EJCDC
ENGINEERS JOINT CONTRACT DOCUMENTS COMMITTEE

RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

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1. Insurance company's duty to warn insured of possible judgment in excess of policy limits.	*R.C. Wegman Construction Co. v. Admiral Insurance Co.,* U.S. Court of Appeals, Seventh Circuit (2011).	Injured construction worker (subcontractor's employee) sued the general contractor and others. Contractor's Commercial General Liability carrier retained counsel and paid for defense. Insurer (and counsel) failed to notify the Contractor that the injured worker's claims were well in excess of the policy limit of $1 million. When contractor learned shortly before trial that it was at risk for the portion of the judgment in excess of the policy limit, it immediately notified its umbrella insurer. The umbrella insurer denied coverage based on failure to give timely notice. The insurance company's strategy was apparently to go to trial where it would gamble that the insured was less than 25% liable. It also viewed the insured worker's demands/damages as excessive. At trial the contractor was found 27% liable, but was exposed to paying the full damages (approximately $2 million) under the Illinois rule of joint and several liability. The contractor sued the insurance company, contending that if the insurer had given it timely notice, it could have secured protection under the umbrella policy, explored settlement options, and possibly retained its own counsel to protect its distinct interests. The district court dismissed the suit based on arguments by the insurance company that the risk to the insured was only "potential" and that the attorney, not the insurance company, had the duty to notify. The appellate court found these arguments unpersuasive (and even "ridiculous").	EJCDC's standard insurance provisions require Contractor to carry CGL and umbrella (excess) coverage. In this case the umbrella coverage was rendered useless by the failure to provide a timely notice of claim. We can speculate that some insurance companies avoid routinely warning insureds of a possible excess judgment because of the alarm such warnings create, and the pressure that insureds would bring to throw the entire policy amount into a settlement offer. The court here (an influential and highly respected federal appeals court) held that the threshold for informing the insured of its risk is if there is a "nontrivial probability" of an excess judgment. This rule may result in better communication between insurers and insureds regarding risks. The decision mentions that the contractor was pursuing a separate action against the insurer-hired defense lawyer.

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2. Engineering firm's exposure to liability for city workers' injuries at wastewater treatment plant.	*Michaels v. CH2M Hill, Inc*., Supreme Court of Washington (2011)	"Catastrophic failure" at Spokane wastewater treatment plant during plant operations. Plant was struggling to maintain warm temperatures in digester tanks. CH2M Hill was on-call at the plant as part of a 10 year upgrade project and for ongoing operational expertise. A CH2M engineer proposed an interim operational fix that would re-route sludge inputs. This would in turn affect the transfer of sludge between digesters, but this was not explained to the plant superintendent or operators. After the re-routing, the operators attempted to transfer the contents of Digester 3 to Digester 2. They were unaware that the operation as executed was sending sludge into a "deadhead" such that Digester 3 was not draining. Pressure and volume rose. Workers were sent on top of the digester dome to siphon off foam with a hose. Ultimately Digester 3 overfilled and collapsed, resulting in one death and several serious injuries. A Washington statute provides A/Es with immunity to worker claims at a "construction site," except for claims based on plans and specs. The court here held that this immunity did not apply because (1) the digester was in operation, not under construction, and (2) the CH2M "fix" proposal, though never put in writing, was equivalent to plans and specs—it was a design. The court also held that an A/E has a duty of care to workers at a site, and a duty to analyze how its work (the fix) might affect the plant and its operations.	This case has received a substantial amount of attention. It is tempting to say "bad facts make bad law." Certainly the Washington Supreme Court was struck by the facts as reported by the trial judge, such as the description of a death by drowning in sludge, in "excruciating physical pain…in darkness, pain, and utter helplessness." However, on close examination the legal conclusion that there was no A/E immunity is not unreasonable. In most jurisdiction there would not be any immunity. The Washington immunity is in the worker's comp statute and is a special exception to the general right of employees to pursue claims against parties other than their employers. In essence the legislature had given A/Es limited exempt "employer" status for their onsite activities on construction projects. No such immunity was given to A/Es for operational duties, or for design errors.

EJCDC: RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS October 2011			
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3. What are the limits of legal causation for liability purposes?	*Edwards v. Anderson Engineering, Inc.,* Court of Appeals of Kansas (2011).	Engineering firm designed municipal storm sewer project and provided construction-phase engineering services. Elliptical concrete pipe failed after installation and was replaced. Contractor retained a testing firm to analyze the failed pipe. The testing firm instructed Contractor's employee to stand on a piece of pipe and saw off a section. The pipe split at the saw cut, the worker fell, and the pipe rolled onto him and killed him. His family contended that the pipe had failed as installed as a result of a flawed bedding specification, or in the alternative that it failed because of poor workmanship in the installation—which the engineering firm failed to observe and address. Thus: if bedding spec had been good, or if engineer had corrected the poor installation, the pipe would not have needed to be replaced, no investigation and testing of the pipe would have occurred, and the worker would not have been directed to make the fatal saw cut. Both the trial court and appeals court held that this logic sequence was too attenuated. "Proximate cause"—legal causation—requires that an injury be the natural and probable consequence of the wrongful act, with no superseding causes. Here, the alleged engineering errors were too removed from the injury to be "natural and probable" causes; and the negligence in the testing (sawing) process superseded any prior errors.	The court noted that the determination of proximate cause is ordinarily a task for the fact-finder (typically a jury) but in extreme cases the court will step in and dismiss a claim for lack of legal causation. No discussion here of what the contracts (the engineering firm's with the city, the construction contract, the agreement between Contractor and testing firm) stated about safety. One interesting wrinkle is that the testing/sawing occurred off-site. The failed pipe had been hauled away to another location. Perhaps only the Contractor—testing firm agreement was even relevant. The case is well written and contains a good explanation of the term "proximate cause" along with classic quotes from tort law cases.

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4. Contract requirements for a termination for cause and performance bond claim; Owner's right to pursue breach of contract claims when it has botched an attempted termination.	*Town of Plainfield, Indiana v. Paden Engineering Co., Inc.,* Court of Appeals of Indiana, 2011.	The Town contracted with Paden to provide and construct the "steel package" for a recreation center. The contract included AIA A201, General Conditions. The project was "contentious" and marked by various delays. Eventually the Town sent the contractor a notice of termination. In subsequent litigation, the Contractor pointed out that A201 required that a termination must be supported by a certification by the Architect that sufficient cause exists for the termination. No such certification had been issued, and both the trial court and appeals court concluded that Owner had not successfully terminated the Contractor. The Town compounded its problems by not giving timely notice to the performance bond surety. Under the terms of the performance bond the surety was entitled to notice in part to allow it to choose among several options for averting the termination or managing the completion of the work. The court held that the notice requirements were clear and unambiguous and entitled to enforcement. The Town's bond claim was dismissed. The Town took the fallback position that even if it had failed to terminate the contractor properly, it should still be able to pursue breach of contract claims against the Contractor. The court of appeals somewhat cryptically held that the Town's breach of contract rights were "constrained" by the procedural failures and dismissed the breach of contract claim.	1. The EJCDC termination procedures in C-700 do not require Owner to obtain a certification by Engineer with respect to a termination for cause. Such a requirement could hamstring owners in protecting their interests; places the design professional in a difficult position where engineering knowledge and expertise typically play a minor role as compared with legal, monetary, and schedule factors; and is of little protective value to the Contractor. 2. The case supports the principle of full compliance with contract provisions. The court referred to the importance of parties having "the utmost liberty" in forming contracts; once formed and executed, the terms should be followed and enforced. 3. Dismissing the Town's breach of contract claims seems extreme. Typically the owner would have been able to pursue these, subject to contractor's wrongful termination defense.

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5. Surety's enforcement of contractor's general indemnity agreement.	*Cagle Construction, LLC, v. The Travelers Indemnity Co.,* Court of Appeals of Georgia, 2010.	Contractor entered into four contracts with the Georgia Department of Defense. The contracts were supported by performance and payment bonds. To procure the bonds, Contractor executed a General Agreement of Indemnity in which Contractor agreed to reimburse surety for payments made to bond claimants, and related costs. The projects did not go well and the Owner declared Contractor to be in default. Upon Owner's timely demand the surety stepped in and completed the projects. The surety then sought reimbursement from the Contractor under the indemnity agreement. Contractor argued that the Owner had not been justified in declaring the Contractor in default. However, the standard in the indemnity agreement was simply that surety could obtain reimbursement if the Owner formally declared a default—regardless of the merits. The Contractor also objected that the price paid by the surety (over $600,000) was far too high, but the indemnity agreement stated that receipts and invoices would be "prima facie" evidence of reimbursable expenditures. Contractor did not present counter-evidence, only speculative criticism.	Sureties typically use harsh indemnity agreements to protect their interests. Unlike insurance companies, the business model for a surety is to be merely an intermediate source of collateral, not the ultimate deep pocket. The indemnity agreements often give the surety access to personal assets of the principals of the construction company. Under longstanding law, these agreements are fully enforceable, despite the "unfair" results that can occur. Termination for cause should be viewed as an extreme remedy. In addition to triggering the harsh indemnity obligations, a termination can also harm a contractor's reputation, and make it difficult to obtain bonds on future projects.

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6. CGL insurance coverage for damage to adjacent building during construction.	*Gilbert Texas Construction v. Underwriters at Lloyd's London,* Supreme Court of Texas, 2010.	Dallas Area Rapid Transit Authority construction project. Heavy rains resulted in $6 million in damage to an adjacent building. The building owner brought suit against the contractor, alleging that the construction activities exposed the building to the water damage. The bases for the claim were negligence (tort) and third-party beneficiary of the construction contract, based on contractor's commitment in the contract to compensate adjacent landowners for damage. The tort claims were dismissed based on a government agent immunity defense. The building owner prevailed on the third-party beneficiary claim, however. The Contractor's Commercial General Liability carrier had provided a defense under a reservation of rights, but the carrier (and the umbrella insurers) refused to cover the insured for the damages, asserting that liabilities undertaken by contract were not covered because of a specific exclusion. The Texas Supreme Court ruled in favor of the insurance companies. The exclusion does have two exceptions, but the court held neither applied. There is an exception providing coverage for contractual indemnity commitments, but this was a direct obligation, not an indemnity situation. There is also an exclusion for situations in which the contractual liability would exist anyway, under a tort theory. Ironically the contractor's successful tort immunity defense had proven that tort and contract exposure were dramatically different.	Typically damage to an adjacent building would be covered under a CGL policy. Most construction contracts (including EJCDC C-700) contain a requirement that the contractor pay for damage that it causes to neighboring property, but such contract requirements are not impediments to CGL coverage, since the neighbor's claim is typically a tort claim, and in any event the requirement essentially echoes what the law would require anyway. The Texas court acknowledged that its decision was at odds with cases from other jurisdictions. The Texas ruling could be characterized as "form over substance." Nonetheless the ruling appears to be logically reasoned, following the terms of the policy. One thing that is not discussed is whether it was correct for the lower court to hold that the building owner was a third-party beneficiary of the construction contract—wasn't the provision really for the owner's benefit?

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7. CM as Advisor—site safety obligations.	*O'Connell v. Turner Construction Co.,* Illinois Court of Appeals, 2011.	School construction project in Grayslake, Illinois. Turner served as a CM as Advisor. The Owner contracted with various trade contractors for the construction. The plaintiff was the employee of a subcontractor. He was injured while unraveling a steel cable. The injured worker contended that the CM exercised control over jobsite safety and contractor means and methods, and failed to protect the worker from injury. The trial court dismissed the claim, and the appellate court confirmed the dismissal. The courts held that the CM did not have any direct contractual control, since the contracts flowed from the school district to a trade contractor to plaintiff's employer. The courts also rejected liability arising from "possession" (control) of land, noting that the CM did not control the site.	The court listed and quoted various contract provisions that excluded the CM from site safety duties; it did not expressly indicate that the provisions were the basis for its ruling, though that may be inferred. Similar provisions in EJCDC professional services agreements establish a bright line between the Engineer and site safety/means and methods. The distinction is perhaps somewhat less clear here because the CM did have a role in reviewing the contractors' safety programs, but that point was not developed in the appellate decision.

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8. Contractor's compliance with specifications; correction duty; warranty	*Strong Construction, Inc. v. City of Torrington,* Wyoming Supreme Court (2011)	Strong Construction was the general contractor on a municipal water project. The contract included the 1996 EJCDC Standard General Conditions. The scope of work included furnishing and installation of three submersible pumps in three city wells. The specs indicated that the pump motors would need to operate at 60 hertz and be compatible with a variable frequency drive, but did not specify the range of frequencies. The required submittals regarding the pumps Contractor intended to supply indicated that they would operate in the 42 to 60 hertz range and were VFD compatible. The City's consulting engineer approved the submittal. The Contractor actually furnished pumps whose motors operated only in the 55 to 60 hz range. These performed inadequately and after a time the City replaced them with motors that operated in a broader range, allowing normal use of the wells. The city sought to pass the cost of replacement on to the Contractor. The court agreed with the City's point that the Contractor was bound by the commitment made in the submittal. The court cited as controlling the EJCDC provision that allows the requirements of the Contract Documents to be supplemented by approval of a shop drawing. The court held that the one year correction period (which had expired) did not bar a breach of contract claim, holding that breach of contract claims are distinct from warranty claims.	The provision allowing for supplementation of the requirements of the Contract Documents is in C-700 (2007) at para. 3.04.B.2. The court was correct that the intent is that commitments made in an approved Shop Drawing be enforceable just as if they had been included in the project specifications. The court was also correct in concluding that the City's claim was not barred by the expiration of the one year correction period (C-700, para. 13.07). However, the court's decision erroneously labels the correction duty as a "warranty" obligation, and mistakenly indicates that the City no longer had any warranty rights. In fact the General Warranty (para. 6.19) is not limited to one year—Owners may pursue warranty rights until the applicable statutory limitation period expires (usually four years or longer). In addition, they may also seek recourse under a breach of contract claim.