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CONSTRUCTION LITIGATION
Representing the Owner

Second Edition

Robert F. Cushman
Kenneth M. Cushman
Stephen B. Cook

2009 Cumulative Supplement

Mark S. Rhodes
Loren W. Peters

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Edited by
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Construction Litigation
Representing the Owner
Second Edition

by Robert F. Cushman, Kenneth M. Cushman, and Stephen B. Cook

Construction Litigation: Representing the Owner, Second Edition, is a comprehensive resource written by nationally recognized construction litigators, who examine each of the participating segments of the construction process. They describe how owners can avoid costly and time-consuming litigation and, if necessary, how owners can best protect themselves if litigation becomes unavoidable.

Highlights of the 2009 Cumulative Supplement

The following developments and issues are included in the 2009 Cumulative Supplement:

- The allocation of risk between the parties and the use of insurance to control the allocation and effect of certain risks.
- The right to demand arbitration under construction contracts and the types of disputes that may be arbitrated as determined by the terms of the arbitration agreement.
- The effect of defective plans and specifications on claims based upon differing site conditions and claims for additional work and the failure of the contractor to investigate the site and contract documents in order to avoid such problems.
- The necessity of reducing all agreements to writing in a carefully drafted form to clarify the rights and obligations of the parties thereby reducing the potential for certain types of disputes.
- Contract provisions dealing with delay damages and the liability therefor, including liquidated damages potentially recoverable from contractors.

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The Table of Cases and Index have been updated to reflect all the changes to the text.

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Representing the Owner

Second Edition

2009 Cumulative Supplement

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PREFACE

The 2009 Cumulative Supplement includes a discussion of various problems common to owners, as well as illustrations of strategies for success in claims against architects, general contractors, subcontractors, and suppliers. Consistent with the bound volume, we continually include cases where the owner is sued by the contractor or other parties arising out of construction disputes because representing the owner as a defendant is also a significant part of construction litigation.

Since the purpose of this book is to forewarn owners of potential areas of concern and how to handle such problems should concrete disputes actually arise, we continue to stress the importance of risk management techniques. These may include the use of particular risk allocation clauses in addition to the use of insurance and surety bonds. The issues subject to prudent risk management include the effect of delays, unforeseen differing site conditions, problems involving project plans and specifications, additional work, and ambiguities or defects in project plans and specifications. Clearly, there is always the potential for defective construction work and great care should be taken with respect to handling such an issue through warranties. However, the owner must realize that a warranty is of little value if given by a contractor who is financially unable or unwilling to meet the warranty obligations. In such a situation, the owner may reasonably require the purchase of a warranty from a financially stable third party.

We cannot overstate the need for caution in contract drafting, since such care may assure that the written contract will comport with the intent of the owner and be enforceable should a suit ultimately be filed. Additionally, this care will ensure that the intended allocation of risks in a variety of situations will be enforced by the courts.

CONTENTS

CHAPTER 1

THE OWNER CONTEMPLATING LITIGATION AND ITS ALTERNATIVES: AN OVERVIEW

§ 1.3 Construction: A Process That Demands Planning

Page 9, at end of section, add:

In order to avoid potential disputes during the construction process, the owner must take great care to assure that the terms of the final agreement comporting to the contractor's bid are properly memorialized. In *Frost Construction v. Lobo Inc.*, 951 P.2d 390 (Wyo. 1998), the defendant general contractor hired the plaintiff subcontractor to work on a highway paving contract. The subcontract incorporated the terms and conditions contained in the general contractor's successful bid for the work. The parties used the customary form for such work. Nine months after the bid was let, the plaintiff wrote to the general contractor that its agreement was predicated on the work being performed during the specified time period and the proposal was not valid except under the stated conditions. The general contractor stated that it planned to proceed so that the subcontractor could meet its scheduling concerns. The plaintiff sent a new subcontract that differed from the original subcontract, deleted substantial quantities of work, and proposed to impose liability on the general contractor for consequential damages for any delays regardless of the cause. The general contractor rejected the new subcontract and insisted that the terms of the initial proposal be adhered to and if the subcontractor did not return the original subcontract properly executed, the general contractor would replace the subcontractor. The plaintiff subcontractor was replaced and then brought this suit claiming that the oral contract between the parties was breached. The court affirmed the dismissal of the complaint, holding that a contract had been formed based on the original bid and the language of the bid controlled over industry usage. The court found that the subcontractor breached this agreement.

§ 1.4 Costs and Benefits of Legal and Contractual Decisions (or Indecisions)

Page 9, at end of section, add:

Clearly, the owner is best served if the agreement is properly reduced to writing. However, a contract may be created even in the absence of a formal writing if all the contract elements can be found to exist. In *Codest Engineering v. Hyatt International Corp.*, 954 F. Supp. 1224 (N.D. Ill. 1996), the plaintiff engineering firm and general contractor submitted a proposal for the design, construction, and outfitting of a Hyatt hotel complex in Moscow. Hyatt asked the plaintiff to perform preconstruction services and modify the design to reduce the projected construction costs. The firm hired and paid outside design consultants and incurred substantial out-of-pocket expenses. The parties negotiated a letter of agreement signed by the plaintiff, Hyatt, and Moscow International Hotels (MIH), which was a shell corporation established and controlled by Hyatt. The agreement named Hyatt as the party to coordinate the appointment of a general contractor. The plaintiff performed substantial work and incurred additional costs and expenses when Hyatt changed and delayed its plans. The agreement was amended to show a balance due to the plaintiff of nearly $600,000, with one-third of that amount due on a date certain. The plaintiff continued work and incurred an additional $270,000 in expenses. Hyatt failed to pay the $200,000 due on the specified date, subsequently paid $100,000, and ultimately claimed that the amounts due were payable by an assignee of MIH. The plaintiff claimed that it had always dealt with Hyatt and that Hyatt was responsible for paying the amount due. The court held that Hyatt's defense that the contractor failed to mitigate its damages was to be stricken, but that the affirmative defense that the contractor was estopped from piercing the corporate veil of MIH was not to be stricken. The court also struck the defense that the plaintiff's complaint failed to state a claim upon which relief could be granted.

In *Scott v. Rolling Hills Place, Inc.*, 688 So. 2d 937 (Fla. Dist. Ct. App. 1996), the developer hired the engineer to work on a planned subdivision development. The engineer was employed by the city and had a part-time engineering practice. The engineer prepared two proposals for his services, the second of which was orally accepted. The agreement was silent as to payment but included specific tasks to be performed by the engineer, who commenced the work and submitted invoices. The first three invoices were paid, the fourth invoice was paid in part, and the fifth and sixth invoices were not paid. The plans were completed and all that remained to be done was for the engineer to sign and seal the plans. He refused to do so without payment, and filed a mechanic's lien against the property to protect his interest. The developer then filed suit, claiming that the engineer breached his contract. The court held that the developer breached the contract by failing to pay for the services rendered and that the mechanic's lien was properly filed and enforced.

§ 1.7 MULTIPLE PRIMES

In *Silverite Construction Co. v. Montefiore Medical Center*, 238 A.D.2d 591, 657 N.Y.S.2d 196 (1997), the contractor sued the owner to recover under a purported construction contract that was not reduced to writing. The court held that the parties could not be bound because (1) the agreement was that they would not be bound unless and until the agreement was reduced to writing, and (2) no such writing was ever executed. The mere fact that the contractor performed preliminary tests under separate work orders did not constitute partial performance of the contract so as to render it enforceable.

In *Curtis Const. Co. v. American Steel Span*, 707 N.W.2d 68 (N.D. 2005), the concrete contractor sued the defendant for a breach of oral contracts for two separate jobs. With respect to the first job, the court held that a work order to tear out old concrete and pour new concrete for a commercial building did not constitute an enforceable written contract where the order identified the owner but not the contractor. The order was not signed by the contractor and only described a portion of the work to be performed. However, there was sufficient evidence to establish that the work was to be performed on a time and materials basis. With respect to the second job, there was sufficient evidence to support a finding that there was an oral contract on the same basis and not for a flat rate price as claimed by the owner, after the contractor refused to do the work on the flat rate basis due to the poor condition of the location where the concrete was to be poured. Clearly, such a dispute could have been avoided had the parties reduced their agreement to writing. This underscores the necessity for proper drafting to reduce potential problems.

§ 1.7 —Multiple Primes

Page 12, add to note 4:

A prime contractor who has suffered damage from failure of another prime may also have a cause of action against the prime contractor at fault. In Barth Elec. Co. v. Traylor Bros., Inc., 553 N.E.2d 504 (Ind. Ct. App. 1990), the court construed Article 6 of AIA document A201 (1976 ed.) to render each prime contractor a third-party beneficiary of the owner-prime contractor contracts with the other prime contractors, and allowed one prime contractor to sue another for delays. Barth thus provides the damaged prime contractor with two defendants: the other prime contractor who is allegedly at fault, and the owner who might have failed properly to coordinate contractor activities. If the damage resulted from delays caused solely by a separate prime contractor, the owner sued by the damaged prime would have an action over against the defaulting prime under art. 6.2.3 of AIA Document A201, which provides that costs caused by ill-timed work shall be borne by the party responsible therefor. (Similar language is included in both the 1976 and 1987 editions of AIA Document A201.)

§ 1.9 —Design-Build

Page 14, at end of section, add:

The design-build contractor assumes liability for design defects as well as construction defects. However, employment of the design professionals by the general contractor does not preclude the owner's suit directly against the design professionals. In *Nicholson & Loup, Inc. v. Carl E. Woodward, Inc.*, 596 So. 2d 374 (La. Ct. App. 1992), the court permitted recovery for foundation failure against the design-build general contractor, the architect employed by the general contractor, and the geotechnical engineer that supplied the soils report to the general contractor. The court did not discuss absence of privity of contract between the owner and the design professionals, reasoning only that the design professionals were the ones whose malfeasance resulted in damage, and that they should thus be liable for the damage. The result is consistent with cases that specifically address the issue and find privity of contract unnecessary to hold a design professional liable for malpractice. *See, e.g., Tambrands, Inc. v. Lockwood Greene Engineers*, 178 A.D.2d 406, 576 N.Y.S.2d 883 (1991).

In *Building Structures, Inc. v. Young*, 131 Or. App. 88, 883 P.2d 1308 (1994), the contractor brought this action seeking damages from the project owner under breach of contract, quantum meruit, and fraud theories. The owner hired the plaintiff to perform design-build work with design specifications balanced against cost. The parties signed a one-page agreement stating that:

> Building Structures is to act as Project Manager/General Contractor and will retain the architect and engineers and coordinate the design services and obtain all permits. At the time of actual construction, a contract based on maximum not-to-exceed costs will be negotiated. Any monies paid to BSI under this agreement will be included in the construction contract and credited to the owner's account.
>
> [Defendant] will compensate [plaintiff] based on actual cost, not including taxes, plus ten percent for general overhead, plus five percent for fee. Payments will be made on a monthly progress basis. Any applicable taxes will be paid by owner in addition to the above.

883 P.2d at 1310. After the agreement was signed, the plaintiff made the preliminary drawings. The parties negotiated price and the plaintiff presented a construction estimate, but the defendant objected to the price of $245,126. The plaintiff was unaware that the defendant had contacted other contractors, one of which submitted a bid of $200,000. The city approved the plaintiff's design and the plaintiff told the defendant it would proceed with the construction drawings and the building permits. The defendant agreed, but one month later contracted with another company for construction of the building. The plaintiff was only told about that contract after it discovered another contractor working on the site. The completed building was substantially the same as the one designed by the plaintiff.

The plaintiff filed suit, alleging that the defendants only wanted the plaintiff to perform design work and never intended to use the plaintiff to build the building. The defendant admitted liability under quantum meruit for the value of the design work, but denied liability for a breach of contract or fraud. The court held that there was sufficient evidence to support the fraud claim and that it was for the jury to determine whether the plaintiff had breached the contract. Thus, the court affirmed the judgment on the jury verdict entered on the breach of contract claim.

In *Roberts & Schaefer Co. v. Hardaway*, 152 F.3d 1283 (11th Cir. 1998), applying Florida law, the owner hired the plaintiff to design and build a phosphate beneefication plant on a fast track basis. The plaintiff awarded three subcontracts to the defendant for structural steel/mechanical erection, underground piping, and above-ground piping. Disputes arose out of the first and last categories of work. Each of these contracts contained engineering plans and specifications comprising hundreds of pages. Because fast track construction means that work starts even though the design work has not been completed, there were specific provisions dealing with work schedules as well as provisions dealing with changes, deletions and extra work. Where the subcontractor was required to work overtime and incur extra costs to complete the work within the fast track schedule, it could recover those costs. The subcontractor could recover additional costs incurred with respect to being supplied inaccurate and defective designs and defect work upon which it was to perform its work.

§ 1.10 —Hybrid and Multiple

Page 14, after next-to-last sentence, add:

In large cost-plus-fee contracts, the owner might want to employ a construction manager with extensive construction experience as the owner's representative, with authority to work directly with the design professionals prior to beginning construction, and to work with the general contractor and design professionals during construction. With good interpersonal skills, and with a contract structure that provides the general contractor with costsaving incentives, such a manager could help control costs by suggesting design changes and means-and-methods changes during construction, as well as be in a position to competently audit costs upon completion.

In *T.W. Morton Builders v. von Buedingen*, 450 S.E.2d 87 (S.C. Ct. App. 1994), the plaintiff home improvement contractor brought suit to foreclose on its mechanic's lien after the homeowners failed to pay in full for the work. The homeowners counterclaimed for breach of contract and unfair trade practices. The homeowners sought the addition of a master bedroom/bathroom wing, a barn, and other significant improvements. They received bids, including one from the plaintiff for $540,000. Following negotiations during which the scope of the work was scaled down, they accepted the plaintiff's bid of $370,000. The parties used an AIA form providing that payment for the work would be on a cost-plus-fee basis.

The contract recited that the negotiated price was only an estimate, with the actual amount to be adjusted for changes in the work. The contract provided that costs attributable to the negligence of the contractor would not be reimbursed and that any changes resulting in additional costs would be effective only when a change order was signed by the homeowners. During the work, the parties failed to follow the change order procedure because changes were frequently made. The final cost for the bid plus written authorized change orders totalled $654,000.

The court held that this indeed was a cost-plus contract, not a fixed fee. There was no evidence to support the claim of unfair or deceptive trade practices. The court affirmed the judgment for the contractor and awarded the contractor attorney fees pursuant to the mechanic's lien statute.

§ 1.13 —Contractor

Page 18, at end of section, add:

In *Gateway Exteriors, Inc. v. Suntide Homes, Inc.*, 882 S.W.2d 275 (Mo. Ct. App. 1994), the plaintiff, which was in the residential siding business, supplied and installed vinyl siding. It did not use Masonite siding. The defendant was a residential builder and developer. Masonite siding was standard on the defendant's homes in the subdivision, but purchasers were offered vinyl siding as an option. The defendant had several siding contractors working on the job, but was not satisfied and gave the plaintiff the preliminary plans for a bid. The plaintiff ultimately started work on one house outside the subdivision after it was referred by the defendant to the owner; the plaintiff charged the same basic cost it had given the defendant. The plaintiff billed the defendant for the basic cost and extras but was not paid. The defendant told the plaintiff that the owners would pay and eventually the majority of the amount due was paid.

Subsequently, the defendant told the plaintiff to start ordering siding for the subdivision, even though no homes had yet been built. The plaintiff ordered $32,000 worth of materials, ordering in quantity to obtain a discount. The defendant disputed that he had authorized the plaintiff to proceed at that time. The defendant then gave the plaintiff a start sheet for the display house and the plaintiff showed the defendant the siding it had ordered. After the defendant started to build the display home, he found that another siding company was working on it. The defendant stated that a mistake had been made and that the plaintiff would do the other homes in the subdivision. The plaintiff never supplied or installed siding on any of the subdivision homes and sued.

The court found that the plaintiff had failed to make a submissible case on the existence of a contract for work in the subdivision. There was only a representation that the plaintiff would do some work in the subdivision, but there was no agreement that it would be hired to perform all siding work. The court found that the discussions between the parties were merely preliminary and did not constitute a valid agreement in themselves.

In *Spirtas Co. v. Division of Design and Construction*, 131 S.W.3d 411 (Mo. Ct. App. 2004), the contractor was awarded the contract for the demolition of a mental health facility. The work included the abatement of various asbestos-containing materials, the exact quantities and location of which were only estimated in the contract. The contract amount was to be adjusted based upon the exact quantities discovered and removed. The contract provided at least seven different unit prices for removing asbestos for various size pipes and joints.

In the course of the work, it was discovered that ductwork above ceilings was also encased in asbestos coverings. The division determined that the composition of this covering required a different method of removal and asked the contractor to submit a separate bid. The division rejected the bid and opened the bidding process. The ductwork abatement was awarded to another contractor. After the plaintiff contractor completed the work, it submitted a claim for lost profits, arguing that it was deprived of such profits by the decision to have the other contractor perform the additional abatement work. The claim was rejected and resulted in this suit.

The court held that there were questions of fact as to whether the asbestos discovered around the ductwork constituted a material change of circumstances requiring that the parties come to a separate agreement as to its removal and whether the discovery constituted a material change in the contract, thereby requiring that the division apply the unit prices for the additional abatement work.

In *Ram Engineering & Construction v. University of Louisville*, 127 S.W.3d 579 (Ky. 2004), the university accepted bids for the construction of a stadium in accordance with the state procurement code. There were seven different packages. The university determined that the low bids exceeded the construction budget, whereupon it negotiated with the three lowest bidders. The plaintiff was declared the lowest of the three bidders. The original low bidder filed a protest challenging the bid package. The university denied the protest and issued a notice to proceed to the plaintiff. The protestor filed a declaratory judgment action against the university. The plaintiff was not given notice nor made a party to that action. The circuit court issued a temporary restraining order (TRO) preventing the plaintiff from proceeding, but the TRO was never signed.

The protestor and the university entered into an agreed order declaring that any prior award was null and void and the university was to rebid the package. The university issued another invitation to bid and the plaintiff was again the low bidder, but the bid was $600,000 less than the previous bid. The university accepted this bid and issued another Notice to Proceed. The plaintiff filed a protest objecting to the reduction in the bid contract. The university denied the protest on the grounds that the university never had a contract with the plaintiff. Thereupon, the plaintiff filed suit seeking damages for the breach of the original bid contract.

The court held that the plaintiff was an indispensable party to the prior litigation wherein the protestor had the earlier bidding process thrown out. Furthermore, the court held that none of the events were sufficient to support the