



RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

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1. **Issue:** Statute of limitations for action under the False Claims Act. *United States ex rel. Benjamin Carter v. Halliburton Co.*, United States Court of Appeals, Fourth Circuit (2013).

Summary: The False Claims Act is a federal statute that was enacted during the Civil War as a tool for reducing fraud against the government by its contractors. The FCA codifies the government's right to bring suit to recover funds, and also allows a private citizen who has knowledge of such fraud to initiate a lawsuit on behalf of the federal government. In the case of privately initiated cases, the private plaintiff is entitled to a share of the recovery. The False Claims Act features triple damages as a disincentive to fraudulent contracting practices.

Benjamin Carter was an employee of Kellogg Brown & Root. He worked for KBR in Iraq as a reverse osmosis water purification unit operator in 2005. According to Carter, KBR instructed him and others to submit time sheets showing 12-hour days and 84-hour weeks, regardless of the number of hours actually worked, and even for time periods when no work whatever was performed. KBR allegedly submitted these time sheets to the government as part of a cost-based government contract. In addition, Carter asserted that KBR falsely represented that the water purification facility was functioning during time periods when it was not.

One of many procedural issues in Carter's False Claims action was whether the applicable statute of limitations period for the claim had expired. In general, such claims must be initiated within six years of the violation. However, Carter argued that the Wartime Statute of Limitations Act tolled (suspended) the running of the limitations period. The WSLA was passed during World War II, and currently provides that when the United States is at war, and for five years after the end of the war, the running of statutes of limitations applicable to acts of wartime fraud against the government are suspended.

The district court dismissed Carter's action as untimely.

Decision: The case was appealed to the Fourth Circuit. The appellate court overruled the district court, and revived Carter's lawsuit. The Fourth Circuit held that for purposes of the WSLA, the United States was "at war" in Iraq. The statute did not limit its application to congressionally declared wars, even though many other statutes do specifically reference that category of war. The court also noted that requiring a declared war would be "an unduly formalistic approach that ignores the realities of today," given the massive U.S. military campaigns that have occurred since the last formal congressional declaration of war during World War II. The Fourth Circuit stated that the purpose of the WSLA—to combat fraud at times when the United States may not be able to act as quickly because it is engaged in war—would be thwarted by a narrow definition of "at war."

The Fourth Circuit also reviewed the question of whether the WSLA applies to False Claims actions brought by private parties rather than the government. The court

held that tolling the statute of limitations for private actions was entirely consistent with the WSLA goal of rooting out fraud against the United States during wartime.

Comment: The government contractor defendants in the Carter case have petitioned the United States Supreme Court to review the case. One of the contractor defenses that was persuasive to the district court was that the WSLA as interpreted exposes government contractors to wartime fraud claims “perhaps indefinitely.” The Fourth Circuit saw this viewpoint as a criticism of the purpose of the WSLA, and not a relevant argument to the issue of the WSLA’s application to Carter’s False Claims Act lawsuit. The Supreme Court may be willing to revisit that specific issue, and other aspects of the case.

Note that the False Claims Act is not limited to fraud in military/defense situations. All government contractors must be aware of the Act and comply scrupulously with contract and billing requirements. Moreover, many states have similar laws that apply to state contracts.

As a recent example of the False Claims Act in action, in August it was announced that an Ohio roofing company that had been supplying construction materials and services to the federal government for many years had agreed to pay the government \$60 million to settle a False Claims Act case. A former company executive had blown the whistle on a long-term fraudulent practice of overbilling the government, and failing to furnish lower cost materials, despite contract requirements to provide alternatives to expensive materials and to give federal agencies the company’s best prices. The private claimant is scheduled to receive \$10.9 million for reporting and pursuing the fraud.

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- 2. Issues:** Defective design; contractor’s entitlement to assume that owner would furnish detailed engineering information about existing structure. *Appeal of R.L. McDonnell Construction*, Armed Services Board of Contract Appeals (2012).

Summary: Contractor agreed to add endwalls to two existing Butler-style buildings at a remote U.S. Army depot in the Sierra Nevada foothills. Butler-style buildings are pre-engineered, pre-fabricated metal buildings (Butler being a prominent manufacturer of such buildings). The buildings had been built without endwalls, but were being put to a new use that required full enclosure. Contractor was contractually responsible for all necessary structural and foundation engineering.

The government had provided bidders a drawing that showed vertical endwall supports, depicted as bold vertical lines, connected to the existing structures at the roof trusses. According to the contractor, this drawing established that the endwalls could rely on the existing buildings for support. Contractor also contended that its

bid price was based on the assumption that during the design phase it would obtain the original building manufacturer's information regarding the structural capacity (most importantly wind load) of the existing structure, and that this information would confirm that the endwalls could be supported safely by the existing structure. The government had never promised any such information, and was not able to locate any as-builts or identify the manufacturer of the existing buildings. An engineer retained by the contractor concluded that the only safe course was to assume that the existing structures could not support the endwalls (and increased wind loads that attached endwalls would create). Therefore the contractor's only option was to design and build freestanding endwalls, which required substantial and expensive concrete foundations.

The contractor submitted a claim for additional costs. The government's contracting officer rejected the claim, and the contractor appealed to the Armed Services Board of Contract Appeals.

Decision: The Board held that the contract was very explicit in establishing performance specifications, and in delegating the design responsibility to the contractor. The drawing showing vertical supports connected to the existing structure was not intended to be a structural design, and the contractor's CEO had admitted during the proceedings that the limited specs and drawings that the government had furnished "made no representation as to whether the new endwalls were to be attached [structurally] to the existing structure or not."

The Board also held that nothing in the solicitation for bids had indicated that any additional information about the existing structures was available, the contractor had not inquired about such information pre-bid or attempted to conduct its own research, and the contractor was well aware that even if such information had later been located, it might well have established that the original buildings could **not** accommodate structurally attached endwalls. As a whole, the contractor's wishful expectation that it could attach the endwalls to the existing structures was "unreasonable."

Comment: The contractor should have inquired regarding the availability of additional information and the intended meaning of the drawing during the bidding phase. The EJCDC Instructions to Bidders (C-200) require bidders to submit questions regarding the contract documents at least seven days before the bid date.

The Board decision cites a government acquisition regulation—in essence a contract clause—that provides that the government is not responsible for assumptions, interpretations, or conclusions made by the contractor. The EJCDC documents make the same point regarding contractor interpretations or conclusions about owner-furnished site information; perhaps the point could be broadened, in the instructions to bidders or elsewhere.

3. **Issue:** Punitive damages for contractor's failure to pay subcontractor for services. *T.C.B. Construction Company, Inc., v. W.C. Fore Trucking, Inc.*, Supreme Court of Mississippi (2013).

Summary: After Hurricane Katrina, Harrison County retained W.C. Fore Trucking to remove debris from county rights-of-way. Fore subcontracted debris removal in an area north of Highway 53 to TCB Construction. After a short time TCB began removing debris south of the highway as well. During a period of over six months Fore billed the county for all debris removed by TCB, and received payment for all the billings, but underpaid its sub by nearly \$7 million. Fore claimed that the terms of the written subcontract limited TCB's geographic scope to the area north of the highway, and that Fore had no duty to pay for debris that TCB had collected south of the highway. TCB countered that Fore had issued an oral modification of the contract, instructing TCB to expand the scope of its work.

The dispute proceeded to a jury trial. The jury found that TCB and Fore had indeed modified the subcontract to include both the north and south areas, but without explanation the jury awarded TCB only about half of what it was owed, ignoring the subcontract's express payment rate (per cubic yard of debris) and undisputed quantities, as measured by the county.

The case then progressed to the Mississippi Court of Appeals. The court held that as a matter of law the contract had been modified, and that damages must be based on the arithmetic of the contract rate of payment and the undisputed quantities. Therefore the court revised the damages award upward to \$6.6 million. The court denied TCB's ongoing request that the issue of punitive damages be submitted to the jury, ruling that there was some evidence that Fore's refusal to pay TCB was not malicious. The punitive damages issue was appealed to the state supreme court.

Decision: The Mississippi Supreme Court held that the punitive damages issue should be submitted to the jury. The high court noted that under state law, punitive damages can be awarded in a breach of contract case if a defendant has (1) acted maliciously, (2) committed an intentional wrong, or (3) acted with reckless or gross disregard for the rights of others. The court of appeals had focused on the notion of malice, and had generously concluded that Fore's failure to pay TCB could be categorized merely as "a hard-line business position." The state supreme court indicated that attention should be shifted to the question of whether the contractor's conduct was in reckless disregard of TCB's rights. The court expressed skepticism about the sincerity of Fore's "obliviousness" to the work being conducted south of the highway, and opined that Fore had acted in bad faith, seeking to reap the benefits of the subcontract while denying its obligations.

Comment: There is no discussion of the subcontract provisions regarding contract modifications—there may not have been any. The contractor may have placed too much reliance on the geographic restriction in the subcontract—even if that clause had never been modified, it would not justify allowing the sub to work for months south of the highway and then spring a “gotcha!” surprise. But the real driving factor here was the fact that Fore had billed the county for TCB’s work, and had received full payment from the county. Pocketing the proceeds and failing to pay the sub under those circumstances was an invitation to sanctions.

4. **Issue:** Limitation of liability clause in design contract. *SAMS Hotel Group, LLC, v. Environs, Inc.*, United States Court of Appeals, Seventh Circuit (2013).

Summary: SAMS, a hotel ownership company, entered into a professional services agreement with Environs, an architectural firm, for the design of a six-story Homewood Suites hotel in Indiana. The agreement included a clause that limited the architect’s liability to the amount of the architect’s flat fee of \$70,000. By its terms the clause limited claims based on negligence, breach of contract, breach of warranty, and other grounds.

Serious structural defects were discovered prior to occupancy of the new hotel, and the local building department condemned the building. Remedial efforts were unsuccessful and the hotel was demolished without ever opening. SAMS sued Environs in federal court, alleging breach of contract and negligence under Indiana law. Damages for the loss of the building were approximately \$4.2 million.

The trial court dismissed the negligence claim, based on a recent economic loss doctrine decision issued by the Indiana Supreme Court. The economic loss rule (doctrine; defense) is a judicially created doctrine that prohibits or limits tort claims if the only damages are economic (as opposed to property damage or physical injury claims). There was no dispute that the doctrine applied, requiring dismissal of the negligence claim. The court also held that the limitation of liability clause was enforceable, and thus ruled that the breach of contract claim was limited to \$70,000.

Decision: On appeal to the Seventh Circuit, the hotel owner argued that the limitation of liability clause was deficient because it did not refer specifically to limiting Environs’ liability for its own negligence. The appellate court found this to be unpersuasive. The argument is one that is relevant to indemnification clauses, which in many states must be very explicit in alerting the indemnifying party that it is agreeing to indemnify the other party even in cases of the other party’s own negligence. The same line of reasoning does not apply to a limitation of liability clause. The whole purpose of such clauses is to excuse or pardon some of the

liability of an otherwise culpable party. The court emphasized the importance of freedom of contract for a freely bargained commercial agreement, remarking that the result might be different in a consumer contract, or a one-sided contract of adhesion. The court also pointed out that the indemnity cases involved negligence claims, whereas the hotel design case had been boiled down to a breach of contract claim. In conclusion, the court quoted an Indiana Supreme Court decision that “freedom of contract includes the freedom to make a bad bargain.”

Comment: EJCDC makes several limitation of liability clauses available as options for its professional services agreements. See E-series documents, Exhibit I. Such clauses may be justified on some projects, to encourage lower fees (because the price does not need to account for exposure to substantial liability) or keep risks proportional to rewards.

5. **Issues:** (a) Does an indemnification clause function as a limitation on the indemnifying party’s liability? (b) Must there be actual damages to sustain tort and breach of contract claims? *Central Brown County Water Authority v. Consoer, Townsend, Envirodyne*, United States District Court, Eastern District of Wisconsin (2013).

Summary: The Central Brown County Water Authority retained the engineering firm Consoer, Townsend, Envirodyne (CTE) to design a 65-mile underground pipeline to bring water from Lake Michigan to Brown County, and provide related construction-phase services, for a not-to-exceed fee of \$9.7 million. As the project neared completion in 2007, CTE demanded an increase in the engineering fee, and after an ensuing dispute CTE terminated its services. A year later the Authority launched lawsuits against CTE and three project construction contractors. The core of the claim against CTE was the allegation that the pipeline was not properly constructed because CTE: failed to require the contractors to conduct required deflection testing; neglected to correct the contractors’ failure to install specified concrete saddles under all 47 butterfly valves; and failed to require the specified gaskets and bolts for the flanged valve connections. The Authority contends that as a result of these failings, it will need to spend some \$15 million to excavate and repair the pipeline, and the pipeline will be shut down for seven months.

The lawsuit against CTE has been in federal court for years, and has taken many procedural twists and turns. In a recent decision the court ruled on various motions for summary judgment by both parties.

Decision: (a) The professional services agreement between the Authority and CTE contained a clause stating that CTE would perform its services according to the professional standard of care, and if during the two year period following completion of services it was shown that CTE had failed to meet that standard, CTE

would indemnify the Authority from all damages, losses, and costs. CTE argued that this clause limited its liability to indemnifying the Authority from third-party claims arising from CTE's services and resulting in damages, losses, and costs. Because there had not been any third-party claims, CTE moved the court for summary judgment.

The court acknowledged that one legal definition of "indemnify" focuses on reimbursement of losses suffered because of third-party claims. However, the court also identified a more general definition of "indemnify" that refers more broadly to compensation for losses, without referral to third parties. The court held that this broader definition was more consistent with the overall intent of the agreement. The court also noted that as a matter of law an indemnity clause should be liberally construed in favor of the beneficiary (here, the Authority) if it deals with the negligence of the indemnifying party (here, CTE); such was the case for this clause. Thus the court rejected the argument that CTE had no duty to the Authority except for third-party claims.

(b) The pipeline has been functioning without a problem for about six years. One of CTE's principal defenses is that regardless of any errors or lapses by CTE, the Authority has not incurred any damages and therefore the claim should be dismissed.

The parties and the court were in agreement that to state a tort (negligence) claim, the plaintiff must have suffered actual damages. Various breach of contract cases supported the notion that a case could go forward based solely on the breach, resulting in a finding of liability and the award of nominal damages only (\$1.00). The court held that these cases had been rendered meaningless by rules allowing plaintiffs to pursue declaratory judgments, and that it would be a waste of public and private resources to let a breach of contract case proceed without actual damages being at stake. Thus the key question was whether the Authority had suffered actual damages.

The court noted that when there is a breach of contract in the construction setting, the owner is generally entitled to recover the amount of money it would cost to correct the deficiencies. In essence, the owner is entitled to the benefit of its bargain. There is no need to prove a functional failure. The court offered the example of a contractor installing an asphalt shingle roof rather than a 100-year metal roof. The shingle roof may be performing well, but the owner has incurred actual damages because it has not received the benefit of the bargain. Here, the lapses with respect to deflection testing and the butterfly valves (if proven) denied the Authority of the benefit of the bargain. It paid for services and work that was not performed and material that was not installed, and did not receive the quality of pipeline that it contracted for with CTE and the contractors. As a result the court denied CTE's motion, holding that the Authority had incurred actual damages.

Comments: The concept of indemnification is rooted in protecting a party from third-party claims. Typically, the indemnification clause is a supplemental right. As a baseline, both parties to a contract have breach of contract rights (and sometimes tort rights) against each other that are inherent in the contract or relationship, and independent of the indemnification clause. The indemnification clause provides specific rights (usually including reimbursement of attorneys' fees) and is intended to apply only if third-party claims are made against the protected party. Because there has been uncertainty about this point in various court cases, the indemnification of Owner in EJCDC® E-500 (2013) expressly limits the clause's application to third-party claims.

The custom clause in the CTE case suggests confusion on the part of the drafter. Three different concepts are addressed in the clause, resulting in a loss of clarity. The professional standard of care is adequately stated, but to this is added what appears to be an attempt to impose a time limit on owner claims (two years following completion), as well as a casual reference to indemnification. The court was right to resist the argument that the intent was to limit the owner's rights solely to reimbursement for third-party losses (which would have been an extremely unusual provision). Unfortunately the court's holding may be misconstrued as favoring a broad interpretation of all indemnification clauses, such that they are construed to encompass more than protection against third-party claims.

As to damages, the CTE decision provides a thorough examination of the relationship between a breach of contract and the resultant damages. In many construction cases a breach (whether by design professional or contractor) will come to light as the result of a functional or performance failure (as an example, the hotel case discussed above). However, the situation with the pipeline is not unusual: it is functional but not what was bargained for. In a tort setting, a claimant would need to show that actual harm is reasonably certain to occur in the future—perhaps a difficult burden of proof to carry. Contract law is better suited to address this type of problem. Note that although the cost of correction is the general rule, there is some flexibility that allows for diminished value as an alternative measure of the damages under some circumstances.

One remarkable aspect of this case is that there do not appear to be any claims relating to CTE's design work. Considering the scope of the project, that is a credit to the design engineers.

As a final note, consider that the claims against CTE might never have occurred if it had not taken an aggressive stance on obtaining an increase in its fee. The reported decision does not explain how the Authority learned of the construction deficiencies in the pipeline—this is purely speculative, but perhaps it was the result of an investigation into CTE's services that was triggered by the fee dispute.

6. **Issue:** Consequences of not complying with express requirements of request for proposals. *Matter of Alares, LLC*, United States Government Accountability Office (2012).

Summary: The Department of Veteran Affairs issued a request for proposals (RFP) for replacement of HVAC units at a VA medical center in Providence, R.I. The RFP informed the proposers that the VA would award the contract without conducting discussions or negotiations, on a best value basis, under the following factors:

- Management approach
 - Schedule
 - Technical approach
 - Experience
 - Construction safety plan
 - Infection control procedures
- Past performance
- Price

Alares submitted the lowest price, but was scored low on management approach and past performance. The primary problem in Alares's proposal was the failure to address the construction safety plan and infection control requirements of the RFP. In both cases the RFP was plain in requiring submittal of a plan. Alares argued that its compliance could be inferred from its experience on similar past projects, and protested the VA's decision to award the contract to another company.

Decision: The GAO general counsel reviewed the RFP and Alares's proposal and denied the protest. The published decision points out that it is the proposer's responsibility to submit a well written proposal with adequately detailed information and clear compliance with the RFP. The government agency has no duty to infer information or piece together the proposer's intent.

Comment: The price advantage of selecting Alares was about \$270,000, or roughly 10% of the price. Perhaps this savings would have been attractive to the agency, but the non-price proposal scoring was conducted without knowledge of the proposer's price. Using the stated weighting procedures, Alares was not the winner despite the better price.

The GAO decision states that a failure of a proposal to conform to material terms of the RFP is "unacceptable" and may not form the basis for an award. This seems to suggest that by not including the safety and infection plans the Alares proposal was "non-responsive" (the concept used in the EJCDC Instructions to Bidders) and therefore should have been rejected outright, rather than scored.

7. **Issue:** Sewerage district's responsibility for dewatering private property. *Bostco LLC v. Milwaukee Metropolitan Sewerage District*, Supreme Court of Wisconsin (2013).

Summary: Milwaukee Metropolitan Sewerage District (MMSD) constructed massive "deep tunnels" under the city in the 1980s and 1990s. The intent of the tunnels is to store excess storm water and sewage so that wastewater treatment facilities discharging into Lake Michigan are not overwhelmed by peak flows. By design, and as a result of budgetary, geotechnical, and policy decisions, the tunnel underneath downtown Milwaukee is partially lined and partially unlined. The plaintiff's building is in the downtown, and rests on wooden foundation pilings that must remain saturated to prevent deterioration. According to testimony, the deep tunnel's unlined sections have acted as a siphon that has drawn down the groundwater under Bostco's building, resulting in premature deterioration of the foundation. A jury held that the damages for the drawdown and deterioration were \$6.3 million. The jury also found that MMSD's operation and maintenance of the deep tunnel constituted a nuisance, and that MMSD could abate the nuisance at a reasonable cost.

The case eventually made its way to the state supreme court, with both parties appealing specific aspects of the lower court decisions.

Decision: The Wisconsin Supreme Court held that a statutory cap on tort damages against municipalities limited Bostco's monetary recovery to \$100,000. The court held against MMSD on the abatement issue, confirming the circuit court's order (based on the jury verdict) that MMSD abate the nuisance by taking steps to prevent the siphoning of groundwater into the tunnels. According to a dissenting opinion in the case, the cost for this mandatory abatement would be over \$10 million.

Much of the decision centered on state law regarding municipal immunity from claims. In short, public planning, policy, and design decisions are immune from claims, while the execution of operation and maintenance tasks are not immune. Because MMSD's wrongdoing was categorized as operation and maintenance, MMSD was not immune and therefore was subject to the order to abate the nuisance.

Comment: The dissenting opinion in the case asserts that the deep tunnel was "operated and maintained" exactly as it was intended to be—that is, the portions that were unlined by design remained unlined, and allowed groundwater to seep in. By categorizing the problem as one of operation and maintenance, the majority opinion may have opened a huge exception to the concept of municipal immunity for infrastructure projects, and created unavoidable exposure to court-mandated expenditures of public funds.