



**RECENT COURT DECISIONS OF RELEVANCE
TO CONTRACT DOCUMENTS**

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**Hugh Anderson
EJCDC Legal Counsel
608-798-0698**

hugh.anderson@aecddocuments.com

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1. **Issue:** Effect of failing to report a claim within the claims period, under a claims-made-and-reported professional liability policy. *Anderson v. Aul*. Wisconsin Supreme Court (2015).

Summary: Thomas Aul is an attorney who represented the purchasers in a commercial real estate transaction. After the transaction the purchasers wrote to Aul, asserting that they had learned that he had a conflict of interest in the transaction, resulting in unfair and unreasonable terms; that they were dissatisfied with his representation of them; and that they had incurred \$117,000 in damages. Aul reported this to his professional liability carrier more than a year later. The carrier denied coverage because the report occurred outside the policy year in which the claim had been made.

Prompt notice of claims to insurance companies is generally important to allow the company to investigate the facts while they are fresh, to set reserves, and to begin organizing a defense. A tardy report of a claim can be prejudicial to the insurance company.

Because of the harsh impact of a denial of coverage based on a tardy notice, both on the insured and on third-party claimants with valid claims against the insured, in Wisconsin and other states there are statutes that provide some leeway in reporting a claim, provided there is no prejudice to the insurance companies. The application of those statutes to a claims-made-and-reported policy were the focus of this case.

The Wisconsin Court of Appeals concluded that the mitigating statutes applied, requiring a judicial determination of whether the untimeliness of the notice prejudiced the insurer. The court of appeals concluded that there was no serious impairment of the insurance company's ability to investigate, evaluate, or settle the specific claim, or to determine coverage or present a defense. As a result, the court required the insurance company to provide coverage. The insurance company appealed that decision.

Decision: The Wisconsin Supreme Court reversed the court of appeals decision, and ruled that there was no coverage of the claim because of the late reporting. The court held that the mitigating statutes were not applicable to claims-made-and-reported policies.

For claims-made-and-reported policies, there is a fundamental significance to the policy period. The underwriting of the policies assumes that once the policy year ends, the insurance company's exposure ends. Unlike occurrence-type policies, there is no "tail" on a claims-made policy that allows for claims well after the policy year.

The court viewed the mitigating statutes as tools to be used only for occurrence type policies, where the time in which the claim is made is not fundamental to the policy. The court also opined that even if the statutes were relevant, the insurance company would prevail because of the inherent prejudice:

In short, requiring an insurance company to provide coverage for a claim reported after the end of a claims-made-and-reported policy period is *per se* prejudicial to the insurance company because it expands the grant of coverage provided by the insurance policy. Premiums on claims-made-and-reported insurance policies are ordinarily set below the levels charged for comparable occurrence policies based in part on the limitation of coverage to claims reported within the policy period. Thus, when a claim is not reported within the policy period, requiring the insurance company to nevertheless provide coverage is prejudicial. Holding otherwise would defeat the fundamental premise of claims-made-and-reported policies.

Comment: EJCDC’s standard documents require that engineering firms and other design professionals (architects, surveyors, etc.) carry professional liability insurance. This is an important risk management tool, but as the Wisconsin case demonstrates, the tool is useless if basic claim-reporting duties are ignored.

It is natural for professionals, whether attorneys, engineers, or others, to be embarrassed or paralyzed by a claim from a client. Firms should have protocols in place to assure that individuals do not hide the claim, ignore the claim, or attempt to resolve it themselves—or worse yet engage in conduct such as destruction of evidence, or fabrication of false documents. Far better in nearly every case to promptly report the claim and allow the defense team (including the professional liability insurer and attorneys) to confront it and resolve it.

2. Issue: Consequences of manipulation of unit price bids. *Celco Construction Corp. v. Town of Avon*. Massachusetts Appeals Court (2015).

Summary: On a water main extension project, the successful low bidder had bid \$0.01 per cubic yard on excavation of rock. The bidder believed that 1000 cubic yards, the “indeterminate quantity assumed for comparison of bids,” was too high and represented an opportunity to gain an advantage in the bid competition (the bidder also inflated certain other unit prices). In fact, the contractor encountered and excavated 2,524 cubic yards of rock. In a claim the contractor contended that unit costs were \$220/yard (or \$190/yard) and asked for an equitable adjustment.

The contractor's claim relied primarily on the contract's differing site condition clause (which the court noted was required by Massachusetts statute). The project owner and the local superior court rejected the claim, resulting in the appeal to the court of appeals.

Decision: The court of appeals affirmed the lower court's ruling against the contractor. The court noted that conditions did not differ from those stated in the contract documents: the bidding documents had expressly warned that the 1000 cy number was strictly for bid comparison, and that the actual quantity of rock was "indeterminate." The use of a unit price approach for rock removal was a reasonable way of addressing the uncertainty. Putting aside the quantity factor, the court stated that the nature of the rock itself, and the means and cost to remove it, did not differ in any way from what was anticipated in the contract documents. The court held that the contractor could have protected itself by reasonably approximating the unit cost of removal, and that it "defies logic to invoke 'equity' as a basis for adjustment" under the circumstances.

Comment: The decision does not discuss whether the owner could have or should have rejected the bid based on the plainly manipulative one cent bid for excavation. EJCDC® C-200 allows for rejection of "unbalanced" bids, and this bid appears to fall in that category. It is especially significant that in a competitively-bid unit price contract the award rests on the stated comparison quantities—if one bidder ignores those quantities, the playing field is no longer level and the bid is arguably non-responsive.

3. Issue: Responsibility for ambiguity in escalator design. *Otis Elevator Co. v. W.G. Yates & Sons Construction Co.* United States Court of Appeals, Eleventh Circuit (2014).

Summary: Expansion of the Huntsville-Madison County Airport (Alabama) baggage-claim area. The architect, Chapman Sisson, prepared drawings and specifications for four new escalators. Escalators come in three nominal step widths: 24 inches, 32 inches, and 40 inches. In each case the actual width may vary by nearly an inch. In addition to nominal width, an escalator's "rated width" measured from handrail to handrail is also sometimes depicted on drawings. Here, the key drawing used tick marks to show a width of 39.5 inches. During the bidding process Otis Elevator noted that it was unclear whether that dimension was the step width (and thus a 40-inch escalator) or the rated width (and thus a 32-inch escalator). Otis elected to assume a 32-inch step width, and did not inquire about the ambiguity during the bid process. Yates, a general contractor, relied on the Otis price in winning the bid competition.

Otis's shop drawings were apparently clear in showing 32-inch escalators. However, Otis did not call out on the shop drawings that the escalator size was based on an assumption regarding the ambiguous tick mark drawing, or request an interpretation of that drawing in an RFI process or otherwise. The architect approved the shop drawings, but did not review submittal details such as dimensions and thus was unaware that Otis and Yates were about to install a medium-sized escalator. During installation the escalators were generally shrouded, or barricaded, and it was not until completion that the architect had a close look at the escalators and realized they were smaller than the architect had intended. Yates was ordered to remove the noncompliant escalators and replace them with 40-inch units.

After unsuccessful negotiations the issue was formally placed before the architect as a claim to be resolved. In the architect's judgment, the drawing showed a step width (39.5 inches) that mandated a 40-inch elevator. Eventually Yates and Otis installed 40-inch escalators, reserving rights against each other. Additional costs were somewhat more than \$500,000.

The dispute between Yates and Otis made its way to federal court. The district court ruled in favor of Otis, apparently concluding that the standard was whether Otis's interpretation of the bidding documents was reasonable—which it was. Yates appealed to the Eleventh Circuit.

Decision: The court of appeals held that a subcontractor cannot recover based on a reasonable but unilateral resolution of an ambiguity in the documents, if the sub was aware of the ambiguity and had an opportunity to have it clarified. The court ruled that Otis was obligated to bring the discrepancy to the attention of the owner, and the failure to do so meant that Otis proceeded "at its peril."

The court of appeals also held that the parties to the contract had submitted to the authority of the architect as a "third-party expert" for resolution of disputes. This concession to the authority of the architect flowed down to Otis. The court concluded that the decision of the architect was meant to be binding and final, like an arbitrator's decision; and that because there was no indication of fraud or gross mistake on the architect's part when it determined that the design called for a 40-inch escalator, "the district court should not have set aside the third-party expert's [architect's] binding interpretation."

Comment: The EJCDC construction documents require that bidders and the contractor seek clarification of any apparent ambiguities. They also require that shop drawings call out deviations from the requirements of the contract documents; arguably this suggests the need for contractor (or its subs) to point out underlying ambiguities. The Eleventh Circuit's support of the duty to seek clarification, and the

transfer of risk if clarification is not sought, is consistent with EJCDC's expectations for projects.

The Eleventh Circuit's high degree of deference to the decision of the architect is greater than the deference established in favor of engineer as decisionmaker in EJCDC® C-700. Under C-700, Engineer's decisions are "final and binding" but may be appealed. The appeal is to be considered on its merits, without mandatory deference to the engineer.

- 4. Issue:** Construction defects in condominium project. *Saratoga at Toms River Condominium Association, Inc. v. Menk Corporation*. Superior Court of New Jersey, Appellate Division (2014).

Summary: Menk was the developer and design-builder of this large condominium project, built in the mid 1990s. The architect retained by Menk drafted a design that (a) required a "groundwater investigation" to determine if waterproofing would be needed, before commencing with masonry (concrete block) foundations, basements, crawl spaces, and steps, and (b) provided that the buildings be wrapped in "Tyvek Building Paper or equal."

As to the groundwater conditions, Menk relied on a set of 1981 boring logs that indicated dry conditions, and on 37 150' x 50' x 10' building excavations, none of which showed any signs of groundwater problems. For the building paper, Menk used Vapor-x 14-pound black tar paper.

Years later, when some of the condo buildings experienced water problems, the condo association pursued claims against Menk and some of its subs.

Decision: The New Jersey trial court and appellate court both rejected the claims against Menk, on factual as well as legal grounds. The claimants' own expert conceded that the excavations, which were approved by a building code official and showed dry conditions, satisfied the "groundwater investigation" requirement, as did the 1981 borings. However, another of plaintiff's experts testified that Vapor-x was not an equal product to Tyvek, based on his belief about the permeability of the two products. During questioning he conceded that he did not investigate or analyze either material, and that Vapor-x satisfied the applicable building code. The court disregarded his unsupported opinion about Vapor-x's non-equal status.

In its decision rejecting the claims, the court also noted that the condominium unit sales documents had informed purchasers that Menk reserved "absolute and sole discretion" to make substitutions of "comparable" materials and equipment so long as the items were building-code compliant.

Comment: As both “owner” (developer) and design-builder, Menk reasonably gave itself considerable flexibility in constructing the condos. However, the project might have benefited from more involvement or participation from the architect during the construction phase. Once its architect specified “Tyvek or equal” Menk might have saved itself later trouble if there had been a procedure in place for the architect to establish or concur that an alternative building product was “or equal,” and document the conclusion. Similarly, given that the architect’s design called for a “groundwater investigation,” a modest paper trail during construction, confirming or stating that the requirement had been satisfied by the 1981 drawings or the actual excavations, or both, might have deterred subsequent disputes.

5. **Issue:** Did the contractor on a federal project make a formal claim, as a required precondition to seeking recovery of additional compensation? *Construction Group, LLC v. Department of Homeland Security*. United States Civilian Board of Contract Appeals (2015).

Summary: Coast Guard project to rebuild a facility at the harbor in Charleston, South Carolina. The Coast Guard considered the project complete and satisfactory, and wanted to close out the contract. The contractor sent several letters indicating an intent to submit a claim for additional compensation, contending that a claim was “pending,” and complaining that the Coast Guard’s security force had not pursued a subcontractor that allegedly stole copper from the project. In subsequent proceedings, the Coast Guard asserted that no legally sufficient claim had ever been submitted, and therefore the contract review board did not have jurisdiction.

Decision: The Board agreed with the Coast Guard and rejected the attempted pursuit of additional compensation. Under federal law a valid claim either seeks the payment of a “sum certain” (a specific sum) or challenges an interpretation of contract terms. In this case, the contractor had indicated an intent to make a monetary claim but had never expressly stated a claim or asked for a specific sum. Nor did the contractor contest any interpretation of the contract wording, or seek other relief.

Comment: As the Board commented, there was no doubt that the contractor had communicated that it was upset with the project, with an apparent focus on the owner’s handling of the situation with the subcontractor. However, the contractor had never specified the relief it sought, referring only to a broad range of damages. And its communications always stopped just short of being an outright claim; thus the contracting officer for the government never felt a formal reply (decision) was needed.

Most contracts contain formal requirements that are generally enforceable, though exceptions based on “substantial compliance” or lack of prejudice may sometimes

be allowed. Strict enforcement is especially likely when a contract provision arises from a statute or regulation, as is the case for many federal contract clauses.

- 6. Issue:** Enforceability of a no-damages-for delay clause. *Zachry Construction Corp. v. Port of Houston Authority*. Texas Supreme Court (2014).

Summary: Zachry contracted to construct a wharf for the Port of Houston for \$62 million. The wharf was to include a large concrete deck supported by piers, and would be 1660 feet long. Zachry devised an innovative work plan under which it would use dredged soils and a freeze wall (using refrigerated brine to freeze the soils and create a barrier to water flow) to allow Zachry and its workforce to work in the dry.

Nine months into the project the Port changed the scope of the work, requiring an extension of the wharf and a sequencing change to accommodate an imminent delivery of large wharf cranes from China. In negotiating the \$12 million change order, Zachry informed the Port that Zachry would need to build another cutoff wall (again using the freeze technique) to accommodate the change. The Port did not initially object, but two weeks after the change order was executed the Port denied permission to build the cutoff wall, apparently out of concern that the freeze system would jeopardize the integrity of existing pier structures. Zachry protested that this was an unpermitted intrusion on its freedom to use its preferred means and methods of construction. It nonetheless proceeded without the cutoff wall, working in the wet, incurring added costs, and falling substantially behind schedule.

The contract contained a strong pro-owner no-damages-for-delay (“NDD”) clause. The clause stated in part that there would be no damages for delay even if the Port was responsible for the delay as a result of its “negligence, breach of contract, or other fault...” In a subsequent three-month trial, a jury found that the Port had breached the contract by rejecting the cutoff wall plan, resulting in \$18 million in delay damages. The jury found that the delay was caused by the Port’s “arbitrary and capricious conduct, active interference, bad faith and/or fraud,” and that the NDD was inapplicable.

An intermediate appellate court reversed the jury decision, holding that the claim was barred by the NDD clause. The appellate court also upheld \$2.2 million in liquidated damages, and imposed \$10.6 million in attorneys’ fees on Zachry. (See “Recent Court Decisions...February 2013” for more discussion of the claims and the appellate court decision.) An appeal to the Texas Supreme Court followed.

Decision: As a preliminary matter, the Texas Supreme Court concluded that a state local public contract claims statute waived any governmental immunity to Zachry’s claim for delay damages. The court then reviewed whether the terms of the contract’s NDD barred Zachry’s claim. The court held that it was doubtful that the

NDD was attempting to condone “deliberate, wrongful conduct” of the type that the jury had found that the Port had engaged in. The court concluded that when contractors accepted harsh NDD clauses, they were accepting only the risk of certain predictable delay events. Active owner interference or bad faith was not within contemplation.

The court issued a strong general rule. It noted that pre-injury waivers of future liability for gross negligence are void under Texas law, as a matter of public policy, as are contract clauses that attempt to exempt a party from tort liability arising from intentional or reckless conduct. The court extended that rule to attempts to exempt a party from contractual liability arising from “future, deliberate, wrongful conduct.” Enforcement of such a provision would “allow one party to intentionally injure another with impunity”—a result contrary to public policy in Texas.

Comment: EJCDC’s documents take a balanced approach to delay. The contractor is entitled to damages for delays caused by owner or the engineer.

The real problem for the Port was the extremely harsh jury decision. Was it fair or justified for the jury to label the Port’s decision to not allow the cutoff wall, out of concern for the impact on existing wharf structures, as “arbitrary and capricious, active interference, bad faith and/or fraud”? Nothing in the description of project events indicated any animosity or adverse intent by the Port toward Zachry. Perhaps during the three-month trial such evidence was indeed presented. At any rate, the general rule established in this case is premised on the jury findings, which higher courts are reluctant to challenge.

- 7. Issue:** Application of insurance policy’s “total pollution exclusion.” *Advanced Waste Services, Inc. v. United Milwaukee Scrap, LLC*. Court of Appeals of Wisconsin (2015).

Summary: United Milwaukee Scrap buys and processes scrap metal from industrial sources and construction demolition projects. Advanced Waste Services recycles oily wastewater, such as that generated by United Milwaukee Scrap, and sells the extracted oil. According to Advanced, wastewater from United Milwaukee Scrap contained PCBs that contaminated Advanced’s recycling facility and its recycled oil products. In a complaint filed in court, Advanced alleged that United Milwaukee had failed to disclose the presence of PCBs in its oily wastewater and was responsible for the costs of the contamination.

United Milwaukee Scrap called on its commercial general liability carrier to provide defense and coverage. The insurer declined, citing the policy’s total pollution exclusion. That clause provided that there was no coverage for property damage from the “discharge, dispersal, seepage...” of pollutants. United Milwaukee Scrap brought the insurance company into the lawsuit as a third-party defendant.

The trial court granted the insurance company summary judgment based on the pollution exclusion, and the issue was appealed to the court of appeals.

Decision: United Milwaukee Scrap's primary argument in favor of coverage (and against application of the exclusion) was that it (UMS) did not "disperse" the PCBs; rather, the PCBs were a "contained substance" that the recycler, Advanced, eventually dispersed through its activities. The court of appeals affirmed the lower court's conclusion that this was not a correct analysis of the pollution exclusion. The exclusion does not specify or limit the "actor" responsible for the dispersal, rather it applies broadly to any dispersal. In the court's view, this would encompass a dispersal at any time, intentional or unintentional, without any action whatever by the policyholder.

The appellate court noted that a recent Wisconsin supreme court case had enforced the same clause in a coverage claim by homeowners concerning the "penetrating and offensive odor of bat guano that had escaped from the walls of their vacation home, permeating the entire premises." Relevant to the wastewater recycling case, the homeowners/insureds had not dispersed the polluting bat guano, the bats had done so; yet the pollution exclusion still applied.

Comment: The published decision does not mention whether Advanced had any type of insurance to guard against the consequences of unknowingly accepting contaminated waste.