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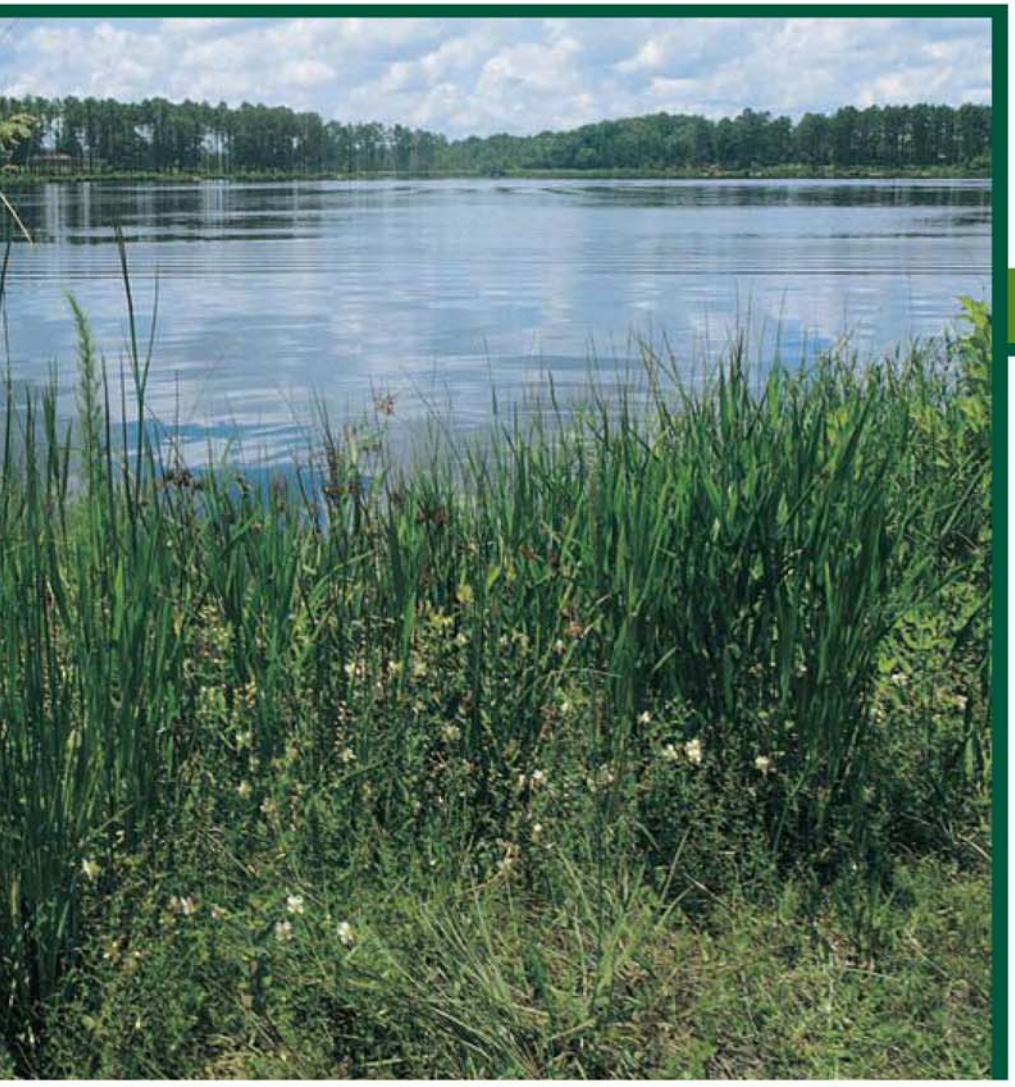
CONSTRUCTION LAW BRIEFING



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The Clean Air Act

Watch your permit or lose your project

The federal Clean Air Act applies strict requirements to the permitting and construction of all coal-fired electric plants. In *Sierra Club v. Franklin County Power*, an Illinois power company tested the flexibility of the act when challenged by a special interest group. The outcome of the case holds important lessons for owners and contractors alike.

Work begins

On July 3, 2001, Franklin County Power obtained a permit from the Illinois Environmental Protection Agency (IEPA) to build a coal-fired generating plant in Benton, Ill. According to the terms of both that permit and the Clean Air Act, the permit would automatically expire if construction weren't commenced within 18 months or completed within a reasonable time (or if, once commenced, construction were discontinued for more than 18 months).

Franklin had a 99-year lease on the Benton land. Excavation for the boilers began on Jan. 3, 2003, but payment disputes with the excavator resulted in the excavator stopping work on Feb. 14, 2003. And when Franklin County missed a lease payment in July 2004, the landlord filled in the excavation.

A third party strikes

On Nov. 14, 2004, the IEPA notified Franklin of a preliminary finding that the project's construction permit had expired. Franklin challenged that determination. But while administrative proceedings over expiration of the construction permit proceeded, Sierra Club of Illinois, an environmental activism group, sued in federal court seeking an injunction against construction of the proposed plant.

As fate would have it, the power plant site is located three miles from Rend Lake, a natural area where a Sierra Club member and her family frequently traveled to camp, fish and kayak. Sierra Club argued that, if the plant were built, its member and her family would discontinue their recreational trips to the lake because pollution from the plant would make these excursions less enjoyable. Franklin argued that these facts were insufficient to give the Sierra Club standing to sue for an injunction.

The federal district court disagreed. It granted summary judgment in favor of Sierra Club, entering a permanent injunction against construction of the plant under the 2001 permit. Franklin appealed to the Seventh Circuit Court of Appeals.

An appeal is heard

In the Court of Appeals, Franklin argued that, even if the 2001 permit had expired, the power company would surely obtain a new permit and the plant would be built in any event.

While acknowledging that possibility, the Court of Appeals determined that a new permit was likely to require more stringent emission standards than the 2001 permit, noting that other IEPA construction permits issued in 2003 and 2005 already required more stringent emission controls than those included in Franklin County's 2001 permit.

The Court of Appeals therefore ruled that, under a new permit, Sierra Club's member and her family would have even greater protection for their trips than the 2001 permit could provide, and that Sierra Club had standing to bring the lawsuit against Franklin.

The power company argued that, by excavating for the boilers in January 2003, it had commenced construction within 18 months of the issuance of the permit. The Court of Appeals pointed out, however, that excavation had stopped on Feb. 14, 2003, and didn't begin again until Sept. 29, 2004. That 19-month delay, the Court of Appeals said, "killed the Company's PSD permit."

Critical activities

Although this case involved a power company, not a contractor, it nonetheless illustrates that application for required permits can't be considered in isolation from other critical activities that go into a project — especially when permits contain strict time limits.

The permit application process and the permit's time limits must be scheduled into the project's critical path to avoid interruptions in continuous progress of a project. Failure to do so can give project opponents an opening to interfere with completion of the project.

Doth the contractor protest too soon?

Public construction bid dispute sparks question of legal timing

Since 1913, Pennsylvania's "Separations Act" has helped prevent favoritism in the selection of trade contractors on public construction projects. This statute requires the preparation of separate specifications, and the taking of separate bids, for plumbing, heating, ventilation and electrical work on any public building, if overall construction costs exceed $4,000.

If a project is released for bidding without the required separation of trades, the act is enforced by allowing excluded trade contractors to submit bid protests. The timing of just such a bid protest was at the heart of the matter in the case of *Philips Bros. Electrical v. Pennsylvania Turnpike Commission*.

Feeling left out

In September 2007, the Pennsylvania Turnpike Commission (PTC) announced that it expected to solicit bids during the fourth quarter of 2008 for construction of a $20 million highway maintenance facility in Plymouth Meeting.

Interested, Philips Brothers Electrical Contractors inquired whether the bid solicitation would include separate specifications for electrical contractors. The PTC responded that the solicitation would seek only single bids from general contractors because the building was, in the commission's view, not a "public building."

Philips, disappointed that it wouldn't be permitted to bid on the project because it wasn't licensed as a general contractor, filed a bid protest on Dec. 12, 2007. As bids on the project hadn't been formally solicited, however, the PTC denied the bid protest as premature. Philips appealed the denial to Pennsylvania's Commonwealth Court, which hears appeals from the state's administrative agencies.

Defining "public"

When the case went to court, the PTC argued that, though the maintenance facility was to be built using $20 million of taxpayer funds, it wouldn't be a public building because the facility wouldn't be open to the general public.

Pointing out safety concerns arising from citizens being allowed to wander among the truck shop, salt

dome and fueling station, the PTC argued that the public wouldn't be invited or permitted to stop at the facility. The commission's position was that, to qualify as a public building under the Separations Act, the facility would have to be both paid for with public money *and* be open to the general public once built.

The Commonwealth Court disagreed, reasoning that, so long as a facility was built with public money and its operation benefited the general public, it was a public building — despite the fact that access to the facility would be restricted to PTC employees and contractors.

Agreeing that one purpose of the Separations Act is to "guard against favoritism, improvidence, extravagance, fraud and corruption in the award of municipal contracts," the Commonwealth Court also agreed that a bid protest was the proper vehicle for challenging the commission's determination to use a single general contract for soliciting project bids.

A surprising twist

In a perhaps surprising twist, however, the Commonwealth Court also dismissed the Philips bid protest as premature. The court ruled that, even though all the issues were fully presented and argued, Philips wouldn't suffer any harm if review of the bid process was delayed for a year until bids on the $20 million project were actually solicited in late 2008.

At that time, the court said, Philips *could* protest the bid and appeal again if the PTC persisted in its determination to refuse a separation of the trades in taking bids. Should a contract be awarded while the protest appeal was pending, the court would have the authority to declare that contract void and require rebidding under the provisions of the Separations Act.

Risky protestations

In arriving at this decision, the Commonwealth Court didn't appear to consider the potential consequences for the PTC and the taxpayers of Pennsylvania when a solicitation was finally issued in late 2008. Any delay resulting from a subsequent bid protest, possible appeal and eventual rebidding would surely lead to considerable expenses for rewriting the project specs, separating the bids and finally awarding a contract.

> *One purpose of the Separations Act is to "guard against favoritism, improvidence, extravagance, fraud and corruption in the award of municipal contracts."*

Perhaps the court hoped the commission would take the court's opinion into consideration and voluntarily use the time before the project's scheduled release to separate the trades and take bids as scheduled on that basis. For if the PTC merely considers the dismissal of Philips' protest as a victory, another expensive and time-consuming round of administrative proceedings and litigation could end up wasting everyone's time and money. *T*

Separate bidding approach best for large municipalities

While the Separations Act has been in effect in Pennsylvania for nearly a century (see main article), many other states are now looking to the process of bidding major trades separately as a way to reduce project costs. When prime contracts are bid separately under the supervision of a construction manager, who bears responsibility for schedule and trade coordination, it's sometimes possible to reduce the job's overall cost.

Whether this type of bidding is an effective tool for promoting efficient operation on a project, however, depends on the contracting authority's ability to mobilize its own staff into an effective team. After all, it needs to oversee the performance of a number of separate contractors beholden to no one but the contracting authority itself.

In the case of agencies with full-time, experienced staff and a full complement of ongoing work in progress, these techniques can prove fruitful. But small towns and other agencies that only occasionally contract out construction projects may find that managing several independent entities on the occasional project could prove to be more trouble than the expected savings are worth.

Bundled military contracts threaten to squeeze out small builders

Few relationships depict the David vs. Goliath concept better than that between small builders and the U.S. military. Although David has had his share of victories on the often tumultuous jobs offered up by the Army, Navy and others, an ominous plot twist arose in the case of *Tyler Group v. United States*.

Design-build plans sought

In a solicitation in October 2007, the U.S. Army released its requirements for modernizing training and staging facilities at a number of bases in the southeastern United States. In particular, design/build plans were sought for constructing modular basic training, advanced training and "warrior-in-transition" facilities at bases in eight states.

After meetings and an Internet questionnaire to contractors and modular housing companies, the Army Corps of Engineers determined it would spend about $40 billion to achieve a 20% cost reduction and 30% time acceleration for completion of the needed facilities.

The final solicitation was for an indefinite delivery/indefinite quantity (IDIQ) provision of construction task orders for the base improvements in the range of $14 million to $47.5 million, with a limitation that no bidder would be required to accept assignments exceeding $95 million in the aggregate during the procurement.

In response, Tyler Construction Group, a small general contractor, filed a lawsuit in the Federal Court of Claims, objecting to the Corps of Engineers' "bundling" of the contracts in this manner. Tyler argued that the IDIQ method of procurement for geographically separate construction projects improperly excluded small contractors like itself from the bidding because they lacked sufficient working capital to undertake the possibility of accepting as much as $95 million in government work.

The court rules

In its ruling, the Court of Claims pointed to the provision of the Federal Acquisition Regulations stating that any procurement strategy or practice not addressed in the regulations or otherwise prohibited by statute should be considered permissible.

Thus, it ruled that the cost savings and time savings anticipated from the economies of scale involved in standardized modular construction of these training facilities was an appropriate justification for bundling the projects into a single IDIQ procurement.

Moreover, relying on the Army's determination that project-specific solicitation and contracting would require additional staff and resources not available within the Corps of Engineers, the court made this ruling despite the fact that doing so might exclude smaller contractors from the available pool of bidders. Specifically, the court cited that consolidation and modular construction of these military facilities would produce:

- ✓ Reduced award time and design costs,
- ✓ Increased labor efficiency and labor pool stability,
- ✓ Reduced construction time and material costs, and
- ✓ Improved working relationships between the government and its contractors.

Ultimately, the court entered judgment in favor of the government on the administrative record and dismissed Tyler's complaint.

Partnerships may provide solution

Smaller contractors have benefited for years from specific set-asides in regard to military and other federal government procurement programs. This case may signal a retreat from the position that such preferences must be enforced at all costs. One solution for smaller builders may be to partner with larger companies to gain the needed capital and capacity for bidding on similarly bundled construction projects.

Surveyor says: You get back only what you paid

A surveyor's job is typically completed very early in a project's existence — so much so that these firms are often an afterthought in the construction process. As the case of *Ocotillo v. WLB Group* demonstrates, however, a surveyor's contract can be just as binding as that of any other party to a job.

Missed it by that much

Developer Ocotillo planned a townhouse development near the banks of an Arizona canal. Ocotillo hired WLB Group to survey the property and identify any rights of way that would limit the buildable areas within it. WLB's survey, however, omitted a right of way in favor of the canal operator and, as a result, Ocotillo was required to hire a new engineer to change its project layout before a building permit could be issued.

In response to the permit delay, Ocotillo sued WLB for the additional engineering costs and increased construction costs. Ocotillo defended itself on the basis of a clause in the standard conditions of its surveying contract that limited its liability for negligence, errors and omissions to the total fees paid by the client.

In this case, the surveying fee was $14,242 — considerably less than the cost increases and additional design fees resulting from omission of the canal operator's right of way.

> *Would enforcement of the damage limitation be against the public policy of Arizona regarding professional services of surveyors?*

Not contrary at all

The trial judge granted summary judgment in favor of WLB in an order limiting damages against WLB to the $14,242 amount of its surveying fee. Ocotillo appealed, arguing that enforcement of the damage limitation was against the public policy of Arizona regarding professional services of surveyors.

The Arizona Court of Appeals, however, agreed with WLB that the contractual limitation wasn't contrary to public policy and was, therefore, enforceable. But the court went on to rule that the contract provision was an "assumption of risk" by Ocotillo and, under the Arizona constitution, would have to be the subject of a jury trial rather than summary judgment.

Both sides appealed to the Arizona Supreme Court. That court also ruled that the damage limitation clause was an enforceable provision and wasn't against public policy as long as it was "freely and knowingly negotiated between the parties."

The court further ruled that the clause limiting damages to return of the professional fee wasn't an assumption

of risk because the entire value of the agreement to WLB remained at risk in the event of errors and omissions. Accordingly, the court sent the case back to the lower courts for a factual determination of whether the clause in question had or hadn't been "freely and knowingly negotiated."

The terms matter

Most states are likely to follow the ruling in Arizona in this case. And some states won't even investigate the issue of whether the damage limitation clause was "negotiated" in an agreement between a contractor and a surveying firm.

The lesson for builders and developers who use independent surveyors is that it's important to review all the fine print in a surveyor's contract *before* signing the document. Otherwise, a surveyor's mistake may cause a great deal of loss beyond the limited amount recoverable under the agreement's terms. *T*

CLB *Quickcase*

St. Joseph's Condominium Assn. v. Pacific Insurance

Condo water damage may give contractors a sinking feeling

On May 4, 2007, New Orleans experienced a big rainstorm, causing the gutters at St. Joseph Condominium Association's property to overflow. Water spilled into the building and damaged both common areas and some of the individual units. In response, the condominium association filed a proof of loss with Pacific Insurance, but the property insurance company denied the claim. So the association filed a lawsuit in federal court.

Pacific argued that overflowing gutters are comparable to backed up sewers and drains, and that the language of its policy specifically excluded coverage for water damage from such situations. The association countered that the gutters weren't "drains" and Pacific should cover the water damage as a loss.

The federal judge agreed with the insurer, stating that the association's claim wasn't covered by the property insurance because the policy excluded coverage for overflowing drains as well as for any water entering the building through openings resulting from construction defects. The judge interpreted the policy language to mean that only water damage arising from wind damage or toppled trees penetrating the building's walls or roof could trigger coverage. Any other water penetration would, therefore, be caused by openings resulting from construction defects and, as mentioned, the policy excluded coverage for such damage.

Although the condominium builder wasn't a party to this lawsuit, the language of the opinion suggests to every condominium association dealing with storm damage from water penetration that, when water gets inside the building, either the property insurer should pay out a claim or "construction defects" must be to blame.

As a consequence, and as a result of the increasing volume of water penetration litigation in play across the country, contractors can expect to be named in more and more lawsuits that would ordinarily have been simple disputes between a condo association and its property insurer.