Design and Construction Management Professional Reporter

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Donovan Hatem LLP is pleased to announce the publication of: *Public-Private Partnerships: Opportunities and Risks for Consulting Engineers*

EDITED BY David J. Hatem, PC and Patricia B. Gary, Esq. and published by ACEC, this book will provide a comprehensive guide to successfully navigating the important issues confronting consulting engineers in projects being delivered as Public-Private Partnerships (P3s), including risk management and professional liability issues. Commencing with procurement and extending through the operations and maintenance phase of a multi-decade concession agreement, the authors share their "lessons learned" by providing guidelines and recommended practices for engineering consultants involved in P3s. The book also provides recommended guidelines for public owners and other P3 stakeholders. The book may be purchased through the ACEC's online bookstore at www.acec.org. All proceeds from the sale of this book are exclusively retained by ACEC.

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Connecticut Supreme Court Rules That Damages for Faulty Workmanship May Be Encompassed Within a Commercial General Liability Insurance Policy

By Kristin A. Hartman, Esq.

N *CAPSTONE BUILDING CORP AND CAPSTONE DEV. CORP VS. AM MOTORISTS INC. CO.* ("AMICO") (June 11, 2013) the Connecticut Supreme Court addressed three certified questions arising out of an underlying action in which breach of contract and bad faith claims had been brought against an insurer. In summary, the Court held that:

1. The cost of repairing faulty workmanship is not covered under a commercial general liability ("CGL") policy, but allegations of unintended defective construction work by a subcontractor may constitute an "occurrence" resulting in "property damage" in limited circumstances.
2. An insured cannot maintain a bad faith cause of action based solely upon an insurer's failure to conduct a discretionary investigation of a claim.
3. Where an insured settles a dispute involving mixed covered and non-covered claims against which an insurer wrongfully refused to defend, the insured is entitled to recover from the insurer only that portion of the settlement that the insured can prove should be reasonably allocated to those claims that the insurer had a duty to defend.

Three years after completion of a $39 million housing project, the University of Connecticut ("UConn") forwarded a letter to Capstone setting forth a litany of construction claims which the Connecticut trial court summarized into four categories: (1) "damage to non-defective property stemming from defective construction"; (2) release of carbon monoxide from improperly vented water heaters; (3) defective work in violation of building codes; and (4) costs of repairing the damaged work. The matter was mediated, resulting in a $1 million settlement of UConn's claims. AMICO denied all coverage and refused to participate in mediation. The coverage dispute was eventually concluded in the Connecticut Supreme Court.

Addressing the basic issue of coverage for flawed construction, the court ruled that "allegations of unintended defective construction work by a subcontractor that damages non-defective property may constitute 'property damage' under certain circumstances." In doing so, the court followed what appears to be the majority rule in such cases. However, the *Capstone* court ultimately concluded that the CGL policy's definition of covered "property damage" did not cover claims for "correction of faulty installation." Without evidence that faulty workmanship damaged other, "non-defective property…allegations of construction defects, without more, "do not constitute claims for "injury to tangible property." The court found that the cost of repairing the "damaged work" itself, the faulty workmanship, was not covered under the AMICO CGL policy.

The *Capstone* court then ruled that damage caused by faulty workmanship of a subcontractor does constitute an occurrence of property damage within the scope of the Projects-Completed Operations Aggregate Limit provisions of a standard form CGL policy. The Connecticut Supreme Court expressly rejected AMICO's argument that "defective construction," whether the product of faulty workmanship or installation of defective equipment, cannot be covered under the CGL policy. The *Capstone* opinion adds momentum to the trend among courts to interpret the CGL policy as written, correctly and consistently, with the reasonable expectations of insured general contractors to cover unintended damage caused by negligent subcontractors.

In addition to the foregoing, and noting a split of authority on the issues, the *Capstone* Court also ruled that there was no cause of action under Connecticut law against an insurer for "bad faith" failure to investigate, even when the carrier wrongfully breaches its duty to defend. The court explained, to succeed on a claim for breach of the covenant of good faith and fair dealing, a plaintiff must demonstrate that the allegedly wrongful conduct deprived the plaintiff of some benefit of the parties' agreement. The court explained further

that "[u]nless the alleged failure to investigate led to the denial of a contractually mandated benefit… [a plaintiff cannot raise] a viable bad faith claim."

The court held that, where the case involved multiple claims, and a carrier has wrongfully refused to defend a "suit," the carrier is "estopped from contesting liability," but the insured must prove which claims the insurer failed to defend, and then demonstrate the "reasonable allocation of the settlement" to those claims. Although the *Capstone* Court concluded that claims attributable to damage for release of excessive carbon monoxide and for building code violations were not covered under the AMICO policy, because the plaintiff failed to identify the claims against which to allocate its damages, the court chose not to assume that responsibility, and did not allocate the $1 million settlement between covered and non-covered claims.

Finally, in construing prior Connecticut decisions that addressed the impact of a carrier's refusal to defend an insured against a "suit," the court acknowledged even non-judicial resolutions through settlement would qualify as a "suits" for purposes of allocation of damages. Therefore, it is important to understand the law of the jurisdiction in which a failure to defend claim is raised as to the definition of "suit," to determine whether a carrier will be held liable, and to what extent, for damages. While some jurisdictions have limited the cause of action to those instances in which a lawsuit has actually been commenced, others, like Connecticut, do not require such formal constraints.

Florida Aborogates Individual Liability For Design Professionals

By Craig J. MacLellan, Esq.

ON APRIL 24, 2013, THE GOVERNOR OF THE STATE OF FLORIDA approved Florida State Senate Bill 286, creating Section 558.0035 of the Florida Statutes. F.S.A 558.0035 specifies the conditions under which a design professional, employed by a business entity or acting as an agent of the business entity, may not be held individually liable for damages resulting from negligence occurring within the course and scope of a professional services contract.

Under F.S.A. 558.0035, a design professional, who is employed by or acting as an agent of a business entity[1] which maintains any professional liability insurance and has contracted with the claimant, may contractually disclaim personal liability for economic losses, suffered by the claimant and arising from the design professional's negligence, if: (1) "The contract includes a prominent statement, in uppercase font that is at least 5 point sizes larger than the rest of the text, that, pursuant to this section, an individual employee or agent may not be held individually liable for negligence," and (2) the damages are solely economic in nature and the damages do not extend to personal injuries or property not subject to the contract.

The new law, which became effective on July 1, 2013, affords design professionals with a means to protect themselves against personal negligence claims in cases where they have rendered professional services on behalf of an employer or other entity that had contracted with the claimant. This is an important development for design professionals working in or providing services within the state of Florida, as Florida has historically held that design professionals may be held personally liable in negligence actions arising out of services provided on behalf of an employer. See *Moransais v. Heathman,* 744 So.2d 973, 979 (Fla. 1999) (Establishing a common law cause of action against professionals based on their acts of negligence, despite the lack of a direct contract between the professional and the aggrieved party).

[1] F.S.A. 558.0035 defines a "business entity" as: "…any corporation, limited liability company, partnership, limited partnership, proprietorship, firm, enterprise, franchise, association, self-employed individual, or trust, whether fictitiously named or not, doing business in [the state of Florida]."

Economic Rule Bars Claims for Negligent Misrepresentation Under Nevada Law

By Kristen R. Ragosta, Esq.

IN THE PROFESSIONAL LIABILITY CONTEXT, THE ECONOMIC LOSS DOCTRINE ("ELD") is a legal theory that prohibits tort recovery when an alleged tortious act causes only economic damages, as opposed to personal injury or property damage. Some states have abolished the ELD, some states enforce it, and some states fall somewhere in between, e.g., enforcing the doctrine for claims of negligence, but not for claims of negligent misrepresentation. Recently, in the matter of *Halcrow, Inc. ("Halcrow") versus Pacific Coast Steel, et al. ("PSC"),* the Supreme Court of the State of Nevada extended the economic loss doctrine to bar negligent misrepresentation claims against commercial construction design professionals where the recovery sought is solely for economic losses.

The Nevada decision was in response to Halcrow, a design professional's, writ of mandamus. The original proceeding stemmed from the construction of, and subsequent litigation regarding, the Harmon Tower ("the Harmon") located within CityCenter, a mixed-use urban development in Las Vegas, owned and developed in part by MGM Mirage Design Group ("MGM"). MGM retained an architectural firm and a general contractor, Perini Building Company, Inc. ("Perini"), to assist in the project's development. The architectural firm retained Halcrow to design the Harmon's structure, prepare drawings, and perform ongoing structural engineering services, including observations and inspections. Perini hired Century Steel, Inc. ("Century"), to provide the steel installation following the construction of a portion of the Harmon. Century assigned its assets, including the contract for the Harmon, to PCS (PCS and Century are hereinafter collectively referred to as PCS).

Halcrow had no contract with PCS or Perini. Nonetheless, pursuant to PCS's contractual obligations to Perini, it was required to follow Halcrow's design and specifications for installing reinforcing steel in the Harmon. Problems arose when defects were discovered relating to the reinforcing steel's installation. Ultimately, the Harmon, which originally was to consist of over 40 floors, could not be built above 26 floors due to flaw in the steel installation.

After construction stopped on the Harmon, Perini filed a fee claim against MGM and MGM filed a counterclaim against Perini for the alleged reinforcing steel defects and other nonconforming work. Perini then filed a third-party complaint against PCS, among others, asserting claims for contractual indemnity. PCS in turn filed its own third- and fourth-party complaint against several entities, including Halcrow, alleging claims for negligence, equitable indemnity, and contribution and apportionment, and seeking declaratory relief.

Halcrow successfully sought summary judgment and PCS's claims against Halcrow were dismissed based on the Nevada Supreme Court's holding in *Terracon Consultants Western, Inc., v. Mandalay Resort Group,* 125 Nev. 66, 206 P.3d 81 (2009). In *Terracon,* the Nevada Supreme Court held that the ELD precludes a plaintiff from asserting professional negligence claims against design professionals where the plaintiff seeks to recover purely economic losses in a dispute concerning commercial construction. The court explained that the ELD marks "the fundamental boundary between contract law, which is designed to enforce the expectancy interest of the parties, and tort law, which imposes a duty of reasonable care and thereby [generally] encourages citizens to avoid causing physical harm to others." *Id.* at 72.73. Application of the doctrine protects parties from unlimited economic liability, which could result from negligent actions taken in commercial settings. *Id.* at 74, 26 P.3d at 86-87.

In *Terracon,* the court left open the door for exceptions to the ELD for negligent misrepresentation claims "in [a] certain category[y] of cases when strong countervailing considerations weigh in favor of imposing liability." 125 Nev. At 73, 206 P.3d at 86. However, the Supreme Court explained that, in the context of commercial construction, negligent misrepresentation claims against design professionals do not fall within this limited exception to the ELD because "contract law is better suited" for resolving such claims. *Terracon,* 125 Nev. At 77, 206 P.3d at 89. In commercial construction situations, the highly interconnected network of contracts delineates each party's risks and liabilities in case of negligence, which in turn "exert significant financial pressures to avoid such negligence." Id. at 77, 206 P.3d at 88.

Following dismissal of its claims based on the ELD, PCS sought leave to amend the third-party complaint to include a cause of action for negligent misrepresentation. Halcrow filed an opposition to the motion to amend, arguing that Terracon did not carve out an exception to the ELD for negligent misrepresentation claims, and thus, PCS should not be permitted to maintain such claims. PCS on the other hand argued that it relied on Halcrow's erroneous representations that on-site inspections and adjustments would alleviate errors in Halcrows plans so that Halcrow could be held liable for negligent misrepresentation.

Following a hearing, the district court granted PCS' and Century's motions to amend but stayed the proceedings pending resolution of the legal issues by the Nevada Supreme Court, which held that the district court acted arbitrarily and capriciously in granting leave to amend. The Supreme Court reasoned that imputing to design professionals a separate and distinct duty to any subcontractor that must rely on their plans would essentially allow any party to recast their barred negligence claim into a negligent misrepresentation claim. In the context of commercial construction projects, the evidence that would need to be presented in order to prove a negligent misrepresentation claim is almost identical to that which would be necessary in proving a claim for negligence. Allowing one and not the other would create a loophole in *Terracon's* objective of foreclosing professional negligence claims against commercial construction design professionals and would, essentially nullify the ELD with negligent misrepresentation claims. Negligent misrepresentation is an unintentional tort and cannot form the basis of liability solely for economic damages in claims against commercial construction design professionals. Consequently, the court held that PCS cannot assert claims of negligent misrepresentation against Halcrow and that leave to amend should not have been granted because the amendment to PCS's pleadings was futile.

Massachusetts Superior Court Holds Architect Has No Liability to Guarantee Jobsite Safety

By Pamela C. Selvarajah, Esq.

IN A FAVORABLE DECISION FOR DESIGN PROFESSIONALS, a Massachusetts superior court recently held that the terms of contract documents did not vest in the project Architect ("Architect") an obligation to protect workers from personal injury or to otherwise guarantee jobsite safety. In *Barbara Cowhey v. Colony Insulation, Inc. & others,* No. 09-01211 (Mass. Supp. Jan 11, 2013), Plaintiffs filed a wrongful death action stemming from the death of a spray foam installer that occurred during a home renovation project. Plaintiffs alleged the Architect was negligent.

In 2006, the Architect entered into a contract with homeowners ("Owner") to provide architectural and engineering services for the renovation of their home. The agreement delineated the Architect's design and construction phase services, including visiting the site, reviewing payments, reviewing contractor submittals, rejecting nonconforming work, and interpreting contract documents. The agreement also incorporated AIA Document A205, which provided that the Architect was not responsible for "construction means, methods, techniques, sequences or procedures, or for safety precautions and programs in connection with the Work, since these are solely the Contractor's responsibility." The Owner also entered into an Owner/Contractor agreement with a contracting firm ("Contractor"), that specified that the Contractor was solely responsible for the construction means and methods including jobsite safety of such means and methods, and also provided that the Contractor was responsible for the acts and omissions of the work of its own employees and of the employees of any subcontractors hired.

The Architect prepared design plans, and specified Icynene insulation for use in the attic area of the project. The Contractor subsequently decided to use SoyTherm spray foam insulation instead of Icynene. The Contractor later claimed that the Architect approved the use of this SoyTherm

insulation. In May 2008, a spray foam installer employed by a subcontractor of the Contractor was applying the new spray foam insulation in the attic area when a fire occurred. He died of asphyxiation. Thereafter, the decedent's estate brought this action.

The Plaintiff claimed that the Architect was negligent in permitting the use of the SoyTherm insulation that was not in conformance with design specifications. The Plaintiff argued that the Architect owed a duty to the deceased because he was foreseeably exposed to danger due to the Architect's negligence. The Plaintiff further claimed that expert testimony on an architect's standard of care was unnecessary because a layperson could comprehend the material facts without an expert's assistance. The Court held that the contract documents did not create in the Architect an obligation to protect any worker from personal injury or to otherwise guarantee jobsite safety, nothing that the contract specified that the Architect was not responsible for construction means, methods, or safety precautions. As a result, the contract documents did not impose a duty on the Architect to insure compliance with design specifications or compel conformance with safety precautions regarding the use of the SoyTherm insulation. Moreover, although the Architect had a contractual obligation to visit the job site and reject nonconforming work, the Court held there was no evidence warranting a finding of negligence, as the Architect could not have foreseen that the use of this insulation product would expose the installer to danger.

The Court further held that the Plaintiff's claim that the Architect should have known of the dangers inherent in applying the new insulation did require expert testimony, because the Architect's approval of this material was not conduct so obvious that a layperson could have relied on its common knowledge to determine that the Architect was negligent. The Court accordingly granted summary judgment in favor of the Architect on the negligence claim.

This is a positive decision for design professionals because it demonstrates that Massachusetts courts are unwilling to extend a duty of care with respect to protecting workers against unsafe working conditions when the design professional's contract documents unequivocally disclaim any responsibility for means and methods and safety precautions.

New Jersey Court Finds Contractor's Suit Against Architecture Firm Not Barred by Economic Loss Doctrine; Contractor's Failure to File Affidavits of Merit Precludes only Professional Standard of Care Claims

By Rebecca J. McWilliams, AIA, Esq.

A U.S. DISTRICT COURT IN NEW JERSEY held that a construction company that filed suit against an architect was not barred by the economic loss doctrine or the contractor's failure to file affidavits of merit. It denied the architect's Motion for Summary Judgment and granted in part and denied in part its Motion to Dismiss.

In 2001, the Atlantic City Housing Authority ("ACHA") awarded a lump sum contract to contractor SRC Construction Corporation ("SRC") to build the John P. Whittington Senior Living Center in Atlantic City. The facility was to be completed in approximately a year and a half, but was still incomplete seven years later. Extended construction delays allegedly resulted in more than $3,000,000 in additional costs, and SRC sued ACHA alleging breach of contract, unjust enrichment, wrongful termination of contract and conversion claims.

SRC also filed suit against the architectural firm ("Architect") alleging the Architect:

> "Failed to provide the necessary building permits to SRC in accordance with their duties, responsibilities and obligations; failed to provide adequate project drawings to facilitate the necessary coordination of the utility design; failed to disclose important information regarding subsurface conditions; failed to provide SRC with necessary architectural drawings; submitted drawings on multiple occasions to the Building Department that were deemed non-code compliant; failed to respond in a timely manner to Plaintiff's multiple requests for pertinent information on numerous issues; repeatedly provided defective verbal approvals of change orders to Plaintiff, only to have these change orders rejected by the Housing Authority later."

The Architect filed a summary judgment motion claiming the suit was barred by New Jersey's "economic loss" doctrine. It argued that, because it did not have a direct contractual relationship with contractor SRC, and because SRC was pursing an action against ACHA, the lawsuit was barred under New Jersey law. Historically, the New Jersey economic loss doctrine helps to maintain the "critical distinctions between tort and contract actions" by precluding a party's "negligence action, in addition to a contract action, unless the plaintiff can establish an independent duty of care." *Saltiel v. GSI Consultants, Inc.,* 170 N.J. 297, 310, 314 (2002).

In the case at issue, the court determined that the economic loss doctrine applies only to bar certain tort claims between parties to a contract. The court looked to the decision in *Juliano v. Gaston* where there was no direct contractual relationship between the parties but, in that instance, the court allowed recovery in a negligence action for damages for replacement and repair of defective workmanship. 187 N.J. Super. 491, 493 (App. Div. 1982). The court chose not to follow prior case law because, here, there were no contractual remedies upon which SRC could have relied with ACHA. Therefore, the court held that SRC's suit against ACHA did not prevent SRC from pursuing claims against the Architect and denied its motion for summary judgment.

The Architect then filed a motion to dismiss SRC's claims based on SRC's failure to file an affidavit of merit in support of its claims. The New Jersey Affidavit of Merit statute *N.J.S.A.* 2A:53A-27 requires that:

> "In any action for damages for personal injuries, wrongful death or property damage resulting from an alleged act of malpractice or negligence by a licensed person in his profession or occupation, the plaintiff shall… provide each defendant with an affidavit of an appropriate licensed person that there exists a reasonable probability that the care, skill or knowledge exercised or exhibited in the treatment, practice or work that is the subject of the complaint, fell outside acceptable professional or occupational standards or treatment practices."

The court held that, to the extent SRC's allegations were for "malpractice or negligence" without an affidavit of merit allegations for "adequate project drawings," these allegations should be dismissed because SRC failed to submit an affidavit of merit to establish the standard for adequate architectural drawings. However, the court held that "a claim otherwise subject to the Affidavit of Merit statute may nevertheless proceed without an affidavit of merit 'when expert testimony is not required at trial to establish the defendant's negligence.'" For example, as to the Architect's alleged failure to provide necessary building permits and non-code compliant drawings, a layperson could understand that these allegations could cause delays that might result in higher costs for a project. Therefore, the Architect's motion to dismiss based on the Affidavit of Merit statute was granted in part and denied in part.

Based on the foregoing, the United States District Court of New Jersey appears to have rejected wholesale application of the economic loss doctrine as applied to design professionals where the parties to the action are not in a contractual relationship. The court also draws a fine line between claims that require an expert opinion as opposed to those that a layperson could evaluate. This enabled the court to selectively dismiss claims that require an expert to prove the professional standard of care due to the absence of an Affidavit of Merit, and allow claims against a design professional to proceed.

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