



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

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1. **Issue:** Did the payment bond issued for a design-build project provide protection to an engineering subcontractor? *Aztec Engineering Group, Inc. v. Liberty Mutual Insurance Company*. United States District Court, Southern District of Indiana (2017).

**Summary:** Aztec Engineering Group provided design services for the upgrade of 21 miles of state highway near Bloomington, Indiana, under a professional services subcontract with design-builder Isolux-Corson. Isolux-Corson's work was in turn part of a Public Private Partnership to "design, build, finance, operate and upgrade" the highway. The design-build contract between the project's Developer and Isolux-Corson required the design-builder to furnish performance and payment bonds.

As the project progressed, Isolux-Corson fell behind in its payments to Aztec. Aztec ultimately filed a lawsuit in federal district court against the payment bond surety, Liberty Mutual, seeking \$4.6 million in unpaid (and uncontested) fees. Liberty first asserted that the arbitration clause in the professional services agreement required that the claim be sent from federal court to arbitration; the court rejected that assertion, noting that the claim was made under the bond (which did not have an arbitration requirement, and did not reference or incorporate the professional services agreement), not under the professional services agreement. The case was then decided based on summary judgment motions by both the surety and the unpaid engineering firm. The primary issue was whether the payment bond provided recourse to unpaid design professionals.

**Decision:** The District Court held that Aztec Engineering was eligible to collect on the payment bond, rejecting both arguments made by the surety. The first argument was that Indiana public private partnership law did not require that the payment bond include design services. After examining the statutes, the court concluded that while it was true that Indiana did not have a statutorily-confirmed policy favoring (or mandating) payment bond protection for design services, "it cannot be said that Indiana has prohibited parties from contracting for such protection." Citing the principle of freedom of contract, the court held that the design-build contract required a payment bond for the "D&C Work" under the contract, with both "D&C" ("Design and Construction") and "Work" being defined in the contract as including design and construction. Thus even if not required by statute to do so, the Developer and design-builder had agreed that the payment bond would cover design services.

The second issue was the wording of the bond itself. The court noted that the bond incorporated the design-build contract, which required coverage for design services. The bond's scope was payment for "labor performed and materials and supplies

furnished,” which the surety interpreted narrowly as meaning construction only, arguing that design services are not “labor.” The court viewed the term “labor” broadly, citing a dictionary in ruling that “the common meaning of the word ‘labor’ includes human activity that provides services.”

The court’s decision in favor of payment bond coverage resulted in a judgment of the full \$4.6 million in Aztec’s favor.

**Comment:** One point that might have been relevant was the amount of the bond. If the amount of the bond was the full amount of the design-build contract, then presumably it could have been shown that the design component of the contract amount was substantial. The bond’s premium was presumably based on this full amount, with no subtraction for the design component. This would indicate an intent to cover design-related payment claims.

EJCDC’s design-build payment bond (D-615) provides coverage for “labor, **services**, materials, and equipment” thus eliminating any plausible argument that services are not within the bond’s scope.

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2. **Issue:** Is an aggregate analysis a professional service that triggers the application of a certificate of merit requirement? *Ronald R. Wagner & Co. LP v. Apex Geoscience Inc.* Texas Court of Appeals (2018).

**Summary:** Wagner was the construction contractor on a paving project. The Texas DOT (TXDOT) specifications required the contractor to provide aggregate meeting stated characteristics. During the bidding phase, Wagner had relied on a report, issued by a senior engineer at Apex Geoscience, that found that proposed aggregate from the Wilson Pit met the specification. Later, Wagner learned that, in the opinion of the TXDOT engineers, the Wilson aggregate did not meet the state specification, and as a result Wagner had to obtain aggregate from a more expensive source. Wagner sued Apex, alleging breach of contract, fraudulent inducement, negligence, negligent misrepresentation, gross negligence, and breach of implied warranty. Wagner did not file a certificate of merit with its lawsuit.

The Texas certificate of merit statute requires that in an action for damages arising out of the provision of professional services, the plaintiff must file an affidavit from a licensed design professional making a threshold case that the claim has merit. Wagner argued that the Apex employee’s aggregate analysis was not within the scope of the practice of engineering because of an exemption in the licensing statute

for employees who are engaged in construction or repair of improvements to real property. The trial court disagreed, and dismissed Wagner's lawsuit because of the lack of a certificate of merit. Wagner appealed.

**Decision:** The Court of Appeals affirmed the dismissal of Wagner's claim against Apex Geoscience, based on Wagner's failure to file a certificate of merit. The appellate court held that the statutes regarding the practice of engineering, and specifically the limited exemption that Wagner had cited, were clear and unambiguous. The exemption is for non-engineers who work for engineering firms, providing construction-related services pursuant to drawings and specifications requiring an engineer's seal. By contrast, the allegedly faulty Apex services were performed by a licensed engineer, and consisted of analysis that required engineering education, training, and experience and the application of special knowledge of mathematical, physical, or engineering sciences. The fact that the engineer was an employee of his firm did not diminish his status as an engineer conducting an engineering—not construction—analysis.

**Comments:** The contractor's lawsuit was dismissed without prejudice. The published decision does not indicate whether there was any barrier to Wagner refiling the lawsuit, with the required certificate of merit. One such barrier that sometimes is present is the expiration of a statute of limitations or similar deadline for advancing the claim.

The court here appeared to conclude that it was obvious that conducting the aggregate analysis was a professional service, and the fact that the analysis was conducted by a licensed engineer certainly supported that conclusion. However, there is a spectrum of technical services in testing and inspection—not all services on the spectrum are necessarily professional services for purposes of claims and certificates of merit.

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3. **Issue:** Entitlement to arbitration under design agreement. *Thomas Zimmer Builders LLC v. Kurt E. Roots and Monika Roots*. Court of Appeals of Wisconsin (2018).

**Summary:** In a residential construction dispute between contractor and homeowners, the homeowners (the Rootses) brought a third-party claim against architect Mark Udvari-Solner. Udvari-Solner moved to compel arbitration, based on the arbitration clause in the design agreement between the Rootses and Udvari-Solner Design Co., a corporation.

The trial court denied the motion to compel arbitration, and Udvari-Solner appealed.

**Decision:** The appellate court reversed the trial court’s decision. The case centered on two issues.

First, the Rootses had argued that the arbitration clause did not apply because Udvari-Solner had falsely represented himself to be an architect in order to induce the Rootses to enter into the design consultant agreement in which the arbitration clause was located. The appellate court held that under state and federal case law even a claim of fraud in the inducement of the contract—a challenge to the validity of the contract itself—must be resolved in an arbitration proceeding.

Second, the Rootses contended that their claim was against Mark Udvari-Solner himself, as an individual; whereas the arbitration clause was in a contract between the Rootses and a corporation, Udvari-Solner Design. On this issue, the appellate court held that an employee or agent of an entity that is a party to an arbitration agreement is protected by that agreement, for acts that occur while working as an employee or agent. The purpose behind this rule of law is that it prevents the signatory of an arbitration agreement from “unilaterally eviscerating” the clause by suing individual non-signatories.

**Comment:** According to the decision, the homeowners provided a somewhat anemic response to Udvari-Solner’s arguments in favor of arbitration. The appellate court enforced legitimate general rules favoring arbitration, but there is an implication that perhaps the homeowners could have developed arguments justifying exceptions to the general rules.

Many EJCDC contract documents provide the option of including an arbitration clause. When such a clause is included, state and federal case law and statutes support enforcement of arbitration, based not only on contractual principles but also based on public policy strongly favoring arbitration (and thereby reducing the burden on the court system).

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4. **Issue:** Enforceability of clause stating that engineer has no duty to contractor. *Domson, Inc. v. Kadrmas Lee and Jackson, Inc.* Supreme Court of South Dakota (2018).

**Summary:** This case is focused on an EJCDC construction contract clause, currently set forth as Paragraph 10.07.A of EJCDC C-700 (2018). This clause was included in the road construction contract between the project owner, the Oglala Sioux Tribe, and Domson, Inc. Dakota Engineering and Kadrmas, Lee and Jackson (KLJ) were the

design engineers, and KLJ had contract administration duties during construction. Domson was late in completing the project and KLJ, on behalf of the Tribe, assessed over \$100,000 in liquidated damages against Domson. The contractor responded by suing KLJ based on negligent administration of the contract.

In the lawsuit, KLJ asserted that it was insulated from liability for negligent contract administration by the following clause (the contract is not identified in the decision as EJCDC, but the clause is verbatim from various editions of C-700):

9.09 Neither Engineer's authority or responsibility under this Article 9 or under any other provision of the Contract Documents nor any decision made by Engineer in good faith either to exercise or not exercise such authority or responsibility or the undertaking, exercise, or performance of any authority or responsibility by Engineer shall create, impose, or give rise to any duty in contract, tort, or otherwise owed by Engineer to Contractor....

The trial court agreed with KLJ and granted summary judgment in KLJ's favor, based in part on the 9.09 clause. An appeal to the state supreme court followed.

**Decision:** As a starting point in its decision the Supreme Court of South Dakota confirmed that under South Dakota law an engineer can owe a duty to a contractor, despite the lack of contractual privity between them. The key question was whether clause 9.09 was enforceable to insulate the engineer from a claim based on the potential duty.

A South Dakota statute states that contracts that attempt to exempt anyone from responsibility for negligent "violation of law" are against public policy. The court held that exempting a party from negligent contract administration claims is not the same as exempting a party from violations of law, and therefore the statute did not apply.

The court next discussed case law, from federal and other jurisdictions, in which the same or similar clauses to 9.09 were examined. Most of these cases held that such clauses are enforceable in protecting engineers against claims of ordinary professional negligence (as opposed to willful or intentional acts). The court distinguished those few cases that had been decided in favor of contractor—for example, a case in which the clause in question (not an EJCDC clause) was deemed ambiguous.

The court cautioned against finding a contract clause void or unenforceable on public policy grounds except in "cases free from doubt." Here, the court was unable

to identify any specific public policy, precedent, or statute that would suffice to justify voiding the 9.09 clause. The court stated that the clause “unambiguously” informed the contractor that the engineer was immune from attacks arising from good faith exercise of engineer’s duties.

Domson had submitted an affidavit to the trial court in which a professional engineer offered the expert opinion that KLJ’s engineering actions and decisions during construction were below an acceptable standard. However, Domson did not present any evidence that the engineer had acted in bad faith, or had been willful or intentional in the actions that allegedly harmed the contractor. As a result, the South Dakota Supreme Court held that the lower court had correctly issued summary judgment in KLJ’s favor, based on the 9.09 clause.

**Comment:** Clause 9.09 in its various forms (such as C-700 2018’s 10.07.A) is intended to allow the engineer to administer the construction contract without fear of claims from the contractor and its subcontractors and suppliers. This is especially important with respect to engineer’s decisions with respect to the interpretation of the design and contractor’s compliance with the requirements of the drawings and specifications. In this commentator’s view, the clause is not intended to exonerate engineer from the consequences of design errors. The South Dakota case examined that issue and likewise concluded that claims by Domson based on allegations of negligent design would not be shielded by 9.09. Nonetheless the court upheld summary judgment in the engineer’s favor based on the lack of evidence of any violation of the professional standard of care.

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5. **Issue:** Does the Spearin Doctrine apply in a design-build setting? *United States for the Use and Benefit of Bonita Pipeline, Inc. v. Balfour Beatty Construction, LLC*. United States District Court, Southern District of California. (2017).

**Summary:** Balfour Beatty was the design-builder for a Naval Facilities hangar replacement project at Camp Pendleton, California. Balfour Beatty subcontracted a portion of the work, also on a design-build basis, to Bonita Pipeline. Balfour Beatty provided design documents, prepared for Balfour by engineering firms, to Bonita. These design documents were expressly characterized as incomplete, and were accompanied by subcontract clauses under which Bonita acknowledged the incomplete nature of the documents and agreed to assume the risk—at Bonita’s expense—that the documents would need further refinement. The subcontract

placed on Bonita the risk of an expanded scope (and cost) of construction, resulting from completion of the design.

Bonita later sued Balfour Beatty, seeking additional compensation arising out of the subcontract. Bonita contended that the design documents had contained errors, that under the Spearin doctrine the design documents had been impliedly warranted by Balfour Beatty, and that Bonita was entitled to additional compensation for breach of the Spearin Doctrine.

The Spearin Doctrine states that an owner impliedly warrants the drawings and specifications, such that a contractor that proceeds in reliance on the soundness of the design is entitled to compensation if the design is flawed. The Spearin Doctrine most commonly is applied in traditional design-bid-build construction disputes.

**Decision:** The U.S. District Court issued a preliminary decision that included the statement that the Spearin Doctrine “may apply to design-build projects.” The court explained that the responsibility to provide correct drawings and specifications is not overcome by “general clauses requiring the contractor to examine the site, to check up the plans, and to assume responsibility for the work.” However, the court did not directly address the very specific clauses in the Balfour-Bonita subcontract regarding responsibility for the admittedly incomplete design documents. Bonita contended that it had taken on the risk of refinement, but not the risk that the documents that it had been given were defective. The court appeared to support this argument, but the decision is far from conclusive.

**Comment:** It is typical in design-build that the Owner will furnish incomplete preliminary design documents to the design-builder, and also common that, as in this case, the design-builder will provide incomplete documents to its subcontractors. The parties here agreed to subcontract provisions that allocated substantial but explicit risk to the subcontractor. Harsh though that may have been, we may assume that the subcontractor’s price reflected the risk and uncertainty to which it agreed. Imposition of an implied warranty in this context seems to undercut the parties’ attempt to manage a complicated and fluid situation that requires the progressive development of the design, and the need for the more specialized contractor to take “ownership” of the design.

In its Design-Build series of documents, EJCDC requires the design-builder to take full responsibility for the conceptual design documents that owner has provided to design-builder, but provides for equitable compensation when design-builder identifies errors in the furnished documents. See EJCDC D-700 (2016), Paragraph 2.03.A.



6. **Issue:** Conflict of interest because of participation in peer review. *In the Matter of HBI-GF, J.V.* United States Government Accountability Office (2017).

**Summary:** In March 2016, the Corps of Engineers retained Gannett Fleming to conduct an external peer review of the design of a six-mile cutoff wall project at the Herbert Hoover Dike embankment, at Lake Okeechobee, Florida. Gannett Fleming’s personnel, including a geotechnical engineer, reviewed project design documents, submitted more than 80 comments, and prepared findings and lessons learned based on the review. Its peer review work was completed in September 2016.

In June 2017 a joint venture comprised of Hayward Baker and Gannett Fleming submitted a proposal in response to a Corps request for proposals for construction of the cutoff walls. The Corps contracting officer identified a potential organizational conflict of interest because of the peer review, investigated, and ultimately excluded the Hayward Baker—Gannett Fleming joint venture from consideration. The specific category of conflict was stated to be “biased ground rules.” Such a conflict of interest arises when a firm, as part of its performance of a government contract, has in some sense set the ground rules for the competition for another government contract, for example by writing or providing input into the specifications. The primary concern is that the firm could skew the competition, whether intentionally or not, in favor of itself.

In this case, the contracting officer’s investigation determined that the Gannett Fleming geotechnical engineer who had worked on the peer review was also heavily involved in the preparation of the joint-venture proposal. The peer review comments had influenced changes in the design, and perhaps gave Gannett Fleming special knowledge of the Corps’ requirements, thus skewing competition. The contracting officer also noted the obligation to avoid even the appearance of a conflict, because of the possible adverse impact on competition.

The Hayward Baker—Gannett Fleming joint venture appealed the adverse conflict of interest ruling to the Government Accountability Office (GAO).

**Decision:** The GAO affirmed the Corps contracting officer’s decision. The review by GAO is based on a reasonableness standard, such that the GAO will not substitute its judgment for that of the underlying agency, absent clear evidence of unreasonableness. The GAO held that it could not “conclude that the contracting officer’s OCI [organizational conflict of interest] determination was unreasonable.” In doing so it emphasized that not only was there an appearance of a conflict (itself sufficient to support a finding of a conflict of interest) but that there were “hard facts” showing that Gannett Fleming, as peer reviewer, had assisted in the

preparation of specifications, thereby putting itself in a position to skew the competition.

**Comment:** The federal government conflict of interest provisions are stringent, but provide a starting point for analysis of potential conflicts of interest in a variety of settings, including engineering services, design-builder selection, and special circumstances such as a CM's competition for construction bid packages that it has helped prepare.

EJCDC publishes a peer review services document, EJCDC E-581, Agreement between Owner, Design Engineer, and Peer Reviewers for Peer Review of Design. The document expressly requires disclosure of relevant past or existing relationships, and bars the peer reviewer from any future involvement on the project:

No Peer Reviewer shall solicit, accept, or perform any Project-related services for Owner other than those set forth in this Agreement.

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7. **Issue:** Application of Florida's Slavin Doctrine to patent defect in street construction project. *Valiente v. R.J.Behar & Company, Inc.* Third District Court of Appeal, Florida (2018)

**Summary:** In Florida, under the Slavin Doctrine a contractor cannot be held liable for injuries sustained by third parties when the injuries occur after the contractor completed its work, the owner of the project has accepted the work, and the defects that caused the injury were patent. The Slavin Doctrine protects contractors from exposure to claims by countless third parties, such as property guests, who may occupy the premises in the future.

The test for what is a patent (as opposed to latent) defect is whether the dangerousness of the condition would have been obvious if owner had exercised reasonable care in observing the condition.

The Valiente case arose from a fatal automobile collision at an intersection in Hialeah, Florida. Visibility at the intersection was hindered by the planting of five-foot tall *Jatropha hastata* shrubs at the conclusion of a construction project. The plaintiff sued the project's general contractor (which in fact had no scope of duty regarding landscaping), the engineer (which did not design or specify landscaping),

and the nursery that furnished and planted the shrubs under a direct contract with the City.

To avoid the prohibitions of the Slavin Doctrine, the plaintiff contended that although the height and presence of the shrubs was patent, the danger the shrubs posed to motorists was latent. The trial court concluded otherwise, ruling that if the shrubs created a visual obstruction, the obstruction would have been patent to the City of Hialeah at the time it accepted the project as complete. On that basis the trial court enforced the Slavin Doctrine and entered summary judgment in favor of the three defendants. The plaintiff appealed.

**Decision:** The Court of Appeals affirmed the summary judgment. The court reasoned that when the project was completed, a reasonable inspection by the City would have included a determination of whether the shrubs impaired the view at the intersection:

The question is not what the City actually did, but what the City **could** have done. It is undisputed that the City could have discovered a visual obstruction, if one did exist, by simply looking.

The court reasoned that if the shrubs did not impair the view, at the time of completion, the defendants would have no liability, for obvious reasons; and if they did impair the view at that time, under the Slavin Doctrine they would likewise have no liability. In other words, the condition, whether dangerous or not, was obvious and patent when the City conducted its final review and accepted the work—the five-foot shrubs were intrinsically patent.

**Comment:** There are severe limits to the ability of a contract to prevent exposure of liability to third parties—the Slavin Doctrine defense arises from Florida case law, not from contract clauses. A first important step is to use the contract to make clear allocations of scope and responsibilities, for contractor, owner, and engineer. These contractual allocations may not be binding on third parties, but generally have high persuasive value in any subsequent claim.

An orderly and well-defined process for determining contract completion and acceptability of the work is beneficial regardless of any potential defenses; the standard EJDC documents have comprehensive provisions regarding completion and acceptability. See C-700 (2018), Standard General Conditions of the Construction Contract, Paragraphs 15.03 and 15.05, and C-626 (2018), Notice of Acceptability.