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CONSTRUCTION LAW BRIEFING

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Is construction management the same as general contracting?

California courts are notorious for refusing to let unlicensed general contractors collect payments due them — even in cases where the license had lapsed only for a few days during a lengthy project. But the case of *Fifth Day, LLC v. Bolotin* demonstrates that, even in California, a court may draw a distinction between construction management and general contracting.

Developing a campus

James P. Bolotin owned a 12-acre tract of land in Chino, Calif., and sought to develop his property as an industrial campus. In May 2003, Bolotin signed a Development Management Agreement with Fifth Day under which Fifth Day would serve as owner's representative for the project.

In January 2004, Bolotin signed a contract with Fullmer Construction in the amount of $4.9 million for construction of seven concrete tilt-up buildings on the property. Fifth Day provided the services called for in the Development Management Agreement, and Bolotin paid Fifth Day $785,000 in fees under the agreement for completion of the first three buildings.

> *It was also particularly important to the Court of Appeal to note what Fifth Day was* **not** *authorized to do under the Development Management Agreement.*

When the other four buildings were completed, however, Bolotin refused to pay Fifth Day the remaining balance of $1.8 million in management fees.

Going to court

Fifth Day sued Bolotin for its fees, and the trial court granted summary judgment, dismissing

Fifth Day's lawsuit because of the California contractor licensing statute and a raft of court decisions denying any recovery to general contractors who build projects in the state without maintaining a general contractor's license "at all times during the work." Fifth Day appealed.

In its opinion, the California Court of Appeal clearly recognized the issue so important to the state's construction industry: "[W]hether an entity which provides construction management services to a private owner developing commercial real property is required to be licensed pursuant to the Contractors' State License Law." The Court of Appeal reviewed Fifth Day's five primary duties under the Development Management Agreement:

1. To assist in coordinating the activities of the various workers to enable them to complete their work in an organized and efficient manner, on time and on budget,

2. To maintain insurance certificates and financial records for the project,

3. To keep the owner apprised of the status of the project,

4. To be the on-site point person to respond to issues as they arose, and

5. To act, generally, as the owner's agent with respect to various parties connected with development of the project.

It was also particularly important to the Court of Appeal to note what Fifth Day was *not* authorized to do under the Development Management Agreement. That is, it could neither perform any construction work on the project nor enter into any contract or subcontract for the performance of such work.

Parsing the result

The majority opinion in the Court of Appeal ruled in favor of Fifth Day, reversing the summary judgment and sending the case back to the trial court for a trial on Fifth Day's damage claims. The majority relied strongly on the failure of the California Legislature to enact a law for licensing of construction managers or requiring construction managers to be licensed under the Contractors' Licensing Law.

Because of this failure by legislators to address the modern trends in organization and management of major construction projects, the majority concluded, construction managers aren't required to be licensed in California. The majority wrote:

> The Legislature is empowered to conduct public hearings on the merits of such licensure to solicit the views of the various players in the building industry who would be affected by such a requirement, and to amend the licensing law if it concludes that the public interest would be better served by such a revision. Unless and until the Legislature does so, its failure to expressly address the issue must be the last word.

It may well be that this lawsuit — with all its implications for the construction industry and construction managers in California — will,

Dissenting judge looks at services, not contract language

When the California Court of Appeal heard the case of *Fifth Day, LLC v. Bolotin* (see main article), one judge disagreed with the majority. This dissenting judge looked to the purpose behind the licensing of general contractors in California — and in particular to unlicensed contractors' prohibition from suing to collect payment on California construction projects.

The collection prohibition, the dissenting judge writes, "reflects a strong public policy which favors protecting the public from unscrupulous and incompetent contractors. ... The licensing requirements provide minimal assurance that all persons offering such services in California have the requisite skill and character, understand the applicable local laws and codes, and know the rudiments of administering a contracting business."

The dissenter found no relevance in the fact that owner James P. Bolotin had a separate construction contract with Fullmer Construction. Arguing that it was the services provided by Fifth Day, LLC, not the existence of another general contractor on the project, that should determine whether Fifth Day was required to be licensed, the dissenting judge reasoned that many of the services Fifth Day provided were, in fact, general contracting services.

Therefore, the judge concluded, Fifth Day should have been licensed in California, and its failure to do so called for its lawsuit to be dismissed.

ultimately, reach the California Supreme Court. Should that happen, it will be interesting to see whether that court is as deferential to the Legislature as the majority of the Court of Appeal.

Knowing one's role

Construction projects aren't always as relatively simple as the owner-general contractor-subcontractor model that's served the industry for many years. As newer models come into vogue, it's in every contractor's best interest to know its role on a project and how to mount an effective legal defense should a dispute arise. T

Tell it to the jury

Dustup over soil conditions puts case in dubious hands

You find yourself in a courtroom facing a gallery of strangers, most of whom presumably have little to no understanding of the construction industry or its processes. In their hands lies a legal decision that could cost you thousands of dollars. This may sound like a nightmare, but it was a stark reality for the parties in the Mississippi case of *Wal-Mart Stores v. Qore*, Inc. The question is: How did they get there?

Shifting theories

Wal-Mart contracted for the design and construction of a "supercenter" in Starkville, Miss. The newly completed building and parking lot were both damaged when the soil beneath the building shifted, and movement of the store on its foundation caused extensive damage to the structure.

Wal-Mart sued the designer, Sain Associates; the geotechnical engineer, Qore; and the general contractor, Shannon, Strobel & Weaver. The case went to trial and, following presentation of Wal-Mart's evidence, all three defendants presented motions for directed verdicts, contending that Wal-Mart hadn't offered sufficient evidence to warrant a jury verdict in its favor under any circumstances.

Wal-Mart argued that Qore should have recommended select fill at least seven feet deep beneath the store and parking lot because of the type of clay underlying the store property. Qore sought to disqualify Wal-Mart's expert testimony on this issue, arguing that the expert failed to use objective standards in reaching his conclusion.

The trial judge ruled that such an argument was for the jury to consider in evaluating the weight to be given to the expert testimony and refused to throw out the evidence.

Repeated rulings

Wal-Mart also presented expert testimony to the effect that Sain Associates should have known of the need for independent verification

of Qore's design suitability because of the "dirt issues." The trial judge ruled that this was also a jury issue.

In addition, Wal-Mart asserted that Shannon, Strobel & Weaver had failed to provide sufficient lime stabilization and compaction of the fill under the foundation in certain locations, leading to the uneven settlement of the foundation. Again, the trial judge ruled that there was sufficient evidence to support both the argument that Shannon, Strobel & Weaver was negligent in performing the site work and that Qore was negligent in testing the soil before construction of the foundation — even without expert testimony on this issue.

All three defendants argued that Wal-Mart had failed to prove that the damages claimed were caused by any of the construction defects or design errors for which Wal-Mart had presented evidence, but the judge ruled that "the pictures and lay testimony make it obvious that movement of the building has caused massive damage."

As a result, the judge denied all defense motions and permitted the case to be argued to the jury on the theories of negligent design, negligent construction and breach of contract against all of the defendants. The judge further ruled that Wal-Mart would be limited to only one recovery of its damages, but that it would be allowed to argue all liability theories to the jury at the close of the case.

> *A newly completed Wal-Mart "supercenter" and parking lot were both damaged when the soil beneath the building shifted, and movement of the store on its foundation caused extensive damage to the structure.*

An unsatisfactory process

The lesson from this case is this: If parties to a construction contract can't resolve their differences via negotiation or arbitration, those differences may be decided by lay jurors who may very well have no background in construction. And, as you can well imagine, this is likely to be an unsatisfactory process. T

Talk is cheap: Loan agreements often exclusionary

Many contractors on commercial projects are well aware that bank financing is in place to pay for the construction. Owners and bankers, however, usually take great pains to ensure their loan documents don't permit an action by an unpaid contractor against the bank. A recent Pennsylvania case, *Martik Brothers, Inc. v. Huntington National Bank*, illustrates the lengths to which a court will go in excluding a contractor from the benefits under a construction loan agreement.

Arrangements are made

In August 2006, Martik Brothers entered into two contracts with Kiebler Slippery Rock for construction of Slippery Rock Quadrangle in Butler County, Penn. The project consisted of 19 buildings and a clubhouse, and Martik performed site work for the entire project and construction of 14 of the 19 buildings.

The project was financed by a loan agreement between Kiebler and Huntington National

Bank, in which Kiebler and Huntington agreed that "no contractor, supplier laborer, architect, engineer or other party shall be deemed to be a third party beneficiary of this Agreement or any of the Loan Documents." The terms of the loan also required, and Martik provided, a no-lien clause in the construction contract between Kiebler and Martik.

"No problems"

During construction, Martik became aware that, in violation of the terms of the loan, Kiebler was using some of the construction loan proceeds to pay for things other than Martik's invoices. In response, Martik sought assurances from Huntington that there would be sufficient funds in the loan to pay for Martik's work.

In two conversations with a bank officer in June 2007, Martik was assured that "there was funding there. You guys have no problems." The bank officer gave this assurance even though he'd already written an internal report concluding that there would be a shortfall in the loan funding of nearly $1.1 million.

Martik completed the project and, in November 2008, it obtained an arbitration award in its favor against Kiebler for the unpaid balance of $2,687,781.31 plus interest and arbitration fees. Unable to collect from Kiebler, Martik brought a lawsuit against the bank, seeking recovery on the basis of the bank officer's statements that loan funds would be sufficient to pay Martik in full.

> *In denying the third-party beneficiary argument, the court relied on the language of the loan agreement, ruling that there could be no clearer statement of lack of intent to make outsiders beneficiaries of the loan transaction.*

The court's view

In court, Martik argued it was a third-party beneficiary of the loan agreement. It also cited intentional misrepresentation, detrimental reliance and unjust enrichment. Despite the bank officer's statements, the court granted summary judgment in favor of Huntington, denying any recovery to Martik.

In denying the third-party beneficiary argument, the court relied on the language of the loan agreement, ruling that there could be no clearer statement of lack of intent to make outsiders beneficiaries of the loan transaction. The intentional misrepresentation and detrimental reliance arguments were refused because, the court determined, Martik had never threatened to leave the project should the bank disclose a lack of sufficient funds in the loan to pay Martik in full.

Finally, the court ruled, there was no unjust enrichment, because the bank had gotten no more than what it had bargained for in the loan documents — a completed project securing its end-loan mortgage on the property.

The moral of the story

There may be provisions in construction loan documents requiring the borrower to use loan proceeds for no purpose other than paying for construction of that particular project. Yet this language, even when combined with assurances from bank officers that sufficient loan proceeds exist to pay for project completion, provides no real recourse for contractors.

In these situations, contractors should insist on getting full payment on delivery of trailing waivers every month — anything less will likely leave them entirely at the mercy of the developer. *T*

Construction Law *Quickcase*

Solis v. Summit Contractors

OSHA says subcontractor safety is general contractor's problem

Summit Contractors, general contractor for construction of a college dormitory in Little Rock, Ark., subcontracted the masonry work to All Phase Construction. During that masonry work, Summit had only a superintendent and three assistant superintendents on the site. No tradesmen employed by Summit were present.

On two or three occasions, Summit's supervisors warned All Phase against permitting its bricklayers to work in scaffolding over 10 feet high without guardrails or fall protection. All Phase would comply but, when the scaffolding was moved to a different location, it would repeat the OSHA violation.

Although everyone involved agreed that All Phase's safety infractions didn't present any danger to the Summit supervisors on site, OSHA issued a violation citation to Summit. OSHA cited its "controlling employer" policy, under which the agency may issue a citation to the general contractor as "controlling employer" on the site — even if the general contractor on a project has already warned its subcontractor to correct safety violations and even if the subcontractor's safety violation doesn't endanger the general contractor's workers.

Summit went to court to challenge the controlling-employer citation with the support of amicus briefs from the National Association of Home Builders, Associated General Contractors of America, Associated Builders and Contractors, and other business groups. Over a dissent, and despite doubts articulated in an earlier case in the District of Columbia Circuit, the Eighth Circuit upheld OSHA's authority to require general contractors to accept responsibility for the safety of a subcontractor's employees on a job site.

Acknowledging that its decision "places an enormous responsibility on a general contractor to monitor all employees and all aspects of a worksite," the Eighth Circuit nevertheless deferred any change in the policy to Congress and the Secretary of Labor. And it doesn't seem likely that the Secretary of Labor will change this policy anytime soon. Accordingly, general contractors must take pains to ensure that all subcontractors rigorously follow OSHA requirements.