

## Jury Sides with Public Owner in Fast-Track Project Dispute with Contractor

**V**ERY RARELY are construction disputes with significant price tags resolved by juries. When the financial exposure for both parties runs into the tens of millions of dollars, most business owners prefer not to place their fates in the hands of laypersons who know very little or nothing at all about construction. But there are certainly exceptions, as seen in this month's case, *Sacramento Municipal Utility District v. FCC Corporation*, in which a California appeals court affirmed a staggering \$54-million jury award against a general contractor.

The dispute arose from a contract that the Sacramento Municipal Utility District (SMUD) awarded to the Fru-Con Construction Corporation (the former name of the FCC Corporation) to build a \$106.8-million, 500 MW combined cycle power plant. After experiencing a critical shortage of electricity in 2000, the SMUD wanted to build a power plant on a fast-track schedule. Fru-Con was to construct the plant for \$106 million within a 19-month construction schedule. However, construction difficulties plagued the project, and Fru-Con missed a number of milestones, triggering liquidated damages of \$25,000 per day. One of the major reasons for the delays was the failure of more than a third of all of the concrete placed by Fru-Con to meet contract specifications. With the exception of one part of the cooling tower, the SMUD for the most part accepted the deficient concrete.

When the cooling tower foundation in "section C" failed to measure up to the compressor strength requirements, the SMUD directed Fru-Con to submit a plan for removing and replacing the deficient concrete. The company consistently refused, urging instead that the SMUD accept an alternative plan involving an epoxy sealant. The plan would have required the district to carry out a costly reapplication process every three to five years. When Fru-Con refused to remove the deficient concrete after several demands, the SMUD terminated the firm's right to proceed and engaged a replacement contractor to finish the plant.

The SMUD and Fru-Con filed a number of claims against each other in state court. After a three-month trial, the jury returned a verdict in favor of the district for \$35.5 million in excess procurement costs, nearly \$6.6 million in liquidated damages, \$10,000 in penalties for false claims, and \$13 million in prejudgment interest.

On appeal, Fru-Con contended that the entire construction contract could not be terminated for its refusal to perform

only a separable part of the power plant construction. The firm argued that since the costs associated with the foundation for section C constituted less than 1 percent of the entire contract price, it was not guilty of a substantial breach. The appellate court noted that the "single aim of the contract" was timely construction of the plant. Because the power plant required a cooling tower to function, the foundation for that cooling tower was an "integral" part of the plant's construction. The contract expressly provided the SMUD with the right to terminate the contract with Fru-Con upon the latter's refusal to remedy a deficiency, and the appeals court agreed with the jury's finding that the termination was appropriate.

Fru-Con also argued that the SMUD's right to terminate was limited to defects that adversely affected the power plant's completion date. Because the defects in the cooling tower foundation could have been remedied with a sealant, Fru-Con argued that the reason given for terminating the contract was specious and inappropriate. The court flatly rejected this argument, holding that Fru-Con's refusal to comply with the contract specifications "necessarily meant that it could not have completed the scope of work called for in the contract."

Fru-Con next argued that the SMUD waived its right to terminate when it considered alternatives to replacing the concrete and, in its prior course of conduct, accepted deficient concrete. The appellate court held that nothing in the district's conduct indicated a waiver of its contractual right to have the cooling tower concrete replaced.

Fru-Con also advanced what is referred to as a mitigation of damages argument. As most readers know, in any default termination the owner is charged with making efforts to keep replacement costs reasonable. Fru-Con alleged that the SMUD would have reduced its own damages by allowing Fru-Con to remain on the job to complete the project and should not have been awarded excess procurement costs. Again, the appellate court rejected this argument, finding that Fru-Con's refusal to replace the concrete precluded completion of the power plant in its entirety. The district thus had no reason to keep Fru-Con on the job.

What stands out in this case is that the jury, the presiding judge, and the appeals court were largely persuaded by one key point: Fru-Con refused to remove and replace deficient concrete. In past columns we have emphasized that taking an objectively reasonable approach not only helps prevent disputes but ultimately plays well with jurors and laypersons. Here the contractor's adamant stance in trying to persuade the owner to accept a less costly (for Fru-Con) remedy ultimately proved to be a strategic decision the contractor now surely regrets. **CE**

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## U.S. Army Corps Loses \$7-Million Claim against Design Engineer

**A** PARTY WHO sues a design professional for negligence often faces a difficult legal burden. To prevail in this type of claim, the claimant must first show that the architecture or engineering firm owed a duty to exercise an accepted standard of care. Next, the firm must be found to have breached that duty. Finally, the claimant must show that the damages incurred were not only legitimate but also proximately caused by the negligence. In this “but for” test, a claimant essentially must show that the injury would not have occurred without the negligent act or omission on the part of the firm in question. In cases against design professionals, it is often this third prong of the test that is the most difficult to meet. This month we highlight a case in which the federal government was unable to prove that the mechanical, electrical, and plumbing (MEP) design engineer was to blame for more than \$7 million in flooding damage and piping remediation efforts.

The disputes in *BPLW Architects & Engineers, Inc. v. The United States* stem from a contract BPLW had with the U.S. Army Corps of Engineers to provide a below-floor piping system in two student dormitory buildings at Lackland Air Force Base (now part of Joint Base San Antonio). Shortly after construction was completed, piping problems occurred below grade, and several dorm units were flooded. The Corps repaired the broken pipes, replaced the entire subsurface sanitary piping system, and carried out regrading work. When the Corps's contracting officer issued a final decision awarding the Corps \$7.6 million in damages, BPLW appealed to the U.S. Court of Federal Claims.

Both parties agreed that the appli-

cable standard of care requires the MEP engineer to comply with the soil reports in designing a piping system. The parties disagreed, however, on which sections of the reports applied to the below-floor piping. On the basis of the prediction contained in the reports that the soil beneath the dorms could heave by more than 9 in., the Corps contended that BPLW was required to design a plumbing system capable of withstanding more than 9 in. of heave. BPLW, however, relied on other language in the “mechanical connections” subsection and asserted that it was required to design a plumbing system that could accommodate only 1 in. of movement.

Expert witnesses for the government explained that the applicable standard of care requires a mechanical engineer to accommodate the maximum potential soil heave forecast in the soil reports. The reason for this, they explained, is that soils are likely to experience the maximum amount of heave over time. BPLW conceded that its plumbing design was not intended to address the maximum possible soil movement. It maintained instead that its design provided for “up to one inch...where the pipe runs vertical and turns horizontal and up to four to five inches of movement where the horizontal pipe moves away from the vertical turn.”

The court agreed that BPLW's designs for the below-floor piping, as well as its grading plans, failed to comply with the contract and the applicable standard of care. However, the court held that, since the Corps had failed to prove causation, it was not entitled to recover its repair costs; that is, the Corps did not demonstrate that the design, in contrast to some intervening event, caused the damage. There was testimony to the effect that the general contractor had not performed the piping installation correctly, and evidence was presented that the contractor installed a bent and broken piping component beneath some of the units. The Corps was also unable to show that the contractor had constructed the grades in accordance with BPLW's design, as it had no as-built data and presented no witnesses on the as-built con-

dition of the site grading. The Corps was thus unable to show that the negligent design led to the improper grades and the pooling of water.

Not only did the court find that causation was lacking; it also determined that the Corps had failed to show the reasonableness of its damages with respect to the piping repairs. The Corps's two witnesses on the subject of damages were not experts and provided insufficient testimony on whether the scope of repair work was reasonable or necessary. While the court awarded the Corps a smaller sum for certain modifications it made to BPLW's design, most of the previous damages were reversed. The court also found that, as the prevailing party, BPLW was entitled to recover from the Corps its costs (not its fees) in mounting a defense.

This case is another reminder of the difficulties owners face in recovering on claims for negligent design. Readers will recall our June 2012 column, “Florida Jury Exonerates Design Engineering Firm,” where we discussed the failure of Tampa Bay Water to prove to a jury that the engineering firm was responsible for reservoir cracks. The performance of the contractor was a major argument raised by Tampa Bay Water's engineering firm.

The Corps prevailed in this case on what may be considered a very difficult legal standard: demonstrating that the architecture and engineering firm breached the standard of care owed by the MEP engineer in that region. However, the MEP engineer was able to mount an effective defense by showing that construction errors could have caused the soil heave and, thus, the damage. Through this potentially intervening cause of damage—poor pipe installation—the Corps ultimately failed to prove that the damage was proximately caused by the bad design. **CE**

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## Arbitration Awards Are Seldom Overturned

**E**ACH YEAR we examine a case that underscores how difficult it is to overturn an arbitration award. Generally speaking, as long as an arbitrator's errors are not in such bad faith as to amount to fraud, misconduct, or a manifest disregard of the law, courts will uphold an arbitration award. Despite these substantial hurdles, losing parties sometimes go to extraordinary lengths to obtain a different result. This month we review *Neighbors Construction Co., Inc. v. Woodland Park at Soldier Creek, LLC*, a case in which an owner appealed an adverse arbitration decision to state court and then to the appeals court. The award was affirmed by both courts, and it is interesting that one of the owner's arguments was that the architect's review and decision on the contractor's claim should have been binding on the arbitrator.

Woodland Park, the owner, contracted with Neighbors Construction to build a multifamily housing project in Topeka, Kansas, for \$16 million. The project got off to a smooth start, Woodland Park issuing 19 timely progress payments. On the 20th payment application, however, Woodland Park underpaid Neighbors by \$200,000 and also refused to pay an additional \$622,102 certified by the architect as due and owing.

The contract contained a standard dispute resolution clause stating that all claims "shall be referred initially to the architect for decision. An initial decision by the architect shall be required as a condition precedent to mediation, arbitration, or litigation." Woodland Park submitted the issue of the payments to the architect for review, and the architect rescinded his previous certification of the \$200,000 owed to Neighbors. Neighbors ultimately gave notice of termination and filed a demand for arbitration.

The arbitrator entered judgment against Woodland Park for a total of \$1.2 million, including Neighbors' attorney fees, costs, and interest. In so

finding, the arbitrator determined that Woodland Park breached the contract by its nonpayment of \$200,000, that the owner's breach excused all further performance by Neighbors, and that Neighbors was entitled to recover the contract balance minus the costs to complete (in other words, its unpaid profit).

Woodland Park sought to reverse this award by arguing that the arbitrator erred when he failed to defer to the architect's decision that the \$200,000 was not due. Both the trial court and the appeals court rejected the owner's contention that the architect's decision (to rescind certification of the \$200,000) should have been binding on the arbitrator.

The appellate court noted that although parties could contractually agree to make an architect's finding conclusive with regard to an arbitrator, the parties to this contract had no such agreement. The contract required submission of any disputes to the architect as a condition precedent to filing the arbitration demand, but nothing in the contract contained language making the architect's decision "final and conclusive" for the arbitrator. Indeed, there would have been no need for an arbitration clause in the contract if the architect's decision on a dispute was in fact final and conclusive.

Next, the owner argued that the arbitrator exceeded his power and showed a manifest disregard for the law in determining that nonpayment of the \$200,000 was a material breach. The owner contended that since the amount in dispute involved only 1.2 percent of the contract value, nonpayment could not have been a material breach. While there was no discussion of the other \$622,102 certified but unpaid, the appeals court noted that, even if the owner were correct, "errors of law and fact, or an erroneous decision...are insufficient to invalidate an award fairly made. Nothing in the award...even though incorrectly decided, is grounds for setting aside the award in the ab-

sence of fraud, misconduct, or other valid objections." It ruled that Woodland Park failed to meet this extremely high standard.

Woodland Park also contested the award of attorney fees, costs, and interest on the grounds that the contract contained a consequential damages waiver clause. The court held that the clause expressly itemized the types of consequential damages waived and that since the clause did not list attorney fees or interest, Neighbors did not waive its right to claim such damages. The trial court and the appellate court thus affirmed the arbitrator's award for \$1.2 million.

The clearest lesson from this case is the difficulty of overturning an arbitration award. But that does not tell the whole story. The owner essentially tried this case three times using a very weak argument: that the architect's decision on the \$200,000 nonpayment was binding and final. Nothing in the contract said that the architect's decision would be binding or conclusive. In fact, it said just the opposite: that claims were to be referred "initially" to the architect for an "initial decision." What is more, the owner's legal analysis and argument centered on the \$200,000 nonpayment, and little or no mention was made of the nonpayment of \$622,102, which could very well have been a material breach.

Why did the owner aggressively pursue what promised to be a hopeless appeal? Perhaps it was to convince the contractor to accept something less than the arbitration award, given that the contractor would have to absorb attorney fees and appeals costs in going through the appellate process. The real lesson from this case? Know who your client is and whether that party has a reputation for being fair and reasonable. **CE**

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## Court Refuses to Enforce Pay-If-Paid Provision

**P**AY-IF-PAID provisions in construction contracts shift the risk of owner default from the contractor to the subcontractor. They do so by making the contractor's payment to the subcontractor contingent upon the contractor being paid by the owner. These provisions are disfavored for their harshness because they push the risk of nonpayment downstream to the parties least likely to withstand the financial consequences. Because of this, many jurisdictions have enacted legislation voiding such clauses as against public policy. In jurisdictions in which the clauses are not outright void, courts are eager to limit their effect. One way courts do this is by interpreting an intended pay-if-paid provision as a pay-when-paid clause. The difference is significant.

A pay-when-paid clause keeps the risk of owner insolvency with the prime contractor; that is, the contractor has a reasonable amount of time to collect payment from the owner before paying its subcontractor, but the prime contractor is not excused from its payment obligation. As a general rule, courts will typically interpret a clause to be pay-when-paid unless the provision expressly states that payment on the part of the owner to the prime contractor is a "condition precedent" to the prime's obligation to pay the subcontractor. This month, however, we highlight a case in which the court ruled a disputed clause to be a pay-when-paid provision even though it contained "condition precedent" language.

The dispute in *Transtar Electric, Inc. v. A.E.M. Electric Services Corporation* arose from the construction of a hotel swimming pool in Ohio. A.E.M. Electric Services Corporation was the general contractor and subcontracted certain electrical work to Transtar Electric, Inc. The latter performed its

subcontract and invoiced A.E.M. \$186,709 for the work. When A.E.M. paid Transtar all but \$44,088, Transtar sued to recover the unpaid amount. A.E.M. asserted that the subcontract contained a pay-if-paid clause, and since the project owner had failed to pay, A.E.M. was not liable. The subcontract contained the following language: "Receipt of payment by contractor from owner for work performed by subcontractor is a condition precedent to payment by contractor to subcontractor for that work." Transtar argued that if A.E.M.'s interpretation were accepted, then the subcontractor in effect promised to provide labor and materials while the general contractor made no promise to pay.

The trial court agreed with A.E.M. that no monies were due Transtar because the clause contained the proverbial "magic" language that created a valid pay-if-paid clause. Transtar appealed, and the appellate court reversed the lower court ruling, holding that the language created a pay-when-paid provision, which was an unconditional obligation by A.E.M. to pay its subcontractor within a reasonable amount of time.

The appeals court began its analysis by stating that the risk of owner insolvency ordinarily rests with the general contractor, as the latter is in the best position to assess the owner's creditworthiness and minimize the risk of owner default. The court then looked to Ohio case law, which requires pay-if-paid clauses to clearly allocate to the subcontractor, in plain language, the risk of the owner's nonpayment.

The court held that the "condition precedent" language in this contract was not plain and thus was insufficient to shift the risk of the owner's nonpayment to the subcontractor. Instead, the court stated that the clause needed to express in unequivocal terms that the subcontractor bore the risk of any potential owner insolvency. "The sine qua non of [a pay-if-paid] provision is

a clear, unambiguous statement that the subcontractor will not be paid if the owner does not pay." The court reasoned that the words "condition precedent" were not sufficiently clear to inform both parties that the provision was altering a fundamental custom between a general contractor and a subcontractor.

In its analysis the court cited a pay-if-paid clause previously deemed valid, presumably as an example of what it considered to be clear and plain language regarding a pay-if-paid condition: "The parties to this purchase order specifically acknowledge and agree that a condition precedent to the obligation of the contractor to pay subcontractor is the payment to contractor by owner of monies due. This provision does not merely set forth the time at which payment must be made to the subcontractor. Subcontractor expressly acknowledges that subcontractor may never be paid in full, or at all, to the extent contractor is not paid by the Owner."

This holding represents a significant departure from the rulings of many other courts, which have held that the phrases "condition precedent" or "if and only if" or "unless and until" constitute valid pay-if-paid clauses. Indeed, this decision tends to turn pay-if-paid case law squarely on its head, as most readers would interpret the clause in this case as a clear pay-if-paid provision. When reviewing any contract, it is important to evaluate the conditions and timing placed on payment rights. And readers should be mindful of the growing unpopularity of pay-if-paid clauses. Standard "condition precedent" language is no longer sufficient to shift the risk of owner nonpayment to a subcontractor, at least in Ohio. **CE**

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## Engineer Faces Potential Liability For Contractor's Project Delays

**A** NUMBER OF our columns over the years have addressed the application of the economic loss doctrine in cases involving contractor claims against designers. This doctrine establishes a legal “shield” that bars a contractor from suing a designer for money damages when the contractor does not have a contract with the designer. Unfortunately for designers, many states do not recognize this doctrine. A recent case in Louisiana, *Greater LaFourche Port Commission v. James Construction Group, LLC*, is a reminder of how potential liability can arise.

The case involved an \$8.4-million contract between the Greater LaFourche Port Commission and James Construction Group for the construction of a steel sheetpiling bulkhead and mooring bits in Port Fourchon, Louisiana. Picciola & Associates, Inc., was retained by the port to provide professional engineering services on the project, including design and construction administration.

The dispute involved a portion of the project referred to as the Delmar Site, which comprised a bulkhead, two crane pads, and a crane pad foundation. The contract called for James to pay liquidated damages of \$2,000 per day if it failed to complete the Delmar Site within 210 days of the notice to proceed. However, the location of the Delmar Site was moved, and James received a change order that increased the contract price and contract time.

James was 133 days late in finishing the Delmar Site, and the port withheld \$266,000 in liquidated damages as well as the contract balance, prompting James to sue both the port and Picciola. The port and James settled their dispute but reserved their rights and claims against Picciola. Among other conten-

tions, James argued that it detrimentally relied on certain representations by Picciola to the effect that it would not be required to complete the Delmar Site within 210 days of the notice to proceed and that the liquidated damages would be waived. It also contended that it was misled because Picciola negligently issued ambiguous or defective plans and contract documents and that this caused delays, disruptions, and increased costs. Picciola argued, among other contentions, that it was simply an agent of the port and that James, by settling its claims against the port, also rescinded its claims against Picciola.

In granting Picciola's motion for summary judgment, the trial court found that Picciola was acting as a professional engineer on behalf of the port and implied that Picciola owed no separate duty of care to James. James appealed, contending that its claims against Picciola were not based on the contract but derived from breaches of independent duties that Picciola allegedly owed to James.

The appellate court agreed with James, finding that Louisiana law permitted a construction contractor to sue an engineer for negligence if the engineer provided deficient design specifications, caused delays or disruptions, or misrepresented facts. The court found that there were material facts in dispute that affected the ultimate disposition of the case and that James had the right to have the dispute decided by a jury.

The key disputed facts included allegations that Picciola stated during a meeting that James would not be required to complete the work on the Delmar Site within 210 days of the notice to proceed and that liquidated damages would not be assessed. After that meeting, James allegedly prepared and submitted a revised project schedule to Picciola that showed a later completion of the Delmar Site, and Picciola approved that revised schedule. James also allegedly changed its plan of performance of the work as a result of the relocation of the Delmar Site and argued that it was affected by other changes to the work made by Picciola and by Picciola's ambiguous and defective plans.

There was little discussion in the decision about Picciola's primary defense, which was that it was acting as the port's representative during construction administration. The contract gave Picciola “the authority to give directions pertaining to the work, and to alter or waive contract provisions.” Picciola thus argued that James's claims related to representations it, that is, Picciola, made within the scope of its authority and that James's only recourse was against the port, the party with which James had contracted. The court did not directly address this point other than to hold that, while James could not assert a cause of action against Picciola on the basis of a breach of contract, James was not precluded from “asserting a cause of action in tort based upon Picciola's alleged negligence.”

It is impossible to read the appellate court's decision and come to a conclusion on whether Picciola did something wrong. But the case is a prime example of why many states have adopted the economic loss doctrine for disputes of this type between contractors and designers. Is it in the public's interest to allow a designer to be sued by a contractor for acting as an owner's representative and making (what should be) reasonable decisions on behalf of the owner? Will designers simply choose to act defensively or conservatively if they face liability for being cooperative?

James's ultimate fate is in the hands of the jury, and it may face an uphill battle. If Picciola properly communicated the port's position, then it can argue that it was not negligent. Moreover, James still has to prove a cause-and-effect relationship between any alleged deficiencies in the plans or specifications and its performance. Nevertheless, it is clear that Picciola faces the risk of being a financial scapegoat if James is a compelling plaintiff. It also will bear the burden of paying what may be substantial legal fees. **CE**

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## State Anti-indemnity Statutes Keep Powerful Parties from Overreaching

INDEMNITY provisions play an important role in managing the risks associated with construction contracting. Such clauses require one party to take on the obligation to cover the loss or damage that has been or might be incurred by another party. As many readers have undoubtedly experienced, there is a tendency for a party with superior bargaining power to seek the broadest possible indemnification from lower-tiered contractors. However, since the public benefits from limits on overreaching indemnity clauses, many states have enacted anti-indemnity statutes that void indemnity agreements if they go too far, for example, by requiring party A to indemnify party B for losses caused solely by the negligence of party B.

The Minnesota Supreme Court, in *Engineering & Construction Innovations, Inc. v. L.H. Bolduc Co., Inc.*, recently considered whether a contractor's indemnity provision was valid and enforceable against a subcontractor. The project at issue involved the installation of an underground sewer pipeline. The general contractor, Frontier Pipeline, engaged Engineering & Construction Innovations (ECI) to install a lift station and force main access structures at specified locations along the pipeline. As part of its excavation operations, ECI subcontracted with L.H. Bolduc Co. to build cofferdams for the access structure pits.

While performing the work at one of the cofferdam locations, one of Bolduc's metal sheets drove through the sewer pipe. ECI repaired the sewer pipe at a cost of \$235,339 and sought reimbursement from Bolduc for negligence and contractual indemnification. The indemnity clause in the subcontract stated that Bolduc

agrees to protect, indemnify, defend, and hold harmless ECI and Owner, to the fullest extent permitted by law and to the extent of the insurance requirements below, from and against (a) all claims, causes of action, liabilities, obligations, demands, costs, and expenses arising out of injury to any persons or damages to property caused or alleged to have been caused by any act or omission of [Bolduc].

It was undisputed that ECI provided the template and markings designating where Bolduc was to drive the sheeting. After a three-day trial, the jury found that Bolduc was not negligent in performing its work and not liable to indemnify ECI, and it awarded ECI nothing for damages. ECI petitioned the court to override the jury's verdict and rule that Bolduc should indemnify it. ECI argued that there was no requirement in the indemnity provision that the damage be caused by Bolduc's negligence. Rather, the provision stat-

ed that the damage just had to arise from "any act or omission of Bolduc." Here, it was undisputed that Bolduc's physical "act" in driving the sheeting caused the damage. ECI also pointed out that there was no judicial determination that it had been negligent.

The trial court disagreed, finding that the indemnification clause was unenforceable under Minnesota's anti-indemnity statute. Like most such statutes, the Minnesota law renders unenforceable those indemnity provisions that require indemnification of a party whose own wrongful conduct is to blame for the damage.

ECI successfully appealed the decision to the state Court of Appeals, which found that Bolduc was obligated to indemnify ECI even if it meant that Bolduc would be indemnifying ECI for the latter's own negligence. Its rationale was that the language of the indemnity clause required Bolduc to indemnify ECI from and against any and all claims "arising out of... damages caused... or alleged to have been caused by any act or omission of" Bolduc. The appellate court found this language to require indemnification from Bolduc even upon an allegation that its work caused the damage. The court therefore held that the trial court erred in concluding that the jury's finding that Bolduc was not negligent extinguished its indemnity obligations.

Bolduc appealed to the Minnesota Supreme Court, arguing that it was not at fault for the damaged pipe and that requiring it to indemnify ECI would contravene the explicit language of the state's anti-indemnity statute. ECI argued that although Bolduc may not have been determined to have been negligent, it nevertheless breached its contractual duties to perform the work properly by hitting the pipeline. The high court did not find this argument persuasive, in part because the jury determined that the damage was not attributable to Bolduc. Because ECI failed to present any evidence concerning how Bolduc breached the subcontract in performing its work, the court held that requiring Bolduc to indemnify ECI for damage that was not proved to be Bolduc's fault would violate Minnesota's anti-indemnity statute.

This case emphasizes the importance of knowing the particular state anti-indemnity statute applicable to your project or contract. Many contract negotiations get bogged down over indemnity clauses, and frequently it is for naught as the clauses may very well be unenforceable. It also demonstrates a practical reality. If a party is going to take advantage of an indemnity clause, it must generally show that the party providing the indemnification did something wrong. Triers of fact are reluctant to enforce an indemnity obligation when they know that the damage arose from some fault on the part of the indemnitee. **CE**

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## Architect Sued In Federal Court For Fraudulent Concealment

**I**N MOST CASES, subcontractors have no direct cause of action against the federal government and can recover only if they go through the prime contractor. This is generally done in one of two ways. In the first, subcontractor claims are allowed if they are sponsored or certified by a prime contractor and are brought in the prime contractor's name. In the second, a prime contractor can include its liability to a subcontractor in its claimed damages against the government. These pass-through scenarios, however, can lead to litigation if the prime contractor and the subcontractor do not agree on the nature or scope of a claim or on the manner in which it is presented.

This month we highlight a case with unusual pass-through aspects. In *Architectural Resources Group, Inc., v. HKS, Inc.*, the principal architect on a federal project settled its own claims with the government without telling its design subconsultant. This had the effect of precluding the subconsultant from recovering on a pass-through claim that it had spent months preparing. The subconsultant sued the architect for, among other reasons, fraudulent concealment, and a federal district court in California considered the architect's motion to dismiss.

The issues in dispute stem from a General Services Administration (GSA) project to renovate a federal building of historical importance in San Francisco. The GSA contracted with the architecture firm HKS to provide all of the design services for the project. HKS in turn hired Architectural Resources Group (ARG) to serve as a consultant. ARG and HKS identified themselves as a joint design team in the bidding documents.

According to ARG, the design process became strained when the GSA provided the design team with conflicting guidance. On the one hand, the GSA urged the design team to prepare "aspirational" plans reflecting "21st-century green building visionary concepts." On the other, it cautioned that the budget might not accommodate those concepts. ARG claimed that, in response to pressure from HKS, it devoted substantial time and effort to meeting unrealistic project deadlines and solving design problems that did not conform in a realistic way to the GSA's budget. HKS eventually gave ARG notice of termination for convenience. Just before giving notice, however, HKS asked ARG to provide additional services for an "option B" design, along with a fee estimate. ARG complied with that request.

After being terminated, ARG notified HKS executives of its intent to submit a pass-through claim for presentation to the GSA. Unbeknownst to ARG, however, HKS had already entered into a modification with the government that released the GSA from all claims related to the project, including ARG's. ARG also learned that HKS had retained an entirely new team of architectural and engineering subconsultants to realize option B on the project.

In its complaint ARG alleged that, before the termination, HKS knew and concealed from ARG that the GSA's preferred design could not be executed within the project's budget. ARG also claimed that HKS informed it on a number of occasions that the GSA intended to increase the budget, even though HKS knew that that was not the case. ARG further contended that HKS concealed the fact that it had recruited another design team to design an entirely new option for the building, one that dispensed with most of the green building features. ARG noted that HKS continued to solicit design work from it. In this way, even though intending to terminate ARG, HKS secured ARG's work product for use by the new design team. HKS moved to have the case dismissed by arguing that it did not have a legal duty to disclose to ARG its dealings with the GSA or other design subcontractors.

The court's decision focused on two

of ARG's alleged facts: (1) "that HKS intended to proceed with the project on an Option B with the benefit of ARG's work product, while cutting ARG out of the negotiation process for securing continued work on the Project; and (2)... that HKS intended to, and indeed did, enter into [a] Modification... to release and cut off all of ARG's rights to claim entitlement to compensation or otherwise pursue legal remedies against the GSA relating to the Project."

The court held that, assuming all allegations to be true, the parties' contractual relationship established a duty to disclose these facts to ARG. It reasoned that the duty of disclosure is implicit in the fact that, had ARG known of HKS's intention to terminate it, it would never have created and provided its work to HKS without ensuring it would be paid.

The court also rejected HKS's argument that because ARG had no direct claim against the government it had no duty to disclose the fact that it settled with the government at an earlier date. The court noted that pass-through claims are routine in the construction industry and that even if HKS did not intend to certify ARG's claim, it knew that ARG was preparing the claim for presentation to the GSA. HKS also knew that its modification with the GSA impaired its ability to even submit a pass-through claim to the government.

Readers should keep in mind that this case is at a very early stage of litigation, and the court did not reach any conclusions on the merits of ARG's case. It merely considered whether ARG had alleged enough facts to remain in court. As this case moves deeper in the litigation process and facts come out as to whether HKS's silence misled ARG, we will obtain a better picture of whether the fraudulent concealment argument will prevail. At this point, the lesson for readers is that HKS's alleged conduct gave ARG sufficient basis to file and maintain a lawsuit. **CE**

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## Federal Court Finds Teaming Agreement Unenforceable

**T**EAMING AGREEMENTS are widely used in the construction industry. Whether it's contracting and engineering firms joining forces to pursue design/build contracts or small contractors vying to compete for work on bundled federal procurements, the purpose of a teaming agreement is the same. Before substantial resources are devoted to preparing a bid, team members need to have something in place that sets forth their rights, risks, and responsibilities during the preproposal period.

This month we highlight a recent case, *Cyberlock Consulting, Inc., v. Information Experts, Inc.*, in which a federal court in Virginia ruled on whether a subcontractor had a legally enforceable right to require its teaming partner to enter into a formal subcontract with it after the award for a project the two bid on as a team.

In the fall of 2008 subcontractor Cyberlock Consulting and general contractor Information Experts (IE) entered into a teaming agreement to work together in securing a prime contract from the U.S. Office of Personnel Management and one of its divisions. The agency awarded IE the prime contract, and on the very same day IE executed a subcontract with Cyberlock for the work. When a second, similar project opportunity arose with the Office of Personnel Management, Cyberlock and IE entered into another teaming agreement. This second agreement was far less detailed than the first. It also contained an integration clause to the effect that the agreement "constitute[d] the entire agreement of the parties hereto and supersedes all prior and contemporaneous representations, proposals, discussions, and communications, whether oral or in writing."

The stated purpose of the second agreement was "to set forth the arrangement between [IE] and [Cyberlock] to obtain an [IE] prime contract...and to set forth

the basis for a subcontract between [IE] and [Cyberlock]." The parties were to exert "reasonable efforts" to obtain the prime contract for IE and to negotiate a subcontract. The second agreement also indicated that the eventual subcontract would state that IE was to perform 51 percent of the scope of work and Cyberlock 49 percent. IE was awarded the prime contract. However, even after a month of negotiations IE and Cyberlock were unable to draw up a formal subcontract. Cyberlock sued IE, alleging breach of contract, fraud, and unjust enrichment.

Cyberlock argued that the second teaming agreement provided that if IE was awarded a contract by the government, Cyberlock was guaranteed a 49 percent share of the work. IE, on the other hand, contended that the teaming agreement was nothing more than an agreement to negotiate a subcontract at a later time and, therefore, was not binding on IE. Ultimately, the court held that the teaming agreement at issue was unenforceable because it was merely an agreement to agree in the future, not a binding contract.

Citing Virginia legal precedent, the court held that the second agreement was "too vague and too indefinite to be enforced." Cyberlock requested that the court look beyond the written agreement to the parties' conduct, communications, and negotiations as evidence that the parties intended the second agreement to be binding. The court, however, noted that it could not do so because of the integration clause in the agreement barring such evidence.

The court found it compelling that no draft subcontract was attached as an exhibit to the second teaming agreement, whereas a draft had formed part of the first agreement. The court also relied on the express language providing for the termination of the relationship should the parties "fail to reach agreement on a subcontract after a reasonable period of good faith negotiations." The court determined that this language could have no other meaning than that a subcontract award to Cyberlock was not a certainty.

The court struggled, however, with

the express identification and allocation of work to be completed by the two parties in the second agreement. It conceded that by listing the exact percentages (51 percent and 49 percent) that each party would perform, there was some level of specificity as to the scopes of work. However, there was no mention of the particular tasks that each party was to perform. Taken as a whole, the court believed that there was no contractual obligation on IE's part to do anything other than attempt to negotiate a subcontract with Cyberlock, which it had done.

It is interesting that the court went so far as to say that "calling an agreement something other than a contract or subcontract, such as a teaming agreement or letter of intent, implies that the parties intended it to be a nonbinding expression in contemplation of a future contract." The court held that even when the parties fully agreed on the terms of their contract, the "circumstance that the parties do intend a formal contract to be drawn up is strong evidence to show that they did not intend the previous negotiations to amount to a [binding] agreement."

The primary purpose of teaming agreements is to define the structure of the parties' business relationship prior to the awarding of a contract. This case provides guidance on what to do if the goal is to enter into an agreement that is binding after the award. First, the agreement should be detailed and should define the tasks each team member is to perform, along with the percentages of the work. The fewer details contained in the agreement, the more likely it is that a court will regard the document simply as an agreement to negotiate. Another good practice for parties intending their agreement to be binding after the contract award is to attach a draft subcontract as an exhibit and to state that its execution will occur upon award. **CE**

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## Construction Manager Not Liable For Contractor's Jobsite Injuries

**G**IVEN THAT many design professionals provide construction administration services, it is important for engineering firms to be aware of the liability associated with jobsite safety. This month we highlight a recent case in which a state supreme court considered whether to hold a construction management firm responsible for an injury sustained by a contractor's employee.

The disputes in *Hunt Construction Group, Inc., and Mezzetta Construction, Inc., v. Shannon D. Garrett* arose during the construction in Indianapolis of the Lucas Oil Stadium. The owner, the Indiana Stadium and Convention Building Authority, engaged Baker Concrete Construction to perform the concrete work. It also hired Hunt Construction Group to serve as the construction manager. While removing forming material, Shannon D. Garrett, a Baker employee, was struck with a piece of wood dropped by a coworker. In addition to pursuing a workers' compensation claim against Baker, Garrett sued Hunt for negligence for failing to provide a safe jobsite.

Garrett filed a motion for summary judgment against Hunt, claiming that Hunt was vicariously liable for Baker's negligence. The trial court agreed, but the Indiana Court of Appeals did not, finding that Hunt had a contractual duty of care relative to safety and therefore could be liable if it failed to perform that duty. Hunt appealed to the Indiana Supreme Court.

The high court unanimously agreed with the appellate court's ruling on vicarious liability, but it overturned that court's decision that Hunt could be directly liable to Garrett because of negligence. The court relied heavily on Indiana precedents relating to liability

for third-party injuries and considered these precedents in relation to Hunt's contract and actions.

The court first evaluated Hunt's contract with the Indiana Stadium and Convention Building Authority to determine the extent of the firm's responsibility for safety. It found that Hunt did not undertake the duty to act "as the insurer of safety for everyone on the project. Rather, Hunt's responsibilities were owed only to [the] Stadium Authority, not to workers like Garrett."

Among the contract provisions relied upon by the court were statements that Hunt's construction management services were to be "rendered solely for the benefit of the [authority] and not for the benefit of the contractors, the architect, or other parties performing work or services with respect to the project"; that Hunt was not "assuming the safety obligations and responsibilities of the individual contractors"; and that Hunt was not to have "control over or charge of or be responsible for... safety precautions and programs in connection with the work of each of the contractors, since these are the contractor's responsibilities." The court also noted that the contracts signed by the project's contractors and subcontractors, including Baker, indicated that these parties had responsibility for the safety of their employees.

Garrett cited a variety of clauses that addressed Hunt's safety obligations, among them requirements that Hunt schedule and conduct weekly meetings with the contractors to discuss such matters as safety; that it have safety representatives inspect the site daily for violations of the project safety program; and that it implement appropriate safety procedures and warnings to guard against injury to the general public. However, the court declined to find that these clauses made Hunt liable for injuries sustained by workers of trade contractors. In its view, the

Stadium Authority's contracting with Hunt for specific responsibilities related to jobsite safety, and Hunt's taking on these responsibilities, was an effort to

promote safety on the construction site beyond that required by law. At oral argument, Garrett advanced the all-or-nothing proposition that with Hunt's responsibility for jobsite safety comes liability and that the only way to avoid liability is to turn a blind eye toward safety. But safety at construction sites, especially at large public-works projects like this one, should not be sacrificed for fear of exposure to liability. The contracts at issue here reflect a way of promoting safety without exposing construction managers to suits like this one.

The court next considered whether Hunt had voluntarily assumed a duty of care to Garrett and other workers by assuming responsibilities beyond those stated in its contract. It found that Hunt's actions with regard to safety were consistent with its contractual obligations. For example, while Hunt held safety committee meetings every week and inspected the site each day for safety violations, the court declined to construe these acts as a voluntary assumption of a duty of care to Baker's employees.

It is critical for engineers and construction managers to understand how courts assess liability for injuries sustained by third-party workers. While Hunt's contract imposed upon it certain safety duties, these duties were for the benefit of the owner and did not shift primary responsibility for safety away from the trade contractors. Could the result have been different? Assume that Hunt's contract said nothing about safety meetings or inspections but Hunt conducted them anyway. A court might have been persuaded that Hunt "voluntarily" assumed duties of care to protect tradesmen from unsafe site conditions and might have allowed a jury to determine whether Hunt breached that duty of care. **CE**

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## Maryland High Court Limits Protections Against Design Professionals

**I**N THE PAST we have reported on certificate of merit (COM) statutes. These statutes generally require the plaintiff suing a design professional to file an affidavit from an expert attesting that the professional failed to meet the applicable standard of care. These affidavits must be filed with the lawsuit or soon thereafter as a condition for maintaining the suit. Because these statutes require a plaintiff to have the case ready from the outset, it is imperative that the plaintiff fully understand the nuances of the statute at issue.

Consider Maryland's COM statute, which was enacted in 1998. At that time the statute stated that a suit would have to be dismissed if the requisite certificate was not produced within 90 days of the suit being filed. The statute applied to any claim against a licensed architect, an interior designer, a landscape architect, a professional engineer, or a professional land surveyor that was based on alleged professional negligence.

In 2004 an architecture and engineering firm was sued for negligence, but the plaintiff failed to file a COM in accordance with the statute. When the firm moved to have the suit dismissed, the plaintiff argued that the COM statute applied to negligence suits against individuals, not corporations. Maryland's highest court agreed with the plaintiff. The state legislature responded to the decision by amending the statute in 2005 to broaden the definition of "claim" to encompass actions against "the employee, partnership, or other entity through which the licensed professional performed professional services." Without question, the intent of the amendment was to include architecture and engineering firms within the ambit and protection of the statute.

Earlier this year Maryland's high-

est court was again presented with questions regarding the applicability of the statute, the case being *Heavenly Days Crematorium, LLC, v. Harris, Smariga and Associates, Inc.* The disputes arose from the proposed relocation of an animal crematorium owned by Heavenly Days. That firm sought to move its operations to a neighboring county and began the process of obtaining permission to build and operate the crematorium at the new site. It engaged the civil engineering firm Harris, Smariga and Associates, Inc. (HSA), of Frederick, Maryland, to help it obtain approval for a site plan for a memorial garden, a cemetery, and a crematorium.

An employee of HSA submitted a revised site plan to the county that was incomplete and contained errors concerning the dimensions of the building. That employee then advised Heavenly Days in reference to the site plan to "consider it approved." Construction began but was halted when the parties learned that the site plan had in fact not been approved. Even though HSA corrected the errors in the site plan and resubmitted it, the county refused to approve the plan or grant an extension, essentially terminating Heavenly Days' ability to proceed with its project.

Heavenly Days filed suit against HSA for professional negligence, but the suit was dismissed without prejudice by the trial court because of the failure to file a COM within 90 days. However, because the statute of limitations had run out, Heavenly Days was unable to refile its suit with the requisite certificate. The firm appealed the decision, but the appellate court affirmed the ruling of the lower court. Heavenly Days then appealed to the Court of Appeals, Maryland's highest court.

That court reversed both lower court rulings, holding that Maryland's COM

statute is triggered only when a complaint alleges professional malpractice by one or more individual licensees. In other words, even though the complaint was a suit against HSA as a defendant (as envisioned by the 2005 amendment) and the complaint contained numerous allegations against HSA, there were no references to licensed professionals. While the complaint set forth a number of mistakes attributed to one of HSA's employees, that individual was not a licensed professional.

HSA argued that because Heavenly Days contracted for civil engineering services, the services in question necessarily involved work or supervision by a licensed professional. However, the high court found that because "no engineer is mentioned by name" in the complaint, there was nothing from which the court could discern that the complaint was based on the negligent acts or omissions of a "licensed professional" within the meaning of the statute. "It is thus indisputable," the court said, "that the certificate requirement is triggered only when a complaint alleges professional malpractice by one or more individual licensees."

It is unclear what this case means for professional malpractice lawsuits in Maryland. A plaintiff might decide not to name a licensed professional in its complaint to avoid the COM requirements, but this course of action could affect its ability to win the case at trial. Perhaps this decision will prompt the Maryland legislature to reexamine the wording of the COM statute. Readers should note that the architecture and engineering industry was not silent on this issue, as the Maryland chapter of the American Council of Engineering Companies filed a brief with the court in this case in support of HSA's position. **CE**

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