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ATTORNEYS AT LAW

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Construction Law

In This Issue…

Good faith and fair dealing in federal procurement contracts: Which way will it go?

Since the Civil War, courts have held that in administering construction contracts, the federal government may be held accountable for its actions in the same way that private parties are held accountable. This includes the application of the implied covenant of good faith and fair dealing to construction contracts. This duty includes the duty to cooperate and the duty not to hinder the performance of the contractor. Breaches of this duty include the failure by the government to timely deliver models necessary for performance, to unreasonably delay acceptance of the contractor's deliverables, to fail to timely make the work site available for work to proceed, to fail to provide required plans and drawings, to engage in overzealous inspection, to damage the work site and to conduct inadequate surveying of the site causing delays.

The historical standard in order to succeed on a claim of breach of the implied duty of good faith and fair dealing has been that the contractor must show by a preponderance of the evidence (51 percent) that the government acted unreasonably.

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Risk allocation in construction contracts: The importance of a differing site conditions clause

A recent decision from the Texas Supreme Court serves as a warning to all contractors to insist on a differing site conditions clause in every construction contract.

In *El Paso Field Services, LP v. MasTec North America*, MasTec was the winning bidder on a contract for pipeline construction. The information provided with El Paso's invitation for bids identified roughly 280 foreign crossings.

While the contract provided that El Paso "will have exercised due diligence in locating foreign pipelines and utility line crossings," the contract also required that MasTec "confirm the location of all such crossings…." The contract also contained a "site visit" clause in which MasTec represented that it had visited the work site and "made all investigations essential to a full understanding of the difficulties which may be encountered" and that regardless of the representations or information provided by El Paso, MasTec "assumes full and complete responsibility for any such conditions pertaining to the Work, the site of the Work … and all risks."

When performing the work, MasTec encountered nearly 800 foreign crossings—far more than the 280 identified in the contract documents.

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Good faith and fair dealing in federal procurement contracts: Which way will it go?
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In *Metcalf v. United States*, Metcalf was the low bidder for a design/build project for the Navy to construct in Hawaii a 158-unit residential complex with an option for an additional 24 units. Metcalf's bid was approximately $43 million. Metcalf was paid, with change orders, over $49 million. Metcalf's claimed costs exceeded $76 million.

Metcalf filed claims for delay and direct costs arising from disputes over which scheduling software was to be used, whether the government failed to timely investigate differing site conditions and wrongly rejected its expert's reports, two major differing site conditions, interference with Metcalf's design/build decisions and means and methods, arbitrary rejection of submittals of proposed personnel, inconsistent administration of the payment process and active interference with its efforts to turn over housing units in order to achieve substantial completion.

Metcalf's claims were based on breach of contract and breach of the duty of good faith and fair dealing.

Following extensive hearings, the trial court denied most of Metcalf's claims, notwithstanding **its own findings** that the government had engaged in "overzealous" and "retaliatory" inspections, overbearing contract administration by an unqualified contracting officer and "hardnosed" withholding of payments. This included an instance in which the contract inspector had rejected a countertop that was 1/64 inch out of tolerance, but told a Metcalf employee that "on any other job in the universe, he would accept [the] countertop" and that "it actually looked good…."

In reaching its decision on Metcalf's claim as to breach of the implied duty of good faith, the trial court, relying on a previous decision by the federal circuit in a different factual context, held that, notwithstanding these findings, Metcalf had failed to establish that the government's actions were "specifically designed to reappropriate the benefits [that] the other party expected to obtain from the transaction, thereby abrogating the government's obligations under the contract." This standard effectively meant that Metcalf had to show that the government acted intentionally and in bad faith, subjectively targeting Metcalf with its conduct.

> *"This decision, which Metcalf has appealed to the federal circuit, has set off a firestorm in the contracting industry."*

This decision, which Metcalf has appealed to the federal circuit, has set off a firestorm in the contracting industry. Numerous contractor groups have filed friend of the court briefs with the federal circuit arguing that the trial court's holding must be reversed. A decision from the federal circuit is expected sometime in mid-2014.

The policy arguments for reversal of the trial court decision in *Metcalf* are straightforward and compelling. Contractors, when bidding work, must consider the risk of government-caused delays, impacts and changes. If the incredibly high burden of proof for the breach of the implied duty of good faith and fair dealing applied in *Metcalf* stands, then contractors will either be forced to dramatically increase their price or forego bidding government work. In either case, the market, the procurement process and the public will suffer.

The choice for the federal circuit on appeal is stark: (1) endorse the high burden of proof applied in *Metcalf* and require the contractor to show intentional bad faith by the government or (2) follow the historical standard requiring the contractor to show only that the government objectively acted unreasonably and, in doing so, breached its reciprocal duty to cooperate and not hinder contractor performance of the contract.

Stay tuned.

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An REA by any other name: Recognizing the differences between claims and requests for equitable adjustment in federal construction projects

Nearly every contractor has encountered a project where things do not go as planned. Maybe a differing site condition stalled progress for months or maybe late-breaking design modifications required different material. In the midst of the changed work, the contractor drafts a "Request for Equitable Adjustment," asking for additional money, time or both, sends the REA certified mail to the owner's representative, and waits for a response. If this just so happens to be a federal project, however, that REA may have set off a series of consequences that the contractor may not have even considered. The consequences result from the way an "REA" may relate to a "claim" under federal procurement law. Savvy contractors should know the way the two concepts relate to avoid any unexpected problems.

Generally, an REA is a request for an adjustment to the contract balance or terms of performance, typically based on circumstances that are outside the contractor's control. While often presented at the conclusion of a project, sometimes REAs are submitted in the midst of performance, as an invitation to negotiation. A contractor may submit an REA while performing to place the owner on notice of increased costs and to try to figure out a mutually acceptable solution.

By contrast, in federal contracting, a "claim" is a demand for a specific sum of money or other relief that asks the contracting officer (the government's representative on the project) to issue a written response concerning the demand. While an REA might be an invitation for discussion, a claim definitively asserts that the contractor is entitled to certain relief, and requests that the contracting officer either award or deny it.

Under applicable federal regulations, there is no formal definition of "REA" or "claim," but the overlap is obvious. In many situations, a document titled "REA" will be demanding a specific sum of money and requesting a written response from the contracting officer. The REA may, therefore, constitute a "claim," and various Court of Claims decisions have recognized REAs as such.

The distinction is highly significant because REAs and claims have different requirements, grant different rights and bestow different responsibilities. For instance:

Certification Requirements

Depending on the government agency and amount of money at issue, a contractor may be required to attest that the REA or claim is true and accurate, to the best of contractor's knowledge. The certification language is spelled out in applicable federal regulations and in specific agency supplements. Crucially, however, the certification requirement may be different for REAs and claims. If a contractor desires to present a claim, but uses the REA certification language, the claim may be rejected.

Significantly, the certification requirement is jurisdictional. If a contractor submits a claim without the proper certification, the contracting officer may simply respond that she lacks authority to address the matter without the certification. Additionally, if the contractor attempts to appeal the contracting officer's decision, the appellate court may also lack jurisdiction to address the appeal. Understanding the proper certification requirements, therefore, is crucial to ensuring that the contractor's rights are preserved.

Timing Of Contracting Officer's Response

Assuming there is no time frame required by the contract, an REA does not place the contracting officer under any mandatory time constraints. Under applicable precedent, a response to an REA must be given within a "reasonable" amount of time, but what is reasonable depends on the circumstances of the project, and size of the request, and any number of other factors. A contractor who submits an REA may wait a significant period of time.

By contrast, the Federal Acquisition Regulations mandate that a contracting officer must respond to a claim within 60 days or, at least, give a definitive response timetable. A contractor who submits a claim, therefore, knows that it has placed the contracting officer on the clock.

Appeal Rights After Decision

That clock, however, will continue to tick for the contractor, too. When a contractor submits a claim, if the contracting officer denies it, the contractor has a right to appeal, either to the applicable agency board of contract appeals or to the federal Court of Claims. However, the contractor is required to appeal within a certain amount of time—90 days and 12 months, respectively. If the contractor fails to act within that time frame, the appeal right may be lost. Conversely, if the contracting officer denies an REA, the contractor may not have any appeal rights. If the contractor wanted to appeal, it would have to resubmit a formal claim.

At first blush, presenting an REA instead of a claim may seem wasteful—why go through the hassle of submitting an REA when a response may be delayed and no appeal rights are granted? This is where individual project considerations come into play. If an issue arises in the middle of a project, the contractor may not appreciate the full impact of that problem for months. If a claim is submitted, and denied, in the middle of the project, the contractor may be in the awkward position of being forced to appeal a claim that it does not fully understand. That appeal could also damage its ongoing working relationships on the project. In this situation, submitting an REA, in the hopes of triggering further discussions, may be the more prudent course.

Understanding the sometimes subtle differences between an REA and a claim, therefore, is essential for success on government projects. Before you send that certified letter, be sure you fully appreciate the benefits and obligations that each will bring.

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Arbitration clauses allowing one party to sue in court: Enforceable or not?

Three recent cases address the question of whether an arbitration clause allowing one party to choose between arbitration and litigating in court, while requiring the other party to arbitrate its claims, is enforceable. The courts' answers are far from uniform. For example, in *Jones Masonry Contractors v. Brice Building Company*, the subcontract provided that any disputes "which cannot be settled by negotiations among the parties … shall at the election of the Contractor (but not otherwise) be submitted by the parties to arbitration ..." Thus, the contractor could choose arbitration or court, but the subcontractor could only arbitrate its claims. The subcontractor sued in federal court in Louisiana, and the contractor moved to enforce the arbitration clause. The subcontractor attempted to remain in federal court by arguing that the arbitration clause was "adhesionary," and thus unenforceable due to the subcontractor's alleged lack of consent. The court enforced the arbitration clause and found that the contractor's option to litigate in court did not invalidate the clause.

Many states, including Pennsylvania, follow the rule of *Jones Masonry* and enforce arbitration clauses in the commercial context despite one party having the option to choose court or arbitration. On the other hand, in *Dan Ryan Builders v. Nelson,* the West Virginia Supreme Court considered an arbitration clause in a home construction contract requiring the buyer to arbitrate *all* of his claims, but allowing the contractor to file a lawsuit if the buyer failed "to settle on the Property within the time required under the Agreement." The Court declined to rule that *all* arbitration clauses allowing one party to pursue its claims in court are unenforceable. However, the Court found that in that particular context, the clause may be "unconscionable," i.e., unenforceable, because it "lacks mutuality of obligation." Therefore, in West Virginia it is possible that courts will invalidate an arbitration clause allowing one party to choose between court and arbitration, particularly in a residential construction contract.

The federal Fourth Circuit Court of Appeals addressed a similar issue in *Noohi v. Toll Brothers*. The Noohis contracted with Toll Brothers to build a luxury home in Maryland. The contract "required only the buyer—but not the seller—to submit disputes to arbitration." The Noohis failed to secure a mortgage and Toll Brothers declined to return their deposit of $77,000. The Noohis sued in federal court; Toll Brothers moved to stay the suit and enforce the arbitration clause. The Fourth Circuit found that under Maryland law, the one-sided arbitration clause lacked "mutuality of obligation," i.e., consideration, and was therefore unenforceable.

The bottom line is that a contractor who wants the sole right to choose between arbitration and litigating in court should analyze whether such clauses are enforced in the relevant jurisdiction. As discussed above, some jurisdictions closely scrutinize and may invalidate arbitration clauses permitting one party to choose between court and arbitration. Furthermore, courts are more likely to invalidate such clauses in residential construction contracts, and less likely to invalidate them in commercial construction contracts.

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Risk allocation in construction contracts: The importance of a differing site conditions clause (continued)

The disruption to MasTec's work was tremendous, as each pipeline had to be treated as potentially explosive. MasTec filed suit, arguing that El Paso breached its duty to exercise due diligence in identifying the foreign crossings. In response, El Paso argued that the site visit clause put all risks on MasTec.

At trial, the jury agreed with MasTec and awarded it over $4.76 million in damages, finding that El Paso had failed to exercise due diligence in providing information relating to foreign crossings. The trial judge reversed the jury's decision, finding that MasTec had contractually assumed all risks associated with unidentified foreign crossings. MasTec appealed, and the appellate court reversed the trial judge, agreeing with the jury that El Paso had breached its due diligence obligations.

El Paso appealed this decision and won over a majority of the Texas Supreme Court, which held that El Paso's promise of "due diligence" was not a guarantee and that the parties had allocated the risk of any undisclosed crossings to MasTec. The court noted that MasTec could have protected itself by having the contract contain a term that would imply the owner's "guarantee of the sufficiency of the specifications."

This decision teaches several important lessons to contractors negotiating contract terms: first, that courts will enforce a contract as written—and more specifically, the allocation of risks that the parties have agreed upon. Thus, a contractual promise to perform work for a fixed sum will not be excused because of unforeseen difficulties, no matter how unfair the result may be, unless the contract says otherwise. Contractors would be wise to insist on including a differing site conditions clause in every contract, and/or requiring the owner to guarantee the sufficiency of specifications.

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Recovery of investigative costs in construction defects cases

Construction defect disputes often present the question of whether an owner can recover the cost of investigating the suspected defect before it manifests. This issue can be preemptively addressed by contract. When it is not so addressed, and the owner is faced with potential defects that may result in future damages, the owner is forced to decide whether to undertake costly investigations to determine if the suspected defect actually exists or just wait and see if the feared failure actually occurs.

In some cases, the owner chooses to first investigate and then seek reimbursement through litigation later. This approach has the benefit of avoiding dismissal of the lawsuit as frivolous for lacking evidence of any actual harm. The downside is that the owner pays for such investigations out of its own pocket, and there is no certainty that such investigative costs will be reimbursed, even if actual harm is discovered, because most jurisdictions adhere to the general rule that each party to a lawsuit bears its own costs and fees. These issues have led owners to bring suit seeking the investigative and repair costs up front, before any investigation has occurred. This approach is problematic, because the claimed damages are speculative—damages have not yet been sustained and may or may not occur in the future.

A federal trial court in Wisconsin has recently addressed this matter in *Central Brown County Water Authority v. Consoer, Townsend, Environdyne*. The court found that the lack of proof of actual damages prevented recovery for negligence, but that investigative costs that flowed directly from a breach of contract and were reasonably foreseeable may be recoverable. While there is no clear answer as to whether the costs of such investigations are recoverable, this recent case suggests that courts may be more receptive of claims for investigative costs when the need to investigate results directly from a breach of contract, and such breach would have reasonably been expected to result in the need for such an investigation.

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Contractors' direct claims against design professionals in New Jersey may be barred by the Economic Loss Doctrine

Claims by contractors against design professionals arising out of New Jersey construction projects may be barred by the Economic Loss Doctrine (the Doctrine). Despite the lack of a contract between contractors and design professionals, contractors often assert direct claims against design professionals relying on *Conforti & Eisele, Inc. v. John C. Morris Associates*, a 1985 case that held that a contractor's economic damages attributable to a design professional's negligence are recoverable. Many of those claims may now be barred under recent case law citing the Doctrine, which bars the recovery of purely economic losses in tort.

Tort law applies if a party is damaged by another's negligence. Contract law applies if a contract is breached. Under the Doctrine, a party may sue for purely economic damages under contract law, but not in tort (although economic damages are recoverable in tort if there is also personal injury or property damage). While the Doctrine has a long history and wide applicability, it has not been applied to construction projects until recently.

Application of the Doctrine to construction projects arises from the New Jersey Supreme Court's decision in *Spring Motors v. Ford Motor Co.*, a non-construction case, which held that a party suing over a transaction governed by the Uniform Commercial Code is barred from bringing negligence claims. The rationale was that contract law is better suited to resolve disputes between sophisticated commercial parties.

In 2002, the New Jersey Supreme Court applied the Doctrine in *Saltiel v. GSI Consultants, Inc.*, when an architect sued a subconsultant for contractual damages. The plaintiff also included negligence claims against the subconsultant's principals. Building on *Spring Motors*, the court held that, in the absence of an independent duty, enforceable separately, the Doctrine prohibited the claims for negligence.

In 2011, in the unpublished, but widely discussed, *Horizon Group v. NJSDA*, the appellate court held that a contractor suing the owner for contractual damages could not also sue the architect in tort for economic damages. Relying upon *Saltiel*, the court ruled that when a contractor's rights derive from its contract with the owner, it is left to its contract damages.

This year, in another widely discussed, unpublished decision, *Spectraserv v. Middlesex County Utility Authority*, a trial court struck a contractor's claims against the architect because there was no separate duty to the contractor and because the contractor's remedy lay in its contract claim against the owner.

While New Jersey courts are not bound by these unpublished decisions, they can be presented as persuasive authority. Accordingly, unless a contractor can show an independent duty to it on the part of the design professional, or the unavailability of contractual remedies, its claims against a design professional are likely to be barred under the Doctrine.

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Supreme Court to address enforcement of contractual forum selection clauses

A common practice in the construction industry is the inclusion of forum selection clauses in contracts, which require that any dispute between the parties be resolved in a specific forum. Most courts enforce such provisions, reasoning that such clauses are essential to the benefit of the bargain between the parties. When a party files a lawsuit in any forum other than the contractual forum, that venue is inherently "improper," and in the vast majority of cases, the dispute is dismissed or transferred to the proper court.

In federal courts, however, a split has emerged, whereby certain Circuits have found that a forum selection clause does not render a venue "improper" if the venue is otherwise appropriate under the Federal Rules of Civil Procedure. Courts in these Circuits utilize a balancing test to determine whether a forum selection clause should be enforced, and if the scales do not tip in favor of the clause, the court will not enforce it.

The Supreme Court will seek to resolve this split in the matter of *Atlantic Marine Construction Company v. U.S. District Court for the Western District of Texas*. In this case, a subcontractor filed a claim for nonpayment relating to a Texas construction project. The subcontractor asserted its claim in Texas, despite a forum selection clause that mandated litigation in Virginia. The district court and the Fifth Circuit, applying that Circuit's balancing test, declined to enforce the clause. The Supreme Court has agreed to hear the dispute with the purpose of resolving the split and determining the proper test to apply to forum selection clauses. The Court's decision will have significant consequences for those in the construction industry, where forum selection clauses are routine.

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Construction Law Group News

Honors

Chris Opalinski, **Scott Cessar** and **Neil O'Brien** were recently recognized by Best Lawyers in America® for Construction Law and Construction Litigation for 2014. Best Lawyers compiles its lists of outstanding attorneys by conducting peer-review surveys in which thousands of leading lawyers confidentially evaluate their professional peers.

Publications and Presentations

Scott Cessar penned an article for the September 6, 2013, edition of the Allegheny County Bar Association *Lawyers Journal* titled "Demand for claim waiver in exchange for final payment."

Brian Calla, **Scott Cessar** and **Chris Opalinski** co-authored an article for the March/April 2013 issue of *Breaking Ground* magazine titled "Controlling Electronic Discovery Costs: Cutting 'Big Data' Down to Size."

Client Wins

Tim Grieco and **Jake McCrea** secured a $932,000 jury verdict in favor of our client after a one-week jury trial in federal court in the Northern District of Ohio, before Judge Adams. Our client sued a large nationwide scrap processor in connection with a dispute over an alleged significant negative variance on the recovery rate for a large sale of nonferrous materials. With prejudgment interest, the award will top $1 million.

Eckert Seamans' Trenton Office attorneys were re-selected as outside counsel to the New Jersey Schools Development Authority (NJSDA) in the areas of construction litigation, professional errors and omissions/cost recovery and real estate, including voluntary acquisitions, condemnations and general transactions. The predecessor firm of Sterns & Weinroth had served as outside counsel to NJSDA in these areas continuously since 2002. By statute, NJSDA must procure outside professional services biennially, in a competitive RFP process. The process is highly competitive, with many of New Jersey's largest and most reputable firms competing in each legal area involved. **Vincent Paluzzi** served as the primary contact for the NJSDA with the support of **William Bigham, Jennifer Cordes, Ed Dunham, Frank Petrino, David Roskos, Michael Spero** and **Robert Zoller**.

The Superior Court of New Jersey has affirmed an earlier trial court dismissal of multimillion-dollar claims against our client, an equipment supplier, arising from the construction of a water treatment plant. **Scott Cessar** and **Audrey Kwak** represented our client.

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