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ENGINEERS JOINT CONTRACT DOCUMENTS COMMITTEE

RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

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1. **Issue:** Validity and meaning of a limitation of liability clause in a professional services agreement between an architectural firm and an engineering firm. *Johnson Nathan Strohe, P.C. v. MEP Engineering, Inc.* Court of Appeals of Colorado (2021).

   Summary: The architectural firm (Architect), Johnson Nathan Strohe, designed an apartment building in Denver. The Architect retained MEP Engineering (Engineer) for the design of the building's mechanical, electrical, and plumbing systems. The professional services agreement between Architect and Engineer was drafted by the Engineer and contained a limitation of the Engineer's liability. The actual limitation was straightforward: Engineer's liability for loss or damage was capped at $2000 or twice the fees Engineer had been paid, whichever was greater. This limitation was then described at the end of the clause "as consequential damages and not as penalty" followed by the apparently incoherent phrase "and that is liability exclusive" (sic).

   The apartment building was plagued by problems with its heating and hot water systems. The Engineer designed and implemented repairs that were not adequate. Ultimately the building owner initiated an arbitration with the Architect, resulting in an award of $1.2 million in the owner's favor. The Architect then sued the Engineer for professional negligence, seeking to recover the losses the Architect had incurred in the arbitration.

   The Architect requested a ruling by the district court that the limitation of liability clause was not enforceable because it was "too vague, confusing, and ambiguous to be enforceable." The district court did not agree, holding that the obvious intent was to limit the Engineer's liability, focusing on the clearly stated monetary cap, and concluding that there was only one plausible interpretation of the clause: to allocate risk in the Engineer's favor. The Engineer deposited an amount equal to twice its fee with the court (for disbursement to the Architect), and the court dismissed the lawsuit. The Architect appealed.

   Decision: The Court of Appeals of Colorado concluded that the district court had erred by declaring that the limitation of liability clause was clear and unambiguous. The district court's primary error was failing to analyze or address the "consequential damages" wording in the clause. Courts must review contracts in their entirety, seeking to harmonize and give effect to all provisions.

   "Consequential damages" is a legal term used to describe losses that do not flow directly from an injury. The Court of Appeals pointed out that it was possible that in the limitation clause the drafter had intended to limit consequential damages only, in which case other categories of damages (such as direct damages) were not limited. Or, possibly the drafter had not intended the phrase to have its technical legal meaning, and had assumed that the word "consequential" would broaden, not

narrow, the scope of the limitation. Similarly, the odd "that is liability exclusive" wording may have been a clerical error or perhaps had some meaning that was not plain. In any event, the Court of Appeals concluded that the limitation of liability clause as a whole was ambiguous and would need to be fully examined and its intent determined back in the district court.

The Court of Appeals also issued a ruling on a broader point. The Architect had argued that not only was the limitation of liability clause ambiguous, but also that the limitation of liability clause was an exculpatory clause—and if an exculpatory clause is ambiguous, it must be declared void. If this argument was correct, rather than sending the ambiguous limitation of liability clause back to the district court for a determination of its intent and meaning, the Court of Appeals would instead declare the clause void and the Engineer's liability would be determined without any possible benefit from the clause.

The Court of Appeals held that in Colorado limitation of liability clauses are generally enforceable, are not a complete bar to liability, and do not completely negate the shielded party from responsibility for its negligence. Taken together, this showed that the limitation of liability was not inherently exculpatory and could be enforceable even if found to be ambiguous.

Comment: The limitation of liability clause in question did not appear to be based on EJCDC or other standard limitation of liability clauses. See EJCDC® E-570, Agreement between Engineer and Subconsultant for Professional Services (2020), Exhibit I, Limitations of Liability. Certainly the problematic "as consequential damages" and "that is liability exclusive" phrases are not typical in any way.

Despite the setback of the Court of Appeals declining to enforce the limitation of liability clause, the Engineer here may yet prevail when the clause is examined more thoroughly back in the district court. One plausible outcome is that the district court will find that the intent was to broadly limit liability, and the awkward word choices do not prove fatal to the remainder of the clause. Plainly the Court of Appeals ruling against the notion that the limitation was "exculpatory" was essential to giving the Engineer another opportunity to enforce the limitation.

2. **Issue:** Differing site conditions, delay, breach of implied warranty, withholding superior knowledge, and wrongful termination of U.S. Army Corp of Engineers dredging contract. *Marine Industrial Construction, LLC, v. the United States.* United States Court of Federal Claims (2022).

   Summary: *Marine Industrial* is a dense, fact-laden 58-page decision that addresses numerous issues of interest. This summary will focus on just one of the issues: the project owner's withholding of superior information.

   The 2014 Corps of Engineers contract called for dredging of the Quillayute Waterway (including an adjacent marina known as the boat basin) in La Push, Washington. The waterway is dredged every 2-3 years. The contractor, Marine Industrial Construction, had 60 years of experience as a dredger, but did not have recent experience with the Waterway. Marine was not aware that the 2014 bidding/contract documents were different from previous documents for dredging the Waterway. The Corps had been frustrated by not receiving enough interest from bidders in past years, so it streamlined the 2014 solicitation by (among other things) revising the specifications and removing warnings to bidders about the presence of "sunken boats, fishnets, steel trolling wire, and machinery"—conditions that the reviewing court summarized as "all likely to cause frequent downtime."

   The solicitation for the contract urged bidders to conduct a site visit to inspect the "character, quality, and quantity of surface and subsurface materials or obstacles," but the site visit was not mandatory. Marine Industrial did not inspect the site.

   After the bids were received, the Corps advised Marine Industrial that its low bid was 31% below an independent government estimate, and "significantly lower than all other bids," and therefore asked Marine to verify its bid. Marine did so and the government awarded the contract to Marine. Various delays, weather problems, and dredging issues hampered the contractor's progress, leading the government to issue a cure notice, a show-cause letter, and finally a termination for cause. Marine Industrial sued the government for wrongful termination and the government countersued for damages related to procuring a replacement contractor.

   Decision: During the litigation in the Court of Claims, Marine Industrial contended that the Corps had withheld superior knowledge regarding minimum pipe size for the dredging discharge; debris; log traffic on the Waterway; and clay soil conditions. The claims regarding log traffic and clay were rejected, but Marine was successful in establishing breach of contract based on the government withholding knowledge regarding the pipe size and debris.

To show a breach of contract under the superior knowledge doctrine, the plaintiff must produce specific evidence that it (1) undertook to perform the work without vital knowledge of a fact that affects performance, cost, or duration; (2) the government was aware that plaintiff had no knowledge of and had no reason to obtain such information; (3) the applicable contract specification misled plaintiff or did not put it on notice to inquire; and (4) the government failed to provide the relevant information.

As to minimum dredging pipe size, previous dredging contracts for the Waterway had contained a specification requiring a 12-inch minimum discharge pipe size. This requirement was removed from the 2014 contract, as part of the government's effort to streamline the procurement, increase bidding, move toward a performance-based contract, and avoid dictating the contractor's means and methods. The Court of Federal Claims ruled:

> Once the government sets a minimum requirement for a solicitation, it is not required to maintain that minimum requirement for every subsequent solicitation. Where, however, the government establishes a minimum requirement that it uses for several years—one it identifies multiple times as minimally "sufficient"—and then fails to inform bidders that it has removed the minimum requirement, the government impermissibly withholds vital knowledge.

As to debris, the court rejected the government argument that Marine Industrial could have gained knowledge of the presence of debris in the boat basin by conducting a site visit. In testimony, the government's contracting officer had admitted that a site visit would not have revealed "what is beneath the water." More importantly, in contrast to prior solicitations that had included specific information about substantial man-made debris, the government had informed bidders in 2014 that bidders "may encounter accumulations of forest trash, sunken logs, stumps, and miscellaneous debris….Except as indicated, the government has no knowledge of cables, pipes, or other artificial obstructions or of any wrecks, wreckage, or other material that would necessitate…additional equipment for economical removal." The court stated:

> From a bidder's perspective, if the contracting agency preemptively stated it had no knowledge of such things, then most bidders would exercise their "right to rely on the government's specifications," as it would be highly unlikely any investigation or inquiry on the part of the bidder would reveal any more information. By making such patently false representations, the government must have been

> fully aware plaintiff was without knowledge of the over thirty years of man-made debris and sunken vessels that awaited plaintiff in the boat basin. Plaintiff could not possibly possess knowledge which the on-site contracting agency allegedly lacked…no contractor could have discovered the boat basin contained over thirty years of man-made debris accumulated from its use as a "garbage dump."

The court summarized that "the superior knowledge doctrine imposes upon a contracting agency an implied duty to disclose to a contractor otherwise unavailable information regarding some novel matter affecting the contract that is vital to its performance" (quoting a controlling federal decision on the subject).

Comment: The EJCDC standard documents address owner disclosures regarding site conditions, the presence of hazardous materials, and utilities (Underground Facilities). The superior knowledge doctrine is somewhat broader in scope—disclosure of any information that would be vital to contractor's performance—but as indicated in the Marine Industrial case, this is an implied duty, not typically an express contract provision.

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3. **Issue:** Time limitations on initiating an arbitration proceeding. *Park Plus, Inc. v. Palisades of Towson, LLC and Encore Development Corp.* Court of Appeals of Maryland (2022).

   Summary: Park Plus entered into a contract under which it would furnish and install an electro-mechanical parking system in a luxury apartment building owned by Palisades of Towson. The contract contained an arbitration clause.

   The parking system experienced problems, culminating in a fatal accident. Eventually Palisades sent a demand for arbitration to Park Plus. After discussions between the parties, resistance by Park Plus, and various procedural challenges, Palisades filed a motion to compel arbitration in circuit court in Baltimore. Park Plus argued that the motion to compel was not filed within the three-year Maryland statute of limitations for breach of contract, making the owner's claim untimely. The circuit court agreed that the three-year statute of limitations was applicable, but found that Palisades had acted within the three-year period, making the legal action timely.

   While Park Plus's appeal of the circuit court decision was underway, the parties proceeded with the arbitration. The arbitrator awarded Palisades $3.2 million; the arbitrator also awarded Park Plus $365,677 in fees for maintenance expenses that it had incurred on the owner's behalf.

Decision: The Court of Appeals reviewed multiple arguments by Park Plus "which all boil down to one fundamental proposition: the statute of limitations applicable to Palisades' underlying breach of contract claim should have been applied" to reject the motion to compel the arbitration as untimely. The appellate court conducted an analysis of the legal and equitable aspects of arbitration, and concluded that if an arbitration agreement exists, and does not contain a time limit, then a court of law must enforce the arbitration agreement by ordering the parties to arbitrate—"the court's work is done at that stage." The expiration of a statute of limitations for breach of contract "did not extinguish Palisades' right to arbitrate." By its terms, the statute of limitations applied only to "civil actions at law"—this specific category did not include a motion to compel arbitration.

Comment: This case may alarm readers who have assumed that the applicable statutes of limitations will continue to govern if the parties to a contract include an arbitration clause for resolution of disputes. The decision is not an outlier: other courts have come to a similar conclusion. However, most standard arbitration clauses will take care of the problem in advance by expressly invoking the statute of limitations. For example, the arbitration clause in EJCDC® E-500, Agreement between Owner and Engineer for Professional Services, contains this prerequisite:

> Notice of the demand for arbitration must be filed in writing with the other party to the Agreement and with the selected arbitration administrator. The demand must be made within a reasonable time after the Dispute has arisen. **In no event may the demand for arbitration be made after the date when institution of legal or equitable proceedings based on such Dispute would be barred by the applicable statute of limitations.**

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4. **Issue:** Binding effect on insurance company of representations made in a certificate of insurance. *Security National Insurance Co. v. Construction Associates of Spokane, Inc.* United States District Court (Eastern District of Washington) (2022).

   Summary: Construction Associates of Spokane is a general contractor. An employee of a subcontractor, Merit Electric, was injured on a Construction Associates project and later sued the general contractor seeking damages for the injuries. Construction Associates tendered the lawsuit to Merit Electric's insurance broker, asserting additional insured status under Merit's commercial general liability insurance policy. In support of the tender, Construction Associates presented a certificate of insurance, issued by the broker, showing Construction Associates' additional insured status.

The subcontract between Construction Associates and Merit Electric had required Merit to maintain a commercial general liability policy with stated policy limits, and further required Merit to provide Construction Associates with insurance certificates "naming Contractor as an additional insured." The subcontract did not explicitly require Merit to add Construction Associates (Contractor) as an Additional Insured, and it appears from the record that no endorsement adding Construction Associates was ever issued for the CGL policy in question. The CGL carrier, Security National Insurance, denied coverage, contending that the certificate of insurance informing Construction Associates of its Additional Insured status had been in error and was not binding. The dispute was litigated in federal district court, with the general contractor and the injured worker seeking to compel coverage.

Decision: The federal district court's decision was based on a recent precedential decision by the Washington Supreme Court, *T-Mobile v Selective Insurance Co. of America* (2019). That case had also involved a certificate of insurance. The Washington Supreme Court had reiterated the longstanding general rule in Washington:

> [A]n insurance company is bound by all acts, contracts, or representations of its agent, whether general or special, which are within the scope of [the agent's] real or apparent authority notwithstanding they are in violation of private instructions or limitations upon [the agent's] authority, of which the person dealing with [the agent], acting in good faith, has neither actual nor constructive knowledge.

Based on the *T-Mobile* case, the federal court in the *Construction Associates* case ruled as follows:

> Ultimately the Court finds that the Washington Supreme Court's majority opinion is clear. As it repeats throughout the decision: "An insurance company's agent who makes an authoritative representation binds the insurance company, even when that specific representation is transmitted via a certificate of insurance and is accompanied by general disclaimers."
>
> Enforcing those authorized representations is good public policy: it provides the principal with an additional incentive to ensure that the agent's representations—made in person, on the phone, or in writing—are true.

Comment: Unlike Washington, many jurisdictions (perhaps most) do not view certificates of insurance as binding, instead giving full weight to the standard certificate disclaimers (certificate does not alter the policy, etc.). Regardless of jurisdiction, it is good practice to obtain a copy of the actual policy and endorsement to assure Additional Insured status, coverage limits, and other essential requirements.

The EJCDC documents expressly require that Additional Insureds be named as such, rather than attempting to rely on certificates, and in appropriate situations give specific directions regarding the precise endorsement form to use.

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5. **Issue:** Denial of coverage based on contractor's failure to comply with a subcontractor warranty endorsement in the Commercial General Liability insurance policy. *Baudoin v. American Glass & Mirror Works, Inc.* Court of Appeal of Louisiana (2022).

   Summary: A subcontractor warranty endorsement (also known by various other names, such as "Subcontractor Endorsement" or "Contractor's Special Conditions") is a supplement to a general contractor's commercial general liability (CGL) policy that lists risk-transfer requirements that the insured contractor must meet in its subcontracts. The endorsements sometimes impose harsh consequences, such as nullification of insurance coverage, on general contractors that fail to comply with the endorsement requirements.

   Such was the case on a bridge project in Louisiana. The general contractor, Charles Goudeau General Contractor, was required by a subcontractor endorsement, as a condition precedent to insurance coverage, to obtain an indemnity from each subcontractor; obtain certificates of insurance naming Goudeau as an additional insured under the subcontractor's policy; obtain proof the subcontractor carries worker's compensation insurance; and obtain proof of required licensing. The endorsement also required the contractor/insured to maintain thorough records of compliance with the endorsement requirements.

   When a subcontractor employee was injured on the jobsite, Goudeau's CGL carrier contended that Goudeau had failed to collect the required records (and in particular the Additional Insured status had not occurred). Because a condition precedent had not occurred, the general contractor's CGL carried denied coverage.

   Decision: The Court of Appeal affirmed the trial court's decision that there was no coverage because of the failure to comply with the subcontract endorsement. "Absent a conflict with statutory provisions or public policy, insurers are entitled to

limit their liability and to impose and enforce reasonable conditions on the policy obligations they contractually assume."

Comment: An IRMI (International Risk Management Institute) article about the Baudoin/Goudeau case provides sound advice to contractors regarding such endorsements:

> Contractors and their insurance representatives should be on the alert for this type of endorsement and ensure that all requirements are fair and feasible and that penalties for noncompliance are equitable. For example, instead of a complete bar of coverage, a more reasonable penalty would be paying a higher rate on the value of noncompliant subcontracts.

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6. **Issue:** Status of arbitration award if arbitrator was noticeably drowsy or asleep during the arbitration hearing. *Loren Imhoff Homebuilder, Inc. v. Taylor and Cuevas.* Supreme Court of Wisconsin (2022).

   Summary: Eight months into a residential construction project the homeowners and the contractor were at odds regarding the quality of the work and alleged "discrepancies" in the contractor's invoices. After an unsuccessful mediation, the dispute was arbitrated. Following a five-day evidentiary hearing, the homeowners objected to the proceedings, complaining that the arbitrator had shown bias toward the contractor, and had repeatedly fallen asleep, including during the presentation of evidence by the homeowners. The arbitrator denied the homeowners' motion that he recuse himself from the proceedings, and issued an arbitration award of $320,000 in favor of the contractor.

   In subsequent circuit court proceedings to enforce the arbitration award, the court took testimony from the parties themselves and from the attorneys who had participated in the arbitration (but apparently not from the arbitrator himself). The circuit court found credible evidence that the arbitrator had "glazed eyes, haziness, drowsiness, and sometimes went into a state of outright sleep." The circuit court concluded that the homeowners had "satisfied their burden by clear and convincing evidence that the arbitrator so imperfectly executed his power that an [enforceable] award upon the subject was not made." The circuit court remanded the case for a new arbitration of the dispute with a different arbitrator.

   The contractor appealed this decision, to the court of appeals, which reversed, holding that by waiting until the end of the hearing to object, the homeowners had forfeited drowsiness or sleeping by the arbitrator as a basis to vacate the award. The

issue was appealed again, this time by the homeowners, resulting in a review by the Wisconsin Supreme Court.

Decision: The Wisconsin Supreme Court held that because the homeowners had raised their objection before the arbitrator issued the award—before the merits of the dispute were decided—the homeowners had not forfeited their right to object.

> The policy goals underlying forfeiture are protected and the fairness of the proceeding is preserved. Before the award is issued, the arbitrator can reopen testimony to hear or rehear testimony and to correct any perceived errors without resorting to the appeals process.*** Here, the homeowners raised their objection to the arbitrators sleeping to him before he issued the arbitral award. Even though it was after the evidentiary hearing was completed, there remained the opportunity for the arbitrator to make corrections for his sleeping during the evidentiary hearing. However, he failed to do so. Therefore because the homeowners raise their objection before the issuance of the arbitral award we conclude that the issue was not forfeited and was preserved for review by the circuit court.

In making its decision, the court noted that the rules of the arbitration did not include requirements regarding when to make an objection. By contrast, in judicial proceedings various specific rules may apply, and "case law directs a general rule that failure to contemporaneously object to an issue may result in forfeiture of the argument on appeal...." The greater latitude given to the parties in arbitration is often perceived as a benefit of this form of dispute resolution, allowing more focus on substance and fewer worries about procedural traps: "Arbitration often is selected in order to escape the formalities inherent in a judicial process."

Comment: Every construction lawyer is lectured at some point by a judge or mediator about the risks of taking a complex technical dispute to a jury: "It's your client's right to take this to trial, but I am warning you that you are going to put the jury to sleep." There has always been less concern on that score in placing a dispute before an arbitrator or arbitration panel, because the arbitrators typically spent their careers in the same industry and shouldn't find it boring—but in this case we observe that there are always exceptions to the rule.

The case contains a good analysis of forfeiture, waiver, and procedural rights in arbitration.
