



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

June 2016

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

hugh.anderson@aecddocuments.com

The following case summaries and comments are general in nature and should not be taken as legal advice or counsel. The summaries and comments are solely the views of the author based on a preliminary review of the cited cases. The contents of this document do not represent the official position of EJCDC, its sponsoring organizations, or its members, on any topic.

© 2016 American Council of Engineering Companies, National Society of Professional Engineers, and American Society of Civil Engineers. All rights reserved.

1. **Issue:** Project Owner’s right to pursue claims directly against Engineer’s subconsultant. *City of Whiting v. Whitney, Bailey, Cox & Magnani, LLC*. United States District Court, Northern District of Indiana (2015).

Summary: The City of Whiting, on Lake Michigan, retained Structurepoint as its consulting engineer on a lakeshore park, marina, and shoreline protection project. Structurepoint in turn retained WBCM as a subconsultant for portions of the professional services. WBCM designed a shoreline revetment structure armored with stone. According to the city, during and after construction the revetment failed on three occasions, with much of the armor stone being washed away, and damage to the new pavilion, gazebo, and fishing pier. The city linked these failures at least in part to confusion in the design regarding actual water depth and the correct mud-line for design purposes.

Structurepoint and the city entered into an agreement in which Structurepoint assigned its claims against its subconsultant to the city (we can speculate that this was the result of a settlement or payment by Structurepoint, but the published decision does not discuss the reason) and the city agreed to not pursue Structurepoint for the design errors attributed to the subconsultant. The city then embarked on a lawsuit against WBCM based on the assigned claims, and on the city’s own direct claims.

Decision: The reported decision is made at a preliminary stage based on the pleadings (primarily the city’s complaint) in the case. WBCM seized on the point that the city referred in the complaint to recovery of the city’s own damages in connection with the assigned claims—whereas technically under an assigned claim the assignee (the city) is pursuing the damages of the assignor (Structurepoint), not the assignee’s own damages. The court rejected this point, holding that under federal pleading rules there was no basis for dismissing a complaint based on an “imperfect” statement of the legal theory of recovery.

WBCM also argued that because the assignment contained a commitment that the city would not pursue Structurepoint, there was no claim to assign. The court held that contract claims are legally assignable, and that the specific assignment was valid.

The court next examined the city’s direct (not assigned) claim under a third-party beneficiary of contract theory. The court concluded that the claim could proceed for the time being, because there was no “no third party beneficiary” clause in the contracts, but indicated that WBCM could pursue discovery as to the parties’ intent regarding third-party beneficiaries.

As to the city’s direct negligence claim against WBCM, the parties and the court acknowledged the possible bar of the economic loss doctrine, but the court held that the pleadings suggested possible damage to other city property (other than the

failure of the project itself), which would constitute a limited exception to the bar of the economic loss doctrine, and that this point could be explored as the case moved forward.

Comment: The EJCDC contracts contain express “no third party beneficiary” clauses. The standard subconsultant agreement, E-570, disclaims that it is creating a duty to Owner.

The EJCDC agreements also limit assignments of rights. A point for future policy discussion would be whether the documents should make it easier for an intermediate party such as the Engineer or Contractor to assign rights in the event of a claim.

The prime engineering contract was described as using the “Short Form of Agreement”—possibly EJCDC® E-520.

- 2. Issue:** Obligation of Commercial General Liability insurance carrier when the insured has settled a claim without notice to, or involvement of, insurance carrier. *Travelers Property Casualty Company v. Stresscon Corporation*. Supreme Court of Colorado. (2016).

Summary: After a serious crane accident on a construction project, the general contractor, Mortenson, sought delay damages from its concrete subcontractor, Stresscon. Stresscon notified its Commercial General Liability insurance carrier, Travelers. After a period of inaction, Mortenson and Stresscon agreed to a settlement, and Stresscon paid Mortenson the settlement amount. Stresscon subsequently sought damages from its crane subcontractor, and indemnification of the settlement amount against Travelers.

Traveler’s moved for summary judgment based on a fundamental clause in the insurance policy, the “no voluntary payment” clause. That provision states that an insured must secure the insurance company’s consent before making a payment or taking on an expense with respect to the claim at issue—the policy states that if such a payment is made voluntarily, without the insurance company’s consent, it is at the insured’s cost and will not be covered by insurance.

The trial court and Colorado’s intermediate court of appeals both held that a recent Colorado insurance case, *Friedland*, had created a requirement that the insurance company establish that it had in fact been prejudiced by the voluntary payment, and thus refused to grant Traveler’s motion for summary judgment. Traveler’s appealed to the Supreme Court of Colorado.

Decision: The Supreme Court of Colorado reversed the lower court rulings. The high court stated that its *Friedland* decision applied only to the issue of an insured's failure to give timely notice of a claim to its insurer. In such a situation, the court must determine whether there was actual prejudice to the insurer as a result of not receiving prompt notice. With respect to the no-voluntary-payments clause, a violation goes to basic contractual (policy) rights of the insurance company: the right to defend against third-party claims, and the right to negotiate settlements. The court held that the no-voluntary-payment clause affected the scope of coverage: voluntary payments are not covered. For that reason, the issue of prejudice was not relevant.

Another distinction drawn by the Colorado Supreme Court was that failure to give timely notice of a claim will often occur as the result of inadvertence, whereas making a settlement payment is an affirmative act that cannot happen as an accident or innocent omission.

Comment: The insured subcontractor in this case may have been frustrated that the matter was not being resolved promptly, or that it was not receiving help and cooperation from the insurer; and the sub may also have been concerned about its relationship with Mortenson, or about other project issues or payments. Taking direct action to negotiate a settlement, possibly a favorable settlement, was understandable, but obviously placed the recovery of insurance proceeds at risk.

3. Issue: Engineering/Architecture firms' exposure to liability for scaffold collapse. *McKean v. Yates Engineering Corporation*. Court of Appeals of Mississippi (2015).

Summary: This case presents a host of issues, some of which will be listed in bulleted form at the end of the Comment below. The focus of the summary will be on the potential liability of the project architect and the contractor's engineering consultant for injuries that occurred when a scaffold collapsed.

The hospital project was underway when the contractor, Yates Construction, determined that it needed engineering guidance on the construction of scaffolding and concrete formwork above the first floor. Yates Construction retained Yates Engineering for this purpose. Yates Engineering prepared a scaffolding design that was fundamentally flawed. It called for use of 24-foot long 4x4 posts, which were not commercially available. Without seeking clarification or redesign from the engineering consultant, Yates Construction proceeded to construct the scaffolding

by stacking shorter 4x4 posts end to end, and splicing them together with strips of plywood. An expert later characterized this as “an invitation to catastrophic splicing failure” of the entire scaffolding. And catastrophically fail it did, resulting in injuries to four workers. (The contractor also used 1x4 bracing, rather than the design’s 2x4 bracing; this downgrade in materials may have contributed to the collapse.)

The four workers were employees of the contractor, and thus restricted to their worker’s compensation benefits and barred from any other claim against the contractor. They sought recovery of additional injury damages from Yates Engineering and from the project architect. After the trial court granted summary judgment in favor of the two design professional firms, the plaintiffs appealed.

Decision: The Court of Appeals of Mississippi affirmed the lower court decision. Based on the unrefuted evidence, the court concluded that Yates Construction had not followed the design prepared by Yates Engineering. Thus, the court reasoned, even if the Yates Engineering design was defective and in fact unbuildable, it was not the cause of the accident. The court emphasized the fact that Yates Construction never asked Yates Engineering to clarify the problem of the need to use shorter 4x4 posts, or gave Yates Engineering the opportunity to design a structurally sound splice or alternative. Nor did Yates Construction ask the engineering consultant about the possible effects of using 1x4 rather than 2x4 structural bracing.

The appellate court also rejected the argument that Yates Engineering had a duty to inspect the construction. The court noted the lack of a contract provision requiring Yates Engineering to inspect, and found no evidence in the record that Yates Engineering by its conduct had taken on safety or site inspection duties.

The project architect had entered into an AIA Owner-Architect agreement that contained standard industry provisions indicating that the architect did not have responsibility for site safety or the contractor’s means and methods of construction. The court of appeals held that the scaffolding was a “means” of construction and therefore not the architect’s responsibility. The court noted that under the AIA provision giving the architect periodic site visit duties, it was clear that the duties pertained to what was being built under the Contract Documents—which did not include scaffolding.

Comment: The owner and contractor did not have a written contract, despite the fact that this appears to have been a substantial project. Perhaps more understandably, it appears that there was no written contract between Yates Construction and Yates Engineering. Written terms and conditions might have simplified the resolution of issues, as was the case for the claims against the architect, which was working under a standard form contract.

The conclusion that the contractor's engineer is exonerated from liability because the contractor did not follow the defective design has merit, but the dissent in the case argued that the question of whether the collapse was a direct result of the consultant's failure to deliver a viable scaffold design was a question that deserved to go to an ultimate fact-finder (jury).

Some other points from the case:

- The claims of one of the plaintiffs were rejected because of his immigration status.
- The architect successfully excluded affidavit testimony by an expert who opined that the architect had inspection duties regarding the scaffolding, because the expert was an engineer, not an architect.
- Yates Construction began work on the scaffolding before receiving the scaffolding design.
- There were possible questions of fact as to whether Yates Engineering did in fact inspect the scaffolding during construction, including conflicting evidence from statements made to OSHA.
- The plaintiffs contended that it was negligence for the owner to not enter into a written contract with the contractor.

4. Issue: Exceptions to statute of repose. *Miron v. MNI, Inc.* Court of Appeals of Wisconsin (2016).

Summary: Alan Miron was a laborer for a company hired by Target to demolish a store in Milwaukee. During demolition in 2011, a fixture wall fell on and injured Miron. An investigation showed that a wall cleat intended to hold the fixture wall in place had been screwed into drywall, rather than into the wood frame backing behind the drywall. Miron brought a lawsuit against MNI, the contractor that had built the fixture wall in 2000.

Wisconsin has a statute of repose that bars construction-related claims made more than 10 years after substantial completion of the project. There are a few exceptions in the statute, including exceptions for misrepresentation, concealment, or fraud with respect to a deficiency or defect. The plaintiff, Miron, acknowledged that more than 10 years had passed, and therefore attempted to avoid summary judgment by contending that one of the exceptions applied.

Miron argued that: MNI had promised in a proposal to perform the work in a workmanlike manner—but had failed to do so; had submitted payment applications that falsely purported that the work had been performed satisfactorily; and should

have known of the substandard installation of the cleat and therefore must have concealed it. The trial court rejected all these arguments and issued summary judgment based on the statute of repose.

Decision: The Wisconsin Court of Appeals affirmed the trial court decision. In part, it concluded that although there was evidence of the condition of the cleat (not attached to wood) in 2011, there was no evidence of its condition in 2000, and no evidence of any concealment. The court also held that a promise to perform cannot be categorized as a misrepresentation: the concept of misrepresentation is based on existing facts, not future actions. Finally, of most interest, the court held that if submitting payment applications, or for that matter breaching the implied covenant to perform the work in a satisfactory manner, could be construed as “misrepresentations,” then contractors would never be able to enjoy the protections of the statute of repose. The arguments put forward by the plaintiff would “eviscerate the intent of the statute of repose and lead to absurd results.”

Comment: By their very nature, statutes of repose protect wrongdoers as well as the innocent. One important basis for the statute of repose is the idea that it is usually impossible to have a fair adjudication of an issue many long years after the project was completed. Another purpose is to reduce uncertainty and exposure, for the sake of the orderly conduct of business planning and transactions. This might result in some unfairness in individual cases, but serves a more general beneficial public purpose.

-
5. **Issue:** Engineer’s exposure to contractor claims. *Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl,, LLP*. Court of Special Appeals of Maryland (2016).

Summary: Design-bid-build City of Baltimore wastewater treatment plant upgrade project. The engineering firm Rummel Klepper & Kahl prepared the design and project timeline estimates. Fru-Con Construction (predecessor to Balfour Beatty Infrastructure) was the successful bidder. BBI ultimately filed a \$10 million lawsuit against RKK, alleging negligence and similar tort claims based on contentions that BBI had experienced delays and complications as a result of errors in the design, and that BBI had relied to its detriment on flawed timeline projections. BBI stated that RKK was aware that BBI and other bidders would rely on the design and schedule documents, and that therefore the engineer owed a duty to the bidders. BBI asserted that although there was no contract between BBI and the engineer, that nonetheless an “intimate nexus” existed between the two during the project, tantamount to a direct contract.

The engineering firm filed a motion to dismiss, arguing that the losses that BBI sought to recover were purely economic in nature and therefore could not be

recovered in a tort action under Maryland law. The trial court granted the motion to dismiss, and the contractor appealed.

Decision: The Maryland Court of Special Appeals affirmed the dismissal of the contractor claims in a very thorough decision. The court held that in Maryland, in the absence of privity of contract, death, personal injury, property damage, or the risk of personal injury or death, there is no duty of care by an architect or engineer to a contractor. The court rejected the proposed “intimate nexus” argument.

The court noted that in construction, contracts allocate the risks and provide mechanisms for bringing claims. The economic loss doctrine forces the parties to pursue rights under the applicable contracts, rather than under a negligence/tort theory. The court discussed the rights that contractors enjoy under the Spearin Doctrine, under which the contractor may rely on the soundness of the design that it is required to follow, and may bring a breach of warranty claim against the owner if the design is flawed.

In rejecting the “intimate nexus” idea, the court remarked on the beneficial aspects of insulating the engineer from contractor claims, especially on public projects. Exposing the engineer to tort liability would “create a chilling effect on the design professional’s neutrality and ability to communicate effectively” regarding the project, especially in regard to public safety. The court also reiterated the importance of the written contracts and case law providing remedies to contractors—factors not found in other contexts in which the intimate nexus rule had been enforced (such as accountants’ duties to certain third parties).

Comment: As the Maryland court noted, there are a few jurisdictions where the courts have recognized an equivalent to privity of contract in certain situations. For example, there are Ohio cases from the 1990s that held that if the design professional supervises the work, or exercises excessive control over the contractor (for example, stop work orders), then the relationship would be deemed the equivalent of having a direct contract relationship. The EJCDC contracts create a limited, arm’s length role for the engineer that avoids the “intimate nexus” problem.

Maryland is in the ranks of states that strongly support the economic loss doctrine as a defense by design professionals against contractor claims. As discussed in other case summaries over the years, the status of the economic loss doctrine is ambiguous in some states, and in some states contractors are relatively unrestricted in their ability to assert claims directly against design professionals.

6. **Issue:** Additional insured status, if contract merely requires being named as an additional insured on a certificate of insurance. *Old Republic Insurance Company v. Gilbane Building Co.* (2014); and *West Bend Mutual Insurance v. Athens Construction Co.* (2015); both Illinois Appellate Court.

Summary: Subcontractors' commercial general liability policies in the two cases indicated that if the insured entered into a written contract that required that other parties (for example, the Contractor and the Owner) be added as additional insureds, the policies would do so. However, the subcontracts in question merely required that Owner, Contractor, and others be listed on a certificate of insurance submitted to the Contractor. The subcontractors did submit certificates that listed the required parties, but the certificates contained numerous standard disclaimers about their legal impact.

When claims arose, the insurance companies took the position that the written contracts did not require adding the Owner, Contractor, and others as additional insureds. In the absence of this triggering condition, the insurers argued that the parties had never been added as additional insureds, and pointed out the disclaimers in the certificates.

Decision: In both cases, the Illinois Appellate Court ruled that the subcontracts' requirement to submit a certificate listing additional insureds did not satisfy the insurance policies' specific requirement that the subcontracts state that a party shall be added to the policy as an additional insured. The court also acknowledged the limited legal force and effect of the certificates of insurance, which state that they are informational only; that they confer no rights on the recipient; that they do not alter or expand the rights under the policy; and that the policy must be "endorsed" to add an insured.

Comment: The EJCDC contracts properly state that the identified additional insureds must be added to the policies. Certificates of insurance are required, but are treated as informational, not as the core means of establishing insurance coverage.

Even though the subcontracts in the Illinois cases did not state the requirement as plainly as they might have, nonetheless based on the case reports it seems obvious that the subcontracts were requiring the addition of insureds to the policies, even if they approached it from the perspective of submitting the confirming certificates.

The construction industry faces several ongoing issues arising from additional insured requirements, and from insurance requirements generally. There are several pending concerns regarding the substantive content of additional insured endorsements. There is often uncertainty on the part of upstream parties, such as owners and contractors, as to the extent of the protection they will receive from an underlying policy. And the limitations inherent in the standard certificates of insurance are well documented—yet the alternatives, such as a professional analysis of the actual contents of required policies and their endorsements, are inefficient and burdensome.

- 7. Issue:** Economic loss doctrine and engineering-related issues. *Ric-Man Construction, Inc. v NTH*. Michigan Court of Appeals (2016).

Summary: This is a pending case in the Michigan Court of Appeals. The trial court ruled that the economic loss doctrine did not apply as a defense to the engineering firm, and that issue is a major point in the appeal. ACEC and the other sponsoring organizations are monitoring the case.