trial. But they raise a number of questions, among them, how actively involved was FPBA, as the principal architect, in making MEP design decisions? Alpha's view seems to be that the MEP design was controlled by FPBA and Sparling. If these facts are proved at trial, FPBA could face liability to Alpha, notwithstanding the notion that Alpha should have been the party to design and build a properly functioning MEP system. **CE**

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Architect Fends Off Indemnity Suit

THE Spearin doctrine gives a contractor the right to cost and schedule relief when the owner's designer has furnished a defective design that adversely affects the contractor. Many owners have tried to avoid this liability through contract language, but for the most part they have been unsuccessful. Courts around the country have repeatedly concluded that contractors should not be forced to bear the risk of design defects when they have no responsibility for design. But what happens if the owner assigns its design contract to the contractor?

This month's case, *Hensel Phelps Construction Co. v. Cooper Carry, Inc.*, sheds some light on these questions. It involved the construction of the Marriott Marquis Washington, DC. In 2008 Marriott International, Inc., hired the architecture firm Cooper Carry, Inc. (CCI), to design the hotel. In 2010 Marriott contracted with Hensel Phelps to build the structure for a guaranteed maximum price of \$350 million. The Hensel Phelps contract contained a list of preliminary design documents that Hensel Phelps relied on in calculating that price. Marriott's contract with Hensel Phelps assigned the CCI design contract to Hensel Phelps.

When Hensel Phelps assumed responsibility for building the hotel, CCI was in the midst of drafting construction documents; final construction documents were due in 2011. So Hensel Phelps relied on partially completed construction documents as it broke ground. After completing certain construction work, Hensel Phelps discovered errors in CCI's design documents. For example, as determined in 2011 by the District of Columbia's Department of Consumer and Regulatory Affairs, the designs did not comply with the local building code's fire containment requirements. Hensel Phelps alleged that these design errors had a disruptive effect on the project.

Hensel Phelps ultimately sued CCI

in federal court. The suit alleged that CCI breached its design obligations by failing to properly design the hotel. It also contended that CCI breached the indemnity provision of the contract by failing to indemnify Hensel Phelps for the expenses incurred by the latter in addressing the design mistakes.

CCI moved for summary judgment, seeking to dismiss both counts and alleging that the contractor's claim was barred by a three-year statute of limitations. It also argued that the indemnity provision involved in the suit related to responsibility for third-party claims, not to direct claims by the contractor.

Under the indemnity clause in CCI's contract, CCI was required to "indemnify, defend and hold...harmless" Hensel Phelps "from and against any claim judgment, lawsuit, damage, liability, and costs and expenses, including reasonable attorneys' fees, as a result of, or in connection with, or as a consequence of the Architect's performance of the Services under this Agreement."

Hensel Phelps argued that this provision applied to the costs and expenses it incurred as a result of CCI's deficient performance. The court disagreed, concluding that Hensel Phelps had not read the indemnity clause in a "natural way." The court first noted that indemnity clauses are generally interpreted narrowly against the party seeking indemnification. Next, it pointed out that the words "damage" and "costs and expenses" in the clause reflected the notion that litigation from other parties is being addressed. The court's interpretation was bolstered by the fact that Hensel Phelps's preferred reading of the clause would make the indemnity obligations superfluous with a breach-of-contract claim. As the court put it, "It is unlikely the parties intended the indemnification clause to create an additional opportunity for breach, arising from the same design errors."

The court also considered whether Hensel Phelps's claims were barred by

the applicable three-year statute of limitations. The key question considered by the court was when the three years began. Did they begin when CCI delivered the design documents that Hensel Phelps relied upon, as CCI argued? Or did they begin when the design services were "substantially complete," as argued by Hensel Phelps?

In a thoughtful discussion, the court evaluated the cases cited by Hensel Phelps. It determined that Hensel Phelps's acceptance of CCI's nonconforming designs was the point at which the three years began. In practical terms, Hensel Phelps was incurring damages on the design long before substantial completion of the design services. Consequently, Hensel Phelps could have sued CCI when it recognized that it would need to make changes to the design. The court therefore found that Hensel Phelps's claims that CCI breached its design contract were time barred.

Although this project was not originally let as a design/build undertaking, it could be argued that Hensel Phelps became a designer/builder by accepting the assignment of CCI's design contract. Builders under a design/build arrangement have an expectation that their designers will be responsible for defects affecting them, and it would not be unusual to look to the indemnity clause as recourse for that claim.

And readers should remember that the accrual of a cause of action for statute of limitation purposes depends to a marked extent on state law. Other states could very well have concluded that Hensel Phelps had the right to wait until substantial completion of either the entire project or all of the design services before needing to file suit against CCI. Note that the decision has been appealed by Hensel Phelps, and we will revisit this case if anything noteworthy arises from the appeals process. **CE**

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Are Arbitration Awards Always Final?

ARBITRATION is viewed by many as a fair, fast, and economical process. One of the principal reasons that construction industry players often agree to arbitration as the sole method of dispute resolution is the finality of the award. Appeals from arbitration awards are a rarity because they must generally be based on arbitrator bias or the integrity of the process.

But reversals of awards are sometimes made on other grounds, as evident by two recent cases. The U.S. Court of Appeals for the Seventh Circuit reversed an arbitration award because the arbitrators exceeded their authority by basing their award on documents outside the parties' contract. And the Supreme Court of Rhode Island likewise held that an arbitrator exceeded his authority in disregarding contractual terms. Could these rulings signal a trend away from the finality of arbitration awards?

In *Bankers Life & Casualty Insurance Co. v. CBRE, Inc.*, disputes arose concerning a contract between Bankers and CBRE, a commercial real estate services firm. Bankers was seeking to lease new office space in Chicago and CBRE acted as its representative under a listing agreement. CBRE provided Bankers with a cost-benefit analysis (CBA) projecting almost \$7 million in savings if Bankers leased new space and subleased its old space. Bankers moved to another location and subleased its office, but it realized only \$3.8 million in savings.

After Bankers discovered that the CBA calculations were inaccurate, it demanded arbitration with CBRE for the lost savings. The arbitration panel issued an award in favor of CBRE, finding that the listing agreement did not require CBRE to provide a CBA, let alone an accurate one. Moreover, the CBA had included a standard disclaimer covering errors. The U.S. District Court for the Northern District of Illinois confirmed the arbitration award, and Bankers appealed.

The U.S. Court of Appeals for the Seventh Circuit reversed the decision, finding that the panel exceeded its authority by relying upon the CBA's disclaimer. While the panel was authorized to interpret the listing agreement, that agreement never mentioned the CBA or the disclaimer regarding accuracy, the court said. The CBA was merely the format through which CBRE responded to inquiries from Bankers about the progress of the negotiations, and the disclaimer was inserted into the CBA unilaterally by CBRE. The appeals court concluded that this tainted the award.

Nappa Construction Management, LLC, et al. v. Carolyn Flynn et al. involved the construction of an automobile repair facility. The contract between Nappa, the contractor, and the Flynns, the owners, allowed the Flynns to unilaterally terminate the contract either for cause or for convenience. It also permitted them to suspend, delay, or interrupt Nappa's work for any reason.

At some point, the Flynns directed Nappa to cease further work on the project, alleging that the building was not being constructed according to the plans. Nappa countered that the Flynns had not paid Nappa for its work, which was a contract breach entitling Nappa to terminate the contract. The parties submitted their disputes to an arbitrator.

The arbitrator found that Nappa "failed to act in the best interest of the project" by submitting a payment application that included sums for deficient work. This led the arbitrator to conclude that Nappa was not justified in declaring the Flynns to be in breach of contract. However, he also concluded that the "combative, contentious, dysfunctional relationship" between the parties meant that neither Nappa nor the Flynns were in breach of contract and that the most appropriate remedy was to use the termination-for-convenience clause and for the Flynns to pay Nappa a

fair and reasonable amount. The arbitrator then calculated that value.

The Rhode Island district court confirmed the award, but the Supreme Court of Rhode Island saw things differently. It vacated the award on the grounds that the arbitrator's interpretation of the contract contravened the contractual language. The court held that termination for convenience was a contractual right that could be exercised only by the Flynns and wholly at their discretion.

The court argued that while the arbitrator effectively found Nappa to be in breach of contract, rather than determining damages, the arbitrator converted Nappa's wrongful termination into a termination for convenience, which under the contract was a right exercisable only by the Flynns. Although acknowledging that courts should not endeavor to replace the arbitrator's interpretation of a contract with their own, the court found it inappropriate for an arbitrator to reach beyond the contract "for the purpose of rendering what he or she believes is a more desirable result."

Generally speaking, arbitrators' decisions are not reviewed for substance by higher courts. Instead, if an arbitrator makes an error in applying the law or making factual findings, the parties are usually stuck with that incorrect result. This is called the manifest error standard. An arbitration award will not be touched unless the arbitrator showed a manifest disregard for the contract or law. While that standard has historically been very difficult to prove, the appealing parties in these cases were able to meet that burden. Note, however, that in both cases dissenting opinions were authored arguing that the arbitrators' decisions should not have been reversed and vacated without proof of some manifest error or proof that the arbitrator had exceeded his or her authority. **CE**

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A Subcontractor Is Stuck with Mistakes In Its Bid

GENERAL CONTRACTORS often must list the subcontractors they intend to employ if successful in obtaining a contract, and if a subcontractor refuses to honor its bid price after award, the parties sometimes sue one another even though no formal written contract exists.

This was the case in *Weitz Co., LLC, v. Hands, Inc.*, in which the Supreme Court of Nebraska held that a general contractor could hold a subcontractor to its bid price under the theory of promissory estoppel. Under this doctrine, a general contractor is allowed to sue a subcontractor based on a promise, that is, a bid, if the general contractor relied on that promise to its legal detriment. The dispute arose when Evangelical Lutheran Good Samaritan Society invited four prequalified general contractors to bid on the construction of a nursing facility.

One of the contractors was Weitz. Fifteen minutes before the bids were due, Weitz received bids for the mechanical work from Hands, Inc., doing business as H&S Plumbing and Heating, for \$2,430,600, plus options for additional duct and radiant heating work. Weitz used H&S's numbers for the heating, ventilation, and air-conditioning (HVAC) scope of the bid and was awarded the project for \$9.2 million. After the award, H&S revealed that its bid contained mistakes totaling \$430,000.

The parties were unable to come to an agreement for increased compensation, and Weitz completed the project using different subcontractors. This cost Weitz almost \$300,000 more than H&S's bid with options. Weitz then sued H&S for breach of contract

and promissory estoppel, seeking to recover that amount. The trial court concluded that although no contract was formed, Weitz was entitled to enforce the bid and recover the \$300,000 in damages.

On appeal, the Nebraska Supreme Court affirmed the trial court's decision, stating that under promissory estoppel a plaintiff is entitled to damages if it can show: "(1) a promise existed that the promisor should have reasonably expected to induce the plaintiff's action or forbearance; (2) the promise did in fact induce the plaintiff's conduct; and (3) injustice can only be avoided by enforcing the promise."

The court began its legal analysis by considering whether H&S's bid was a promise upon which Weitz should have been able to rely, and it determined that it was. It pointed out that in the construction industry most subcontractors understand that when they submit a price, the contractor is going to rely on that number and submit it

that the bidding documents themselves precluded reliance since the owner had a right to veto subcontractors. The court, however, noted that such veto power was theoretical and not exercised in this case. H&S next argued that Weitz did not require subcontractors to "keep their bids open" for a specified period of time. The court noted that contractors are not required to affirmatively state, notify, or remind those submitting bids that their bids cannot be revoked. Third, H&S asserted that because Weitz could have withdrawn its own bid at any time with no consequences, its reliance on H&S's bid was not reasonable. But the court was persuaded that if Weitz had withdrawn its own bid, its business reputation would have suffered greatly with its clients and prospective clients. The court concluded that Weitz should not have to back out of a deal "because of a squabble with its HVAC contractor."

Lastly, H&S argued that Weitz's reliance was not reasonable because H&S had submitted an exceptionally low bid replete with mistakes. Weitz, however, presented evidence that its own internal HVAC estimate was lower than what H&S proposed. Because there was testimony that the market was weak and many subcontractors were submitting low bids, the court deemed Weitz's reliance reasonable.

What is interesting about this case is the way in which the court determined what was fair. H&S argued that it was not fair to enforce a bid with mistakes in it, especially when, H&S alleged, Weitz "engaged in... bid shopping." But the court saw no evidence of bid shopping and ruled that "the loss resulting from the mistake should fall on the party who caused it." **CE**

"HOW COULD competitive bidding function at all if general contractors did not rely on subcontractors' bids?"

to the owner in the hope of winning the award. Moreover, the court said, the fact that H&S submitted its bid 15 minutes before the deadline meant that H&S should have known that Weitz would have little time to review or analyze the numbers.

The court next considered whether Weitz's reliance on H&S's numbers was reasonable, and it noted that Weitz had worked with H&S 10 or 15 times before without incident. The court asked, "How could competitive bidding function at all if general contractors did not rely on subcontractors' bids?"

H&S made four primary arguments against that reliance. First, it contended

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Texas Port Interfered with Contractor's Means And Methods

IN THE October 2012 issue (page 88), we reported on a high-stakes battle between a contractor and a public owner over a wharf construction project in Texas. In *Port of Houston Authority of Harris County v. Zachry Construction Corporation*, a contractor, Zachry, had been awarded \$19 million after a three-month jury trial because the owner, the port, had actively interfered with its work. The contractor's substantial legal victory was of short duration, however, because the port successfully appealed. The appellate court enforced a no-damage-for-delay provision in the contract against the contractor and directed the firm to pay the owner \$11 million in attorneys' fees.

Many in the Texas contracting industry were distressed that the court would vitiate the delay claim even when there was evidence that the owner had actively interfered with the contractor's performance. In the November 2014 issue (page 88), we reported on the Supreme Court of Texas's noteworthy reversal of that appellate court decision. Despite Texas's long legal history of upholding no-damage-for-delay clauses, the high court found that the clause could not be enforced if the owner's intentional misconduct caused the delay. The case was sent back to the appellate court for review with instructions that the court consider the port's 10 distinct arguments against the jury's original findings.

The factual disputes arose out of an approximately \$62-million contract for the construction of a wharf. Zachry was selected as the contractor in large measure because it proposed building the wharf in the dry using a U-shaped frozen earth wall to dewater the site. When the owner ordered the addition of a

332 ft section to the wharf, Zachry proposed building a second frozen cutoff wall perpendicular to the first and splitting the project into two phases. The port refused to allow construction of the second cutoff wall. Zachry protested that the port had no right to dictate the method and manner of work. The port's decision ultimately delayed the project, and Zachry sued for tens of millions of dollars in damages from delays.

At trial the port contended that it had not interfered with Zachry's work and that it was contractually entitled to reject Zachry's frozen wall design. As evidence the port adduced the contract's submittals clause, which stated that submittals could be rejected and returned to the contractor with a request for changes. The port also argued that the contract's health and safety clause gave it the right to review Zach-

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ry's safety plan and that the frozen wall was actually part of that plan.

The appellate court rejected the port's arguments, stating that the contract treated Zachry as an independent contractor that had the right to select its own means and methods of performance. With respect to submittals, the court relied on language in the clause stating that the review and acceptance process was "merely an effort... to determine whether the Contractor is complying with the Contract Documents" and that the port's "review and acceptance of the Contractor's Submittals shall not constitute approval... of any construction means, methods, [or] techniques." The health and safety clause had similar language, stating that, notwithstanding the port's review of the safety plan, Zachry was responsible for ensuring the safety of its personnel and subcontractors.

Regarding the responsibility for project delays, the port's argument was circumscribed by the Supreme Court of Texas's ruling that active owner interference is an exception to the no-damage-for-delay clause. To overcome this hurdle, the port argued that the actions it had taken did not constitute active interference. At most, it conceded, the actions were reckless but not intentional.

The appellate court said that active interference by the owner occurs when its actions are "willful and unreasoning" or "without due consideration" and "in disregard of the rights of others." Perhaps not wanting to be reversed a second time, the appellate court in this round found that active interference had indeed occurred. It overruled all of the port's other arguments and reinstated the 2012 jury verdict in favor of Zachry for \$19 million. It is worth noting that postjudgment interest has probably been accruing on that amount over the past five years of litigation, adding to the port's losses.

The recent ruling affirming the award for Zachry is important in at least three respects:

- The decision does not discuss an owner's ability to object when it believes that a contractor's chosen means and methods will result in a loss of millions of dollars, as happened here.
- Owners typically attempt to insulate themselves from liability for such events as jobsite safety claims and injuries by including disclaimers in contracts. However, in this case those disclaimers worked against the port in its attempts to pinpoint contractual authority to reject the contractor's technique.
- Finally, the active interference exception to the no-damage-for-delay clause was further clarified. Indeed, it may even have been broadened to encompass measures taken by the owner "without due consideration." **CE**

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Missouri Upholds Spearin Doctrine In Case of First Impression

MOST DESIGN professionals are familiar with the Spearin doctrine. One hundred years ago, George Spearin was handed a set of contract drawings by the federal government to build a dry dock in a navy yard in Brooklyn, New York. Part of the design included the diversion of a 6 ft sewer system. When the navy furnished its design to bidders, the government knew that the sewer had capacity and overflow problems, but it did not disclose those issues to Spearin. Moreover, neither the government nor the bidders had any knowledge of the existence of a dam beneath an adjacent sewer that was contributing to the overflow problems. After Spearin constructed the diverted sewer, a heavy downpour, coupled with a high tide, caused the sewer to collapse and flood the dry dock. The parties discovered the existence of the dam, which had not been shown on the drawings.

Spearin abandoned the work until the government assumed responsibility for the design documents. The government declared Spearin's contract null and void and sought damages for his refusal to repair the defective sewer. Ultimately, the Supreme Court held that where the government furnishes defective plans and specifications, the risk of loss should be placed squarely on the government. Thus the Spearin doctrine was born, and it remains one of the most enduring principles in construction law today.

While the doctrine is widely followed, some states have not yet had an opportunity to rule on it. When they do, they generally find that the doctrine remains valid. Consider a recent case of first impression from Missouri's Court of Appeals, *Penzel Construction Company, Inc. v. Jackson R-2 School District*. Here the court allowed a contractor to recover

damages against a public owner based on the fact that the latter had furnished deficient plans and specifications.

The case began when the Jackson R-2 School District engaged Warner Nease Bost Architects, Inc., to design an addition to a high school. The district also entered into a contract with Penzel Construction Company as the general contractor, and Penzel in turn entered into a subcontract with Total Electric. Neither Penzel nor Total Electric noticed any errors in the plans during the bidding process.

The notice to proceed required the project to be completed in 550 days. Total Electric substantially completed its work 16 months late and attributed the delay to defects in the electrical plans provided by the school district. Penzel filed a breach-of-contract claim—a pass-through for Total Electric's claim—

THE COURT concluded that Penzel did not need to show that the district fell below a reasonable standard of care to prove its Spearin claim.

against the district under the theory that, pursuant to the Spearin doctrine, the district had breached an implied warranty that the electrical plans for the contract were adequate and complete.

To evaluate Penzel's claim, the Missouri Court of Appeals turned its attention to *U.S. v. Spearin* (1918) and concluded that a contractor indeed can have an actionable claim against an owner under the Spearin doctrine. The court highlighted Missouri case law that countenances breach-of-warranty claims based on a contractor's reliance on positive representations that plans and specifications are adequate. It concluded that if a contractor relies in its bid on an owner's representations, express or implied, of what a project will entail based on furnished plans and specifications, the contractor should not bear the risk of loss stemming from design defects.

To establish a claim for breach of contract under the Spearin doctrine, the court stated that the plans and specifications must be defective or "substantially deficient." Plans and specifications are considered "defective" if they are so faulty as to prevent or unreasonably delay completion of the contract performance. The court concluded that Penzel did not need to show that the district fell below a reasonable standard of care to prove its Spearin claim, so expert testimony was not required to attest to a breach of the standard of care.

The court found that while electrical engineering is highly technical and complicated, the problems alleged by Penzel and testified to by its witnesses were simple enough for a layperson to understand. For example, Penzel's witnesses testified that the plans omitted critical components, called for outdated or nonexistent products, and failed to comply with building codes. As a result, Penzel was not required to produce expert testimony to prove the plans were substantially deficient.

Penzel also contended the plans were so defective that it could not allocate work hours or costs to particular defects. As a result, the court allowed Penzel to use the modified total cost method of proving damages, which enabled the court to calculate damages in a way that simply relied on the contractor's total losses.

This case is significant for design professionals, owners, and contractors alike because it marks the first time that a Missouri court has recognized an actionable claim under the Spearin doctrine. Private and public entities in Missouri should be aware of this new liability regime and take precautions to ensure that the project plans and specifications they submit to contractors are complete and accurate. **CE**

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Contractor That Overreaches Is Terminated For Default

IN THE RECENT CASE *Appeals of Industrial Consultants, Inc.*, a project was put out for bids by the U.S. Army Corps of Engineers to upgrade the heating, ventilation, and air-conditioning (HVAC) equipment at a child development center at the Cold Regions Research and Engineering Laboratory, in Hanover, New Hampshire. The tenants had been experiencing thermal comfort issues because of an undersized system. The Corps decided for budgetary reasons to replace the air-handling units, the variable air volume terminal units, and the louvers and to modify the ductwork rather than completely overhaul the system.

Industrial Consultants failed to make a prebid site visit but nevertheless bid on the project and won as the low bidder. It then conducted an initial site visit during which its president determined that the government's design had significant shortcomings. It submitted a request for information notifying the Corps that, among other issues, a certain duct was grossly oversized and pointed out that there "was no technical reason" to replace certain louvers or air returns in the kitchen.

The Corps's project engineer responded to the request for information with technical guidance and the following statement: "The long-and-short of it is to install the system as designed. Please send in your submittals so we can begin our review and get this contract moving." When Industrial did not supply the required submittals, the Corps sent a cure notice advising it that a continued failure to provide the submittals could result in a default termination. Industrial re-

sponded by demanding a "higher authority and competent engineering review." Among other contentions, it accused the Corps of having "copied the design of a failed HVAC system" and stated that it could not be held responsible for a failed design.

The Corps responded by advising the firm that the work was part of a minor rehabilitation of the HVAC system, that it did not call for a major system redesign, and that it addressed the client's needs. Industrial continued to assert that satisfactory construction could not be completed because the Corps "has failed to design a system that will function properly." Even though the firm stated that it would complete the contract, the back-and-forth over the efficacy of the design continued.

Industrial provided only some of the submittals required, and it again asked for permission to make necessary changes to the existing system to meet the tenants' requirements. It finally drew a line in the sand by stating that the Corps's "refusal to work together to resolve several design issues, for the benefit of the customer and society in general... [makes] execution of this contract impossible." The Corps eventually terminated the contract for default because of the firm's failure to furnish submittals and complete the work specified in the contract.

Industrial unsuccessfully tried to have the termination converted to a type that is done for the convenience of the government and also brought a claim for defective specifications, delays, failing to cooperate in approving submittals in a timely manner, and breach of the government's implied warranty of design. This resulted in an appeal to the Armed Services Board of Contract Appeals (ASBCA).

The ASBCA determined that Industrial failed to complete the work on time, failed to proceed with the work after the Corps rejected its proposed design changes, and failed to furnish submittals. As a result, the government met its legal burden to establish

proper grounds for default termination. The legal burden then shifted to Industrial to prove that its nonperformance was excusable.

The ASBCA began its analysis of the firm's burden of proof by noting that a contractor's role is to build the project for which it "made a binding promise, not some contract that, in hindsight, it believes is more appropriate." The board reasoned as follows:

Industrial repeatedly informed the Corps of its opinion that the design of the existing system was defective and that it was a mistake to keep that design and [the] bigger equipment. The Corps considered Industrial's point of view but elected to continue with its design. At that point Industrial's only option was to build the project it had signed up to do."

Ultimately the ASBCA found that Industrial was not entitled to have the termination set aside or to recover on its alleged delay claim. It considered Industrial's attempts to work through the submittal process to be "half-hearted and sporadic."

We often stress in this column the importance of taking positions that are defensible and reasonable. While the legal result in this case may seem logical in that the contractor was justifiably terminated for refusing to perform the work, the facts are somewhat puzzling. The contractor behaved in a way that to most outside observers would appear to be obstinate and ill advised. The court's perception was that Industrial began a campaign to redesign the work and that it persisted in this no matter how many times the Corps told it to build the project as designed. At the very least, this case presents a lesson in the dangers of overreaching. **CE**

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Maryland's Highest Court Upholds Economic Loss Rule

THE ECONOMIC LOSS rule (ELR) insulates designers from liability for purely economic damages (that is, not property damage or physical injury) from parties with whom they have no contract. But despite the existence and enforcement of the ELR in most states, designers continue to be sued on such grounds. In a recent case, *Balfour Beatty Infrastructure, Inc., v. Rummel Klepper & Kahl, LLP*, a general contractor in Maryland sought to hold the owner's engineer liable for losses it incurred because of an allegedly defective design. The Maryland Court of Appeals, in a thorough and thoughtful discussion of the ELR, agreed with the engineer and concluded that the contractor could not seek recovery from the engineer for its losses.

The Case

THE CITY OF BALTIMORE engaged an engineer, Rummel Klepper & Kahl, LLP, to produce the plans and specifications for upgrades to a wastewater treatment plant. It awarded the construction contract to the low bidder, Balfour Beatty Infrastructure, Inc. Balfour encountered a variety of problems that it claimed derived from the plans and specifications, and it sued Rummel for almost \$10 million. Among other points, Balfour alleged that leaks at the expansion joints of the cells were the result of design deficiencies, that the engineer failed to establish a reasonable contract duration or project schedule, and that the engineer supplied false information to prospective contractors that were developing cost estimates.

Balfour argued that Rummel was guilty of professional negligence and negligent misrepresentation. Rummel moved to dismiss, contending that the ELR was applicable. Under this rule, because Rummel had no contract with Balfour, it owed no legally recognizable duty of care to Balfour. For its part, Balfour attempted to invalidate

the ELR by arguing that there was an "intimate nexus" between the engineer's design and Balfour's construction, creating contractual privity.

The trial court and intermediate court of appeals both agreed with Rummel. Ultimately, Maryland's highest court, the Court of Appeals, did as well.

The Appeal

THE COURT OF APPEALS cited a number of other rulings around the country that both recognized and rejected the ELR. It was particularly struck by an Indiana case that provided the following rationale for recognizing the ELR:

Perhaps more than any other industry, the construction industry is vitally enmeshed in our economy and dependent on settled expectations. The parties involved in a construction project rely on intricate, highly sophisticated contracts to define the relative rights and responsibilities of the many persons whose efforts are required—owner, architect, engineer, general contractor, subcontractor, materials supplier—and to allocate among them the risk of problems, delays, extra costs, unforeseen site conditions, and defects. Imposition of tort duties that cut across those contractual lines disrupts and frustrates the parties' contractual allocation of risk and permits the circumvention of a carefully negotiated contractual balance among owner, builder, and design professional.

The court also noted the role of the designer as an agent of the owner and believed that that relationship could be undermined if a designer could be sued by a contractor with whom it was not in privity of contract:

Especially in situations where the design professional is hired as a neutral agent of the owner, expanding Maryland law to permit exposure to tort liability for economic loss would create

a chilling effect on the design professional's neutrality and ability to communicate effectively.

Note that the court was careful to limit its application of the ELR to government construction contracts. Its rationale was that a contractor performing work on a government design/bid/build contract is protected under the Spearin doctrine against losses arising from defective engineering designs. Furthermore, the court called attention to the economic ramifications: "We are also mindful that government contracts have a special consideration: the public purse. Imposing a tort duty on design professionals will likely correlate with an increase in project costs and with a corresponding risk in price for government entities."

Regarding the negligent misrepresentation count, Balfour argued that because Rummel had misrepresented certain facts to Balfour's detriment, the ELR should not be applicable to this cause of action. Among other contentions, Balfour alleged that Rummel knew that its design was not sufficiently complete to allow the wastewater project to be constructed within the contract schedule. In rejecting this argument, the court noted that Balfour's complaint did not allege that Rummel made a false statement or that the firm told Balfour that the project would be completed by a certain date. The court also pointed out that Balfour had the opportunity to review Rummel's design and ask for clarifications.

This case was followed very closely by the engineering and architecture professions. ASCE and several other groups submitted amicus curiae briefs. While the ruling was a decisive win for design professionals, the opportunity to close the proverbial door on suits by contractors in Maryland for defective design was not seized.

The Analysis

BY EXPRESSLY limiting its holding to cases involving government construction projects, Maryland's highest court did not address whether such suits would be barred in private-sector cases. This limitation affects both engineers and contractors since the latter often argue in suits against owners that the Spearin doctrine is applicable to both public- and private-sector projects. Here Maryland's highest court had an opportunity to extend Spearin principles to private construction contracts, but it expressly declined to do so.

The other notable aspect of this case is the court's painstaking review of how the ELR is applied around the country. The court noted that jurisdictions are fairly evenly split over applying the ELR in suits against design professionals. A number of engineer-friendly states reject the notion that contractors can sue design professionals for economic losses (among them, Colorado, Indiana, Texas, Washington, and Wyoming). However, a number of states decline to apply the ELR (among them, Pennsylva-

nia, Rhode Island, West Virginia, and Delaware).

The reasoning of some of the states in the latter group is that the design professional knew or should have known that the contractor would rely on its design documentation. Some states also find that a "special relationship," akin to Maryland's intimate nexus requirement, exists between a design professional and a contractor, satisfying the privity requirement. (Among these states are New York, South Carolina, and Ohio.)

Maryland's Court of Appeals noted that cases on either side provide good policy reasons to expand or limit tort liability in the construction industry, and it saw no clear majority position. Even though the court ultimately decided to keep the parties bound by their contractual remedies and not tort, it is interesting that the court was reluctant to create a categorical protection for architects. This reluctance suggests that the court's decision could have gone either way and that it had reservations about the end result.

Finally, one might ask why Balfour didn't simply sue the city for the problems it encountered. The decision sheds no light on this, but it does suggest that the city's contract may have created some impediments for Balfour and that Balfour attempted to circumvent the contract by pursuing the engineer. This would not be an unusual reason for a contractor to sue a designer.

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Subcontractor Cannot Circumvent No-Damages-for-Delay Clause

IN CONSTRUCTION contract negotiations, one of the biggest areas of risk can boil down to just one sentence in a contract, in which a contractor agrees to accept a time extension only—and no compensation—for any kind of delays, regardless of who is at fault for the delays. These no-damages-for-delay clauses create great consternation in the contractor community, as the financial consequences of a delay can be devastating to a contractor. As a result, such clauses frequently lead to litigation in which courts around the country are asked to determine their enforceability and application.

Unfortunately, there is no black-and-white answer to whether a no-damages-for-delay clause will be literally enforced. It depends on the controlling jurisdiction. Broadly speaking, a limited number of state courts have recognized and enforced these clauses strictly without exception. The majority of states have concluded that it would be unfair to apply the clause for some types of delays, such as those caused by active owner interference; unreasonable delays of prolonged duration; fraud, bad faith, or misrepresentation; and delays not contemplated by the parties. In fact, some states have statutes that specifically make no-damages-for-delay clauses unenforceable on public contracts.

Another way that contractors try to attack the application of a no-damages-for-delay clause is by arguing that the kind of damages they seek are not delay damages per se, but are based on theories of disruption, inefficiency, loss of productivity, improper sequencing, and acceleration. This is the argument that was considered, and ultimately rejected, by a Connecticut court in this month's case, *Suntech of Connecticut, Inc. v. Lawrence Brunoli, Inc.*

The Case

LAWRENCE BRUNOLI, INC., a general contractor based in Farmington, Connecticut, was awarded a \$25-million

contract to construct a technology center at a Connecticut community college. Brunoli entered into a \$1-million subcontract with Suntech of Connecticut, Inc., of North Branford, to fabricate and install the project's glass curtain wall. The project was originally scheduled to be completed in less than two years, but was ultimately completed two years late. Delays were caused by design issues between the Department of Public Works and the architect. The owner never gave Brunoli a time extension.

Brunoli ultimately submitted a \$7-million claim against the owner and settled it for \$1.65 million. The

The Suntech case is a lesson in one subcontractor's attempts to repackage what appeared to be delay damages as inefficiency claims to avoid the no-damages-for-delay clause.

claim did not include costs for Suntech. In the settlement agreement, the owner did not accept responsibility for the project delays.

Suntech claimed it was damaged by the delays. Specifically, it argued that it was forced to contend with various disruptions, delays, suspensions, scope changes, and changed conditions caused by proposed change orders, construction change directives, supplemental instructions related to the architecture, requests for information, and nonpayment. The subcontract contained a no-damages-for-delay provision that stated in part: "[T]he subcontractor agrees not to assess any delay damages or claims against the contractor unless the Owner accepts responsibility and payment."

Suntech sued Brunoli and its surety for approximately \$400,000, alleging that the damages it suffered were not barred by the provision because the damages were not "delay damages," but instead arose from hindrance and interference on the part of Brunoli. Suntech relied on a Massachusetts case in which a subcontractor successfully argued that hindrance and interference claims, as opposed to delay claims, were recoverable in spite of the presence of a no-damages-for-delay clause.

The trial court found in favor of Brunoli. It concluded that Suntech had failed to prove that it was damaged by the project delays. It also found that Suntech's damages were, in fact, delay damages and were therefore subject to the no-damages-for-delay clause.

The Appeal

SUNTECH appealed to the Appellate Court of Connecticut, arguing, among other things, that the trial court improperly relied on the no-damages-for-delay clause in denying its claim.

But Suntech fared no better before the Connecticut appeals court. The appeals court first found that Suntech was indeed claiming damages from delays and not inefficiency or interference. Throughout its complaint, Suntech identified the nature of its losses as "delays." Second, while the general contractor in the Massachusetts case bore responsibility for its failures in sequencing the activities of various construction trades on the project, there was no evidence that Brunoli had caused the delays on this project. Rather, the evidence was that the delays were caused by a design dispute. Moreover, there was no evidence that Brunoli prevented Suntech from working in an orderly fashion.

There were, however, some factual distinctions arising from the trial court's

decision that troubled the appellate court. The trial court found that during the time that Suntech was working on the project, it was also working on four or five other jobs, had assigned only two to four laborers to work on the project, and had failed to provide the number of laborers necessary to complete the project. In essence, the appeals court found that Suntech was responsible for some of its own delays.

As a result of all of the above, the appeals court concluded that the trial court had properly declined to adopt the Massachusetts precedent in ruling upon Suntech's claims.

Lessons Learned

THE SUNTECH case is a lesson in one subcontractor's attempts to repackage what appeared to be delay damages as inefficiency claims to avoid the no-damages-for-delay clause. The subcontractor might have had a better outcome if it had been able to show that the general contractor actually interfered with its work. But the trial court's findings strongly suggested

that Brunoli acted prudently, holding meetings with its subcontractors and doing its best to work around the delays caused by the owner. The outcome also might have been different had the subcontractor been diligent in performing its work.

It is noteworthy that both courts were influenced by a common subcontract clause, which stated that the "subcontractor agrees that the construction schedule is approximate only and is subject to change" and "the subcontractor agrees to accept responsibility for adhering to a fluctuating schedule." While there was not significant discussion in the appellate court decision about this, the clear implication is that the courts found that the subcontractor assumed the risk of having to deal with a changing schedule.

Finally, it is important to realize that Massachusetts is not the only state that has addressed the issue of whether disruption damages are exempt from a no-damages-for-delay clause. North Carolina recently permitted recovery of delay costs despite a no-damages-for-delay

clause in a case in which the contract contained other, conflicting provisions that allowed the contractor to be compensated for delays. On the other hand, courts in New York have denied contractors' attempts to circumvent the effect of the no-damages-for-delay clause by classifying delay damages as inefficiency or hindrance damages. In this matter, as in many others, it is critical to keep up with local and state decisions. **CE**

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