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# CONSTRUCTION LAW BRIEFING



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# In Katrina's wake

## Historic storm leads to contract termination ... and a lawsuit

**H**urricane Katrina was among the most documented disasters in U.S. history. The legal ramifications of that terrible, historic storm have been relatively less acknowledged. This may change as more and more Katrina-related decisions are handed down. One such case, which addresses a contract termination dispute, is *Citadel Builders v. Transcontinental Realty*.

### Giving up on the job

On Aug. 15, 2005, Transcontinental Realty Investors signed a contract with Citadel Builders for construction of a \$7.2 million parking garage in downtown New Orleans. Then, on Aug. 29, 2005, Hurricane Katrina struck.



Transcontinental canceled the parking garage contract on Nov. 7, 2005, observing that logistical problems and cost increases caused by the storm's aftermath made completion impractical. At the time of termination, there had been no work performed on the site, and Citadel had spent only \$16,549.40 to hire two supervisory personnel for the project.

Citadel sued Transcontinental for \$366,549.40, claiming that the contract was terminated "for convenience" and Citadel was entitled not only to the \$16,549.40 it had actually spent, but also to its anticipated profit (\$350,000) on project completion.

Citadel filed a motion for summary judgment, arguing that hurricanes in New Orleans are foreseeable events, and that Katrina didn't make construction of the parking garage impossible, as Transcontinental asserted.

### Seeing the future

Citing the unprecedented extent of storm damage and flooding in New Orleans after Katrina as compared with other hurricanes that had struck there, the U.S. District Court for the Eastern District of Louisiana ruled against Citadel.

It held that, unless Citadel could prove it was prepared to complete the project without any price increase above the amount agreed on before the storm, the construction company wasn't entitled to the lost profits sought in the summary judgment motion.

The court observed that, in negotiations between the date of the storm and the date Transcontinental terminated the contract, Citadel itself had been seeking a price increase of not less than 2%, citing higher costs for materials, labor and housing after the hurricane. In denying the summary judgment motion, the court stated:

But Citadel cannot prevail unless it stood ready to honor its own obligations under the contract including completing the project at the pre-Katrina agreed upon price notwithstanding the post-Katrina increases in materials, labor and housing.

Drawing a distinction between its opinion and earlier ones ruling that hurricanes in New Orleans are foreseeable, the court observed that, even two years after Katrina, the New Orleans area hadn't returned to anywhere near the state of normalcy present before the storm. Therefore, the court couldn't decide, as a matter of law, that the parties to the contract could have foreseen Katrina's aftermath.

The opinion goes on to point out that, under Louisiana law, even partial impossibility of performance could allow the court to void the contract, leaving Citadel entitled to only the \$16,549.40 in costs actually incurred before the storm.

## Doing a favor

Basically, the court in this case looked at all the circumstances and concluded that Transcontinental was doing Citadel a favor by letting the construction company out of the contract. In turn, the court indicated that Citadel, in seeking additional recovery of the profits it might have received if not for Hurricane Katrina, was attempting to take advantage of Transcontinental's generosity.

Had Transcontinental held Citadel's feet to the fire, the court concluded, Citadel could well have *lost* money, rather than profited, once the project was completed.

The court decided that, before Citadel could recover lost profits, the construction company would have to prove both that the parking garage project could have reasonably been completed after Katrina, and that Citadel could have made the profit it sought even at the pre-Katrina contract price.

## Recognizing the extraordinary

As the outcome of this case shows, extraordinary circumstances can affect a court's decision regarding the termination of a construction contract. Hurricanes may not be uncommon in the New Orleans area, but the Katrina disaster was unprecedented in scope. **T**

# Put in a bind

## *Recent federal decisions limit copyright protection of architectural plans*

**T**he typical AIA agreement between an architect and an owner includes various protective provisions. One mandates that architectural plans, specifications and other design documents are "instruments of service" and, as such, remain the property of the architect. They're not to be reused by the owner or others without the architect's consent. And, presumably, even with such consent, these documents are to be reused only after payment of additional fees to the architect.

As clear as these terms may sound, recent federal court decisions have put anyone seeking to protect architectural plans from unauthorized use in a serious bind. The case of *Frontier Group v. Northwest Drafting* provides a prime example.

## Plans gone awry

In April 2003, the Frontier Group agreed to prepare plans of a single family home for Wayne and Barbara Shields in Goshen, Conn.

When disputes with Frontier over construction of the Shieldses' new home arose, Mr. and Mrs. Shields sold the property, along with the partially constructed foundation and footings, to Martial Grondin. The Shieldses also gave Grondin copies of Frontier's plans — without the architect's permission.

In turn, Grondin took the Frontier plans to Northwest Drafting and Design, which drafted new plans using the footings and foundations built following Frontier's plans.

Frontier sued both Northwest and Grondin under Connecticut state laws for wrongfully converting its plans and for violating the Connecticut Unfair Trade Practices Act. In the lawsuit, Frontier's attorneys carefully avoided any mention of federal copyright laws, because Frontier had never registered its plans under the Copyright Act.

## Really an infringement claim

Asserting that the lawsuit was really a claim for copyright infringement, Grondin filed a notice to have the case removed to federal court.



## ANOTHER COURT GOES ONE STEP FURTHER

In *Dalton-Ross Homes v. Williams*, the U.S. District Court for the District of Arizona went even further in limiting the copyright protection available to architectural plans than did the court in *Frontier Group v. Northwest Drafting*. (See main article.)

VW Homes in Lake Havasu, Ariz., built and sold homes, including a model called “Villa del Mesa.” In January 2000, VW registered the Villa del Mesa plans under the Copyright Act and licensed the plans to Dalton-Ross Homes. Under the license, Dalton-Ross paid VW \$2,000 for each home it built using the Villa del Mesa plans.

Later, Dalton-Ross hired a draftsman to prepare revisions to the Villa del Mesa plans for a home for George and Chris Link. Later still, Dalton-Ross had the draftsman revise the Link plans to build a home for Brian and Silvia Conway. Neither the Link plans nor the Conway plans were ever registered under the Copyright Act.

Finally, in January 2005, Daryl Williams hired the same draftsman to mark up the Conway plans for use in building a house. Upon learning of this, Dalton-Ross sued Williams, claiming that the Conway plans were a “derivative work” of the Villa del Mesa plans and that Williams’ unauthorized use of the Conway plans to build his home was an infringement of the Villa del Mesa copyright.

When the case went to court, the judge dismissed the Dalton-Ross lawsuit on the ground that the Copyright Act requires each “derivative work” to be registered separately before any action for infringement can be brought.

Once in federal court, Grondin argued that, because Frontier had never registered its plans, no copyright infringement lawsuit could be brought. (Under federal copyright law, an architect may sue another party for using architectural plans without paying for them only if the architect has registered the design under the Copyright Act.)

The U.S. District Court for the District of Connecticut agreed with Grondin, finding that, under Connecticut law, both the conversion claim and the unfair trade practices claim were really infringement claims on Frontier’s copyright of the architectural plans.

And because Frontier had never registered the plans under the Copyright Act, it could bring no lawsuit. Consequently, the case against Grondin was dismissed.

### The lesson for architects

For architects, the lesson from the case appears to be: Register your plans. But it’s not that simple.

Although the fee for doing so is nominal, copyright registration essentially makes a copy of the plans available to anyone willing to go to the Library of Congress and look them up. And once the plans have been registered, it’s virtually impossible to find out who, when or where someone has built a home using the plans without permission.

Perhaps the biggest problem for architects in relation to registering plans is that the copyright protects only *the exact plans registered*. No protection exists for copyrighted plans that have been modified at all; modified plans must be registered separately to receive protection. (See “Another court goes one step further” at left.) And, for architects designing homes, the

quantity of modified plans may make registering each version impractical.

Unfortunately, an architect would face a similar downside even if he or she chose *not* to register: The unregistered plans would still be available to the public through a freedom of information request to the building department that issued the building permit.

In other words, even if an architect went out and collected all but the record copies of his or her plans, those documents would still be out there at the mercy of unscrupulous members of the building public. So, the availability of registered plans in the Library of Congress shouldn’t necessarily preclude an architect from registering them.

### A safe assumption

If there’s a moral to the story, it’s this: An architect should fix his or her fee for preparing plans on the assumption that the first fee for a set of plans is all the compensation he or she will likely receive for the professional skill and effort exerted to prepare those plans. *T*

# Fire and rain: A builders risk policy dispute

**P**recisely what a construction-related insurance policy does and does not cover is a common source of contention between contractors and insurers. Sometimes it even leads to litigation. Such was the case in *Hunt Construction v. Allianz*.

## Terminal delays

Hunt Construction agreed to build a new terminal for Northwest Airlines at the Detroit airport. Hunt bought builders risk insurance on the project from Allianz.

Because of heavy rain, Hunt was late in completing the terminal and, as a result, was forced to pay millions in liquidated damages to Northwest. Hunt claimed the liquidated damages for delay as a loss under its Allianz builders risk policy but didn't file suit seeking recovery until more than one year after paying the damages.

Based on a contention that the builders risk policy was actually fire insurance under Michigan law with a one-year limitation period for filing suit, Allianz obtained summary judgment against Hunt in the U.S. District Court for the Southern District of Indiana.

In a timely claim, Hunt countered that the policy was not fire insurance and, therefore, the limitations period was six years.

*Was Allianz raising its time limitations to get out of paying a big claim that otherwise would be covered by its builders risk policy?*

## An appeal

The U.S. Court of Appeals for the Seventh Circuit reversed the judgment. The court pointed out that, if the one-year limitations statute were to apply to the Allianz policy, then, under Michigan law, the policy should have contained 19 policy provisions mandated by the same statute that included the one-year limitation.

Because none of the 19 provisions were included in the Allianz policy, the court concluded Allianz must



not have thought the policy was a fire insurance policy when it issued the coverage. Therefore, the insurer could not argue that it was fire insurance to defeat Hunt's claim.

The court recognized that, in essence, Allianz was raising its time limitations to get out of paying a big claim that otherwise would be covered by the builders risk policy. In fact, it appeared neither Allianz nor Hunt believed the policy was for fire insurance at the time it was issued. And, though fire was one of the many risks covered under the policy, none of the loss claimed by Hunt was the result of a fire.

Accordingly, the Court of Appeals ruled that the six-year time limit for filing the suit to collect the policy benefits was the correct Michigan law to apply and sent the case back to the district court for trial on the amount of damages Hunt should be able to collect under the policy.

## A likely objection

The objection raised by the insurer in this case is a likely one. That is, most insurance companies will explore — and exploit — all of their options for avoiding hefty claim payouts. For this reason, contractors should have an experienced construction lawyer review any policy they're considering for purchase. **T**

# Don't just file that insurance policy — follow it!

**M**any contractors make the mistake of buying insurance and immediately filing away their policy papers in the back of a drawer somewhere. Yet failing to pay attention to the ongoing requirements written into a liability insurance policy can mean coverage isn't there when it's needed. One builder learned this lesson the hard way in *Schmitt v. NIC Insurance*.

## Details, details

In April 2003, Richard Schmitt, a construction contractor, bought liability insurance from NIC. In the application for the insurance, Schmitt told NIC that he always used written subcontracts requiring subcontractors to indemnify him and to have \$1 million of their own insurance.

In addition, he said he always collected insurance certificates demonstrating that the subcontractors complied with the requirement. The insurance policy required Schmitt to continue these practices throughout the policy period.

In February 2004, developer Gidha & Gidha contracted Schmitt to put up a commercial building. Schmitt performed the concrete work himself and subcontracted steel erection, exterior stucco and

garage door work to others. In violation of the insurance policy requirements, Schmitt didn't make the subs sign written contracts, nor did he collect insurance certificates from them.

*The question of whether NIC should have paid for defense of the arbitration depended on the allegations rather than the arbitrator's ultimate findings.*

In the spring of 2005, Gidha & Gidha complained of water damage and mold growth in the new building, asserting that the excess moisture resulted from defective concrete work by both Schmitt and his subs. Gidha took Schmitt to arbitration, and the arbitrator found that Schmitt's own work contributed to 40% of the moisture and mold problems.

Schmitt asked NIC to defend the arbitration and pay the award against it. When NIC refused both requests, Schmitt sued.

## Defenses raised

NIC raised two defenses to coverage: 1) a mold exclusion in the policy, and 2) Schmitt's failure to get written subcontracts and certificates of insurance from the subs. The U.S. District Court for the Northern District of California ruled that, because the arbitrator found all of Gidha & Gidha's losses resulted from mold growth (not water damage), NIC didn't have to pay the arbitration award.

The court further ruled, however, that the question of whether NIC should have paid for defense of the arbitration depended on the allegations rather than the arbitrator's ultimate findings.

Because, according to the court, Gidha & Gidha claimed Schmitt's own concrete slab work contributed to both the water damage (which was *not* subject to a policy exclusion) and the mold growth, Schmitt's failure to require indemnification and insurance



certificates wouldn't defeat coverage for excessive slab moisture. So, the court ruled that NIC should pay for the attorneys' fees and defense costs.

### Bullet dodged

In this particular case, Schmitt dodged a bullet. Nonetheless, the court's opinion should serve as

a reminder to all contractors of the need to examine their insurance policies, note all requirements the policies impose on dealings with subcontractors, and make sure those requirements are met before the policy is filed away for future reference. **T**

## CLB Quickcase

### *R.R. Gregory v. Labar Enterprises*

## Forsaken construction schedule leads to substantial losses

In September 2004, the Stafford County, Va., school board awarded construction company R.R. Gregory a \$13.2 million contract to build a new elementary school. Gregory subcontracted the site work to Labar Enterprises for an initial subcontract price of \$1.8 million.

Because of scope changes, the Labar subcontract was eventually increased to \$1,843,877.33. To have the building ready for the first day of school, the board established a completion date of Aug. 1, 2005.

Gregory's initial schedule called for Labar to finish the building pad by Nov. 1, 2004, but this was later revised to Dec. 9, 2004. Because of a lack of labor and equipment, however, Labar didn't complete its work until Jan. 3, 2005, holding up the project by 25 days.

Because of this delay, as well as other problems, the completion date wasn't met. In response, on Sept. 26, 2005, Gregory terminated Labar and hired Rice Contracting to finish Labar's incomplete work. Rice sent three crews to the site and, working 10- to 12-hour shifts, substantially completed the school by Nov. 28, 2005.

By the time the job was finished, Gregory had paid Labar \$1,090,274. Gregory also settled with two unpaid suppliers to Labar for a total of \$92,047.59. In addition, Gregory paid Rice \$931,544.46 for work within Labar's scope and incurred \$382,153.57 in direct and indirect costs to complete Labar's work. Last, Gregory had to pay the school board \$50,000 in delay damages.

After trial, the U.S. District Court for the Eastern District of Virginia awarded Gregory the difference between its total cost to complete Labar's work (\$2,496,019.62, including amounts paid to Labar) and the Labar subcontract (\$1,843,877.33) for actual damages of \$652,142.29 against Labar. The court then added the \$50,000 in delay damages caused by Labar's 25-day delay, making the total judgment against Labar \$702,142.29.

Thus, because Labar couldn't keep up with an established construction schedule, it ended up getting paid only \$388,131.71 for over \$1 million worth of work. And this was in addition to the problems the company brought on itself by being terminated on a bonded public project.

