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CONSTRUCTION LAW BRIEFING

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A new twist on an old story

"Automatic" termination catches many contractors off guard

Contractors who work on public projects often assume going in that they could be terminated only for either defaulting under the terms of the contract or because the public body decided not to proceed (typically known as "termination for convenience").

But a recent Massachusetts case, *BBC Company v. Town of Easton*, revealed a third way to be fired — "automatic" termination. And the tale behind the decision brings a new twist to the old story of a contractor being sent packing from a public job.

An added provision

The Town of Easton, Mass., wanted to renovate its historic Ames Free Library building. The town obtained a construction grant for the project from the Massachusetts Board of Library Commissioners, but the terms of the grant required construction to begin by Oct. 1, 2000.

In the spring of 2000, the town solicited bids for the renovation and eventually awarded a contract to BBC Company. The contract was on AIA Form A101-1977, including AIA A201-1997 General Conditions. Under those general conditions, the town had the right to terminate BBC "for default" if it materially breached the contract or "for convenience" in other situations.

Termination for convenience would permit BBC to recover reasonable overhead and profits it would have earned had the project been completed. Such provisions are typical in public works contracts, where the government may decide for budgetary or other reasons not to finish a job.

In addition to including the standard AIA contract terms, the town and BBC added a provision to comply with the state Board of Library Commissioners grant. It stipulated that the contract would *automatically* terminate on Oct. 1, 2000, in the event the town was unable to "obtain any and all required permits before Oct. 1, 2000."

Costly delays

The project required, in addition to the usual building and zoning permits, environmental wetlands approval and, because it was a historic structure, a permit from the Massachusetts Historical Commission.

The wetlands approval initially issued was opposed by a citizens' group and, on Sept. 29, 2000, the Massachusetts Department of Environmental Protection issued a superseding order of conditions letter, describing environmental requirements for the project.

That same day, the town issued a notice to proceed to BBC. Mindful of the grant requirements respecting commencement of construction, BBC began work at the site on Oct. 2, 2000. Yet, almost immediately, lawyers for the town instructed that the work cease, because proceeding with the project during the wetlands appeal period was prohibited. BBC stopped work but held the contract open for 14 months.

Lost profits

This delay resulted in loss of the Library Board construction grant, though the town did pay BBC $148,793.75 for the mobilization and site work performed before the stop work order. Nonetheless, BBC sued, claiming that, because neither the town nor BBC had ever provided written notice that the contract was being terminated, the termination for failure

Bonding: A major factor

A major factor for BBC Company in *BBC Company v. Town of Easton* (see main article), and indeed for many construction companies embroiled in legal battles, is bonding. In this case, the contractor had to carry the "mothballed" library project on its books for *14 months* while everyone ostensibly worked to revive the grant and complete the project.

Because bonding companies restrict the total amount of bonded work a contractor may have ongoing at any one time, depending on the contractor's working capital, cash flows and other financial criteria, this left BBC in a costly bind. In retrospect, the company would have been better off to immediately recognize termination of the Easton project and free up its bonding capacity to bid on other projects.

to obtain required permits was a termination for convenience, entitling BBC under the terms of the AIA contract and general conditions to:

- ✓ Overhead and lost profits on the library contract, and
- ✓ Profits lost on other contracts it could not bid on during the 14-month delay because of the diminished bonding capacity it suffered from having to keep the library contract on its books. (See "Bonding: A major factor" on page 2.)

In response, the town argued that the automatic termination provision written into the contract to cover failure to obtain permits and the resulting loss of the library board grant did not provide for any right to recover overhead or lost profits.

"Automatic" power

The trial court judge ruled in favor of the town, and BBC appealed. The Appeals Court of Massachusetts affirmed the dismissal of BBC's overhead and lost profits claims, ruling that, despite the typical AIA terms allowing recovery of overhead and lost profits in cases of termination for convenience, the automatic termination language inserted into the AIA document clearly indicated that, if the town's inability to secure all required permits resulted in loss of the library board grant, the town should not be held liable under the contract.

BBC argued that the town had issued a notice to proceed that should make the town liable for termination

for convenience. But the court ruled that the notice to proceed "does not change the fact that the contract automatically terminated when the preconditions to commencement of the work were not met."

No safe assumptions

Before submitting a bid on a local government construction project that will be paid for entirely or in part with conditional state or federal grant monies, general contractors must, in consultation with their attorneys, carefully review the contract language of the job in question. It's not safe to assume that, if the project ends because of the loss of grant money, the contractor can claim termination for convenience and collect overhead and lost profits.

Job, interrupted

Mechanics' lien rights are a matter of perspective — the court's

Many states prohibit recording mechanics' lien notices until a project is "complete." They do so to protect owners and contractors alike from cluttering up real estate titles with premature lien notices based on claims that may well get resolved by job's end.

But when termination, bankruptcy or another unanticipated circumstance interrupts a project, the courts often must determine when the project is "complete" and the unpaid contractor is entitled to record its lien notice.

A recent California Court of Appeals opinion, *Howard S. Wright Construction v. BBIC Investors*, illustrates the complexity of just such a situation.

Dot com-struction

360networks, an Internet service provider, hired Wright Construction to convert a portion of an old warehouse building in Oakland into a high tech "point of presence" site complete with redundant power supply, earthquake protection, dry sprinklers, waterproofing and other enhancements. The price was $5.2 million.

Work began in March 2001, but by May of that year 360 encountered serious financial difficulties and notified Wright that it was "mothballing" the project. At the end of May, Wright and 360 agreed on a price of $194,950 for punch list and demobilization work to be completed for a June 26 final inspection.

Yet, in a June 18 telephone call, and confirmed in writing the next day, 360 advised Wright that: "360networks does not intend to make any payments ... for 30 days even though certain amounts are due ... and [360 is] unable to give ... any assurances that payments due would be made after the 30 day period."

On June 19, Wright and its subcontractors pulled all tradesmen from the site and stopped work.

Pickup problems

Wright delayed no further in pursuing its claim, recording its lien notice on June 20. It did, however, send a pickup truck to the job site to move some uninstalled ductwork. In addition, company representatives attended the June 26 final inspection. 360 filed for bankruptcy on June 28.

When Wright filed a lawsuit to foreclose on its mechanics' lien, 360 argued in defense that the lien notice was recorded prematurely. After all, 360 asserted, sending the pickup to move the ductwork and attending the inspection showed that Wright's work was not yet "complete" at the time the lien notice was recorded. The trial judge was convinced and dismissed Wright's lawsuit.

Cutting through the complex arguments advanced by lawyers for both sides, the California Court of Appeals fashioned its own simpler conclusion.

Done, finished, finito

On appeal, mindful of the trial judge's conclusion about the prematurity of its lien, Wright's lawyers argued that the $194,950 agreed-on price for mothballing the job was a separate closeout contract, and the pickup truck excursion and final inspection were not, therefore, performed under the construction

contract on which its lien claim was based. 360 argued that Wright should not have recorded any lien notice until 60 days after the final inspection.

Cutting through the complex arguments advanced by lawyers for both sides, the California Court of Appeals fashioned its own simpler conclusion: There was only one contract, but a construction contract is complete "when all work under the contract has been performed, excused, or otherwise discharged."

The court went on to rule that the mid-June notification that 360 would not pay invoices as they became due was an anticipatory breach of the construction contract. This breach excused further performance by Wright and justified Wright's recording a mechanics' lien notice the next day.

Ultimately, the court reversed the trial judge's decision and allowed Wright to recover the amount of its lien in full.

Right on time

Whenever an owner mothballs a project, leaving the contractor unpaid, a rather precarious legal predicament comes to pass. In response, the contractor should immediately contact an experienced construction attorney for help determining whether the contract has been completed so lien paperwork can be filed neither too soon nor too late. *T*

Historical fiction

Owner's failure to disclose building history brings harsh lesson

Owners who contract for renovations of historic buildings are obliged to disclose to their contractors all the relevant history of the building. Should they fail to do so, a judge may be waiting in the wings to teach them a harsh lesson.

Painted into a corner

Case in point: *A. G. Cullen Construction v. State System of Higher Education*, which began when the Pennsylvania State System of Higher Education decided to renovate John Sutton Hall, the 125-year-old historic centerpiece of the campus of Indiana University of Pennsylvania.

Cullen Construction, successful bidder on the project, began work June 1, 2000, with a scheduled completion date of Aug. 24, 2001. The scope of the renovation project included replacement of 550 windows with elaborately carved wood frames.

A prebid notice assured bidders that the System would address all asbestos- and lead-containing materials affected by the project, and neither the plans and specifications issued for bid nor those issued for construction mentioned lead-based paint.

But in May 2001, Cullen discovered lead-based paint on the existing window frames and stopped demolition work on the old windows until a lead abatement program could be put in place.

Known all along

Even after Cullen notified the System of the discovery of lead-based paint, the System waited 31 days to respond to Cullen's request for information and direction regarding an abatement program. As a result, Cullen made a claim for delay damages to the Pennsylvania Board of Claims.

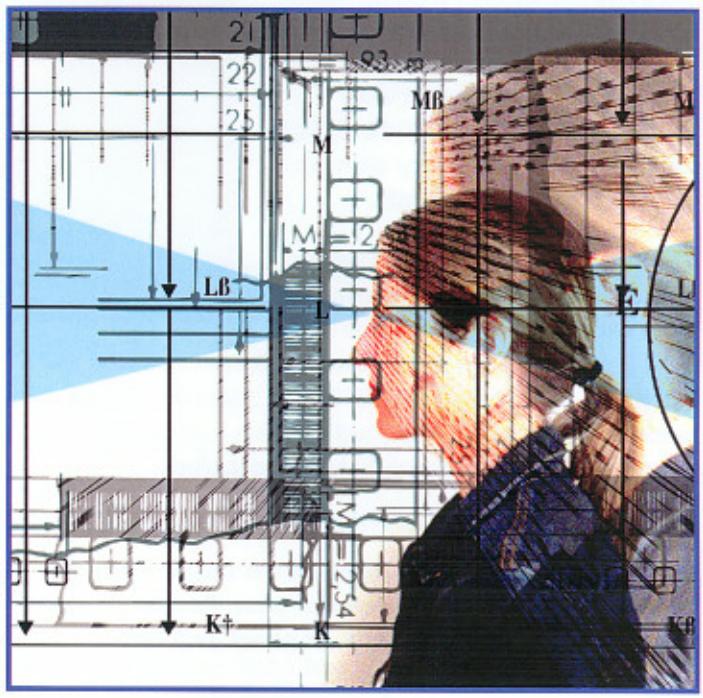
Evidence at the trial demonstrated that the System had known about the lead paint on the windows all along, and the board awarded the contractor $28,998.95 for the 31 days during which window demolition ceased to establish a lead abatement program.

Arguments made, lost

The System appealed, arguing that it had made no positive misstatement to Cullen regarding lead paint. It also argued that Cullen's use of the total cost method to calculate delay damages was speculative and that Cullen's contract included a "no damages for delay" clause.

The Commonwealth Court rejected all three arguments. It ruled that the absence of any reference to lead paint in any plans and specifications, combined with the prebid notice that "all asbestos and lead containing materials affected by the project will be addressed" *and* the actual knowledge that the window frames were painted with lead-based paint, constituted a positive misstatement to Cullen.

The court also ruled that, under the circumstances of a discovered environmental condition requiring abatement, the total cost method was properly applied, and the contract's "no damages for delay" clause was unenforceable because the System had failed to act on the lead problem, which was an "essential matter necessary to the prosecution of the work."



Lesson learned

Ultimately, the Commonwealth Court not only affirmed the award, but also awarded Cullen its attorneys' fees associated with the case. And what began as an earnest effort to renovate a historic building turned out to be a costly lesson in the importance of structural history to the owner in question. *T*

Not dead yet: Claim periods may defy expectations

According to statutes of limitations, there must come a time after project completion when all contract claims must be either put into suit or left to die. But, as a recent Texas decision demonstrates, while the legislature may provide that the opportunity to file a claim ends after a certain period, it's the courts that decide when the claim period begins — and how long it really lasts.

Building a school

The seeds of *Pharr–San Juan–Alamo Independent School District v. Turner Construction* were planted in 1995, when the Pharr–San Juan–Alamo Independent School District contracted with Turner Construction to build a new high school. A certificate of completion was issued to Turner on Aug. 11, 1997, and students and faculty went to work the following month.

With classes in session, however, a defective HVAC system began to allow moisture accumulation and mold growth within the ductwork. Turner notified the district of the problem in 1997 but, because of cost concerns, the district rejected its own engineers' recommendation to remediate the problem.

Getting a pass

As a result of mold growth, students began getting sick during the 1999-2000 school year. Personal injury lawsuits against the district's architect and Turner followed in the spring of 2000.

The students couldn't sue the district directly because of its sovereign immunity as a unit of local government. What's more, according to the district, the four-year statute of limitations for contract claims under the construction agreement expired on Aug. 11, 2001.

Turner filed papers on Sept. 11, 2002, seeking to bring the district into the students' personal injury cases because, it contended, the district's decision not to clean up the mold in 1997 was the cause of the students' illnesses. The district, however, convinced the trial judge that Turner's claims were too late, and the trial judge dismissed the case. Turner appealed.

Returning to the fray

The Court of Appeals of Texas returned the district to the fray. It found that, in drafting the construction contract, the district had sought to protect itself by inserting a clause that provided:

> As to acts or failures to act after [the date of substantial completion], any applicable statute of limitations shall commence to run ... not later than ... the date of actual commission of any other act or failure to perform any duty or obligation ... whichever occurs last.

The court agreed with Turner that, once the district knew about the mold problem, the district "... ha[d] an ongoing obligation to correct or otherwise remediate the design defects ... ." Therefore, the four-year statute of limitations didn't begin until the district began cleaning up the mold at the end of the 1999–2000 school year.

Because Turner's filings joining the district in the injury litigation came in September 2002, the court ruled they were well within the statute of limitations, and Turner could proceed against the district.

Staying in the fight

What can contractors learn from this case? When pursuing a claim, stay in the fight — even if that claim appears to have expired. An experienced construction attorney can help determine when the claim began under the terms of the contract in question and when it should end.

Can construction managers insure against their own breach of contract?

It has long been an axiom in both the insurance and construction industries that a general contractor cannot insure against its own breach of contract with an owner.

Yet many general contractors are expanding into the "construction management" business by involving themselves in the design development stage of projects. And their attendant purchase of professional liability insurance may be introducing a chink in the armor of many insurers.

Coverage acquired

A recent example of this is *1325 North Van Buren LLC v. T-3 Group*, a case that arose from a Milwaukee developer's decision to engage T-3 Group to convert an industrial warehouse into condominiums. As construction manager, T-3 bought construction manager's professional liability insurance from Westport Insurance.

Subsequently, construction delays and accidental structural damage by subcontractors led the developer to terminate T-3 and sue the contractor for $11 million in extra costs to have another construction company complete the project.

Policy upheld

When the case went to trial, both the developer and T-3 claimed that Westport should cover the developer's claim. Westport, however, convinced the trial judge to rule that its policy could not cover claims based on breach of the construction management contract.

But, on appeal, this finding was reversed. The Wisconsin Court of Appeals found that the Westport policy did indeed cover the loss, and the Wisconsin Supreme Court agreed. In fact, the Wisconsin Supreme Court's opinion upholding the coverage under Westport's professional liability policy cuts right to the heart of the issue: "What matters is whether the complaint alleges T-3 failed to provide competent professional services ... ."

Answer forthcoming

Whether other courts nationwide will follow this same tack is, of course, hard to say. But it's beginning to appear that use of the "construction manager" format may afford both owners and contractors some insurance protection that may not have been available under the traditional "owner and general contractor" arrangement. That said, look for more litigation in many different states before any clear answer over this question comes to light.

KMFM CONSULTING GROUP
RISK MANAGEMENT SERVICES

You probably know that Koletsky, Mancini, Feldman & Morrow is an "AV" rated construction litigation firm with 40 attorneys serving California from offices in Los Angeles and Oakland. But what you may not know is that in addition to providing unparalleled legal services, the Firm has formed **KMFM Consulting Group** which has joined forces with Gallagher Construction Services to assist our clients in the construction industry with their risk management needs. The goal of the program is to aid builders of all sizes in developing or enhancing in-house protocols for the reduction or elimination of risk associated with medium to large construction projects.

KMFM Consulting Group's Specialized Risk Management Services:

Increased construction defect litigation has resulted in higher costs and increased risks to developers and general contractors. The increased expense of litigation is seen not only in a company's bottom line, but also when renewing necessary commercial liability insurance. The resulting higher premiums, deductibles, and self insured retention limits in connection with these policies can have a devastating impact on companies of all sizes. Increased deductibles and self insured retention limits means increased legal costs bourne by your company when defending claims within the parameters of these limits. The core objective of **KMFM Consulting Group** is to eliminate or significantly reduce these costs and risks by:

- ✓ Working with clients at the outset of the building process to ensure subcontractor agreements are in place with proper indemnification and mandatory insurance clauses in effect. The drafting of proper subcontract agreements is essential for the shifting of risk of future construction defect claims to the subcontractors who performed the work, and their insurers;
- ✓ Providing employee training and instructive seminars in prevention and management of defect-related risk including the right of builders to avail themselves of California's Right to Fix Statutes (Title 7 of the Civil Code formerly SB800).
- ✓ Training relating to claims handling and early resolution procedures to avoid potential litigation;
- ✓ Effective identification, investigation, documentation and file retention of potential losses in order to maximize effective claim evaluation and resolution;
- ✓ Working with claimants in order to facilitate early resolution of claims prior to the institution of formal legal proceedings. Early, effective resolution of homeowner claims is an essential part of customer satisfaction and brand relations. It also helps maximize recovery from subcontractors whose work is implicated by the claim should future litigation become necessary.

These are just a few examples of the risk management services provided by **KMFM Consulting Group**. We invite you to contact our offices to arrange for a meeting where we can further demonstrate how this new aspect of the Firm's construction practice can benefit your business.

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