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Construction Law

In This Issue…

A short history of defective building delivery damages


David M. McGlone

The earliest known construction law arose in Babylonia around 1600 BCE. King Hammurabi legislated the following:

229. If a builder build a house for a man and do not make its construction firm, and the house which he has built collapse and cause the death of the owner of the house, that builder shall be put to death.

230. If it cause the death of a son of the owner of the house, they shall put to death a son of that builder.

This did not seem to do much for the plaintiff to put them back in the place they were before the damages occurred. Rather, Hammurabi's code specified an eye for an eye. Thus, there were purely punitive damages for a defective structure. Hammurabi was silent on whether the plaintiff would be entitled to damages after he had his revenge. Nonetheless, I am sure there wasn't too much defective construction in Babylonia after this code was emplaced.

continued on page 2

Incorporation by reference clauses in surety bonds: A sometimes problematic interaction


Scott D. Cessar

The recent Maryland Court of Special Appeals opinion in the case of *Schneider Electric v. Western Surety Company* underscores the sometimes problematic interaction of incorporation by reference clauses in surety bonds.

Schneider was engaged to perform work as a subcontractor for a medical facility located in Maryland. The project was administered by the U.S. Army Corps of Engineers. Schneider, in turn, entered into a sub-subcontract with National Control Services (NCS) in accordance with a Master Subcontract Agreement (MSA) between Schneider and NCS. Importantly for present purposes, the MSA included a mandatory arbitration clause. The MSA also required NCS to provide a performance bond naming Schneider as obligee for 100% of the sub-subcontract value, $2,050,000. The performance bond was issued by Western Surety and incorporated by reference both the MSA and the sub-subcontract.

continued on page 5

A short history of defective building delivery damages
(continued)

Shortly after Moses parted the Red Sea, he found that construction was different on the other side. The Israelites were unfamiliar with flat roofs. He made it law that: "When you build a new house, then you shall make a battlement for your roof, that you bring not blood on your house, if any man fall from there." Deuteronomy 22:8.

Otherwise known as the "parapet requirement," this qualifies to be the "First Commandment of Construction Law."

Its import was that if somebody fell from your roof that lacked a parapet, there was a presumption that you were a murderer. Moses' remedy is vaguer than Hammurabi's, but there is a clear implication in the word "murderer" that this is a capital crime and you would be executed. Note, if you could negotiate the crime down to manslaughter, you would be eligible to flee to one of three sanctuary cities in Israel, hopefully one with pitched roofs.

Even before Nero's new building code (understandably preoccupied with fire prevention), the Romans generally would inquire as to whether the builder actually intended to allow the building to fall down before imposing the death penalty upon him. The Romans, while traditionally remembered as a bit cold, ironically required a finding of malice aforethought before they put you to death.

The Romans also created causes of action that, in the case of a defective building, could be tortious or contract based. As they litigated in the forum, the magistrate could order money damages based on a finding of liability on the causes of action. These concepts eventually were incorporated into our Common Law.

The Roman's tortious standard contained the rudiments of our present tort law, which governs the measure of damages for a defective structure that killed somebody, or merely one that was delivered in a defective state. In most modern jurisdictions, the measure of damages for a wrongful death would include medical expenses, conscious pain and suffering, out-of-pocket funeral expenses, and lost wages. The Plaintiffs in this case would be the deceased's spouse and minor children (loss of Consortium).

With respect to modern residential construction, in 1964, the Supreme Court of Colorado was the first court in the country to abandon the doctrine of *caveat emptor* (buyer beware) and hold that a builder-vendor of a completed residential home impliedly warrants that it complies with applicable building code requirements, is built in a workmanlike manner, and is suitable for habitation [*Carpenter v. Donohoe*, 154 Colo. 78, 83-84 (1964)]. This is generally referred to as the Implied Warranty of Habitability. This warranty applies when there are latent defects in the home that create substantial questions of safety and/or habitability. Many jurisdictions have adopted this cause of action.

Depending on the jurisdiction (and ruling out statutory, punitive and consequential damages) the measure of damages for breach of a construction contract is the cost of repairing or remedying the building. However, if this is not possible, alternative damages could be the difference between the fair market value of the property without the defect and the fair market value of the property with the defect.

If Hammurabi were alive today, I would guess that he would be a proponent of statutory, punitive and consequential damages to enforce his code. These would substantially add to a money judgment amount. While I would never equate these remedies to the death penalty, it does seem that societies need to flirt with the draconian to enforce their building codes.

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The importance of indemnification language

Michael A. Montgomery

In a recent case arising out of the construction of a public project, the Supreme Court of Virginia underscored the attention that should be paid to indemnification language at the front end of a project before the contract is signed. Otherwise, many years later a general contractor could be left footing the entire bill for the correction of defective work, and have no recourse against the responsible subcontractor.

In *Hensel Phelps Construction Company v. Thompson Masonry Contractors*, a dispute arose out of the construction of a student health and fitness center at Virginia Tech. All work on the project had been completed by June 2000, including warranty work. Many years later, Virginia Tech discovered and then corrected a number of issues with the original construction. In April 2012, Virginia Tech filed suit against the general contractor, Hensel Phelps, for breach of written contract. Although a five-year statute of limitations typically would serve to bar such a claim, the statute of limitations does not apply to state agencies such as Virginia Tech. Therefore, the general contractor found itself defending a lawsuit for allegedly defective work that had been completed more than 12 years earlier.

After paying a considerable sum to resolve the litigation with Virginia Tech, the general contractor then filed suit against the subcontractors and their sureties. The defendants responded with various defensive pleadings, including a "special plea" that sought to dismiss the breach of contract claim based on the very same five-year statute of limitations upon which the general contractor had not been able to rely. And the defendants won.

On appeal of the trial court's decision, the general contractor first maintained that the subcontractors had waived the five-year statute of limitations. In making this argument, the general contractor relied on typical "flow down" language that incorporated provisions from the prime contract into the subcontracts. Based on this language, the general contractor maintained that the subcontractors had agreed that they were obligated to the same extent, and for the same indefinite period of time, that the general contractor was obligated to Virginia Tech under the prime contract. Therefore, according to the general contractor, any right to assert a five-year statute of limitations had been waived. The Supreme Court of Virginia, however, was not persuaded. According to the Court, general "flow down" language alone is not sufficient to demonstrate the subcontractors' intent to waive a right to a specific limitations period, or even to demonstrate that the knowledge of such a right exists. Some additional, specific language sprinkled throughout the subcontracts did nothing to change the Court's mind. Moreover, even if all of the language of the prime contract had been incorporated into the subcontracts, the result would have been the same. As the Court noted, in its prime contract, the general contractor had not agreed to waive any applicable statute of limitations. Rather, Virginia Tech could pursue its claims because a particular statute in the Virginia Code provides that the five-year limitations period does not apply to a state agency. Nowhere in any of the subcontracts is this statutory waiver incorporated, and therefore binding on the subcontractors. Accordingly, the claim against the subcontractor was time-barred.

In making its second, alternative argument to overturn the trial court's decision, the general contractor attempted to couch its claim as one for indemnification. If allowed to pursue such a claim, any statute of limitations would not have started to run until the general contractor had paid money in 2012 to settle the claims. The general contractor, however, had not expressly asserted a claim for indemnification, and for good reason. The indemnification language in the prime contract contained language that purportedly would indemnify the general contractor for its own negligence. The Supreme Court of Virginia had previously held that such language violates public policy, and accordingly is void. The general contractor sought to sidestep this issue, though, by recasting other language in the subcontracts as indemnification provisions. Again, the Supreme Court of Virginia was unpersuaded. In the eyes of the Court, these provisions related to the work as it was being performed, and imposed responsibility on the subcontractors for the cost of remedying work that had not been performed or not performed correctly. The provisions did not impose an obligation to indemnify the general contractor for all liability arising out of any failure to perform after the work had been completed. If the general contractor had desired to achieve that result, it could have included specific indemnification language in the subcontracts that was enforceable under applicable Virginia law.

There are several takeaways from this decision. First, review your contracts, and consider consulting with an attorney before you sign the contract. Each word in the contract matters, and ultimately can result in the recovery (or loss) of millions of dollars long after the project has been completed. Second, make certain the indemnification language in the contract is enforceable. If properly drafted to comport with applicable law, the indemnity clause should allow claims to be pursued against the subcontractors, even when dealing with contracts related to public projects. Finally, "flow down" language is commonly used in subcontracts and is generally effective in binding the subcontractor by referencing the prime contract or by expressly incorporating it into the subcontract. Therefore, as to the subcontractor, it should review the prime contract before signing the subcontract, and make certain it is not unwittingly agreeing to terms such as an indefinite time limitations period. As to the general contractor, it should make certain that the general "flow down" language accomplishes the intended purpose. If not, or if there is any doubt, then the general contractor should consider inserting additional language in the subcontracts where appropriate.

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How long am I liable?

> *'Can I still be liable for a project I finished long ago?' The answer is going to depend on an analysis of the circumstances of your case, the Statute of Limitations, the Discovery Rule and the Statute of Repose for the project's locale.*


Edgar Alden Dunham, IV

You are a construction contractor with a number of successful projects under your belt, when you find out that you are being sued over a project you completed years ago. Your reaction is "Can I still be liable for a project I finished that long ago?" The answer is going to depend on an analysis of the circumstances of your case, the Statute of Limitations, the Discovery Rule and the Statute of Repose for the project's locale.

All states have Statutes of Limitations. The Statutes of Limitations provide a deadline for filing a lawsuit. Typically the Statute of Limitations is longer for breach of contract claims than it is for tort claims. A "tort" claim is generally a claim that someone wrongfully caused someone else damage under circumstances that were not governed by a contract. A personal injury claim is a prime example. Depending on the state, other types of claims may be subject to other specific Statutes of Limitations. In other words, the deadline for a plaintiff to file claims against you is going to be different depending on the locale and the claims being asserted.

Determining that a plaintiff filed a lawsuit against you after the Statute of Limitations deadline has passed, however, is not the end of the analysis. Statute of Limitations deadlines can be extended by what is known as the Discovery Rule. In most cases, the time period set by the Statute of Limitations on your construction projects begins when you achieve Substantial Completion of your contract. Under the Discovery Rule, the Statute of Limitations does not begin to run until the plaintiff knows, or should have known, that he has a claim.

A determination that a plaintiff has filed its claim within the Statute of Limitations, as extended by the Discovery Rule, still does not complete the analysis, however. Most states have a Statute of Repose in addition to a Statute of Limitations. A Statute of Repose generally places a cap on any extension to the Statute of Limitations, beyond which the plaintiff is barred from bringing a claim, regardless of whether it knew or should have known of its claim. Like the Statute of Limitations, it typically (but not always) runs from Substantial Completion.

An example would be as follows: Let's say you substantially completed project "Y" 11 years ago. Let's further say that the Statute of Limitations for a contract claim in the locale where project "Y" is located is 6 years, and the Statute of Repose is 10 years. You are sued for breach of contract. The claim is brought more than 6 years after you achieved Substantial Completion, so it was filed beyond the deadline set by the Statute of Limitations, but the plaintiff argues that the Statute of Limitations has been extended by 7 years because it could not reasonably discover the problem until 7 years after Substantial Completion. While the reasonable discovery of the claim 7 years after substantial completion might very well extend the Statute of Limitations, it does not extend it past the 10-year cap imposed by the Statute of Repose. Accordingly, after discovering its claim, the plaintiff should have filed its lawsuit against you within the 10-year cap. Because it did not, the case against you should be dismissed.

Something else that needs to be taken into account is repairs. While a plaintiff may be out of time to bring a claim on the project itself, it may be within time to bring a claim on the repair itself, if the claim is only that the repair was not properly done.

To give you an idea of the difference the locale of your project may have on the various statutes, the chart below compares the Statutes of Limitations and Statutes of Repose for New Jersey, Pennsylvania, New York and West Virginia for contract claims (the most popular claims against contractors).

Finally, the parties to a construction contract generally can agree in the contract to shorten the applicable Statute of Limitations. They can also generally agree, pursuant to a forbearance agreement, to toll a Statute of Limitations, which has the effect of extending the deadlines in which a party can sue.

Knowing the Statutes of Limitations and Statutes of Repose for the areas in which you are working can help you manage risk and have an intelligent discussion with your defense attorney if you are sued.

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State	Statute of Limitations	Statute of Repose
NJ	6 years - N.J.S.A. 2A:14-1	10 years - N.J.S.A. 2A:14-1.1*
PA	4 years - 42 Pa. C.S.A. 5525(2) and (3)	12 years (14 years for certain personal injury or wrongful death claims) - 42 Pa. C.S.A. 5536
NY	6 years - NY C.P.L.R. § 213	No statute of repose**
WV	10 years - W.V. Code 55-2-6	10 years - W.V. Code 55-2-6a***

*New Jersey's Statute of Repose has an extra condition. In addition to arising out of a construction project, the claim must allege an unsafe condition.

**New York is one of the few states in the country that does not have a Statute of Repose.

***The West Virginia Statute of Repose is atypical and more along the lines of a Statute of Limitations for construction claims. It may be extended by a court pursuant to the Discovery Rule.

Incorporation by reference clauses in surety bonds: A sometimes problematic interaction
(continued)

As a result of a payment dispute, NCS refused to perform work required by the sub-subcontract with Schneider, notwithstanding a clause in the sub-subcontract which required NCS to "diligently perform the Work…despite the pendency of any dispute…." Schneider proceeded to hire other contractors to complete what it contended was work that was the responsibility of NCS.

As a result, and pursuant to the MSA, Schneider filed a demand for arbitration against NCS. Schneider's demand for arbitration also named Western Surety as a respondent. Schneider claimed damages of $1,473,100, plus attorney fees and interest.

Western Surety filed suit to enjoin its participation in the arbitration, contending that, based on the terms of the performance bond, Western Surety was not subject to the mandatory arbitration provision contained in the MSA. The lower court agreed with Western Surety that Western Surety had not agreed to arbitrate claims under the performance bond. Schneider appealed.

While the appeal was pending, the arbitration proceeded against only NCS with an award entered by the arbitrator in favor of Schneider and against NCS in the amount of $1,653,924.21 in damages, attorney fees, arbitrator fees and interest.

The issue on appeal was whether Western Surety was bound to the arbitration provision in the MSA based on the incorporation by reference language contained in the performance bond, even though Western Surety was not a signatory to the MSA.

As a threshold issue, the Court noted that the underlying project implicated interstate commerce and considered whether, based on the Federal Arbitration Act, federal common law or state law governed the underlying issue of contract interpretation. In view of a 2009 United States Supreme Court case and several subsequent United States Court of Appeals' opinions, the Court of Special Appeals concluded that state law governed, not federal law.

Based on settled Maryland contract law, the Court stated that its task was to determine "from the language of the agreement [the performance bond] what a reasonable person in the position of the parties would have meant at the time the agreement was effectuated." The Court then proceeded to review the terms of the performance bond to determine what a reasonable person would have meant at the time the surety bond was entered.

First, the Court noted that the performance bond referenced that Western Surety was bound to NCS' performance of both the sub-subcontract and the MSA. The Court then considered the particular language of the performance bond by which Western Surety bound itself "jointly and severally" to "the **performance** of the Construction Contract [the sub-subcontract]." The Court then also noted that the purpose of the MSA was to "ensure that NCS would '**perform work**' described in the [sub-subcontract]."

In focusing on the terms "**performance**" and "**perform work**" in the operative agreements, the Court found that Western Surety had obligated itself only to the "performance of the work it agreed to complete and not to every contractual provision in the incorporation by reference chain" of the performance bond, sub-subcontract and MSA.

Second, the Court addressed paragraph 9 of the bond, which provides that "any proceeding…under this Bond may be instituted in any court of competent jurisdiction in the location in which the work or part of the work is located and shall be instituted within two years after Contractor default…." The Court found that, to hold that arbitration of claims under the performance bond was compelled would be to improperly read this provision out of the bond.

Based on its review of the language of the performance bond, MSA and sub-subcontract, the Court of Special Appeals upheld the decision of the lower court and found that Western Surety was not compelled to arbitrate with Schneider its obligations under the performance bond in the event of default by NCS.

The Court of Special Appeals opinion in the *Schneider* opinion presents several helpful practice pointers. First, if a party wants claims under a surety bond to be arbitrated consistent with the underlying contract, it should provide that all of the terms and conditions of the underlying contract are incorporated into the bond and not just provisions that relate to the performance of the work.

Second, in the event that the underlying contract does not provide that all of the terms are incorporated, a party should review the surety bond that is supplied and, if there is any issue as to whether arbitration is compelled, require the surety to agree to a rider to the surety bond incorporating the dispute resolution clause of the underlying contract.

Finally, if the surety objects to arbitration and there is any question as to whether the bond provides for arbitration of disputes, a party should file a protective civil action in the appropriate court against the surety and then move to stay the civil action pending the outcome of the arbitration. At the same time, the party should invite the surety in writing to observe and participate in the arbitration. The purpose of this approach is twofold: (a) the filing of the action avoids any risk that any contractual or statutory time period for filing against the bond (usually one year or two years) will expire and allow the surety to escape its obligations on a technicality; and (b) the invitation letter strengthens the contractor's claim that the surety is bound by the underlying liability finding from the arbitration pursuant to the doctrine of collateral estoppel.

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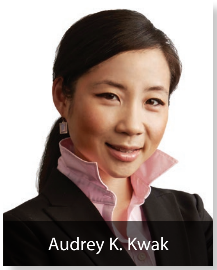
Court holds the door open for bad faith claims against sureties



Audrey K. Kwak

As both sureties and contractors are well aware, the question of whether the surety-principal relationship can—or should—be held to the same standards as the insurer-insured relationship is far from settled. While some courts have declared outright that "suretyship is not insurance," barring allegations of bad faith by contractors against their sureties, the argument in favor of allowing bad faith claims against sureties does have some facial appeal. Indeed, sureties often act in a manner similar to insurers, including settling claims on behalf of their principals (usually contractors) without consent.

Late last year, in *Great American Ins. Co. [GAIC] v. E.L. Bailey & Co.*, the Sixth Circuit Court of Appeals was confronted with a variant of this question—specifically, the proper standard for "bad faith" in the settlement of claims by a surety on behalf of its principal—and declined to answer it definitively either way.

The facts of Bailey

In *Bailey*, the surety GAIC settled two underlying pieces of litigation on behalf of its principal, Bailey, arising from a contract between Bailey (as general contractor) and the State of Michigan for the construction of a prison kitchen. In one suit, Bailey and the State sued each other for breach of contract for delays on the project. GAIC ultimately settled the matter—in negotiations that excluded Bailey—with the State, receiving a payment of $358,000 from the State. In the second suit, some of Bailey's subcontractors sued Bailey and GAIC for payments owed on the project. GAIC demanded that Bailey post collateral consistent with the surety agreement, and Bailey refused. Ultimately, GAIC settled the second suit as well.

After settling these suits, GAIC filed suit against Bailey, seeking (1) indemnification for failure to provide collateral for the subcontractors' claims, and (2) a declaration that GAIC had the right to settle Bailey's claims with the State.

Bailey's defense to the declaratory judgment claim was that GAIC had acted in bad faith in settling with the State, because the amount was too low, because GAIC failed to advise Bailey that GAIC was engaged in direct negotiations with the State, and because GAIC supposedly failed to adequately research Michigan law on liquidated damages. Bailey argued that the lesser bad faith standard applicable to insurers in Michigan—"more than negligence but less than fraud"—should apply to GAIC as surety. Under this standard, "good faith denials, offers of compromise or other honest errors" would not constitute bad faith, but because bad faith "is a state of mind, there can be bad faith without actual dishonesty or fraud" including, for example, "if the insurer is motivated by selfish purpose or by a desire to protect its own interests at the expense of its insured's interest."

The Sixth Circuit's decision

After considering Bailey's arguments, the Court refused to take a definitive position as to whether Michigan law would apply an insurer bad faith standard to a surety relationship. Nonetheless, the Court proceeded to examine the facts applying that lesser standard, ultimately ruling against Bailey in rejecting the notion that GAIC had engaged in bad faith.

First, the Court found that Bailey had presented no evidence about GAIC's state of mind, nor any reason why GAIC's interest in settling the case differed from Bailey's; rather, both "share[d] an interest in securing the highest settlement possible from the State." Further, emails demonstrated negotiations between GAIC and the State were "genuinely adversarial," indicating GAIC's good faith, and indeed, GAIC had secured a significantly higher settlement from the State ($358,000) than the $220,000 recommended by a mediator in prior negotiations (a recommendation rejected by the State). The Court also rejected Bailey's assertion that GAIC had concealed negotiations in bad faith, because it appeared that GAIC had only engaged in negotiations with the State for a week before telling Bailey of the likely settlement. The Court did, however, note that a "surety's concealment of its settlement negotiations does raise concerns."

Ultimately, *Bailey's* significance may lie in its failure to resolve the debate as to whether sureties owe principals the duties insurers owe their insureds. It has preserved, for now, the ability of contractors to argue that sureties are not immune to claims of bad faith conduct in the settlement of affirmative claims.

Although a surety's legitimate business concerns often make swift and early settlement important to the surety, if this concern does not equally serve the interests of its principal, *Bailey* implies that a surety may have the duty to advocate for a larger payout—even if it means prolonging negotiations and/or litigation. Regardless, sureties would be wise to keep principals fully advised of any and all settlement negotiations, especially if doing business within the Sixth Circuit's reach. Contractors would be equally wise to remind their sureties of these obligations.

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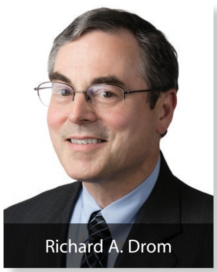
FERC requirements affecting electricity generation projects


Richard A. Drom

Electricity generation and cogeneration projects (which are faced with a variety of state and local regulatory requirements) sometimes must also comply with a host of federal requirements established by the Federal Energy Regulatory Commission (FERC). For example, FERC has the authority to regulate: (1) the wholesale sales of electricity in interstate commerce; (2) the merger or acquisition of a FERC jurisdictional asset; and (3) the rates of a Qualified Facility generation asset, pursuant to the Public Utility Regulatory Policies Act (PURPA). There are significant penalties associated with failure to comply with FERC's requirements.

> *"FERC has the authority to regulate: (1) the wholesale sales of electricity in interstate commerce; (2) the merger or acquisition of a FERC jurisdictional asset; and (3) the rates of a Qualified Facility generation asset, pursuant to the Public Utility Regulatory Policies Act."*

FERC does not have the authority to approve or to regulate the physical construction of electricity generation facilities. FERC also has limited authority to regulate generation facilities that are not connected to the wholesale power grid; these are sometimes described as "behind-the-meter" generation facilities because all electricity that is produced is used where the generation facility is located, and the electricity is not metered into the wholesale electricity grid.

However, if a generation facility delivers power "in front of the meter" (e.g., provides power to third parties outside of the property limits of the facility), then the generation facility may be subject to FERC's jurisdiction because of the facility's potential impact on the wholesale power market, and on the reliability of the electricity grid. In such an instance, the owner of the resource must register with the public utility that operates the wholesale power grid, frequently a Regional Transmission Organization (e.g., PJM Interconnection, L.L.C.) or an electric utility (e.g., Southern Company). These organizations have complex electricity tariffs that govern the ability of the generation asset to deliver electricity, to consume electricity from the grid, and to participate in wholesale energy and capacity markets.

Section 203(a) of the Federal Power Act (FPA) prohibits a public utility from selling, leasing or otherwise disposing of facilities subject to the jurisdiction of the FERC, or any part thereof of a value in excess of $10 million (that is used for interstate wholesale sales over which FERC has jurisdiction for ratemaking purposes), *unless* the public utility first secures an order from FERC authorizing the disposition. Thus, the owners of jurisdictional facilities may be required to obtain FERC's consent prior to the transfer of such facilities through a merger or an acquisition, unless the owner can demonstrate with substantial evidence that the facility is used only for retail sales. FERC is responsible for determining whether a proposed merger is consistent with the public interest. In making its determination, FERC examines a merger's effect on competition, rates and regulation, and the potential for cross-subsidization.

An electricity generation facility that also produces usable thermal energy or is powered by renewable energy resources (e.g., solar, biomass, landfill gas, etc.) may meet FERC requirements as a "Qualified Facility" or a "QF" under the PURPA requirements. (QFs often use industrial or other waste heat to generate electric energy, or use waste heat from electric-generating activities for other beneficial purposes.) PURPA established of a new class of generating facilities that would receive special rate and regulatory treatment. Generating facilities in this group are known as QFs, and they fall into two categories: qualifying small power production facilities and qualifying cogeneration facilities. The owner of a QF, however, must comply with FERC requirements, including, for example, submitting a Self-Certification utilizing FERC's Form 556, prior to commencing operations.

FERC also oversees compliance with the approved mandatory reliability standards by the users, owners and operators of the bulk power system. This could, for example, require that an electricity generation facility register with the nation's Electric Reliability Organization (ERO) as a Generation Operator or Generator Owner. The ERO requires registration of: (1) individual generation units of 20 Megavolt amperes (MVA) or greater that are directly connected to the bulk electric system; (2) generating plants with an aggregate rating of 75 MVA or greater; (3) any blackstart unit material to a restoration plan; or (4) any generator, regardless of size, that is material to the reliability of the bulk power system.

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Waiver of consequential damages clauses: Are your damages direct or consequential?

F. Timothy Grieco

In *Jay Jala, LLC v. DDG Construction, Inc.,* the issue facing the district court was whether certain damages categories were waived by the owner pursuant to a waiver of consequential damages provision in the parties' contract. Ruling that the owner had waived certain damages and not others, the district court attempted to clarify the sometimes uncertain distinction between direct and consequential damages.

The owner, Jay Jala, had contracted with DDG as general contractor for the construction of a Motel 6. Various delays occurred, and the owner terminated the general contractor for cause and finished the project utilizing its own forces. The hotel opened late several months after the termination of the general contractor and the contractual completion date. The owner sued the general contractor for various damages, including a project completion fee by owner; loss of income/profits; insurance; advertising expenses; furniture, fixtures, and equipment (FF&E); bank interest on the construction loan; and extended utilities. The parties' contract included a mutual waiver of consequential damages, which provided that "the contractor and owner waive Claims against each other for consequential damages arising out of or relating to this Contract… [and including] damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons."

The contractor moved for summary judgment, arguing that various of the owner's damages were barred by the provision waiving consequential damages. In deciding the motion, the district court first acknowledged that many parties tend to focus on foreseeability when evaluating the difference between direct and consequential damages. But the district court emphasized that foreseeability should not be the focus. Rather, the touchstone must be what was the contractually promised performance or the benefit of the bargain. If the damages represent the replacement of the promised performance, then the damages are direct; if the damages represent some secondary loss caused by the breach, then the damages are consequential. Quoting the Third Circuit, the district court stated: "The difference between direct and consequential damages depends on whether the damages represent (1) a loss in value of the other party's performance, in which case the damages are direct, or (2) collateral losses following the breach, in which case the damages are consequential." Based on this authority, the district court attempted its own articulation as follows: "So direct damages are the costs of a plaintiff getting what the defendant was supposed to give—the costs of replacing the defendant's performance. Other costs that the plaintiff may not have incurred if the defendant had not breached, but that are not part of what the plaintiff was supposed to get from the defendant, are consequential."

Applying this definition, the district court ruled that the owner had waived any damages for loss of income, insurance costs, advertising expenses and FF&E rental expenses. First, the loss of income to the owner from the motel opening late came directly within the ambit of the waiver clause and was actually withdrawn as an element of damages by the owner after the submission of the defendant's summary judgment motion. Second, the owner's claimed insurance costs—which related to insurance coverage for the operation of the motel during the period of the delayed opening—were not tied to any insurance the general contractor was obligated to provide under the contract. Third, like the insurance costs, the advertising expenses —which were for a billboard and print media that the owner claimed were unnecessarily extended or made wasteful by the missed grand opening date—"were not designed to deal with or make up for [the defendant's] breach or recover the lost value of defendant's performance." Finally, the owner's costs in renting FF&E for an extra period of time due to the delay were consequential damages because the contract obligated the general contractor only to provide a storage container to store FF&E between delivery and eventual installation. The leasing of the actual FF&E was not something the owner expected to get from the general contractor.

Conversely, the district court ruled that the owner's damages relating to the project completion fee, extended utilities, and bank interest were not consequential in nature and thus not barred by the waiver clause. First, the district court interpreted the project completion fee as a reimbursement of overhead costs for the time period during which it served as its own contractor after Defendant quit. According to the district court, the owner was entitled to recover the cost of substituted performance, and "if it had hired a replacement contractor, that company may well have charged an overhead fee just as Defendant did (or it might be otherwise built into the price)." Because the fee was part of the substituted performance, it was "direct" in nature. Second, because payment of utility costs during construction was expressly part of the general contractor's performance under the contract, the owner was entitled to the "direct" damages of several months of additional utility bills incurred in carrying out the defendant's scope of work. Finally, despite being a closer issue and contrary to some existing authority, the district court ruled that the owner's claim for additional bank interest on the construction loan represented direct damages and thus was not waived. "Here, Defendant agreed to build the motel using no more than a certain amount of time and therefore, necessarily, a certain amount of loan interest. Defendant used up all the time and left the building unfinished, so Plaintiff can recover as direct damages the costs of additional time necessary to finish construction." For the district court, the taking out of the construction loan and paying additional interest on the loan was an "integral cost of completing Defendant's performance."

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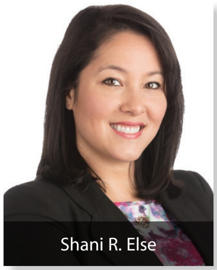
Quiet Room® Guide advises on standards to calculate and recognize noise levels for hotels


Shani R. Else

The level of noise in a hotel room is a high source of complaints; thus, ensuring quiet is of great concern for the hotel industry in the construction and design of its rooms. The industry must balance the peace and quiet of its clients with the ability to offer quality entertainment and to generate revenue. Hotels have developed various strategies to reduce noise, including increased soundproofing, sound masking, and grouping rooms together in designated "quiet zones." The Knowledge Center Sound Insulation (KGI) is a consortium of acoustic and sound insulation specialists who have taken the next step—creating a Quiet Room® label to objectively qualify and standardize noise level in individual hotel rooms for its clients.

As reducing noise can be done most cost-effectively in the construction stages, KGI has developed a new Quiet Room® Guide to help architects, developers and construction professionals understand the essential elements of acoustic insulation of hotel rooms and the certification requirements of the Quiet Room® label. The Guide explains how hotel rooms must be evaluated to determine their existing noise level, necessary steps they must take to improve their noise level, if necessary, and overall sound limitations required to receive a QR label.

In order to qualify for the QR label, a hotel room must meet certain standards in four areas: (1) the airborne sound insulation between rooms, (2) the airborne sound insulation between rooms and traffic areas, (3) the service equipment sound level, and (4) the reverberant sound period. Each of these must be evaluated in order to evaluate a hotel room's existing sound level and determine if the room meets the QR label requirements.

The Guide sets forth the equipment needed to take the appropriate measurements, the preparation and selection of rooms for testing, the protocols for every measurement to ensure accuracy and consistency, the calculation method used for the limiting values of the QR label (to account for service equipment noise levels and size of the room), and suggested improvement measures to increase sound insulation and reduce noise levels, as necessary. Hotels can retain KGI to conduct the tests as set forth in the Guide, or the architects and construction teams for the hotel can perform their own tests and provide the results to KGI in order to qualify for a QR label or to simply ascertain how the hotel stands in terms of noise levels.

For more information, please visit https://www.quiethotelroom.org/en/
If you wish to receive a copy of the Quiet Room® Guide, you may request it under the tab "Info for Professionals—Architects/ Developers."

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Advice for federal contractors during the new administration

Matthew J. Whipple

The adage "may you live in interesting times" is thought by some to be a blessing and others a curse. While every Presidential transition brings change, the move from the Obama administration to the Trump administration adds an extra dose of intrigue. For federal contractors, the new administration brings both gainful opportunities and unique challenges. It is impossible to know precisely what the next four years will bring, but this article attempts to offer some guidance for those seeking to not only to live but also to thrive in these new "interesting times."

There will be opportunities, but be mindful of the details

While on the campaign trail, President Trump touted himself as a builder and made clear that his administration will prioritize infrastructure improvements. Indeed, one of the first things he mentioned in his election night victory speech was a commitment to rebuild roads, bridges, airports and schools. Increasing IT infrastructure and security has also been a consistent theme. The President has strongly emphasized the need for growing domestic businesses, even at the expense of multinational companies, and has already taken steps, such as withdrawing from the Trans-Pacific Partnership, to effectuate that priority. That priority is likely to continue in the coming months and may mean the Buy American Act and similar laws will receive greater emphasis.

Additionally, President Trump has emphasized public-private partnerships, with a likely increase in outsourcing to the private sector, as evidenced by the federal hiring freeze issued just days after Trump's inauguration. The bottom line is that there will be opportunities for construction contractors seeking to do business with the federal government.

The challenge for any President is moving from promises to practice, and that is where contractors must be mindful. Trump may be a career developer, but he is not a career politician, and the demands of the federal government are not the same as those placed on the president of a closely held family company, no matter how large. President Trump is likely used to making decisions on his terms, with tasks being completed on his timetable. He has little experience with the slower, consensus-building, majority-rules system that underlies the federal government. As can be seen in some early executive orders, the White House may be willing to act quickly, but can be ahead of precise plans to implement its desires.

Trump may also face challenges from budget hawks within his party who may see an opportunity to shrink the federal apparatus, and so may be reluctant to fund certain projects. Under applicable regulations, contractors who accept long-term projects may be in a bind if a later decision is made to cease allocating funds to a project. Prudent contractors should pay attention to planning and funding details and to weigh any risks before jumping into a project.

Be prepared for volatility

It is well known that Trump's rise to the presidency did not follow a traditional path, and the volatility that marked his campaign may translate into procurement policy. It seems reasonable to conclude that the executive orders that have marked the first weeks of his administration will continue. Additionally, those familiar with the @POTUS Twitter account know that he is willing to criticize not only SNL, but also contractors involved in projects he deems wasteful. One unfavorable tweet can thrust a reluctant contractor into the spotlight.

President Trump has further shown he is willing to roll back Obama-era policies, which can increase volatility for contractors seeking to make long-term plans to maximize their competitiveness. Many federal contractors were focused in 2015 and 2016 on compliance with Obama executive orders, including the Fair Pay and Safe Workplaces Order (also known as the "Blacklisting" Order), as well as orders pertaining to LGBT protections and sick leave. Even before Trump took office, the "Blacklisting" Order was faced with legal challenges, and it may be that some or all of the Obama-era orders will be rescinded or modified. And this is to say nothing of Obama-era accomplishments such as the Affordable Care Act, which impacts businesses other than federal contractors, but which requires contractors to "bake in" overhead costs in their bids. If the ACA is repealed or significantly altered, contractors may be required to respond accordingly to keep bids competitive.

Those at the top may have changed, but your contracting officer likely has not

Contractors should also remember that even though there may be turnover at the highest levels of government, the majority of federal employees have not changed. Most are career workers who held positions before the Trump Administration and will after. This is likely true of your contracting officer.

Contractor performance evaluations are now, more than ever, a crucial aspect of government contracting, as the evaluation process has received increased standardization, and evaluations are routinely shared across agencies. A poor performance review by one agency may negatively impact a contractor's bid with a second agency. That review will not be written by a new cabinet appointee; it will be written by the same contracting officer you have dealt with for months. Maintaining good working relationships with those who are the "boots on the ground" remains essential.

Further, even though executive orders may grab headlines, most orders cannot, on their own, meaningfully alter procurement practice. Implementing regulations, which may take months or years to be finalized, are necessary to truly alter the procurement landscape. And most of that landscape—voluminous statutes, the Federal Acquisition Regulations, accompanying agency supplements—is unchanged, regardless of who sits at the top. Intimate knowledge of the policies and procedures that affect your business is still the best way to ensure success for federal contractors.

Stick to the fundamentals

Finally, resist the urge to change just because the occupant of the Oval Office has. It can be tempting to have a short-term outlook, but businesses are not built in two- and four-year cycles. Know what changes may be required to comply with the contract or to submit a competitive bid, but do not overhaul your business model just because of a new President.

Additionally, if you are faced with volatility, control what you can control. Cross T's and dot I's. Communicate clearly. Be responsive to requests from the contracting officer. Contemporaneously document contract negotiations, modifications and problems. Create a record of following the rules. Adhere to notice procedures. When there is a problem, seek help from counsel sooner rather than later. Follow the fundamentals of good business practice, and you will thrive regardless of who lives at 1600 Pennsylvania Ave.

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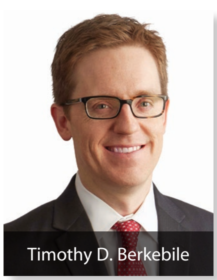
D.C. Court of Appeals liberally construes notice requirements for delay claims


Timothy D. Berkebile

The District of Columbia Court of Appeals, which is the equivalent of a state supreme court for the district, recently adopted the rule that the 30-day notice requirements for delay claims should be liberally construed. In that case, a contractor was engaged to complete alterations and repairs to a solid waste transfer facility. The public owner directed additional work due to unanticipated problems. The additional work resulted in unexpected and unbudgeted changes that caused a nine-month project delay, and significantly increased the cost of the work.

The contractor sought payment for the indirect costs incurred during the delay. The owner of this project, the District of Columbia, argued that such claims were barred because the contractor did not submit its claim within 30 days of the written change order, or submit certified cost or pricing data. Both the Appeals Court and the Contract Appeals Board disagreed, instead adopting a flexible stance on notice requirements for delay claims, except in cases where the public owner is unaware of the circumstances surrounding the claim, causing prejudicing to the government.

The Appeals Court explained that the government is not prejudiced by a late claim where the government has the necessary knowledge to "to perform necessary fact-finding and decision-making[.]" The Court of Appeals further found that in these instances, the contractor should not be barred from making a claim because it relies on actual costs rather than prospective cost data.

The clear message is that delay claims on construction projects in the District of Columbia will generally not be decided on technical readings of these notice provisions, and the courts will acknowledge the actual knowledge of the parties.

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Construction Law Group NEWS

Scott D. Cessar and **Christopher R. Opalinski** were selected by 2017 Pennsylvania Super Lawyers® as two of the "Top 50 Attorneys in Pittsburgh."

Scott Cessar, Neil O'Brien and **Chris Opalinski** were selected for inclusion in the 2017 edition of The Best Lawyers in America® for their legal work in construction. Also, Scott was named Litigation – Construction "Lawyer of the Year" in Pittsburgh. Best Lawyers compiles its lists of outstanding attorneys by conducting exhaustive peer-review surveys in which thousands of leading lawyers confidentially evaluate their professional peers. Inclusion in The Best Lawyers in America 2017 is determined by more than 5.5 million detailed evaluations of lawyers by other lawyers.

Scott Cessar and **Matthew Whipple** recently achieved a favorable result for a longtime firm client in the water technology industry. The client was awarded $1.889 million, and claims by a contractor of nearly $6 million were denied. The award brought to close five years of litigation, which arose from the construction of a $150 million storm water containment facility. This matter led to the establishment of new case law in Michigan on the use of the Eichleay formula to calculate home office overhead.

Scott and Matthew also successfully fended off a bid protest before the U.S. Government Accountability Office (GAO) to an award of an $18 million contract to a firm client in the underground construction industry. The contract is for the construction of cutoff walls at a United States Army Corps of Engineers project.

Audrey Kwak authored "Owner's termination for convenience will not preclude entitlement to liquidated damages," for the Winter 2017 issue of Dimensions Magazine, published by the New Jersey Builders Association; and "Precise Contract Language Is the Key to Avoiding Liquidated Damages," in the March issue of Engineering News Record.

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