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CONSTRUCTION LAW BRIEFING

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"Preprinted" may mean "precarious"

Failure to review key documents leads to payment disputes

In processing payments on construction projects, owners, architects, general contractors and subcontractors often rely on the language of preprinted forms to support their legal rights and, thus, fail to carefully review those forms.

This kind of lack of attention to detail can be costly, because the forms' language usually fails to take into account the effects of change orders and withheld retention on the timing of payments for work performed. How costly? The case of *Traco Steel Erectors v. Comtrol, Inc.* provides a prime example.

Changes and charges

Traco Steel Erectors had three subcontracts with general contractor Comtrol on projects for the Army Reserve, Utah Valley State College and Weber State University.

During the course of the three jobs, the subcontract values were adjusted by various change orders and backcharges for Traco's use of Comtrol-supplied hoisting equipment as well as for Comtrol's performing work within Traco's scope. The two sides never completely agreed on the final balance of the three projects' respective change orders and backcharges.

The Army Reserve project

On this project, interim payments to Traco totaled $59,201.95, and the next-to-last change order reflected a subcontract value of $64,218.90. Traco had refused, however, to sign a previously presented $13,345 change order for using Comtrol's crane, and there remained another disputed $850 backcharge to Traco for Comtrol hoisting services.

Comtrol prepared a final change order approving the $850 backcharge and inserted a revised subcontract value of $50,023.90. Although Traco's president did sign this final change order, Traco sued Comtrol for its claimed balance of $5,016.95 (the next-to-last change order's subcontract value less the interim payments).

When the case went to court, Comtrol defended itself by arguing that Traco was actually *overpaid* $9,178.05 because, in signing the final change order, Traco had acknowledged a total subcontract value of $50,023.90. Indeed, the final change order form signed by Traco's president did include preprinted language stating that the document "represents the final adjustment of all

Retaining retention: Interim billing tips for subcontractors

When it comes to submitting interim billings on a construction project, subcontractors often review only the numbers on the payment application form and ignore the partial lien waiver form that goes along with it. As the case of *Traco Steel Erectors v. Comtrol, Inc.* illustrates (see main article), this can be a big mistake.

In any situation where progress payments involve withholding retention from the amount earned, subcontractors should make sure the partial lien waiver form:

- ✓ Explicitly reflects that the subcontractor is, as a result of labor and materials provided to date, releasing its claim only for the "amount now due" under the contract,
- ✓ Notes that the "balance to complete" *includes* retention funds earned up to the date of the partial waiver, and
- ✓ Indicates amounts expected to be earned from labor and materials to be provided in the future — especially in cases where the subcontractor expects to finish most of its work early in the job and return at the end only for minor punch-list items.

In the absence of language acknowledging that retained funds have, in fact, been earned but remain unpaid, a sharp owner or general contractor could, at job's end, use partial waivers to defend itself against claims for payment of earned retention by arguing that the value of labor and materials provided during the punch-list work doesn't justify full payment of earned retention. And, indeed, a court could find that partial waivers given early on during the project constitute releases of claims to earned retention.

costs, delays, time extensions or other equitable adjustment ... arising out of ... the work."

Despite being presented with a signed affidavit from Traco's president stating that he'd signed the document by mistake, the Salt Lake District Court ruled in favor of Comtrol and ordered Traco to repay $9,178.05.

The university projects

On these two projects, Traco sought to recover payment of retention amounts withheld by Comtrol from the progress payments Traco had received during construction.

Here Comtrol argued that the preprinted partial lien waiver forms that Traco had filled out released Traco's claim to the retention amounts. Specifically, Comtrol pointed to language in the waivers releasing "all rights to ... claims ... for labor and materials furnished on or before [the date the waiver was signed]."

Traco argued that the waiver language was ambiguous, because the partial payments didn't include payment of earned retention. On appeal, however, the Court of Appeals of Utah again ruled in favor of Comtrol, finding the waiver language clear and unambiguous.

The right time

Financial closeout of a construction project often brings to light all of the disputes and unhappiness that have festered throughout the job. So, it's an inauspicious time to try to amicably resolve conflicts

arising from the wording of the various forms used to process interim payments during the project.

The time to raise issues regarding the wording of change orders or lien waiver forms is when the job's first payment is applied. At this point, parties are likely to be more flexible and more willing to accede to the fair and impartial language typical to interim payment documentation.

Courts, on the other hand, tend to take the wording of the preprinted forms used to process change orders and lien waivers literally. And this almost always leaves one party on the hook, perhaps unfairly, for a substantial dollar amount.

Haste makes waste

Ignoring a construction contract's fine print can be costly

Whether putting together a bid or writing contracts, parties to a construction project sometimes give the paperwork only a cursory review. Focusing primarily on price and scope, they tend to gloss over the rest of the documents, which often have to be assembled in a hurry.

In *1800 Ocotillo, LLC v. The WLB Group*, an Arizona developer learned the pitfalls of such practices.

A river runs through it

Ocotillo is a real estate development firm in Phoenix. In 1998, Ocotillo was planning a townhouse development on property it owned alongside the Arizona Canal. Ocotillo hired Morris Building and Management to design and build the project.

On behalf of Ocotillo, Morris signed a contract with WLB Group to provide surveying, engineering and landscape architecture services for the job. After

certain scope additions, WLB's professional surveying fees under the contract totaled $54,970.

WLB surveyed the Ocotillo parcel and produced a plat depicting boundaries of the property and noting all claimed rights of way over it. Yet WLB mistakenly omitted a right of way in favor of the Salt River Project, which manages the Arizona Canal.

When Ocotillo applied for a building permit using plans based on WLB's incorrect survey, the City of Phoenix refused to approve the project. As a result, Ocotillo had to have the entire project redesigned by another engineering firm to take the correct canal right-of-way limits into account.

At the time the omission in WLB's survey was discovered, Ocotillo had paid WLB only $14,242 under the WLB contract. Not surprisingly, Ocotillo not only refused to pay anything more, but also sued WLB for professional negligence. In response, WLB counterclaimed for its unpaid professional fees.

An increasingly common defense

When the case went to court, WLB mounted what's becoming an increasingly common defense. It stated that, along with the professional services proposal faxed to Morris to be signed on Ocotillo's behalf, the surveying firm had faxed a second page of "Standard Conditions," which Morris separately initialed.

These "Standard Conditions" included a term that's now frequently creeping into surveying and other professional services contracts in the construction business. The term in question limits WLB's liability to its "Client and all persons having contractual relationships with them" for errors and omissions to "the total fees actually paid by the Client to WLB."

Based on WLB's assertion of this provision as a defense in the lawsuit, the trial court granted summary judgment. It ruled that the clause was enforceable and that Ocotillo's damages for having to redesign its entire townhouse project to account for the canal right of way would be limited to the $14,242 Ocotillo had already paid WLB.

The appellate view

Ocotillo appealed, arguing that enforcement of such liability limitations in professional engineering and surveying contracts is against public policy. The Arizona Court of Appeals rejected the public policy argument, ruling that commercial businesses, such as landscape architects and real estate developers, are free to contract for allocation of liability among themselves as they may agree.

The Court of Appeals further ruled, however, that the liability limitation in the "Standard Conditions" clause of the WLB contract was an assumption of risk by Ocotillo and, thus, the limitation's enforceability shouldn't have been decided by summary judgment. An unusual provision in the Arizona state constitution treats assumption of risk as a fact question for a jury.

Easily overlooked provisions

Once a court in one state decides that a professional services firm can enforce a "return of fees" liability limitation clause like this one, similar language typically — and quickly — gets inserted into standard terms and conditions of like contracts across the industry.

In light of this tendency, owners and general contractors engaging surveyors and landscape architects for survey and layout work should diligently review the fine print of proposals from such professionals *before* submitting bids or signing contracts. After all, as *Ocotillo* demonstrates, it's all too easy to overlook provisions that shift the risk of professional errors and omissions back to the owner or general contractor in question.

Too late! Untimely homeowner claims often go nowhere

As many contractors can attest, homebuyers often seek to recover damages for defective work. Yet few homebuyers take the opportunity to inspect their houses while construction is actually in progress. And failing to do so may deprive them of any chance of recovering the damages they seek — particularly if a substantial amount of time has passed since the house in question was built.

A group of Wisconsin homeowners learned just this lesson in *Aslani v. Country Creek Homes*.

Years later, a discovery

In 1997, Country Creek Homes built a subdivision of single family homes in Oak Creek, Wis., under contracts with the original purchasers of the houses. Nine years later, the original buyers or their successors discovered that the roofing subcontractor had failed to place felt paper beneath the roof shingles at the edges and peaks of their roofs, leading to water penetration and rotting of the wooden roof decking.

As soon as a home inspector identified the problem, the owners filed suit against Country Creek for breach of contract, negligence and misrepresentation. The owners claimed Country Creek was responsible for their losses because, as general contractor, it had failed its obligation to supervise and inspect the roofer's work.

The court weighs in

Country Creek argued that the breach of contract claims were barred by Wisconsin's six-year statute of limitations on such contracts. The trial court agreed, dismissing the contract claims. The court ruled that the breach of contract had occurred when the roofs were built, not when the problem was discovered nine years later. Accordingly, the six-year limitations period started when the houses were sold — and expired long before the lawsuit was filed.

In addition, the trial judge ruled that the tort claims of negligence and misrepresentation were barred by the economic loss doctrine, which limits tort recovery to cases of bodily injury or harm to other property. The damage from the water penetration affected only the houses themselves, and there was no bodily injury or damage to other property. As a result, the trial judge granted summary judgment in favor of Country Creek against the homebuyers, dismissing all the claims.

On appeal, the Court of Appeals of Wisconsin affirmed. Like the trial court, it stated that, because the problem was discovered more than six years after the houses were sold to the buyers, the homeowners had no basis for suing Country Creek for their losses.

Moreover, following earlier Wisconsin rulings, the Court of Appeals held that the contracts for construction of the houses were predominantly for the purchase of a product. Therefore, under the state's economic loss doctrine, no damages to the houses themselves could be recovered from the builder on any tort theory.

Time goes by

As this case shows, in Wisconsin, homebuilders can generally rest assured that problems coming to light more than six years after the sale of a new home are going to be the homeowner's problem, not the builder's. In addition, as long as the contracts are written as product purchases, the state's economic loss doctrine will likely apply. Contractors would be well advised to consult an experienced construction attorney on how laws in the states where they build tend to fall in similar situations. *T*

"Little" subcontracts can turn into big problems

Sometimes a subcontractor with a comparatively small portion of work on a project can have an inordinately negative impact on job progress. When this situation arises, the language of subcontract provisions will often determine the general contractor's ability to mitigate the losses caused by the subcontractor's performance problems. Such was the case in *Potomac Constructors v. EFCO Corp.*

A bridge to trouble

Potomac Constructors was awarded a $191 million general contract to build the Maryland approach spans for a $2.5 billion replacement of the Woodrow Wilson Bridge in the Washington, D.C., area.

Using a purchase order, Potomac hired EFCO to design and supply forms for casting the concrete support structure of the approach spans. EFCO's purchase order had a value of $2,075,000 — or just a little more than 1% of Potomac's portion of the project.

Unfortunately, there were considerable problems with both delivery and performance of the formwork, and Potomac eventually sued EFCO for $13 million in damages resulting from project delays. This delay claim was more than six times the amount of the EFCO purchase order.

The power of the purchase order

When the suit went to court, EFCO relied on its purchase order language excluding damages for delay, as well as incidental and consequential damages, and limiting Potomac's remedies to "actual and direct costs ... necessary for repair or replacement of equipment covered."

Potomac countered that, because the resulting delay was so significant, the "exclusive remedy" of repair and replacement failed its essential purpose. Potomac also argued that the clauses limiting its remedies were inapplicable because blowouts of the forms created a risk of harm to laborers on the project.

The U.S. District Court for the District of Maryland ruled that the remedy-limiting provisions in the EFCO purchase order represented an agreed-upon allocation of commercial risk by sophisticated parties regarding goods of complicated design built specifically for the buyer.

> *EFCO's purchase order had a value of $2,075,000 — or just a little more than 1% of Potomac's portion of the project.*

Accordingly, the court ruled that the exclusion of delay damages was enforceable and dismissed the nearly $13 million delay portion of Potomac's claim. The court, however, left open the possibility that Potomac might be able to prove it had incurred some of the form-blowout repair costs to protect laborers from injury, and it allowed that small portion of the case to proceed.

No small subcontracts

The lesson from this lawsuit is an important one: When a particular subcontract represents a very small portion of a project's value, the impact that subcontract could have on the schedule and job progress as a whole could be markedly out of proportion to its monetary value.

Thus, general contractors must carefully review the small print included in subcontracts — or, as this case demonstrates, the language included in subcontractor purchase order forms. Doing so is the only way to be aware of which party bears the risk of schedule delays arising from late deliveries or the need to repair or replace defective work. T

CLB *Quickcase*

Underwriters Group v. Clear Creek Independent School District

Phony performance bond costs contractor plenty

Although unable to obtain the performance and payment bonds required by Texas law for public construction contracts, Braselton Construction just couldn't resist bidding on a nearly $6 million elementary school gym project.

Braselton submitted the low bid of $5,965,377 to Clear Creek Independent School District and was awarded the contract. Before beginning work, the company submitted phony performance and payment bond documents to the school administrators and billed the district for the premium on the so-called bonds. Braselton then took the school district's money and bought a "trust receipt," which it thought a satisfactory substitute for the bonds required by law.

By the time Braselton received its fourth payment for work on the job, the district discovered that the bond documents were fraudulent. It gave Braselton one week to come up with authentic bonds and, when the contractor could not, it replaced Braselton with Morganti Texas.

Morganti charged the district $416,623.48 more than Braselton's price to complete the gym construction. In addition, to secure lien releases for labor and materials that Braselton had not paid for, the district paid $365,453.35 to Braselton's subcontractors and suppliers.

(Note: Although, in most states, the property of the public body cannot be the subject of a lien, an unpaid subcontractor can obtain a lien against the funds appropriated to pay for the project. As a result, the situation can arise in which lien notices prevent the public body from paying for ongoing work until the lien claim is resolved in court. In many instances, a large lien claim against the appropriated funds means other trades working on the job will not get paid for a long time.)

Finally, the district paid its lawyers $28,566.25 in fees for work related to reissuing the construction contract to Morganti and another $54,898.50 for pursuing its lawsuit against Braselton. The school district's total losses of $865,541.58 were offset by a return of $187,720.56 in premiums from the issuer of the "trust receipt" to Braselton.

Ultimately, the U.S. District Court for the Southern District of Texas levied a net award against Braselton of $677,821.02, though it didn't address why Braselton had submitted its bid on the project without making sure it could obtain the bonds required by law. In any case, Braselton's attempt to save a few thousand dollars in bond premiums ended up costing it much, much more.