



RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

November 2012

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Issue	Citation	Summary	Decision and Contract Document Implications
<p>1. Liability of engineering firm, retained by town, to private developer.</p>	<p><i>Meridian at Windchime, Inc., v. Earth Tech, Inc.</i>, Appeals Court of Massachusetts (2012)</p>	<p>Subdivision development project. Town retained Earth Tech, an engineering firm, to conduct subdivision reviews and inspections, including underground utilities, roadways, and sidewalks. The town’s engineering costs were the responsibility of the developer, Meridian.</p> <p>The site development was constructed by a contractor retained by Meridian. Meridian had also retained an engineer for the project but apparently did not use him/her for field services.</p> <p>Earth Tech provided services to the town over a period of two years. It issued numerous field reports, which were provided to the developer. These reports sometimes identified deficiencies in the contractor’s work.</p> <p>Well after project completion, numerous serious defects became known, including improper installation of water lines, hydrants, curbing, and manholes. Meridian had to foot the bill for excavating and repairing the defective infrastructure.</p> <p>Meridian brought a claim against Earth Tech, asserting that Meridian had relied on Earth Tech, and that if Earth Tech had performed its duties adequately the construction errors could have been detected during the ordinary course of the work, and corrected at a much lower expense. Under Massachusetts law it is possible for a design professional to be liable to a third party for negligent performance of its contractual services, if there is evidence of “foreseeable reliance.”</p>	<p>The appellate court found that there was no foreseeable reliance here, for three reasons. (1) Earth Tech had issued a memorandum to Meridian warning that deviations from the town’s requirements or approved plans were at Meridian’s risk. (2) The contract between the town and Earth Tech indicated that ET had no responsibility for the construction contractor’s means and methods. (3) Meridian had retained its own engineer, disproving any expectation of reliance on Earth Tech.</p> <p>The decision does not indicate if there was a “no third party beneficiary” clause—such might have been more indicative than the means/methods clause.</p> <p>The issues here are not uncommon. Ideally the development agreement between municipality and developer would insulate the municipality’s engineering firm from liability. Not explored in the case was the impact of Meridian paying for the engineering services.</p>

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<p>2. Owner’s responsibility for numerous utility conflicts on pipeline project.</p>	<p><i>Mastec North America, Inc. v. El Paso Field Services</i>, Court of Appeals of Texas (2010).</p>	<p>El Paso, a large energy company, awarded a contract to Mastec for replacement of a 68-mile long butane pipeline. El Paso provided bidders with alignment sheets that identified some 280 “foreign crossings”—places where other utilities, cables, or structures crossed the pipeline. The contract prepared by El Paso stated that it had exercised due diligence in locating the crossings, but also required that bidders examine the site and confirm the locations. Mastec conducted a review by helicopter.</p> <p>During construction Mastec encountered approximately 800 foreign crossings, which greatly increased the cost of construction. Most of these could not have been identified through feasible bidder site reviews, but could have been located through extensive research and full investigation.</p> <p>Various contract provisions placed the burden of the cost of contending with crossings on the contractor.</p> <p>In ensuing litigation, the jury found that El Paso had not exercised due diligence in locating the crossings. The trial judge overruled the jury, holding that the contract had allocated the risk of higher numbers of crossings to the contractor, through the provisions requiring that the contractor confirm the crossings.</p>	<p>The court of appeals reversed the trial court, holding that Mastec had been justified in relying on the due diligence commitment by the owner. The court ruled that even when the contract places the risk of differing or unexpected conditions on the contractor, the contractor is not, as a matter of law, required to bear the risk that the contract documents are defective, as was the case with the alignment sheets.</p> <p>In effect the owner had warranted the contract documents—in essence the Spearin doctrine.</p> <p>The EJCDC construction documents make intentionally narrow commitments regarding subsurface information that is provided. Nonetheless bidders and contractors are entitled to rely on some of the factual data, and on the Contract Documents. Also note the special treatment that the EJCDC documents afford to “Underground Facilities.”</p>

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<p>3. Statute of repose as a bar to stale claims.</p>	<p><i>Feldman v. Arcadis U.S. Inc.</i>, Court of Appeals of Georgia (2012).</p>	<p>Arcadis planned and designed a stretch of roadway whose construction was completed in 1999. In 2009 Feldman was injured in an accident on the roadway. Feldman alleged that Arcadis’s design was negligent, and was a contributing cause of the accident. (There was also a drunk driver involved.)</p> <p>Georgia has an eight year statute of repose: for the design and construction of improvements to real property, no claim may be brought more than eight years after substantial completion. However, Feldman pointed out that the Georgia courts had held that the statute of repose did not apply to certain utility infrastructure projects (underground gas line; electric transmission equipment), on the basis that these were not “improvements to real property” but rather were mere fixtures. Feldman argued that the highway should be placed in this same category, because no one occupied it in the way that traditional improvements are occupied.</p>	<p>The appellate court rejected Feldman’s arguments and concluded that a highway is an improvement to real property. Therefore the eight year statute of repose applied, and the claim was rejected as untimely.</p> <p>The court acknowledged that one of the assumptions underlying the statute of repose, making it equitable as a matter of public policy, was that during the repose period any flaws would typically be revealed through the normal use of the improvement. The court stated that this was just as true for a roadway as for an occupied structure. Though no one actually lives on the road (so said the court), the countless vehicles that traverse the road provide daily public “occupation” that should have revealed any flaws during the eight year period.</p> <p>Substantial completion is a defined term under the EJCDC documents, and most statutes of repose are measured from substantial completion. The case brings to mind the question of whether other states exclude certain infrastructure projects.</p>

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<p>4. Stale claims allowed by legislative decree.</p>	<p><i>In re: Individual 35W Bridge Litigation</i>, Supreme Court of Minnesota (2011).</p>	<p>After the tragic collapse of the Interstate 35 W bridge across the Mississippi River in Minneapolis, the Minnesota legislature set up a victim compensation program and enacted the following statute:</p> <p>“Notwithstanding any statutory or common law to the contrary, the state is entitled to recover from any third party...any payments made from the emergency relief fund...to the extent the third party caused or contributed to the catastrophe.”</p> <p>Jacobs Engineering (as successor to Sverdrup) was among the “third parties” that the state pursued. Sverdrup had designed the bridge in the 1960s. In the meantime, the state had passed statutes of repose to cut off stale construction and design-related claims. Jacobs argued that its (Sverdrup’s) exposure had been extinguished in 1982 by the close of the statute of repose.</p> <p>Jacobs’ first argument was that the recent 35W statute could not have a retroactive application that would revive the state’s rights against the firm; statutes do not typically apply retroactively. Jacobs also contended that applying the statute retroactively would be a violation of Jacobs’ constitutional due process rights.</p>	<p>The Minnesota Supreme Court held that the language of the statute “clearly and manifestly” indicated a legislative intent that the compensation statute apply retroactively. The court reviewed other decisions interpreting similar “Notwithstanding...” clauses to reach this opinion.</p> <p>The court agreed with Jacobs’ assertion that when the statute of repose period ended in 1982, Jacobs (Sverdrup) had obtained a protectable property interest. Such an interest is entitled to due process protection. However, the court stated that such a right is not absolute and must be balanced against the state’s legitimate interests. Though perhaps economically unfair to Jacobs to revive its exposure to liability, the 35W statute was narrowly limited to fundamentally responsible parties, and rationally related to protection of a legitimate state interest.</p> <p>It is not clear from the decision whether the statute also trumps any contractual provisions that might benefit Jacobs, such as a limitation of liability.</p>

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<p>5. Does the Economic Loss Doctrine shield a design professional from negligence claims?</p>	<p><i>Leis Family Limited Partnership v. Silversword Engineering</i>, Court of Appeals of Hawaii (2012).</p>	<p>The owners of a commercial building on Maui retained a contractor to furnish a design-build thermal energy system. Silversword Engineering was a sub-sub responsible for system design. Subsequent owners of the building alleged that due to Silversword’s negligence, the system was severely undersized, could not handle the cooling load, and was prone to failure.</p> <p>Silversword had worked under a written professional services agreement that among other things included a limitation of liability clause. Like many states, Hawaii recognizes the economic loss doctrine, which bars recovery in tort (negligence) for purely economic loss (as opposed to physical injuries or property damages). The doctrine promotes the use of contracts to define commercial relationships and address the consequences of inadequate services or products.</p> <p>The property owners here argued that the Economic Loss Doctrine should apply as a bar to claims only between parties who have a contract. The owners further argued that there should be an exception to the economic loss defense if there is evidence that a design professional deviated from industry standards.</p>	<p>The court of appeals presented a very clear explanation of the economic loss doctrine and its full acceptance by the Hawaii courts. The court noted that in the case at bar, the original parties had allocated risks and responsibilities through a framework of contracts and subcontracts, and that to introduce a tort claim would “disrupt the contractual relationships between and among the various parties.” Direct privity of contract was not a factor.</p> <p>The court also rejected the notion that a deviation from industry standards should create an exception. As the court aptly noted, “If work falling below industry standards was excepted from the economic loss doctrine, it would, for all practical purposes, destroy the design professional’s ability to contract for protection from liability.”</p> <p>EJCDC fully supports common law rulings that favor the use of written contracts in design and construction.</p>

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<p>6. a. Application of the statute of repose to bar a stale contract claim, and</p> <p>b. Application of the economic loss doctrine to bar a negligence claim.</p>	<p><i>Kalahari Development, LLC, v. Iconica, Inc.</i>, Court of Appeals of Wisconsin (2012).</p>	<p>Iconica was the design-builder of the Kalahari water park, hotel, and conference center in Wisconsin Dells. The project was completed in 2000. In 2008 the owner discovered water damage within the walls, which it blamed on improper vapor barrier design and installation. Kalahari initiated a lawsuit against Iconica based on breach of contract and negligence.</p> <p>Wisconsin’s statute of repose precludes construction and design-related claims brought more than ten years after substantial completion. The statute allows extra time if the claim was discovered in years, 8, 9, or 10 of the repose period.</p> <p>Wisconsin’s statute of limitations for breach of contract is six years from the date of the breach.</p> <p>Wisconsin recognizes the economic loss doctrine as a defense, but applies it in a more limited fashion than many other jurisdictions do. Because the economic loss doctrine originated in cases involving products (with the courts holding that the warranty and purchase order should determine liability, not negligence principles), the Wisconsin courts require an analysis to determine if a project is primarily to provide a product (such as a building), or a service. The end result is that design professionals have considerably less protection under the Wisconsin economic loss doctrine than contractors and suppliers.</p>	<p>a. The owner, Kalahari, argued that the statute of repose was effectively the controlling statute of limitations, giving Kalahari ten years for its claims. As a twist on this, Kalahari asserted that even if a claim was initially barred, it would be revived if discovered in years 8, 9, or 10. The court rejected this, stating that the breach of contract claim was barred six years after the design and construction of the vapor barrier. The court acknowledged that the structure and wording of the statute of repose made it difficult to follow. However, a careful, rational reading made plain that it did not function to extend the controlling statutes of limitations, but rather was there to cut off limitation periods. The court lambasted Kalahari’s strained arguments (“absurdity,” “nonsense”).</p> <p>b. Noting that the purpose of the design-build contract was to deliver structures, and that the design component was 4% of the contract price, the court held that the contract was for a “product” and thus the ELD applied.</p>

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<p>7. Lawyer denying architect friend a share of profits on condominium project.</p>	<p><i>Farrell v. Whiteman</i>, Supreme Court of Idaho, (2012).</p>	<p>Whiteman was a lawyer turned real estate developer. He invited his friend, Farrell, an architect, to join him on a condo project in Ketchum, Idaho. Farrell would provide the design, and would receive 25% of the profits from the project.</p> <p>As Farrell neared completion of his services, Whiteman misrepresented Idaho law, telling Farrell that it would be illegal for Farrell to have an ownership interest less than 50%, and that therefore they could not enter into a partnership agreement. Whiteman then terminated Farrell, on seemingly contrived grounds, and the project was constructed using Farrell’s incomplete design.</p> <p>The project was a success, generating a \$2 million profit. Whiteman refused to share the profits or pay Farrell. The resulting litigation included two journeys to the Idaho Supreme Court. Farrell’s position was hamstrung by the lack of a written contract and the fact that he had not been licensed in Idaho at the time he started providing architectural services.</p>	<p>The Idaho courts did what they could for the architect. Ultimately he received equitable compensation for services provided after he obtained his Idaho license, all out-of-pocket expenses incurred on the project, and an award of legal fees at both the trial court and appellate court levels.</p> <p>Lessons learned:</p> <ul style="list-style-type: none"> a. Beware of condo projects—they are know to spawn many claims. b. Beware of deals that seem too good to be true. c. Retain independent legal counsel before entering into a business deal. d. All deals and engagements should be supported by a written contract. e. Do not enter into contracts or perform services unless properly licensed.