



RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

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1. **Issue:** When does the statutory limitations period begin for an action based on a contractual indemnification clause? *Miller-Davis Company v. Ahrens Construction, Inc.* Michigan Supreme Court. (2014).

Summary: Miller-Davis was the general contractor for the construction of a large indoor swimming pool building for the local YMCA. Ahrens Construction was the subcontractor for the project's roof system. After completion in 1999 the building was plagued by severe moisture problems. Accumulated condensation was sometimes so great that it appeared to be raining in the building. When ceiling material was removed it was revealed that there had been significant deficiencies in Ahrens' installation of the roof system, including large gaps and tears in insulation and the vapor barrier.

Despite demands from the general contractor, Ahrens failed to participate in the remedial work. In 2003 Miller-Davis pursued a termination or default of the sub, and also entered into a settlement with the YMCA, under which Miller-Davis rebuilt the undersection of the roof at its own expense (approximately \$350,000). The remedial work was successful in ending the moisture problems.

Two years after completing the remedial work, in 2005, the general contractor sued the subcontractor based on breach of contract (failing to construct according to the drawings and specifications) and contractual indemnification. The case wended its way through ADR and the Michigan trial and appellate courts for years. The controlling statute of limitations was determined to be six years from the claim first accruing. The breach of contract claim was rejected because the lawsuit was filed more than six years after completion of the subcontractor's work. The final issue before the state supreme court was when the claim for contractual indemnity accrued. Ahrens contended, and an intermediate appellate court agreed, that the duty to indemnify must have arisen no later than the date that Ahrens' poor workmanship occurred—more than six years prior to filing of the lawsuit. Miller-Davis argued that the statutory period did not begin to run until after it had incurred damages.

Decision: The Michigan Supreme Court held that the contractual indemnity claim accrued when the subcontractor "refused to indemnify Miller-Davis for the corrective work" that Miller-Davis has to perform, and that logically this refusal could only have occurred after the nonconforming work was uncovered, in 2003. Therefore the indemnification claim had been asserted within the statutory six-year period.

Comment: The basic point that a breach of a contractual duty to indemnify may occur well after completion of the project, and thus that a viable breach of indemnity lawsuit may be filed long after the project ends, is not controversial. The court makes a clear case for the proposition that the indemnity claim for failing to pay for a remedy is logically distinct from the claim based on faulty installation of the roof system.

One feature of this case is that there is no clarity as to when the demand for indemnification was made, or when the demand was refused. It is conventional practice, in situations involving a possible duty to indemnify, for the indemnitee (here the general contractor) to send a formal demand for indemnification to the indemnitor, by letter; it appears that this did not occur here. Although there was not a clear demand, the court implied a refusal, at one of three points: when the nonconforming work was discovered, when the general contractor was forced to commit to correcting the sub's work, or when the corrective work was completed. The end result here was good for indemnitee, but the facts of the case do not provide a road map for handling indemnity situations. Indemnitees should document their demands and not delay in pursuing their rights.

The case also included a discussion of whether the YMCA made a claim against Miller-Davis. The court held that the very fact of the settlement between the YMCA and Miller-Davis was sufficient implied evidence of an owner "claim" that would satisfy the terms of the subcontract indemnification clause. The court in essence applauded the peaceful owner-contractor settlement that had occurred without resort to legal action. Denying the general contractor the ability to settle and then proceed against its sub would be contrary to public policy in favor of compromise and settlement.

One final issue in the case was causation. Ahrens questioned whether its workmanship deficiencies had been established as the cause of the moisture problems. The court held this was not relevant: the owner was entitled to Work that was in compliance with the drawings and specifications, regardless of whether the faulty work was the cause of secondary consequences. The settlement was a commitment to correct the faulty work, not to correct the moisture problem—though happily it accomplished both.

The subcontract indemnification clause was extremely broad. More typical clauses, such as those in EJCDC C-700 and other standard contracts, would cover third-party property damage and injury claims, but not claims involving poor workmanship. Although in some jurisdictions there may be common law indemnity rights, the prudent course in the typical case is to make certain that breach of contract claims are pursued within the controlling statute of limitations period.

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- 2. Issue:** Implication of use of the term "condition precedent" in subcontract payment clause. *Transtar Electric, Inc. v. A.E.M Electric Services Corporation*. Supreme Court of Ohio (2014).

Summary: The payment clause in a subcontract indicated that payment of the subcontractor was conditional on the general contractor receiving payment from the owner, using the words "condition precedent." The subcontractor argued that because the clause did not expressly state that the risk of nonpayment was

transferred to the subcontractor, the clause should be construed as a mere “pay when paid” clause, thus giving the subcontractor the right to payment even if the owner ultimately failed to pay the general contractor.

Decision: The intermediate appellate court agreed with the subcontractor, holding that more emphatic wording was needed to create an enforceable pay-if-paid clause. The Ohio Supreme Court disagreed, ruling that the term “condition precedent” unambiguously established that receipt of payment from owner was required before the general would have any duty to pay the subcontractor. The court cited precedent from other courts, including a federal court of appeals. Under these decisions the term “condition precedent” is sufficient to convey the pay-if-paid concept. No additional “redundant” wording about risk transfer is needed.

Comment: Pay-if-paid is an option in EJDC’s engineering subagreements, such as E-570. The EJDC pay-if-paid clause uses the magic words “condition precedent.”

The Ohio case does not include any discussion about the public policy issues that accompany pay-if-paid clauses in some jurisdictions, nor is there an Ohio statute that forbids the use of pay-if-paid.

3. Issue: Enforceability of liquidated damages of \$700/day. *Boone Coleman Construction, Inc., v. Village of Piketon, Ohio*. Court of Appeals of Ohio (2014).

Summary: A modest public works project for construction of a traffic signal and related intersection improvements, for a stipulated price of \$683,300. Based on excerpts in the appellate decision, the construction contract appears to include EJDC C-520 or similar. The village inserted “\$700/day” in the liquidated damages clause governing unexcused contractor delays in completion.

Partly as the result of subcontractor problems, and perhaps because of site difficulties, the contractor was 397 days late in completing the work. The contractor made weak attempts at seeking additional time and compensation, but never complied with the contract’s formal notice provisions. At the \$700/day rate, the total damages for late completion were liquidated at \$277,900.

The village and the contractor made their way to court to resolve the contractor’s claims for time and compensation, and the village’s claim for liquidated damages. The trial court ruled in favor of the village on both issues, and the contractor appealed.

Decision: The court of appeals held that the contractor's claims should be rejected, primarily on procedural grounds. The contractor had not followed the contract's procedural requirements for claims, and did not properly appeal a differing site condition ruling. However, the appellate court held that liquidated damages of more than a third of the total contract price was an unenforceable penalty. The court noted that there was no evidence presented regarding the legitimacy of the \$700/day amount. There were no supporting calculations, and no relevant background facts such as a record of accidents at the intersection. The court mentioned that the intersection had never previously had a traffic light, so the lengthy delay merely sustained the status quo.

Comment: This decision has caused a minor stir and is being appealed to the Ohio Supreme Court. Several amicus groups are participating in support of the village. As one commentator has stated, the ruling can be taken as encouraging a lengthy delay in completion: as the days go by, the liquidated damages amount goes up and becomes a higher percentage of the contract total, thereby providing a basis for asserting that the liquidated damages are a penalty. Perhaps the state supreme court will focus on the length of the delay, rather than on the rather unremarkable daily rate.

Unremarkable though the \$700/day rate may be, the appellate court does raise a worthy point in asking what basis the owner had for the rate. EJCDC strongly encourages owners (and their engineering consultants) to establish a daily damages rate using reasonable criteria, and to carefully document the reasoning. Such documentation might have carried the day in the face of the challenge that occurred in the Piketon case, despite the large total.

It is important to note that there was no criticism in the case of the EJCDC liquidated damages clause's wording or structure.

- 4. Issue:** impact of fraudulent concealment on limitation period for bringing a payment bond claim. *Minnesota Laborers Health and Welfare Fund v. Granite Re Inc.* Supreme Court of Minnesota (2014).

Summary: Envirotech Remediation Services was the contractor on a bridge demolition project in St. Paul. It obtained a payment bond from Granite Re. In addition to subcontractors, suppliers, and laborers, one beneficiary of the bond was an employee fringe benefit fund. Envirotech concealed payroll records for the project, and failed to make the full measure of payments to the employee fund, shorting it by \$245,000. The fund ultimately brought a claim against the bond. Granite Re responded that the claim was untimely under the bond's one-year period for bringing a claim. The fund countered that the doctrine of fraudulent concealment tolls (in effect extends) the time for bringing an action.

Decision: The Minnesota Supreme court acknowledged that Granite Re was innocent of any involvement in the contractor's scheme to underpay the fund. However, the court held that when a choice must be made between imposing a loss on the obligee (here the fund) and the surety, the court would choose the surety. The surety in essence walks in the shoes of its principal, and is bound to the consequences of the principal's conduct, even unlawful conduct. Further, the surety can protect itself through strong indemnity and collateral arrangements with its principal. Finally, the court noted that to avoid this result, sureties could include an express risk-shifting provision in the bond, stating for example that the one year period would be enforceable and would not be tolled even in the case of fraudulent concealment by the principal.

Comment: The payment bond in question appeared to have industry-standard wording similar to that of EJCDC's published payment bond.

It remains to be seen whether sureties will press for a change to the standard payment bond wording to protect against losses of this type. The situation may be rare enough to not merit changes to the standard payment bond. In addition, it is not clear how well received such a change would be in the industry. The flow of payment to entitled contributors to the construction of improvements is vital to the construction process.

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5. **Issues:** (a) Applicable statute of limitations for indemnification claim; (b) contractual stipulations regarding time when limitation period starts. *15th Place Condominium Association v. South Campus Development Team LLC*. Appellate Court of Illinois (2014).

Summary: A few years after completion of a condominium construction project, the condominium homeowner's association discovered design and construction errors involving the balconies, masonry, and garage. Eventually the HOA filed a lawsuit against the developer of the project under various liability theories. After a time the developer brought a third-party action against the architect and the contractor, based on breach of contract, implied indemnity, and in the case of the contractor express indemnity.

(a) Illinois has a statute of limitations that applies specifically to design and construction claims: four years from when the claimant knew or should have known of the wrongful act or omission. The more general Illinois breach of written contract statute of limitations is ten years. Based on the four-year statute of limitations, most of the developer's claims against the architect and contractor were determined to be untimely, and were dismissed. One significant claim remained in question. The construction contract contained an express indemnification clause that gave the developer rights against the contractor in the case of a claim against the developer

by the HOA. (The text of the indemnification clause is not reported in the case; presumably it was a relatively broad clause.) The developer argued that the express indemnification claim is governed by the general ten-year contract statute of limitations, and thus was timely. This issue was presented to the court of appeals for resolution.

(b) Meanwhile the dismissal of various claims based on the four-year statute was predicated on contract clauses that stated that all actions accrue no later than the date of substantial completion. Thus although the condo association and the developer might not have known or had reason to know of the defects until long after substantial completion, the four-year claim period would already be running. The issue of the enforceability of the “accrual at substantial completion” clause was also appealed.

Decision: (a) The court of appeals held that the special four-year design/construction statute of limitations only applies to issues that emanate from construction-related activity. Acts or omissions in design, planning, supervision, observation, or management of construction would be covered; whereas a commitment to indemnify is not a construction activity. Although this may appear to be a rather fine distinction, the court emphasized precedent indicating that not every obligation in a construction contract is a construction activity.

(b) The court of appeals strongly supported the ability of the parties to a contract to shorten otherwise-applicable statutory limitation periods. The shortened period of time must be “reasonable.” A shortened limitation period is enforceable even if it bars a meritorious claim. The court noted that “Illinois public policy strongly favors the freedom to contract.” The lone exception would be contracts of adhesion, in which an unsophisticated party must accept the terms of a contract on a take it or leave it basis (for example, some insurance purchase situations). Since this was a negotiated \$34 million construction project, the developer was deemed to be a sophisticated party capable of understanding the “accrual at substantial completion” clause.

Comment: EJCDC includes an “accrual at substantial completion” clause in its engineering documents. Such clauses are generally enforceable, as the Illinois decision suggests.

- 6. Issue:** Subcontractor’s disregard of markings on structural drawings. *Goodrich Quality Theaters, Inc., v. Fostcorp Heating and Cooling, Inc.* Court of Appeals of Indiana (2014).

Summary: For an IMAX theater project, the general contractor retained Wilson Iron Works as the subcontractor for structural steel and roof decking, including joists and joist girders. The contract documents included drawings and the Steel Joist Institute

manual. The structural drawings for the roof framing were plan view depictions showing the joist girders. In certain locations on these drawings the architect used a dashed line in the shape of an hourglass, together with the word “opening” and a dimension, to mark where the HVAC ductwork would pass through. The architect’s intent was to indicate that these girders should have nonstandard openings.

Wilson Iron Works was not familiar with the hourglass marking, and therefore chose to ignore it. Wilson submitted shop drawings indicating standard joist girders only; the architect approved these drawings. Wilson eventually installed the standard girders. Ultimately these had to be custom-modified in place, at considerable additional expense.

In subsequent litigation, Wilson pointed out that according to the Steel Joist Institute manual, which was an incorporated contract document, the industry-standard marking “SP” is supposed to be used to mark a joist girder that is nonstandard, and there should be an accompanying note or detail drawing showing the manner in which the joist girder is nonstandard. The general contractor contended that a court must strive to treat all parts of a contract as meaningful; thus it would be erroneous to disregard the hourglass markings. Moreover, the general contractor directed the court’s attention to the contract clause requiring the contractor (in this case, by flowdown, the subcontractor) to bring contract ambiguities to the attention of the architect for resolution.

Decision: The court of appeals ruled in favor of the subcontractor. The court held that there was no ambiguity in the contract documents because the SJI manual stated how nonstandard girder joists should be indicated, and that method was not used. In addition, the court found it persuasive that the hourglass notation was not explained in any legend on the drawings, and that the contractor and architect had approved the shop drawings.

Comment: This is a troubling decision. Subcontractors and suppliers should not have a free pass to ignore content in the contract documents. It may well be the case that the hourglass notation was contrary to industry standards and the SJI manual. That does not reduce the need to bring it to the designer’s attention. The contract provisions requiring resolution of ambiguities and highlighting of nonconformance in shop drawings (doing nothing about the hourglass markings was essentially nonconforming) were in effect written out of this construction contract.

In this case the consequence of ignoring the hourglass marking was substantial additional expense, but in other cases a strange or novel marking could be intended to require a critical structural feature with implications for public safety. Here the problem came to light during construction, allowing for a fix; in other cases the noncompliance might have been overlooked until a failure occurred.

7. **Issues:** (a) duty to continue performance pending resolution of change order issue; (b) contractor's failure to comply with notice requirement regarding differing site conditions. *JEM Contracting, Inc., v. Morrison-Maierle, Inc.* Supreme Court of Montana (2014).

Summary: Public works project for improvements to 3.6 miles of highway in Montana. The general contractor encountered difficulties with site conditions on the first day and raised the issue in the field. There was no consensus about whether the conditions differed from those shown in the contract documents, but the contractor and the owner's consulting engineer reportedly worked out a deal under which the contractor would be "paid" for the difficult conditions if it could find savings in other aspects of the project, thus keeping the project within budget. It is not clear if the deal was in any way reduced to writing, or if the owner (two Montana counties) was aware of the deal.

The contractor later placed the increased costs in a draft change order for differing site conditions. The owner rejected the change order, and instructed the contractor to continue working. The contractor filed a lawsuit against the owner and the engineering firm.

The contract stated that contractor must continue working pending resolution of disputes. The contractor took the position that the clause was void and unenforceable because of a Montana statute that protects contractors that are not receiving payment from being forced to continue working without pay.

The public owner settled with the contractor for an undisclosed amount. The case against the engineering firm continued.

Decision: The case ultimately made its way to the Montana Supreme Court. The court noted that the construction contract explicitly allowed the contractor to terminate performance for lack of payment, and thus was in accord with the Montana statute. The issue here was not failure to pay an agreed amount (the focus of the statute), but rather entitlement to a change order for additional compensation. Thus the engineering firm was not liable for its role (if any) in advising the owner to decline payment of the change order and require contractor to continue working.

The contractor also complained that it had followed through on its end of the "deal" that allegedly had been brokered in the field, by finding cost savings on other work, and should have been entitled to compensation for the differing site conditions. The state supreme court rejected this, holding that there could be no differing site conditions claim (and apparently no "horse trading" of such a claim), because the contractor failed to give notice of a differing site condition to Owner and Engineer within 5 days, as required by contract.

Comment: The construction contract provisions here appear to be based on EJDC's standard general conditions. See C-700, Paragraph 4.04 (duty to continue working and stay on schedule while disputes are resolved) and Paragraph 5.04.A (written notice of differing site condition to Owner and Engineer).

Deals made in the field or on a handshake basis sometimes help a project move forward. However, when such a deal fails or its terms are in doubt, and the dispute is adjudicated, the plain written terms of the contract are likely to control.

8. *M&G Polymers USA v. Tackett*. United States Supreme Court (2015). A union contract with a corporation did not address whether retirement health benefits were vested for life, or could be reduced by the company. The issue reached the U.S. Supreme Court.

During oral argument:

Mr. Justice Scalia: "Both sides know it was left unaddressed, so, you know, whoever loses deserves to lose for casting this upon us when it could have been said very clearly in the contract. Such an important feature. So I hope we get it right, but, you know, I can't feel bad about it."