



RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

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1. **Issue:** Enforceability of liquidated damages of \$700/day. *Boone Coleman Construction, Inc., v. Village of Piketon, Ohio*. Supreme Court of Ohio (2016).

Summary: The EJCDC case summary of February 2015 reviewed the Ohio Court of Appeals decision in this case, noting that the case had been appealed to the Ohio Supreme Court. The 2016 decision of the Ohio Supreme Court reverses the Court of Appeals decision.

The case arises from a modest public works project for construction of a traffic signal and related intersection improvements, at a stipulated price of \$683,300. Based on excerpts in the appellate decisions, the construction contract appears to include EJCDC® 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 contractor filed a lawsuit against the village seeking to enforce the contractor’s claims for additional time and compensation. The village countered with a demand for enforcement of the liquidated damages clause. The trial court ruled in favor of the village on both issues, and the contractor appealed. 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.

Somewhat surprisingly, however, the Court of Appeals ruled in favor of the contractor with respect to liquidated damages. The 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.

The liquidated damages issue was appealed to the Ohio Supreme Court.

Decision: The Supreme Court of Ohio reversed the Court of Appeals, and issued a strong decision in favor of the enforceability of liquidated damages provisions on

public works projects. Among the court's conclusions favoring liquidated damages (LDs):

- By agreeing to LDs, the parties avoid controversy over the amount of damages
- An LD clause is an advance settlement of damages from a future breach in meeting the completion deadlines
- The law should not look with disfavor on LD provisions (citing a 1948 U.S. Supreme Court decision)
- LD clauses promote prompt performance of contracts
- If the LD amount is a "genuine covenanted pre-estimate of damages" that is not a punishment for default, it is enforceable
- It is uniquely difficult in public works construction to calculate damages to the public interest, making it advisable to agree to damages in advance
- Delays in public projects result in inconvenience, increased costs, and loss of use to the public
- LD clauses that establish a rate (daily, weekly) are especially favored, compared with lump-sum LD clauses
- The Court of Appeals wrongly focused on the total amount of LDs—the focus should have been on the reasonableness of the per diem amount
- The LD rate must be reasonable, but does not need to bear an exact relation to actual damages
- The analysis of an LD clause must be prospective (looking forward from the point when the contract was formed, based on facts known at that time) rather than retrospective (focusing on aggregated damages after the fact)

Comment: The Ohio Supreme Court made some pointed comments in its decision. It labeled the Court of Appeals fixation on the aggregate damages as "myopic." It concluded that looking at the aggregate amount would lead to a "perverse rule of law" that would result in short delays being assessed liquidated damages, but not more egregious lengthy delays. The intermediate court was also chided for not enforcing the plain terms of the contract, but rather undertaking "to be wiser than the parties."

As noted in 2015, the Piketon dispute does raise a worthy point in asking what basis the owner had for the \$700 rate. The Ohio Supreme Court decision supports the decision by pointing out many published public works cases in which the daily rate was similar. Nonetheless, EJDC strongly encourages owners (and their engineering consultants) to establish a daily damages rate using reasonable criteria, and to carefully document the reasoning. Such documentation in the Piketon case might have carried the day at the Court of Appeals level, despite the large total.

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

As a footnote, the case includes a citation to an 1822 U.S. Supreme Court case on liquidated damages for delay. The decision was written by the one of our country's most preeminent jurists, Chief Justice John Marshall. It is interesting to learn that the contract drafters of the early 19th century were already using liquidated damages provisions.

- 2. Issue:** Contractor's obligation to comply with recommendations in a geotechnical report, and entitlement to rely on a change order issued in response to a request for clarification. *Maines Paper & Food Service, Inc. v. The Pike Co., Inc.* Appellate Division, Third Department, New York (2016).

Summary: The contractor, The Pike Co., constructed a supermarket in Ithaca, New York. After completion the floor of the new building settled substantially. The owner, Maines, sued the contractor for breach of contract and breach of warranty.

The owner had provided a copy of the geotechnical report for the project to the contractor. The report stated that a slab-on-grade concrete floor could be constructed, but recommended that the foundation slab not be connected to the pile caps. The project design did not show the slab being tied into the pile caps. The contractor submitted a request for clarification, essentially seeking confirmation that the pile caps and slabs should not be connected. As a result of the inquiry, the architect issued a drawing and related change order directing the contractor to add rebar reinforcement to tie the pile cap, slab, and certain columns to each other, to "provide additional lateral support for the pile caps."

Based on uncontested evidence that the contractor had constructed the building in accord with the design, as modified by the change order, the contractor sought summary judgment dismissing the case. The owner opposed the dismissal, primarily based on the geotechnical report, which had advised against connecting the floor slab to the pile caps. The owner faulted the contractor for not pointing out the conflict between the recommendation in the report and the design, as modified.

The trial court granted the motion for summary judgment, and the case was appealed.

Decision: The appellate court agreed with the trial court that the motion for summary judgment should be granted, and the case against the contractor dismissed. The court concluded that the geotechnical report was not a contract document. The contract had allowed for specific parts of the report to be adopted as

contractual requirements, but this procedure had not been used with respect to the floor and pile cap recommendation. The contract also required the contractor to conduct a careful review of the contract documents, but the court decided that this review was for the purpose of facilitating construction, not to provide professional services in analyzing the design. The court rejected the notion that based on its awareness of the geotechnical report recommendation, the contractor should have challenged the flawed directive to tie the slab and pile caps together, pointing out that a duty to report known conflicts with other contractual requirements existed, but the duty did not extend to the geotechnical report. Finally, the court concluded that the issuance of a definitive change order in response to the RFC eliminated any further issues about design intent or the floor slab issue.

Comment: As in the supermarket case, a project conducted using the EJDC documents would not make a geotechnical report a contract document. EJDC does provide for the designation of portions of the geotechnical report as “Technical Data” that Contractor can rely on, somewhat parallel to the ability in the supermarket contract to designate portions of the report as contract documents. However, the recommendation about not connecting the slab and the pile caps should have been viewed not as potentially reliable site data, but rather as advice that the design professional should consider in preparing the design.

EJDC makes Contractor responsible for reviewing the Contract Documents and noting conflicts and errors, but there is no requirement to challenge the sufficiency or wisdom of the design. It is worth considering whether the requirement in 3.03.A.2 that Contractor report any conflicts between the Contract Documents, on the one hand, and various external items such as applicable laws or reference standards, on the other, should be expanded to include a duty to report conflicts with other external documents such as the geotechnical reports prepared for the project.

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- 3. Issue:** Contractual allocation of risk regarding underground facilities. *J.F. Allen Corporation v. Sanitary Board of City of Charleston, West Virginia*. Supreme Court of Appeals of West Virginia (2016).

Summary: \$5 million municipal sewer project. J.F. Allen, the contractor, brought a breach of contract claim against the owner, alleging that during construction the contractor encountered 122 unmarked or mismarked underground utilities, resulting in delay and additional costs, and also contending that the owner allowed other contractors to conduct work that interfered with Allen’s work.

At a preliminary stage in the lawsuit, the owner moved for dismissal based on lack of written notice of claim, and on the argument that the construction contract

allocated the risk of underground facilities to the contractor. The trial court granted the motion to dismiss, and the contractor appealed.

Decision: The court of appeals allowed the contractor’s case to continue, reversing the lower court’s dismissal.

The construction contract contained an “Underground Facilities” clause very similar to the provisions of what is currently Paragraph 5.05 of the EJCDC Standard General Conditions (C-700). The appellate court concluded that the trial court had erroneously ignored the terms of this clause, which allows for an adjustment in contract time and contract price if the contractor encounters an underground facility that is not shown on the drawings, or not shown accurately.

The appellate court also determined that although the contractor had not filed timely formal notices, it was possible that the owner had received adequate actual notice of the contractor’s underground facilities claims. The pleadings alleged that the owner’s representative had documented each subsurface incident, and that the owner had waived strict compliance with many other procedural provisions of the contract. If proven, such allegations might be sufficient to overcome the lack of formal notice.

Comment: The EJCDC Underground Facilities clause makes clear that the contractor is entitled to additional compensation and time for the cost of contending with unmarked and mismarked utilities at the jobsite. However, it is possible that a reader unfamiliar with the Underground Facilities clause might focus on the parts of the clause that emphasize the contractor’s responsibilities for the safety and protection of all utilities—but that responsibility is not uncompensated.

According to the somewhat abbreviated written decision, the contractor did not begin to pursue its claim until after receipt of final payment. Most construction contracts, including EJCDC® C-700, indicate that final payment closes the opportunity for contractor to make claims. The written decision does not mention whether this sewer contract contained such a clause, or whether there were factors that allowed for post-payment claims.

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- 4. Issue:** Is a contractor’s deliberate decision to install flooring, despite knowing that the underlying slab was still emitting a high level of moisture, an “occurrence” that is covered under a commercial general liability insurance policy? *Navigators Specialty Insurance Company v. Moorefield Construction, Inc.* Court of Appeal of California, Fourth Appellate District (2016).

Summary: Construction of a Best Buy store in Visalia, California. Based on test results, the contractor, Moorefield, knew that the concrete floor was emitting high amounts of moisture at the time that vinyl and carpet floor tiles were ready to be installed. The specifications did not allow such installation to occur until the moisture levels dropped to a specified threshold. Nonetheless, after discussion with owner representatives, the contractor proceeded with installation. The contractor gave its flooring installation subcontractor a waiver of liability for the high moisture conditions. Later, much of the flooring failed, as a result of the moisture preventing adequate adherence.

The dispute regarding the failure of the flooring and related costs was ultimately resolved in a mediation. The contractor's commercial general liability insurer agreed to make a \$1 million contribution to the \$1.3 million settlement, but had reserved its rights to seek reimbursement of its contribution from the contractor (insured). The insurance company contended in a lawsuit that the contractor's decision to plunge ahead with the flooring work was not an "occurrence" under the insurance policy. The trial court held that the deliberate decision to install the flooring was not an "occurrence" and required the contractor to reimburse the \$1 million to the insurance company. An appeal followed.

Decision: The Court of Appeal agreed that the flooring failure was not an occurrence. The court noted that an occurrence is "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." In California, an accident does not occur when there is a deliberate act, unless some "additional, unexpected, independent, and unforeseen happening" occurs, producing the damage. No such factors were present in this situation.

The contractor argued that although it knew that moisture levels were high, based on extensive past experience it did not think that the flooring would fail, and thus the subsequent failure was an unforeseen happening. However, the Court of Appeal concluded that a mistake of fact or law does not convert an intentional act into an accident. In addition, the appellate court surmised that the trial judge may have discounted the contractor's testimony on this score, noting that the contractor's credibility had been damaged by reports that it had purged its files of unfavorable evidence.

Comment: Obtaining CGL coverage of construction defect claims is challenging. This case focuses on one narrow issue, but many other factors typically come into play. At its core, CGL insurance is not intended to cover poor workmanship or poor decision-making, though many exceptions do allow coverage for defects.

5. **Issue:** May a general contractor avoid obligations to a subcontractor because that sub is not licensed in the location where the work occurs? *U.S. Pipelining LLC v. Johnson Controls, Inc.* United States District Court for the District of Hawaii (2016).

Summary: The owners' association of a large Maui condominium complex retained Johnson Controls as the general contractor for the renovation of infrastructure at the complex, including HVAC, the central cooling plant, solar energy, plumbing, and the sewer system. Johnson Controls ultimately retained U.S. Pipelining LLC, a specialist in rehabilitating damaged and worn out building piping, as one of the project subcontractors.

The subcontract contained a routine clause requiring U.S. Pipelining to be licensed to perform the work. As the work progressed, various disputes arose between the general and the sub about the baseline condition of the piping, extra work, delays, and compensation. When the sub presented invoices totaling more than a million dollars for the extra work, the contractor raised the issue of whether the sub was properly licensed, and contended that under Hawaii law contractor had no duty to pay the sub if it was unlicensed. The dispute eventually reached federal court in Hawaii.

Hawaii law does require licensing of contractors and subcontractors. U.S. Pipelining admitted that it was not licensed in Hawaii—it presented some evidence that there was supposed to be an arrangement under which it would work under the license of another project contractor. The licensing law indicates that an unlicensed contractor is precluded from suing for payment for services. The sub argued that this restriction applied to claims by unlicensed contractors against members of the general public, but did not apply to bar claims by an unlicensed contractor against a fellow contractor.

Decision: The federal district court reviewed various Hawaii court decisions regarding the licensing law, as well as the legislative history of the law and case law from other states, and concluded that the purpose of the licensing law is to protect the public against dishonest, fraudulent, unskilled, and unqualified contractors. The court held that the purpose of the law does not exist when dealing with claims between contractors. It found that the legislature had intentionally referred to the general public and contractors in “dichotomous, mutually exclusive terms”—thus if the legislature had intended to protect contractors, it would have done so in express statutory wording. The court concluded that the statute should not be transformed into an “unwarranted shield for the avoidance of just obligations.” Therefore U.S. Pipelining’s case against Johnson Controls was allowed to proceed.

Comment: The rule in the Hawaii case is not unusual, but would not necessarily occur in every jurisdiction. Providing services without proper licensing poses many

risks. The case focuses on the licensing statute, and does not discuss the possible implications of the breach of the contract clause requiring licensing.

6. **Issue:** Procedural compliance with certificate of merit statute. *Otak Nevada, LLC v. Eighth Judicial District Court* (2011).

Summary: Over a dozen states have certificate of merit statutes. These laws require that a lawsuit against a design professional be accompanied by a certificate from a fellow design professional (or sometimes from an attorney) stating that the malpractice claim has a reasonable basis in law and fact. Some states, such as Nevada, also require the submittal of a detailed report in support of the accusations. The intent of certificate of merit statutes is to discourage frivolous and meritless claims against design professionals.

The Otak case involves a death and personal injury claim arising from a traffic accident. The plaintiffs filed suit against the general contractor allegedly responsible for defects in street improvements that caused or contributed to the injuries and death. The general contractor then filed a third-party complaint against the project's "design architect," Otak. The initial third-party filing was not accompanied by a certificate (affidavit) or a supporting report. The general contractor realized that it had not met the requirements for a claim against a design professional and promptly submitted an amended complaint that was buttressed by the required certificate and report. Subsequently, other parties attempted to assert claims against the design professional, and tried to "piggy back" on the general contractor's certificate and report.

The design professional contested the validity of the claims against it, based on failure to comply with the certificate of merit statute. The issue was ultimately submitted to the Supreme Court of Nevada.

Decision: The Supreme Court of Nevada ruled in favor of the design professional. The court held that the general contractor's claim was void from the outset, because of the failure to include the certificate and report. This procedural defect was deemed to be fatal—no correction or amendment could occur. The court also held that each party making a claim against a design professional must submit its own certificate and report, and could not satisfy the certificate of merit requirements by attempting to adopt the certificate or report of another party.

Comment: Some design professionals seek to insert requirements similar to those in certificate of merit statutes into professional services agreements and construction contracts, in an attempt to thwart meritless claims as a matter of contract. Doing so provides protection against claims in states that do not have certificate of merit statutes, or have statutes that are not as strict or strictly enforced as the Nevada statute. The other parties to such contracts tend to oppose inclusion of such clauses.