BRADLEY ARANT BOULT CUMMINGS LLP **First Quarter 2010**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Your Work Stinks! – Insurance Coverage for Odor Remediation as "Physical Injury to Property"

An insurer has two principal duties arising from a Commercial General Liability (CGL) policy. The first is the duty to provide a defense for its insured (duty to defend) and the second is the duty to pay for covered losses (duty to indemnify). Generally, courts require an insurer to defend cases where a reasonable view of the facts alleged could render the insurer responsible, even if the facts necessary to prove coverage are not known when the insured is sued. The practical effect of a broad duty to defend, coupled with a narrower duty to indemnify, is that insurance companies often end up paying for losses where coverage is questionable when the cost of the defense would be close to or higher than the amount of the alleged loss.

The United States Court of Appeals for the First Circuit – one of the eleven circuit courts just below the U. S. Supreme Court in the federal system – recently held that an odor allegedly caused by defective carpeting in a building could constitute "physical injury to property" such that an insurer has a duty to defend under the terms of a CGL policy. The impact of this ruling is that CGL insurance carriers faced with similar allegations must provide a defense, though not necessarily indemnity for the underlying damages, to their policy holders.

In *Essex Insurance Company v. Bloom South Flooring Corporation*, a general contractor was an additional insured on its subcontractor's CGL policy. The subcontractor was responsible for installing carpet in an office building, which required testing and cleaning an existing concrete floor prior to installation. The occupants of the building noticed a foul odor and instructed the general contractor to fix the problem. The general contractor removed the installed carpet and its adhesive, and re-carpeted the floor. This effort did not fix the problem and actually

Inside:

made it worse. After disputing the cause of the odors with the subcontractor, the general contractor incurred $1.4 million in remediation costs and sued the subcontractor to recover them. During the course of the remediation, the general contractor demanded a defense from its insurer based on the owner's demands for remediation and indemnity for the costs it incurred. The insurer refused. The general contractor also sued the subcontractor, which again demanded a defense from the insurer. The insurer filed a declaratory judgment action, asking the court to determine it has no duty to defend its insured.

The court began by finding that the odor, which was alleged to have permeated the building, constituted "physical injury" under the policy. Thus, the alleged damage was within the scope of the insured's coverage. Next, the court turned to the business risk exclusions of the CGL policy. It held that the odor damaged the existing concrete floor, which was real estate rather than the subcontractor's "work" or "product." Because the property damage could not be remedied by "the repair, replacement, adjustment or removal" of the insured's work – special air venting was required to remove the odor, in addition to repairs – the "impaired property" exclusion did not apply. These holdings placed the damage arguably within the coverage clause and arguably outside the exclusions, which was all that was necessary to require the insurer to defend its insureds.

When issues arise on a construction project, owners, contractors, subcontractors, and others involved should consider each of their insurance policies and whether damages could be covered by one of the parties' policies. Insurance policies and their exclusions are often complex and are governed by laws which may vary from state to state. Thus, it is always advisable to contact counsel for advice regarding coverage. If there is any possibility of coverage, it is worth putting the insurer on notice to initiate an insured's duty to defend.

By Jonathan Head

Termination for Convenience Clauses: Why They May Be Inconvenient and How to Use Them Effectively

Termination for convenience clauses have become popular provisions in many construction contracts. They allow an owner or contractor to terminate obligations under a contract without alleging any fault. A typical termination for convenience clause might read "Owner may at any time and for any reason terminate the contract at Owner's convenience. At such time, Contractor must cease all activities under the contract." As these clauses have become more common in the construction industry, courts have struggled over their effect and scope. Generally, courts have been unwilling to interpret these clauses as providing an owner carte-blanche power to terminate the contract. Instead, some courts have required a showing of good faith before enforcing a termination for convenience clause. However, few courts have explained the extent of this good faith obligation.

In *Questar Builders, Inc. v. CB Flooring, LLC,* the Court of Appeals in Maryland confronted this issue. The court found that the duty of good faith which the court held was implied in termination for convenience clauses afforded owners discretion to terminate a contract so long as termination followed the reasonable expectations of the contractor.

In this case, a general contractor for a luxury apartment project subcontracted the flooring installation. The subcontract included a termination for convenience clause. Before the subcontractor started its work, the general contractor terminated the subcontractor citing the convenience clause. In response, the subcontractor filed suit for breach of contract. One of the general contractor's primary defenses focused on the validity of the termination for convenience clause.

The court considered whether the general contractor had exercised good faith such that it had a right to invoke the termination for convenience clause. Specifically, it considered the behavior of the contractor in the weeks prior to termination. This gave the judge serious pause because the general contractor contacted another business to organize a proposal for

the floor installation and failed to express any concerns regarding performance to the subcontractor before doing so. The judge determined that the convenience clause did not provide a limitless power to terminate and awarded damages to the subcontractor for the general contractor's breach of contract.

On appeal, the general contractor claimed that the trial court did not provide an adequate explanation of its reading of the convenience clause. The court of appeals agreed and responded by reading a duty of good faith into all termination for convenience clauses. In explaining its rationale, the court looked to the widespread use of the good faith standard across the country. According to the court, a termination for convenience clause affords a general contractor discretion to terminate in the event of some change in circumstances that makes a project economically unfeasible like, for instance, a rapid change in market conditions. However, such discretion must be exercised in accordance with the reasonable expectations of the subcontractor or other party.

As a practical matter, owners and contractors should ensure that they are acting reasonably before terminating another party based on a termination for convenience clause. Otherwise, they may face lawsuits for lost profits and other damages by the terminated party. Attempts by owners or contractors to "shop around" after executing a contract will not be tolerated. Thus, to avoid liability for breach of contract, owners and contractors should be cautious when exercising their right to terminate under a convenience clause.

By Aman Kahlon

Even Minor Defects in Liens Can Result in Contractors Losing Their Lien Rights

Many areas of the law provide a party who makes an error, whether procedural or substantive, with relief to correct the error, generally under principles of fairness and equity. States' lien laws are often not so forgiving. A defect in a lien, even a minor one, can render a lien invalid. Most state courts strictly interpret statutory procedural requirements for liens. Contractors should be aware that the deadline to file a lien is strict, that a lien with a defect will often not be enforced, and that a defective lien cannot be cured once the deadline has passed.

Because of this strict enforcement, attorneys who notice such defects will wait until after the contractor's lien deadline expires and then move to dismiss the lien. Two recent state court cases, one from Illinois and the other from Kansas, remind us that this scenario can happen in residential and commercial projects involving minor defects in liens.

In *Weydert Homes, Inc. v. Kammes*, a general contractor filed an action to enforce a lien on real property for work and materials performed on the construction of a residence in Sycamore, Illinois. Illinois lien statutes require that before any monies are to be paid on a project, "a contractor must provide to the owner a statement in writing, under oath or verified by affidavit, of the names and addresses of all parties furnishing labor, services, material, fixtures, apparatus or machinery, forms or form work and of the amounts due or to become due." In *Weydert*, the owner requested, and the general contractor provided, such a statement. However, the contractor statement was not verified or given under oath (i.e., notarized). The owner argued that because the Illinois lien statutes are strictly construed, this error, regardless how minor, rendered the lien invalid. The trial court agreed and granted the owner's motion for summary judgment as to the lien claim. On appeal, the Illinois Court of Appeals affirmed, holding that the Illinois lien statutes are to be strictly construed and, therefore, because the contractor's statement was not in strict compliance with the statute, the lien filed by the general contractor was invalid.

The same strict compliance lien requirements are evident in commercial projects. In *National Restoration Co. v. Merit General Contractors, Inc.*, a general contractor on a commercial project in Overland Park, Kansas moved for summary judgment dismissing its supplier's lien because the supplier's lien mistakenly noted the general contractor as "Merit Construction Company, Inc." The general contractor's correct corporate name was "Merit General Contractors, Inc." The trial court granted the general contractor's motion for summary judgment as to the lien claim, and the supplier appealed. The Kansas

Court of Appeals affirmed and held that the supplier had notice of the correct corporate name of the general contractor and, therefore, because Kansas law strictly construes its lien law, the supplier's lien was invalid. Because the supplier's time to file a lien had expired, it was unable to amend its lien, and it lost its lien rights entirely.

Contractors beware – before the start of construction review the relevant lien law and pay close attention to the details to ensure that you preserve your rights. Some states like Illinois and Ohio even require pre-construction notice, and the failure to review the lien law and recognize these requirements prior to project commencement can be fatal. In this economy, with many entities filing bankruptcy and many others in financial distress, a valid lien can determine whether or not you will ever receive payment. Moreover, an invalid lien can be the lever for an owner to argue that a contractor or subcontractor has improperly clouded the owner's title, giving the owner a claim against the lien claimant. Because the risk of filing an invalid lien is significant, contractors should seek advice from a construction attorney before starting construction in a new state and should seek assistance when filing liens to ensure compliance with each state's individual nuances.

By Nick Voelker

Not in the Contract, Not Part of the Deal

A recent case out of New York is a good reminder to all contracting parties to pay particular attention to what is (and what is not) included in the final, executed version of their contracts. Contractors and owners should not rely on documents presented and discussed during negotiations when these documents are not included in the signed contract.

In *Century-Maxim Construction Corp. v. One Bryant Park, LLC*, the concrete trade contractor on a skyscraper project in midtown Manhattan sued the developer and construction manager for acceleration damages. The contractor claimed that the construction manager represented at various pre- and post-bid discussions that the work would be completed in three separate phases. It claimed that the construction manager had presented a schedule which reflected this staged plan for construction. According to the contractor, this schedule showed that concrete work would take between 24-27 months, and it showed sufficient float as well as sufficient periods of slowed or suspended steel erection to allow the contractor to keep pace with steel erection, as it was required to do by New York City code.

The contractor claimed that from the outset of the project, the schedule was delayed six months through no fault of its own. As a result, the schedule was compressed and the periods of slowed or suspended steel erection were removed from the schedule. The concrete contractor claimed that it was forced to accelerate its work to keep pace with the steel contractor. It sought $22 million in acceleration damages.

In response, the construction manager and developer argued that the schedule upon which the contractor relied was not referenced in the contract documents. The contract contained a clause stating that the parties were not relying on any previous conversations, agreements, or documents, other than those specifically mentioned (a merger clause). It also contained provisions which directly contradicted the concrete contractor's allegations regarding the schedule. So, the construction manager and developer argued that this alleged schedule could not be the basis for an acceleration claim.

The concrete contractor's acceleration claims were dismissed. The court held that the contractor was not entitled to rely on a document which was not referenced or incorporated into the contract, especially in the situation where the contractor's allegations regarding this schedule were directly contrary to the plain terms of the contract. This should be a reminder to all owners and contractors to be sure to base your price and plan for construction on the documents which are included in the executed contract. It is a risky proposition indeed to rely on representations made during negotiations of a contract, especially when these representations are not included in the final, executed contract.

By Luke Martin

Site Inspection Clauses: Preventing Loss for Those Unexpected Conditions

Many owners attempt to shift the risk (and extra costs) associated with unexpected project conditions to the general contractor by inserting site inspection clauses in their contracts. Typically, owners provide contractors a preliminary report of the site conditions in bid packages, but include a clause in the subsequent contract stating that the contractor has reviewed and familiarized itself with the project site, is aware of project conditions, and that it assumes full responsibility for any site conditions it may encounter. If there is no "differing site condition" clause in the contract, this provision attempts to push the risk of unknown site conditions to the contractor. The enforcement of these risk shifting clauses has been called into question by a recent case in Texas.

In *Mastec North America v. El Paso Services*, the general contractor who installed a gas pipeline (Mastec) sued the owner (El Paso) for the extra construction costs it incurred because of an excessive number of pipeline crossings These pipeline crossings did not appear on the drawings the owner provided with the bid package and resulted in almost five million dollars in extra costs. The owner defended the lawsuit by relying on clauses it included in the contract with the contractor which stated that the contractor was familiar with the pipeline route, including all subsurface conditions, and that the contractor agreed to construct the pipeline for a lump sum price regardless of the conditions it encountered. The trial court agreed with the owner and dismissed the case because the contractor had assumed the risk of subsurface conditions and therefore was not entitled to be reimbursed for the cost associated with the pipeline crossings.

The appellate court took a broader view and focused on the owner's representation that it had exercised due diligence to locate any pipeline crossings in the bid documents, which, in actuality, grossly misrepresented the number and location of pipeline crossings. The court also made the determination that the owner was in a much better position to determine the number and location of pipeline crossings. Thus, it reversed the trial court and ordered the owner to reimburse the contractor for the extra installation costs it incurred, despite the risk shifting site inspection clause. The court also indicated that it may be willing to take its logic a step further in the future and find that risk shifting site inspection clauses may not protect the owner when the bid documents misrepresent the nature and amount of the work to be performed.

Risk shifting site inspection clause will likely remain a contentious point between contractors and owners. Special attention should be given to such clauses and hidden conditions to proactively limit the potential problems for both owners and contractors. However, problems will arise because of site conditions and when they do, remember that a risk shifting site inspection clause may not provide the final answer, particularly where the owner makes an affirmative representation, in the contract itself, about a condition or fact which is material to the contract.

By Bryan Thomas

Bradley Arant Lawyer Activities:

Jim Archibald, **Axel Bolvig**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, and **David Taylor** are named in the 2010 edition of *The Best Lawyers in America* in the specialty of Construction Law.

Axel Bolvig, **Rick Humbracht**, **David Hymer**, **Joe Mays**, **Doug Patin**, **Bill Purdy**, **Mabry Rogers, Wally Sears**, and **David Taylor** have been selected as Super Lawyers 2010 for Construction.

Jim Archibald and **Wally Sears** recently updated the Alabama section of the *State-by-State Guide to Construction Contracts and Claims*.

Keith Covington published an article entitled "Court Revives OSHA's Multi-employer Citation Policy" in the October/November 2009 edition of the *Alabama Construction News*.

Keith Covington was also published in the November 2009 edition of the *Construction Business Owner*.

The article is entitled "E-Verify Now Required for Federal Contractors."

David Taylor's article on Tennessee's retainage law, "Tennessee Retainage Law: Ignore at Your Peril," was published in the January edition of Tennessee Bankers Magazine.

David Taylor's article on dispute resolution entitled "Arbitrating and Mediating Real Estate Disputes" will be published in the March edition of the Institute of Real Estate Management Magazine.

BABC co-hosted the ABC Economic Forecast seminar, titled "2010 Economic Forecast: Where the Projects Are" on October 22, 2009.

Mabry Rogers Attended Princeton University Symposium, "Managing the Challenges of Scarcity: The Critical Path for Global Construction," on November 5-6, 2009.

Keith Covington spoke on November 6, 2009 at the Home Builders Association of Alabama Conference concerning 'Chinese Drywall'.

David Taylor facilitated a 'Construction Financing' meeting of bankers, developers, subcontractors, and general contractors in Nashville on November 12, 2009.

David Taylor recently chaired and spoke at a Tennessee Bar Association seminar entitled "Arbitrating and Mediating Construction Disputes".

Arlan Lewis, Rhonda Caviedes, and **Ed Everitt** recently participated in the ABA Forum on the Construction Industry's mid-winter conference in San Francisco entitled "Government Construction Contracting."

Ed Everitt's article "Mississippi Lien and Bond Law; Make Sure You Know Your Rights," was published in the First Quarter 2010 edition of Construction Mississippi, a special publication of the Mississippi Business Journal.

Bill Purdy, **Wally Sears**, and **Mabry Rogers** attended the annual meeting of the American College of Construction lawyers in San Diego in February. Bill is Program Chair for the meeting to be held in February, 2011.

David Taylor and **Bryan Thomas** will be presenting a session entitled "The Great Debate: Do You Arbitrate" at the national CONSTRUCT 2010 meeting in Philadelphia in May 2010.

It is with mixed emotions that we report that **Jeremy Becker-Welts** and **Mitch Mudano** have left Bradley Arant Boult Cummings. We would like to thank Jeremy and Mitch for their years of service and for the time they dedicated to the firm and its construction clients. We wish both of them the best of luck in their new endeavors.

We would also like to welcome **Aman Kahlon and Avery Simmons** to the firm's construction practice Group. Aman is practicing in our Birmingham office and Avery is practicing in our Charlotte office.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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