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ARBITRATION

ARBITRATION AGREEMENT IN SUBCONTRACT MEANT GENERAL CONTRACTOR MUST ARBITRATE ITS CLAIMS AGAINST THE SUBCONTRACTOR'S SURETY

Motion to Compel Arbitration Granted

Swinerton Builders, Inc. v. Argonaut Ins. Co., 2024 WL 1057473 (N.D. Cal. Mar. 11, 2024) (slip op.)

Holdings

• A defendant, who believes the claims against it are subject to an arbitration agreement, should file a motion to compel arbitration, not a motion to dismiss the complaint for lack of jurisdiction.

• An obligee-contractor's claim against the subcontractor's performance bond surety was subject to the arbitration agreement in the subcontract, notwithstanding the contractor's argument that the principal's default was clear and only the surety's conduct was at issue.

• After granting the defendant surety's motion to compel arbitration of the contractor's claims against it, the trial court administratively closed the case until opened by the parties by filing a joint status report after the completion of arbitration.

Summary of Decision

A general contractor (Swinerton) entered into a Master Subcontract Agreement (MSA) with a subcontractor (Northern), under which Northern would perform tasks specified in work orders. The MSA's dispute resolution provision required disputes—broadly defined—to be resolved by binding arbitration "administered and conducted using the Construction Industry Arbitration Rules of the American Arbitration Association."

The parties entered into three work orders on three separate projects. The work orders required the subcontractor to obtain payment and performance bonds, which it did from a surety (Argonaut). Under the performance bonds, Argonaut promised to perform in the event Northern, its principal, failed to "fully indemnify and save harmless the Obligee [Swinerton] from all loss, liability, costs, damages, penalty, attorney's fees or expense" resulting from any Northern subcontract defaults or, under the payment bonds, in the event that Northern failed to "pay promptly and in full the claims of all persons, firms, or corporations performing labor or furnishing equipment, materials, or supplies incurred in connection with the contract[s] to be performed[.]"

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After its commencement of work, Northern's owner and license qualifier passed away, rendering the subcontractor incapable of further performance. Swinerton notified Argonaut of its principal's default, but the surety allegedly failed to fulfill its obligations.

Swinerton sued Argonaut for breach of both bonds. The surety moved for dismissal of the action on the ground that the trial court lacked jurisdiction because the claims were governed by the MSA's arbitration requirement.

The District Court for the Northern District of California converted the surety's motion to dismiss into a motion to compel arbitration. It pointed out that the Federal Arbitration Act (FAA) § 3, 9 U.S.C.A. § 3, states that, in any suit or proceeding, in which the court is satisfied that the action is "referable to arbitration," then "on application of one of the parties," the court "shall . . . stay the trial of the action until such arbitration has been had[.]" Similarly, the FAA § 4 specifies that the court, once satisfied that an arbitration agreement exists and that it applies to the underlying claims, "shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement."

Here, Swinerton acknowledged the existence of an arbitration agreement in the MSA. However, it argued that its disputes were only with the surety—that "this action arises out of conduct wholly independent of disputes governed by the agreement"—and so its claims fell outside the scope of the arbitration provision. The court responded that, while a contractual right to arbitrate generally may not be invoked by one not a party to the agreement, "courts have held that where a surety bond incorporates an underlying contract that contains an arbitration provision, the surety agrees to be bound by the arbitration provision of the underlying contract even if it was not a party to that contract." *Boys Club of San Fernando Valley, Inc. v. Fidelity & Deposit Co. of Md*., 6 Cal. App. 4th 1266, 1274, 8 Cal. Rptr. 2d 587, 591 (2d Dist. 1992), 13 CLR 247 (1992).

The court explained that in *Boys Club*, the owner on a construction project withheld final payment and filed a demand for contractual arbitration against the contractor and the contractor's performance bond surety (Fidelity). Fidelity argued that it was not a party to the prime contract and that it did not agree to arbitrate. The court of appeal ruled that the surety was subject to the arbitration provision because the bond referenced the prime contract. The court reasoned that

> when a party enters into a contract to do certain work on certain terms, and procures a surety to guarantee the faithful performance of the work, the surety necessarily contracts with reference to the contract as made; otherwise it would not know what obligation it was assuming. And this is particularly so where the bond expressly declares that the contract is made a part of the bond and the terms of the contract are incorporated into the bond.

Id. at 1271-72, 8 Cal. Rptr. 2d at 589-90 (quotation marks and citation omitted). The court concluded that "by the language in its bond incorporating the contract Fidelity intended, and agreed, to be bound by the arbitration provision in the contract even though it was not a party to the contract." *Id*. at 1273, 8 Cal. Rptr. 2d at 590.

Swinerton sought to distinguish *Boys Club* on the ground that the issue to be resolved in that case was whether the principal had been in breach of contract, whereas in this case it was clear that Northern was in default and the only dispute was whether Argonaut failed to honor its bond commitments. The court essentially found this argument constituted a distinction without a difference:

> But [Swinerton] does not dispute that Argonaut's liability on the bonds likely turns on Northern's own breaches of the work orders. It also does not offer authority for its position that where an obligee sues a surety for breaches of bonds that incorporate a contract containing an arbitration agreement, the obligee (or the surety) is not required to arbitrate claims based on those breaches.

Next, to the extent that Swinerton disputed whether the arbitration agreement applied to its claims, the court noted that the MSA delegated that gateway issue to the arbitrator by incorporating by reference the AAA's Construction Industry Arbitration Rules. See *Portland General Electric Co. v. Liberty Mutual Ins. Co*., 862 F.3d 981, 985 (9th Cir. 2017), 38 CLR 326 (2017) (noting that "parties may delegate the adjudication of gateway issues to the arbitrator if they 'clearly and unmistakably' agree to do so" and stating, "[w]e have found such delegation when the parties have incorporated by reference the rules of the American Arbitration Association").

The court returned to a procedural matter stemming from its conversion of the surety's motion from a motion to dismiss for lack of jurisdiction to a motion to compel arbitration. "The court finds it appropriate to stay this action pending the outcome of the parties' arbitration proceedings. For case management reasons, the court will accomplish this by administratively closing the case. To reopen the case, the parties are directed to file a joint status report within two weeks of the completion of any arbitration."

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Comment

The contractor no doubt recognized the general rule that its claims against the subcontractor's surety were presumptively subject to the subcontract's broad arbitration agreement. Yet the unique nature of the subcontractor's default—its principal's death leaving the company without a license qualifier—gave the contractor a basis for arguing that its sole dispute was with the surety's compliance with its bond obligations, outside the scope of the arbitration agreement.

The court was unconvinced. It first rejected the premise that the contractor's claims were not arbitrable, stating that the contractor "does not dispute that Argonaut's liability on the bonds likely turns on Northern's own breaches of the work orders." After all, even if the claim was limited to the cost of completion, a factual dispute existed as to the degree to which the principal had completed its work, and whether that completed work was free of defects. As an alternative rationale, the court noted that, under the AAA arbitration rules, any disputes as to the arbitrability of the claims was to be decided by the arbitrator, not the court.

For further discussion, see Philip L. Bruner & Patrick J. O'Connor, Jr., 7 *Bruner & O'Connor on Construction Law* § 21:108 (Thomson/West 1992; Westlaw 2023) (titled "Sureties as non-signatories"); H. Bruce Shreves & Kevin L. Lybeck, "Arbitration of Performance Bond Disputes" in *The Law of Suretyship* 375-92 (ABA Edward G. Gallagher, ed. 2d ed. 2000); and Greta A. McMorris & Lawrence Lerner, *To What Extent Is a Surety Bound by Arbitration and Forum Selection Provisions in Its Principal's Contract?* 33 Construction Lawyer 22 (Spring 2013).

ARCHITECTS/ENGINEERS

DESIGN AGREEMENT'S DISCLAIMERS AS TO ARCHITECT'S RESPONSIBILITY FOR SAFETY NEGATED DESIGNER'S DUTY OF CARE OWED TO INJURED WORKER

Contractor Was Responsible for Safety

Bonilla v. Verges Rome Architects, 2024 WL 1229219 (La. Mar. 22, 2024)

Holding

A design agreement's disclaimers as to the architect's responsibility for safety negated a duty of care owed to an injured construction worker.

Summary of Decision

Gustavo Bonilla was employed by the demolition subcontractor on a project to renovate a multiservice center owned by the City of New Orleans. The city separately hired a general contractor (who hired Bonilla's employer) and an architectural firm (VRA).

The subcontractor was required to demolish a vault located on the second floor of the center. The vault was a square cinderblock room with a concrete ceiling. After removing one side of the vault and part of another, Bonilla was instructed to stand on the vault's roof and to demolish it with a hydraulic jackhammer. Soon after beginning this task, the entire vault collapsed, causing Bonilla to fall and suffer neck and back injuries.

Bonilla sued VRA, alleging negligent failure to specify in the design required supports for the area to be demolished, and failure to monitor and supervise the construction to ensure it was carried out in a safe manner. The trial court granted the architect's motion for summary judgment. The court of appeals reversed. It found issues of material fact as to VRA's awareness the vault was being demolished in an unsafe manner and that deviations from the relevant contractual provisions/specifications had occurred. *Bonilla v. Verges Rome Architects*, No. 2022-CA-0625, 2023 WL 3371559 (La. App. 4th Cir. May 11, 2023), 44 CLR 232 (2023).

The Louisiana Supreme Court reversed, ruling that the design agreement's provisions negated the existence of a duty of care imposed upon the architect and in favor of construction workers. The court explained that "[t]he duty owed to an employee of a contractor by an engineer or architect is determined by the express provisions of the contract between the parties." *Yocum v. City of Minden*, 649 So. 2d 129, 131 (La. App. 2d Cir. 1995), 16 CLR 194 (1995). Here, the agreement contained multiple provisions which (1) allocated safety responsibility to the general contractor and (2) disclaimed the architect's responsibility for, or control over, "the construction means, methods, safety precautions and programs." General Conditions (GC) § 2.5.

Various contract provisions addressed inspections of the work by VRA. The architect was required to undertake periodic visits to the construction site, but

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those visits "shall not be construed as supervision of actual construction." GC § 2.3. The contract's § F(5) clarified the limited purposes of the architect's site visits: "[Architect] will make site visits to the site as required (with a minimum of one per week) to review the progress and quality of the Work and to determine, in general, if the Work, when fully completed, will be in accordance with the Construction Documents and the Construction Progress Schedule." Based on these visits, the architect "will keep the Owner informed of the progress and quality of the work performed[.]" *Id*. Section F(8) contained a disclaimer: "[Architect] shall not have control over, charge of, or responsibility for the construction means, methods, techniques, sequences, or procedures, or for safety precautions and programs in connection with the Work, nor shall the [Architect] be responsible for the Contractor's failure to perform the Work in accordance with the Construction Documents."

On appeal, plaintiff asserted that § F(5) imposed a duty on VRA to supervise and report any deviation from the design specifications which might impact site safety. He argued in the alternative that the contract imposed an extra-contractual duty on VRA, as an architect, to use reasonable care to protect against injury to construction workers. VRA countered that the contract imposed no duty upon it with regard to the contractor's means and methods of construction. It interpreted § F(5) as imposing upon it a duty to ensure the owner receives the building it contracted for, nothing more.

The court held that the design agreement and general conditions clearly and unambiguously dictated that VRA owed no duty of care to the plaintiff. It cited *Black v. Gorman-Rupp*, 791 So. 2d 793, 795 (La. App. 4th Cir. 2001), *writ denied*, 802 So. 2d 635 (La. 2001), for the proposition: "The mere fact that [a design professional] was involved in the construction process and had contractual duties to the [owner] does not create an all encompassing duty to protect everyone from every risk which could be encountered during the course of the project." While § F(5) required VRA to make weekly site visits, the purpose of these visits was to ensure that the city secured the building it had contracted for. This conclusion was reinforced by GC § 2.3, which clarified that the "undertaking of periodic visits and observations by [Architect] or his associates shall not be construed as supervision of actual construction." Similarly, § F(8) specified that VRA did not have responsibility for or control over the construction means, methods, or safety precautions and programs. Rather, the contract imposed safety requirements solely on the contractor.

In a footnote, the court stated that it refused to establish an extra-contractual duty owed to plaintiff by VRA. While lower courts have extended a duty of care to third parties, those cases were inapposite as they involved economic harm to contractors resulting from deficient performance of a service, not an injury to a subcontractor's employee for failure to warn of a hazardous condition. In sum, "VRA cannot therefore be held liable for failing to perform duties it had no responsibility or authority to undertake."

Comment

VRA had hired an engineering firm (MMI) and Mr. Bonilla had sued both of the design professionals. The trial court granted MMI's motions for summary judgment. The court of appeals in appeal No. 2022-CA-0802, affirmed the summary judgment in favor of MMI. The evidence clearly established that: MMI's role on the project was limited to acting as a consultant for VRA; the engineer's drawings and specifications did not include demolition of the vault; and MMI was unaware of the demolition procedure as its first inspection of the project occurred a month after the accident. *Bonilla v. Verges Rome Architects*, 368 So. 3d 170 (La. App. 4th Cir. 2023), 44 CLR 232 (2023). Mr. Bonilla did not appeal this ruling.

An understanding of why the court of appeals reversed the summary judgment in favor of VRA sheds light on the significance of the supreme court's decision. The architect's principal, Mr. Taffaro, performed the site inspections. He had taken 10 photographs on a site visit the day of the accident, but before the accident happened (at which time he had left). One photo showed Bonilla standing on the roof of the partially demolished vault. The appellate court summarized Taffaro's testimony:

> Mr. Taffaro acknowledged in his deposition that there were no temporary supports in place on the vault at the time he took the photographs. He further stated that he could not see inside the vault to tell if there were temporary supports on the inside. Mr. Taffaro explained that he could not say if temporary supports were necessary because he did not know how the contractor proposed to demolish the vault. Mr. Taffaro did not point out the lack of temporary shoring to anyone at the time.

Although Mr. Taffaro testified he did not see anything wrong or dangerous in the photo, plaintiff's two experts disagreed. The court of appeals ruled that this testimony, suggesting Taffaro may have known of the hazardous working condition, distinguished this case from others (such as *Black*) which found the design professional owed no duty of care to the injured worker.

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By making no mention of this part of the record, and ruling solely based upon the contract language, the supreme court arguably disavowed an "actual notice" exception to a design professional's no-duty obligation regarding site safety. A Louisiana Court of Appeals had earlier come to the same conclusion. In *Young v. Hard Rock Construction, L.L.C.*, 292 So. 3d 178 (La. App. 5th Cir. 2020), *writ denied*, 301 So. 3d 1190 (La. 2020), 41 CLR 178 (2020), Nijel Young, a contractor's employee, was injured in a trench collapse and sued the project construction manager (CM) for negligence. One argument made by Young was that the CM owed him a "moral duty," one *not* arising out of the contract provisions, to stop the work if it observed a dangerous condition. Plaintiff cited in support *Yocum v. City of Minden*, *supra*, a factually similar case. In dicta, the *Yocum* court noted that both parties' expert witnesses testified that the engineer would have had a "moral duty to warn" the contractor if he knew the ditch's condition was unreasonably dangerous.

The *Young* court rejected plaintiff's attempt to assert an actionable "moral duty" owed by a CM to the contractor's employees. In its footnote 10, the court opined that the *Yocum* court's use of the term "moral" was meant to describe a tort duty; i.e., one not contractual in nature. It characterized the court's language as dicta, motivated by an attempt to address the arguments made by the parties. Finally, the *Young* court pointed out that no other Louisiana court has given credence to the *Yocum* court's language:

> Tellingly, a thorough search of Louisiana jurisprudence fails to uncover any Louisiana court citing Yocum as creating or recognizing a moral or tort duty to a contractor's employee on behalf of an engineering firm contrary to the established body of case law holding that specific contractual provisions govern the duties and responsibilities of the parties. Furthermore, we find no other line of cases supporting this theory of recovery. Such dicta does not jurisprudentially create a duty to a contractor's employee from an engineer/architect for safety that operates independently of explicit contractual provisions. (Footnote omitted.)

The *Bonilla* supreme court cited to *Young*, but only for the proposition that VRA did not owe Bonilla an extra-contractual duty.

The courts are split as to whether an architect's or engineer's knowledge of a site hazard can be grounds for imposing upon it a duty of care owed to an injured worker. Some agree with the Louisiana Supreme Court that an architect's or engineer's lack of contractual responsibility for safety is the only consideration and that knowledge of the site condition is not relevant. See *Herczeg v. Hampton Municipal Auth.*, 2001 PA Super 10, 766 A.2d 866, 874 (2001), *appeal denied*, 567 Pa. 742, 788 A.2d 376 (2001), 22 CLR 96 (2001) and *Yow v. Hussey, Gay, Bell & DeYoung Internat'l, Inc.*, 201 Ga. App. 857, 412 S.E.2d 565, 568 (1991), *cert. denied* (Ga. Jan. 30, 1992), 13 CLR 10 (1992). The earliest decision to find an a/e's duty of care based upon knowledge of the hazardous condition is *Erhart v. Hummonds*, 232 Ark. 133, 334 S.W.2d 869, 870-71 (1960). Over 35 years later, the New Jersey Supreme Court treated an a/e's actual knowledge as one factor among others to consider when evaluating whether the designer had a duty of care. *Carvalho v. Toll Bros. & Developers*, 143 N.J. 565, 675 A.2d 209 (1996), 17 CLR 189 (1996).

For further discussion of a design professional's tort liability arising from the design professional's knowledge of the hazard, see Marc M. Schneier, *Construction Accident Law: A Comprehensive Guide to Legal Liability and Insurance Claims* 297 - 303 (ABA 1999) (available on Westlaw); John E. Bulman, Scott K. Pomeroy & Paul A. Sandars III, *The Horns of a Dilemma: Too Much Involvement in Worksite Safety Can Backfire on Design Professionals*, 21 Construction Lawyer 5 (Spring 2001); Marc M. Schneier, *Design Professional Liability for Construction Worksite Accidents—How Arkansas Led the Way to a National Consensus*, 75 Ark. L. Rev. 383 (2022); and Marc M. Schneier, Annotation, *Architect's or Engineer's Liability for Injury or Death of Construction Worker on Construction Site Project*, 56 A.L.R.7th Art. 7 (2020).

ARCHITECT, HIRED BY HOMEOWNERS TO REVIEW CONTRACTOR'S INVOICES, WAS NOT LIABLE TO THE TERMINATED CONTRACTOR FOR INTENTIONAL INTERFERENCE WITH CONTRACT

Summary Judgment Affirmed

Cutting Edge Homes, Inc. v. Mayer, 229 N.E.3d 613 (Mass. App. Ct. 2024)

Holding

An architect, hired by homeowners to review a contractor's invoices, was not liable to the terminated contractor for intentional interference with contract, as

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the architect's questioning of the contractor's invoices was done in good faith.

Summary of Decision

Homeowners hired a general contractor to undertake a home renovation project at a cost in excess of $2 million. The contractor was to submit monthly invoices and be paid based on a set schedule of monthly payments, rather than a percentage of the work completed. The owners separately hired Alan Mayer, an architect, to review the contractor's work and invoices. The owners instructed the contractor to collaborate with Mayer.

Although the contractor began work in May 2018 and substantial completion was to happen by the end of that year, the court reported that the contractor began submitting itemized invoices to the owners in late 2018, and Mayer began reviewing those invoices in December 2018. Mayer determined that the contractor had overbilled $250,000 in this first invoice, but the court noted that Mayer (who had not seen the prime contract) may have assumed that the work would be invoiced using the American Institute of Architects (AIA) percentage-of-work method, which the contract did not follow. In any event, Mayer consistently had questions about the remaining invoices, often asking for backup documentation of expenses and work completed. Despite the architect's advice, the owners continued paying the contractor the full amount of its invoices so that the work would continue.

In October 2019, Mayer sent the owners an email stating that the contractor's invoice was $680,000 more than it was currently due and that as to certain entries the contractor was "just making this stuff up and [it] has done [so] for every previous invoice." Mayer opined that the consistent overbilling constituted sufficient grounds for dismissal. At the end of the month, the owners terminated the contractor, citing routine overbilling as just one of several reasons for their decision.

The contractor sued Mayer in state court for intentional interference with contract. Concluding that the contractor did not present evidence sufficient to create a question of fact as to whether Mayer had acted with improper motive or was the cause of the owners' decision to terminate, the trial court granted the architect's motion for summary judgment.

Applying de novo review, the Massachusetts Court of Appeals affirmed, but limited to the reason that the contractor had not presented sufficient evidence that Mayer's conduct was "improper in motive or means" because there was no evidence that would support a finding of deceit or dishonesty. To avoid summary judgment, the contractor was required to present sufficient evidence to meet four elements: (1) a contract between plaintiff and a third party (here, the owners), (2) Mayer knowingly induced the owners to break the contract, (3) Mayer's "interference was improper in motive or means," and (4) plaintiff was harmed. Only the third element of improper motive or means was at issue, and the court observed that this element "has proved difficult to capture in a universal standard." The Restatement (Second) of Torts § 772 instructs that a person does *not* interfere improperly with another's contractual relations with a third person by giving the third person "truthful information" of "honest advice within the scope of a request for the advice." Comment e elaborates on what is meant by "honest" advice:

> It is sufficient for the application of this rule that the actor gave honest advice within the scope of the request made. Whether the advice was based on reasonable grounds and whether the actor exercised reasonable diligence in ascertaining the facts are questions important only in determining his good or bad faith. *But no more than good faith is required*. (Emphasis added.)

Comment c further explains that "[t]he rule as to honest advice applies to protect the public and private interests in freedom of communication and friendly intercourse."

Accordingly, in order to establish improper *motive*, it is not sufficient for the plaintiff to show that the advisor was negligent, or made negligent or even grossly negligent misrepresentations to the third party. "What is required is at least a showing of dishonesty, which the Restatement equates with a lack of good faith." Here, the contractor did not argue that Mayer acted with an improper motive, and there was certainly no evidence that Mayer exhibited an intent to specifically harm the contractor, independent of any legitimate purpose.

Nor was there sufficient evidence of improper *means*, the court continued. It is true that Mayer, when reviewing the first invoice (without having seen the prime contract), may have assumed (wrongly) that the contractor was to be paid based on the percentage of work completed—the AIA standard—but this matter was soon cleared up. More broadly, the court found that "Mayer made mistakes from time to time in his reviews and calculations. But what the evidence does not show is conduct amounting to deceit or intentional misrepresentation; nor does it show dishonesty." Indeed, the evidence showed multiple occasions in which the architect

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and contractor sought to resolve confusion over discrepancies. "In short," the court concluded, "the parties' communications reflect honest disagreement and efforts to work through issues, not bad faith."

Comment

Recall that the trial court found two grounds to grant the architect's motion for summary judgment—no evidence of improper motive or means *and* lack of causation. In its footnote 7, the court of appeals expressed disagreement with the trial court's decision that the contractor failed to show causation; i.e., that Mayer's communications caused the owners to terminate the contractor. The court of appeals stated that, based on the record, a reasonable jury could find that Mayer's communications caused the termination.

It appears that the owners either created a unique contract or, if that contract borrowed from industry standard form documents such as the AIA's, the contract so altered those standard provisions as to be *sui generis*. This deviation from the AIA documents is clear with regard to the basis upon which the contractor's monthly invoices were to be calculated. As noted in the above summary, the architect began reviewing the contractor's invoices without having reviewed the prime contract, and this may have been the origin of Mayer's view that the first invoice was too high (when compared to the amount of work completed).

It was also possible that the prime contract varied from the AIA with regard to the degree of the architect's participation in the owners' decision to terminate. The "General Conditions of the Contract for Construction," AIA Doc. A201-2017, § 14.2.2, authorizes the owner to terminate the prime contractor for enumerated reasons, but only "upon certification by the Architect that sufficient cause exists to justify such action[.]" In its recitation of the facts, the court noted that Mayer opined to the owners that the consistent overbilling would justify termination of the contractor, but there is no mention of Mayer *certifying* his opinion to the owners prior to their action.

For further discussion of architect or engineer liability to a contractor or subcontractor for interference with contract, see Philip L. Bruner & Patrick J. O'Connor, Jr., 5 *Bruner & O'Connor on Construction Law* § 17:29 (Thomson/West 1992; Westlaw 2023); Marc M. Schneier, *Tortious Interference with Contract Claims Against Architects and Engineers*, 10 Construction Lawyer, No. 2, p. 3 (May 1990); and Marc M. Schneier, Annotation, *Tort Liability of Project Architect Or Engineer For Economic Damages Suffered By Contractor Or Subcontractor*, 61 A.L.R.6th 445 (2011).

BANKRUPTCY

UNDER MASSACHUSETTS LAW, DEBTOR'S MISCLASSIFICATION OF WORKERS AS INDEPENDENT CONTRACTORS WAS NOT "WILLFUL" FOR PURPOSES OF THE WORKERS ESTABLISHING AN EXCEPTION TO DISCHARGE OF THE DEBT HE OWED THEM FOR OVERTIME PAY

Bankruptcy Court Decision Affirmed Under Reliant Standard

In re Sivieri, 657 B.R. 303 (1st Cir. BAP 2024), *appeal filed*, *Simoes v. Sivieri*, No. 24-9002 (U.S. Apr. 10, 2024)

Holding

Under Massachusetts law, a debtor contractor's failure to pay the creditor workers overtime pay was dischargeable, as the workers failed to prove the contractor's classification of them as independent contractors, rather than as employees, was "willful" within the meaning of 11 U.S.C.A. § 523(a)(6).

Summary of Decision

Facts

Plaintiffs were two brothers who moved to the United States from Brazil and became a carpenter and a framer. They spoke Portuguese and some English. They worked for NAS, a company owned by the debtor, Nicholas Sivieri, building houses in Massachusetts. Sivieri spoke no Portuguese. One of the plaintiffs would assemble a crew and had authority over it. The brothers worked six days per week for NAS, with no vacation.

While Sivieri paid plaintiffs for the hours they worked, they were not compensated overtime pay. Sivieri treated the plaintiffs as independent contractors, apparently unaware of the state's "independent contractor statute," Mass. Gen. L. ch. 149, § 148B, which creates a presumption that employed persons are employees. However, when the brothers were injured on

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the job, Sivieri declared they were employees so as to entitle them to workers' compensation benefits and to shield himself from tort liability.

Plaintiffs sued NAS and Sivieri in state court, asserting that they were misclassified as independent contractors and that they had been deprived of overtime pay to which employees are entitled. Mass. Gen. Laws ch. 151, § 1A. The court awarded plaintiffs overtime pay, interest, multiple damages, and attorney's fees under a theory of statutory strict liability.

Sivieri filed for chapter 7 bankruptcy, seeking to eliminate the debts he owed to the plaintiffs. Plaintiffs filed an adversary proceeding, invoking 11 U.S.C.A. § 523(a)(6), which exempts from discharge any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." The bankruptcy court issued a written bench ruling, concluding that plaintiffs failed to meet their burden of proof under § 523(a)(6). Plaintiffs appealed, and the Bankruptcy Appellate Panel for the First Circuit affirmed.

Court Decision

The court first noted that a creditor claiming an exception to discharge bears the burden of proof by a preponderance of the evidence. The phrase "willful and malicious injury" are not defined in the Code, and courts turn to other sources of interpretation, especially the Restatement of Torts. The *Sivieri* court observed that, as a creditor has the burden of proving that the injury was both "willful" and "malicious," it was sufficient to uphold the bankruptcy court's ruling to find that plaintiffs did not prove "willfulness." In *Kawaauhau v. Geiger*, 523 U.S. 57, 61-62, 118 S. Ct. 974, 140 L. Ed. 2d 90 (1998), the Supreme Court defined the term:

> The word "willful" in (a)(6) modifies the word "injury," indicating that nondischargeability takes a deliberate or intentional *injury,* not merely a deliberate or intentional *act* that leads to injury. Had Congress meant to exempt debts resulting from unintentionally inflicted injuries, it might have described instead "willful acts that cause injury." Or, Congress might have selected an additional word or words, *i.e.,* "reckless" or "negligent," to modify "injury." Moreover, . . . the (a)(6) formulation triggers in the lawyer's mind the category "intentional torts," as distinguished from negligent or reckless torts. Intentional torts generally require that the actor intend "the *consequences* of an act," not simply "the act itself." Restatement (Second) of Torts § 8A, Comment a, p. 15 (1964) (emphasis added).

Accord, *DeWitt v. Stewart (In re Stewart)*, 948 F.3d 509, 528 (1st Cir. 2020) ("willfulness" "requires a showing of intent to injure or at least of intent to do an act which the debtor is substantially certain will lead to the injury in question.")

In short, the present court continued, "an act and a consequence are fundamental to a willful injury." Here, the act leading to the consequence (nonpayment of overtime pay) was worker classification—a concept defined by state law. As noted, the state's independent contractor statute establishes a rebuttable presumption that "an individual performing any service" is an employee. § 148B(a). The statute lists three criteria, all of which must be met, for rebutting the presumption; that is, for showing the worker was an independent contractor. Those three criteria are: (1) the individual is free from control and direction in the performance of the service; and (2) the service is outside the usual course of the employer's business; and (3) the individual has an independently established trade or occupation. § 148B(a). Notably, "good faith" or a similar consideration plays no part in a determination of worker status. "Thus, 'misclassification' simply means incorrect classification, without regard to how or why it happened. In other words, the independent contractor statute creates a strict liability regime. . . . Likewise, strict liability is imposed for certain failures to comply with wage-related law, including overtime pay provisions."

The bankruptcy court found that Sivieri classified plaintiffs as independent contractors, who would not be entitled to overtime pay. Only if that classification was wrong, and Sivieri's misclassification was willful within the meaning of the statute, would plaintiffs have suffered an injury—nonpayment of the overtime premium to which they would have been entitled as employees. As noted, for § 523(a)(6) to apply, Sivieri must have caused injury more than negligently or recklessly. Otherwise stated, "[i]f Sivieri thought, perhaps even unreasonably, that [plaintiffs] qualified as independent contractors, he cannot have desired or believed that they would be deprived of wage law protections that do not apply to independent contractors—such as an entitlement to an overtime premium."

The bankruptcy court was not persuaded that plaintiffs proved Sivieri "intentionally avoided a known legal obligation[.]" During their business relationship (which ended after the worksite accident), Sivieri treated plaintiffs as independent contractors. He further testified that he believed at the time that he had the right to classify workers as independent contractors and that this was the industry standard. The bankruptcy court credited Sivieri's testimony as reflecting his subjective intent, which meant (the appellate panel explained)

this credit constituted a factual finding, reversible only for clear error.

The court determined it could not surmount that high standard of "clear error." The bankruptcy court observed that, prior to plaintiffs' claims, Sivieri had not been confronted with a worker classification claim. There was no evidence undermining his testimony that he was unaware of classification issues, believing instead that he could classify plaintiffs as independent contractors, which he viewed as the industry standard. The circuit court focused on what was missing from the lower court's opinion: "there was no factual finding that Sivieri knew the first thing about the Massachusetts independent contractor statute when the appellants worked with him. And the record does not compel any such finding." In the absence of evidence of deliberate misclassification, plaintiffs could not meet their burden of showing the failure to pay them overtime pay was "willful." Accordingly, Sivieri's debt to plaintiffs, established by a state court judgment, was discharged.

Concurrence

A concurrence felt compelled by the deference due the bankruptcy court's findings of fact to concur in the majority's affirmance. The concurrence wrote separately to disagree with the majority's willingness to assume, in the absence of a clear record, that the bankruptcy court had made factual findings consistent with its ruling in favor of the debtor.

Next, the concurrence disagreed with bankruptcy court's factual findings. In the concurrence's view, the record disclosed "aggravating circumstances which speak to Sivieri's willfulness." Plaintiffs worked 52 weeks a year, six days a week. They were unsophisticated parties in that their education was limited, as was their English. By contrast, Sivieri described himself as a "construction supervisor/manager," with an associate degree in business, a construction supervisor's license, and a hydraulics license. The concurrence flatly disagreed with the bankruptcy court's rejection of the view that the debtor "took advantage" of the plaintiffs. The concurrence would have pointed to the fact that the plaintiffs were vulnerable to exploitation, coupled with the public policy of the right to prompt payment and proper classification of workers, to conclude the debts were nondischargeable. Accord, *Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202, 1207 (9th Cir. 2001) ("Wages are not ordinary debts. Because of the economic position of the average worker and, in particular, his family, it is essential to the public welfare that he receive his pay promptly.") Nonetheless, the concurrence concluded, the "clearly erroneous standard" of review meant affirmance was proper.

Comment

Plaintiffs were confronted with three hurdles before the BAP: their burden of proof; the standard for review of the bankruptcy court's factual findings (including of the debtor's intent); and the subjective standard for establishing willfulness within the meaning of § 523(a)(6). Perhaps with an eye toward the concurrence's discussion, which emphasized Sivieri's lack of credibility, the court majority concluded its opinion as follows:

> [Plaintiffs] suggest that, based on his extensive credibility issues, Sivieri is not the "honest but unfortunate debtor" that bankruptcy is intended to benefit. Maybe they are correct. The bankruptcy court observed—and seemingly for good reason—that Sivieri's testimony was implausible and inconsistent with his testimony in other proceedings. But a general lack of credibility does not amount to intent to injure. The appellants may have succeeded in proving that they were employees for purposes of Massachusetts wage law, something that was already established by the state court. They may also have succeeded in painting Sivieri as a person who ignored certain legal and business formalities and who was willing to change his "story" to suit his needs. That success is not a proxy for the type of intent finding that was necessary for them to except their debts from discharge under § 523(a)(6).

For further discussion, see James L. Buchwalter, *Cause of Action to Determine Dischargeability in Bankruptcy of Debt Arising From "Willful and Malicious" Injury or Damage*, 30 Causes of Action 2d 493 (2006).

BIDS

UNLICENSED JOINT VENTURE'S BID FOR CITY WORK WAS NONRESPONSIVE, EVEN THOUGH BOTH COMPANIES WERE LICENSED

Case of First Impression

Ernest Block & Sons—Dobco Pennsauken Jt. Venture v. Township of Pennsauken, 477 N.J. Super. 254, 305 A.3d 941 (App. Div. 2023)

Holding

Where two companies, each individually licensed,

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formed a joint venture to bid on a public works project, their failure to obtain a certificate of registration for the joint venture itself rendered their bid nonresponsive.

Summary of Decision

Two contractors, each licensed, created a joint venture in order to bid on a municipal library and public building project. The joint venture submitted the lowest bid. The second lowest bidder (Terminal) challenged the bid as nonresponsive because the joint venture itself had not submitted a registration certificate as required by the bidding documents.

Upon advice of counsel, the township awarded the contract to Terminal. The joint venture registered as a contractor, then brought a declaratory judgment suit against the township and Terminal, seeking to enjoin and reverse the award to Terminal. The trial court ruled in favor of the defendants, but stayed its ruling pending appeal.

Addressing an issue of first impression, the New Jersey Superior Court, Appellate Division, ruled that the joint venture's bid was nonresponsive and that its failure to register as a contractor prior to submitting its bid was not waivable. This project was undertaken pursuant to the Local Public Contracts Law (LPCL), N.J.S.A. 40A:11-1 to -60. The solicitation for sealed bids required bidders to be registered as a contractor under the Public Works Contractor Registration Act (PWCRA), N.J.S.A. 34:11-56.48 to -56.57.

To be responsive, bids must not materially deviate from the specifications and the bidding requirements. N.J.S.A. 40A:11-2(33); *Meadowbrook Carting Co. v. Borough of Island Heights*, 138 N.J. 307, 314, 650 A.2d 748, 751 (1994), 16 CLR 89 (1995). Even though the township's solicitation required contractors to be registered pursuant to the PWCRA, each joint venturer submitted a registration certificate, but the joint venture itself did not. The court determined that the joint venture's omission of the PWCRA registration certificate was a material deviation from the township's bid specifications. "A joint venture is simply a single-purpose partnership, or an entity formed for a limited duration." *Fliegel v. Sheeran*, 272 N.J. Super. 519, 524, 640 A.2d 852, 854 (App. Div.), *certif. denied*, 137 N.J. 312, 645 A.2d 140 (1994). The PWCRA defines a "contractor" to include "a person, partnership, . . . or other legal business entity[.]" N.J.S.A. 34:11-56.50. The court stated that a joint venture is akin to a partnership and so registration of the joint venture was required on that basis. "Moreover," the court continued, "even if we do not consider Joint Venture a partnership, it is an 'other legal business entity' within the meaning of" the same statute. The township unambiguously specified that a registration certificate was required under the PWCRA, and the joint venture's failure to submit a certificate of registration rendered the bid materially defective.

Comment

As the two companies which formed the joint venture were themselves registered, and were clearly sophisticated contractors, their failure to register the joint venture as a stand-alone business entity was presumably a simple oversight. While the court's decision might be viewed as a foregone conclusion, a recent case out of Louisiana shows otherwise. In *Lemoine Co., L.L.C. v. Ernest N. Morial Exhibition Hall Auth.*, 369 So. 3d 39 (La. App., 4th Cir. 2023), 44 CLR 307 (2023), the appellate court ruled that, where two companies, each individually licensed, formed a partnership to bid on a public works project, the government entity improperly awarded it the contract where the partnership was unlicensed. Yet the Louisiana Supreme Court reversed in a per curiam decision, stating in full: "In light of the unique and extenuating circumstances presented herein, and given the time-sensitive nature of the ongoing project, the court of appeal is reversed. The judgment of the trial court, which found the Authority's decision to award the contract to AECOM-Hunt/Broadmoor was not arbitrary and capricious, is reinstated." *Lemoine Co., L.L.C. v. Ernest N. Morial Exhibition Hall Auth.*, 372 So. 3d 327 (La. 2023).

For a review of legal issues pertaining to joint ventures, although not addressing the issue of registration or licensing, see John I. Spangler & Deborah Cazan, *Construction Joint Ventures—Essential Terms, Representation Issues, and Potential Claims*, 42 Construction Lawyer, no. 2, p. 5 (2023).

DEVELOPERS

SUBDIVISION BUILDER HAD A NONDELEGABLE DUTY TO ENSURE ITS CONTRACTOR INSTALLED A SUBDIVISION DRAINAGE SYSTEM PROPERLY

Owners' Fraud Claim Allowed

Elpers Bros. Construction & Supply, Inc. v. Smith, 2024 WL 796080 (Ind. App. Feb. 27, 2024)

Holdings

● A subdivision builder owed a nondelegable duty of care to the subdivision owners for proper design and construction of the drainage system, where the builder had hired an independent contractor to design and build the system.

● Where purchasers of a subdivision lot hired the general contractor to build their house, and they sued the developer (a separate entity) for negligence, the developers were not liable to the owners as the parties were not in privity and the owners suffered only property damage.

● Where a subdivision builder convinced lot owners to install a geothermal heating and cooling system, even though the builder had been told by a heating contractor that the system could not work under the site conditions, the builder could be sued by the owners for fraud, where the owners were required to replace the system.

Summary of Decision

Elpers Construction owned Elpers Development, a separate entity. Elpers Construction acts as the general contractor on subdivision construction projects.

The business entities purchased land so as to create a subdivision. Elpers Construction employed an engineering firm (Sitecon) to design and construct the subdivision's drainage system. Sitecon's design included a lake on one of the lots to catch storm water runoff that would be released into a downstream waterway. Sitecon's drainage plan was approved by the County Drainage Board, and its construction was inspected by the county engineer.

None of Sitecon's work was reviewed or overseen by Elpers Construction. Nonetheless, Paul Elpers, the president of Elpers Construction, designated himself to the county as the "responsible person" for creation of the water disposal system.

Deane and Lori Smith bought the lot which included the lake. They hired Elpers Construction to build their house. Sometime afterwards, Paul Elpers recommended to the Smiths that they purchase a geothermal heating and cooling system—even though he knew a heating company had refused to install a geothermal system on the same lot because the lake lacked sufficient depth. Paul did not tell the Smiths that information, and they agreed to have the system installed. Elpers Construction hired a contractor to install the geothermal system, collecting an additional 10% general contractor's fee.

Over several years, the Smiths saw that the system was functioning less efficiently. They also perceived soil and mud runoff, silt buildup in the lake, and that their yard flooded when it stormed. They hired an engineering firm (Morley), which found multiple environmental violations, including that Elpers Construction failed to obtain the required authorization for the lake on the Smiths' property.

The Smiths sued both Elpers Construction and Elpers Development. They alleged that the lake was no longer usable because of the sediment from upstream runoff, and that the Smiths' geothermal system was damaged and they had to replace it. The owners sought a declaration that the defendants were in violation of applicable ordinances and regulations. They alleged both defendants negligently designed, built, and maintained the drainage system. They separately alleged that Elpers Construction was liable under a theory of nondelegable duty, notwithstanding that Sitecon had designed and built the system. They also sued Elpers Construction for breach of contract and fraud with regard to their decision to install the geothermal system.

Elpers *Construction* countered that it was not liable for the negligence of Sitecon, its independent contractor, and that the owners had not pled fraud with sufficient specificity. Elpers *Development* argued that it could not be liable to the owners for their property damage absent privity of contract.

The parties moved for summary judgment. The trial court ruled: (1) Elpers Construction owed plaintiffs a nondelegable duty to design and build the subdivision's drainage properly; (2) Elpers Development was not liable to the owners; and (3) the owners' fraud claim could go forward. Both parties appealed, and the Indiana Court of Appeals affirmed in part and reversed in part.

Court of Appeals Decision

The court of appeals first ruled that Elpers Construction owed the owners a nondelegable duty of care to design and construct the drainage system. As a general rule, a principal that delegates a duty to an independent contractor is not liable for the negligence of that contractor in performing the duty. However, an exception to the general rule exists "where the principal is by law or contract charged with performing the specific duty." *Bagley v. Insight Communications Co., L.P.*, 658 N.E.2d 584, 586 (Ind. 1995).

The court found guidance from *Bartholomew Cnty. v. Johnson*, 995 N.E.2d 666 (Ind. App. 2013). In that case,

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landowners, whose property was flooded, sued the county for negligent design, construction and operation of a nearby bridge. The county brought a third-party complaint against the bridge's designer and builder. The court ruled that the county could not delegate its duty to maintain bridges and so remained liable to the landowners.

The present court found that Elpers Construction owed the owners a nondelegable duty to design and build the drainage system. The court pointed to a statute, Ind. Code § 36-9-27-69.5, which requires subdivision developers to comply with the drainage requirements. Similarly, Ind. Code § 36-7-4-702, imposes upon subdivision developers a duty to properly design and install the area's drainage components. The county made compliance with § 36-7-4-702 a condition for receipt of approval of a subdivision developer's drainage design. In addition, a calculation error identified by the Morley engineering firm violated a county regulation governing computation of stormwater runoff quantities. The court concluded,

> In light of the above, Elpers Construction cannot delegate the duty to properly design and construct the drainage system for the Subdivision with impunity because it is a duty specifically imposed upon it by law. If Elpers Construction were permitted to prevail, its roles and responsibilities would be significantly reduced, which is contrary to the express terms of the statutes and ordinance that require conformity with the drainage code. We therefore conclude that the trial court properly granted partial summary judgment to the Smiths on their claim that Elpers Construction owed a non-delegable duty to properly design and construct the Subdivision's drainage system.

The court next held that the lack of privity between the Smiths and Elpers Development meant the company was not liable to the owners for negligence. In *U.S. Automatic Sprinkler Corp. v. Erie Ins. Exchange*, 204 N.E.3d 215 (Ind. 2023), 44 CLR 159 (2023), the court ruled that when a contractor's alleged negligent work poses a risk to only property—not persons—the privity requirement precludes recovery for property damages in a negligence action. The present court reiterated the facts: "The designated evidence establishes that Elpers Development did not construct the Smiths' residence, it had no role in developing the Subdivision's drainage system, and it did not participate in the lake's construction. It is also undisputed that Elpers Development's alleged negligence did not pose a risk of personal injury to the Smiths." Under these facts, the parties' lack of privity precluded the owners from suing Elpers Development for alleged negligence which did not pose a risk of personal injury to the Smiths.

Last, the court ruled that the trial court properly denied Elpers Construction's motion for summary judgment on the owners' fraud claim. The Smiths alleged that Paul Elpers recommended they install a geothermal system, while withholding from them that a heating contractor had informed him that such a system would not work in light of the lake's condition. They further alleged that they relied upon Paul's representations to their detriment, as they were required to entirely replace their system. While Elpers Construction argued that the owners failed to allege fraud with the required specificity, the court found the allegations were sufficient to satisfy the required specificity for fraud.

DIFFERING SITE CONDITIONS

ON A DREDGING PROJECT, A CONTRACTOR'S TYPE I DIFFERING SITE CONDITIONS CLAIM, THAT A CANAL BANK WAS TOO UNSTABLE FOR THE PLACEMENT OF DUMP TRUCKS, FAILED AS THE CONTRACT CONTAINED NO REPRESENTATIONS AS TO THE BANK'S CONDITION

Google Earth Images Inadmissible

Appeal of - Hamp's Construction LLC, ASBCA No. 62257, 2024 WL 669328 (Armed Serv. B.C.A. Feb. 2, 2024)

Holdings

- On a canal dredging project, the contractor's Type I differing site conditions claim, that a canal bank was too unstable for the placement of dump trucks, failed as the contract contained no representations as to the bank's stability.

- On a canal dredging project, where virtually all the boring logs were from the east bank of the canal, but the contractor encountered slope failure on the west bank, the contractor could not reasonably extrapolate to the west bank's condition based on the boring logs' information.

- Google Earth images of the project site were inadmissible to establish the site conditions at the time

of contracting, as the lighting and coloration of the image mosaics may mislead the viewer.

Summary of Decision

The underlying project was to deepen and improve a canal (the Trapp Canal) in Southeast Louisiana. The project was sponsored and designed by the parish but overseen (and presumably at least partially funded) by the U.S. Army Corps of Engineers. The general contractor was Hamp's Construction LLC (HC); it hired Cheniere as the dredging subcontractor. Cheniere's employee, Mr. Lorenz, reviewed the design and performed two pre-bid site inspections.

The government's solicitation included 10 boring logs. As trouble with the stability of the canal bank was limited to the *southwest* side of the canal, it is significant that eight of the boring logs were from the east side, and the remaining two logs from the northwest side. Lorenz's inspections of the canal did not alert him to any problem with the bank's stability; indeed, he had viewed parish trucks and equipment parked on the banks in the past and so assumed they were stable.

Cheniere anticipated performance of the dredging by floating an excavator on a barge and depositing the dredging spoils unto dump trucks sitting on the canal's banks. However, after the work began, the subcontractor saw that the southwest bank was slumping several inches. The contractor then found several other depressions in in the same area. In addition, the contractor's employee, while working on a bank, sunk several feet into a sinkhole (but was uninjured). When the contractor brought its concerns to the contracting officer, the CO responded that it was the contractor's responsibility to determine the means of performance. HC decided that it would be unsafe to operate loaded trucks on the southwest bank and that the work would have to be accomplished through the use of equipment operating only from barges. The board observed that "[t]his was far more inefficient than the original plan, required the double-handling of material, and cost HC extra time."

The CO denied HC's Type I differing site conditions claim, and the contractor appealed to the Armed Services Board of Contract Appeals. A Type I claim is premised upon a misrepresentation in the contract indications as to the site conditions. The board ruled that the claim failed because the contract documents provided no indications, one way or the other, about the stability of the southwest bank. None of the boring logs were from that area, and even HC's expert (Dr. Traughber) testified that those boring logs provided no warning of the condition of the southwest bank. The board went one step further with the observation that, "though we do not doubt the testimony that HC looked at the boring logs prior to bid, we do not believe they were given anything more than perfunctory attention: no testimony provided by HC discussed what they actually saw on the logs and that June 2013 letter informing the Corps of the first slope failure is written as if the contractor only recently took a close look at the logs and discovered underlying problems."

The board noted that Mr. Lorenz, the contractor's employee who conducted the pre-bid visits, testified that he saw no evidence of bank collapse; to the contrary, he had seen parish vehicles parked on the banks. The board countered that, while the photographs taken by Lorenz did not reveal a slope failure at the time of the inspections, they *did* show a possibility of slope failure. "Though Mr. Lorenz testified that he did not see much evidence of slope stability problems on the west bank, the simple fact is that he was not looking for that particular problem, having previously concluded that HC would be able to operate from the top of the canal just like he'd seen Jefferson Parish do on multiple occasions throughout the years."

Indeed, the board continued, both the site visits and a cross-section representation of different parts of the canal clearly revealed that the east bank was more stable than the southwest bank was. As virtually all boring logs were taken from the east bank, this provided further evidence the contractor could not have reasonably relied upon the boring logs to assess the stability of the southwest bank:

> Taken as a whole, even if we do not find that the pre-bid evidence (meaning, both the contractual documents and what a reasonable contractor would have observed in a pre-bid inspection) put HC on notice of exactly what was to occur, we do find that it would have made clear to a reasonable contractor that conditions on the west bank of the Trapp Canal were not the same, and were substantially worse, than those on its east bank. Thus, we find that, since the boring logs provided with the contract documents were from a materially different part of the Trapp Canal than where the failures occurred, they would not constitute representations of the geotechnical conditions in the locations where the failures actually manifested themselves.

On a separate matter, the board addressed the government's intent to introduce into evidence Google Earth images of the Trapp Canal. The Corps sought to have its witness use these images to demonstrate that slope failures had begun on the canal's banks prior to the bid for the contract.

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The board ruled that the images were inadmissible. It acknowledged that its Board Rule 10(c), which provides that "[t]he parties may offer such evidence as they deem appropriate and as would be admissible . . . in the sound discretion of the presiding Administrative Judge or examiner," gives it more judicial discretion to admit evidence than do the Federal Rules of Evidence. However, the touchstone for admissibility is always that the evidence is actually reliable. See *E.R. McKee v. United States*, 205 Ct. Cl. 303, 500 F.2d 525, 528 (1974) ("rank hearsay" may provide substantial evidence before a board if "convincing to a reasonable mind").

The board concluded that Google Earth images are not sufficiently reliable in showing site conditions to be admissible. Even assuming the date of the photos is accurate (this itself raises a question of hearsay), these photos are made through the stitching of mosaics, which are then colorized. The board found a danger that "we may be inadvertently misled by different lighting conditions on portions of the image taken at different times or dates. In the case of the coloration, it is all too easy to see how we could mistake changes in coloration due to the different filters used and the different lighting conditions for changes to the images caused by a change in the actual topography." The board added that the government's witness would not be able to testify competently to these issues. In sum, "[i]t is a close call, but we deem the Google Earth images to be inadmissible."

Comment

HC brought a Type I differing site conditions claim, which is premised on a misrepresentation in the contract indications. The board's finding that the contract contained no indications as to the condition of the southwest bank was an adequate ground for denying the claim. See *Comtrol, Inc. v. United States*, 294 F.3d 1357, 1363 (Fed. Cir. 2002), 23 CLR 411 (2002) (the contract must provide an "affirmative" representation as to subsurface conditions); *Renda Marine, Inc. v. United States*, 66 Fed. Cl. 639, 695 (2005), *aff'd*, 509 F.3d 1372 (Fed. Cir. 2007), 19 CLR 70 (2008) (a Type I claim cannot be maintained if the plans and specifications "say nothing one way or the other about the unforeseen conditions"); *Neal & Co., Inc. v. United States*, 36 Fed. Cl. 600, 617 (1996), 18 CLR 35 (1997) (stating that, "where contract is silent, a claim cannot arise"), *aff'd*, 121 F.3d 683 (Fed. Cir. 1997); and *Slone Assocs., Inc. v. United States*, 166 Fed. Cl. 771 (2023), 44 CLR 313 (2023) (on a pier repair project, the contract's silence as to subsurface conditions defeated the contractor's Type I differing site condition claim—that the contract's silence implied it would not encounter the remnants of a former, wooden pier).

However, the board continued with its analysis to determine that a review of the contract's documents, coupled with a pre-bid site visit, would have alerted a reasonable contractor to a possibility of less stability in the southwest bank. Thus, the board stated that "we do find that it would have made clear to a reasonable contractor that conditions on the west bank of the Trapp Canal were not the same, and were substantially worse, than those on its east bank." The board also questioned how careful the contractor had been in preparing its bid: "though we do not doubt the testimony that HC looked at the boring logs prior to bid, we do not believe they were given anything more than perfunctory attention[.]"

In short, the board was sympathetic to HC's felt need to take drastic action in response to the slope failure (and its employee sinking several feet), but this did not displace the contractor's original failure of proper bid preparation.

The differing site conditions clause has been the subject of much attention. For some recent articles, see Jeffrey M. Chu, *Differing Site Conditions: Whose Risk Are They?* 20 Construction Lawyer 5 (April 2000); Steven G.M. Stein & Carl L. Popovsky, *Design Professional Liability for Differing Site Conditions and the Risk-Sharing Philosophy*, 20 Construction Lawyer 13 (April 2000); and Kimberly J. Winbush, Annotation, *Federal Contractor's Right to Equitable Adjustment for Differing or Changed Site Conditions*, 36 A.L.R. Fed.3d Art. 7 (2018). Of course, the topic is comprehensively addressed in Philip L. Bruner & Patrick J. O'Connor, Jr., 4A *Bruner & O'Connor on Construction Law* Chapter 14 (Thomson/West 1992; Westlaw 2023).

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INSURANCE

A "RESULTING LOSS" CLAUSE, IN AN OWNER'S ALL-RISK INSURANCE POLICY'S "FAULTY WORKMANSHIP" EXCLUSION, EXTENDED COVERAGE FOR PROPERTY DAMAGE CAUSED BY HUMIDITY, THAT RESULTED FROM THE CONTRACTOR'S DEFECTIVE WORKMANSHIP OR DESIGN

Humidity Was a Covered Risk

Gardens Condominium v. Farmers Ins. Exchange, 544 P.3d 499 (Wash. 2024)

Holding

A "resulting loss" clause, in a condominium's "all risk" insurance policy's "faulty workmanship" exclusion, extended coverage for property damage caused by humidity, a covered risk, even though the humidity had been caused by a contractor's faulty workmanship or design.

Summary of Decision

A condominium board discovered water damage to the sheathing, fireboard, joists and sleepers of the building's roof. The humidity which caused the property damage was itself caused by the design's failure to allow for adequate ventilation. The condominium maintained an "all-risk" insurance policy from Farmers Insurance Exchange. The condominium sought coverage from Farmers for repairs to the roof caused by the humidity (damage to the fireboard and sheathing), not for coverage for the cost of correcting the defective sleepers. Farmers denied coverage based on the policy's exclusion for property damage caused by faulty design or repair, reasoning that because faulty construction "initiated a sequence of events resulting in the loss or damage," the damage came within the scope of the exclusion.

The insured sued for breach of contract and declaratory relief. It argued that the property damage caused by humidity—a covered peril—was covered by application of the above exclusion's "resulting loss" clause, that provided: "But if loss or damage by a Covered Cause of Loss results, we will pay for that resulting loss or damage." The Washington Supreme Court explained this provision: "In other words, as written, if faulty workmanship causes a covered peril to occur and that covered peril results in loss or damage, the loss or damage will be covered."

On cross-motions for summary judgment, the trial court ruled in favor of the insurer. It cited *TMW Enterprises, Inc. v. Federal Ins. Co*., 619 F.3d 574 (6th Cir. 2010), for the proposition that the resulting loss clause only "kicks in when there's some sort of unexpected or some kind of causal break." The Washington Court of Appeals reversed, stating that the trial court had misinterpreted the resulting loss clause. *Gardens Condominium v. Farmers Ins. Exchange*, 24 Wash. App. 2d 950, 521 P.3d 957 (Div. 1 2022), 44 CLR 94 (2023). Farmers appealed.

The Washington Supreme Court affirmed, explaining that the resulting loss exception preserves coverage for covered losses when an exclusion would have otherwise removed it. "Resulting loss clauses preserve coverage for loss that ensues after an excluded event if it would otherwise be covered by the policy. However, the excluded event itself is never covered."

The court previously decided two cases involving the faulty workmanship exclusions and resulting loss exception. In *Vision One LLC v. Philadelphia Indemnity Ins. Co*., 174 Wash. 2d 501, 276 P.3d 300 (2012), 33 CLR 320 (2012), a floor slab collapsed when shoring gave way because of defective workmanship, leading to loss of the slab and cleanup costs. The owner sought coverage for damage caused by "collapse"—a covered peril. The supreme court ruled in favor of the owner, stating that the resulting loss clause restored coverage for damage caused by the collapse because faulty workmanship—an excluded peril—had resulted in a covered loss—collapse. Moreover, "[a] resulting loss exception applies whether or not the covered peril is independent."

The court issued the second case, *Sprague v. Safeco Ins. Co. of Am*., 174 Wash. 2d 524, 276 P.3d 1270 (2012), 23 CLR 323 (2012), the same day *Vision One* was released. In that case, the insured homeowners discovered a wooden deck suffered from severe rot and was in danger of collapse. The court ruled that, even assuming the deck suffered a collapse, coverage was excluded by application of the defective workmanship exclusion. Coverage was *not* restored by application of the ensuing loss clause, because the deck's "condition was the result of the excluded perils of defective workmanship and rot and did not constitute a separate loss apart from those

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perils." 276 P.3d at 1272. The *Gardens Condominium* court pointed out:

> In a concurring opinion, Justice Alexander reasoned that there should be no coverage because the deck had not yet collapsed and the only damage was the rotting of the fin walls themselves. Applying *Vision One*, *Sprague* clarified that a resulting loss exception requires separate ensuing loss—damage beyond the faultily constructed or defectively designed element—caused by a new and distinct covered peril.

After this caselaw review, the present court turned to the underlying facts. The parties agreed that faulty design and workmanship existed—the failure to add enough space for adequate ventilation in the roof redesign and repair. This faulty workmanship resulted in covered perils (condensation and water vapor) causing loss (water-related damage to other parts of the roof). "If condensation and water vapor are new and distinct perils and the loss to the roof components (other than those defectively constructed) is a separate ensuing loss, the policy provides coverage, assuming condensation and water vapor are also covered perils."

Citing *Sprague*, Farmers argued that condensation was not a new peril because it was the "natural and unavoidable byproduct of the faulty lack of ventilation." The court responded that the insurer misunderstood *Sprague*'s reasoning:

> In *Sprague*, we did not hold that a resulting loss is not covered if it is a natural consequence of an excluded peril. Instead, we considered whether rot was the same condition as collapse to determine if the rot exclusion applied. *Sprague*'s reasoning was specific and our discussion of the "natural process" of deterioration was describing whether the advanced state of decay of the fin walls was the same peril as rot. [Citation omitted.] We did not discuss whether collapse is a natural and unavoidable byproduct of faulty workmanship. Farmers' argument that the natural consequences of an excluded peril are not covered is contrary to the conclusion in *Vision One* and would negate the effect of the resulting loss clause. Collapse caused by instability is the very loss that proper installation of shoring is intended to prevent. If natural consequences were not covered, we would have found no coverage in *Vision One*.

Finally, the court noted that insurers are free to draft policies that contain "sequence of events" causation and do not have resulting loss exceptions to exclusions. However, Farmers did not do that here and the court refused to rewrite the policy so as to exclude from coverage the natural consequence of faulty workmanship.

Comment

For further discussion of the resulting (or "ensuing") loss exception, see Philip L. Bruner & Patrick J. O'Connor, Jr., 4 *Bruner & O'Connor on Construction Law* §§ 11:453 -:455 (Thomson/West 1992; Westlaw 2022); Christopher C. French, *The "Ensuing Loss" Clause in Insurance Policies: The Forgotten and Misunderstood Antidote to Anti-Concurrent Causation Exclusions*, 13 Nev. L. J. 215 (Fall 2012); and David J. Marchitelli, Annotation, *What Constitutes "Ensuing Loss" Caused by Water Damage Within Coverage Provision of Property Insurance Policy*, 14 A.L.R.7th Art. 6 (2016).

INSURANCE AGENT NEGLIGENTLY MISREPRESENTED TO CONTRACTOR IN A CERTIFICATE OF INSURANCE THAT THE CONTRACTOR WAS AN ADDITIONAL INSURED, WHERE THE POLICY'S REQUIREMENT FOR COVERAGE WAS NOT MET

Professional Services Exception Did Not Bar Coverage

TCF Enterprises, Inc. v. Rames, Inc., 415 Mont. 306, 544 P.3d 206 (2024)

Holdings

- A general contractor, named as an additional insured on a certificate of insurance but not properly added to the subcontractor's policy, could sue the subcontractor's insurance agent for negligence, even though the contractor was not the agent's client.

- An insurance agent was liable to a contractor for negligent misrepresentation for issuing a certificate of insurance which falsely represented the contractor was an additional insured on a subcontractor's liability policy, notwithstanding the certificate's disclaimer that only the policy terms determined coverage.

- Where an owner sued the general contractor for settlement damage to a new building, coverage was not negated by the policy's professional services exception as the contractor had been sued for ordinary negligence as well as professional negligence.

Summary of Decision

Facts

A general contractor (Malquist) was employed on a condominium building construction project. Malquist

required its engineering subcontractor (C&H) to procure liability insurance containing the following language:

> [Malquist] is named as an Additional Insured with respect to General Liability, including Primary/Non-Contributory and Completed Operations coverage, per forms CG2010 0413 and GC2037 0413 or equivalent. Waiver of Subrogation in favor of [Malmquist] on General Liability.

C&H asked its insurance broker (Rames) to procure a liability policy listing Malquist as the "certificate holder" and containing the following language:

> The certificate holder is listed as an additional insured on a primary and noncontributory basis for General Liability per policy for GCD037 04/05, for ongoing and completed operations. Waiver of subrogation for General Liability applies to certificate holder.

Contrary to what the certificate of insurance (COI) represented, Rames failed to procure additional insured coverage for Malquist because it did not list the contractor as an additional insured on C&H's policy using a scheduled endorsement.

C&H provided the contractor with a geotechnical report in which it represented that the new building should suffer less than an inch of settlement. When the completed building settled over four inches, the owner sued Malquist for damages. Malquist asked C&H's liability insurer (Travelers) to provide it with a defense and indemnity, but the insurer declined coverage on two grounds: (1) Malquist was not an additional insured because there was no written contract reflecting such between Malquist and C&H and (2) even if Malquist was an additional insured, the policy's professional services exclusion would bar coverage. Malquist eventually paid the owner over $2.2 million to repair the building and settle the lawsuit.

Trial Court Proceedings

Malquist sued Rames (C&H's insurance agent) for negligence and negligent misrepresentation. The trial court granted the contractor's motion for partial summary judgment, finding that Rames: had a duty to procure the additional insured coverage; failed to do so; negligently misrepresented (in the certificate of insurance) that it had; and breached the standard of care. The court further determined that coverage would not have been barred by application of the professional services exclusion.

Liability having been established, the court submitted to the jury the questions of Malquist's comparative fault (in relying on the certificate of insurance) and damages. The jury found in the contractor's favor, awarding it both the loss of coverage and its defense costs. The agent appealed.

Supreme Court Decision

Legal Background

The Montana Supreme Court affirmed, ruling first that C&H, as an insurance agent, owed Malquist, a nonclient, a duty of care. Montana law requires that a client's request to procure insurance, followed by the agent's commitment to do so, imposes upon the agent a duty to procure the promised insurance. Here, Rames' client, C&H, directed Rames to obtain additional insured coverage for Malquist in conformity with a sample supplied by the contractor. Rames committed to do so and emailed to both C&H and Malquist a certificate of insurance that (falsely) represented that Malmquist was "listed as an additional insured on a primary and noncontributory basis for General Liability[.]"

In addition to violating a duty that stemmed from its commitment to procure the insurance requested by its client, Rames also owed both its client and Malquist a general common law duty to use reasonable care. Rames' employee testified that it was reasonable for Malquist to rely on the contents of the certificate of insurance, notwithstanding a disclaimer that the policy, not the certificate, governs the insurer's obligations. The court reasoned:

> It is foreseeable that a party may be harmed when it believes it has insurance coverage but does not. [Citation omitted.] And no public policy considerations would bar the imposition of a duty on Rames here, . . . because it is reasonable to expect an insurance agent to secure the coverage it agreed to procure and represented existed. Imposing a duty on an insurance business to act with reasonable care and not misinform its customers regarding their insurance coverage clearly comports with public policy considerations.

The court further stated that duty arose from the well-established common law principle that one who assumes an act, even gratuitously, may thereby become subject to the duty of acting carefully.

The court found ample evidence for the jury to find Rames liable for both negligence and negligent misrepresentation. With regard to the claim of negligent misrepresentation, Rames argued on appeal that a question of fact existed as to whether the certificate of insurance constituted an actionable representation because it contained a disclaimer warning certificate holders that it "does not affirmatively or negatively

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amend, extend or alter the coverage" and that "a statement on this certificate does not confer rights to the certificate holder in lieu of [ ] endorsement(s) [required by certain policies]." The court responded that, while it is true the COI contained the disclaimer, Rames' office manager testified that the COI constituted a representation to the holder that she had secured the coverage stated in the certificate.

The court next ruled that the professional services exclusion would not have barred coverage even were Malquist an additional insured on the Travelers policy. The exclusion bars coverage for property damage "arising out of the rendering of or failure to render any 'professional services,' " with the term "professional services" broadly defined to encompass C&H's geotechnical engineering investigations and recommendations made to Malquist.

To determine whether application of the exclusion would bar coverage for Malquist, the court examined the owner's complaint, which alleged that Malquist was hired to provide general contracting services, including furnishing "labor, materials, tools, and equipment." The owner sued Malquist for negligence and professional negligence. The court pointed out that, even if the exclusion applied to the professional negligence count, the duty to defend is triggered where one portion of a complaint alleges facts which, if proven, would result in coverage. "The allegations of general negligence in the Underlying Complaint did not require Malmquist to have specialized skill or training, and therefore the professional services exclusion does not apply to defeat coverage under the facts of this case," the court concluded.

Comment

The dispute in *TCF* arose from the basic fact that the terms of the policy, not the representations in the COI, determine coverage. This result is achieved with disclaimer language in the certificate, such as that it is provided "for information only," or "does not affirmatively or negatively amend, extend or alter the coverage," and like language. A certificate may falsely represent that the holder is an additional insured, but the holder would not be aware of this fact. This situation may arise for many reasons. Most commonly, the party simply was not properly listed as an additional insured. See, e.g., *Certain Underwriters at Lloyd's, London v. American Safety Ins. Servs., Inc*., 702 F. Supp. 2d 1169 (C.D. Cal. 2010) (purported additional insured not named on blanket endorsement and so was not covered despite representation in certificate) and *Tribeca Broadway Assocs. v. Mount Vernon Fire Ins. Co*., 5 A.D.3d 198, 774 N.Y.S.2d 11 (1st Dept. 2004) (owner not added as an additional insured on the contractor's policy notwithstanding representation in certificate). Negation of coverage for the named insured would also defeat coverage for the additional insured despite the certificate's representation. In *Pekin Ins. Co. v. American Country Ins. Co*., 213 Ill. App. 3d 543, 157 Ill. Dec. 648, 572 N.E.2d 1112 (1st Dist. 1991), the subcontractor's insurer properly refused additional insured coverage to the general contractor notwithstanding the certificate, where the policy excluded coverage for damage arising out of roofing work. Similarly, in *TCF*, the subcontractor's insurer sought to deny coverage to the contractor based upon the professional services exclusion in the subcontractor's policy, although this defense was unsuccessful.

The *TCF* decision is not in conflict with this jurisprudence as the contractor sued not the subcontractor's insurer but instead the subcontractor's insurance agent, Rames. In allowing recovery against the agent under a theory of negligent misrepresentation, the court pointed to testimony by the agent's own expert, Ms. Waddell, an employee of Rames who had prepared the certificate for the contractor. The court stated: "While it is true the COI contains such disclaimers, Rames's expert, Waddell, testified the COI was a certification and representation she secured the coverage stated in the COI." In a footnote to that sentence, the court added: "In light of this, we find it unnecessary to address the string of out-of-state cases cited by Rames regarding third party reliance on COI's themselves." In short, the *TCF* decision stands for the proposition that a party who was not properly added to the named insured's policy, despite the representation in the certificate of insurance, may have a remedy against the insurance agent even if not against the insurance company itself.

Adopting a distinctly minority position, the Washington Supreme Court ruled in *T-Mobile USA Inc. v. Selective Ins. Co. of Am*., 194 Wash. 2d 413, 450 P.3d 150 (2019), 40 CLR 511 (2019) that an insurance company's agent's repeated representations in consecutive annual certificates of insurance, that plaintiff was an additional insured, was made with apparent authority and so binding on the insurer, notwithstanding plaintiff's lack of coverage under the policy language.

For further discussion of certificates of insurance and additional insureds, see Philip L. Bruner & Patrick J. O'Connor, Jr., 4 *Bruner & O'Connor on Construction*

Law §§ 11:30 -:34 (Thomson/West 1992; Westlaw 2023); Donald S. Malecki, Pete Ligeros & Jack P. Gibson, *The Additional Insured Book*, Ch. 20 (International Risk Management Institute, Inc. 6th ed. 2011); Jordan R. Plitt et al., 3 *Couch on Insurance* § 40:31 (3d ed. 2023); 1 Scott C. Turner, *Insurance Coverage of Construction Disputes* § 1:8 (Thomson Reuters 2d ed. 2019, Westlaw 2023); and Steven Plitt, *The Impact of Certificates of Insurance in Determining the Availability of Coverage for Additional Insureds*, 30 Ins. Litg. Rep. 461 (2008).

LIMITATIONS PROVISION IN CONTRACT BETWEEN INSURED AND A CONTRACTOR PRECLUDED PROPERTY INSURER'S SUBROGATION ACTION AGAINST THE CONTRACTOR

Provision Applied to Contract and Tort Claims

Markel American Ins. Co. v. Mr. Demolition, Inc., 2024 WL 630422 (E.D.N.Y. Feb. 14, 2024)

Holding

A limitations provision in a contract between an insured and a contractor barred the property insurer's subrogation action against the contractor.

Summary of Decision

On January 9, 2019, a collapse occurred during the demolition process at a commercial building under renovation. Plaintiff, the building's property insurer, paid for the damage, then brought this subrogation action on December 20, 2021 against the project's developer to recoup its payments. At a court conference, the developer argued that plaintiff should add another party (MT) as a co-defendant.

Accordingly, on September 28, 2022, plaintiff filed an amended complaint suing MT for negligence and breach of contract. Specifically, plaintiff alleged that MT was retained on the project "to provide assurance services for all phases of building construction, including but not limited to testing and inspecting asphalt, concrete, fireproofing, fire stopping, reinforcing steel, roofing, soil backfill, structural steel and sub-surface soil at the Property." Plaintiff further alleged that MT owed plaintiff's insured—the project owner—a duty of care to perform its services in a workmanlike manner, including warning the insured of shoddy work by other contractors, but failed to do so.

Nearly a year later, in August 2023, MT filed a motion to dismiss on the ground that plaintiff's claims were time-barred. MT's motion was based on a provision in its contract with plaintiff's insured which provided (omitting here the use of all capital letters): "No action or claim, whether in tort, contract, or otherwise, may be brought against [MT] arising from or related to [MT's] work more than two years after the cessation of [MT's] work hereunder, regardless of the date of discovery of such claim." MT further asserted that its services were completed on the date of the collapse, so that plaintiff was required to bring its subrogation action no later than January 9, 2021.

Plaintiff in opposition to the motion argued that (1) MT ceased its work in October 2019 and (2) the limitations period was tolled by the governor's COVID-19 executive order. MT responded that the insurer's lawsuit would still be untimely even assuming the limitations period was tolled because of the governor's order.

The federal district court, applying New York law, ruled that the two-year contractual limitations was enforceable against plaintiff, so the insurer's complaint was untimely. The court noted that the limitations for a tort action is three years from the date of the injury (N.Y. CPLR § 214) and six years from the date of the breach (N.Y. CPLR § 213(2)); however, the contractual limitations expressly applies to all claims against MT "whether in tort, contract, or otherwise." Nonetheless, the court authorized limited discovery with respect to plaintiff's claim of equitable tolling.

Comment

The *Markel* court, applying New York law, held that, if a named insured could not sue a defendant, the insured's insurer could not bring a subrogation action against that same defendant. A recent Louisiana court decision is in accord.

In *Conti Enterprises, Inc. v. Providence/GSE Assocs., LLC*, 377 So. 3d 715 (La. App. 1st Cir. 2023), *writ denied*, No. 2023-C-01704, 2024 WL 805821 (La. Feb. 27, 2024), 45 CLR 42 (2024), the court ruled that a state agency's third-party action against an engineering firm was time-barred. In a companion decision issued the same day, *Conti Enterprises, Inc. v. Providence/GSE Assocs., LLC*, 377 So. 3d 737 (La. App. 1st Cir. 2023), *writ denied*, No. 2023-C-01703, 2024 WL 805587 (La. Feb. 27, 2024), the court affirmed a summary judgment dismissing an ac-

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tion by a local government entity (TPCG) against an insurer (XLSIC) that issued a professional liability policy for an engineering firm. The court ruled: "Because XLSIC's insureds can have no liability to TPCG as a matter of law, XLSIC cannot be held liable to TPCG as the professional liability insurer of [the engineering firm]. Therefore, the trial court correctly entered summary judgment dismissing all claims asserted by TPCG against XLSIC in this litigation."

UNDER "COMPLETED OPERATIONS" ENDORSEMENT, GENERAL CONTRACTOR CEASED BEING AN ADDITIONAL INSURED ON SUBCONTRACTOR'S LIABILITY POLICY ONCE SUBCONTRACTOR COMPLETED ITS WORK

De Novo Review

Zurich American Ins. Co. v. Old Republic General Ins. Corp., No. A166715, 2024 WL 827710 (Cal. App. 1st Dist. Feb. 28, 2024) (unpublished)

Holding

Under a "completed operations" endorsement, a general contractor ceased being an additional insured on a subcontractor's liability policy once the subcontractor completed its work; thus, the subcontractor's insurer had no duty to defend the contractor where the owner brought suit many years after the project's completion.

Summary of Decision

In 2006, a general contractor (McNerney) subcontracted the plumbing work on a condominium retrofit project to Broadway. The subcontract imposed upon Broadway both indemnification and insurance-procurement obligations. The indemnity provision required Broadway to indemnify and hold harmless the contractor from claims arising from performance of the subcontract work, then added: "The indemnity obligations herein shall survive the termination of the Contract for any reason and shall survive the completion of the work on the project."

With regard to the subcontract's insurance-procurement obligations, Broadway maintained liability insurance from two, consecutive insurers: Zurich (from 2003 - 2008) and Old Republic (from 2011 - 2016). The Zurich policy was in effect during the subcontractor's work on the project, which was completed in 2007. The Zurich policy's additional insured endorsement was a "completed operations" and "blanket" endorsement. The completed operations endorsement provided coverage to the additional insured for damages caused by Broadway's work performed for the additional insured and included in the "products-completed operations hazard." The "products-completed operations hazard" provided coverage for liability arising out of Broadway's work, with the exception of work that has not been completed.

The blanket endorsement did not name the additional insured but instead extended coverage to persons or entities "where required by written contract, but only when coverage for completed operations is specifically required by contract." The endorsement further provided: "[I]f coverage provided to the additional insured *is required by a contract or agreement*, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide for such additional insured." (Emphasis added.)

In 2016, the homeowners' association sued the general contractor for construction defects, including plumbing defects, and the contractor cross-complained against Broadway. Both Zurich and Old Republic defended Broadway and split the defense expenses. In addition, Zurich alone defended the McNerney as an additional insured. The litigation settled and both insurers equally funded the settlement on behalf of Broadway.

Zurich brought this equitable indemnity action, seeking reimbursement from Old Republic for an equitable share of McNerney's defense fees and costs. After a bench trial, the court entered judgment in favor of Old Republic, and Zurich appealed.

Applying de novo review, the California Court of Appeal affirmed, ruling that McNerney was not an additional insured under the Old Republic policies. It was undisputed that Broadway completed its work on the project long before inception of the Old Republic policies. As noted, the blanket endorsement defines an additional insured as a person or business that Broadway "required by a contract or agreement" to name as an additional insured, "but only when coverage for completed operations is specifically required by that contract." The court noted:

> By using the present-tense phrase "is required," the completed operations endorsement requires an existing

> contractual obligation. Thus, for an organization to qualify as an additional insured, Broadway must have had an existing contractual obligation to name it as an additional insured while the Old Republic policies were in effect.

The court next examined whether Broadway had a contractual obligation to name McNerney as an additional insured while the Old Republic policies were in effect. The subcontract imposed upon Broadway an obligation to procure insurance and name McNerney as an additional insured "until the work under this Agreement is fully completed." As Broadway's work on the project was completed in 2007, and Old Republic did not begin providing the subcontractor with insurance until 2011, the court readily concluded that McNerney was no longer an additional insured on Zurich's policy when the underlying lawsuit was filed in 2016.

Zurich argued that this interpretation rendered the additional insured coverage illusory because it is in the nature of construction defect lawsuits for them to arise after the completion of a subcontractor's (here, Broadway's) work. Zurich asserted that a more reasonable way to interpret the phrase "until the work under this Agreement is fully completed" would be to require the maintenance of coverage until the expiration of the statute of limitations governing construction defect actions. The court was unswayed, stating that it is not the goal of contract interpretation to "make different or better deals for the parties than they negotiated for themselves."

The court bolstered its conclusion—that additional insured coverage in favor of McNerney ended when Broadway's work was completed—by contrasting the additional insured endorsement's language with that of the indemnity provision. The court reasoned that the indemnity's provision's specification that the duty to indemnify "shall survive the termination of the Contract for any reason and shall survive the completion of the work on the project" established that the parties knew how to extend a subcontractor obligation after termination of the subcontract work.

Last, the court rejected Zurich's invocation of *Pardee Construction Co. v. Insurance Co. of the West*, 77 Cal. App. 4th 1340, 92 Cal. Rptr. 2d 443 (4th Dist. 2000), *rev. denied* (Cal. Apr. 26, 2000), 21 CLR 101 (2000), for the proposition that Old Republic's interpretation ignored the practical reality of complex construction defect cases, in which damage from a subcontractor's work often does not materialize until years after work has been completed. The court stated that "[w]e have no quarrel with this characterization of construction defect cases." Nonetheless, it found *Pardee* distinguishable. Although in that case, as in this one, the challenged insurance policies incepted after the construction project was completed, in *Pardee* it was undisputed that the general contractor was an additional insured.

Comment

Often, indemnity and insurance-procurement obligations in a subcontract are intended to provide coextensive coverage, so that the indemnity obligation is backed up by insurance. However, in this case the indemnity obligation expressly extended past completion of the subcontractor's work, while the subcontractor's insurer's additional insured coverage terminated upon completion of the subcontractor's work. While Zurich argued that this de-coupling of coverage meant the additional insured endorsement's coverage was illusory, the court reached the opposite conclusion, viewing the difference in language between the insurance-procurement and indemnity provisions as bolstering Old Republic's argument that it was not subject to equitable contribution for the cost of McNerney's defense by Zurich.

The *Zurich* court provided a very cryptic refutation of the relevance of *Pardee*. In that case, the additional insured endorsement named the developer "but only with respect to liability arising out of your [the subcontractor's] work for that insured by or for you." The court found that the endorsement, with its broad "arising out of" nexus, did not impose a time limitations on the coverage extended to the additional insured. For further analysis of the *Pardee* decision, see Timothy S. Menter & Gene M. Witkin, *If You Don't Mean It, Don't Say It: California's Fourth District Court of Appeal Rejects Insurers' Attempt to Limit Coverage Available to Additional Insureds*, 21 CLR 163 (2000). Additional insured coverage under California law is further discussed in James Acret & Annette Davis Perrochet, *California Construction Law Manual §* 5:211 (Thomson Reuters 2023-2024).

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LABOR & EMPLOYMENT

FEDERAL DISTRICT COURT INVALIDATES NLRB'S 2023 RULE DEFINING JOINT EMPLOYER STATUS UNDER THE NLRA AND REINSTATES 2020 RULE

2023 Rule Exceeded Common-Law Requirements

Chamber of Commerce of U.S. v. NLRB, 2024 WL 1203056 (E.D. Tex. Mar. 18, 2024)

Holding

In a declaratory judgment action, a district court invalidated the NLRB's 2023 Rule defining joint employer status under the NLRA and reinstated the 2020 Rule.

Summary of Decision

Legal Framework

The National Labor Relations Act of 1935 (NLRA), 29 U.S.C.A. § 151 et seq., mediates the relationship between "employees" and "employers." The Act originally extended the employer's responsibilities to cover persons "acting in the interest of the employer." In *NLRB v. Hearst Publications, Inc*., 322 U.S. 111, 64 S. Ct. 851, 88 L. Ed. 1170 (1944), the Supreme Court extended the definition of an "employee" beyond the common law agency test and adopted a broader, economic-realities test. However, in 1947, Congress passed the Taft-Hartley Act and overruled *Hearst*. It changed the above definition of an "employee" to apply to those "acting as an agent of an employer," 29 U.S.C.A. § 152(2), to the exclusion of independent contractors. *Id*. § 152(3).

The Act does not address whether an employee can have more than one employer. The Supreme Court addressed the question of joint-employer status only once, and then briefly. In *Boire v. Greyhound Corp*., 376 U.S. 473, 84 S. Ct. 894, 11 L. Ed. 2d 849 (1964), the question was whether a bus terminal (Greyhound) and its cleaning contractor (Floors) were co-employers of the cleaners. The Supreme Court stated:

> Whether Greyhound, as the Board held, possessed sufficient control over the work of the employees to qualify as a joint employer with Floors is a question which is unaffected by any possible determination as to Floors' status as an independent contractor, since Greyhound has never suggested that the employees themselves occupy an independent contractor status. And whether Greyhound possessed sufficient *indicia of control* to be an 'employer' is essentially a factual issue . . .

376 U.S. at 482 (emphasis added).

While it was clear from the *Boire* decision that the Court was applying the common law definition of employment, its otherwise paltry guidance meant the courts and the NLRB did not coalesce around an agreed test to determine joint employer status. In *NLRB v. Browning-Ferris Industries of Penn., Inc.*, 691 F.2d 1117 (3d Cir. 1982) (*BFI I*), the issue was whether a waste-management company (BFI) was, along with trucking brokers used by BFI, a joint employer of the truck drivers. The Third Circuit ruled that separate business entities are joint employers if they each "exert significant control over the same employees" in that they "share or co-determine those matters governing essential terms and conditions of employment." *Id*. at 1124.

The present court noted that, over time, two limiting principles to the *BFI I* "significant control" test arose: (a) the potential-control limit and (b) the indirect-control limit. Under the potential-control limit, only the exercise of actual control, not potential control, is required for employer status, including joint-employer status. E.g., *TLI, Inc*., 271 NLRB 798 (1984), *aff'd mem*., 772 F.2d 894 (3d Cir. 1985). Under the indirect-control limit, exercise of "direct and immediate" control is required for joint-employer status. *In re Airborne Freight Co*., 338 NLRB 597, 597 n.1 (2002). Citing *TLI*, 271 NLRB at 799, the court added that "[t]he indirect-control limit also means that a customer cannot be deemed a joint employer based only on "limited and routine" supervision of the employees of an independent company serving the customer." [Editor: Note that the court cited *TLI* when referring to both the potential-control and indirect-control limits, which brings into question whether there were in fact two limits or a limit in which different courts emphasized different variables or factors in their analysis.]

The court stated that, against this legal landscape, the NLRB appeared to revive *Hearst*'s economic-realities test by stating that the existing joint-employer test was "increasingly out of step with changing economic circumstances." *Browning-Ferris Industries of Calif., Inc*., 362 NLRB 1599, 1599 (2015), 36 CLR 479 (2015) (*BFI II*). BFI owned and operated a recycling facility. The workers involved in operation of the recycling process were of two categories: those who worked inside the facility and those who worked outside. Those work-

ing *outside* the facility (who gathered and transported the materials to the facility) were unionized. Those who worked *inside* the facility (who sorted the materials) were provided to BFI pursuant to a labor services agreement with Leadpoint, a labor supplier. The BFI-Leadpoint agreement provided that Leadpoint was the sole employer of the personnel it supplied, and that nothing in the agreement shall be construed as creating an employment relationship between BFI and the personnel that Leadpoint supplied. A union sought to organize the recycling sorters, but also asserted that BFI was a joint employer with Leadpoint of those workers.

A divided NLRB held that BFI and Leadpoint were joint employers of the workers in the petitioned-for bargaining unit. The Board overruled *TLI*, stating that it "will no longer require that a joint employer not only possess the authority to control employees' terms and conditions of employment, but must also exercise that authority, and do so directly, immediately, and not in a 'limited and routine' manner." *Id*. at 1613-14. Importantly, the present court found that the Board added a second step, as follows: "even after an alleged joint employer of another company's employees qualifies as their common-law employer, the alleged joint employer must also 'share or codetermine those matters governing the essential terms and conditions of employment.' *Id*. at 1613."

The D.C. Circuit reviewed the Board's order. *Browning-Ferris Industries of Calif., Inc. v. NLRB*, 911 F.3d 1195 (D.C. Cir. 2018), 40 CLR 123 (2019) (*BFI III*). While that review was pending, the Board announced that it planned to undertake rulemaking on the joint-employer standard. Because any new rule would be prospective only, the D.C. Circuit proceeded to review the Board's order that BFI engaged in an unfair labor practice.

The district court provided an exceedingly cryptic summary of the circuit court's decision. According to the district court, the circuit court identified two types of evidence as "relevant" to joint-employment status: (1) unexercised, retained control over workers and (2) indirect control over workers, at least insofar as that means control exercised through an intermediary. However, the district court emphasized, the circuit court "did not decide whether either is *sufficient* to show joint-employer status. And the [circuit] court acknowledged that 'whether indirect control can be dispositive is not at issue.' " The circuit court reversed and remanded for the Board to articulate any "blueprint for what counts as 'indirect' control."

According to the district court, the circuit court's joint-employer test differed from that of the Board:

> As a parting note, the D.C. Circuit criticized the Board's two-step framing of the joint-employer test. In fact, the court held that the action of "sharing or codetermining" essential terms and conditions of employment is what *makes* two companies each an employer of the same workers in the first place. *BFI III*, 911 F.3d at 1201 (stating that "separate business entities" are joint employers if they each exert significant control over the same employees "in that" they share or codetermine essential employment conditions). In contrast, the Board's order on review framed the act of sharing or codetermining essential terms as an *additional* joint-employer requirement, for companies that already qualify as employers of the same workers under the common law.

In February 2020, before addressing the remand order, the Board issued a 2020 Final Rule. *Joint Employer Status Under the National Labor Relations Act*, 85 FR 11184-01, 2020 WL 903314 (Feb. 26, 2020), 41 CLR 148 (2020), codified at 29 C.F.R. § 103.40 (2020). That rule provides that an entity is "a joint employer of a separate employer's employees only if the two employers share or codetermine the employees' essential terms and conditions of employment." 29 C.F.R. § 103.40(a). The district court stated that "the 2020 rule provides that indirect control and purely reserved control can be considered but are not, themselves, sufficient to show joint-employer status."

Court Decision

Finally, the court came to the issue before it: the validity of a 2023 Rule which "a newly constituted Board" issued to rescind and replace the 2020 Rule with a new standard for joint-employer status, codified at a new 29 C.F.R. § 103.40. After twice postponing the 2023 Rule's effective date, the court invalidated that Rule, so that "the 2020 Rule remains the operative joint-employer regulation, despite any changes already made in the Code of Federal Regulations."

The court reviewed the 2023 Rule. Section 103.40(a) provides that an employer is an employer for purposes of the NLRA "if the employer has an employment relationship with those employees under common-law agency principles." Section 103.40(b) defines a joint employer:

> (b) For all purposes under the Act, [1] two or more employers of the same particular employees are joint employers of those employees if [2] the employers share or codetermine those matters governing employees' essential terms and conditions of employment. (Court's added numbering.)

Section (c) then provides: "To 'share or codetermine

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those matters governing employees' essential terms and conditions of employment' means for an employer to possess the authority to control (whether directly, indirectly, or both), or to exercise the power to control (whether directly, indirectly, or both), one or more of the employees' essential terms and conditions of employment."

Granting summary judgment for the plaintiffs Chambers of Commerce, the district court ruled that subsection (b)'s two-part test simply makes no sense, as satisfaction of subsection (a) *alone*—applying the common-law agency test to define an "employer" for purposes of the NLRA—was sufficient to satisfy subsection (b)'s two-part test. The court explained:

> [P]aintiffs [argue] that the second test is always met if the first test is met, so the Rule's joint-employer inquiry has just one step for all practical purposes. That logical relation appears right. An employer of a worker under the common law of agency must have the power to control "the material details of how the work is to be performed." [Citation omitted.] . . . So it seems that an entity satisfying step one, along with some other entity doing so, will always satisfy step two.

The court noted that at oral argument it asked the Board for an example in which subsection (a) was met but subsection (b) was not, and the Board was unable to come up even with a hypothetical example. Accordingly, the court held that it "accepts plaintiffs' position that step two is met whenever step one is met."

The court agreed with Board Member Kaplan, who dissented from adoption of the 2023 Rule, that the 2023 Rule would create havoc in the construction industry. Member Kaplan pointed to standard contract language within the industry as to a general contractor's responsibility over safety precautions and programs at a worksite. This standard clause would arguably establish the general contractor's indirect control (at least) over working conditions relating to subcontractors' employees' safety and health. The district court pointed out that treating a general contractor as an employer of a subcontractor's employees conflicted with *NLRB v. Denver Bldg. & Construction Trades Council*, 341 U.S. 675, 71 S. Ct. 943, 95 L. Ed. 1284 (1951), in which the Court held that "the fact that the [general] contractor and subcontractor were engaged on the same construction project, and that the contractor had some supervision over the subcontractor's work, did not eliminate the status of each as an independent contractor or make the employees of one the employees of the other." *Id*. at 689-90.

In short, the district court ruled that the 2023 Rule was invalid because it sought to increase the law's sweep beyond common-law limits. This ruling immediately triggered the question of remedy, specifically: whether rescinding the 2023 Rule reactivated the 2020 Rule or whether both Rules were invalid, so that application of the joint-employer doctrine was governed by judicial cases. Exercising its discretion under the Declaratory Judgment Act, the court "issue[d] a final judgment declaring that enforcement of the 2023 Rule against plaintiffs or their members would be contrary to law as to the Rule's addition of a new 29 C.F.R. § 103.40 and arbitrary and capricious as to the Rule's removal of the existing 29 C.F.R. § 103.40 (2020)."

Comment

As evidenced by the above case summary, the disagreement as to the test for joint employment status under the NLRA has a long history. The Editor will continue to monitor this case to see if an appeal is filed.

EMPLOYER'S VIOLATION OF STATUTE MANDATING WEEKLY PAYMENT OF MANUAL LABORERS DOES NOT ENTITLE WORKERS PAID BIWEEKLY TO A PRIVATE RIGHT OF ACTION

Split with First Department

Grant v. Global Aircraft Dispatch, Inc., 223 A.D.3d 712, 204 N.Y.S.3d 117 (2d Dept. 2024)

Holding

An employer's violation of a Labor Law statute mandating weekly payment of manual laborers does not entitle workers paid biweekly to a private right of action.

Summary of Decision

Plaintiff alleged he was employed by the defendant as a manual laborer. He brought a putative class action on behalf of himself and a proposed class of manual laborers employed by the defendant. He alleged that defendant paid him and the class members on a biweekly, rather than weekly, basis, in violation of N.Y. Labor Law § 191(1)(a). Plaintiff sought an award of liquidated damages, prejudgment interest, and attorney's fees. The trial court dismissed the action, and plaintiff appealed.

Appellate Division Decision

A divided N.Y. Appellate Division, Second Department, affirmed, ruling that no private right of action exists for violation of § 191(1)(a). Labor Law § 191, titled "Frequency of payments," provides in part: "A manual worker shall be paid weekly and not later than seven calendar days after the end of the week in which the wages are earned." § 191(1)(a)(i). Section 191 is part of Article 6, titled "Payment of Wages."

The court noted that this language of § 191 traced back to adoption of the statute in 1890. The Labor Law provides for civil and criminal penalties of Article 6, enforced by the Labor Commissioner; see §§ 197 ($500 per violation); 198 (costs recoverable by the Commissioner); and 218 (civil penalties). Section 191(a) does not expressly grant workers a private right of action.

Instead, plaintiff argued that such a right was found in § 198(1-a), which allows an employee or the Commissioner to obtain reasonable attorney's fees in wage collection actions, as well as liquidated damages if the failure to pay was willful. The section addresses "any employee paid less than the wage to which he or she is entitled under the provisions of this article[.]" The court interpreted this language to apply to "an employee has received a lesser amount of earnings than agreed upon, not that the employee received the agreed-upon amount one week later, on the regular payday."

The court rejected plaintiff's contention that a private right of action should be implied. The court explained that "[a] private right of action cannot be implied from the statutory provisions and their legislative history unless, among other factors, 'creation of such a right would be consistent with the legislative scheme,' " citing *Konkur v. Utica Academy of Science Charter Sch.*, 38 N.Y.3d 38, 41, 165 N.Y.S.3d 1, 185 N.E.3d 483, 485 (2022) (internal quotation marks omitted). The *Konkur* court held that a private right of action to recover damages for a violation of § 198-b, prohibiting kickbacks, could not be implied because the statutory scheme expressly provided "two robust enforcement mechanisms," thereby indicating a legislative decision as to how the statutory prohibition should be enforced. The *Grant* court concluded that, "[s]ince multiple official enforcement mechanisms for violations of Labor Law § 191 are similarly provided," no private right of action should be implied.

The court disagreed with the First Department, which held in *Vega v. CM & Assocs. Construction Management, LLC*, 175 A.D.3d 1144, 107 N.Y.S.3d 286 (1st Dept. 2019), that a private right of action existed for the late payment of wages under § 198(1-a) for a violation of § 191(1)(a), allowing for the recovery of liquidated damages, interest, and attorney's fees. The *Vega* court reasoned that "the term underpayment [in § 198(1-a)] encompasses the instances where an employer violates the frequency requirements of section 191(1)(a) but pays all wages due before the commencement of an action." The *Grant* court countered that a statute addressing the nonpayment or underpayment of wages is distinct from the issue of the frequency of payment. Accordingly, "we do not agree that payment of full wages on the regular biweekly payday constitutes nonpayment or underpayment."

Dissent

A dissent was of the opinion that § 198(1-a) expressly provides a private right of action for violation of § 191, and that such a right was also implied. Section 191 requires a manual laborer to be paid weekly, and § 198(1-a) authorizes such a worker "to recover the full amount of any under payment," as well as reasonable attorney's fees and prejudgment interest. Citing a federal court decision for the proposition that "[m]oney later is not the same as money now," as well as the *Vega* decision, the dissent stated that, "[i]n my view, the late payment of wages is tantamount to a nonpayment or underpayment of wages which permits recovery under Labor Law § 198(1-a)."

The dissent also disagreed with the majority's conclusion that *Konkur* precludes a finding of an implied private right of action. The dissent pointed out that *Konkur* involved a different and unrelated statute.

Comment

The appellate division has issued opposite conclusions on the question of whether § 191(1)(a), alone or in conjunction with § 198(1-a), provides workers a right of action for the employer's failure to pay them weekly where the workers were paid in full otherwise. Absent a Court of Appeals resolution, what is a federal court to do? They too are split. In *Galantee v. Watermark Services IV, LLC*, 2024 WL 989704 (W.D.N.Y. Mar. 7, 2024), the court independently evaluated New York law and concluded that the Second Department's *Grant* decision was the better reasoned of the two cases. However, in *Bazinett v. Pregis LLC*, 2024 WL 1116287 (N.D.N.Y. Mar. 14, 2024), the court noted that a majority of federal courts have followed *Vega*, and it agreed with that majority position and predicted that the N.Y. Court of Appeals would as well.

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LICENSING

NYC'S HOME IMPROVEMENT CONTRACTOR LICENSE REQUIREMENT APPLIED TO TOWNHOME RENOVATION OWNED BY BUSINESS ENTITY, BUT WHOSE MANAGER TESTIFIED HE WOULD LIVE IN THE RESIDENCE ONCE WORK WAS COMPLETED

Summary Judgment for Owners

KSP Construction, LLC v. LV Property Two, LLC, 224 A.D.3d 58, 204 N.Y.S.3d 54 (1st Dept. 2024)

Holding

New York City's home improvement contractor license requirement applied to a townhome renovation owned by a business entity, where the entity's manager testified he would reside in the townhome once the work was completed.

Summary of Decision

A contractor sued to recover damages for renovation work at a Manhattan townhouse. Suit was brought against two title owners, both limited liability companies (LLCs). Plaintiff alleged that it was orally hired by the defendants to perform the work. Defendants terminated the contract, and plaintiff sought the balance of the invoices due under causes of action for breach of contract and related claims, and to foreclose its mechanic's lien.

Although plaintiff had obtained a home improvement contractor's license from the New York City Department of Consumer Affairs, that license expired before the plaintiff was hired and while the renovation work took place. In an amended complaint, plaintiff alleged it was not required to possess a home improvement contractor's license. Plaintiff asserted that the project was commercial in nature because the co-owners were business entities that could not reside in the townhouse.

The defendants owners moved for summary judgment. The owners' manager, Richard Kellam, submitted an affidavit in which he averred that the premises were purchased for use as his personal residence and that, upon completion of the gut renovation, the townhouse would be used solely as his personal residence. The certificate of occupancy identified the townhouse as residential property. The deed reflected that the premises were transferred from a nonparty grantor to the defendants LLCs. The trial court granted the defendants' motion.

The N.Y. Appellate Division affirmed. It noted that "strict compliance with the licensing statute [Editor: actually, N.Y.C. Admin. Code § 20-387] is required, with the failure to comply barring recovery regardless of whether the work performed was satisfactory, whether the failure to obtain the license was willful or, even, whether the homeowner knew of the lack of a license and planned to take advantage of its absence." *Chosen Construction Corp. v. Syz*, 138 A.D.2d 284, 286, 525 N.Y.S.2d 848, 850 (1st Dist. 1988), 9 CLR 170 (1988). As there was no dispute that plaintiff was a "contractor" for licensing purposes and did not have a valid license, the only issue was whether the defendants were "owners" within the meaning of § 20-387(a). Section 20-386(4) broadly defines "owner" as "any homeowner, cooperative shareholder, condominium unit owner, tenant, or any other person who orders, contracts for or purchases the home improvement services of a contractor or the person entitled to the performance of the work of a contractor pursuant to a home improvement contract." The appellate division observed that, "[a]lthough it is tempting to assume that an 'owner' must be an individual," the above definition of owner makes no distinction between an individual owner and an entity owner. Had the City Council sought to limit the title owner to individuals to the exclusion of business entities, it could have done so.

Next, the court turned to the requirement that the parties have entered into a "home improvement contract," which is defined as "an agreement, whether oral or written, . . . between a contractor and an owner, or contractor and a tenant, . . . provided said work is to be performed in, to or upon the residence or dwelling unit of such tenant, for the performance of a home improvement . . ." N.Y.C. Admin. Code § 20-386(6). Plaintiff argued that a home improvement contract within the meaning of § 20-386(6) can only exist if the owner resides in the property at which the work was performed. The court was not convinced:

> But no provision of the licensing law specifically imposes a requirement that the title owner of a residential structure who enters into a home improvement contract with a contractor for the performance of home improvement reside at the property. Rather, the residency requirement

> pertains to "tenants" of the property: a tenant who enters into an agreement with a contractor for the performance of a home improvement is entitled to the protections of the home improvement contractor's licensing requirement if the "work is to be performed in, to or upon the residence or dwelling unit of such tenant" (Administrative Code § 20-386[6][.])

Moreover, the court continued, even assuming a residency requirement applied to the title owner of the property, Kellam's affidavit, the certificate of occupancy, and the deed all establish, prima facie, that Kellam, the LLCs' manager, intended to reside in the townhome after the renovation was complete. In opposition to defendants' motion, plaintiff offered no evidence regarding Kellam's intention to reside in the townhome.

Comment

In a footnote the court observed that its disposition rested upon its interpretation of the N.Y.C. home improvement contractor's license requirement. It noted that defendants did not move for summary judgment based on N.Y. CPLR § 3015(e), and so the court did not consider that statute. Section 3015(e) provides that, "[w]here the plaintiff's cause of action against a consumer arises from the plaintiff's conduct of a business which is required by state or local law to be licensed . . . the complaint shall allege, as part of the cause of action, that plaintiff was duly licensed at the time of services rendered and shall contain the name and number, if any, of such license and the governmental agency which issued such license."

For further discussion, see Frances M. Dougherty, Annotation, *Failure of Building and Construction Artisan or Contractor to Procure Business or Occupational License as Affecting Enforceability of Contract or Right of Recovery for Work Done—Modern Cases*, 44 A.L.R.4th 271 (1986).

MANUFACTURERS

ELEVENTH CIRCUIT CERTIFIES TO FLORIDA SUPREME COURT WHETHER THE ECONOMIC LOSS RULE APPLIES TO A FAILURE-TO-TRAIN OR FAILURE-TO-WARN CLAIM INVOLVING A NONDEFECTIVE CRANE

Safety Bulletin Arrived Late

NBIS Construction & Transp. Ins. Services, Inc. v. Liebherr-America, Inc., 93 F.4th 1304 (11th Cir. 2024)

Holding

The Eleventh Circuit certified to Florida Supreme Court whether the economic loss rule applies to negligence claims against the manufacturer of a nondefective product, based on the failure to alert the product owner of a known danger, when the only damages claimed were to the product itself.

Summary of Decision

A construction equipment company (Sims) purchased a crane manufactured by Liebherr, a German company. The crane came with two booms, one 50 meters and the other 84 meters. The manufacturer provided training to two Sims crane operators, including instructions on the installation of pins for use of the longer boom. Even though Liebherr normally provides eight hours of training, it provided only four hours. The operators testified that the training was minimal as to how to manipulate the pins on the 80-foot boom. A few days later, in February 2018, when the operator tried to extend the longer boom, the boom collapsed on itself, killing one person and damaging the crane.

The boom's collapse was traced to improper insertion of one of the pins. It turned out that in May 2017, another collapse due to the improper manipulation of the same pin had occurred in Japan. This led Liebherr to publish, three months before the accident in this case, updated product safety information concerning proper usage of the pin. Nonetheless, the manufacturer's American subsidiary failed to get the updated safety bulletin to Sims until a week after the accident.

NBIS—described as "the third-party administrator

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and managing general agent of the insurer of the crane's owner"—sued Liebherr in Florida federal district court for negligence and negligent training, including failure to send the product safety bulletin in a timely manner. NBIS sought to recover only for the damage to the crane itself. Importantly, the parties stipulated that the crane was not defective. The manufacturer argued that it was not liable under Florida's economic loss rule.

After a five-day trial, the magistrate judge entered judgment in favor of NBIS. The magistrate reasoned that the economic loss rule did not apply because that doctrine applies when the economic losses are caused by a defective product, and here the parties stipulated that the product was not defective. The magistrate also found that Liebherr had a duty to provide training that included information about proper use of the pins.

Court of Appeals Decision

The U.S. Court of Appeals for the Eleventh Circuit reviewed the intersection between Florida's products liability law and economic loss doctrine. In the seminal case of *Florida Power & Light Co. v. Westinghouse Elec. Corp*., 510 So. 2d 899 (Fla. 1987), a utility (FPL) contracted with Westinghouse to design, manufacture and supply steam generators. Claiming the generators leaked, FPL sued Westinghouse in federal court. The Eleventh Circuit asked the Florida Supreme Court "[w]hether Florida law permits a buyer under a contract for goods to recover economic losses in tort without a claim for personal injury or property damage to property other than the allegedly defective goods." The court answered no, holding that "contract principles [are] more appropriate than tort principles for resolving economic loss without an accompanying physical injury or property damage." *Id*. at 902. The circuit court noted that while Florida at one point extended the economic loss rule to non-product defect claims, the high court later reexamined its jurisprudence and expressly returned "the economic loss rule to its origin in products liability." *Tiara Condominium Ass'n, Inc. v. Marsh & McLennan Cos., Inc*., 110 So. 3d 399, 407 (Fla. 2013), 34 CLR 313 (2013).

The federal court next pointed out that Florida law imposes upon manufacturers a duty to warn of the potential dangers of "inherently dangerous" products. In *Geffrey v. Langston Construction Co.*, 58 So. 2d 698, 699 (Fla. 1952), it stated that "a crane in operation is inherently dangerous." Moreover, a duty to warn exists even if the product was non-defective. In addition, state courts have described the manufacturer's duty to warn as "products liability action[s] . . . based on negligence." *West v. Caterpillar Tractor Co*., 336 So. 2d 80, 90 (Fla. 1976). In sum, failure to provide an adequate warning is one form of strict products liability law.

Here, Liebherr argued that both theories of negligence—the failure to adequately train and the failure to promptly send the product safety bulletin—were in essence failure to warn claims. In *Airport Rent-a-Car, Inc. v. Prevost Car, Inc*., 660 So.2d 628 (Fla. 1995), the question was whether a cause of action existed outside the bar of the economic loss rule where the manufacturer's duty to warn arose from facts which came to the company's knowledge after the manufacturing process and after the contract. The court ruled that the "failure to warn, without the requisite harm [to person or other property], will not circumvent the economic loss rule." *Id*. at 632.

After this review of state law, the circuit court turned to an examination of the parties' arguments. Liebherr asserted that the economic loss rule applied because this was a products liability case, notwithstanding the stipulation that the crane was not defective. NBIS countered that, because the crane was not defective, it was not suing under a theory of products liability (to which the economic loss rule would apply) but was suing the manufacturer for "negligent services," to which the rule is inapplicable. NBIS distinguished *Airport Rent-A-Car* and *Florida Power & Light* on the ground that those cases involved products that were allegedly defective.

The circuit court found Florida law unclear as to the economic loss rule's applicability in this case. On one hand, the court saw "merit" to Liebherr's argument that NBIS' failure to warn claim was a specie of products liability law and that if the economic loss rule applies to products liability actions, it should apply as well to failure to warn and failure to train claims. On the other hand, NBIS was correct that product defect lies at the heart of Florida's products liability jurisprudence. Unable to resolve the matter, the court certified to the Florida Supreme Court the following question:

> Whether, under Florida law, the economic loss rule applies to negligence claims against a distributor of a product, stipulated to be non-defective, for the failure to alert a product owner of a known danger, when the only damages claimed are to the product itself?

U.S. GOVERNMENT CONTRACTS

AFFIRMATIVE ACTION

FEDERAL PROGRAM, WHICH PROVIDES ASSISTANCE TO SOCIALLY OR ECONOMICALLY DISADVANTAGED INDIVIDUALS PRESUMPTIVELY DEFINED AS SPECIFIC RACIAL OR ETHNIC GROUPS, BUT NOT INCLUDING WHITE-OWNED BUSINESSES, VIOLATES THE FIFTH AMENDMENT'S EQUAL PROTECTION CLAUSE

Permanent Injunction Granted

Nuziard v. Minority Business Development Agency, 676 F. Supp. 3d 473 (N.D. Tex. 2023)

Nuziard v. Minority Business Development Agency, 2024 WL 965299 (N.D. Tex. Mar. 5, 2024)

Holdings

● White business owners have standing to challenge a race- and ethnically-based classification system by a federal program created to provide assistance to businesses owned by socially or economically disadvantaged individuals.

● A federal program created under the Infrastructure Act of 2021, to provide assistance to socially or economically disadvantaged individuals presumptively defined as specific racial or ethnic groups, but not including white-owned businesses, violates the Fifth Amendment's Equal Protection Clause and is permanently enjoined.

Summary of Decision

President Biden's Infrastructure Act, signed into law in November 2021, created a Minority Business Development Agency (MBDA), 15 U.S.C.A. § 9502(a). It is the latest permutation of a federal affirmative action program for minority-owned businesses, begun by President Nixon as the Office of Minority Business Enterprise.

The MBDA established a Business Center Program (the Program) in which centers offer technical assistance, business development services, and specialty services. § 9523. However, those services are offered only to "minority business enterprises," meaning the business must be owned at least 51% by "socially or economically disadvantaged individuals," defined presumptively as Black, African American, Hispanic, Latino, American Indian, Alaska Native, Asian, Native Hawaiian, Pacific Islander, Puerto-Rican, Eskimo, Hasidic Jew, Asian Indian, or Spanish-speaking Americans. § 9501(15); 15 C.F.R. § 1400.1.

Nuziard I

This lawsuit was brought by three plaintiffs who sought but were denied the Program's services because they were white. For example, Matthew Piper owns Piper Architects in Wisconsin. Although having grown up in extreme financial poverty, the Center did not consider him socially or economically disadvantaged because he was white. Plaintiffs sought to enjoin the Program's race and ethnicity requirement as violative of the Fifth Amendment's Equal Protection Clause. The government countered that plaintiffs (1) lacked standing and (2) failed to show a substantial likelihood of success on their claim.

Rejecting these defenses, the U.S. District Court for the Northern District of Texas *preliminarily* enjoined the Program because it relied upon a racial classification but was not narrowly tailored to promote a compelling government interest. With regard to standing, plaintiffs established that they suffered injury-in-fact. Even if one of the plaintiffs did not apply for the services because he was informed he did not qualify, this plaintiff met the injury-in-fact requirement as application for the program would have been a futile act. In addition, plaintiffs established that they met the qualifications for the Program except for their race. Plaintiffs also established that their injury—denial of equal treatment—was traceable to the Program's race- and ethnicity-based requirements and that injunction of those requirements would redress their injuries.

Turning to the merits, the court explained that the Fifth Amendment's Equal Protection Clause is analyzed under the same standards as the Fourteenth Amendment's clause, which prohibits states from "deny[ing] to any person within its jurisdiction the equal protection of the laws." A government race- and ethnicity-based program is scrutinized under strict scrutiny, meaning that the defendant has the burden of proving that racial classifications are narrowly tailored measures that further compelling governmental interests.

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The court rejected the government's assertion of a compelling interest to remedy the effects of past discrimination facing minority-owned businesses. While the government pointed to congressional testimony as to the effects of redlining, the G.I. Bill, and Jim Crow laws on Black wealth accumulation, the court pointed out that the Program also benefits wealthy Blacks. The court observed that defendants provided no evidence of societal discrimination on other ethnicities favored by the Program. Nor did the government provide evidence of past intentional discrimination, as statistical disparities with business loans or contracting cannot account for other variables leading to those results. Last, the government did not attempt to show that it passively discriminated by failing to address economic inequities among minority-owned businesses.

The court added that, even if the government could have shown instances of intentional discrimination by it, the Program was not narrowly tailored to further that interest. First, the government has not shown that race-neutral methods have been tried. Second, the Program was both underinclusive and overinclusive.

> It is underinclusive because it arbitrarily excludes many minority-owned business owners—such as those from the Middle East, North Africa, and North Asia. For example, it excludes those who trace their ancestry to Afghanistan, Iran, Iraq, and Libya. But it includes those from China, Japan, Pakistan, and India. The Program is also underinclusive because it excludes every minority-business owner who owns less than 51% of their business. (Footnote omitted.)

The court next found that plaintiffs have suffered and will continue to suffer irreparable harm by being denied equal protection. While plaintiffs sought a nationwide injunction, the court found that unnecessary at this point and so ordered a preliminary injunction as to the three MBDA Centers applicable to the plaintiffs—in Wisconsin, Orlando, and Dallas-Fort Worth.

Nuziard II

Recall that the *Nuziard I* court's injunction was preliminary and limited to the MBDA Centers to which the three plaintiffs had applied for assistance, but were rejected on the basis of their race. Plaintiffs then brought a second lawsuit, seeking a declaration that the MBDA is unconstitutional and equitable relief prohibiting further unconstitutional conduct by the MBDA. Both parties moved for summary judgment. Plaintiffs cited *Students for Fair Admissions, Inc. v. President & Fellows of Harv. Coll.*, 600 U.S. 181, 143 S. Ct. 2141, 216 L. Ed. 2d 857 (2023) (*SFFA*), in which the Court imposed strict liability on university admission programs. The government invoked *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 109 S. Ct. 706, 102 L. Ed. 2d 854 (1989), 10 CLR 66 (1989), for the proposition that the MBDA was constitutional because it remedied past discrimination in which the government had passively participated.

After a reexamination of the question of standing based on "a more fulsome evidentiary record" revealed by discovery, the court concluded that two of the three plaintiffs had standing to bring this lawsuit (including the named plaintiff).

Stating that "[t]his case is about presumptions," the court ruled that the MBDA statute is unconstitutional. It observed that the Constitution's promise of "equal protection under the laws" came about in 1868, not 1791. Applying an "originalist intent" analysis, the court delved into the state of the country in the years following the Civil War, and Congress' challenge of how to respond to an emancipated Black population but an unrepentant white South. The chosen solution in the Fourteenth Amendment was to impose a race-neutral standard. Of course, this mandate was not honored, and Blacks in the South suffered from the segregation regime of Jim Crow laws. A critical development was passage of the Civil Rights Act of 1964, which prohibits "exclusion from participation in, denial of benefits of, and discrimination under federally assisted programs on ground of race, color or national origin." 42 U.S.C.A. § 2000d.

Given the unambiguous and broad wording of the Fourteenth Amendment—directing that *no* State shall deny *any* person equal protection—the court viewed all statutes and cases using racial or ethnic classifications as constitutionally suspect. "Given its drafters' desire to eschew race-based distinctions, even benign discrimination cannot be squared with the Equal Protection Clause—it can only be an 'exception.' " This tension was mediated through imposition of a strict scrutiny test: that only narrowly tailored means were used to further a compelling government interest. The parties did not dispute that strict scrutiny applied in this case.

The government argued that its interest was to remedy the effects of discrimination, specifically focusing on access to credit and discrimination in contracting by private parties in which the government was a passive participant. The court found that, even if MBEs suffered discrimination in access to credit, this cannot be a

compelling government interest without evidence of concrete acts of discrimination by the government itself. By contrast, the government showed that remedying discrimination in public procurement was a compelling government interest, and that passive participation is as deplorable as private sector discrimination. That passive participation was established by statistical evidence of disparity studies comparing MBE participation with white participation.

The court then held that the MBDA Program was not narrowly tailored to remedy this compelling government interest. As established in *Nuziard I*, the Program is both under- and over-inclusive. The statute's classifications of who is presumptively disadvantaged is arbitrary. "Oprah Winfrey is presumptively disadvantaged, while Plaintiffs and even more disadvantaged Americans are not. While illogical, this wouldn't be a problem if the presumption wasn't based on race." The classifications were rooted in stereotyping, which the *SFFA* Court rejected, stating: "We have time and again forcefully rejected the notion that government actors may intentionally allocate preference to those who may have little in common with one another but the color of their skin." 509 U.S. at 647 (internal quotation marks omitted).

The MBDA Program was not narrowly tailored for additional reasons. It lacked a logical endpoint as the agency's presumptions were unlimited in duration. The race-based presumptions were not shown to be necessary to fix the credit struggles of MBEs (even assuming this was a compelling government interest) or the disproportionate results in the awarding of prime contracts to white-owned businesses. Nor did the agency show it considered alternatives to remedying these ills before resorting to a race-based presumption.

Having found the MBDA Act violative of the Equal Protection Clause, and that plaintiffs established the prerequisites for equitable relief, the court granted a permanent injunction preventing the MBDA from using its racial presumption in its Business Center programming.

Comment

The *Nuziard* decision may be the first published opinion extending *SFFA* to government contracting. In *Ultima Servs. Corp. v. United States Dept. of Agric.*, 2023 WL 4633481 (E.D. Tenn. Jul. 19, 2023), 44 CLR 366 (2023), the court in a slip opinion ruled that the Small Business Administration's Section 8(a) program—which provides a rebuttable presumption in favor of awarding federal contracts to enumerated racial groups—violates the Fifth Amendment's Equal Protection clause, as the program does not further a legitimate government purpose and is not narrowly tailored.

For further discussion, see Olatunde C.A. Johnson, *(How) Can Litigation Advance Multiracial Democracy?* 92 Fordham L. Rev. 1353 (2024) (addressing "the continuing role of rights litigation, using litigation over affirmative action as an illustration"); Nino C. Monea, *Next on the Chopping Block: The Litigation Campaign Against Race-Conscious Policies Beyond Affirmative Action in University Admissions*, 33 B.U. Pub. Int. L.J. 1 (Winter 2024) (section VII is titled "Contracting"); Fern L. Kletter, Annotation, *"Narrow Tailoring" in Non-First Amendment Cases*, 70 A.L.R. Fed. 3d Art. 5 (2022) (§§ 24-27 address the award of public contracts); and Donald T. Kramer, Annotation, *What Constitutes Reverse or Majority Race or National Origin Discrimination Violative of Federal Constitution or Statutes—Nonemployment Cases*, 152 A.L.R. Fed 1, § 6 (1999) (§ 6 addresses public contracting). In discussing why the program was both under- and over-inclusive, the *Nuziard* court in its 2023 opinion stated in a footnote that "[f]ashioning a racial-or ethnicity-based policy that is not underinclusive or overinclusive is extremely difficult and almost impossible in a multiethnic country like the United States." It cited in support, Joseph D. G. Castro, *Not White Enough, Not Black Enough: Reimagining Affirmative Action Jurisprudence in Law School Admissions Through a Filipino-American Paradigm*, 49 Pepp. L. Rev. 195, 226-27 (2022).

Citation Update

- *Clover Communities Beavercreek, LLC v. Mussachio Architects P.C.*, 676 F. Supp. 3d 82 (N.D.N.Y. 2023), 44 CLR 342 (Nov. 2023)

- *Facilities Guidelines Institute, Inc. v. UpCodes, Inc.*, 677 F. Supp. 3d 955 (E.D. Mo. 2023), 44 CLR 359 (Nov. 2023)

- *Velazquez Framing, LLC v. Cascadia Homes, Inc.*, 12 Wash. 3d 552, 540 P.3d 1170 (2024), 45 CLR 91 (March 2024)

Further Case History

- *Conti Enterprises, Inc. v. Providence/GSE Assocs., LLC*, 377 So. 3d 715 (La. App. 1st Cir. 2023), *writ denied*, 379 So. 3d 668 (La. 2024), 45 CLR 42 (Feb. 2024)

- *Fairfield Homes, Inc. v. Amrani*, 2023 IL App (1st)

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220973, 471 Ill. Dec. 883, 229 N.E.3d 913 (1st Dist. 2023), 45 CLR 2 (Jan. 2024)

- *Paglia & Assocs. Construction, Inc v. V.J. Hamilton*, 98 Cal. App. 5th 318, 316 Cal. Rptr. 3d 592 (2d Dist. 2023), *review denied* (Cal. Apr. 10, 2024), 45 CLR 61 (Feb. 2024)

Subject Matter Index

Note: *Page numbers in the Subject Matter Index denote the beginning of the relevant case summary and not necessarily the page on which the issue indexed is located*.

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Suretyship

An obligee-contractor's claim against the subcontractor's performance bond surety was subject to the arbitration agreement in the subcontract, notwithstanding the contractor's argument that the principal's default was clear and only the surety's conduct was at issue, 148 (Cal. App.)

DEVELOPERS

Economic Loss Rule

Where purchasers of a subdivision lot hired the general contractor to build their house, and they sued the developer (a separate entity) for negligence, the developers were not liable to the owners as the parties were not in privity and the owners suffered only property damage, 157 (Ind. App.)

DIFFERING SITE CONDITIONS

Evidence of Site Condition

Google Earth images of the project site were inadmissible to establish the site conditions at the time of contracting, as the lighting and coloration of the image mosaics may mislead the viewer, 159 (ASBCA)

Type I

On a canal dredging project, the contractor's Type I differing site conditions claim, that a canal bank was too unstable for the placement of dump trucks, failed as the contract contained no representations as to the bank's stability, 159 (ASBCA)

On a canal dredging project, where virtually all the boring logs were from the east bank of the canal, but the contractor encountered slope failure on the west bank, the contractor could not reasonably extrapolate to the west bank's condition based on the boring logs' information, 159 (ASBCA)

ECONOMIC LOSS RULE

Manufacturers

The Eleventh Circuit certified to Florida Supreme Court whether the economic loss rule applies to negligence claims against the manufacturer of a non-defective product, based on the failure to alert the product owner of a known danger, when the only damages claimed were to the product itself, 174 (11th Cir.)

INSURANCE

Additional Insured Endorsement

Certificate of Insurance

A general contractor, named as an additional insured on a certificate of insurance but not properly added to the subcontractor's policy, could sue the subcontractor's insurance agent for negligence, even though the contractor was not the agent's client, 163 (Mont.)

An insurance agent was liable to a contractor for negligent misrepresentation for issuing a certificate of insurance which falsely represented the contractor was an additional insured on a subcontractor's liability policy, notwithstanding the certificate's disclaimer that only the policy terms determined coverage, 163 (Mont.)

Time Limits

Under a "completed operations" endorsement, a general contractor ceased being an additional insured on a subcontractor's liability policy once the subcontractor completed it work; thus, the subcontractor's insurer had no duty to defend the contractor where the owner brought suit many years after the project's completion, 167 (Cal. App.)

Ensuing Loss/Resulting Loss Clause

A "resulting loss" clause, in a condominium's "all risk" insurance policy's "faulty workmanship" exclusion, extended coverage for property damage caused by humidity, a covered risk, even though the humidity had been caused by a contractor's faulty workmanship or design, 162 (Wash.)

Exclusions, Liability Insurance

Professional Services

Where an owner sued the general contractor for settlement damage to a new building, coverage was not negated by the policy's professional services exception as the contractor had been sued for ordinary negligence as well as professional negligence, 163 (Mont.)

Limitations

A limitations provision in a contract between an insured and a contractor barred the property insurer's subrogation action against the contractor, 166 (E.D.N.Y.)

LABOR & EMPLOYMENT

Employee vs. Independent Contractor

Under Massachusetts law, a debtor contractor's fail-

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ure to pay the creditor workers overtime pay was dischargeable, as the workers failed to prove the contractor's classification of them as independent contractors, rather than as employees, was "willful" within the meaning of 11 U.S.C.A. § 523(a)(6), 154 (1st Cir. BAP)

National Labor Relations Act

Co-Employer Status

In a declaratory judgment action, a district court invalidated the NLRB's 2023 Rule defining joint employer status under the NLRA and reinstated the 2020 Rule, 169 (E.D. Tex.)

Wage Payment

An employer's violation of a Labor Law statute mandating weekly payment of manual laborers does not entitle workers paid biweekly to a private right of action, 171 (N.Y. App. Div.)

LICENSING

Home Improvement License

New York City's home improvement contractor license requirement applied to a townhome renovation owned by a business entity, where the entity's manager testified he would reside in the townhome once the work was completed, 173 (N.Y. App. Div.)

Joint Ventures

Where two companies, each individually licensed, formed a joint venture to bid on a public works project, their failure to obtain a certificate of registration for the joint venture itself rendered their bid nonresponsive, 156 (N.J. App. Div.)

MANUFACTURERS

Economic Loss Rule

The Eleventh Circuit certified to Florida Supreme Court whether the economic loss rule applies to negligence claims against the manufacturer of a non-defective product, based on the failure to alert the product owner of a known danger, when the only damages claimed were to the product itself, 174 (11th Cir.)

SAFETY

Architects/Engineers

A design agreement's disclaimers as to the architect's responsibility for safety negated a duty of care owed to an injured construction worker, 150 (La.)

SURETYSHIP

Arbitration

An obligee-contractor's claim against the subcontractor's performance bond surety was subject to the arbitration agreement in the subcontract, notwithstanding the contractor's argument that the principal's default was clear and only the surety's conduct was at issue, 148 (Cal. App.)

U.S. GOVERNMENT CONTRACTS

Affirmative Action

A federal program created under the Infrastructure Act of 2021, to provide assistance to socially or economically disadvantaged individuals presumptively defined as specific racial or ethnic groups, but not including white-owned businesses, violates the Fifth Amendment's Equal Protection Clause and is permanently enjoined, 176 (N.D. Tex.)

Table of Cases

Note: *Page numbers in bold face designate summarized cases*.

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Jurisdiction Index

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