November/December 2007

CONSTRUCTION LAW BRIEFING

IN THIS ISSUE

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We're covered, right?

Title insurance has its limits

When buying title insurance on vacant property, developers often harbor the notion that the policy will cover them to the full extent that any title defects reduce the profitability of the planned development. A recent case from Minnesota, *Rakhshani v. Chicago Title*, illustrates the risks of this line of thinking.

Empty lot full of problems

James Rakhshani bought a vacant lot in Stearns County, Minn., intending to build a 9,400 square foot commercial building on the property. After filling and grading the lot, and putting in foundation footings for the proposed new construction, Rakhshani was notified by the municipal government that the footings encroached upon a municipal utility easement across the lot and would have to be taken out.

Rakhshani filed a lawsuit against Chicago Title Insurance Company, claiming that the value of the property with the easement across it was $27,000 less than without the easement.

At trial, Rakhshani offered the Stearns County District Court testimony of a real estate appraiser, who gave the opinion that the existence of the utility easement reduced the value of the vacant lot because the owner couldn't build as large a building as might be built without the easement.

The trial judge rejected the appraiser's opinion because, though the location of Rakhshani's proposed construction was moved to a different part of the property, the building constructed was the same size as the one originally planned. The court granted summary judgment in favor of the title company and dismissed the case.

Losses limited

Rakhshani appealed, and the Court of Appeals of Minnesota carefully analyzed the issues raised by the appraiser's value opinions. It pointed out that a title insurance policy on vacant property covers only the loss in value of the property as vacant land. Such a policy, the appeals court ruled, doesn't cover the profits a landowner expects to realize from the construction of buildings or other improvements on the land.

The court further pointed out that, when new buildings are built on vacant property, new title insurance policies must be taken out to cover the value of the new buildings. If this is not done, and title defects are discovered after the construction is complete, the title insurance policy language strictly limits the amount that may be recovered to the amount of title insurance purchased under the title policy on the vacant land.

So the appeals court agreed with the trial court that the appraiser's opinion was inadmissible because it was based on the proposed future development of the lot rather than any reduction in value of the vacant lot as vacant land caused by the undisclosed utility easement.

A costly choice

Nevertheless, the appeals court acknowledged that the belated disclosure of the utility easement did, in fact, damage Rakhshani because he had incurred the cost of removing and rebuilding the foundation footings that originally encroached on the easement. But Rakhshani and his attorneys had elected not to present proof of

that expense. The appeals court ruled that Rakhshani's failure to offer this damage evidence presumably available to him meant no damages at all had been proved.

Furthermore, the appeals court denied recovery to Rakhshani because the easement that was undisclosed in the title policy was, in fact, discovered *before* any significant construction was performed on the vacant lot. Therefore, the court reasoned, any loss of value in the planned development must have resulted from risks not associated with the existence of the easement.

The court's reasoning was based on the tenet that the value of vacant land is the price a willing buyer will pay a willing seller for the vacant land — not the value of a completed development less the cost of construction. This was the logical flaw in the plaintiff's appraiser's approach to calculating the amount he claimed was lost. Thus, summary judgment in favor of Chicago Title was appropriate, and the appeals court affirmed the trial court's dismissal.

Liability insurance vs. title insurance: A big difference

When many contractors think of insurance, they think of their liability policies. This coverage, critical to any project, is purchased, put into effect, and left as a safety net in case of a variety of unfortunate events.

Yet, unlike liability insurance, title insurance is not "buy it and forget it" coverage. When constructing a building on vacant land or making improvements to existing buildings, owners must carefully review and update their title insurance to make certain coverage is both current and adequate for the value of the property. Failure to update title insurance may result in the owner recovering only a small portion of any loss suffered.

Many potential difficulties

Any owner or developer — or contractor trying his or her hand at developing a property — who intends to build on vacant property needs legal advice from an experienced construction lawyer on title insurance issues. Otherwise, the difficulties presented by the need to keep title insurance up to date during and after completion of construction may lead to unanticipated additional losses should title defects be discovered.

The prevailing wisdom on prevailing wages

It's all about timing …

A recent Pennsylvania case, *Mosaica Education v. Pennsylvania Prevailing Wage Appeals Board*, illustrates how the construction trade unions may be losing ground on prevailing wage laws because of court decisions arising from charter school projects.

Public education, not public funds

Construction trade unions have lobbied hard to enact laws ensuring that nonunion contractors cannot gain a bidding advantage on public projects by paying less than union scale. More specifically, these laws require contractors bidding on such projects to pay "prevailing wages" for the trade in question as determined by a state wage board. Generally, the result is that nonunion contractors must pay union scale on public jobs.

The recent movement toward using charter schools for public education, however, has clashed with prevailing wage laws because charter school buildings are built by charter schools to provide the required public education but aren't paid for with public funds.

> *The recent movement toward using charter schools for public education has clashed with prevailing wage laws.*

Cart before horse

In *Mosaica*, a group in Harrisburg, Penn., formed the Ronald H. Brown Charter School. The school's trustees contracted with a for-profit company, Mosaica Education Inc., to manage the school's day-to-day operations. EFA Co., a wholly owned subsidiary of Mosaica, bought a building for the school to use, and leased it to Mosaica *before* the formal management contract between Mosaica and the school was signed. Also *before* the contract with the school was signed, Mosaica hired Ritter Brothers Construction Company to renovate the building for the charter school's use.

The charter school statute in Pennsylvania specifically provided that, even though no public funds were to be used to build charter schools, the construction of charter school buildings was to be covered by the state's prevailing wage law. Under these circumstances, the Pennsylvania Prevailing Wage Appeals Board ruled that the charter school renovation project was covered by the Pennsylvania prevailing wage law and that Ritter Brothers would have to pay tradesmen prevailing wages for their work.

Ruling reversed

Mosaica took the wage board to court, and the Pennsylvania Court of Common Pleas reversed the board's ruling.

The court held that, because the renovation contract between Mosaica and Ritter Brothers was signed before Mosaica signed its management contract with the charter school, neither Mosaica nor Ritter Brothers was a contractor of the charter school. Therefore, prevailing wages need not be paid on the building renovation project.

The wage board argued that Mosaica had worked closely with the charter school trustees in applying for and obtaining the school charter, using its wholly owned subsidiary to buy the building that Mosaica had leased to house the charter school. Mosaica then let the renovation contract to Ritter Brothers and, a few days later, signed its management agreement with the charter school trustees.

The board asserted that the close relationships among Mosaica, EFA and the school trustees made Ritter Brothers and Mosaica the contractors of the charter school trustees, which brought the building renovations under the prevailing wage statute.

The court decided that, because the charter school trustees were theoretically free to hire a different management company and lease a different school building during the few days' time before the trustees signed their management contract with Mosaica, neither Mosaica nor Ritter Brothers was a contractor to the charter school trustees with respect to the building renovations. Thus, the prevailing wage laws didn't apply to the renovation work.

Statement made

This decision makes a statement about how the growing effort to privatize the delivery of public education services through charter schools can hinder construction trade unions from getting prevailing wage laws enforced. It's all about timing — and one legal miscue can undo even the most carefully worded legislation.

Speaking out of turn: The problem with oral change orders

Despite specific statutes expressly prohibiting oral changes to construction contracts, the practice often occurs anyway. And when it does, courts typically adhere to the basic principle that a property owner cannot knowingly permit a contractor to do work outside of the written contract's scope and then refuse to pay the reasonable value of the out-of-scope work. A recent California case, *Mirabella Design Build v. Von Herrath*, put this principle to the test.

The price is ... what?

A husband and wife, both described by the court opinion as untrained and inexperienced in construction, signed a written contract for remodeling their home. The work was to cost $552,445.35, with both the contract and the applicable California statute requiring any changes to be in writing.

> *Could the homeowners be permitted to knowingly receive valuable construction services and then use contractual and statutory technicalities to avoid paying for them?*

During the course of the project, several scope increases were agreed to, embodied in written change orders and billed to the homeowners, who paid these bills. At the time construction was nearly complete, the builder presented the couple with a 62-page change order reflecting a variety of additional items agreed to and performed during the project. The total price increase was $130,453.14, which the homeowners refused to pay. The builder sued.

What did the courts think?

The Superior Court of San Diego County refused any recovery to the contractor, reasoning that the oral changes were unenforceable under both the state statute barring oral change orders and the terms of the contract requiring changes to be in writing.

Moreover, the court refused to permit recovery based on the reasonable value of the additional work actually performed by the builder.

The California Court of Appeal agreed that enforcement of oral change orders is barred both by the contract language and by statute, but ruled that the homeowners could not be permitted to knowingly receive valuable construction services and then use contractual and statutory technicalities to avoid paying for them.

To allow recovery by the builder, the Court of Appeal sent the case back to the trial court for determination of the reasonable value of the work described in the 62-page list of changes.

And the lesson is ...?

For contractors, the lesson here is fairly clear: Always record in writing changes in the contract's scope and the price for the change. And get the owner to sign the change order. Without a signed change order, a contractor runs the risk that a court will decide that the "reasonable" value of the changed work is less than the true value or, even worse, that the work was not a change at all. T

Prime contractors on public job battle over delay damages

To save taxpayers money on public works projects, municipal governments are ever eager to adopt innovations from private sector construction. Among the most popular of such innovations is the use of separate prime contracts for each division of work, rather than using the traditional owner/general contractor/subcontractors structure for project agreements.

Unfortunately, public procurement officers may not always go over their form construction agreements with a fine-tooth comb to adjust the contract language to the new organizational format. Case in point: *Everman's Electric v. Evan Johnson & Sons*, which arose in Biloxi, Miss.

Key language is omitted

The Biloxi Public School District built a new high school using separate prime contracts for each trade and with a construction manager who was to schedule and coordinate all the work.

Each prime contract included the usual "no damages for delay" provision setting out that the only relief against the district and its construction manager for delaying a prime trade contractor would be a time extension. In addition, there would be no money damages for "direct or indirect costs, extended home office overhead, idle or inefficient labor or equipment, cost escalations, or monetary claims of any nature" should the owner or construction manager delay a prime contractor in performing its trade work.

> *The "no damages for delay" provision omitted any language protecting the trade contractors from delay claims among themselves and other trades.*

What was omitted in the "no damages for delay" provision, however, was any language protecting the trade contractors from delay claims among themselves and other trades.

The courts weigh in

At project's end, Everman's Electric Co., the electrical prime contractor, filed suit against the school district, W. G. Yates (the construction manager), and Johnson & Sons Construction (the masonry trade contractor), citing coordination delays that reduced Everman's profit on the project. Based on the contract's "no damages for delay" provisions, the Harrison County Circuit Court granted summary judgment against Everman's and in favor of all three defendants.

Everman's took the case to the Court of Appeals of Mississippi, which upheld the rulings in favor of the

school district and the construction manager, ruling that the traditional "no damages for delay" language in the front-end documents protected the district and the construction manager from any claim other than a time extension.

The court further ruled, however, that, because the contract documents didn't specifically exclude delay damage claims by one trade contractor against another, the masonry trade contractor would be liable for the damages resulting from any delays it caused to the electrical contractor's work.

The case was sent back to the Harrison County Circuit Court for a trial on the amount of damages the masonry contractor would have to pay.

Review is necessary

A careful legal review of the contract, and adjustment of the language through an addendum before bidding, could have prevented the ugly situation that developed here. Let this be a lesson to any contractors who get involved with municipal governments trying out unfamiliar construction formats.

Construction contracts must be a two-way street

Occasionally, a party to a construction contract attempts to use the language of the document to position itself to receive all of the agreement's benefits without paying the agreed-upon price. Such was the case in *Papetsas Building Company v. L'Heureux.*

Hitting the deck

Raymond L'Heureux contracted with Papetsas Building Company to build a house in North Truro, Mass. The house was completed, but there was a dispute over the soundness of the rear deck's foundation piers.

Owner and builder entered into a settlement escrow, with L'Heureux putting up $25,715 of the total price in escrow pending either certification from a specified engineering firm that the piers were structurally sound or completion of corrective work to bring the piers up to code.

When the builder was unable to obtain the engineer's certificate, it offered to perform the corrective work. L'Heureux, however, wouldn't allow the builder back on the property.

Going to court

The builder sued, seeking release of the $25,715 in escrow, and a jury trial in the Orleans Superior Court resulted in an award of the entire amount. The homeowner appealed, arguing that the builder had not performed either of the conditions for release of the escrowed funds.

The Appeals Court of Massachusetts ruled that the owner couldn't claim return of the escrowed funds because his refusal to permit the builder's crew back on the property to perform the remedial work was a breach of the settlement agreement. Yet, by the same token, the court also rejected the builder's claim that it was entitled to the entire escrow amount.

Instead, the appeals court sent the case back to the Superior Court to determine how much money the builder saved by not having to perform the repairs. That cost savings was to be deducted from the escrowed amount before the money was released.

Considering a compromise

Both sides of this modest dispute probably paid more to try the case twice and take the appeal than the $25,715 in dispute. And therein lies the point: A fair compromise is almost always less costly than pursuing rights a party believes it's entitled to under the most technical reading of the contract language.