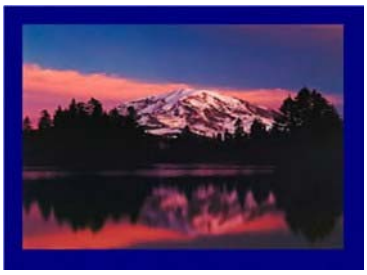
WELCOME TO

Pearlman

PEARLMAN 2017

Pearlman 2017

Building Relationships – Keeping Them Strong



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On behalf of the Board of Directors and Sustaining Members of the Pearlman Association, I want to express our sincere appreciation to you for choosing to attend the Pearlman events this year. Whether you traveled across the country or across town, whether this is your first visit or your 24th, we have worked hard to make your time with us a rewarding and memorable experience and we hope we surpass your every expectation.

Pearlman is an organization designed, built and managed exclusively by company-side surety professionals. Its close, continuous access to the collective heartbeat of a large number of surety companies makes for a unique, targeted perspective on the needs, goals and challenges facing the industry – a perspective available to no other similarly situated organization. Our annual events draw from this special vantage point as we design our curriculum, training and recreational events.

As you take part in our events this year, please keep in mind that Pearlman has but one mission; to strengthen and enhance the talent, professionalism and career prospects of the surety professional. We will accomplish this mission through our scholarship distribution, our educational programs and our commitment to building industry relationships and keeping them strong.

Thank you, again, for joining us this year.

All the best –

R. Jeffrey Olson
Chairman/Director Pearlman Association

Schedule of Events

Wednesday, September 6

4:30-7:30 **Hospitality Reception** – Willows Lodge, Woodinville
Hosted by The Vertex Companies, Inc., Langley, LLP, Sage Associates, Inc., and The Hustead Law Firm

Hospitality Reception Entertainment
Hosted by Faux Law Group and Williams Kastner

Thursday, September 7

7:30-8:00 **Registration and Breakfast** – Columbia Winery, Woodinville
Hosted by Alber Frank, PC, PCA Consulting Group, and Forcon International Corporation

All Day Coffee/Beverage Service
Hosted by Stewart Sokol & Larkin, LLC

8:00-8:15 **Welcome/Introductory Remarks**
R. Jeffrey Olson
Co-Chairs: David Olson, Rodney Tompkins, Jr., George Rettig

8:15-8:45 **Recent Decision on MBE Bonding Litigation**
David Olson, Jason Potter

8:45-9:30 **The Surety's Assertion of the Principal's Defenses and Acts of the Principal that Impact those Defenses**
Patrick Hustead, Michael Sugar, Jr., Jason Potter, Ben Chambers

9:30-10:00 **Implied Warranties Regarding Design**
David Olson, Dennis Cavanaugh, Patrick Toulouse

10:00-10:15 **Break**

10:15-10:45 **Efforts to Expand Spearin to Claims of Third Parties**
Margery Bronster, Shashauna Szczechowicz, Derek Popeil

10:45-11:15 **Section 552, Restatement (Second) of Torts**
Kurt Faux, Paul Versage, Tiffany Schaak

11:15-12:00 **Defenses to Warranty Claims**
Tom Windus, Daniel Lund III, Richard Sexton, Sam Barker

12:00-1:15 **Lunch**
Hosted by Wolkin Curran, LLP, Sage Consulting Group and Weinstein Radcliff Pipkin, LLP

1:15-2:00 **Avoidance of or Challenges to Liability**
Edward Rubacha, Meredith Dishaw, Mark Degenaars
Luis Aragon, Paul Friedrich

2:00-2:45 **Design vs. Performance Specifications**
Gina Shearer, Greg Smith, John Anderson, Bryce Holzer

2:45-3:30 **Adoption of Spearin at Federal and State Levels**
Amy Bernadas, James Case, Wayne Lambert, Todd Braggins, Jim Hamel

3:30-3:45 **Break**

3:45-4:30 **Impact of Delivery Methods**
Jonathan Dunn, Jennifer Fiore, Bob Legier, John Fouhy

4:30-5:00 **Damages**
Jan Sokol, John Fallat, Ed Hancock, Paul Harmon

5:00 **Welcome Reception/Cocktails** – Columbia Winery, Woodinville
Hosted by Stewart, Sokol, and Larkin, LLC

6:00 **Dinner** – Columbia Winery, Woodinville
Hosted by Watt, Tieder, Hoffar & Fitzgerald, LLP and J.S. Held, LLC

7:15 **Hold 'Em Tournament** – Columbia Winery, Woodinville
Dealers Sponsored by Benchmark Consulting Services, LLC and Weinstein Radcliff Pipkin, LLP

Cocktails
Hosted by Krebs Farley, PLLC

Friday, September 8

7:30-8:30 **Registration and Breakfast** – Columbia Winery, Woodinville
Hosted by Cashin Spinelli & Ferretti, LLC, and
Snow, Christensen & Martineau

All Day Coffee/Beverage Service
Hosted by Guardian Group, Inc.

Bloody Mary Bar
Hosted by SMTD Law LLP

8:30-8:45 **Welcome/Program Introduction**
David Olson, Rodney Tompkins, Jr., George Rettig

8:45-9:45 **Changes in Discovery Rules**
Keith Langley, Gene Zipperle, Charles Langfitt

9:45-10:45 **Use of Reptile Brain Trial Strategy**
Mike Pipkin, Nina Durante, Todd Betanzos

10:45-11:00 **Break**

11:00-12:00 **Ethical Issues in Use of Cloud for Exchange and Storage of Documents**
Mark Gamell, Jonathan Bondy, Rodney Tompkins, Jr., Frank Lanak

12:00 **Lunch – On Your Own**

12:15 **Bus Service to/from Harbour Pointe Golf Club**
Hosted by Law Offices of Larry Rothstein
Bus leaves Willows Lodge at 12:15PM

1:00 **Sign In/Warm Up** – Harbour Pointe Golf Club

1:30 **Scramble Tournament – Shotgun Start**
Harbour Pointe Golf Club, 11817 Harbour Pointe Blvd, Mukilteo, WA 98275

Beverage Cart
Hosted by Watt, Tieder, Hoffar & Fitzgerald, LLP,
Benchmark Consulting Services, LLC, and The Sutor Group

7:00 **Dinner** – Harbour Pointe Golf Club
Hosted by Ward, Hocker & Thornton, PLLC,
Chiesa Shahinian & Giantomasi PC, and
Kerr Russell and Weber, PLC

Cocktails
Hosted by Stewart Sokol & Larkin, LLC

7:45 **Awards – Scholarships – Closing**

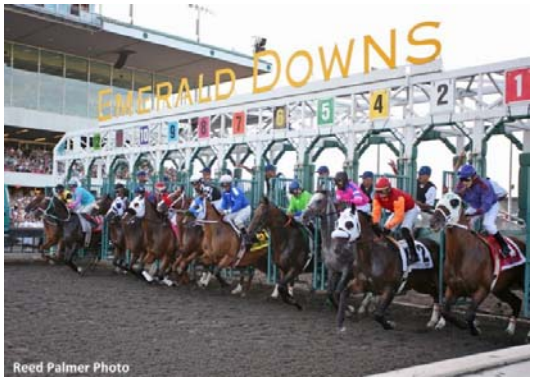
8:00 **Buses return to Columbia Winery and Willows Lodge**

Saturday, September 9 – "On Your Own"

We would like to extend our sincerest appreciation to our Sustaining Members and friends of Pearlman who graciously volunteered their time to coordinate and chaperone Saturday's "on your own" events.

For those of you who signed up for any of the elective events, you will have received by now an e-mail message from your respective "chaperone" alerting you to the logistics of your event.

Horse Racing at Emerald Downs



Jennings, Haug & Cunningham, LLP
SMTD Law LLP

Woodinville Wine Tour

Torre, Lentz, Gamell, Gary & Rittmaster,LLP
J.S. Held LLC
Clark Consulting Group
Law Offices of T. Scott Leo, P.C.

Program Co-Chairs

DAVID C. OLSON

David Olson is a member of Frost Brown Todd LLC and practices with the litigation department. He received his BA from Williams College and his J.D. from The Ohio State University Law School.

In the past 38 years, he has represented numerous sureties and other clients in the construction industry in complex commercial litigation in Ohio, Kentucky, Indiana and West Virginia.

He has spoken in New York, Connecticut, Massachusetts, Kentucky, California and Ohio on various issues regarding suretyship issues, litigation strategy, discovery, and construction disputes. His presentations have been to the ABA's Fidelity and Surety Law Committee, the Surety Claims Institute, the National Association of Credit Management, the Construction Financial Management Association, the National Business Institute and the Ohio Legal Center. He has also contributed as an author in many ABA publications on topics regarding suretyship.

He was Chair of the ABA's Fidelity and Surety Law Committee in 2013-2014.

RODNEY J. TOMPKINS, JR., JD

Rodney J. Tompkins Jr. is a managing partner and VP of RJT Construction Inc., Consulting Services. Rodney has worked in Surety claims and construction consulting for over 14 years, and maintains RJT's focus on Surety claims, construction law, complex project and surety loss mitigation, case management, scheduling, estimating, accounting, litigation, and construction processes and methodology.

Rodney earned his Bachelors Degree at University of San Diego, and Post Graduate Construction Management Certificate at U.C. Berkley School of Engineering, as well as his J.D. at Lincoln Law School of Sacramento where he was Editor-In-Chief of the Voir Dire, and won multiple awards in ADR, Negotiations, and Moot Court.

He is a member of numerous professional organizations, has presented on topics of Construction and Project Management, Claims, Electronic Discovery and Books and Records, and others. Rodney has served as Vice President and President of the Surety Claims Association of Los Angeles, as well as current ongoing leadership positions within

the Fidelity Surety Law Committee (FSLC). He also dedicates his time to his family and youth sports and serves on the board of local youth sports organizations in Southern California.

GEORGE W. RETTIG

George W. Rettig is an Assistant Vice President, Claims Counsel for International Fidelity Insurance Company in Newark, New Jersey. He obtained his B.A. from State University of New York at Stony Brook and his J.D. from Brooklyn Law School. He has more than twenty-five years surety and construction law experience working in private practice and in the surety industry. He is admitted to the New York and New Jersey bars.

Presenters/Biographies

We would like to thank each of our co-chairs and presenters for the significant time and talent that each of them have selflessly invested into the success of our educational programs.

JOHN C. ANDERSON, P.E.

John Anderson is a Director for Berkeley Research Group's (BRG's) Construction Practice and operates out of their Emeryville, California office. Mr. Anderson is a recognized expert in the area of construction scheduling, cost estimating, and construction claim analysis. He has over 30 years of experience in construction and is a licensed civil engineer and contractor. Mr. Anderson received a Bachelor and Master's degree in Civil Engineering from the University of California at Berkeley. Mr. Anderson has extensive experience in the surety field, having performed investigations on over 100 contractor default claims. Prior to his work as a consultant and expert, Mr. Anderson worked in the construction industry, holding various positions including project engineer, project manager, estimator, and project executive. He supervised and worked on a wide variety of building types, including bridges, marine, underground and overhead utility, schools, and high-rise commercial.

BRG is a leading global strategic advisory and expert consulting firm that provides independent advice, data analytics, authoritative studies, expert testimony, investigations, and regulatory and dispute consulting to Fortune 500 corporations, financial institutions, government agencies, major law firms, and regulatory bodies around the world. BRG has more than 860 professionals with 70 devoted to the construction practice.

LUIS ARAGON

Luis Aragon is Surety Claim Counsel for Liberty Mutual Insurance Company. Prior to Liberty Mutual, Luis spent over two years as a surety attorney in the Seattle office of Watt Tieder Hoffar & Fitzgerald. Luis has a B.A. in History with Honors and a B.S. in Biochemistry, both from the University of Washington. Luis also received his J.D. from the University of Washington. Luis simply cannot find it in himself to leave Seattle. Outside of work, Luis has a wife who is a better lawyer than he is, and two amazing young daughters. When the ladies let him out of the house, he enjoys playing soccer. He is an exceptionally mediocre golfer.

SAM BARKER

Sam Barker is a Senior Surety Counsel for Liberty Mutual Insurance Company in Seattle, WA. Sam currently handles international claims. Sam has 17 years of surety claims handling experience. Sam is fluent in Spanish and Italian and speaks some French. Sam received his law degree from Seattle University School of Law and his B.A. from Stanford. Sam enjoys acting and performing in community theater.

AMY M. BERNADAS

Amy M. Bernadas is a partner at Krebs Farley, PLLC in the firm's New Orleans office. Admitted to the State Bar of Texas in 2003 and the Louisiana State Bar in 2008, she has a broad litigation background and primarily focuses her practice on Surety and Construction law. Amy received her B.A. from Baylor University in 1996 and her J.D., *cum laude,* from Tulane University School of Law in 2003. Amy is active in the Fidelity and Surety Law Committee of the Torts, Trial and Insurance Practice Section of the ABA and serves as a Volunteer attorney for the New Orleans Pro Bono Project.

TODD BETANZOS

Todd Betanzos, a Principal Consultant at American Jury Centers™ and AJC Consulting, has worked closely with AJC founders Allan Campo and Stuart Simon on litigation and strategic communications matters since 2006. He has become a highly sought-after expert in assisting companies with the preparation of key witnesses for testimony and the development of juror-focused trial strategies and tactics. Mr. Betanzos has also developed a specialty in summarizing complex, industry-specific issues, from pharmaceutical development to highly technical engineering principles to insurance underwriting and claims management, using elegantly simple, lay-friendly storytelling with which juries and other decision makers can readily identify.

Formerly a partner with a national law firm that had retained American Jury Centers on several cases, he engaged with Simon and Campo in extensive study and practice of communication science, persuasion theory, and the human-behavior aspects of litigation and jury trials in 2010. As a result of his consulting study and work, and his prior experience as a trial lawyer, Mr. Betanzos has a unique understanding of the communication challenges in every aspect of complex litigation, including the identification and development of trial themes, preparation of key fact and corporate representative witnesses for deposition and trial testimony, and the effective presentation of technical evidence through expert witnesses and demonstrative aids. Of great interest is Mr.

Betanzos' work in the overall development of dispute resolution plans built upon carefully tailored focus group and mock trial studies.

Mr. Betanzos is a member of the American Society of Trial Consultants. He is a contributing author of *Witness Preparation: A Manual for Attorneys* (Campo, Simon, Betanzos; Amazon 2011) and co-author of *Witness Communication Training: Helping Witnesses Learn to Deliver and Defend the Truth Under Adverse Examination* (Simon, Betanzos, Campo; Amazon 2016). He currently resides with his family in Dallas, Texas.

JONATHAN BONDY

Jonathan Bondy is a member of Chiesa Shahinian & Giantomasi PC, which maintains offices in New York City and West Orange, New Jersey. He received his Bachelor of Science in Economics from the Wharton School of Business of the University of Pennsylvania in 1988, and a Juris Doctor degree in 1991 from the Benjamin N. Cardozo School of Law, Yeshiva University, where he was a member of the Moot Court Honor Society. Mr. Bondy previously served as an Assistant District Attorney in Kings County (Brooklyn), New York. He concentrates his practice in surety and fidelity law, and commercial and construction litigation. He is a member of the New York and New Jersey State Bar Associations and the Fidelity and Surety Law Committee of the Tort, Trial and Insurance Practice Section of the American Bar Association. He is admitted to practice in New York and New Jersey, the United States Court of Appeals for the Second Circuit, and the United States District Courts for the Southern and Eastern Districts of New York and the District of New Jersey. He has previously spoken on surety and construction law issues before the Fidelity and Surety Law Committee of the American Bar Association's Tort, Trial and Insurance Practice Section, the Surety Claims Institute, the Northeast Surety & Fidelity Claims Conference, and the Commercial Finance Association.

TODD R. BRAGGINS

Todd R. Braggins is Managing Partner of Ernstrom & Dreste, LLP, in Rochester, New York. Mr. Braggins concentrates his practice in the fields of contract and commercial suretyship and construction law. In addition to Ernstrom & Dreste, LLP's Pearlman Sustaining Membership, Mr. Braggins is an active member of the Fidelity and Surety Law Committee ("FSLC") of the ABA's Tort Trial and Insurance Practice Section, currently serving as a Vice-Chair, as well as a Co-Editor of the FSLC Newsletter. Mr. Braggins is also a member of the Surety Claims Institute, the National Bond Claims Association, the Chicago, Atlanta and Philadelphia Surety Claims Associations, and the ABA's Forum on the Construction Industry. Mr. Braggins graduated with honors from Binghamton University and received his Juris Doctor from the Washington College of Law of The American University.

MARGERY S. BRONSTER

Margery S. Bronster is one of the founders of Bronster Fujichaku Robbins in Honolulu, Hawaii. Ms. Bronster has a varied practice that includes complex business litigation and representing sureties in all matters, from claim investigation through litigation.

Ms. Bronster was the Attorney General for the State of Hawaii from 1995 to 1999. For her service, Ms. Bronster received the Profiles in Courage Award, Conference of Western Attorneys General, 2000 (Southerwestern Bell) and Kelly- Wyman Award for Outstanding Attorney General, 1999 (National Association of Attorneys General). Ms. Bronster has also been recognized by the Litigation Counsel of America as a Senior Fellow and by Best Lawyers in America as 2016 "Lawyer of the Year" in Honolulu, in the practice area of Insurance Litigation.

Ms. Bronster is licensed to practice in Hawaii and New York.

JAMES R. CASE

James R. Case is a member of Kerr, Russell and Weber, in Detroit, Michigan. Mr. Case has over 35 years' experience in commercial, construction and surety litigation. He serves on the Commercial/Construction Arbitration Panel and as a mediator for the American Arbitration Association. Mr. Case is an active member of the National Bond Claims Association; Pearlman Surety Association; Surety and Fidelity Claims Institute; International Association of Defense Counsel - Construction Law and Litigation Committee, and Fidelity and Surety Committee; and the ABA Forum on the Construction Industry, Tort and Insurance Practice Section, and Fidelity and Surety Law Committee. Mr. Case is a graduate of Colgate University and St. John's University Law School.

DENNIS C. CAVANAUGH

Dennis Cavanaugh is a Partner with Robinson+Cole LLC's Construction Group and focuses on construction law and contract suretyship matters. He counsels public and private building owners, tenants, lenders, building contractors, design professionals, subcontractors, and sureties. Mr. Cavanaugh's capabilities span a period of over three decades in his handling of complex transactions that often involve construction finance, contract procurement and negotiation, and commercial-related litigation and alternative dispute resolution.

Mr. Cavanaugh has lectured and authored articles on a variety of construction and suretyship topics. He has been recognized in the The Best Lawyers in America© in the

areas of Construction Law and Litigation - Construction since 2011. Additionally, he was Best Lawyers® Hartford Lawyer of the Year in the area of Construction Law in 2012 and 2015 and in the area of Litigation - Construction in 2013 and 2016 (Copyright 2015 by Woodward/White, Inc., Aiken, SC). Mr. Cavanaugh has been recognized by Super Lawyers® since 2006 as a New England Super Lawyer in the areas of Construction Law and Construction Litigation, the result of a joint selection process conducted by Law & Politics and Connecticut Magazine (Super Lawyers is a registered trademark of Key Professional Media, Inc.).

Robinson+Cole LLC has offices in Connecticut, Massachusetts, New York, Rhode Island, Florida and California.

BENJAMIN CHAMBERS

Benjamin Chambers is a Senior Bond Claims Representative for The Hartford. He received a J.D. from Seattle University School of Law and a B. A. in Philosophy from Western Washington University.

MARK DEGENAARS

Mark Degenaars is the Managing Director of the Construction Services group within The Vertex Companies, Inc. He has been with VERTEX for over 7 years with a primary focus as a consultant to the surety claims industry and private public developers. Mark brings over 20 years of project management, facility management, private / public development and construction experience to each assignment. Mark has successfully managed a large variety of projects ranging from various types of vertical construction to heavy highway / civil design projects. Mark has served as an expert and fact witness for a variety of projects. Prior to joining VERTEX, Mark owned and managed his own consulting firm for nearly a decade.

MEREDITH DISHAW

Meredith Dishaw is an associate in the Seattle office of Williams Kastner and part of the Construction and Surety Practice Teams. Her practice focuses on representing public and private owners, contractors, and sureties throughout the construction process, with a particular focus on commercial construction litigation. Ms. Dishaw has represented clients in federal and state courts throughout the country and in private arbitration proceedings in various construction-related matters, including payment, performance and supply bond

claims, prompt payment claims, mechanic's lien claims, indemnity issues, latent and patent defects in construction and design, and contract and warranty claims.

Ms. Dishaw's practice also focuses on defending sureties and insurers from common law and statutory bad faith and extra-contractual claims.

JONATHAN J. DUNN

Jonathan J. Dunn is a partner in SMTD Law LLP's Irvine, California office. Jonathan focuses his practice in construction practices, surety law, creditor's rights and remedies, including bankruptcy and work-outs, and transactions relating to construction, debtor/creditor and commercial matters. Prior to forming SMTD, Jonathan was a partner at an international law firm, an in-house attorney with two national bonding companies where he handled construction defaults in the Western United States, and active in his family's construction business.

Jonathan is asked to write and speak frequently, and has written numerous articles and presentations. Jonathan is a vice chair of the AGC-California Legal Advisory Committee, active in the ABA's Forum on Construction Law section, a prior Vice Chair of the Fidelity & Surety Law Committee, as well as involved in numerous other construction and surety associations and legal bar organizations.

Jonathan obtained his J.D. from Seattle University School of Law (formerly Univ. of Puget Sound L.S.), and his Bachelor of Arts degree in Economics from UCLA in 1989. Jonathan is licensed to practice in California, as well as various federal, special and bankruptcy courts.

NINA M. DURANTE

Nina M. Durante is Senior Surety Claims Counsel with Liberty Mutual Insurance Company in its Commercial Claims Department. She is based in Seattle, WA. For most of her professional career, Nina has worked in the surety industry handling a variety of claims, including contract, fidelity and miscellaneous matters. In 2013, Nina joined Liberty's newly created Commercial Claims Region where she handles a variety of large commercial claims, bankruptcies, and contract claims.

Nina received her B.A. in Political Science from Seattle University and her J.D. from the University of Puget Sound School of Law (now, Seattle University School of Law). She is an active member of the Washington State Bar Association and the American Bar Association - TIPS section.

JOHN L. FALLAT

John L. Fallat was admitted to the California Bar after graduating cum laude from the California Western School of Law in 1984. He has been practicing surety bond defense since 1986 when he joined the Oakland defense firm of Bennett, Samuelson, Reynolds, and Allard in defending among notary public surety bonds for the Kirby brothers who then owned Western Surety Company, now part of CNA. He then joined Williams & Martinet in San Francisco where he expanded his surety bond practice to include all types of claim and lawsuits. He started his own practice in 1989 representing sureties throughout California with an emphasis on commercial claims. The firm currently has two associates and three paralegals. He considers himself very fortunate to have stumbled into this field which has enabled him to raise a family in Marin County and be free to represent clients in other civil litigation such as consumer class actions, employment litigation, and real estate disputes.

KURT FAUX

Kurt Faux is the president and founder of the Faux Law Group, practicing in Nevada, Utah, and Idaho. Mr. Faux received a B.A. from Brigham Young University-Hawaii, magna cum laude, in 1982. He obtained a J.D. from Brigham Young University, J. Reuben Clark Law School in 1986, where he was an editor for the Law Review. Mr. Faux has represented sureties for over 30 years, and is a frequent presenter to various groups regarding surety and construction issues.

JENNIFER FIORE

As a principal in Dunlap Fiore, LLC, Ms. Fiore specializes in construction law, business law, litigation, public finance as well as Federal and State regulatory and administrative law matters.

Ms. Fiore's practice encompasses the full breadth of private and public construction and surety law. She represents clients in the drafting and negotiation of contracts; the administration of project obligations; and the preparation, prosecution and defense of claims. She also has extensive experience in performance and payment guaranty-related matters, bonding, and indemnity issues giving her an experienced, educated perspective on all aspects of construction, and surety law. Ms. Fiore has represented contractors, owners, and sureties and has experience in contracting issues involving the Federal Acquisition Regulation. She has assisted clients with compliance of the Federal Contractor ethics rules in a wide variety of construction-related matters.

Ms. Fiore is a Vice-Chair of the Fidelity and Surety Law Committee of the Tort Trial and Insurance Practice Section of the American Bar Association, a member of American Bar Association, Construction Law Forum, the Louisiana Bar Association, National Bond Claims Association and the Pearlman Association.

JOHN M. FOUHY

John M. Fouhy is a Claim Counsel for Travelers Casualty & Surety Company of America in Federal Way, WA, where he has worked since 2010. He graduated with a B.B.A. from Pacific Lutheran University in 2005, and received his J.D. from the University of Oregon School of Law in 2009. He is admitted to practice in Washington State.

PAUL K. FRIEDRICH

Paul K. Friedrich is an attorney with Williams Kastner and is a member of the firm's Construction Litigation & Surety Practice Team. His practice involves representing sureties and insurers in all aspects of bond claims with a particular emphasis on construction law. A significant portion of his practice is devoted to prosecuting indemnity and subrogation matters on behalf of his surety clients. Mr. Friedrich has a proven track record of success for his clients at both the trial court level and on appeal.

MARK S. GAMELL

Mark S. Gamell is a founding partner in the New York law firm of Torre, Lentz, Gamell, Gary & Rittmaster, LLP. Mark was previously a partner at Hart & Hume, LLP and Stockman Wallach Lentz and Gamell, LLP, and has practiced in the fields of fidelity, surety, construction litigation and related commercial insurance and bankruptcy law for over 30 years. A 1976 graduate of Dartmouth College and a 1979 graduate of Fordham University School of Law, Mark has served as a Vice-Chair of the ABA/TTIPS Fidelity & Surety Law Committee, co-chairman of its Bankruptcy Law Subcommittee, and has delivered papers and addresses at meetings of the committee through the years on surety and fidelity law related subjects as well as contributed to several of the committee's publications. Mark has also addressed the ABA Forum on the Construction Industry, as well as other fidelity and surety industry professional organizations such as the Fidelity Law Association, the Surety Claims Institute, the National Bond Claim Association and the Pearlman Association. From 2009 to 2014, Mark served as Educational Program Director for The Pearlman Association, which is dedicated to developing the skills of surety industry professionals. He is admitted to practice in New York, as well as in all four U.S. District Courts in the State of New York,

the U.S. Courts of Appeal for the Second, Third and Federal Circuits and the U.S. Court of International Trade.

JIM HAMEL

Jim Hamel has worked at Claims Counsel for Zurich American Insurance Company since 2010. Prior to that, he was in private practice for 12 years, most recently with Langley Weinstein Hamel, LLP. He obtained his JD from Southern Methodist University (cum laude) in 1997 and a BA from University of Texas – Dallas (cum laude) in 1994.

R. ED HANCOCK

Ed is the President of Surety & Construction Consultants, Inc. and has been in the surety and fidelity industry for over 20 years. Ed is a forensic accountant and has experience handling surety and fidelity claims as well as claims involving accounts receivable, crop insurance, and trade credit. Ed has served as an expert witness in state court in Florida and as an expert witness in federal court. Ed is a Certified Public Accountant in the state of Florida and holds the professional designation of CFF (Certified in Financial Forensics). Ed has an undergraduate degree in Criminology from the University of South Florida and an MBA from the University of Phoenix. Ed is currently pursuing a seminary degree at New Orleans Baptist Theological Seminary online and is an ordained minister.

PAUL C. HARMON, ESQ.

In December 2007, Paul Harmon joined the Federal Way, WA Regional Claim Office having previously been admitted to the Washington State Bar. Paul is a 2007 graduate of the University of Oregon School of Law where he was the Executive Editor of the *Oregon Review of International Law.* At Oregon, Paul was a student intern in the civil law clinic and a teaching assistant for first-year civil procedure and property law students. Previously, Paul received his B.A. in Political Science with a Minor in Music from the University of California, San Diego. At UC San Diego, Paul earned Provost Academic Honors. As an undergraduate, Paul was an exchange student at the University of Glasgow. Paul enjoys travel, running and playing the viola.

BRYCE HOLZER

Bryce Holzer is Claim Counsel for Travelers Bond and Specialty Insurance in Federal Way, WA. Bryce graduated from Washington State University with a B.A. in Economics, summa cum laude, in May, 2007. After working for the Boing Company as an Industrial Engineer, Bryce attended the University Of Washington School Of Law and graduated in March of 2011. Bryce worked in private practice prior to joining Travelers in August 2012. Bryce is a member of the Washington State Bar Association.

PATRICK Q. HUSTEAD

Patrick Q. Hustead is the founder of The Hustead Law Firm in Denver, Colorado. He has a regional practice centered in the Rocky Mountain region. He is a founder of the ABA Fidelity and Surety Extra-Contractual Liability Committee and has represented sureties and insurers for over 29 years. He has tried many cases in the Rocky Mountains, on topics ranging from bad faith to brain injuries and construction defaults. He graduated from Boston College Law School, *cum laude*, and is admitted to practice in all courts in Colorado, Montana, Wyoming, Nebraska and the Dakotas.

WAYNE D. LAMBERT

Wayne D. Lambert is the Regional Manager in Farmington, CT for the Northeast office of Cashin, Spinelli & Ferretti, LLC where he serves as a consultant to the Surety industry in Performance and Payment Bond claims and project completions. Prior to becoming a surety consultant, Mr. Lambert was a Senior Surety Counsel for Liberty Bond Services (now Liberty Mutual Surety); AVP of surety claims for Continental Insurance Company, a lawyer in private practice, and a Captain in the U.S. Army's Judge Advocate General's Corps. Mr. Lambert is a graduate of Georgetown University and the Western New England College School of Law.

FRANK M. LANAK

Frank M. Lanak is Executive Vice President, Bond Claims with Tokio Marine HCC, Surety and Credit Groups. From his office in Los Angeles, Frank manages the Surety Group's claims, subrogation and collateral departments. Frank earned his B.A. in Business Economics from the University of California at Santa Barbara in 1993 and his J.D. from Loyola Law School of Los Angeles in 1996. He is admitted to practice law in California.

CHARLES W. LANGFITT

Charles (Chuck) W. Langfitt is a Travelers Insurance 2nd Vice President & Counsel and leads the Travelers Western Region's Bond Claim Department. Chuck graduated from the University of Oregon in 1977 and from Gonzaga University School of Law in 1980, with honors. After practicing with a Tacoma insurance defense law firm for 4 years, Chuck entered the surety business in 1984 by accepting a position with a surety company subsequently acquired by Travelers. Chuck has 32 years of experience in handling contractor defaults throughout the country. Over the years, Chuck has presented at seminars and written a number of articles, including co-authoring Chapter 3 of the Law of Performance Bonds, *Performance Options Available to the Surety,* and was one of the co-authors revising Chapter 14 in the 2nd Edition of the Law of Payment Bonds, *Payment Bond Claim Handling and the Law of Bad Faith.* In 2013, Chuck was one of the Co-Chairs for the Construction Program for the TIPS/FSLC Mid-Winter Meeting and an editor for that seminar's book, *Construction Damages: An In-Depth Analysis.* Chuck was admitted to the Washington State Bar Association in 1980 and the U.S. District Court Western District of Washington in 1981.

KEITH A. LANGLEY

For 30 years of practice, Keith Langley has focused on understanding the client's business while seeking the earliest resolution of issues by starting with early comprehensive evaluation. He focuses his practice on complex workout, litigation, and bankruptcy matters. Keith is also experienced at counseling his clients on dispute avoidance. His trial experience includes serving as lead counsel on federal and state trials in Texas and other jurisdictions, as well as a successful record in arbitrations and appeals. Keith stays on the cutting edge of the latest technology in presenting evidence to the sophisticated jurors in today's courtrooms.

Keith's practice includes construction and surety law focusing on construction-related claims, lawsuits, mediations, and arbitrations. His experience in claims, trials, arbitrations, and mediations includes projects such as highways and bridges, public works projects, commercial and retail construction, industrial and warehouse facilities, health care facilities, power plants, pipelines, petrochemical plants, refineries, chemical plants, gas processing plants, schools, and multi-family housing.

He is a frequent author and speaker on a variety of litigation, bankruptcy, construction law, surety and fidelity topics. Keith is licensed in Texas, Florida, Arkansas, and Oklahoma.

ROBERT J. LEGIER, P.E.

Robert J. Legier, P.E., is vice president of Global Construction Services, Inc. (GCSI), in Redmond, WA. He offers clients over 30 years of experience in construction management and the evaluation of complex construction disputes. His experience encompasses a broad variety of projects, including: medical facilities, office buildings, dormitories, schools, roads and utility systems, airfields, and waterfront structures. Prior to joining GCSI, Robert served for 21 years in the U.S. Coast Guard, where he was heavily involved in design, construction management, and facility operations. In both the public and private sectors, he has considerable experience in construction claims and claims avoidance, project scheduling, evaluating issues of delay, impact, disruption, acceleration, and changed conditions. He has managed completion of many surety loss projects on behalf of national surety firms. His work with surety losses includes making an assessment of the uncompleted work, determining the cost to complete and the ability of the principal to perform, as well as monitoring the work of completion contractors, and review of payment bond claims. Robert is a registered Professional Engineer in the State of Washington. He earned a Bachelor of Science in Civil Engineering from the United States Coast Guard Academy and a Master of Science in Civil Engineering from the University of Illinois (Champaign-Urbana).

DANIEL LUND, III

Daniel Lund, III is a Director in the New Orleans office of the law firm of Coats Rose, P.C. and for his 29 years' of practice has been engaged in general civil litigation, focusing primarily on construction industry and surety matters, products liability, telecommunications law and zoning. Mr. Lund received his B.A. degree in philosophy from the University of New Orleans, his J.D. degree from Tulane University, and an M.T.S. degree from Duke University. He serves on the Construction Arbitration Panel of the American Arbitration Association and on the panel of mediators and arbitrators for Perry Dampf Dispute Solutions in New Orleans. Mr. Lund is admitted to practice before all courts in Louisiana and the United States District Courts in Louisiana, as well as the United States District Court for the Northern District of Florida. He is a member of the American Bar Association Fidelity and Surety Law Committee, and is a member of the Louisiana State Bar Association.

DAVID C. OLSON

David Olson is a member of Frost Brown Todd LLC and practices with the litigation department. He received his BA from Williams College and his J.D. from The Ohio State University Law School.

In the past 38 years, he has represented numerous sureties and other clients in the construction industry in complex commercial litigation in Ohio, Kentucky, Indiana and West Virginia.

He has spoken in New York, Connecticut, Massachusetts, Kentucky, California and Ohio on various issues regarding suretyship issues, litigation strategy, discovery, and construction disputes. His presentations have been to the ABA's Fidelity and Surety Law Committee, the Surety Claims Institute, the National Association of Credit Management, the Construction Financial Management Association, the National Business Institute and the Ohio Legal Center. He has also contributed as an author in many ABA publications on topics regarding suretyship.

He was Chair of the ABA's Fidelity and Surety Law Committee in 2013-2014.

R. JEFFREY OLSON

Jeff Olson is a Senior Surety Claims Counsel for Liberty Mutual. Jeff has worked in the surety claims field since 2000, handling primarily performance and payment bond claims. Jeff also became the President of the Pearlman Association in 2015. Jeff enjoys spending time with his family and getting in a round of golf every so often. He claims a 10 handicap. Jeff has been a licensed attorney in the state of Washington since 1996.

MIKE F. PIPKIN

Mike F. Pipkin is a partner with Weinstein Radcliff Pipkin LLP, Dallas, Texas. He is a graduate of Abilene Christian University, B.B.A. 1986, and Southern Methodist University Dedman School of Law, J.D. 1989. He is a Past Chair of the ABA TIPS Fidelity and Surety Law Committee and was the Founding Co-Chair of the FSLC's Construction Law Subdivision. He serves as one of eight attorneys in the USA on the National Association of Surety Bond Producers Attorney Advisory Council. In 2016, Mike was elected to membership in the Federation of Defense & Corporate Counsel (FDCC), an organization comprised of leaders in the insurance and corporate defense bar. And, in 2017, Mike was selected as a Charter Fellow in the Construction Lawyers Society of America, an invitation-only construction lawyer honorary society with membership limited to 1,200 practicing Fellows from the United States and internationally.

DEREK POPEIL

Derek Popeil is an Assistant Vice President and a Surety Claims Manager in the Surety Claims department with over 25 years of experience in the surety industry. He has been with Chubb since 2013. In his capacity as surety claims manager he is responsible for handling performance bond claims and overseeing other surety claims examiners in the Surety Claims Department.

Derek started his career as an Associate General Counsel for First Indemnity of America Insurance Company where has was responsible for surety claims and for overseeing outside attorneys and consultants. After 10 years with First Indemnity of America Insurance Company, he left to enter the private practice of law where he opened a New Jersey office for the New York based law firm of Ernstrom & Dreste, LLP. Just prior to joining Chubb Derek worked for seven years at the law firm of Dreifuss Bonacci & Parker, LLP. During his years in private practice he handled all types of surety claims and litigation on behalf of numerous surety clients.

Derek graduated from Muhlenberg College in 1988 receiving a Bachelor of Arts degree. In 1991, he received his Juris Doctorate from Widener University School of Law. He is licensed to practice law in both federal and state courts of New York and New Jersey. He is a Vice Chair of the American Bar Association and a member of the TIPS Section.

JASON POTTER

Jason Potter is a partner in the Baltimore, Maryland law firm of Wright, Constable & Skeen, LLP. He received his B.A. from The Ohio State University and his J.D. degree from the University Of Baltimore School Of Law. Mr. Potter served as judicial law clerk for the Honorable Thomas E. Marshall of the Circuit Court for Harford County for the 2005-06 term. After his clerkship, he joined Wright, Constable & Skeen, where he practices in the areas of surety law, construction law, and commercial litigation. He is a member of the bar of the State of Maryland. He is also a member of the Maryland State Bar Association's Construction Law Section, the ABA's Fidelity and Surety Law Committee of the Tort, Trial and Insurance Practice Section, the American Bar Association Construction Law Forum, and a member of the Board of Directors of the Surety Claims Institute. Mr. Potter has been named as Super Lawyer® for 2016 and 2017 in the area of suretyship and was named as Super Lawyers® Rising Star from 2011 to 2015.

EDWARD RUBACHA

Edward Rubacha is a partner with the Phoenix, Arizona law firm of Jennings, Haug & Cunningham, LLP, practicing in the firm's Surety Section. Ed has a B.S.E.E. from Purdue University, an M.B.A. from Arizona State University, and a J. D., cum laude, from Arizona State. Ed joined Jennings, Haug in 1987. Ed's practice includes representing sureties in all phases of bonding, including underwriting and claims litigation, including issues concerning bonding on Indian reservations. Ed represents a number of sureties in Arizona, California, Colorado, and on various reservations throughout the western United States. Ed is admitted to practice each of those states, in both state and federal court, and in a number of tribal courts. Ed has published three articles on the topic of bonding and contracting on the reservation and is a frequent speaker on that unique area of the law.

TIFFANY SCHAAK

Tiffany Schaak is Western Regional Home Office Counsel for Liberty Mutual Group in Seattle, Washington. Ms. Schaak earned a Bachelor of Arts degree in Finance from the University of Puget Sound and a Juris Doctorate, cum laude, from Seattle University School of Law. Ms. Schaak has also received the Associate in Fidelity and Surety Bonding designation from The Institutes as well as the Chartered Property Casualty Underwriting designation.

RICHARD SEXTON

Richard Sexton has more than 25 years of experience in the fields of surety consultation, contract administration, construction scheduling, and construction claims. His experience includes overseeing the completion of a variety of project types such as general construction, mechanical, electrical, and specialty construction. Richard has performed project default analyses, payment and performance bond claim analyses, preparation of re-let packages, takeover management/oversight, cost-to-complete estimates and exposure analyses. Richard also specializes in project scheduling, spanning all stages of a construction project including the pre-construction/design development phase, permitting and procurement phases, and construction. Richard is experienced in the evaluation, analysis, preparation and defense of construction claims including schedule impact analyses, cost impact analyses, the calculation of construction damages, productivity analyses, time impact analyses and as-planned vs. as-built schedule analyses. Richard is a graduate from the State University of New York at Binghamton. He is a LEED AP, and received a Planning and Scheduling (PSP) certification from AACE International.

GINA D. SHEARER

Gina Shearer is an Associate Attorney at Strasburger & Price LLP. She devotes her practice primarily to construction and surety matters, with particular emphasis on bankruptcy, oil and gas plugging and abandonment obligations, payment and performance bond obligations, construction defect disputes, and enforcing rights against indemnitors. She also represents parties in complex commercial litigation in federal and state trial and appellate courts, as well as before tribunals and federal agencies.

Gina is a displaced Chicagoan who found herself in Texas fifteen years ago for what she thought was a short stay to complete her education. She received a Bachelor of Science in Business Administration from the University of Texas at Dallas, *magna cum laude*, in 2007, and then obtained her J.D. from Southern Methodist University in 2010. While in law school she studied at University College, Oxford during the summer and was president of the Corporate Law Association. She stumbled into the surety industry by chance, but has happily spent her whole career immersed in surety. Once she got to know her fellow surety industry professionals better, she felt compelled to join the circus to maintain her sanity. She now has a backup career as an amateur aerial acrobat and regularly performs silks, rope, contortion, static and duo trapeze acts.

GREGORY A. SMITH

Gregory H. Smith is a partner in the Orange County, California, office of Booth, Mitchel & Strange LLP. Mr. Smith's practice focuses on surety law and business litigation matters in state and federal courts. He graduated from the University of California Berkeley in 2003 with a B.A. in Political Science and received his J.D. from Whittier Law School in 2005. During law school he clerked for the Los Angeles District Attorney's Office, Surfrider Foundation and the Public Counsel Law Center. After law school Mr. Smith worked as an Equal Justice Works/ AmeriCorps Attorney and later as a Staff Attorney at the Public Counsel Law Center where his practice focused on consumer litigation. Mr. Smith is a member of the State Bar of California and resides in Laguna Beach, California.

JAN D. SOKOL

Jan D. Sokol is one of the founders and the Managing Member of Stewart Sokol & Larkin, LLC. He represents prime contractors, subcontractors, real property managers, small corporations, sureties and fidelity insurers. His practice includes advising and organizing businesses, as well as the preparation of construction claims. He also has an extensive practice representing creditors in bankruptcy courts throughout the United States. Mr.

Sokol handles complex corporate, commercial, construction and real property litigation, arbitrations and mediations.

Mr. Sokol is a frequent speaker at the Western States Surety Conference and the Pearlman addressing wide ranging topics in the construction and surety industry.

Oregon Super Lawyers Magazine listed Jan as one of the top lawyers in the state for the last eleven consecutive years (2006 to 2016).

MICHAEL SUGAR, III

Michael Sugar, III is a consultant with Forcon International, assisting Sureties in a wide variety of Contractor Default situations. He specializes in contracting issues and disputes. Additionally, Michael assists with Property & Casualty investigations involving property damage and/or mechanical equipment failures. Prior to joining Forcon, Michael spent 6 years as a Project Manager for Clark Construction Group (Bethesda, MD) specializing in Government intelligence facilities.

SHASHAUNA SZCZECHOWICZ

Shashauna Szczechowicz, a partner at Wolkin Curran, primarily practices out of Wolkin Curran's San Diego office. She specializes in representing surety clients in all aspects of litigation involving surety bond claims. Ms. Szczechowicz assists sureties with developing cost effective strategies to minimize risk and loss.

Ms. Szczechowicz regularly represents surety clients in the defense of complex construction surety bond claims. Her experience includes litigating public and private construction disputes involving sureties, such as negotiating completion obligations in bond default situations, analyzing and defending against public works wage claims, enforcing payment defenses, securing collateral, and pursuing indemnity rights.

Ms. Szczechowicz has significant experience with commercial bonds involving probate estates, trusts, conservatorships and guardianships. She has represented sureties throughout California in a variety of probate matters, including defending against surcharge actions, locating and securing assets, preparing inventories and accountings, and obtaining orders discharging the bond. Ms. Szczechowicz's practice also includes bankruptcy experience representing sureties in pursuing secured claims, lifting the automatic stay and protecting cash collateral, and litigating adversary proceedings, including objections to debtor's discharge.

Ms. Szczechowicz earned her Juris Doctor from Loyola University in New Orleans, Louisiana in 2003. At Loyola, Ms. Szczechowicz was a member of the Loyola Law Review. Ms. Szczechowicz completed her undergraduate degrees at Florida State University, earning a Bachelor of Arts degree in Criminology and a Bachelor of Arts degree in Psychology. Ms. Szczechowicz is admitted to the California State Bar, all U.S. District Courts of California and the U.S. Court of Appeals for the Ninth Circuit.

RODNEY J. TOMPKINS, JR., JD

Rodney J. Tompkins Jr. is a managing partner and VP of RJT Construction Inc., Consulting Services. Rodney has worked in Surety claims and construction consulting for over 14 years, and maintains RJT's focus on Surety claims, construction law, complex project and surety loss mitigation, case management, scheduling, estimating, accounting, litigation, and construction processes and methodology.

Rodney earned his Bachelors Degree at University of San Diego, and Post Graduate Construction Management Certificate at U.C. Berkley School of Engineering, as well as his J.D. at Lincoln Law School of Sacramento where he was Editor-In-Chief of the Voir Dire, and won multiple awards in ADR, Negotiations, and Moot Court.

He is a member of numerous professional organizations, has presented on topics of Construction and Project Management, Claims, Electronic Discovery and Books and Records, and others. Rodney has served as Vice President and President of the Surety Claims Association of Los Angeles, as well as current ongoing leadership positions within the Fidelity Surety Law Committee (FSLC). He also dedicates his time to his family and youth sports and serves on the board of local youth sports organizations in Southern California.

PATRICK TOULOUSE

Patrick Toulouse is a 1983 graduate of Pomona College in Claremont California. He subsequently received his Juris Doctor from Cornell Law School in 1986 and a Master of Business Administration from the University of Washington in 1999. He is a member of the Washington State Bar. Patrick joined Travelers in 2002 after 16 years of private practice in Seattle and is currently a Technical Director and Counsel in Travelers Federal Way office.

PAUL VERSAGE

Paul Versage is a principal of Sage Associates from 2002 to the present. He holds construction licenses in Arizona, California, and Nevada. Mr. Versage has over thirty years of experience in the construction industry, providing services as a general contractor, Construction Manager, Owner's Representative, and consultant. He has extensive experience in project management, estimating, scheduling, claims analysis, and defaulted contract completion. As a member of Sage associates, Mr. Versage is actively involved in Surety matters, construction investigations, claims analysis, and litigation support for a variety of residential, commercial, and engineering projects. His role typically includes defect investigation and analysis, evaluation of contractor/subcontractor performances, contract evaluations, project cost analysis, preparation of cost to complete/repair estimates, affirmative claims preparation, and contract completion methodology. He is especially adept at rapid assessment and evaluation of troubled projects, quickly assessing exposure and formulating solutions to meet all parties' obligations while minimizing risk. His project management experience, as well as estimating and scheduling skills, provide the necessary tools to "jump into the fray" and lead the parties to resolution.

THOMAS K. WINDUS, ESQ.

Tom Windus is in the Seattle office of Watt Tieder, practicing primarily in the area of surety and construction law. Tom has represented surety and construction clients for over thirty years in a variety of disputes involving litigation in both state and federal courts. Tom has extensive experience in in state and federal courts involving trials as well as arbitration and mediation. Tom's undergraduate accounting degree gives his the ability help clients in the analysis of claims involving breach of contract, payment disputes, delay and disruption, labor productivity, contract interpretation and differing site conditions. Tom's practice has also involved representing commercial and surety clients in bankruptcy proceedings.

GENE F. ZIPPERLE JR.

Gene F. Zipperle Jr., is a partner of the Louisville, Kentucky, office of the law firm of Ward, Hocker & Thornton, PLLC. He is admitted to practice in the state and federal courts in Kentucky and Indiana, and federal court in Ohio, North Carolina and Florida. He represents contract sureties in matters involving bid, payment and performance bond claims and litigation, as well as protecting and prosecuting of the surety's indemnity rights. Gene also represents sureties and insurers in other business and commercial contexts, including fidelity bond and coverage issues, estate and probate matters, as well as miscellaneous bond matters, particularly transportation related bonds.

Sustaining Members

Alber Frank, PSC is a regional surety, fidelity and construction law firm that is the product of relationships forged by years of trust and confidence between its attorneys and clients. To effectively serve the interests of our clients in matters of surety and fidelity law, construction law, insurance law, commercial law, bankruptcy law, and probate law, our attorneys hold licenses to practice in Arkansas, Indiana, Kentucky, Michigan and Ohio. Furthermore, by partnering with local counsel, we have been able to expand our geographic boundaries to represent our clients in Alabama, Colorado, Florida Minnesota, North Carolina, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, West Virginia and Washington D.C.

Please visit our website at www.alberfrank.com.

Benchmark Consulting Services, LLC is a full service construction consulting firm serving the Western United States from offices in Irvine, California, Las Vegas, Nevada and Phoenix, Arizona.

Benchmark's staff of construction industry experts consult our clients in the areas of surety, construction defect litigation, property and casualty evaluations, construction claims, scheduling, construction litigation support, construction monitoring/fund control, project management and quality assurance services.

Please visit our website at www.benchmark-consulting.com.

Berkeley Research Group offers professional experience and competence in fact-finding, claims/dispute analysis, and litigation support, along with technical expertise in engineering, architecture, construction management, public contracting, specifications and technical document development, schedule development and analysis, cost analysis, negotiations, and expert witness testimony. Our multidisciplinary team has a strong foundation in project management, scheduling, and accounting combined with deep industry experience.

BRG has worked extensively with our clients and their outside counsel to assess the allegations and facts at issue and develop sophisticated but efficient solutions.

Our experts are experienced in litigation and domestic and international arbitration, and include Professional Engineers, Project Management Professionals, AACE Certified Planning & Scheduling Professionals, Certified Public Accountants, Certified Fraud Examiners, forensic accountants, and industry leaders.

Please visit our website at www.brg-expert.com.

Bierhalter & Associates

Bierhalter & Associates was formed in November 1999. It is a surety consulting firm located in the Houston, Texas area. We specialize in construction claims investigation and analysis. We also provide claims management and construction management to our clients. I have been involved in surety consulting since 1984. My team has over 40 additional years of experience in surety claims.

Please visit our website at www.bierhalterconsulting.com.

Since 1955, Booth, Mitchel & Strange LLP has provided exemplary legal service to businesses and individuals throughout California. With offices in Los Angeles, Orange County and San Diego, we are positioned to efficiently handle litigation and transactions throughout Southern California. In addition, over half of the firm's practicing lawyers are partners who have a personal stake in the quality of our work, the satisfaction of our clients in the results obtained and in the professionalism with which we represent them.

Rated AV by Martindale-Hubbell, Booth, Mitchel & Strange LLP handles private and commercial lawsuits and arbitrations involving tort, contract, environmental, construction, surety, commercial, employment, professional liability, landlord-tenant and real estate disputes. We represent both plaintiffs and defendants and have thereby developed a breath of insight that facilitates prompt and accurate analysis of our client's problem and an ability to obtain the most favorable resolution in the most efficient and cost effective way. We are also available to consult in the areas of commercial and construction contracting, real estate transactions, leasing, surety and employment.

Please visit our website at www.boothmitchel.com.

Bronster Fujichaku Robbins is recognized as one of the premier trial law firms in Hawaii, handling cases on all of the islands. We are an experienced litigation firm with an established track record of successful settlements, work outs, and trial verdicts in a wide variety of complex litigation, arbitrations and mediations. Our firm is strongly committed to serving the community through significant public and private *pro bono* work. Our philosophy is to obtain the best results possible for our clients through aggressive advocacy and efficient management practices.

Our areas of practice include commercial, business, surety and real property litigation; consumer protection law involving financial fraud, unfair or deceptive business practices; antitrust and competition law; litigation and advice to trustees and trust beneficiaries, including claims of breach of fiduciary duties; regulatory and administrative law before state and county agencies; environmental litigation; civil rights employment cases

including discrimination, harassment, and wrongful discharge; and arbitration, mediation and other dispute resolution services.

Please visit our website at www.bfrhawaii.com.

Cashin Spinelli & Ferretti, LLC is a multi-disciplinary firm providing consulting and construction management services to the Surety and construction industries. The Principals of Cashin Spinelli & Ferretti have more than 70 years of experience in providing expert advice and analysis to the nation's leading Surety companies. Drawing on the expertise of its staff of Professional Engineers, Architects, Attorneys, Certified Public Accountants, Field Inspectors and Claims experts, Cashin Spinelli & Ferretti is well poised to offer Surety consulting and litigation support services to the industry.

Operating from offices in: Hauppauge, New York (Long Island); Horsham, Pennsylvania (Philadelphia area); Farmington, Connecticut (Hartford area); Libertyville, Illinois (Chicago area); and Miami, Florida; Cashin Spinelli & Ferretti provides its services to all areas of the United States.

Please visit our website at www.csfllc.com.

Chiesa Shahinian & Giantomasi PC, with offices in New York, NY, West Orange, NJ and Trenton, NJ, is committed to teaming with our clients to achieve their objectives in an increasingly complex business environment. This goal is as important to us today as it was when our firm was founded in 1972.

Over the past four decades, CSG has expanded from eight to more than 130 members and associates, all of whom are dedicated to the legal profession and to the clients they serve. As our firm has grown, we have steadfastly maintained our commitment to excellence, offering businesses and individuals comprehensive legal representation in a cost-effective, efficient manner.

Our firm provides the high level of service found in the largest firms while fostering the type of personal relationships with the firm's clients often characteristic of small firms. We take pride in our reputation for excellence in all our areas of practice, including banking, bankruptcy & creditors' rights, construction, corporate & securities, employment, environmental law, ERISA & employee benefits, fidelity & surety, government & regulatory affairs, health law, intellectual property, internal investigations & monitoring, litigation, media & technology, private equity, product liability & toxic tort, public finance, real estate, renewable energy & sustainability, tax, trusts & estates, and white collar criminal investigations.

Please visit our website at www.csglaw.com.

Clark Consulting Group

Dan Clark, CPA, CFF, CGMA has over 32 years of construction industry experience in providing integrated construction services to the construction industry. Clients include general contractors, subcontractors, architects, sureties, developers, banks, equity investors, private and public owners. Mr. Clark provides litigation support for construction disputes, including claim preparation, claim analysis, schedule analysis and expert witness testimony both domestically and internationally.

COATS | ROSE

Coats Rose has one of the largest and most accomplished construction and surety practice groups in the Southwest. Our lawyers are regularly entrusted by sureties, owners, contractors and design professionals to handle some of the largest and most significant commercial and industrial matters in the United States and abroad.

We also assist the surety industry providing underwriting and claim advice for a wide range of surety products. We can staff projects from "trees to keys" – meaning we work on

developments from inception to turnover and beyond. Our capabilities include not only the construction and surety industries, but also commercial litigation of all types, public finance, real estate/land use/government affairs, banking, affordable housing, insurance, labor and employment and governmental relations.

For over 25 years, the attorneys at Coats Rose have been cultivating long term client relationships and helping clients to achieve their business aims. The vast majority of our business has derived from these longstanding client relationships. We treasure this fact and continue to make our clients' goals our purpose.

Please visit our website at www.coatsrose.com.

ERNSTROM & DRESTE LLP

The Ernstrom & Dreste, LLP law firm is proud to focus its practice on the surety and construction industries. Our experience and in-depth knowledge of surety and construction law is recognized locally, across New York State and even nationally. We serve clients across the country and around the globe. We are more than just a law firm; our industry knowledge helps us understand what is important to our clients. As leaders in surety and construction law, we are a team of accomplished professionals who understand the nature of both industries and the forces which shape those industries. Because the industries we serve are intertwined, our understanding of the surety industry means we can better serve our construction clients, and our knowledge of the construction industry means we can better serve our surety clients. We go the extra mile to make sure our clients are satisfied with the legal services we provide.

Please visit our website at www.ed-llp.com.

FA Fasano Acchione & Associates, LLC.

Fasano Acchione & Associates provides consulting services for a variety of clients in the construction and surety industries. The individuals at Fasano Acchione & Associates are accomplished professionals with expertise in surety, construction, engineering, project management, and dispute resolution including litigation support.

FA&A maintains offices in New York, NY, Philadelphia, PA, Mount Laurel, NJ, Seattle, WA, and Baltimore, MD. If you would like more information, please contact Vince Fasano at (856) 273-0777 or Tom Acchione at (212) 244-9588.

Please visit our website at www.fasanoacchione.com.

Forcon International is a multi-dimensional consulting and outsourcing firm that has provided services to the surety, fidelity, insurance and construction services industry for more than twenty-nine years. Our surety and construction services include books and records review, claim analysis, third party claims administration for sureties, bid procurement, estimating, project administration, scheduling and funds control. We are able to offer these broad ranges of services because FORCON is composed of senior claim management professionals, accountants, professional engineers and construction management executives. Forcon has acted as third party administrator dealing with bond claims and runoff services since its inception. The firm operates from six (6) offices located throughout the United States [FL, GA, MI, MD, PA, VA].

Please visit our website at www.forcon.com.

Global Construction Services, Inc.

Global Construction Services, Inc., located in Redmond, Washington, has provided project management, claims consulting services and surety loss consulting to virtually the entire spectrum of the construction industry since 1972. Our construction experts have assisted owners and contractors alike with the preparation and updating of project schedules, change order pricing and negotiation, and time extension calculations. We have prepared and/or defended claims on behalf of general contractors, subcontractors, sureties, public owners, private owners, architects and engineers. We have extensive experience providing expert testimony at deposition, arbitration and trial. We have deftly handled surety losses through all phases of project completion as well as the resolution of related claims both asserted by and defended by the surety.

Please visit our website at www.consultgcsi.com.

Guardian Group, Inc.

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Guardian Group, Inc. is a full-service consulting firm with offices nationwide specializing in surety claims, property and casualty claims, construction management and claims, construction defect claims, fidelity claims, construction risk management, expert witnessing and litigation support.

When you need expert construction and surety claims support, our distinguished twenty-five year track record yields confidence, unprecedented efficiency and results.

Guardian's management and staff consists of a unique combination of highly qualified engineers, architects, schedulers, project estimators, accountants, claims personnel and other professionals with expertise in all types of construction and surety bond claims. This knowledge, together with fully automated systems, provides our clients with expedient and cost effective claims resolutions.

Call on the one company engineered to exceed your expectations. Please learn more about Guardian Group, Inc.'s successful approach to consulting by visiting our website at www.guardiangroup.com.

JAMS®

Founded in 1979, JAMS is the largest private provider of mediation and arbitration services worldwide. With Resolution Centers nationwide and abroad, JAMS and its nearly 300 exclusive neutrals are responsible for resolving thousands of the world's important cases. JAMS may be reached at 800-352-5267.

JAMS neutrals are responsible for resolving a wide array of disputes in the construction industry, including matters involving breach of contract, defect, cost overrun, delay, disruption, acceleration, insurance coverage, surety, and engineering and design issues. The JAMS Global Engineering and Construction Group consists of neutrals who serve the industry through traditional ADR options such as mediation and arbitration, and through several innovative approaches to ADR such as Rapid Resolution, Initial Decision Maker, and Project Neutral functions. Further, JAMS neutrals understand the complexity of project financing and the demands of large infrastructure and other mega-projects and are

uniquely qualified to serve on Dispute Review Boards and other institutional approaches to conflict resolution. Please visit our website at www.jamsadr.com.

JHC JENNINGS HAUG CUNNINGHAM LAWYERS

The surety, construction, and litigation firm of Jennings, Haug & Cunningham, LLP delivers effective courtroom representation, capable legal advice, and superior personal service to our clients in the construction and surety industries. Our experienced lawyers provide representation in a broad array of practice areas including construction law, surety/fidelity law, bankruptcy, Indian law, business law, and insurance defense.

What distinguishes our Firm is the quality of service and the consistent follow-through clients can expect from our attorneys and staff. We pride ourselves in providing timely, effective, and efficient legal services to our surety and contractor clients.

The firm serves businesses and individual clients throughout the state of Arizona, and we can accept cases in the southwest United States, California, New Mexico, Nevada and in select bankruptcy actions nationwide.

Please visit our website at www.jhc-law.com.

Jennings Strouss
ATTORNEYS AT LAW

Founded in Phoenix, Arizona in 1942, Jennings Strouss is a dynamic law firm with the talent and insight to address a wide range of business legal issues. With law offices in Phoenix, Peoria and Yuma, Arizona, and Washington, D.C., the firm leverages its resources regionally and nationally.

Our litigation department stands as one of the most respected in the Southwest, with a proven track record of trial victories and successful outcomes for clients. The transactional department handles an array of business legal matters, from the negotiation and closing of complex transactions to providing counsel on common legal questions.

One of the many benefits of a relationship with Jennings Strouss is our pragmatic and results-oriented legal advice coupled with a healthy, well-managed and friendly relationship with our attorneys. In fact, several of our key clients have been with us for 30+ years. We feel privileged to enjoy lasting relationships with them, which we take as a testament to their confidence in and comfort with us.

We believe that to offer excellent advice and service, we need to understand our clients, as well as their business. Excellent service also means taking a long-term view and investing in relationships with clients as well as in our own people, processes, and services. No client service could be better than that given by a united firm, which values collaboration and teamwork. We believe everyone at the firm can make a difference in serving all of our clients.

Please visit our website at www.jsslaw.com.

J.S. Held is a leading consulting firm specializing in construction consulting, property damage assessment, surety services, project and program management, and environmental, health & safety services. Our organization is built upon three fundamental pillars: to provide high quality technical expertise; to deliver an unparalleled client experience; and to be a catalyst for change in our industry. Our commitment to these pillars positions us as a leading global consulting firm, respected for our exceptional success addressing complex construction and environmental matters in the world. Our team is a group of multi-talented professionals, bringing together years of technical field experience among all facets of projects including commercial, industrial, high rise, special structures, governmental, residential, and infrastructure. Our uncompromising commitment to our clients ensures our position as one of the most prominent consulting firms in our industry.

Please visit our website at www.jsheld.com.

KOELLER | NEBEKER | CARLSON | HALUCK LLP

Koeller, Nebeker, Carlson, Haluck, LLP (KNCH) prides itself in its handling of complex litigation matters. Our broad spectrum of practice areas includes litigation defense,

business law, employment law, insurance coverage and bad faith, environmental law, and most types of general practice areas. Our clients range from small business owners and their insurance companies; to mid-sized commercial contractors, landlords and tenants; to large nationwide homebuilders and commercial builders.

Over the 30 years of our existence, we have also become a recognized authority in all areas of construction litigation and transactions, with a particular specialty in representing builders, developers and general contractors. From real estate acquisition, development and financing, to construction and business litigation for both residential and commercial projects, our breadth of experience and geographical coverage ensures that our clients' personal business and financial concerns are being represented every step of the way.

As a direct result of the faithful support of our clients and the dedicated service of our attorneys and staff, the firm has grown to over 80 attorneys, 200 employees, with offices in Irvine, San Diego, Sacramento, Las Vegas, Phoenix, Orlando and Austin. Indeed, since its inception in 1986, KNCH has formed a dynamic presence throughout the states of California, Arizona, Nevada and Florida and has recently extended its reach into Texas. We look forward to developing new client relationships while continuing to excel at serving the needs of existing clients by achieving the highest level of excellence.

Dedicated to service, and driving ahead with integrity and courage, we are the law firm you want on your side. www.knchlaw.com

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Established in 1874, Kerr, Russell and Weber, PLC has evolved from a small practice in Detroit into a firm of committed, resourceful and respected lawyers with many talents and specialties. Our areas of practice include fidelity and surety. Kerr Russell represents sureties in a wide range of matters, including the handling of defaults; claims against performance bonds, payment bonds, probate bonds and other commercial bond forms; performance takeovers, tenders and subcontract ratifications; pursuit of indemnification; and all aspects of litigation. Our attorneys also include those whose specialties afford our surety practice access to a wide array of disciplines which are often beneficial to our services for surety clients, including corporate, tax, real estate, bankruptcy, and employment practices.

Please visit our website at www.kerr-russell.com.

KREBS | FARLEY PLLC
ATTORNEYS AT LAW

The nationally recognized attorneys of Krebs Farley, PLLC have litigated cases all over the United States. Our attorneys' skills show not only in the courtroom, but also in negotiation. The personal commitment and dedicated effort that our attorneys put forth make a difference in every case we handle. We are smart, pragmatic and diligent. And we are dedicated to creatively pursuing the best solutions for our clients.

We understand the importance of prompt, correct, and concise responses; foreseeing and accounting for future contingencies in contract drafting; resolving disputes that can be amicably resolved; and positioning those matters that cannot be settled for a successful outcome in litigation. We do this while remaining cognizant that litigation often impacts business considerations beyond the case at hand. We also work closely with our clients in developing and operating within a litigation budget. Whether it be in negotiation, in mediation, in arbitration, in trial or on appeal, the attorneys at Krebs Farley, PLLC seek pragmatic solutions for our clients.

Please visit our website at www.kfplaw.com.

LANGLEY | LLP
ATTORNEYS & COUNSELORS

Langley, LLP is a Texas civil trial, commercial bankruptcy, and appellate firm that represents Fortune 500 and middle- market industry leaders in disputes throughout the United States. Our firm is made up of ambitious and smart lawyers who demonstrate passion and zeal in representation of the firm's clients. We help our clients solve their legal challenges through aggressive negotiation or litigation. Our areas of specialty include surety and construction, property insurance claims, commercial litigation, and commercial bankruptcy.

Our attorneys try cases, handle arbitrations, litigate, negotiate, analyze, and communicate. At the heart of the matter, for us it is all about understanding our clients' business and keeping our clients informed. We are strong believers in creating a plan for each matter designed to arrive at an efficient and effective resolution. Most cases in the United States settle, as do most of ours. When a case must be tried, our trial lawyers relish the opportunity – whether it is a two day trial to the bench or a sixteen week jury trial. Whether the amount in controversy is hundreds of millions of dollars or a small sum, our

experience, communication skills, and use of cutting edge technology position us to achieve the winning result.

Please visit our website at www.l-llp.com.

The Law Office of Charles G. Evans has represented sureties in the last frontier of Alaska for more than forty years. From rebids and completion of defaulted contracts in remote locations, to bonded but busted roads, schools, hospitals, and dams, we solve problems with local knowledge and expertise. We know the environment. Our firm has a proven track record of limiting surety exposure and quickly capturing repayment for our clients. We combine personal service with innovative tech solutions and big firm capabilities to achieve results anywhere in Alaska.

Law Offices of John L. Fallat

Our firm has been representing fidelity and surety companies for over 20 years. We focus on problem solving, always attempting to resolve conflicts efficiently in a good-faith effort to avoid expensive, protracted litigation. However, we are certainly prepared to defend claims through the entire judicial process, including appeals. The size of our firm enables us to give personal attention to our clients' needs.

Please visit our website at www.fallat.com.

MDD is a world-class forensic accounting firm that specializes in economic damage quantification assessments. We have deep rooted and comprehensive expertise in matters related to the surety and construction industry.

Our experts speak over 30 languages and we have 42 offices on 4 continents. Our work spans more than 130 countries and 800 industries, and we frequently work with law firms, government entities, multi-national corporations, small businesses, insurance companies and independent adjustment firms.

For more information please contact David Stryjewski or Peter Fascia at 215.238.1919 or visit us at mdd.com.

Manier & Herod, P.C. is located in Nashville, Tennessee and provides representation, counsel, and advocacy on behalf of sureties and fidelity insurers throughout the United States. Manier & Herod's attorneys are actively involved in the Fidelity and Surety Committee of the American Bar Association (ABA) and frequently address the ABA and other professional organizations on topics relevant to the fidelity and surety industries. Manier & Herod represents fidelity insurers and sureties in underwriting, pre-claim workouts, coverage analysis and litigation, contractor defaults including performance bond and payment bond claims, contractor bankruptcies, surety litigation, indemnity actions, and other matters and forums.

Please visit our website at www.manierherod.com.

PCA Consulting Group was formed in January 1989 for the purpose of providing the surety, insurance, legal and financial industries with cost effective technical services. With over 80 years of aggregate experience, the construction and engineering professionals of the PCA Consulting Group have served the surety and insurance industries throughout the majority of the continental United States and have been involved in matters requiring knowledge of every construction specialty.

PCA has adapted its experience and systems to meet the Surety's requirements. From evaluating the status and cost-to- complete projection for an individual project, to analyzing the fiscal and operating point-in-time cash position of an entire construction company, PCA has developed the systems, acquired the expertise, and retained the personnel to provide results in a timely and cost effective manner.

Please visit our website at www.pcacg.com.

RJT CONSTRUCTION, INC.
CONSULTING SERVICES

For over 30 years, RJT Construction, Inc. has been dedicated to providing exceptional quality, experience, and professional services to the construction, surety, and legal industries. RJT operates as a full service consulting firm specializing in construction, surety, and related claims and litigation. RJT's typical services include: surety claims investigation and default analysis, completion obligations and oversight on behalf of surety, reporting, monitoring, payment bond analysis, claims preparation, claims analysis including support and defense, construction defect claims and litigation support, forensic investigation, scheduling analysis, and expert designation and testimony.

Please visit our website at www.rjtconstruction.com.

Roberts, Taylor & Sensabaugh, Inc.

Through a broad range of services, Roberts, Taylor & Sensabaugh assists its clients in minimizing the inherent risks in the construction process. We approach each task of surety and fidelity consulting, project and program management, construction oversight, construction claims services, and litigation support with the highest level of quality, detail, and professionalism. The education, experience, analytical and accounting skills of our staff provide the expertise to deal with complex construction issues.

RTS and its staff are dedicated to investigative excellence. Providing services worldwide, we endeavor to provide exceptional services to our clients with honesty and integrity.

Please visit our website at www.roberts-taylor.com.

Robinson+Cole

Robinson+Cole is an Am Law 200 firm serving regional, national, and international clients from nine offices throughout the Northeast, Florida, and California. Our 200-plus lawyers and other professionals provide legal solutions to businesses, from start-ups to Fortune 100 companies and from nonprofits and educational institutions to municipalities and state government.

Through an understanding of our clients' industry, the nature and structure of their business, their level of risk tolerance, and their budget considerations, we tailor our legal strategy to align with their overall business needs. Where appropriate, alternative billing arrangements are made to provide clients with a greater degree of certainty about their legal costs. Robinson+Cole's varied practice areas include construction and surety; insurance and business litigation; land use, environmental and real estate; labor, employment and benefits; tax; and intellectual property and technology.

Please visit our website at www.rc.com.

Sage Associates, Inc.

Sage Associates is very pleased to be among the sponsoring firms of Pearlman. We have provided high quality, high value consulting services in the surety industry, as well as construction, banking, and insurance industries, for more than 30 years and our contacts within the construction community and with attorneys and mediators within the construction field is unmatched in the western United States.

The firm's employees and associates offer a broad mix of expertise and skills. Surety claims work is facilitated by knowledge, patience, focus, and relationships. We focus on our client's business and objectives, working hard to assist sureties "deliver on the promise" and resolve claims. Cost to benefit is always a paramount consideration at Sage Associates as is a long term focus both in the assignment and with our relationship with our clients.

Please visit our website at www.sage-associates.com.

Sage Consulting Group provides consulting and expert witness services to the surety and construction industry on projects throughout the United States and Canada. Our expertise is focused on the heart of construction projects: time and money. The background of the Sage Team makes rapid and precise evaluation of costs to complete and project status possible. Sage's extensive background in construction claims and litigation is an asset when reviewing actual or potential defaults since troubled projects often have significant construction disputes. Favorable resolution of those disputes can be a significant source of salvage and reduce losses. Construction disputes arise out of the need by one of the parties to recover monetary damages. Sage focuses on first the areas of damage and then focuses on causation to narrow the research effort to the relevant areas of performance, resulting in a more cost-effective approach to claims assessment, development and defense.

Please visit our website at www.sageconsulting.com.

SALAMIRAD, MORROW, TIMPANE & DUNN LLP
ATTORNEYS AT LAW

SMTD Law LLP is a boutique law firm specializing in construction, surety and business litigation. The Firm's attorneys are highly experienced in handling disputes unique to the construction and surety industries and they understand the rigors and challenges of litigation. The Firm handles matters for many of the world's leading sureties in all types of commercial and contract surety matters. Our attorneys frequently assist our surety clients with: defense of contract and commercial bond claims; analysis and prosecution of affirmative claims; preparation of transactional documents, including loan and financing agreements; subdivision workouts with lenders and local entities; and handling complex indemnity and other salvage actions.

Please visit our website at www.smtdlaw.com.

Simon, Peragine, Smith & Redfearn, LLP has extensive experience in handling fidelity and surety related matters and litigation. Over the years, the firm's attorneys have handled numerous fidelity, contract surety, financial guarantee and miscellaneous bond and commercial surety matters.

The firm's attorneys who practice in the surety law field have been active participants in many professional associations, such as the Fidelity & Surety Committee of the Tort Trial Insurance Practice Section of the American Bar Association; the DRI Surety Committee; National Bond Claims Institute; Surety Claims Institute; and Louisiana Surety Association.

H. Bruce Shreves is the former Chair of the American Bar Association Fidelity & Surety Committee and the DRI Surety Committee; Jay Kern has served as a Vice-Chair of the American Bar Association Fidelity and Surety Committee; Mr. Shreves, Mr. Kern and Denise Puente have delivered numerous papers and lectures before various ABA Committees, as well as DRI, National Bond Claims and Surety Claims Institute.

Mr. Shreves is currently the Chair of the Louisiana Fidelity, Surety & Construction Law Section of the Louisiana Bar Association. Mr. Shreves, Mr. Kern and Ms. Puente have been named by New Orleans Magazine as Best Lawyers in New Orleans in the area of construction/surety, and have been named as Louisiana Super Lawyers in the areas of construction and surety. They are contributing authors or editors to various ABA publications, including the Law of Payment Bonds; the Law of Performance Bond; and the Law of Suretyship.

Please visit our website at www.spsr-law.com.

Snow Christensen & Martineau traces its roots to Provo, Utah, and 1886, ten years before Utah became a state. One of its founders, George Sutherland, later became the only Utahan to serve on the United States Supreme Court. The firm now enjoys a complement of more than 55 attorneys (including a recently retired but still energetic federal magistrate judge)

and a strong staff including more than 15 paralegals. With physical offices in Salt Lake City and St. George and virtual offices wherever needed, the Firm serves some of the Intermountain West's most vital and influential businesses and institutions. Snow, Christensen & Martineau benefits from an impressive history of service, growth and innovation in the legal community, and continues to build toward an equally impressive and significant future. The Firm is recognized for its preeminent trial work, but its attorneys are experienced in a broad spectrum of legal specialties, including complicated business transactions, patents, trademarks and other intellectual property. Many are recognized as among the best in their fields of practice, combining national expertise with personal service. The firm is committed to providing timely, superior legal services at a fair price. Its commitment to the practice of law is manifest in the general lackluster performance of most of its members on the golf course.

Please visit our website at www.scmlaw.com.

STEWART SOKOL & LARKIN LLC

ATTORNEYS AT LAW

Stewart Sokol & Larkin LLC is a Pacific Northwest law firm. The firm enjoys a superior reputation for excellent, competitive and cost-effective legal services in construction and design law, commercial litigation, business and corporate law, insurance coverage and defense, bankruptcy, real estate, and surety and fidelity law.

The firm's Portland, Oregon location provides strong roots for its Pacific Northwest presence, and an ideal location from which it maintains its client base throughout Oregon, Idaho, Washington and Alaska. In addition to the firm's Pacific Northwest presence, Stewart Sokol & Larkin is a national firm, handling matters throughout the United States and its territories, including, Guam, Saipan and the Northern Mariana Islands. The firm's reach throughout various federal and state court systems continues to grow on a regular basis as our loyal clients bring it to more locales each year.

The firm's exceptional service is the product of a cohesive team of highly experienced professionals, each of whom plays a vital role in meeting our clients' needs.

Please visit our website at www.lawssl.com.

Strasburger & Price has been at the forefront of the fidelity and surety industry for over fifty years. From the quiet days of the 1960's to the mercurial 1980's dealing with the banking and real estate crisis throughout the country, to the advent of electronic banking and mega-construction projects of the 1990's and 2000's, the lawyers in Strasburger & Price's Fidelity & Surety group have worked in partnership with our clients in every aspect of the industry.

Strasburger's surety lawyers provide experienced representation in all facets of the surety industry. The group's lawyers have significant experience representing sureties in connection with all types of bonds, including performance, payment, probate, public officials, subdivision, and various other miscellaneous commercial surety bonds. Our lawyers have successfully handled countless complex contract surety claims, expertly guiding sureties through pre-default investigations and negotiations and completion of construction projects after default, including drafting and negotiating completion contracts, takeover agreements, ratification agreements, financing agreements, and other pertinent surety agreements. Our lawyers likewise have extensive experience handling complicated and varied commercial surety bond claims, from the initial investigation and analysis to conclusion. Our expertise and experience extends to protecting the surety's interests in bankruptcy proceedings, including pre-bankruptcy and post-filing negotiations of reorganization plans, conflicts regarding unpaid proceeds of bonded contracts, negotiations regarding assumption of bonded obligations, and other issues affecting the surety in bankruptcy.

Please visit our website at www.strasburger.com.

SURETY & CONSTRUCTION CONSULTANTS, INC.

Surety & Construction Consultants was established in 1990 and has been serving the Surety and Fidelity industry for over 20 years. S.C.C. has offices in Tampa, Atlanta and Dallas which allows our consultants to handle projects throughout the continental U.S., Hawaii, Puerto Rico, Guam and other locations.

Services provided by S.C.C. include surety claims, fidelity claims, forensic accounting, expert testimony, property claims, errors and omissions, construction claims and reclamation claims. All of our consultants are degreed professionals with significant

construction and accounting experience. With diverse backgrounds and experience, our consultants understand construction from all perspectives. We also have the experience to address the complex financial elements present in Surety and Fidelity claims. This results in a quality service that our clients have come to rely upon.

Please visit our website at www.suretyconsultants.com.

THE HUSTEAD LAW FIRM
A Professional Corporation

The Hustead Law Firm, A Professional Corporation, launched in 1996 when Patrick Q. Hustead left the partnership of one of Denver's largest law firms to create a dedicated litigation practice focused on the surety and insurance industry. Since that time, the Firm has grown into a dynamic mix of attorneys and technology that produces the results its clients deserve and expect. From complex surety matters to nuanced bad faith claims, the Firm delivers the firepower of a large firm with the personal attention of a small one.

Please visit our website at www.thlf.com.

TLGGR
TORRE, LENTZ, GAMELL, GARY & RITTMASTER, LLP

Torre, Lentz, Gamell, Gary & Rittmaster, LLP is a boutique New York based law firm specializing in surety, fidelity and construction law and providing clients with the best features of small and large firms. TLGGR is able to provide this service by combining the seasoned legal talent and modern technology of a large firm with the personal attention, expertise and congeniality of a small firm. Our office is located in Jericho, Long Island, New York, which is within 30 minutes of Manhattan. While the firm's practice is located primarily in New York and New Jersey, TLGGR also has recently handled substantial matters in Connecticut, Pennsylvania, Delaware and Washington, D.C.

TLGGR handles all manner of commercial and business problems but in large measure specializes in counseling and litigation relating to (1) construction bonds, commercial surety bonds and other forms of suretyship, (2) construction contract and engineering disputes, (3) claims against project owners for wrongful termination and additional compensation, (4) financial institution bonds and other forms of fidelity or crime insurance, and (5) creditors' rights in bankruptcy. These matters involve us in a broad

range of commercial problems, including workouts, bankruptcy proceedings, and insurance coverage analysis and litigation.

Please visit our website at www.tlggr.com.

VERTEX®

Vertex is an international technical services firm that operates with urgency and produces exceptional value for our clients. VERTEX provides construction, environmental, energy, air quality, and engineering solutions. With over 20 domestic and international offices, along with unique teaming arrangements worldwide, we have the reach and relevant expertise to approach projects with remarkable efficiency gained through local knowledge. Our reputation for excellence, both in terms of timely results and quality service, spans the globe. It has earned us the trust of a prestigious client base that includes Fortune 100 companies and esteemed boutique firms in virtually every line of business.

Please visit our website at http://vertexeng.com/.

WHT PLLC
WARD, HOCKER & THORNTON

For over a quarter of a century, the attorneys at Ward, Hocker & Thornton, PLLC (WHT) have diligently and competently served their clients and have provided them with the highest quality legal representation. With offices in Lexington and Louisville, WHT serves the entire state of Kentucky and has litigated cases in nearly all of its 120 counties. Additionally, WHT often handles cases in the adjoining states of Indiana, Ohio, Tennessee and West Virginia.

WHT is a firm which generally represents the insurance industry and its insureds, the surety and fidelity industry, and the trucking industry. We also directly represent self-insured corporations (many of which are Fortune 500 companies) and various hospitals, health care providers and financial institutions. The net result is that our team of 30 lawyers has tremendous negotiation and litigation experience, having collectively handled thousands of cases encompassing several different areas of law, including: appellate practice, automobile/motor vehicle litigation, construction law, commercial and business litigation, extra-contractual/coverage issues, financial institution law, fire & casualty, governmental liability, healthcare professional liability, insurance defense, large loss

subrogation, products liability defense, premises liability, surety & fidelity law, trucking & transportation litigation, and workers' compensation defense.

Our attorneys are licensed to practice in all courts in Kentucky, and in addition have attorneys licensed to practice in the states of Indiana, Ohio and Tennessee. WHT has been awarded the prestigious AV rating offered by LEXISNEXIS Martindale-Hubbell, and we are listed in the Best Directory of Recommended Insurance Attorneys and Adjustors.

Our goal is to provide you and your business with result-oriented legal services in an effective, cost-efficient manner. We at WHT welcome the opportunity to be of service to you and will aggressively work to achieve a successful outcome.

Please visit our website at www.whtlaw.com.

Watt, Tieder has one of the largest construction and surety law firms in the world, with practices that encompass all aspects of construction contracting and public procurement. Our practice groups include: domestic construction law, government contracts, international construction law and surety law. Watt, Tieder's work characteristically relates to major development and construction projects involving highways, airports and seaports, rail and subway systems, military bases, industrial plants, petrochemical facilities, electric generating plants, communication systems, and commercial and public facilities of all types in the United States and globally.

Watt, Tieder is one of the premier surety law firms in the country. We represent more than a dozen sureties in North America, acting as national, regional or public contract counsel for them. Our surety clients include industry leaders like Arch Insurance Company, Cincinnati Insurance Company, Hartford Fire Insurance Company, Liberty Mutual Insurance Company, RLI Corp., SureTec Insurance Company, Travelers Casualty and Surety Company and Zurich North America. In our thirty years of practicing surety law, Watt, Tieder has gained particular expertise in default terminations, affirmative construction claims, surety "abuse of discretion" cases, government contract disputes, surety bad faith claims and all forms of contract bond defaults.

With offices in Washington DC Metro; Irvine, California; Las Vegas, Nevada; Seattle, Washington; Chicago, Illinois; and Miami, Florida, we have a staff of over 50 legal

professionals working throughout the United States, Canada, Europe, the Middle East, Asia, South America, Australia and Africa.

Watt, Tieder and its attorneys are annually recognized for accomplishments in construction and surety law, including top tier rankings in Chambers USA, the Legal 500 and US News-Best Lawyers.

Please visit our website at www.WattTieder.com.

WEINSTEIN RADCLIFF PIPKIN
ATTORNEYS AT LAW LLP

Weinstein Radcliff Pipkin LLP is a Dallas, Texas–based commercial litigation law firm with extensive experience in commercial construction, surety, fidelity and professional liability coverage and defense, and labor and employment. As advocates, clients nationwide look to us as their go–to firm for litigation in Texas, Oklahoma, Arkansas, and elsewhere. As advisers, we provide an early, honest case assessment, offering creative solutions and establishing reasoned expectations that save time, money, and headaches. Our attorneys have extensive experience handling construction and surety cases involving contractor defaults, construction and design defects, impact and delay claims, and catastrophic loss. We also have considerable trial and litigation experience for fidelity and professional liability insurers, as well handling labor and employment cases involving corporate management, employee benefits, and non-compete agreements.

Please visit our website at www.weinrad.com.

WILLIAMS KASTNER™

Williams Kastner has been serving clients in the Northwest since 1929. With more than 90 attorneys in offices located throughout Washington and Oregon and affiliated offices in Shanghai, Beijing and Hong Kong, we offer global capabilities and vision with a local sensibility.

We are well known for our vast trial and litigation successes. Our deep bench of seasoned litigators have extensive trial experience in federal and state courts. In fact, over the

course of the last three decades, Williams Kastner has tried (and won) more cases to jury verdict than any other firm in Washington.

The Construction Litigation & Surety Practice Team at Williams Kastner serves clients involved in all aspects of the construction industry, including general contractors, specialty subcontractors, owner/developers, architects, engineers, lending institutions, sureties and insurers. In the surety context, the Team handles the entire spectrum of issues, such as: analyzing and responding to default terminations and other performance bond claims; providing advice regarding complex bond claim investigations; addressing various project completion scenarios, including tenders, takeovers and financing the bond principal; defense of performance and payment bond claims under the Miller Act and state law, including discharge, exoneration and other surety-specific defenses; defense of extra-contractual claims by claimants, bond principals and indemnitors involving claims brought under the Washington Insurance Fair Conduct Act, the Consumer Protection Act and common law bad faith; prosecution of affirmative construction claims to mitigate surety losses; prosecution of indemnity and other salvage actions on behalf of sureties; resolving priority disputes between sureties, banks, trustees and public agencies; and defense of claims on miscellaneous bonds, including license bonds and public official bonds. When the situation warrants, the Team draws upon other practice areas within the firm to serve the needs of our construction industry clients. These practice areas often include: labor and employment, collections, bankruptcy, land use and real estate.

Please visit our website at www.williamskastner.com.

WOLKIN • CURRAN, LLP

Wolkin Curran specializes in surety, construction and insurance coverage litigation. With offices in both San Francisco and San Diego, Wolkin Curran's primary practice areas are in California and Nevada.

Wolkin Curran's surety and construction practice emphasizes the representation of sureties, general contractors, and public entities. Wolkin Curran investigates, negotiates, settles and litigates bond claims in trial, bankruptcy, and appellate courts. Wolkin Curran represents sureties in all aspects of commercial and contract suretyship, including takeover, completion, payment and creditor issues.

Please visit our website at www.wolkincurran.com.

Wright, Constable & Skeen's Fidelity and Surety Law Group has over 100 years of combined surety and fidelity experience. WC&S lawyers represent sureties in federal and state courts at both the trial and appellate levels, before regulatory bodies, as well as in various forms of alternative dispute resolution, including mediation and arbitration. WC&S lawyers draw on experiences gained both from working within, and for, surety companies.

WC&S' experience and knowledge provide efficient representation for its clients throughout the Mid-Atlantic region, including handling complex surety cases with the federal government. WC&S' practice encompasses all aspects of performance bond claims, payment bond claims, bankruptcy, indemnity/subrogation, and commercial surety bonds. WC&S is an active participant in various legal and industry groups and associations, and its lawyers are leaders and speakers on a wide variety of important topics to the surety and fidelity industry. In addition, WC&S' lawyers are contributing authors or editors to various ABA and industry publications and books. WC&S has developed a national reputation in representing sureties in bankruptcy, authoring various papers and texts on the subject, and speaking at numerous conferences.

Wright, Constable & Skeen has been named to the "2012 Top Ranked Law Firms™ in the U.S." by Lexis Nexis® Martindale-Hubbell®, as published in Fortune magazine. WC&S was recognized as a U.S. law firm of 21 or more attorneys where at least one out of every three lawyers, including associates, achieved the AV®Preeminent^{TM} Peer Review Rating^{SM}.

Please visit our website at www.wcslaw.com.

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Driving Directions

Willows Lodge to the Harbour Pointe Golf Club – 11817 Harbour Pointe Blvd, Mukilteo, WA

1.	Go right out of the parking lot onto NE 145th St/WA-202	1.7 mi
2.	Turn right onto NE 175th St/WA-202	0.2 mi
3.	Turn left onto 131st Ave NE/WA-202	0.3 mi
4.	Merge onto WA-522 W via the ramp on the left	0.8 mi
5.	Merge onto I-405 N toward Everett	6.7 mi
6.	Stay straight to go onto WA-525 N	4.3 mi
7.	Turn left onto Harbour Pointe Boulevard SW	1.7 mi
8.	End at 11817 Harbour Pointe Boulevard SW	

Harbour Pointe Golf Club to Willows Lodge - 14580 Northeast 145th Street, Woodinville, WA

1.	Start out going south on Harbour Pointe Blvd toward S Grove Dr	1.7 mi
2.	Turn right onto Mukilteo Speedway/WA-525	4.1 mi
3.	Take I-405 S toward I-405 S/Bellevue/Renton	6.8 mi
4.	Merge onto WA-522 E toward WA-202E/Monroe/Wenatchee	1.0 mi
5.	Take the WA-202 E exit toward Woodinville/Redmond	0.1 mi
6.	Merge onto 131st Ave NE/WA-202S toward Woodinville/Redmond	0.2 mi
7.	Take the 2nd right onto NE 175th St/WA-202	0.2 mi
8.	Turn left onto Woodinville Redmond Rd NE/WA-202	1.9 mi
9.	End at 14580 NE 145th St. Destination will be on the left.	

Harbour Pointe Golf Club to Marriott Redmond Town Center – 7401 164th Avenue NE, Redmond

1.	Start out going south on Harbour Pointe Blvd toward S Grove Dr	1.7 mi
2.	Turn right onto Mukilteo Speedway/WA-525	4.1 mi
3.	Take I-405 S toward I-405 S/Bellevue/Renton	11.9
4.	Take WA-908 E exit, exit 18, toward Redmond	0.7 mi
5.	Merge onto NE 85th Street	1.0 mi
6.	NE 85th St becomes Redmond Way	1.9 mi
7.	Turn right onto Cleveland Street	0.3 mi
8.	Turn right onto 164th Ave NE	0.05
9.	Enter next round-about and take the 3rd exit onto NE 76th St	0.09
10.	End at 7401 164th Avenue NE	

Harbour Pointe Golf Club to SeaTac Airport

1.	Start out going south on Harbour Pointe Blvd toward S Grove Dr	1.7 mi
2.	Turn right onto Mukilteo Speedway/WA 525	4.1 mi
3.	Merge onto I-5 S toward Seattle	30.1 mi
4.	Take the S 188th St exit, exit 152, toward Orillia Rd	0.2 mi
5.	Keep right to take the S 188th Street ramp	0.2 mi
6.	Turn right onto S 188th St	1.1 mi
7.	Turn right onto International Blvd/WA 99	1.0 mi
8.	End at Seattle-Tacoma International Airport. Airport is on the left.	0.8 mi

Willows Lodge to SeaTac Airport

1.	Head east on NE 145th St toward Sammamish River Trail.	0.1 mi
2.	At the traffic circle, continue straight to stay on NE 145th St	449 ft
3.	At the traffic circle, take the 1st exit onto Woodinville Redmond Rd NE	0.1 mi
4.	At the traffic circle, continue straight onto WA-202 E/Woodinville Redmond Rd NE	1.5 mi
5.	Turn right onto NE 124th St	2.5 mi
6.	Merge onto I-405 S via the ramp to Renton	20.5 mi
7.	Continue onto WA-518 W	0.9 mi
8.	Take the exit toward Sea-Tac Airport	0.8 mi
9.	Merge onto Airport Expressway	0.9 mi
10.	Slight right onto Departures Dr. Destination will be on the right	0.4 mi

Notes

Notes

Appendix/Papers

SESSION 1

THE SURETY'S ASSERTION OF THE PRINCIPAL'S DEFENSES AND ACTS OF THE PRINCIPAL THAT IMPACT THOSE DEFENSES

Benjamin Chambers | The Hartford Bond Claims | Gig Harbor, WA

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PEARLMAN 2017

September 7-8, 2017

Columbia Winery | Woodinville, WA

A. Introduction.

This paper examines the surety's right to assert claims/defenses available to the bond principal and how acts/omissions of the principal may impact or impair the surety's ability to do so. Consistent with the overall theme for this year's conference, we have attempted to give particular attention to recent case law and trends with a specific emphasis on the *Spearin* doctrine. The first section outlines certain legal and equitable defenses available to the surety. The second section identifies several key areas on which the surety should focus to attempt to ensure the surety's rights are preserved and protected from conduct by the principal.

B. The Surety's Assertion of the Principal's Defenses.

1. Introduction.

The surety confronted with a performance bond claim has a number of contractual and/or other potential defenses in its arsenal. One of the surety's first lines of defense arises from those defenses which its bond principal may assert.[1] It is Black Letter Law that a surety's liability is generally derived from that of its bond principal, and, therefore, the surety is not liable unless its

[1] This paper only addresses the surety's assertion of its principal's defenses. Obviously, the surety has other defenses, including, notably, the suretyship defenses of modification of the bonded obligation, impairment of collateral, release of the underlying obligation, and extension of time to perform the underlying modification. For further discussion of these defenses, *see, e.g.*, Julia Blackwell Gelinas and Genise W. Teich, *Chapter 11, Defenses Available to the Surety*, in THE LAW OF PERFORMANCE BONDS 575-621 (Lawrence R. Moelmann, Matthew M. Horowitz & Kevin L. Lybeck eds., Am. Bar Ass'n, 2d ed. 2009) ("Law of Performance Bonds"); Lauren McLaughlin and Edward Vollertsen, "'Who Impaired Whose Collateral?' An Overview of the Surety's Defense Based on 'Impairment of Collateral'" (June 2016) (unpublished paper submitted at the 2016 Annual Meeting of the Surety Claims Institute); Jim Kisner, Rob Lafayette, and Keith Lichtman, "Material Changes that Alter the Bonded Obligation" (June 2016) (unpublished paper submitted at the 2016 Annual Meeting of the Surety Claims Institute); Carol Z. Smith, "Surety Defenses in Practice, Modification of Contract, Impairment of Collateral, Release and Discharge and Extensions of Time—Proof, Problems, and Practice in Asserting These Defenses" (June 2016) (unpublished paper submitted at the 2016 Annual Meeting of the Surety Claims Institute).

bond principal is liable.[2] Thus, once the bond principal is terminated, the surety steps into its principal's shoes and may, generally speaking, assert its principal's defenses.[3]

One obvious example of this concept is the fact that the surety can rely upon the defense of the principal's actual performance of the bonded contract (the "underlying obligation" in the language of the Restatement of Suretyship), which discharges the bond principal from its bonded obligation to the obligee, and thus discharges the surety's secondary obligation to the obligee.[4] Additional examples of defenses to the obligee's claims that are available both to the bond principal and to the surety include an obligee's wrongful termination of the bond principal, an obligee's failure to follow condition(s) precedent prior to terminating the bonded contract, an obligee's failure to properly administer the bonded project and/or to pay the bonded contractor,

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[2] *See, e.g.*, BMD Contractors, Inc. v. Fid. & Deposit Co. of Maryland, 679 F.3d 643, 653 (7th Cir. 2012), *as amended* (July 13, 2012) (holding that surety answers for the debts of its bond principal and cannot be liable where its bond principal is not liable); Law of Performance Bonds at 576; George J. Bachrach, Jason R. Potter, and William Pearce, *A Primer for the RESTATEMENT OF THE LAW SURETYSHIP AND GUARANTY* 12-14 (Sept. 2016) (unpublished paper submitted at the Nineteenth Annual Northeast Surety and Fidelity Claims Conference) ("Restatement Primer").

[3] *See* RESTATEMENT OF THE LAW (THIRD) OF SURETYSHIP & GUARANTY § 34 (Am. Law Inst. 1996) ("Restatement of Suretyship"); James A. Black and T. Scott Leo, *Ch. IV, Suretyship Defenses*, in The Restatement of Suretyship and Guaranty: A Translation for the Practitioner 47-48 (T. Scott Leo and Daniel Mungall, Jr. eds., Am. Bar Ass'n 2005); Philip L. Bruner and Tracey L. Haley, *Chapter 1, Strategic "Generalship" of the Complex Construction Suretyship Case*, in Managing and Litigating the Complex Surety Case 29-30 (Philip L. Bruner & Tracey L. Haley eds., Am. Bar Ass'n, 2d ed. 2007) ("Managing Complex Surety"); George J. Bachrach, Michael A. Stover, and Kenneth M. Givens, Jr., *A Primer for the Surety's Handling of Performance Bond Claims* 8 (Sept. 2008) (unpublished paper submitted at the Nineteenth Annual Northeast Surety and Fidelity Claims Conference); United States F/u/b/o Jack Daniels Constr., Inc. v. Liberty Mut. Ins. Co., No. 8:12-CV-2921-T-24TBM, 2015 WL 9460115, at *8 (M.D. Fla. Dec. 28, 2015) ("a Miller Act surety stands in the shoes of its principal and is entitled to assert all the defenses that its principal may assert."); Aetna Cas. & Sur. Co. v. Warren Bros. Co., Div. of Ashland Oil, Inc., 355 So. 2d 785, 788 (Fla. 1978) (same); City of Birmingham v. Trammell, 101 So. 2d 259, 262 (Ala. 1958) (same). Note, however, that exceptions exist to this general rule. For example, a surety cannot assert defenses that are personal to its bond principal, such as the principal's bankruptcy or lack of capacity. *See* Restatement of Suretyship § 34(1). Further, many jurisdictions do not permit a surety to rely upon a "paid-if paid" clause or a "pay-when-paid clause" in the bonded contract to avoid liability. *See, e.g.*, U.S. ex rel. Walton Tech., Inc. v. Weststar Eng'g, Inc., 290 F.3d 1199, 1206 (9th Cir. 2002) (pay-if-paid and pay-when-paid clause unenforceable as to surety to avoid Miller Act Liability); Md. Code Ann., Real Prop. § 9-113 (West) (prohibiting surety enforcement of or reliance on pay-if-paid clauses in construction contracts); U.S. v. Gov't Tech. Servs., LLC, 531 F. Supp. 2d 1375, 1378 (N.D. Ga. 2008) (denying surety's assertion of pay-when-paid defense in bonded contract because it had the effect of waiving subcontractor's Miller Act rights).

[4] *See* Restatement of Suretyship § 19(a) (stating that a surety has a defense to a claim under a bond to the extent the bond principal has performed that bonded obligation); *see also* Restatement Primer at 12.

an obligee's breach of the implied duty of good faith and fair dealing, and an obligee's failure to provide adequate plans and specifications.[5] Each of these examples is discussed further below.

2. The obligee's wrongful termination of the bond principal.

The obligee's wrongful termination of the bonded contract is itself a breach of contract that relieves the surety of liability under its performance bond.[6] During its investigation, the surety will review the bonded contract's default termination provision to determine whether the obligee fully complied with it procedurally, as well as whether the termination for default was proper and justified. Generally speaking, in order to justify termination of the bonded contract, the obligee must show that the bond principal materially breached the contract sufficiently to justify termination. The Restatement of Contracts identifies the following factors in determining whether a contract breach is material:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
>
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
>
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;

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[5] These examples are by no means exhaustive. Additional defenses may include an obligee's insistence upon strict compliance in the face of economic waste, an obligee's hyper-technical inspection of the principal's work, the obligee's implied waiver of contract requirements, the impossibility or impracticability of the performance of the work, as well as the principal's right of set offs and/or its counterclaims. For more information on these defenses, *see, e.g.*, David J. Krebs and Shannah J. Morris, *Chapter 3, The Surety's Obligations Under the Performance Bond: To Perform or Not to Perform*, in BOND DEFAULT MANUAL 109-208 (Mike F. Pipkin, Carol Z. Smith, Thomas J. Vollbrecht & J. Blake Wilcox eds., Am. Bar Ass'n, 4th ed. 2015) ("Bond Default Manual 4"); Law of Performance Bonds at 587-89; Jarrod W. Stone, *Ch. 14, Common Obligee Theory and Other Setoff Rights – The Surety's Subrogation Rights to the Obligee's or Principal's Setoff Rights*, in THE CONTRACT BOND SURETY'S SUBROGATION RIGHTS 543-57 (George J. Bachrach, James D. Ferrucci, & Dennis J. Bartlett eds., Am. Bar Ass'n 2013); Restatement Primer at 48; Managing Complex Surety at 19-54.

[6] *See* Bond Default Manual 4 at 182; Miller v. City of Broken Arrow, 660 F.2d 450 (10th Cir. 1981); U.S. Home Corp. v. Suncoast Utils., 454 So. 2d 601 (Fla 1984); Managing Complex Surety at 20; Restatement Primer at 47.

(d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;

(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.[7]

The obligee may also not terminate for default the bond principal once the bond principal has substantially performed the bonded contract.[8] Substantial performance may be defined as the level of performance that provides the owner or obligee with the ability to use the project for the purpose for which it was intended.[9] Put differently, substantial performance means that the bond principal has completed its work to such a degree that it cannot be said to have breached its contractual obligations.[10] Because an owner/obligee may not terminate the bonded contractor for default after substantial performance, the obligee may be similarly precluded from pursuing the surety under the performance bond.

3. The obligee's failure to follow condition(s) precedent prior to terminating the bonded contract.

In addition to determining whether the breach was sufficiently material to justify contract termination, the investigating surety must also determine whether the obligee fully complied with the default termination clause of the bonded contract and any contractual conditions precedent prior to termination. For example, section 14.2.2 of the 2007 version of the American Institute of Architects A201 General Conditions for the Contract for Construction contains the following provision:

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[7] RESTATEMENT (SECOND) OF CONTRACTS § 241 (Am. Law Inst. 1981) ("Restatement of Contracts"); *see also* Bond Default Manual 4 at 176-177.

[8] *See* Bond Default Manual 4 at 179-182 and the cases cited therein.

[9] *See* Bond Default Manual 4 at 179-80; Doucette v. Guient, 2015-1346 (La. App. 4 Cir. 2016), 208 So. 3d 444, 451, reh'g denied (Jan. 20, 2017), writ denied, 2017-00328 (La. 2017), 218 So. 3d 114, and writ denied sub nom. Sterling Doucette v. Guient, 2017-00338 (La. 2017), 218 So. 3d 115; Superior Derrick Servs., L.L.C. v. Lonestar *203*, 547 F. App'x 432, 439 (5th Cir. 2013); Garner v. Hickman, 733 So. 2d 191, 196 (Miss. 1999).

[10] *See* Bond Default Manual 4 at 180; *also* Restatement of Contracts § 237 cmt. d and § 241.

> When any of the above reasons [for terminating the contract] exist, the Owner, after consultation with the Construction Manager, and upon certification by the Architect that sufficient cause exists to justify such action, may without prejudice to any other rights or remedies of the Owner and after giving the Contractor and the Contractor's surety, if any, seven days' written notice, terminate employment of the Contractor and may, subject to any prior rights of the surety: (1) take possession of the site and all materials, equipment, tools, and construction equipment and machinery thereon owned by the Contractor; (2) accept assignment of subcontracts pursuant to Paragraph 5.4; and (3) finish the Work by whatever reasonable method the Owner may deem expedient.

Thus, under 14.2.2, the owner must first consult with the construction manager and obtain the architect's certification that sufficient cause exists to terminate the contract before providing the contractor and surety with seven days' notice of its intent to terminate. In *Town of Plainfield v. Paden Engineering Company*,[11] the court considered the consequences of the owner/obligee's failure to follow these conditions precedent prior to termination.

In *Town of Plainfield*, the owner/obligee contracted with a structural steel fabricator and erector to supply the structural steel for a recreation and aquatic center. In accordance with its contract obligations, the contractor obtained payment and performance bonds. The owner/obligee also retained an architect to approve payments, among other things. The project experienced various problems, and the owner issued a seven-day notice of intent to terminate the contractor, but the notice was not sent to the contractor's sureties; instead, shortly after termination, the sureties were informed that their bond principal had been terminated and that further information would be forthcoming. In the subsequent litigation, the sureties obtained summary judgment, based upon the owner's failure to provide notice to the sureties, in violation of section 14.2.2.[12]

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[11] 943 N.E.2d 904 (Ind. Ct. App. 2011).

[12] The court also granted summary judgment to the contractor/bond principal as a result of the owner's failure to obtain the architect's certification that sufficient cause existed to terminate the contractor, as also required by section 14.2.2. Although the architect had emailed its concerns about the contractor's performance, the email did not sufficiently comply with the owner's obligations pursuant to 14.2.2, and, therefore, the court held the owner breached the bonded contract by failing to meet the condition precedent of obtaining the architect's certification.

On appeal, the court affirmed the entry of summary judgment as to both the sureties and the contractor:

> The parties herein entered into a contract assigning duties, rights, remedies and obligations. In the event of alleged failure by the contractor, Paden, to adequately perform, the owner, Plainfield, was permitted (upon satisfaction of specified prerequisites) to seek to hold the Sureties liable. Even so, the Sureties—as opposed to Plainfield—were accorded the right to elect among specified options. We may not rewrite clear and unambiguous language of a contract to alter the obligations of the parties.[13]

The court thus determined that the owner had not met these specified prerequisites, which deprived the sureties of the right to "elect among specified options" to satisfy their obligations under the performance bond. Thus, the appellate court affirmed judgment in the sureties' favor.

If a notice of intent to terminate is provided to the surety and/or the bond principal, the investigating claims professional should make sure that the notice complies with the requirements under the bonded contract and that it fairly and accurately advises the principal (and surety, if applicable) of the manner in which, in the owner's mind, the principal has defaulted, as well as whether there is a contractual right to cure the default, since the contractor can presumably only cure the default if it first knows how it has defaulted in the first place.[14]

Further, if the contract contains no express obligation to provide the bonded contractor with notice and opportunity to cure, such obligations may be implied. These obligations are particularly relevant where information necessary to the performance of the contract is within the

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[13] 943 N.E.2d at 916; *see also* Dragon Construction, Inc. v. Parkway Bank & Trust, 678 N.E.2d 55 (Ill. App. Ct. 1997) (discharging performance bond surety's bonded obligation as a result of obligee's failure to provide notice of termination to surety in accordance with bonded contract); L & A Contracting v. S. Concrete Servs., 17 F.3d 106, 111 (5th Cir. 1994) (same).

[14] *See* Bond Default Manual 4 at 184.

peculiar knowledge of only one of the parties to the contract.[15] Courts have held that, in such situations, the failure to provide notice and opportunity to cure may constitute a material breach of the bonded contract even where those obligations are not expressly required by the bonded contract.[16]

4. The obligee's failure to pay the bonded contractor and/or to properly administer the bonded contract.

The owner/obligee may also have breached the bonded contract in various other ways that may act to discharge a surety, in whole or in part, from its bonded obligation.[17] For example, the owner may fail to properly administer the bonded contract by not properly paying the bonded contractor, including remitting full payment for change orders issued by the obligee or its representative.[18] The breach by the obligee in properly processing or paying change orders may constitute a material breach of the bonded contract that may void the surety's bonded obligation,[19] or it may serve as grounds for converting the termination of default into a termination for convenience.[20]

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[15] *See* McClain v. Kimbrough Const. Co., 806 S.W.2d 194, 198 (Tenn. Ct. App. 1990) (holding that the obligation to provide notice, even if not expressly required by the parties' contract, in such situations "is a sound rule designed to allow the defaulting party to repair the defective work, to reduce the damages, to avoid additional defective performance, and to promote the informal settlement of disputes.") (internal citations omitted); *see also* Managing Complex Surety at 23-24.

[16] *See, e.g.*, Ins. Co. of North Am. v. Metropolitan Dade County, 705 So. 2d (Fla Dist. Ct. App. 1997); McClain v. Kimbrough Const. Co., 806 S.W.2d 194, 198 (Tenn. Ct. App. 1990).

[17] *See* Law of Performance Bonds at 579-580; T. Scott Leo and B. Scott Douglas, *The Obligee's Duties to Provide Plans and Specifications, Make Payment, and Process Change Orders*, 1997 A.B.A. FID. & SURETY LAW COMM. 10-11 (Jan. 24, 1997) (hereinafter "Obligee's Duties to Provide Plans").

[18] *See* Managing Complex Surety 45-48 and the cases cited therein.

[19] *See, e.g.*, Sage Street Associates v. Northdale Constr. Co., 809 S.W. 2d 775 (Ct. App. Tex. (1991) (obligee's failure to pay bonded contracted excused surety from performing); Obligee's Duties to Provide Plans at 10.

[20] *See* Coppola Const. Co. v. Hoffman Enterprises Ltd. P'ship, 157 Conn. App. 139, 163 (2015) (holding that owner's improper termination of contractor and failure to properly pay contractor was termination for convenience rather than default); Gulf Liquids New River Project, LLC v. Gulsby Eng'g, Inc., 356 S.W.3d 54, 83 (Tex. App. 2011) (holding, *inter alia*, that owner's default under bonded contract in failing to properly pay bonded contractor discharged surety); *see also* Obligee's Duties to Provide Plans at 8-10.

The owner/obligee may also change the nature or scope of the work in fundamental ways that amount to a cardinal change in the bonded contract.[21] A cardinal change is a breach of contract that may act to discharge a contractor, and therefore a surety, from the duty to perform. Courts often rely on one of two tests to determine whether a cardinal change exists.[22] The first such test is whether the change is so drastic that it requires the contractor to perform duties and tasks that are materially different from those that the contractor contacted to perform.[23] This test is often referred to as the "scope of contract test."[24] The second test focuses on projects awarded through the competitive bidding process, in which a cardinal change occurs when the contract is modified in such a way so as to materially change the competitive field.[25] This analysis focuses of the substance, rather than the magnitude, of the change.[26] Regardless of the test that is

[21] *See* Obligee's Duties to Provide Plans at 8-9; Restatement Primer at 54-55; Restatement of Suretyship § 41; Law of Performance Bonds at 595-603; Hartford Casualty Insurance Co. v. City of Marathon, 825 F. Supp. 2d 1276 (S.D. Fla. 2011) (holding, *inter alia*, that owner/obligee's issuance of change order in the approximate amount of $3 million to a contract in the approximate amount of $2 million operated as cardinal change to that bonded contract that discharged surety); *see also* Guy W. Harrison, *"The 'Cardinal Change' Doctrine As A Defenses To Surety Bond Claims: A Practical Guide To The Federal Case Law"* (April 1997) (unpublished paper submitted at the Eighth Annual Southern Surety and Fidelity Claims Conference); Colin Batchelor, "Litigating and Proving the Cardinal Change Defense" (June 2010) (unpublished paper submitted at the 2010 Annual Meeting of the Surety & Fidelity Claims Institute).

[22] Bond Default Manual 4 at 192.

[23] Bond Default Manual 4 at 192 citing Gen. Dynamics Corp. v. U.S., 585 F.2d 457, 462 (Ct. Cl. 1978).

[24] Bond Default Manual 4 at 192 citing Aragona Constr. Co. v. U.S., 165 Ct. Cl. 382, 391 (1964); *also* Northrop Grumman Corp. v. U.S., 50 Fed. Cl. 443, 466 (2001) (recognizing different tests under federal procurement law for cardinal change doctrine); In re Boston Shipyard Corp., 886 F.2d 451, 456 (1st Cir.1989) (cardinal change is drastic and fundamental modification in the work which requires contractor to perform duties materially different from those originally bargained for); J.A. Jones Const. Co. v. Lehrer McGovern Bovis, Inc., 120 Nev. 277, 293, 89 P.3d 1009, 1020 (2004) ("a cardinal change occurs when the work is so drastically altered that the contractor effectively performs duties that are materially different from those for which the contractor originally bargained."); Matter of Swanson Printing Co., GPOBCA No. 27A-94 (Nov. 18, 1996) ("A 'cardinal change' occurs if the ordered deviations alter the nature of the thing to be constructed, or amount to a 'drastic modification beyond the scope of the contract work.'")

[25] Bond Default Manual at 192 citing Cray Research, Inc. v. Dep't of Navy, 556 F. Supp. 201, 2013 (D.D.C. 1982); *also* Northrop Grumman Corp. v. U.S., 50 Fed. Cl. 443, 466 (2001) (recognizing scope of competition in cardinal change analysis).

[26] *See* Bond Default Manual at 192 citing Webcraft Packaging., Comp. Gen. Dec. B-194087, 79-2 CPD 120.

applicable to the cardinal change analysis, it is inevitably a fact-intensive analysis and, while common, has still not been universally adopted.[27]

5. The obligee's breach of the implied duty of good faith and fair dealing.

Most jurisdictions imply some duty on contracting parties to deal with their contracting partners in good faith and with fair dealing.[28] This duty of good faith and fair dealing, in the federal government context, also includes a duty to cooperate, which has been interpreted as the obligation not to "interfere with the other party's performance and not to act so as to destroy the reasonable expectations of the other party regarding the fruits of the contract."[29] Whether the government has breached an implied duty to cooperate is determined by the reasonableness of its actions under the circumstances.[30]

Courts have found breaches in these implied duties arising from an owner's failure to provide timely access to the job site,[31] failure to complete other work necessary for the contractor to proceed, [32] the failure to make timely decisions,[33] the failure to reasonably inspect and approve

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[27] *See* Law of Performance Bonds at 599; *see also* XL Specialty Insurance Co. v. Massachusetts Highway Dept., 2012 WL 3139874 (Mass. Super. July 12, 2012) (noting that no Massachusetts court has adopted the cardinal change doctrine).

[28] *See* Law of Performance Bonds at 196-197; Managing Complex Surety at 42-44; *also* Baistar Mech., Inc. v. U.S., 128 Fed. Cl. 504, 525 (2016) ("the implied duty of good faith and fair dealing includes a duty to cooperate and a duty not to hinder the other party's performance."); Renda Marine, Inc. v. U.S., 71 Fed. Cl. 378, 387 (2006).

[29] Kenney Orthopedic, LLC v. U.S., 88 Fed. Cl. 688, 703 (2009) (internal citations omitted); Renda Marine, Inc. v. U.S., 71 Fed. Cl. 378, 386 (2006). Although neither of these cases are construction or surety related, both provide an overview of federal government contracting and the duties of good faith and fair dealing implied in all such contracts.

[30] Metric Const. Co. v. U.S., 81 Fed. Cl. 804, 818 (2008).

[31] *See* 3 Bruner & O'Connor Construction Law § 9:99 citing, in part, COAC, Inc. v. Kennedy Engineers, 67 Cal. App. 3d 916, 136 Cal. Rptr. 890 (1st Dist. 1977) (owner had implied duty to obtain easements and permits necessary to perform work); Ajax Paving Industries, Inc. v. Charlotte County, 752 So. 2d 143 (Fla. 2d DCA 2000) (requirement to obtain easements); J. A. Jones Const. Co. v. City of Dover, 372 A.2d 540, 22 U.C.C. Rep. Serv. 694 (Del. Super. Ct. 1977); Moorhead Const. Co., Inc. v. City of Grand Forks, 508 F.2d 1008 (8th Cir. 1975) (owner had impliedly warranted site availability which was denied when Phase I contractor was late in completing its work); *see also* Bond Default Manual 4 at 196; Managing Complex Surety at 43.

[32] *See* 3 Bruner & O'Connor Construction Law § 9:99 citing J. J. Brown Co. v. J. L. Simmons Co., 2 Ill. App. 2d 132, 118 N.E.2d 781 (1st Dist. 1954); COAC, Inc. v. Kennedy Engineers, 67 Cal. App. 3d 916, 136 Cal. Rptr. 890 (1st Dist. 1977) (owner required to complete environmental impact statement); *see also* Bond Default Manual 4 at 196; Managing Complex Surety at 43.

work, [34] the failure to assist in the other's performance,[35] and the failure to properly schedule and coordinate the work.[36]

Delays in the completion of the work are among the most common complaints by owners, contractors, trade contractors, and sureties. Owners commonly seek to hold the contractor liable for such delays, even where the contractor bears no responsibility. Ordinarily, the contractor is entitled to additional time for delays that are outside of its control and may be entitled to compensation from the owner for changes within the owner's control.[37] Such compensable owner-responsible delays may arise from the examples identified in the preceding paragraph and may act as a defense to the surety if the obligee default terminates the bond principal.[38] Similarly, an obligee's failure to grant extensions of time for delays caused by weather, labor strikes, or other influences outside of the contractor's and owner's control may also act as a defense to the performance bond surety.[39]

6. The obligee's failure to provide adequate plans and specifications.

The obligee's failure to provide the bond principal with adequate plans and specifications for the project may also act to discharge the bond principal, and thus the surety, from a

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[33] *See* 3 Bruner & O'Connor Construction Law § 9:99 citing Horton Indus., Inc. v. Village of Moweaqua, 142 Ill. App. 3d 730, 97 Ill. Dec. 17, 492 N.E.2d 220 (5th Dist. 1986) (while contractor took on risk of delays, it could recover because it did not assume the risk that owner and its engineer would be slow in responding to its inquiries); Appeal of Continental Consol. Corp., E.N.G.B.C.A. No. 2743, E.N.G.B.C.A. No. 2766, 67-2 B.C.A. (CCH) ¶ 6624, 1967 WL 320 (Corps Eng'rs B.C.A. 1967), modified on reconsideration, E.N.G.B.C.A. No. 2743, E.N.G.B.C.A. No. 2766, 68-1 B.C.A. (CCH) ¶ 7003, 1968 WL 442 (Corps Eng'rs B.C.A. 1968) (untimely shop drawing review entitled contractor to extension of time and money).

[34] *See* 3 Bruner & O'Connor Construction Law § 9:99 citing, in part, Miller v. City of Broken Arrow, Okl., 660 F.2d 450 (10th Cir. 1981); Adams v. U. S., 175 Ct. Cl. 288, 358 F.2d 986 (1966) (inspector rejected high number of items and withheld criteria for inspections).

[35] *See* 3 Bruner & O'Connor Construction Law § 9:99 citing J. A. Jones Const. Co. v. City of Dover, 372 A.2d 540, 22 U.C.C. Rep. Serv. 694 (Del. Super. Ct. 1977).

[36] *See* 3 Bruner & O'Connor Construction Law § 9:99 citing Natkin & Co. v. George A. Fuller Co., 347 F. Supp. 17 (W.D. Mo. 1972); Quaker-Empire Const. Co. v. D. A. Collins Const. Co., Inc., 88 A.D.2d 1043, 452 N.Y.S.2d 692 (3d Dep't 1982); Tribble & Stephens Co. v. Consolidated Services, Inc., 744 S.W.2d 945 (Tex. App. San Antonio 1987), writ denied, (July 6, 1988); *see also* Bond Default Manual 4 at 196-197; Managing Complex Surety at 43.

[37] *See* Bond Default Manual 4 at 196-8.

[38] *See* Bond Default at 197.

[39] *See* Bond Default Manual at 197 citing J.D. Hedin Constr. Co. v U.S., 408 F.2d 424 (Ct. Cl. 1969).

performance bond claim. This principle, first articulated in *U.S. v. Spearin*,[40] has been adopted in virtually every jurisdiction throughout the United States, and has been held to extend not only to general contractors, but also to subcontractors, even though the general contractors in such situations merely pass along the defective design to the subcontractor.[41] The doctrine may be invoked if the contractor reasonably relies on the owner's design information, and may, like most matters, be modified by contract.[42] A few recent cases are instructive.[43]

In *Greenbriar Digging Service L.P. v. South Central Water Association, Inc.*,[44] a contractor was retained to install an ozone system to reduce the color in the water produced by a well to 20 units or less. The contractor followed the plans and specifications supplied by the project's owner, but was still unable to meet the 20 units-or-less standard. The owner withheld final payment, and the contractor filed suit, arguing that, pursuant to the *Spearin* doctrine, the project's owner impliedly warranted the plans and specifications, which were defective.

The court noted that, although no cases directly addressed applicability of the *Spearin* doctrine under Mississippi law, the doctrine has been adopted virtually universally. The court determined, however, that in its contract with the owner, the contractor had agreed to guaranty that the water would meet the 20 units or less standard specified in the plans and specs. Thus, the project's owner successfully argued that it had expressly delegated responsibility for the

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[40] 248 U.S. 132, 39 S. Ct. 59, 63 L. Ed. 166 (1918).
[41] *See* Bond Default Manual 4 at 34-35 citing APAC Carolina, Inc. v. Town of Allendale, S.C., 41 F.3d 157 (4th Cir. 1994).
[42] *See, e.g.*, Granite Re, Inc. v. City of La Crescent, 2009 WL 2982642 (D. Minn. 2009) (holding that contractor hired to install underground piping beneath Mississippi River was wrongfully terminated following problems with pipe installation, despite following architect's plans and specifications, which were defective and which failed to identify potential problems with construction, which thus acted to discharge performance bond surety).
[43] Many courts approach application of the *Spearin* doctrine by determining first whether the allegedly defective specification is a design specification or a performance specification. *See, e.g.*, PCL Const. Servs., Inc. v. U.S., 47 Fed. Cl. 745, 796 (2000) (internal citations omitted). If the specification is an agreed-upon performance specification, then the contractor is more likely to retain responsibility, because the contractor has discretion on how to perform. *Id.* If, however, the specification is a design-specification, the contractor has less discretion and the owner will more likely bear responsibility for any defective design. *Id.*
[44] 2009 WL 812241 (S.D. Miss. March 26, 2009) (as to liability phase) and 2010 WL 972239 (S.D. Miss. March 12, 2010) (as to the damages phase).

project's design to the contractor. The court found it unnecessary to reach the applicability of the *Spearin* doctrine to the project and entered judgment in favor of the owner and against the contractor and its surety.

The take away, as it usually is, is to read the contract (in addition to the bond!) carefully and do not assume that the universality of the *Spearin* doctrine will automatically insulate the principal and surety from liability for defects in the plans and specifications – even where there is no dispute as to their defectiveness. Thankfully, however, *Greenbriar* appears to be more of an outlier case and has not been followed by any other courts to date. A more recent case is more encouraging.

In *Laship, LLC v. Hayward Baker, Inc.*,[45] a political subdivision of the State of Louisiana hired a contractor to install soil-mix columns as the foundation of new shipbuilding facility to prevent the facility from "falling victim structurally to the soft and compressible Louisiana soil."[46] The contract required the contractor to install the soil-mix columns so that 90% of the project's phase I samples and 100% of the phase II and III samples to meet a minimum requirement for unconfined compressive strength. Both the trial and appellate courts found it undisputed that the contractor had met the unconfined compressive strength requirements for all three phases. Despite this, the columns exhibited signs of failure, and the owner hired a contractor to perform remedial work and then filed suit against the defaulted contractor.

In the ensuing litigation, the owner alleged that the contractor had breached its contract to properly install soil-mixed columns for the project and that, if the design of the columns was defective, then the contractor had a duty to warn the project's owner of the design defects. Both the district court and the Fifth Circuit disagreed, holding that the contractor had supplied the soil-mixed columns at the strengths identified in the contract's specifications and, therefore, it did not

[45] 680 Fed. App'x 317 (5th Cir. 2017).
[46] 680 Fed. App'x at 319.

breach its contract with the owner. Both courts also found that the contractor had no duty to warn the owner about the design defects, applying a Louisiana-state equivalent of the *Spearin* doctrine. That state-law equivalent was codified to state that a contractor shall not be liable under state law for any construction if performed according to the plans or specifications supplied to the contractor as long as the defect was due to a "fault or insufficiency of the plans or specifications."[47] Unlike *Greenbriar*, the holding in *Laship* reinforces the modern validity of the *Spearin* doctrine, even in situations where the contractor knew, or could/should have discovered, the defective nature of the design.

B. Acts of the Principal that Impact the Surety's Defenses.

As the above sections make clear, the surety confronted with a performance bond claim has several options – affirmative and defensive – based on the conduct of the obligee. The conduct of the principal, however, can also factor into the equation. This section highlights a few examples from recent cases where the conduct of a contractor – before, during, and after construction – has or could impact the surety's ability to assert claims or defenses, with a particular focus on the *Spearin* line of cases identified above.

While the examples below are by no means exhaustive, especially in the context of the *Spearin* doctrine, particular attention should be given to the language of the bonded contract and the extent to which it may impact or limit the surety's ability to use the *Spearin* doctrine as a claim or defense. Attorneys or claims professionals should also have a full understanding of the principal's conduct during construction, as specific acts or omissions may constitute a waiver of a *Spearin*-based argument. And, during the dispute/litigation phase, the surety or those representing it must ensure that procedural formalities are met to ensure the necessary claims or

[47] *Id.* at 321 citing Louisiana Revised Statute 9:2771.

defenses find their way to the jury. The surety or its representatives should of course be familiar with the law in the governing jurisdiction, as particular laws may vary.

1. The Language of the Bonded Contract.

As noted above, one of the first things to consider when evaluating any claim or defense is the language of the bonded contract. Most bond forms expressly incorporate the bonded contract by reference in some capacity, and the surety may be bound by the language of the bonded contract to the extent the bond does not expressly limit or contradict the language in the contract.[48] As such, even before a project starts, the principal may have impacted the surety's ability to assert a *Spearin* claim by simply entering into an onerous contract.[49]

Indeed, some courts have held that plain and unambiguous contract language that "explicitly places the risk of unanticipated [project] conditions squarely on the contractor" bars a contractor's *Spearin* claim for damages for differing site conditions.[50] In *McDevitt*, the contractor built a Marriott in Herndon, Virginia. The contractor sought, *inter alia*, extra compensation for corrective work allegedly caused by poor and unanticipated soil conditions based on the *Spearin* line of cases. The contractor alleged that the owner "in effect, misled [the contractor] with respect to the actual condition of the soils" by failing to provide accurate soil reports.[51]

The court ruled in favor of the owner, relying almost exclusively on the underlying contract, which contained several clauses unfavorable to the contractor, including the following:

> [The owner] provided the soils report "solely as a matter of convenience and general information," and expressly disclaimed "any responsibility for the data as

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[48] *See, e.g.*, Tower Ins. Co. of N.Y. v. Davis/Gilford, 968 F. Supp. 2d 72, 79-83 (D.D.C. 2013); *but see* American Home Assur. Co. v. Larkin General Hosp., Ltd. 593 So. 2d 195, 198 (Fla. 1992) (explaining that the terms of the bond govern the surety's liability, which cannot be extended beyond the terms of the bond).

[49] Of course, the bond should also be considered, as the bond contains the contractual agreement between the surety and obligee.

[50] McDevitt & St. Co. v. Marriott Corp., 713 F. Supp. 906, 914 (E.D. Va. 1989), aff'd in part, rev'd in part (on other grounds), 911 F.2d 723 (4th Cir. 1990).

[51] *Id*. at 910.

> being representative of the conditions and materials which may be encountered." The Contract, in fact, expressly omits the report from the Contract documents, encourages bidders to conduct their own soil and subsurface investigations, and expressly bars claims based on soil conditions differing from those presented in the Geosystems report. The parties, through the Contract, could not have been clearer in expressing their intent that the risk of differing soil conditions remained on the contractor. In choosing not to conduct its own soil tests and, instead, relying on the Geosystems report when preparing its bid, [the contractor] assumed the risk that the actual soil conditions would be different from those reported. Given these facts, there is no persuasive reason to shift to [the owner] the burden of accommodating the soil conditions on the Project site. Under the explicit terms of the Contract, [the contractor] is not entitled to additional compensation simply because the actual soil conditions created unforeseen difficulties.[52]

McDevitt therefore illustrates the risk that pre-construction conduct of the contractor could be unfavorable to the surety standing in its contractor's shoes. Courts have used similar logic to preclude *Spearin*-based claims when the bonded contract requires the contractor to make an independent inspection of site conditions.[53] In an oft-criticized decision, at least one court relied on a contractual "no damages for delay clause" to preclude a contractor from recovering damages from an owner for failing to provide accurate plans, holding that the language of the bonded contract precluded such claims.[54]

While the existence of unfavorable exculpatory or similar clauses in a bonded contract may inhibit or eliminate the surety's use or defense of claims based on the *Spearin* doctrine, there are exceptions. Not every exculpatory clause is sufficiently broad to shift the risk of ineffective plans onto the contractor.[55] For instance, in *Costello* the owner argued against the contractor's *Spearin* claim, asserting that "[the contractor] agreed in the parties' contract that the

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[52] *Id*. at 914 (internal citations omitted).
[53] *See, e.g.*, Green Const. Co. v. Kansas Power & Light Co., 1 F.3d 1005, 1009 (10th Cir. 1993) (citing Brant Constr. Co. v. Metropolitan Water Reclam. Dist., 967 F.2d 244, 248 (7th Cir. 1992)). For a more in-depth discussion of specific instances where the contractor's duty to inspect was at issue, *see* Obligee's Duties to Provide Plans at 7 n.22.
[54] Dugan & Meyers Constr. Co., Inc. v. Ohio Dept. of Adm. Servs., 113 Ohio St. 3d 226, 230-33 (Ohio 2007). Many states have barred as violative of public policy the type of no damage for delay clause at issue in *Dugan*. *See, e.g.*, C.R.S. § 24-91-103.5; N.C.G.S.A. § 143-134.3; OHIO REV. CODE §§ 4113.62(C)(1) and (2). Please refer to the statute and/or prevailing law in your jurisdiction, as the law in this area varies greatly.
[55] *See, e.g.*, Costello Const. Co. of Md., Inc. v. City of Charlottesville, 97 F. Supp. 3d 819 (W.D. Va. 2015).

construction documents were 'complete and sufficient for bidding, negotiating, costing, pricing, and construction of the Project,' and that [the contractor] had a 'continuing duty to review and evaluate the Construction Documents' and to notify the City of any problems it discovered."[56]

Citing to *Spearin* and its progeny, the *Costello* Court disagreed with the owner:

> These standard contract provisions, however, do not amount to an express warranty by which Costello affirmatively accepted the burden of any defects in the City's construction documents. *See Spearin*, 248 U.S. at 136, 39 S.Ct. 59 (The "responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work."); *Chantilly Construction Corp. v. Commonwealth*, 6 Va. App. 282, 369 S.E.2d 438, 444–45 (1988) ("Courts have been reticent to find that generally worded contract provisions place the burden of defective specifications on the contractor").[57]

As a result, careful attention should be given to the specific contractual language at issue and compared with the law in a given jurisdiction, to analyze the extent to which (if at all) an exculpatory clause in the principal's bonded contract contains sufficiently clear and explicit language to impact the defenses/claims available to the surety. The surety and its representatives are also wise to analyze whether even an explicit exculpatory clause is nevertheless unenforceable on equitable grounds, for example when an owner makes an affirmative representation of a site condition in derogation of the contract language, such that a defense of unclean hands, waiver, or estoppel could be asserted.

2. Conduct During Construction.

The principal's actions during the course of the project can also affect the availability of a claim or defense based on the insufficiency of the plans and specifications. For example, it is axiomatic that, for a claimant to prevail on a differing site conditions claim, the contractor must, among other things, show that it reasonably relied upon its interpretation of the contract

[56] *Id*. at 825-26.
[57] *Id*. at 826.

documents.[58] As *Stuyvesant Dredging Co. v. U.S.*[59] makes clear, a contractor's failure to take reasonable steps to confirm the sufficiency of the plans and specifications may limit or preclude a *Spearin* claim.

In *Stuyvesant*, the contractor was to perform "maintenance dredging" of the Corpus Christi Entrance Channel for the Army Corps of Engineers on the Texas Gulf Coast. As pertinent here, dredging is work performed to ensure that the channel maintains its original size and shape and includes the removal of material within and immediately below the affected channel.[60] The contract documents contained statements regarding the general nature of the material to be removed, the average density of the materials, and an advisement that bidders "are expected to examine the site of the work and the records of previous dredging."[61]

Prior to bidding on the contract, the contractor had performed dredging work on two other Army Corps projects in Texas.[62] Prior to entering into the two prior contracts, the contractor "reviewed the records in the Corps' offices regarding previous dredgings, removed physical samples of the material to be dredged, and performed echo soundings of the channel bottoms."[63] Conversely, for the project at hand, the contractor "did not review the records of previous dredgings available in the Corps' offices, and did not visit the site to take material samples or echo soundings. In examining the government's bid documents, [the contractor] concluded that the wording of the technical provisions in the Corpus Christi project was 'very similar, almost identical' to the technical provisions of the Sabine–Neches and Freeport bid

[58] Sanders Constr. Co. v. U.S., 220 Ct. Cl. 639, 641 (1979).
[59] 834 F.2d 1576 (1st Cir. 1987).
[60] *Id*. at 1578.
[61] *Id*. at 1579.
[62] *Id*.
[63] *Id*.

documents that it had previously reviewed, and that it was not 'warranted to go to the expense of or necessary to do any particular further investigation.'"[64]

During construction, the contractor encountered large quantities of material that were difficult to dredge, causing decreased productivity and an extended project duration.[65] The contractor sought extra compensation, for which the Corps refused to pay because the site conditions did not materially differ from what was represented in the plans. The Court of Claims rejected the contractor's claim, and the First Circuit affirmed, reasoning (in part):

> Each government contract stands by itself…Unless the government advises contractors that conditions in different contracts are the same, a contractor acts at its peril if it assumes that what it learned in bidding on other contracts applies equally to a new contract. Here the government gave no indication that the conditions in the Corpus Christi Channel were the same as or similar to those in the other channels. To the contrary, the government explicitly told prospective bidders that they should "examine the site of the work and the records of previous dredging ... and after investigation decide for themselves the character of the materials."
>
> The Claims Court correctly held that "[p]laintiff cannot prove a differing site condition based upon the information in the files of the Corps because it never reviewed that information until the contract was nearly completed, but more importantly the Corps' records accurately reflected the character of the material encountered by other dredges." As that court correctly stated, where a contractor "has opportunity to learn the facts, he is unable to prove ... that he was misled by the contract."[66]

Stuyvesant is a cautionary tale for the surety to ensure that the principal has substantially complied with all contract documents, failing which the surety standing in its principal's shoes later may be unable to meet an essential element of a differing site conditions claim. A similar admonition can be found in *Nippo Corp./Int'l Bridge Corp. v. AMEC Earth & Envtl., Inc.*,[67] a recent case between a subcontractor (the JV) and AMEC, the general contractor, for work at the

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[64] *Id*.
[65] *Id*.
[66] *Id*. at 1582.
[67] 2013 WL 1311094 (E.D. Pa. 2013).

Andersen Air Force Base on Guam, including the removal of asphalt runways and replacement with Portland cement pavement.

As pertinent here, the JV claimed that AMEC was responsible for the delay and cost of the JV's removal and replacement of spall repairs on the new pavement. Relying on *Spearin*, the JV contended that the specifications regarding the material to be used for spall repairs was defective because it required the JV to use a "low slump" mixture for the repairs.[68]

During the course of the work, AMEC discovered that numerous spall repairs were disintegrating and requested that the JV investigate. That investigation led AMEC to discover that, rather than utilize the material specification required by the contract documents, the JV incorporated its own proprietary patching materials to perform the spall repairs. The JV conceded using its own material, but argued that it nevertheless attempted to meet the "low slump" requirement in the specification, which is what actually caused the repairs to fail (not the proprietary material). The JV therefore sought compensation for the delay and costs associated with the spall repairs.

AMEC disputed liability, arguing that the JV's decision to use its own proprietary material essentially voided the low slump specification.[69] The District Court agreed with AMEC, holding that "although the Court finds that the specification to use a very low slump mixture when employing Portland cement concrete as a spall repair material likely *was* defective, the JV chose instead to use a proprietary patching material, to which the low-slump requirement did not apply, pursuant to the language of the Subcontract. In light of the fact that the JV has conceded that no fault is to be assigned to AMEC's own concrete expert, Paul Okamoto, for his participation in the original spall repair mix design, the Court cannot find AMEC liable for

[68] *Id*. at *37.
[69] *Id*. at *39.

directing the JV to mix to a half-inch slump."[70] As such, the Court rejected the JV's claim on *Spearin* grounds.

These cases – and others like them – reveal that the principal's construction conduct can adversely affect the assertion of a claim or defense based on the *Spearin* doctrine. Especially in the context of a *Spearin* issue, the surety and its representatives are wise to obtain and analyze all the pertinent project files to analyze whether the principal has taken some action that precludes a claim, or conversely, the obligee did something that makes such a claim viable.

3. Conduct During Litigation.

If the surety is fortunate enough to avoid the principal signing a hostile contract with unfavorable exculpatory clauses and then to keep the principal from waiving a *Spearin* claim/defense during the construction process, the last hurdle is to ensure the claim is presented properly. Trials come with sundry technical and procedural pitfalls, and the surety should be careful to ensure a *Spearin*-based claim is presented with the necessary elements of proof. A recent case from the Missouri Court of Appeals neatly outlines the law on point.[71]

The *Penzel* Court explained, "at its core, a *Spearin* claim is a breach of contract action," for which the elements are almost universally something like (1) the existence and terms of a contract; (2) that plaintiff performed or tendered performance pursuant to the contract; (3) breach of the contract by the defendant; and (4) damages suffered by the plaintiff.[72] To establish a claim for breach of contract under *Spearin*, the plans and specifications must be defective or "substantially deficient," meaning they are "so faulty as to prevent or unreasonably delay completion of the contract performance."[73]

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[70] *Id*. at *40.
[71] Penzel Constr. Co., Inc. v. Jackson R-2 School Dist., -- S.W. 3d --, 2017 WL 582663 (Mo. App. 2017).
[72] *Id*. at *5.
[73] *Id*. (citing Caddell Const. Co., Inc. v. U.S., 78 Fed. Cl. 406, 413 (Fed. Cl. 2007)).

Careful attention should be given to how and through what witness(es) a *Spearin* claim is going to be presented. If there is no witness, there is no case, and a principal could effectively thwart a *Spearin* claim if there is nobody to offer testimony to prove it up. To that end, a key question in *Penzel* was whether expert testimony is required to prove a *Spearin* claim. The *Penzel* Court explained that "expert testimony is only required 'when a fact at issue is so technical or complex that no fact-finder could resolve the issue' without it. A trial court's determination of whether the facts in a case are so complicated that they require expert testimony lies within its discretion."[74]

The *Penzel* Court ultimately held that while the issues in the case itself were "highly technical and complicated in general, most of the problems alleged by Penzel, and testified about by its witnesses, were simple enough for a layperson to understand. For example, testimony that the Plans omitted critical components, called for outdated or non-existent products, and failed to comply with building codes are issues a layperson without any technical training could understand. Accordingly, Penzel was not required to produce expert testimony to prove the Plans were substantially deficient."[75] This serves as a thoughtful reminder, however, that even if no expert is used, the surety should still have someone testify about the project conditions, get the plans and specifications into evidence, and explain the case in simple terms so that the jury can understand the issues. Again, without this evidence in the record, a *Spearin* claim could be subject to scrutiny on appeal.

Penzel goes on to explain that, while expert testimony is not required, it may still be admissible if it will help the jury in understanding the issues.[76] If expert testimony is presented, the surety should ensure that the proffered expert "possesses superior knowledge on a subject

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[74] *Id*. at *6; *see also* F.R.E. 702.
[75] *Id*. at *6.
[76] *Id*. at *7.

that persons without such education or experience would be incapable of forming an accurate opinion or drawing correct conclusions. As long as the witness has some qualifications, the testimony may be permitted. The depth and breadth of experts' experience and knowledge are pertinent to the weight to be accorded their testimony, not to the admissibility of their opinion."[77] Likewise, "expert opinions are only admissible if they are based on facts and data that are reasonably reliable and of the same type experts in the field would reasonably rely upon to form opinions and make inferences on the subject."[78] Tendering an unqualified expert, or an expert with an unsupported opinion, with no Plan B, could be fatal to the presentation of a *Spearin* claim.

Finally, the surety should ensure any damages associated with a *Spearin* claim are presented with "reasonable certainty."[79] The overarching goal of damages is to place the non-breaching party in the position they would be in absent the breach, while only penalizing the breaching party to the extent it is responsible for the resultant damages.[80] Critically, uncertainty as to the amount of damages does not prevent a recovery; once the fact of damages has been established, a jury has reasonable discretion to approximate an award as long as the award is tied to some factual evidence.[81]

There are numerous ways to present a damage case to a trier of fact, and those methodologies are outside the scope of this paper (although they are part of a separate paper and presentation at this seminar). What is critical for our purposes here is that the surety and its representatives be aware that sufficient evidence of damages must be put into evidence, from which a jury can fashion a reasonable award. Again, with no damages, there is no claim, and a

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[77] *Id*. (internal citations omitted).
[78] *Id*. at *8; *see also* Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993).
[79] *Id*. at *10.
[80] *Id*. at *12.
[81] *Id*.

principal's failure to provide the surety sufficient documentary support could be fatal to a *Spearin* claim.

C. Conclusion.

The bond principal offers the surety with a variety of defensive and offensive tools to defend against an obligee's performance bond claim. It is important to note, however, that the principal may modify these tools, either contractually or by its behavior on the job site, that can have a significant impact on the surety presented with a performance bond claim. It is therefore essential for the surety claims professional to know and understand not only the defenses available in its arsenal, but to investigate how the principal may have altered those defenses by and through its conduct.

SESSION 2

THE *SPEARIN* DOCTRINE – IMPLIED WARRANTIES IN GOVERNMENT CONSTRUCTION CONTRACTS

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PEARLMAN 2017

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The *Spearin* Doctrine –
Implied Warranties in Government Construction Contracts

Pearlman Conference 2017 – Seattle, Washington

This paper addresses the applicability of the *Spearin* doctrine, the implied warranties that stem from it, and the ability of the contractor to use the doctrine both offensively and defensively.

- The *Spearin* doctrine applies to construction cases where design specifications are provided by the owner to the contractor, and the specifications are defective and do not allow construction of the project to achieve the expected result.
- By providing the specifications to the contractor, the owner impliedly warrants that they are accurate and adequate for their intended use.
- The doctrine can provide a defense for the contractor to avoid liability if it is sued for unexpected issues encountered during construction.
- The doctrine can be used offensively by the contractor as a theory of recovery for extra time, funding, or other resources invested in the project including government-caused delays arising from defective specifications.

I. Introduction

The *Spearin* doctrine is derived from *U.S. v. Spearin*, which was decided in 1918 by the Supreme Court of the United States.[1] The doctrine effectively relieves the contractor of liability to an owner for loss or damage resulting from defective plans or specifications. The doctrine can only be applied if the owner provided those plans, and the contractor was required to follow them.[2] Under *Spearin*, the owner impliedly warrants the adequacy of the plans and specifications when it provided them to the contractor.[3] The doctrine can be used offensively by the contractor to recover compensation for increased time and money spent on the project due to the inadequate

[1] United States v. Spearin, 248 U.S. 132 (1918).
[2] *Id.*
[3] *Id.* at 137.

plans.[4] Or, it can be used defensively, as it was in the *Spearin* case, to avoid liability for an unexpected result.[5]

II. History and Development of the Doctrine

Before the turn of the 19th century, contractors bore all risk in construction unless the contract stated otherwise and absent an act of God.[6] The standard approach to assigning liability provided that "[when] one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered." [7] This was the standard approach applied construction disputes between contractor and owner until *Hollerbach v. U.S.* was decided in 1914.[8]

A. *Hollerbach* Marks First Deviation from Contractor-Bears-All-Risk Approach

The *Hollerbach* decision was the first deviation from the standard approach to construction disputes, as the Court recognized circumstances that would relieve the contractor of liability for flawed contract provisions and shift that risk to the owner.[9] The contract provisions in *Hollerbach* contained positive representations about the condition of the construction site which were blatantly false.[10] The owner (in this case, the federal government) also included a provision in the contract to avoid liability for any inaccurate estimates contained in the specifications and which shifted the burden of inspection to the contractor.[11] The Court of Claims had upheld this provision and ruled in favor of the owner. On appeal, the Supreme Court held that positive statements made by the owner about the specifications must be taken as "true

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[4] Scott Calahan, *The Spearin Doctrine: Determining Who Bears the Risk of Design Errors*, UNDERGROUND CONNECTION (2017), http://www.sgrlaw.com/the-spearin-doctrine-determining-who-bears-the-risk-of-design-errors/ (last visited May 31, 2017).
[5] *Id.*
[6] *Spearin*, 248 U.S. at 136
[7] *Id.*
[8] Hollerbach v. U.S., 233 U.S. 165 (1914).
[9] *Id.*
[10] Paragraph 33 of the specifications said that the dam was backed with broken stone, sawdust, and sediment. When the contractor began to dig, they noticed that the backing was actually made of a soft, slushy sediment. *Id.* at 167.
[11] The text of that provision, Paragraph 20, read: "It is understood and agreed that the quantities given are approximate only, and that no claim shall be made against the United States on account of any excess or deficiency, absolute or relative, in the same. Bidders, or their authorized agents, are expected to examine the maps and drawings in this office, which are open to their inspection, to visit the locality of the work, and to make their own estimates of the facilities and difficulties attending the execution of the proposed contract, including local conditions, uncertainty of weather, and all other contingencies." *Id.*

and binding," and that the contractor had a right to rely on them without incurring a duty to investigate any possible falsity.[12]

The resolution if the case turned on two specific clauses. The first was Paragraph 33 which contained positive representations about the condition of the land and said the dam was backed with broken stone, sawdust, and sediment about two or three feet high.[13] The second provision, Paragraph 20, attempted to deny liability of the owner for any errors through a disclaimer that said all quantities provided in these specifications are only approximations and the contractor cannot bring an action against the government if the approximations were in error.[14] The Court of Claims read the contract holistically and allowed Paragraph 20 to modify the positive representations about the land made in Paragraph 33.[15] In contrast, the Supreme Court highlighted the difference between slightly inaccurate estimations and blatant misrepresentations of fact. The Court stated that government contracts should be interpreted to ascertain the intention of the parties.[16] Applying these principles, the Court held that the positive representations in Paragraph 33 were included to assure the contractor as to the character of the material. Further, if the government wanted the contractor to independently investigate the condition of the construction site, the Court noted that the positive representations in Paragraph 33 should have been omitted.[17]

B. *Spearin* Marks Second Deviation

Four years later, the Court took another step away from what had been the "standard" approach in *U.S v. Spearin* when it held that plans provided by the owner to the contractor create an implied warranty as to their adequacy to perform the work.[18] In *Spearin*, the government provided the specifications to the contractor, Spearin, which described the character and dimensions of the construction site.[19] The specifications did not mention any obstructions that could hinder the project.[20] A hidden sewer beneath the construction site, that was unknown to

[12] *Id*. at 172.
[13] *Id*.
[14] *Id*. at 167.
[15] *Id*. at 169-171.
[16] *Id*. at 172.
[17] *Id*.
[18] The implied warranty of adequacy refers to the notion that the plans provided are adequate to achieve the desired result. *Spearin*, 248 U.S. at 137.
[19] *Id*. at 134.
[20] *Id*.

both parties, led to an unexpected overflow of water and sewage during construction.[21] The government knew that the project had water problems in the past, but it did not disclose that information to the contractor.[22] The damage from the overflow prevented the continuation of the project until it was fixed. The government argued that the contractor had the responsibility to fix the conditions of the construction site, which may have been a successful argument in a pre-*Hollerbach* era where the contractor bore all risk.[23] However, the Court rejected this approach and found that an implied warranty had been made by the government as to the adequacy of the specifications it had provided.[24] The Court also reinforced the principles articulated in *Hollerbach*, holding that the contractor had no duty to investigate the adequacy of the specifications.[25]

In *Spearin* unlike *Hollerbach*, the owner's specifications did not positively represent the construction site to be materially different from the actual field conditions. Neither the government nor the contractor knew of the hidden sewer that ultimately caused the flooding of the construction site.[26] However, the government was liable because they sponsored the inaccurate design specifications and the contractor did not have any flexibility to deviate from the provided plans when constructing the project.

The *Spearin* doctrine applies where design specifications are involved, as opposed to performance specifications. Further, *Spearin* doctrine only applies if the plans or specifications are sponsored by the owner. In other words, the contractor had no flexibility in the construction of the project because the owner provided very specific design specification.

III. Issues of Applicability

Several conditions must be satisfied for the *Spearin* doctrine to apply as an offensive strategy to recover damages or as a defense to liability. The first condition focuses on the type of specification that is used. The second condition looks at the amount of discretion the contractor has to execute the project. The two conditions are related for they help determine the amount of

[21] *Id*.
[22] *Id*.
[23] *Id*. at 135.
[24] *Id*. at 137.
[25] *Id*.
[26] *Id*. at 134.

discretion the contractor has in the design of the project. If the required conditions are met, the doctrine will apply and create an implied warranty as to the adequacy of the specifications.

A. Design vs. Performance Specifications

The applicability of the *Spearin* Doctrine hinges on whether the owner provided design or performance specifications.[27] It is important to understand the difference between the two, because a contractor can invoke the *Spearin* Doctrine only when it constructs a project employing design specifications.[28] The type of specification turns on the amount of discretion that the contractor has in the execution of the project. When greater discretion is afforded the contractor, the project is more likely to have used performance specifications. When the contractor is given little or no discretion, the project is more likely to have used a design specification.

i. Performance Specifications

Performance specifications are goal-oriented and simply describe the desired result without much detail on *how* that goal should be achieved.[29] For example, if the specification only calls for the windows of a building to be replaced, the contractor retains the discretion to decide how to accomplish the stated goal, including the choice of manufacturer and method of installation. Under these circumstances, the contractor is "expected to exercise [its] ingenuity in achieving that objective or standard of performance, selecting the means and assuming a corresponding responsibility for the selection."[30] Since the contractor can exercise its discretion in the construction process when using performance specifications, it shares the risk of liability with the owner for non-performance.[31]

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[27] *See PCL Constr. Servs., Inc. v. United States*, 47 Fed. Cl. 745 (2000).
[28] Wally Zimolong, THE SPEARIN DOCTRINE AS A DEFENSE TO DEFECTIVE WORKMANSHIP CLAIMS CONSTRUCTION LITIGATION (2012), http://apps.americanbar.org/litigation/committees/construction/email/spring2012/spring2012-0402-spearin-doctrine-defense-defective-workmanship-claims.html (last visited May 26, 2017).
[29] *Blake Constr. Co. v. United States*, 987 F.2d 743, 745 (Fed. Cir. 1993).
[30] *Id.*
[31] Zimolong, *supra* note 28.

ii. Design Specifications

Design specifications detail exactly how the construction project is to be performed and the contractor typically has no say in the execution of the project.[32] As described by the U.S. Court of Claims, with design specifications the contractor is "required to follow [these specifications] as one would a road map."[33] For example, the specifications will call for the windows to be replaced by X Manufacturer, using Y installation process and Z materials. The owner is the sole provider of all the details and therefore warrants that, so long as the specifications are followed, they are accurate and adequate to achieve the intended result.[34] In other words, the contractor can trust that performing the work using steps X, Y, and Z will yield a successful window installation. If the specifications do not yield a successful result, the contractor may be able to use the *Spearin* doctrine defensively to avoid liability for damages resulting from the faulty design specifications or offensively to recover any additional costs spent to correct the defects on the project.[35]

B. The Implied Warranties

Since its inception in 1918, the *Spearin* doctrine has grown to include two specific implied warranties: that the plans and specifications are (1) accurate and (2) adequate for their intended use.[36]

An owner breaches the warranty of accuracy when the actual condition of the site is not as indicated in the plans and specifications.[37] In other words, a positive representation is made as to the condition of the land and that representation is false or misleading. For example, the owner might breach this warranty if the specifications indicate that the land on the construction site will contain loose dirt or sand when, in actuality, it contains hard rock.

The warranty of adequacy is breached when the contractor follows the provided plans and specifications but the final product is either impossible to construct or is not the result that the owner wanted.[38] For example, the owner's plan states that the contractor should use X materials and Y method to build Z structure according to the blueprints included in the plan. If

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[32] *Id*.
[33] J. L. Simmons Co. v. United States, 412 F.2d 1360, 1362 (Ct. Cl. 1969).
[34] Zimolong, *supra* note 28.
[35] *Id.*
[36] Zimolong, *supra* note 28.
[37] *Id*.
[38] *Id*.

the contractor follows the blueprints and design specifications, but the Z structure cannot be built because X materials are not strong enough to support it, the owner bore the risk and expense of correcting that unexpected result. The owner impliedly warranted that the plans were adequate to achieve their intended purpose when it provided them to the contractor, and the contractor had a right to rely on that warranty of adequacy. Further, it is the sponsorship of the design specification that creates the owner's liability for defects, not superior knowledge or experience on the part of the owner.[39]

IV. Applications of the *Spearin* Doctrine

As discussed above, *Spearin* can be used as a defensive strategy to avoid liability for the costs to correct an unexpected result. The *Spearin* doctrine can also be used as an offensive strategy by the contractor to show that the inadequate plans increased costs, impacted the total time for performance, or increased the difficulty in performance.[40] To assert the owner's liability, the contractor relies on the implied warranty made by the owner when it provided the plans.

To recover damages for increased costs from flawed design specifications, the contractor must prove that the owner provided the design specifications and that the contractor acted: (a) consistent with the provided plans; and (b) without knowledge of design defects.[41] The contractor must show that it did not have any discretion in the execution of the design specifications to recover. If the contractor had input in the creation of the flawed specifications, recovery may be denied since the contractor assumed the design risk along with the owner.[42] Recovery for increased costs does not require a finding of commercial impracticability or that the flawed specifications were impossible to perform.[43]

Contractors can also recover delay damages if the owner breaches the implied warranty of adequacy. The U.S. Court of Claims held that if defective specifications (provided by the government) prevent or delay completion of the contract, the contractor can recover delay damages for the government's breach of its implied warranty.[44] To successfully recover damages resulting from a government-caused delay, the contractor has the burden of proving:

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[39] Arthur I. Leaderman, The Spearin Doctrine: It Isn't What It Used to Be, CONSTR. LAW at 46, 47.
[40] Calahan, *supra* note 4.
[41] Leaderman, *supra* note 39.
[42] *Id*.
[43] *Id*.
[44] *Id*.

- The extent of the delay;
- The delay was proximately caused by government action, and;
- The delay harmed the contractor.[45]

V. Contractual Risk Shifting

As discussed in Section II, *supra*, the state of affairs prior to the existence of the implied *Spearin* warranties was that contractors bore all of the risk for performance issues once they had agreed to perform a construction contract. Cognizant of the implied warranties which arose from *Spearin* and its progeny, and their inherent-risk shifting nature, parties to government construction contracts will often include contract provisions which are intended to expressly allocate risk among themselves for various costly and time consuming pitfalls which may be encountered on construction projects. One such risk shifting tool often used in construction contracts is the differing site conditions ("DSC") clause.

A differing site condition is an unknown and hidden physical condition encountered at a site that differs materially from the reasonably anticipated conditions.[46] There are two types of differing site conditions that could be recognized in a DSC clause. A Type I DSC is a condition that is materially different from the conditions indicated in the contract. This situation was illustrated in *Hollerbach v. U.S.* where the owner positively represented, in the contract, that the construction site is materially different from the actual field conditions. A Type II DSC is a condition that is materially different from what an ordinary contractor in the general vicinity of the project would expect to encounter.[47] This situation was illustrated in *U.S. v. Spearin* where the hidden sewer on the construction site caused unforeseen hardship on the contractor.

In a situation where a contractor has begun construction and encounters conditions that are materially different from the description in the contract, or materially different from what an ordinary contractor would expect to encounter while performing work of the same type and character called for in the contract, who bears the risk of increased time and costs? If there is no

[45] Wilner v. United States, 24 F.3d 1397, 1401 (Fed. Cir. 1994).
[46] Scott Calahan, *Differing Site Conditions: What Are They and Are You Protected?* UNDERGROUND CONNECTION (2017), http://www.sgrlaw.com/differing-site-conditions-what-are-they-and-are-you-protected (last visited July 5, 2017).
[47] Calahan, *supra* note 46.

differing site condition clause, the doctrine of sanctity of contract[48] places the risk on the contractor absent an owner's breach of contract or an Act of God.[49] Differing site condition clauses represent another step away from the contractor-bears-all approach that *Spearin* and *Hollerbach* have also deviated from.

A differing site condition clause places the risk of unknown site conditions on the owner.[50] The clause requires the contractor to give notice of the unforeseen condition to the owner within 21 days[51], and not to disturb it before the owner has investigated it. The owner is required to investigate and then give the contractor direction as to what to do about the condition.[52]

The purpose of the clause is to avoid high bids from contractors who have added contingencies into their bids for unknown physical site conditions. Owners are often motivated to include differing site condition clauses in their contracts despite the increased risk of liability because it saves money during the bidding process. An owner may receive lower bids if they accept the risk of material discrepancies between the expected and actual conditions of the construction project. Otherwise, the contractor's usual form of protection is to submit a high bid with a built-in contingency to protect themselves from these DSCs. The U.S. Government began implementing differing site condition clauses in 1927 after realizing that they could save money on a public works project by taking on some of the risk of DSCs.[53]

Differing site condition clauses are now incorporated into the major standard contract forms published by the construction industry, including the AIA, EJCDC, DBIA, and most state and local government contracts.[54] Even where a government contract inadvertently leaves this clause out, the Federal Acquisition Regulation incorporates a differing site conditions clause into

[48] "[T]he rule. . . regards the sanctity of contract. It requires parties to do what they have agreed to do. If unexpected impediments lie in the way and a loss must ensue, it leaves the loss where the contract places it. If the parties have made no provision for dispensation, the rule of law gives none. It does not allow a contract fairly made to be annulled, and it does not permit to interpolated what the parties themselves have not stipulated." Dermott v. Jones, 69 U.S. 1,2 7; 17 L. Ed. 762 (1864).
[49] Calahan, *supra* note 46.
[50] Cohen Seglias, *Differing Site Condition Clause*, http://www.cohenseglias.com/federal-contracting-database/differing-site-condition-clause (last visited July 5, 2017).
[51] AIA Document A201 – 2007. § 3.7.4 Concealed or Unknown Conditions.
[52] Seglias, *supra* note 50.
[53] Calahan, *supra* note 46.
[54] *Id*.

each contract by reference.[55] This demonstrates the increased importance of protecting the contractor from bearing all risk in construction projects.

VI. Conclusion

The decision in *Spearin* was a noteworthy step away from the longstanding policy that contractors bore all risk in construction absent a different agreement or an act of God. The doctrine shifts the risk of an unexpected result from the contractor to the owner if certain criteria are met. If the plans provided by the owner are design specifications, which can be identified by the level of detail in the plan and the lack of discretion for deviation by the contractor in constructing the project, the contractor may be able to use the *Spearin* doctrine.

The owner's sponsorship of the plans creates the implied warranty of adequacy, essentially holding that the plans will work. The *Spearin* analysis centers around a two-part test: the contractor must have acted (a) consistent with the provided plans and (b) without knowledge of design defects.[56] The doctrine could be used defend against liability claims if the sponsored specifications yield an unexpected result. The doctrine could also be used offensively to seek compensation for costs incurred by the contractor due to the defective specifications. The contractor's ability to recover is also dependent on whether there is a differing site condition clause in the contract. The incorporation of differing site condition clauses into several standard contract forms within the industry demonstrates the movement toward protecting the contractor from bearing all risk in construction projects.

Other portions of this program will discuss how *Spearin* has expanded to cover state and federal contracts as well as expansions and restrictions impacting the applicability of the doctrine.

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[55] *Id*.
[56] Leaderman, *supra* note 39.

SESSION 3

EFFORTS TO EXPAND *SPEARIN* TO CLAIMS OF THIRD PARTIES

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Spearin **Third-Party Claims: No Match For The Mighty** ***Hercules***

United States v. Spearin is indisputably a landmark construction law case, touted as the foremost authority on implied warranty of design adequacy. In *Spearin*, the Supreme Court recognized a right of action for breach of implied contract warranties against the Government.[1] Spearin contracted with the United States to build a dry dock at the Brooklyn Navy Yard.[2] The Government provided detailed plans and specifications, which called for the relocation of a sewer.[3] Spearin followed the plans and specifications, but mid-project rains caused the relocated sewer to overflow and burst.[4] Spearin brought suit against the Government for the damages foreseeably caused by the Government's defective specifications. The Court held that "if a contractor is bound to build according to plans and specifications prepared by the Government, the contractor will not be responsible for the consequences of defects in the plans and specifications."[5]

The heart of *Spearin*, aptly dubbed the *Spearin* doctrine, went largely unhindered for decades, and was even periodically expanded upon. For example, in 1970, the court in *Poorvu* expanded the implied warranty of specifications to circumstances outside of the time of performance.[6] The Court in *Poorvu* also rejected an argument by the Government that the *Spearin* doctrine did not apply in circumstances in which the contractor knew of the dangerous conditions.[7] It became well-settled law that when the Government provides defective design specifications, as opposed to performance specifications, the Government is deemed to have breached the implied warranty, and the contractor is entitled to recover costs proximately caused by the breach.[8] However, the assessment of foreseeability of the harm, as in a traditional breach of implied warranty analysis, was completely abandoned by the Supreme Court in *Hercules Inc. v. United States*, at least in the context of third-party claims.

In *Hercules Inc. v. United States*, a government contractor that manufactured Agent Orange for the Government during the Vietnam War brought suit against the Government to recover costs of defending and settling product liability suits brought by veterans allegedly injured by Agent Orange.[9]

Hercules worked its way through the United States Claims Court, Court of Appeals, Federal Circuit, and the U.S. Supreme Court. Each reviewing court provides a unique perspective on the legal theories thought to support the opinion the Government should prevail. The distinction between the courts' analyses, however, is important to understand, as the conventional notions of the *Spearin* doctrine were abruptly curtailed by the Supreme Court after decades of precedence. The case history illustrates a progression from a traditional breach of

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1 *United States v. Spearin*, 248 U.S. 132, 138 (1918).
2 *Id*. at 133.
3 *Id*. at 133-134.
4 *Id*. at 134.
5 *Id*. at 136-137.
6 *See Poorvu v. United States*, 420 F.2d 993 (1970).
7 *Id*. at 1000.
8 *Stuyvesant Dredging Co. v. United States*, 834 F.2d 1576, 1582 (Fed. Cir. 1987); *Essex Electro Eng'rs, Inc. v. Danzig*, 224 F.3d 1283, 1289 (Fed. Cir. 2000).
9 *Hercules Inc. v. U.S.*, 516 U.S. 417 (1996).

implied warranty analysis under the *Spearin* doctrine to a complete bar of third-party claims. Ultimately, the Supreme Court concluded that absent an express or implied-in-fact agreement to indemnify manufacturers, government contractors may not seek contribution from the United States for settling third-party tort claims.

This paper investigates the analysis each reviewing court employed to conclude that the United States could not be held liable for third-party claims. The goal is to flesh out the rationale posed within each court and develop an understanding of the impacts of *Hercules* on the *Spearin* doctrine. Although the concept of foreseeability of the harm appears to have been completely abandoned by the Supreme Court through its bright line rule barring third party claims, a question remains as to whether the outcome would have changed if the Court would have gone through a traditional foreseeable analysis.

A. The U.S. Court of Claims Decision in *Hercules v. United States*

Hercules Incorporated ("Hercules"), one of multiple Agent Orange manufacturers in the 1960s, entered into multiple contracts with the Government for the manufacture of the defoliant.[10] The Government supplied the formula and detailed specifications for manufacture.[11] Hercules, in addition to several other Agent Orange manufacturers, complied.[12] In the late 1970's, Vietnam veterans and their families began filing lawsuits against the Agent Orange manufacturers, alleging that Agent Orange was toxic and had caused an array of serious health problems.[13] In May of 1984, the parties settled the class action case, and Hercules agreed with the other Agent Orange manufacturers to create a $180 million settlement fund.[14] In 1990, Hercules filed suit against the Government.

Hercules filed a complaint in United States Court of Claims (now the U.S. Court of Federal Claims) against the Government, seeking contractual indemnification of the amounts paid in settlement of the veterans' class action suit, legal fees, expenses and costs to defend against the Agent Orange suits.[15] In its complaint, Hercules alleged it was entitled to contractual indemnification under four counts, including a claim for breach of implied warranty of specifications under *Spearin*.[16]

Hercules argued an implied-in-fact warranty of specification arose because the Government supplied detailed specifications for Agent Orange, and Hercules manufactured the defoliant in accordance with those detailed specifications.[17] Relying on the *Spearin* doctrine, Hercules argued the Government impliedly warranted the defoliant made from the specifications would be free from defects.[18] Hercules further argued the Government breached the warranty

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[10] *Id*. at 419.
[11] *Ibid*.
[12] *Id*. at 420.
[13] *Ibid*.
[14] *Ibid*.
[15] *Hercules Inc. v. United States*, 25 Cl.Ct. 616 (1992) *aff'd*, 24 F.3d 188 (Fed. Cir. 1994), *aff'd*, 516 U.S. 417 (1996).
[16] *Id*. at 621.
[17] *Id*. at 625.
[18] *Ibid*.

because Hercules was subjected to tort suits by third parties who claimed they were injured by Agent Orange manufactured by Hercules according to the Government's specifications. [19]

The Claims Court rejected Hercules' implied warranty of specification claim, holding Hercules failed to show that the warranty was breached by the Government and that the breach caused Hercules to suffer the type of damages recoverable in contract. [20]

The Court reasoned Hercules could not prove damages for two reasons. First, there was no evidence to scientifically prove the chemical in Agent Orange (dioxin) caused injuries to the veterans.[21] Second, Hercules was protected from third-party liability under the Government contractor defense.[22] Therefore, even if a warranty of specification arose from the Government's detailed specifications for Agent Orange, there was no breach of the implied warranty because there was no damage. [23]

The Claims Court, citing *Hadley v. Baxendale* and *Northern Helex Co. v. United States*, stated it was axiomatic that damages arising from contract breaches "are limited to those that are reasonably foreseeable at the time the parties formed the contract."[24] On this point, the Court found it was "apparent that the costs (damages) plaintiff incurred by defending and settling a lawsuit brought by veterans, who were never able to prove that the plaintiff's product injured them, were not reasonably foreseeable at the time the contract was formed between the Government and the plaintiff."[25]

After considering all of Hercules' contractual arguments, the Claims Court concluded the theories advanced did not apply to hold the Government liable for the amount paid in connection with the settlement of the class action suit. [26] While the warranty of specification might apply to the Government based on the detailed specification for the production of Agent Orange, Hercules failed to come forth with the required quantum of proof regarding the breach of this warranty and the contract damages flowing therefrom. Therefore, the Claims Court granted summary judgment in favor of the Government and dismissed the suit.[27]

B. The U.S. Court of Claims Decision in *Wm. T. Thompson Company v. United States*

A few weeks after the Claims Court decided *Hercules Inc. v. United States*, the Claims Court was faced with a similar suit by Wm. T. Thompson Company ("Thompson"), another manufacturer of Agent Orange involved in the class action settlement by veterans, seeking indemnity from the Government for the amounts paid in settlement.[28]

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[19] *Ibid*.
[20] *Id*. at 626.
[21] *Id*. at 627.
[22] 628-633.
[23] *Id*. at 628.
[24] *Id*. at 627 (citing *Hadley v. Baxendale*, 156 Eng.Rep. 145 (1854).)
[25] *Id*. at 627.
[26] *Id*. at 628.
[27] *Ibid*.
[28] See *Wm. T. Thompson Co. v. United States*, 26 Cl.Ct. 17 (1992). Thompson's claims were based on alleged breached of implied-in-fact contractor theories, including liability under the doctrine of superior knowledge, warranty of specification, and implied-in-fact contractual indemnity.

Judge Yock (the same Judge that decided *Hercules*) rejected Thompson's implied warranty of specification claim, holding Thompson failed to show that the warranty was breached by the Government and that the breach caused Thompson to suffer the type of damages recoverable in contract.[29] The Claims Court's analysis of Thompson's damages was identical to the Claims Court's analysis of Hercules' damages: there was no evidence to scientifically prove the chemical in Agent Orange (dioxin) caused injuries to the veterans; Thompson was protected from third-party liability under the Government contractor defense; and the damages were not reasonably foreseeable.[30] Accordingly, the Claims Court granted summary judgment in favor of the Government and dismissed Thompson's suit.[31]

C. The U.S. Court of Appeal Decision

In a consolidated appeal filed by both Hercules and Thompson (collectively, the "manufacturers"), the United States Court of Appeals for the Federal Circuit, in a split decision, affirmed the lower court's grant of summary judgment.[32]

The Federal Circuit analyzed the contract theories advanced by the manufacturers and the Claims Court's reasoning with respect to each, including the implied warranty of specification theory. Noting *Spearin* stands for the proposition that the Government impliedly warrants detailed specifications included in the contract will not be defective or unsafe and if the contractor follows those specifications it will not be liable if the resulting product is defective, the Federal Circuit denied recovery based on damages.[33]

The manufacturers argued on appeal summary judgment was improperly granted because factual issues remained in dispute regarding the claims, including whether an implied warranty arose out of the contracts, whether the damages were foreseeable at the time the contract was formed, and whether the Government's defective specifications gave rise to manufacturers' liability for class action settlement.[34] The Federal Circuit declined to resolve the alleged factual issues raised by finding a necessary element to the manufacturers' breach of warranty claim – causation – was lacking.[35] To recover for a breach of warranty, the manufacturers must allege and prove a valid warranty existed, the warranty was breached, and the damages were caused by the breach.[36]

The Federal Circuit agreed with the Claims Court's holding that the manufacturers' claims failed because (i) the absence of scientific evidence exposure to dioxin caused injuries precluded a finding the warranty was breached, (ii) even assuming the existence of an implied warranty of specifications, the warranty would not include the kind of indemnity sought, and

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[29] *Wm. T. Thompson Co. v. United States,* 26 Cl.Ct. at 23-35.
[30] *Ibid*.
[31] *Id*. at 35.
[32] *Hercules Inc. v. United States*, 24 F.3d 188, 204 (Fed. Cir. 1994).
[33] *Id*. at 197-201.
[34] *Id*. at 196-197.
[35] *Id*. at 197.
[36] *Id*. at 198 (citing *San Carlos Irrig. and Drainage Dist. v. United States*, 877 F.2d 957, 959 (Fed. Cir. 1989) holding that a plaintiff must allege and prove that a valid warranty existed, the warranty was breached, and plaintiff's damages were caused by the breach.)

(iii) the availability of the immunity to suit under the Government contractor defense precluded a finding the damages were caused by the breach.

The Federal Circuit rested its decision on the third ground: the manufacturers could not prove their damages were caused by the Government's alleged breach of an implied warrant of specification because they were protected from liability under the Government contractor defense. The Court reasoned the Government contractor defense provided a complete defense to the veterans' tort claims. However, the manufacturers voluntarily entered into the settlement, rather than litigating the Government contractor defense. The Court further noted the Government did nothing to encourage or compel the manufacturers to settle. Therefore, the damages incurred by the manufacturers were not caused by the Government.[37]

In a strong dissent, Circuit Judge Plager was not persuaded the manufacturers would have prevailed on the Government contractor defense if they had proceeded to trial.[38] The scope of the Government contractor defense at the time the manufacturers settled was evolving and before the U.S. Supreme Court's opinion in *Boyle v. United Technologies Corp.*[39] Judge Plager criticized the majority's attempt to predict the outcome of the original Agent Orange litigation and the manufacturers' success in relying on the Government contractor defenses. Therefore, Judge Plager believed there were unresolved facts and legal issues that would warrant remand and a full trial on the issues.[40]

D. The United States Supreme Court Decision

The United States Supreme Court granted certiorari on the question of whether the Government is required to reimburse a contractor for damages incurred as a result of third party tort claims.[41]

The Supreme Court affirmed the decision of the Federal Circuit, holding the manufacturers may not recover on their implied warranty of specifications and contractual indemnification claims.[42]

The Court began by noting jurisdiction under the Tucker Act extended only to express or implied in fact contracts, and does not extend to claims on contracts implied in law.[43] An agreement implied in fact is "founded upon a meeting of minds, which although not embodied in an express contract, is inferred, as a fact, from conduct of the parties under the circumstances. By contrast, an agreement implied in law is a "fiction of law" where a promise is imputed to perform a legal duty."[44] The manufacturers did not contend their contracts contained an express warranty or indemnification provision. To prevail on a claim against the Government, the manufacturers must establish, based on the circumstances at the time of contracting, there was an

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[37] *Id*. at 197-201.
[38] *Id*. at 205-210.
[39] *Id*. at 206-207.
[40] *Id*. at 205-210.
[41] *Hercules, Inc. v. United States*, 516 U.S. 417 (1996).
[42] *Id*. at 421-430.
[43] *Id*. at 423; *see also* 28 U.S.C. § 1491(a).
[44] *Hercules, Inc. v. United States*, 516 U.S. at 424.

implied agreement between the parties to provide the obligations that the manufacturers alleged.[45] Therefore, the Court considered the manufacturers' warranty-of-specifications and contractual indemnification claims.[46]

Turning to *Spearin*, the Supreme Court recognized *Spearin* allocates the risk to the Government when the specifications it furnishes are defective.[47] However, the Supreme Court refused to extend the warranty or *Spearin* to cover costs incurred in defending and settling third-party tort claims.[48] The Court stated:

> When the Government provides specifications directing how a contract is to be performed, the Government warrants that the contractor will be able to perform the contract satisfactorily if it follows the specifications. The specifications will not frustrate performance or make it impossible. It is quite logical to infer from the circumstance of one party providing specifications for performance that the party warrants the capability of performance. But this circumstance alone does not support a further inference that would extend the warranty beyond performance to third-party claims against the contractor.[49]

The majority abandoned a factual inquiry into a traditional breach of contract analysis and did not inquire into the lower court's "no causation" holding. Rather, the Supreme Court majority limited its holding to a modified foreseeable analysis as to whether the parties contemplated a warranty extending to third-party tort claims:

> In this case, for example, it would be strange to conclude that the United States, understanding the herbicide's military use, actually contemplated a warranty that would extend to sums a manufacturer paid to a third party to settle claims such as are involved in the present action. It seems more likely that the Government would avoid such an obligation, because reimbursement through contract would provide a contractor with what is denied to it through tort law.[50]

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[45] *Ibid.*
[46] *Ibid.*
[47] *Ibid.*
[48] *Ibid.*
[49] *Id.* at 425.
[50] *Ibid.*, (citing *Stencel Aero Engineering Corp. v. United States*, 431 U.S. 666 (1977) (denying contractor claim for indemnity against Government for tort damages it was required to pay to servicemen injured by malfunction of ejection system in aircraft on the grounds that the underlying claim for injuries to a serviceman was barred against the Government: "To permit [petitioner] to proceed … here would be to judicially admit at the back door that which has been legislatively turned away at the front door.").)

As for the manufacturers indemnity claims, the Court determined the conditions of the contract did not give rise to an implied-in-fact indemnity agreement.[51] On this basis, the Court prohibited Hercules' claims, finding no basis in fact for a promise of relief and ruling out lack of subject matter jurisdiction to consider an implied-in-law term to address the Agent Orange contracts.[52]

For these reasons, the Supreme Court held the manufacturers could not recover on warranty or indemnity claims from the Government.[53]

E. The United States Supreme Court Dissent

Justice Breyer, joined by Justice O'Connor, dissented from the majority, arguing the Court unnecessarily placed limits on *Spearin* warranties and strongly criticized the majority's failure to consider the lower court's "no causation" holding.[54]

The manufacturers' petition for certiorari and initial brief on the merits asked the Supreme Court to review, and to reverse, the "no causation" holding by the Federal Circuit. The Federal Circuit affirmed a grant of summary judgment against the manufacturers, but did not determine if the manufacturers could prove the existence of the promises in an implied warranty of specifications.[55] Instead, the Federal Circuit assumed the manufacturers could prove the existence of the promises, and determined the manufacturers would not be able to prove causation between the promises and the damages.[56] The Federal Circuit concluded that the "voluntary payment" of the settlement amount cut the casual link between a broken promise, or warranty, and the resulting harm.[57]

The majority did not discuss that "no causation" holding, and instead concluded the manufacturers will not be able to prove the existence of the implicit promises of an implied warranty.[58] The dissent disagreed, finding the record before the Court did not permit such a holding. Therefore, the dissent argued the Court should reverse the "no causation" holding and remand the case for further proceedings.[59]

The dissent found a fatal flaw in the Federal Circuit's "no causation" holding with respect to foreseeability. The Federal Circuit, in essence found the settlement to be unnecessary and voluntary (based on the availability of the Government contractor defense), that it could not have been "foreseeable" or it cut the casual link between promise, breach and harm.[60] However, the dissent disagreed, and viewed the settlement (without the benefit of legal hindsight) as neither

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[51] *Id*. at 426.
[52] *Ibid*.
[53] *Ibid*.
[54] *Id*. at 431-441.
[55] *Id*. at 433
[56] *Ibid*.
[57] *Ibid*.
[58] *Id*. at 434.
[59] *Ibid*.
[60] *Ibid*.

unforeseeable, nor an intervening cause of the loss.[61] At the time the manufacturers settled there was legal uncertainty as to the Government contractor defense.[62] Therefore, if the settlement was a reasonable litigation strategy at the time, the settlement must have been a "foreseeable" potential consequence of litigation and within the scope of what the manufacturers claim were implicit promises or warranties protecting them against the harms of litigation.[63] The dissent believed this reason alone warranted setting aside the Federal Circuit's determination on foreseeability.

The dissent criticized the Court for deciding the case on an alternative basis, namely, that the manufacturers could not prove the existence of an implied warranty. The dissent argued the majority's attempt to compartmentalize the manufacturers' claims into several separate doctrinal categories, including a *Spearin* claim, was not supported by the legal and factual circumstances of the claims.[64]

With respect to a *Spearin* claim, the dissent rejected the majority's distinction that the *Spearin* doctrine does not "extend . . . beyond performance to third party claims against the contractor." The dissent noted *Spearin* does not make such a distinction, nor do subsequent cases."[65] For example, the dissent cited to *Michigan Wisconsin Pipeline Co. v. Williams-McWilliams Co.*,[66] which allowed recovery against the Government of damages paid by a contractor to a third party for damages caused by following Government specifications. The dissent posited the following hypothetical question: If the Government must pay for the contractor's property destroyed by defective specifications, why should the Government not also have to pay for identical damage caused to the contractor's neighbor?[67] The dissent does not answer the question, and further suggests an answer to such questions would not answer the manufacturers' further argument: "even if *Spearin* does not compel a decision in their favor, it offers indirect support, as background, for implying a promise that would provide (in the particular circumstances) *Spearin-like* protections."[68]

The manufacturers argued factual circumstances – compelled production, superior knowledge, detailed specifications, and significant defects, which if true, suggested the Government, dealing in good faith with its contractors, would have agreed to the "implied" promise and warranty under *Spearin*. By failing to inquire into the factual circumstances of the case at this state of the litigation, the dissent contends the majority unnecessarily restricted the *Spearin* warranties.[69]

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[61] *Ibid.*
[62] *Ibid.*
[63] *Id.* at 435.
[64] *Id.* at 436.
[65] *Id.* at 438.
[66] *Michigan Wisconsin Pipeline Co. v. Williams-McWilliams Co.*, 551 F.2d 945 (5th Cir. 1977).
[67] *Hercules, Inc. v. United States*, 516 U.S. 417, 439 (1996).
[68] *Ibid.*
[69] *Id.* at 441.

F. The Impact of *Hercules* and Conclusion

As forecasted by the dissent, the majority opinion in *Hercules* will make it more difficult for courts to interpret government contracts with an eye toward achieving the fair allocation of risks that the parties likely intended.[70] The impact of *Hercules* is seen in *Rick's Mushroom Service, Inc. v. United States*.

In *Rick's Mushroom Service, Inc. v. United States*,[71] a government contractor filed suit for equitable indemnity under the *Spearin* doctrine for damages related to defective specifications for a mushroom recycling waste facility. The Court of Federal Claims dismissed the action for lack of subject matter jurisdiction. On appeal, the Federal Circuit affirmed dismissal of the *Spearin* equitable indemnity claim because the Court of Federal Claims lacked jurisdiction over the cost-share agreement on which the implied warranty was founded. In addition, the Federal Circuit found the *Spearin* claim failed for another reason: the Supreme Court's holding in *Hercules* foreclosed the recovery of costs of defending and settling third-party lawsuits.[72]

Hercules reduced the scope of the *Spearin* implied warranty by refusing to extend the warranty beyond performance to third-party claims against the contractor.[73] The limits imposed by *Hercules* shift the risk of post-performance third-party claims back to the contractor. Therefore, if a contractor cannot successfully assert the Government contractor defense to immunize itself, the contractor may be exposed to unforeseen damages.

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[70] *Id*. at 441.
[71] *Rick's Mushroom Service, Inc. v. United States*, 521 F.3d 1338 (Fed. Cir. 2008).
[72] *Id*. at 1345.
[73] For different perspectives of *Hercules*' effect on *Spearin*, see KaCey Reed, *The Supreme Court's Rejection of Government Indemnification to Agent Orange from Manufacturers in Hercules, Inc. v. United States: Distinguishing the Forest from the Trees?*, 31 U. Rich. L. Rev. 287 (1997); see also Leaderman, Arthur, *The Spearin Doctrine: It Isn't What It Used To Be*, CONSTRUCTION LAWYER, October 16, 1996 at 46.

SESSION 4

SECTION 552, RESTATEMENT (SECOND) OF TORTS

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Information Negligently Supplied for the Guidance of Others:

Section 552, Restatement (Second) of Torts

I. Introduction

The economic impacts suffered by a contractor from the negligence of the design professionals can be significant, resulting in increased costs for materials, time impact expenses, implementation costs and increased risk of scope disputes. Irrespective of the magnitude of loss, the economic loss doctrine may bar a contractor from recovery of these losses caused by the negligence of an architect, engineer, construction manager or other design professional absent personal injury or property damage. There are, however, a few exceptions which allow a contractor, or its surety, to proceed against the owner's design professional.

Depending upon the nature of the construction project, the owner often retains the general contractor and the architectural or design professional under separate contracts. Therefore, the contractor may lack privity to pursue the design professional on a contractual basis, leaving any claim to sound in tort. The design team will on many occasions retain specialty engineers as subcontractors which further distances the contractual relationship with the contractor. Third party beneficiary contractual claims can even be explicitly precluded by contract.[1]

Recognizing the potential severity of the economic loss doctrine and the impact the design professional can have on a project, some courts have carved exceptions to the economic loss doctrine. The application and implementation of exceptions to the economic loss doctrine is not uniform. Some courts apply and some courts reject or modify the exceptions. This paper introduces one of the most significant exceptions to the economic loss doctrine - the "business guidance" or "information provider" exception - found in the Restatement (Second) Torts, Section 552 as it applies in the context of a construction project.

II. Economic Loss Doctrine.

To maintain the fundamental boundary between tort and contract law, the court-developed economic loss doctrine has been adopted by the majority of states in various forms. In general terms, the economic loss doctrine "bars the use of negligence or strict liability theories of recovery of economic losses arising out of commercial transactions where the loss is not a consequence of an event causing personal injury or damage to other property." Phillip L. Bruner & Patrick J. O'Connor, Jr., 6 Bruner and O'Connor on Construction Law § 19:10 at 50 (2002). In short, the economic loss doctrine generally bars negligence claims when the injured party suffered only economic losses. The doctrine "is stated with ease but applied with great difficulty," particularly in the context of the construction industry. *Presnell*

[1] *See, e.g.,* the Standard Form of Agreement Between Owner and Architect, AIA Document B101-2007, section 10.5.

Construction Managers, Inc. v. EH Construction, LLC, 134 S.W.3d 575, 584 n.12 (Ky. 2004) (concurrence).[2] The underlying theory of the economic loss doctrine is that the parties had the ability to negotiate and allocate the risks of the contract and have done so, allowing the parties to recover economically elsewhere defeats the purpose of the contract allocation.

Courts have grappled with when, if ever, parties due to the particular circumstances should be able to recover monetary damages from non-parties to the contract. Some courts have noted that the key to determining the availability of a contract or tort action lies in determining the source of the duty that forms the basis of the action. The following discussion by the South Carolina Supreme Court is instructive:

> The question, thus, is not whether the damages are physical or economic. Rather the question of whether the plaintiff may maintain an action in tort for purely economic loss turns on the determination of the source of the duty [the] plaintiff claims the defendant owed. A breach of a duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie. A breach of a duty arising independently of any contract duties between the parties, however, may support a tort action.

Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 320 S.C. 49, 463 S.E.2d 85, 88 (1995); *See also*, *Town of Alma v. Azco Const., Inc.*, 10 P.3d 1256, 1262-63 (Colo. 2000).

Whether Section 552 rises to an independent tort duty or is preempted by contract continues to be disputed among the various jurisdictions.

III. Restatement (Second) Torts 552.

An exception to the economic loss doctrine is found in Section 552 of the Restatement (Second) of Torts. This section provides:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, *supplies false information for the guidance of others in their business transactions*, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

[2] Two landmark decisions in the development of the economic loss rule are *Seely v. White Motor Company*, 403 P.2d 145 (Cal.1965), which is generally recognized as the genesis of the rule, and *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986), which firmly established the rule as part of American product liability jurisprudence. In both cases, recovery was sought in tort solely for economic loss resulting from a defective product—a defective truck in Seely and defective turbines for supertankers in East River.

> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
>
> (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them. (Emphasis added).

Particularly relevant to the construction industry is Comment h, Illustration 9, of Section 552, which provides that an engineer supplying a defective report is liable to those relying upon it:

> The City of A is about to ask for bids for work on a sewer tunnel. It hires B Company, a firm of engineers, to make boring tests and provide a report showing the rock and soil conditions to be encountered. It notifies B Company that the report will be made available to bidders as a basis for their bids and that it is expected to be used by the successful bidder in doing the work. Without knowing the identity of any of the contractors bidding on the work, B Company negligently prepares and delivers to the City an inaccurate report, containing false and misleading information. On the basis of the report C makes a successful bid, and also on the basis of the report D, a subcontractor, contracts with C to do a part of the work. By reason of the inaccuracy of the report, C and D suffer pecuniary loss in performing their contracts. B Company is subject to liability to C and to D.

The design professional can, of course, defend against any negligent misrepresentation claim on the merits by asserting that its performance was within the professional standard of due care. Asserting such a defense typically requires the retention of testifying experts, is time intensive and costly.

An attractive and major defense to the design professional is the economic loss doctrine. If applied, the economic loss doctrine results in the relatively early dismissal of a tort claim for economic loss. In fact, at least one court has indicated that the issue is properly decided on a motion for summary judgment without discovery. *Delaware Art Museum v. Ana Beha Architects*, 2007 WL 2601472, at *4 (D. Del. Sept. 11, 2007) (Decisions as to whether a defendant falls within the exception to the economic loss doctrine are typically made at summary judgment in Delaware). However, the issue can be resolved on a motion to dismiss when the complaint unambiguously places a defendant outside of the exception. *Delaware Art Museum*, 2007 WL 2601472, at *4; *Kuhn Const. Co. v. Ocean and Coastal Consultants, Inc.*, 844 F.Supp.2d 519, 528 (D.Del. 2012).

IV. Application of Restatement (Second) Section 552

The primary and initial inquiry into the application of Section 552 is the particular jurisdiction's application of the economic loss doctrine. The application of Section 552 reflects the overall struggle of the courts to define and maintain the distinction between contract and tort and the attendant policies.

Application of Section 552 is, of course, fact sensitive and requires a case-specific inquiry. The economic loss doctrine may not bar claims for the tort of negligent misrepresentation if (1) the defendant supplied the information to the plaintiff for use in business transactions, and (2) the defendant is in the business of supplying information. *Delaware Art Museum v. Ana Beha Architects*, 2007 WL 2601472, at *3 (D. Del. Sept. 11, 2007) (Section 552 exception not applicable to architect hence Motion to Dismiss granted); *Commonwealth Const. Co. v. Endecon, Inc.*, No. CIV.A.08C01266RRC, 2009 WL 609426, at *4 (Del. Super. Mar.9, 2009).

The first element – supplying information for use in business transactions – seems easily established. A design professional provides plans, drawings, and responses to requests specifically for the use of the contractor to transact its business, which is to construct the project. The more difficult issue may be the second element – the business of supplying information.

The distinction between a design professional and a supplier of information can be a slippery slope. As a class, design professionals fall on both sides of the Section 552 exception as their business has dual purposes. For example, if the design professional provides only calculations, specifications or reports for a project then the engineer arguably acts in the role of a pure information provider. The section 552 exception applies and the economic loss doctrine may not be asserted as a defense.

On the other hand, courts have held that if the design professional does more than provide information only, such as design components of a project, then the economic loss doctrine applies and there is no exception. The reason is because the design is converted into a tangible product – a building – which is more than the supply of information. If information is the final outcome intended, then Section 552 is to apply. Where information is supplied in connection with the sale of a service or product i.e. a building, then the supplier is not considered an information provider and Section 552 is inapplicable. The slope, as stated, can become quite slippery, as reflected by the various judicial interpretations.

For example, in Delaware, to be considered in the business of supplying information, a "case-specific inquiry" must be made, "looking to the nature of the information and its relationship to the kind of business conducted." *RLI Ins. Co.*, C.A. No. 05–858–JJF, 2006 WL 1749069, at *3 (D.Del. June 20, 2006). When information is the "end and aim" of the work, the court may find a section 552 exception and potential liability. Delaware Art at *2; *Guardian Constr. Co. v. Tetra Tech Richardson, Inc.*, 583 A.2d 1378, 1386 (Del.Super.1990) (Section ; *See also*, *Millsboro Fire Co. v. Constr. Mgmt. Serv.*, 2006 WL 1867705, at *3 (Del.Super. June 7, 2006) (listing surveyors, accountants, financial advisors and title searchers as examples of defendants who are pure information providers). "[W]here the information supplied is merely ancillary to the sale of a product or service in connection with the sale," however, the defendant will not be considered to be an information provider. *RLI Ins. Co.*, 2006 WL 1749069, at *3 (quoting Christiana, 2002 WL 1335360, at *7).

Delaware Art Museum is but one example of many cases reflecting the difficulty in application of Section 552. The primary bases for the differences are the various jurisdictions efforts to maintain the boundaries between contract and tort law, provide certainty and predictability in business dealings such as construction contracts, honor the allocation of risks negotiated in contracts, avoid a flood of litigation, and provide remedies for the breach of professional standards in protection of the public.

The following are highlights of cases that have applied Section 552

A. Successful Application.

(1) Architect. The economic loss doctrine did not bar the general contractor's negligent misrepresentation claim against the architect. *Bilt Rite Contractors v. The Architectural Studio*, 866 A.2d 270 (Pa. 2005). This case exemplifies how many states that have adopted the economic loss doctrine carve out exceptions to its application.

In *Bilt-Rite*, the Pennsylvania Supreme Court adopted the 552 exception and found it to be applicable in cases where information is negligently supplied by an architect or design professional under circumstances where it is foreseeable that others will rely upon that information. The issue was whether a building contractor may pursue an architect for alleged negligent misrepresentations in plans and specifications relied upon by the contractor in submitting its winning bid and the economic damages incurred as a result of that reliance.

The architect's plans provided for the installation of an aluminum wall system, sloped glazing system and metal support systems, all of which the architect expressly represented could be installed and constructed through the use of normal and reasonable construction means and methods, using standard construction design tables. Once construction commenced, however, the contractor discovered that the work including the aluminum curtain wall, sloped glazing and metal support systems could not be constructed using normal and reasonable construction methods, and instead required the contractor to employ special construction means, methods and design tables, resulting in substantially increased construction costs.

The lower courts ruled, consistent with case precedent, that a contractor cannot prevail against an architect for economic damages suffered as a result of negligence in drafting specifications, absent privity of contract. Further, the lower court found that the Section 552 exception does not apply to architects sued in their capacity as design professionals.

After an analysis of its case precedent and sister jurisdictions, the court adopted Section 552 as the law in Pennsylvania in cases where information is negligently supplied by one in the business of supplying information, such as an architect or

other design professional, and where it is foreseeable that the information will be used and relied upon by third persons, even if the third parties have no direct contractual relationship with the supplier of information. In so doing, the court emphasized that it did not view Section 552 as supplanting the common law tort of negligent misrepresentation, but rather, as clarifying the contours of the tort as it applies to those in the business of providing information to others. *Id.,* at 482. Section 552 "negates any requirement of privity". *Id*. The court asserted that the strictures of Section 552 are narrowly tailored and reasonably restricted to the class of potential plaintiffs to avoid professional liability without limits. *Id*., at 479 and 481. It exposes architects to no greater accountability than other professionals such as attorneys or accountants and reflects modern business realities. *Id*.

The dissenting opinions asserted that (1) contractual risk allocation should prevail over Section 552 in the construction industry setting; and (2) architectural service providers should not be deemed to be information suppliers within the context of Section 552.

(2) Design Engineer. Claims of negligence and negligent misrepresentation were alleged by the general contractor and subcontractor against the design engineer and found cognizable despite lack of privity of contract and despite the fact that the plaintiffs sought purely economic damages. *Guardian Constr. Co. v. Tetra Tech Richardson, Inc.*, 583 A.2d 1378 (Del. 1990). The general contractor and subcontractor brought an action based on negligence, negligent misrepresentation and third-party beneficiary breach of contract against the design engineer. The factual allegations were that the engineer's miscalculations as to tidal heights and project benchmark resulted in additional labor and equipment costs to the subcontractor and lost profits to the general contractor.

The court held that the general contractor and subcontractor were not third-party beneficiaries of the contract between the engineer and the State. However, the claims for negligence and negligent misrepresentation were cognizable despite the lack of privity and claim for purely economic damages. The court specifically adopted Section 552 and determined that the information provided was the "end and aim" of the transaction and not an indirect or collateral consequence. *Id*. at 1386. Negligently prepared plans and specifications and the information provided were for the use of a specific and limited class of potential users and were relied upon to the detriment of the general contractor and subcontractor.

One court states that the current weight of authority since the *Guardian* decision suggests that Section 552 does not apply and that the provision of plans and drawings in connection with a construction project is considered to be information that is incidental to the sale of a finished, tangible project. *Kuhn Const. Co. v.*

Ocean and Coastal Consultants, Inc., 844 F.Supp.2d 519, 528 (D.Del. 2012); *See also, Delaware Museum, supra*.

(3) Construction Manager. Contractor stated a claim against the construction manager based on Section 552. *Presnell Constr. Co. v. E.H. Construction, LLC*, 134 S.W.3d 575 (Kty. 2004). Contractor alleged that Presnell failed "to properly stage and time the work involved" for the project and that as a result, Contractor "was required to redo much of the work that it had already completed, due to the other contractors and subcontractors coming in and subsequently destroying work that had already been completed by [Contractor]." *Id*. at 578. Additionally, Contractor alleged that "Presnell was careless and negligent in coordinating the Project, and supplied faulty information and guidance and supervision to the contractors working on the Project." *Id*.

After surveying past decisions of Kentucky appellate courts and federal courts applying Kentucky law, the *Presnell* court determined that Section 552 of the Restatement (Second) of Torts was "consistent with Kentucky case law." *Presnell*, 134 S.W.3d at 580-82. The Supreme Court of Kentucky therefore "join[ed] the majority of jurisdictions" in "adopt[ing Restatement] § 552's standards for negligent misrepresentation claims" in Kentucky. *Id*. at 582.

The court held that privity is not necessary to maintain a tort action, and, by adopting Section 552, the court agreed that the tort of negligent representation defines an independent duty for which recovery in tort for economic loss is available. *Id*. at 582. Specifically, Presnell's duty under Section 552 was not to supply false information, and Contractor's complaint alleges that "Presnell ... supplied faulty information and guidance" to the project's contractors. This allegation was sufficient to avoid what was essentially a dismissal for failure to state a claim for relief.

B. Unsuccessful Application.

(1) Construction Manager and Architect. The surety of a subcontractor brought an action against the school district, architect, and construction manager seeking declaratory judgment that district had not complied with its contractual obligations by issuing payments to the subcontractor in excess of the value of the work actually performed, or for work that was never performed. *RLI Ins. Co. v. Indian River School District*, 556 F.Supp. 2d 356 (D.Del. 2008). The court held that the surety's negligent misrepresentation claim against the architect and construction manager did not fall within exception to the economic loss doctrine for suppliers of information. Where the information supplied is merely ancillary to the product, such entity is not in the business of supplying information for the guidance of others.

(2) *Design Professionals*. *Berschauer/Phillips Constr. Co., v. Seattle School District No.1*, 124 Wash.2d 816, 881 P.2d 986 (WA. 1994). General contractor was barred from asserting a negligent misrepresentation claim against the architect, structural engineer and project inspector. The court acknowledged that Section 552 provides support for the recovery of economic damages in the construction industry for negligent misrepresentations. *Id*. at 827. However, the court determined the Restatement to be equivocal and held that "when parties have contracted to protect against potential economic liability, as is the case in the construction industry, contract principles override the tort principles in § 552 and, thus, purely economic damages are not recoverable." *Id*. at 828.

In support, the Court referenced the following cases: *Floor Craft Floor Covering, Inc. v. Parma Comm'ty Gen. Hosp. Ass'n*, 54 Ohio St.3d 1, 7, 560 N.E.2d 206 (1990) (Section 552 of the restatement not adopted to allow a general contractor to recover economic damages from a design professional); *Williams & Sons Erectors, Inc. v. South Carolina Steel Corp.*, 983 F.2d 1176, 1181–83 (2d Cir.1993) (under New York law, § 552 not adopted to permit a general contractor to recover economic damages from an architect); but see *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 188–89, 677 P.2d 1292 (1984) (an architect, absent privity of contract, may be liable to a general contractor for economic damages under Section 552). *Berschauer/Phillips at 828.*

(3) *Engineer/Designer. Halcrow, Inc. v. Eighth Jud. Dist. Ct.*, 302 P.3d 1148 (Nev. 2013). As matter of first impression, the Nevada Supreme Court held that the economic loss doctrine applied to bar claims by the steel installation subcontractor for negligent misrepresentation against the engineer/designer in the context of a construction project. The court acknowledged that it previously adopted Section 552 of the Second Restatement of Torts in upholding a claim for negligent misrepresentation. However, in the context of commercial construction design professionals, negligent misrepresentation claims do not fall into such a category because "contract law is better suited" for resolving such claims. *Halcrow,* at 1152; *Terracon Consultants Western, Inc. v. Mandalay* Resort Group, 125 Nev. 66, 77, 206 P.3d 81, 89 (2009). Further, in commercial construction situations, the highly interconnected network of contracts delineates each party's risks and liabilities in case of negligence, which in turn "exert significant financial pressures to avoid such negligence." *Id*. at 77, 206 P.3d at 88.

Additionally, complex construction contracts generally include provisions addressing economic losses. See *Terracon*, 125 Nev. at 78, 206 P.3d at 89. Therefore, the parties' " 'disappointed economic expectations' " are better determined by looking to the parties' intentions expressed in their agreements. Id. at 79, 206 P.3d at 90 (*quoting Sensenbrenner v. Rust, Orling & Neale, Architects,*

> *Inc.*, 236 Va. 419, 374 S.E.2d 55, 57–58 (1988)). This is further supported by the fact that design professionals supply plans, designs, and reports that are relied upon to create a tangible structure; the ultimate quality of the work can be judged against the contract. *See Id*. at 79, 206 P.3d at 90.

V. Summary

"[T]he courts are fairly evenly divided over whether to apply the economic loss rule in [design professional liability to third party] situation[s]." *Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP*, 155 A.3d 445 (App. Md. 2017), quoting *LAN/STV v. Martin K. Eby Const. Co*., 435 S.W.3d 234, 249 (Tex. 2014).

In the construction context, case law on the economic loss doctrine is conflicting, confusing, and varies widely from jurisdiction to jurisdiction. See A. Holt Gwyn, Tort Damages, in Construction Damages and Remedies 207, 212 (W. Alexander Mosley ed., 2d ed. 2013). As one legal scholar remarked,

> It is in the context of construction design professional services that the application of the economic loss [doctrine] is most difficult to reconcile. No analytical theme predominates. It is almost as if someone had written the words "privity," "special relationship," "foreseeability," "supervising architect," "no duty," and "covered by another contract" on the six sides of a die, and then passed the die to appellate judiciaries of various states to roll. The only constant is that economic damages are the subject of the claim.

A. Holt Gwyn, The Economic Loss Rule, in Construction Damages and Remedies 267, 293.

Given the division over the application of the economic loss doctrine, it is no surprise that states differ whether the Section 552 exception will be allowed. States applying the economic loss doctrine to bar recovery under Section 522 typically reason that the construction industry is governed by a network of often-complicated contracts, and because the parties have carefully contracted to protect against economic losses, there is no reason to add a tort remedy to the mix for use by parties claiming such losses. *See, e.g.*, *Indianapolis–Marion Cty. Pub. Library*, 929 N.E.2d at 740 ("[W]hen it comes to claims for pure economic loss, the participants in a major construction project define for themselves their respective risks, duties, and remedies in the network or chain of contracts governing the project."); *Terracon Consultants W., Inc. v. Mandalay Resort Grp.*, 125 Nev. 66, 206 P.3d 81, 89 (2009) ("In the context of engineers and architects, the bar created by the economic loss doctrine applies to commercial activity for which contract law is better suited to resolve professional negligence claims."); *LAN/STV*, 435 S.W.3d at 249 ("[C]ourts should use contract principles, not tort principles, to determine whether the architect has 'contractual' obligations to the contractors and subcontractors." (footnote omitted)); *Berschauer/Phillips*, 881 P.2d at 992 (limiting recovery of economic losses due to construction delays to contractual remedies "to ensure that the allocation of risk and the determination of potential future liability is based on what the parties bargained for in the contract"). *Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP*, 155 A.3d 445, 458 (App. Md. 2017).

Perhaps more than any other industry, the construction industry is vitally enmeshed in our economy and dependent on settled expectations. The parties involved in a construction project rely on intricate, highly sophisticated contracts to define the relative rights and responsibilities of the many persons whose efforts are required—owner, architect, engineer, general contractor, subcontractor, materials supplier—and to allocate among them the risk of problems, delays, extra costs, unforeseen site conditions, and defects – or a party refuse to enter into the contract. Those rejecting Section 552 assert that the imposition of tort duties that cut across those contractual lines disrupts and frustrates the parties' contractual allocation of risk and permits the circumvention of a carefully negotiated contractual balance among owner, builder, and design professional. *Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP*, 155 A.3d 445, 459 (App. Md. 2017).

Some courts reject Section 552 in large government projects due to a special consideration – the public purse. *Balfour* at 460-61; *See, Boyle v. United Techs. Corp.*, 487 U.S. 500, 507, 108 S.Ct. 2510, 101 L.Ed.2d 442 (1988) ("The imposition of liability on Government contractors will directly affect the terms of Government contracts: either the contractor will decline to manufacture the design specified by the Government, or it will raise its price."). Imposing a tort duty on design professionals may correlate with an increase in project costs with a corresponding rise in price for government entities. *Balfour* at 460-61

States that decline to apply the economic loss doctrine to bar Section 552 recovery, on the other hand, typically focus on classic tort principles to decide whether a design professional owes a third party contractor a duty in tort in the absence of contractual privity. *Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP*, 155 A.3d 445, 458 (App. Md. 2017); *Bilt–Rite Contractors, Inc. v. The Architectural Studio*, 581 Pa. 454, 866 A.2d 270, 286–87 (2005) (general contractor could bring negligent misrepresentation claim based on Restatement (Second) of Torts Section 552 against architect). The hierarchy of contractors, subcontractors, and suppliers, as well as the separate arrangements with architects and engineers, often leave an injured party with inadequate or non-existent contractual rights. The courts may conclude that there is sufficient justification to add protection for certain purely economic injuries as Section 552 provides.

Those courts accepting and rejecting Section 552 provide compelling policy reasons to expand or limit tort liability in the construction industry, and there is no clear majority position (although certain cases profess that there is). *Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP*, 155 A.3d 445, 459 (App. Md. 2017). The primary consideration whether to apply Section 552 rests on the jurisdiction's view whether the parties are entitled to rely upon negotiated contracts or whether an independent duty is required to protect businesses for their reliance on information providers, similar to the duties placed on accountants, attorneys, and similar professionals.

As a starting point, the law of the specific jurisdiction needs to be carefully analyzed in a Section 552 setting. Pursing an exception in a state where the economic loss doctrine is the clear law of the land could result in sanctions for asserting a frivolous claim. *Tomb & Assoc., Inc. v. Wagner*, 612 N.E.3d 468 (Ohio App. 1992).

VI. Practice Pointers

Refer to Section 552 as one of the arrows in your quiver if false information is provided and relied upon.

Carefully scrutinize the law and trend of the law in your jurisdiction. Also, the apparent trend of collaboration among architects, engineers, contractors and owners needs to be examined in each situation. *Understanding Changing Skills & Requirements of Estimators,* CFMA Building Profits, July/August 2017 at 63-65.

In reviewing proposed contracts, counsel should analyze the duties of the design professionals, the associated standard of care and the procedures for obtaining payment for extended general conditions, delays and additional contract time in the event of the design professional's negligent performance of its duties or defects in the plans and drawings.

The contract should specify a time when the design professional must respond to requests for information and similar duties to ensure that any time impacts are more easily measured.

The available insurance policies should be obtained and reviewed prior to contracting to ensure adequacy. A design professional should carry both errors and omissions and commercial general liability insurance. The errors and omissions insurance generally covers acts arising from the rendering of professional services which require specialized skill or knowledge. Coverage under the commercial general liability policy is typically limited to physical injury to persons or property and often excludes professional services.

VII. Conclusion

Careful consideration of the contractual allocation of risks is the best method to ensure certainty of outcome. In the event of a claim for negligent misrepresentation based on Section 552, the outcome is less certain in a conflicting and evolving legal landscape.

SESSION 5

DEFENSES TO WARRANTY CLAIMS

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PEARLMAN 2017

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Columbia Winery | Woodinville, WA

PEARLMAN ASSOCIATION 2017

DEFENSES TO WARRANTY CLAIMS

OBJECTIVE

To Outline the Defenses Available to Contractors and Sureties to Warranty Claims

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Introduction

Breach of construction warranty claims are claims levied against construction contractors – and, as a result thereof, against performance bond sureties – based upon allegations of nonconforming construction work. The nonconforming work may have been work performed in accordance with plans and specifications, but the work is nonetheless is nonconforming at the time the claim is made. More often than not, however, construction warranty claims stem from work that was never constructed in accordance with plans and specifications, or, alternatively, was constructed in accordance with the plans and specifications but the project owner is simply unhappy with the results of the work.

The purpose of this paper is to discuss construction warranty claims – what are they and what are they not – and to provide a compendium of possible defenses of contractors and sureties to warranty claims and the responses those generate by the parties on the other side, with an angle toward establishing preemptive contracting measures which might be taken to avoid certain warranty claims altogether.

1. Contractor construction warranties – what are they?

Contractor warranties regarding construction work are typically either express or implied. Express warranties are those which are set up specifically in the contract documents. Implied warranties are warranties which are implied or imposed by law based upon traditional construction practices and policies in the geographical area in which the project sits or in accordance with the esoteric nature of the project.

a. Express warranties

Express warranties are those warranties which are detailed in contractual provisions between general contractor and owner (or in subcontracts; owners often can often assert as a "third-party beneficiary" to the subcontract a claim to avail the owner of the benefit of warranty provisions in the subcontract).

Standard form construction industry agreements – such as the AIA and ConsensusDocs – contain express construction warranty provisions. For example, in the AIA general conditions to construction, AIA A201 (2007), at Sections 3.5 and 12.2.2.1, the following express warranties exist:

> § 3.5 WARRANTY
> The Contractor warrants to the Owner and Architect of materials and equipment furnished under the Contract will be of good quality and new unless the Contract Documents require or permit otherwise. The Contractor further warrants that the Work will conform to the requirements of the Contract Documents and will be free from defects, except for those inherent in the quality of the Work the Contract Documents require or permit. Work, materials or equipment not conforming to these requirements may be considered effective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, alterations to the work not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.
>
> § 12.2.2 AFTER SUBSTANTIAL COMPLETION
> § 12.2.2.1 In addition to the Contractor's obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under Section 9.9.1,[i] or by terms of an applicable special warranty required by the Contract Documents, any of the

> Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year. For correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the right to require correction by the Contractor and to make a claim for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.4.

Express warranty provisions in the general conditions document (ConsensusDocs 200 (2017) for the ConsensusDocs are similar to the foregoing two quoted AIA provisions (for example, at Sections 3.8.1 and 3.9, respectively), although we note that the ConsensusDocs include specific contractor warranty disclaimers, for example, at 3.8.2, for "products, equipment, systems, or materials incorporated in the Work" when those are "specified in purchased by Owner," limiting the warranties on such items to manufacturer warranties.

Warranties of the type and kind set forth in Section 3.5 of the A201 are more or less warranties which would be normally anticipated as customary in the industry even without an expression of the warranty being set forth in the contract documents. On the other hand, the one-year warranties described in A201 Section 12.2.2.1 and ConsensusDocs 200 Section 3.9 are for most intents and purposes purely contractual warranties, and are to be contrasted with claims for breach of contract. For its part, ConsensusDocs 200 expressly sets out the distinction between warranty and breach of contract claims in ConsensusDocs 200 Section 3.9.4:

> Constructor's obligations and liability, if any, with respect to any Defective Work discovered after the one-year correction period shall be determined by the Law. If after the one-year correction. But before the applicable limitation period has expired Owner discovers any Work which Owner considers Defective Work, Owner shall, unless the Defective Work requires emergency correction, promptly notify Constructor and allow Constructor an opportunity to correct the Work if Constructor elects to do so. ... If Constructor does not elect to correct the Work, Owner may have the Work corrected by itself or others, and, if Owner intends to seek recovery of those costs from Constructor, Owner shall promptly provide Constructor with an accounting of correction costs.

b. Implied warranties

Implied warranties are typically imposed by law. Implied warranties typically include that the work will be constructed in a "workmanlike manner," which is defined to be "the way work is customarily done by other contractors in the community."[ii]

By way of additional example, warranty of habitability is an implied warranty in the sale of new homes.[iii] Other potential implied warranties "can arise through application of the Uniform Commercial Code (UCC) or common-law principles..." including:

- fitness for particular purpose; or
- warranty of merchantability.[iv]

The applicability of implied warranties are typically a jurisdiction-by-jurisdiction inquiry.[v]

2. Contractor defenses to warranty claims

As regards both express and implied warranties, a contractor has potential defenses to breach of warranty actions, including – in accordance with the *Spearin* Doctrine[vi] – the contractor's reliance upon bad plans and/or specifications furnished to the contractor and which the contractor did not make. Other potential defenses include:

- Abnormal wear and tear: misuse of the finished construction, including use of the construction in a manner which was not intended or foreseeable

- Contractual disclaimers and limitations: typically, express warranty disclaimers in favor of the contractor and set forth in the contract documents

- Lack of timely or adequate notice: a violation of express contractual notice requirements, or, otherwise, notice provided belatedly such that the contractor is prejudiced in the contractor's ability to address the alleged warranty item

- Concealment of vital information by the owner: "the owner possesses superior knowledge that is vital to the contractor's performance, and that information is not reasonably available to the contractor"[vii]

- Statutes of limitations: a relatively uncommon defense to express warranty claims unless warranties are specifically governed by legislated statutes of limitations (for example, new home warranty laws, which are effectively by law written into the construction contract), or the warranty obligation is implied by law and, therefore, the breach of the warranty claim is equivalent to breach of the contract[viii]

- Waiver and/or release: voluntary express relinquishment of a known warranty right, or implied relinquishment of the warranty right based upon conduct inconsistent with the intent of the party to maintain or assert the right

Of the foregoing, the *Spearin* Doctrine poses much more (as compared to the other listed defenses) of a "gray area" for a contractor seeking to assert the Doctrine as defense. The *Spearin* Doctrine essentially entails that the owner warrants that the plans and specifications it provides are sufficient for the intended purpose, and "that a contractor will not be liable to an owner for loss or damage that results solely from defects in the plan, design, or specifications provided to the contractor."[ix] Countermeasures employed by owners to attempt to thwart a contractor's *Spearin* Doctrine defense to a warranty claim are discussed in the next section.

3. Foils against contractor defenses to warranty claims based upon bad plans and/or specifications, i.e., the *Spearin* Doctrine

a. exculpatory clauses, including disclaimers as to design liability

Central in *Spearin* is the implied warranty of adequate design. In *Spearin,* the United States Supreme Court suggested that a general non-specific disclaimer would be ineffective to disclaim the implied warranty of adequate design.[x] However, more specific disclaimers have proven to be effective. For example, in *In re D. Federico Co., Inc.*,[xi] a local redevelopment authority was relieved of responsibility for unforeseen underground obstructions because the authority "never intended the plans and drawings to be positive specifications, as is amply shown by the specific, not general, disclaimer language that was replete throughout the plans." See also, *White v. Edsall Const. Co., Inc*[xii] ("Only express and specific disclaimers suffice to overcome the implied warranty that accompanies design specifications.").

b. contractor failure to reasonably investigate and/or make inquiries and/or to report errors in the plans and specifications

Although generally implied by law, customary contractual provisions ordinarily dictate that the contractor's failure to conduct a reasonable site investigation, promptly notify the appropriate party (owner, designer, or higher-tiered contractor) of patent errors in plans and specifications, and otherwise to make reasonable inquiries when the situation warrants inquiries may prevent a contractor from asserting *Spearin* Doctrine defenses.

Although standard form contracts such as the AIA contract forms have (since the 1997 editions) over time relaxed the requirements placed upon a contractor to affirmatively review plans and specifications for errors, the forms nonetheless place an affirmative duty on the contractor to properly report perceived errors if encountered when reviewing the plans and specifications. Whereas pre-1997 versions of the AIA documents affirmatively required a contractor to "discover" errors in the plans and specifications, the 1997 and 2007 versions (now at A201-2007 Section 3.2.2) have reduced the requirement somewhat:

> § 3.2.2 Because the Contract Document are complementary, the Contractor shall, before starting each portion of the Work, carefully study and compare the various Contract Documents relative to that portion of the Work.... These obligations are the purpose of facilitating coordination in construction by the Contractor and are not for the purpose of discovering errors, omissions, or inconsistencies in the Contract Document; however, the Contractor shall promptly report to the Architect any errors, inconsistencies or omissions discovered by or made known to the Contractor as a request for information in such form as the architect may require. It is recognized that the Contractor's review is made in the Contractor' his capacity as

> a contractor and not as a licensed design professional, unless otherwise specifically provided in the Contract Documents.

See also ConsensusDocs 200 (2017), at Section 3.3.2.

The foregoing standard form contractual provisions comport generally with federal case law on the subject: "The implied warranty [of drawings and specifications being free from design defects] does not eliminate the contractor's duty to investigate or inquire about a patent ambiguity, inconsistency, or mistake when the contractor recognizer should've recognized an error in specifications or drawings."[xiii]

c. sufficiency of the plans and specifications notwithstanding minor defects/shortcomings

Not every instance of a defect or shortcoming in plans and specifications will result in a successful *Spearin* Doctrine defense for a contractor.

In *Caddell Const. Co. v. United States*,[xiv] a case involving the modernization and strengthening of the VA Medical Center in Memphis, Tennessee, the plaintiff (the general contractor) claimed, on behalf of its steel fabrication subcontractor, that the federal government owner (the Department of Veteran Affairs) provided structural steel drawings that allegedly contained conflicts, errors, omissions, and/or inadequate details. Plaintiff sought an equitable adjustment of $2,782,149.52 for delays and additional costs.

For its part, the VA argued argues that the designs were not defective and that plaintiff was the cause of the alleged delays and cost overruns. The court found that the steel fabricator faced not defective designs or specifications but simply "a collection of small errors" which did not amount to plans which were either

"unworkable" or "substantially deficient."[xv] Holding that the "plans were not 'so faulty as to prevent or unreasonably delay completion of the contract performance.'..." the court found instead that "the work stalled because of [general contractor's] mishandling of the RFIs."[xvi]

d. delegated design (contractor participation in design)

Shift of design responsibility to contractor – from the typical design-bid-build model – occurs more and more in current-day construction contracting. Contractor insurance considerations aside (and there are many), the matter of the shift is something which should be the subject of a very unambiguous express contractual statement setting forth the design responsibility placed upon the general contractor, so that the responsibility clear. Likewise, the interface of different design components – triggering at least one significant question, among other potential questions: Who is responsible for the transitions between the separately design elements of the work? – needs to be clear.

As early as 1997, standard form contracts such as the AIA contract documents began to include standard provisions governing potential architecture and engineering services which a contractor may be required to perform under the contract. On the topic, AIA general conditions A201 (2007) Section 3.12.10 provides generally as follows:

- The contract can require contractor to provide architecture and engineering services, but not in violation of the law.
- The foregoing requirements must be specifically required in contract documents (that is, the design requirements are not to be inferred).
- The architect must specify all "performance and design criteria" that the design services provided by contractor must satisfy.

- In connection with the foregoing, the architect only checks the general contractor design work product for conformance with the performance and design criteria; that is, the architect is not and does not become the designer. Rather, the general contractor is the designer of that portion of the work.

See also, generally, ConsensusDocs 200 (2017) at Section 3.15 thereof.

Design responsibility delegated to the general contractor in accordance with the foregoing entails that the *Spearin* Doctrine will not be available to the general contractor for the aspects of the project that general contractor designs. However, the general contractor is not responsible for the sufficiency of the architect performance and design criteria specified in the contract documents: if those are criteria are insufficient, those insufficiencies do not become the responsibility of the general contractor– as long as the general contractor properly designed according to what the general contractor was given.

Perhaps the most infamous event involving shift of design responsibility to a general contractor is the 1981 Kansas City Hyatt Regency disaster, an event in which 114 people were killed and hundreds injured.[xvii] In the context of the construction, the general contractor objected to original walkway design by the project's structural engineer and produced an alternative design "shop drawing" by the general contractor's steel detailer's licensed engineer. However, that shop drawing was never approved by the project's structural engineer – that engineer taking the position that review approval was not required because the drawings were stamped by the steel detailer's engineer.

An administrative court disagreed with the project engineer, finding that the approval of the shop drawings was a nondelegable duty of project engineer.[xviii]

However, the general contractor shared in the liability based upon its insufficient design. Note, however, that the project's structural engineer did not have liability back to contractor for the engineer's failure to review the shop drawings: the general contractor had an independent responsibility vis-à-vis the design, and could not – or at least did not – delegate that responsibility back to the engineer.[xix]

e. plans and specifications entail a performance specification, not a design

"Today, the modern approach to *Spearin* assigns responsibility for a defective construction according to whether the specification prescribing the construction is a performance or a design specification. *See PCL Constr. Servs, Inc. v. United States*, 47 Fed. Cl. 745 (2000)."[xx] "'Design specifications explicitly state how the contract is to be performed and permit no deviations. Performance specifications, on the other hand, specify the results to be obtained, and leave it to the contractor to determine how to achieve those results.'"[xxi]

In the *PCL* decision, the court, noting that the "fact the specifications provided some details concerning how the work was to be performed does not convert what would otherwise be a performance specification into a design specification...," [xxii] held that government bore no liabilities "for difficulties encountered by a contractor because performance specifications supplied by the government were insufficiently detailed to enable the contractor to perform the contract in an efficient or profitable manner." [xxiii]

f. contractual risk shifting for design defects

Even if not serving as the actual designer, may a general contractor contractually assume the responsibility for the sufficiency of the design completely furnished to the general contractor for the project? The case law suggests this is distinctly possible.

In *Greenbriar Digging Serv. Ltd. P'ship v. S. Cent. Water Ass'n, Inc.*,[xxiv] plaintiff, Greenbriar Digging Service Limited Partnership ("Greenbriar"), entered a contract with South Central Water Association, Inc. ("South Central") whereby Greenbrier was to install an ozone system to reduce the color in the water produced by one of South Central's wells to a value of twenty (20) units or less. Although Greenbriar installed the system specified by the project engineer, the system in operation actually reduced color to the agreed upon twenty (20) units or less only when the well operated at a rate of 600 gallons per minute (gpm) – that is, when operating at only half of the well's full capacity of 1,200 gpm. It was undisputed in the trial court that the installed system could not meet the agreed-upon performance standards at 1,200 gpm.

Believing that Greenbriar breached the contract – including certain guarantees made by the general contractor in the contract – South Central withheld the final payment due. In response, Greenbriar filed suit, seeking the final payment and arguing that South Central impliedly warranted the adequacy of its plans and specifications. Greenbriar argued that because it followed the specifications, Greenbriar should not responsible for the installed system's failure to meet the stated goal of the contract.

Regarding the guarantees made by the general contractor in the contract, the court found that the "Greenbriar's guarantee expressly included 'repair' of 'any defect due to design,'" and that the "guarantee went well beyond mere workmanship...."[xxv] Hence, the court held it would be unreasonable to interpret the contractor's guarantee to require a reduction of color only when operating at half of the well's full capacity, and ruled against the general contractor.

g. errors did not result in the condition which forms the basis of the warranty claim

In at least two sets of circumstances, errors in the plans and specifications – even errors which ordinarily would reach a level of seriousness to constitute grounds for the assertion by the general contractor of the *Spearin* Doctrine – will not allow application of the Doctrine because the errors are not the source or basis of the claim.

First, the failure of the contractor to follow the allegedly defective plans and specifications may eliminate the contractor's ability to assert the *Spearin* Doctrine. In *Travelers Cas. & Sur. of Am. v. United States*, [xxvi] the court announced that, "... the contractor must fully comply with and follow the design specifications, although faulty, to enjoy the protections of the implied warranty, unless the departure from the specifications is 'entirely irrelevant to the alleged defect.'" [xxvii] In *Travelers*, after an exhaustive analysis, the court held (over the objections of the owner) that the general contractor indeed had reasonably followed the design drawings in its initial construction, and concurrently found that a defect in construction claimed by the government "was due entirely to the government's design drawings." [xxviii]

Second, when the errors in the plans and specifications do not themselves cause the problem which the general contractor complaints, the *Spearin* Doctrine does not apply:

> Spearin stands for the proposition that when the government includes detailed specifications in a contract, it impliedly warrants that (i) if the contractor follows those specifications, the resultant product will not be defective or unsafe, and (ii) if the resultant product proves defective or unsafe, the contractor will not be liable for the consequences. As with any contract-based claim, however, to recover for a breach of warranty, a plaintiff must allege and prove (1) that a valid warranty existed, (2) the warranty was breached, and (3) *411 plaintiff's damages were caused by the breach.

Hercules Inc. v. United States, 24 F.3d 188, 197 (Fed.Cir.1994) (citing *Spearin*, 248 U.S. *at* 136–37, 39 S.Ct. 59; *San Carlos Irrig. and Drainage Dist. v. United States*, 877 F.2d 957, 959 (Fed.Cir.1989); Wunderlich Contracting Co. v. United States, 173 Ct.Cl. 180, 351 F.2d 956, 968 (1965)).[xxix]

CONCLUSION

Beyond those owner defenses to contractor assertion of the *Spearin* Doctrine set forth above are other potential owner defenses, such as: waiver/estoppel (including contractor acquiescence in defective specifications), lack of timely notice to the owner and/or subsequent lack of due care by the contractor, statutes of limitation or repose, prior breach of contract by the contractor, failure of the contractor to mitigate damages, and contractor failure to protect the work.

At its heart, the *Spearin* Doctrine is not a doctrine of standard of care – that is, ordinarily, fault or negligence of the owner or its design consultants need not be shown, but, rather, only that the design documents are deficient or defective.[xxx]

Instead, the *Spearin* Doctrine is a doctrine that is principally based in the law, and application of the Doctrine may be affected according to the manner in which the parties to a construction contract structure their agreements and subsequently perform the work. In the modern construction arena, as professionals in the industry encounter what amounts to shifting sands in regard to design responsibility that may be assigned or apportioned between or among the owner and its design professionals, on one hand, and contractor parties, on the other hand, the parties all need to know going in: who is responsible for what in regard to the design, and who is warranting the design and the final work product.

Taking into account considerations of public policy and prohibitive laws, as well as warranties implied by law in regard to construction and design, the parties to construction contract should strive mightily at the outset – when drafting a construction agreement and before construction starts – to clearly, expressly, unequivocally and fully and satisfactorily address in the construction agreement the contractual responsibilities and warranties of the parties related to design and design sufficiency, in order to avoid future uncertainty and disputes as to those.

ENDNOTES

[i] Reference to 9.9.1 concerns warranties commencing upon partial occupancy or use of the constructed building.

[ii] *Jones v. Davenport*, 2001 WL 62513 (Ohio Ct. App. Jan. 26, 2001), at *8, citing *Salewsky v. Williams, 1990 WL 139731 (Ohio Ct. App. Sept. 17, 1990)*, at *4.

[iii] http://www.cassiday.com/files/Publication/633fdf7f-d281-4db4-bc23-2a042baba6a8/Presentation/PublicationAttachment/b7edfc88-a583-47cb-8e3f-46728b9fca29/IDC%20Quarterly%2024%204-The%20Implied%20Warranty%20of%20Habitability.LongoPisano.pdf.

[iv] Robinson, Richard S., Esq. "Warranties and Construction Contracts: Contractor's Drafting Considerations." Www.pecklaw.com. 2015. Accessed August 1, 2017. https://www.pecklaw.com/images/uploads/news/Warranties in Construction Contracts Co ntractots Drafting Consideration....pdf.

[v] *Id.*

[vi] *United States v. Spearin*, 248 U.S. 132 (1918).

[vii] Long, Richard J., P.E. "Defective and Deficient Contract Documents – A 2013 Update." Http://www.long-intl.com. 2013. Accessed August 1, 2017. http://www.long-intl.com/articles/Long Intl Defective and Deficient Contract Documents.pdf.

[viii] *E.g.*, Louisiana New Home Warranty Act, Louisiana Revised Statute 9:3141, *et seq.*; and, Virginia implied warranties on new homes, Virginia Code § 55-70.1.

[ix] Zimolong, Wally. "The Spearin Doctrine as a Defense to Defective Workmanship Claims." Construction Litigation. April 11, 2012. Accessed August 1, 2017. http://apps.americanbar.org/litigation/committees/construction/email/spring2012/spring20_12-0402-spearin-doctrine-defense-defective-workmanship-claims.html.

[x] Ahlers, John P. "Spearin Doctrine: The Implied Warranty of Plans and Specifications." Http://www.ac-lawyers.com. January 25, 2015. Accessed August 02, 2017. http://www.ac-lawyers.com/news/2015/01/29/spearin-doctrine-the-implied-warranty-of-plans-and-specifications. See also, *Baldi Bros. Constructors v. United States*, 50 Fed. Cl. 74, 79 (2001) (holding that the government could not relieve itself from liability by general provisions where in the government indicates that it does not "guarantee the statements of fact in the specifications").

[xi] *In re D. Federico Co., Inc.*, 8 B.R. 888, 896 (Bankr. D. Mass.1981).

[xii] *White v. Edsall Const. Co., Inc.*, 296 F.3d 1081, 1085 (Fed. Cir. 2002)

[xiii] *Lake Union Drydock Co., Inc. v. United States*, 2007 WL 2984707, at *10 (W.D. Wash. Oct. 10, 2007) (bracketed text added), citing to, *White v. Edsall Constr. Co., Inc.*, 296 F.3d 1081, 1085 (Fed.Cir.2002).

[xiv] *Caddell Const. Co. v. United States*, 78 Fed. Cl. 406 (2007).

[xv] *Id.*, at 416.

[xvi] *Id.* (bracketed text added), quoting to *Wunderlich Contracting Co. v. United States*, 173 Ct.Cl. 180, 351 F.2d 956, 964 (1965).

[xvii] For an excellent discussion of all events surrounding the disaster, see: Texas A&M University. "Hyatt Regency Walkway Collapse." Http://www.engineering.com. October 24, 2006. Accessed August 3, 2017. http://www.engineering.com/DesignerEdge/DesignerEdgeArticles/articleType/ArticleView/ArticleID/175/PageID/197.aspx.

[xviii] Missouri Board for Architects, Professional Engineers and Land Surveyors vs. Daniel M. Duncan, Jack D. Gillum and G.C.E. International, Inc., before the Administrative Hearing Commission, state of Missouri. Jefferson City. Mo.: Administrative Hearing Commission, 1984.

[xix] Note that under AIA B 141 (1997), at Section 2.6.4.1, architects have principal review and approval responsibilities vis-à-vis shop drawings, and shop drawings are not supposed to be delegated design, notwithstanding this language: "... but only for the limited purposes of checking for conformance with the information given in the design concept expressed in the Contract Documents.... Review of such submittals is not conducted for the purpose of determining the accuracy and completeness of other details such as dimensions and quantities, or for substantiating instructions for installation or performance of equipment or systems, all of which remain the responsibility of the Contractor is required by the Contract Documents."

[xx] Zimolong, Wally. "The Spearin Doctrine as a Defense to Defective Workmanship Claims." Construction Litigation. April 11, 2012. Accessed August 1, 2017. http://apps.americanbar.org/litigation/committees/construction/email/spring2012/spring20_12-0402-spearin-doctrine-defense-defective-workmanship-claims.html.

[xxi] *PCL Const. Servs., Inc. v. United States*, 47 Fed.Cl. 745, 795 (2000), citing to *Stuyvesant Dredging Co. v. United States*, 834 F.2d 1576, 1582 (Fed.Cir.1987).

[xxii] *Id*., at 796.

[xxiii] *Id*., at 795. Although this defective design case dealt with attempts by the contractor to recover for project inefficiencies and not some other design defect which led to a problem with physical construction, the gravamen of the decision was in regard to the application or not of the *Spearin* Doctrine when the plans and specifications provided a performance specification to the general contractor. Compare the finding in *Caddell Const. Co., Inc. v. United States*, 78 Fed.Cl. 406 (2007).

[xxiv] *Greenbriar Digging Serv. Ltd. P'ship v. S. Cent. Water Ass'n, Inc*., 2009 WL 812241 (S.D. Miss. Mar. 26, 2009).

[xxv] *Id*., at *4.

[xxvi] *Travelers Cas. & Sur. of Am. v. United States*, 74 Fed.Cl. 75 (2006).

[xxvii] *Id*., at 89, quoting to *Al Johnson Constr. Co. v. United States*, 854 F.2d 467, 470 (Fed.Cir.1988).

[xxviii] *Id*., at 106. For a court decision evidencing a contrary ruling, see: *Valley Const. Co. v. Lake Hills Sewer Dist*., 67 Wash.2d 910, 410 P.2d 796 (1965).

[xxix] *Caddell Const. Co., Inc*. v. United States, 78 Fed.Cl. 406, 410–11 (2007).

[xxx] See, for example, *Penzel Constr. Co., Inc. v. Jackson R-2 Sch. Dist*., 2017 WL 582663 (Mo. Ct. App. Feb. 14, 2017), *reh'g and/or transfer denied* (Apr. 10, 2017).

SESSION 6

IMPLIED WARRANTY OF THE PLANS AND SPECIFICATIONS: AVOIDANCE OF OR CHALLENGES TO LIABILITY

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IMPLIED WARRANTY OF THE PLANS AND SPECIFICATIONS: AVOIDANCE OF OR CHALLENGES TO LIABILITY

By: Paul Friedrich & Meredith Dishaw of Williams Kastner & Gibbs, PLLC
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1. *United States v. Spearin*

The origin of the implied warranty of design adequacy was the landmark case of *United States v. Spearin,* now the applicable law in the vast majority of the United States. 248 U.S. 132, 169 (1918). In *Spearin,* a contractor agreed to construct a dry dock at the Brooklyn Navy Yard. The government's detailed plans and specifications required the contractor to excavate the site and then relocate and reconstruct a six-foot brick sewer line that intersected the site. After the sewer was relocated and reconstructed, heavy rains caused it to back up which, in turn, created internal water pressures that broke the line in several places and flooded the dry dock excavation. Based upon a contract clause pursuant to which the contractor was responsible for the work until the completion and final acceptance, the government insisted that the contractor clean up the site and reconstruct the damaged line at its own expense. The contractor refused to continue its work unless the government assumed responsibility for past damages and either altered the sewer system design or assumed responsibility for any further damage. After months of discussions, the government annulled the contract and took possession of the site. The government then drastically redesigned and enlarged the plans for the sewer line to avoid any future ruptures under heavy rain conditions. The Unites States Supreme Court held that the government was liable for breach of its implied warranty of the adequacy of the plans and specifications, and affirmed an award to the contractor of its contract costs and profits notwithstanding the government's lack of negligence, lack of knowledge or special expertise, and the use of general "boilerplate" disclaimer clauses in the contract.

A. Owner's Implied Warranty.

It is well-settled law that the owner warrants the adequacy and sufficiency of the contract documents. *See, Spearin*, 248 U.S. at 169 (1918); *Ericksen v. Edmonds School Dist. No. 15*, 13 Wn.2d 398, 408, 121 P.2d 275 (1942); *Weston v. New Bethel Baptist Church*, 23 Wn. App. 747, 753, 698 P.2d 411 (1978). If the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in those plans or specifications. *Spearin*, 238 U.S. at 136. Rather, there is an implied warranty that the contract documents are adequate and sufficient to build the project. *Id.* The *Spearin* doctrine has been adopted in Washington, Oregon, Alaska, Arizona, and most other states. *See, Dravo Corp. v. Municipality of Metro. Seattle*, 79 Wn.2d 214, 218, 484 P.2d 399 (1971); *City of Seattle v. Dyad Const.*, 17 Wn. App. 501, 565 P.2d 423 (1977); *A.H. Barbour & Son, Inc. v. State Highway Comm'n*, 248 Or. 247, 257-258, 433 P.2d 817 (1967); *Gen. Constr. Co. v. Or. Fish Comm'n*, 26 Or. App. 577, 581-582, 554 P.2d 135 (1976); *Fairbanks N. Star Bor. v. Kandik Inc. & Assocs.*, 795 P.2d 793, 797 (1990); *Handle Const. Co., Inc. v. Norcon, Inc.*, 264 P.3d 367, 370–71 (Alaska 2011)("In Alaska, as in other jurisdictions, '[i]f defective

specifications cause the contractor to incur extra costs in performing the contract, then the contractor may recover those costs that result from breach of the implied warranty'"); *Chaney Bldg. Co. v. City of Tucson*, 148 Ariz. 571, 574, 716 P.2d 28, 31 (1986); *c.f. Willamette Crushing Co. v. Arizona ex rel. Dep't of Transp.*, 188 Ariz. 79, 81, 932 P.2d 1350, 1352 (Ariz. Ct. App. 1997)("*Spearin* rule applies to design specifications only; it does not apply to performance specifications").

To invoke the implied warranty of adequate design plans and specifications, the contractor must demonstrate that the contract documents were defective. The contractor need not demonstrate that the design falls below some professional standard, which is generally a higher burden, instead, the contractor must only establish a breach of the implied warranty. The contractor is only required to demonstrate that the contract documents contain inconsistencies, are ambiguous, or are otherwise insufficient to build the project.

B. Prime Contractor's Implied Warranty.

A prime contractor, though generally not the drafter of the construction documents, can nevertheless be accountable for the implied warranty which attaches to plans and specifications. For example, in *Hoye v. Century Builders*, 52 Wn.2d 830, 833, 329 P.2d 474 (1958), the Washington Supreme Court held:

> [I]f a party furnishes specifications and plans for a contractor to follow in a construction job, he thereby impliedly warrants their sufficiency for the purpose in view.

And further held:

> Where either party to a building contract agrees to furnish, and does furnish, the plans for a building, he thereby guarantees their sufficiency for the purpose.

Id. at 833.

In another Washington decision, *Haley v. Brady*, 17 Wn.2d 775, 788-789, 137 P.2d 505 (1943), subcontractors brought an action against the general contractor for extra work done in lathing and plastering two buildings. The extra work performed was not provided for in the plans and specifications. In awarding damages for the costs of extra work, the court held:

> Additional compensation may be recovered for extra work which becomes necessary because the building cannot be constructed according to the plans and specifications furnished, as required by the contract, such as for alterations rendered necessary by defective plans; or for additional work or expense which is rendered necessary by the owner's negligence, or failure to perform his part of the contract.

A prime contractor, like the owner, may thus also impliedly warrant the plans and specifications provided to the subcontractor. *See, e.g., Miller v. Guy H. Jones Constr. Co.*, 653 P.2d 211 (Okla. App. 1982); *APAC-Carolina, Inc. v. Towns of Allendale & Fairfax, S.C.*, 868 F. Supp. 815, 825 (D.S.C. 1993)(general contractor may not avoid liability for its breach of implied warranty to subcontractor on the grounds that it was unaware that the plans and specifications it provided were defective), *aff'd sub nom. APAC Carolina, Inc. v. Town of Allendale, S.C.*, 41 F.3d 157 (4th Cir. 1994).

A Washington case takes this issue one step further finding that a contractor can affirmatively warrant the adequacy of the owner's design. In *Shopping Mgmt. Co. v. Rupp*, the owner of the shopping center brought suit against the contractor and its surety when two automatic submersible sewage pumps called for in the owner's specifications malfunctioned, disrupting the disposal of effluent from the septic tank to the drain field. 54 Wn.2d 624, 343 P.2d 877 (1959). The contract between the owner and the contractor contained the following warranty/guaranty:

> The contractor shall guaranty the satisfactory operation of all materials and equipment installed under this contract, and shall repair or replace to the satisfaction of the owner or architect any defective material, equipment or workmanship which may show itself within one (1) year after the date of final acceptance.

In holding the contractor responsible for the pump failures, the Washington Supreme Court relied upon that contract language, which had construed to be a "guaranty" that the work constructed pursuant to the owner's design would "operate satisfactorily:"

> We think the guaranty clause of the contract involved in this case ... broad ... in that [the contractor] thereby undertook to do more than merely repair or replace any defective material, equipment, or workmanship which might appear within one (1) year after the date of final acceptance. The express wording of the guaranteed provision is that the contractor shall guaranty the satisfactory operation of all materials and equipment installed under this contract. The contract includes the plans and specifications. Therefore, [the contractor] must be deemed to have guaranteed the material and equipment installed by him would operate satisfactorily under the plans and specifications of the owner. Thus it is immaterial in this case whether the pumps failed to operate satisfactorily because of the plans and specifications or because of the defective materials, equipment or workmanship. In either event, [the contractor] must be held, under the language of his guaranty, to have assumed the risks of the events which subsequently transpired, as described in the trial court or rescission in its findings of fact.

This holding is by no means universally adopted. For example, in *Corporation of Presiding Bishop of Church of Jesus Christ of Latter-Day Saints v. Cavanaugh*, a scope of work clause required the contractor to provide a "complete and satisfactory system," but the California Court of Appeals did not construe that provision as a warranty. 217 Cal. App. 2d 492, 32 Cal. Rptr.

144 (1963). Instead, the *Cavanaugh* Court found that the provision simply stated the scope of the specified undertaking. *Id.* It also can be noted that courts applying the implied warranty to the general contractor would recognize that the prime may in turn sue the owner, shifting the risk of loss from the lesser culpable party back up the contractual chain of privity.

C. *Spearin* Doctrine Used as a "Sword"

The owner's implied warranty may be used by the contractor as a "sword" to recover compensation for extra work where other express contract provisions (such as a differing site conditions clause) are unavailable. For example, in *Fairbanks North Star Borough v. Kandik Inc. & Assocs.*, the plans and specifications provided to the contractor by the government understated the amount of material that needed to be excavated. 795 P.2d 793 (Alaska 1990), *vacated in part and reh'g on other grounds*, 823 P.2d 832 (Alaska 1991). The government had deleted the differing site conditions clause from the contract. The Supreme Court of Alaska, however, allowed the contractor to recover extra costs incurred by performing pursuant to defective specifications.

Note, however, the courts typically require the contractor to show full and exact compliance with the plans and specifications to invoke the *Spearin* doctrine. *See, e.g.*, *Al Johnson Constr. Co. v. United States*, 854 F.2d 467, 469–70 (Fed.Cir.1988)(if the contractor fails to comply fully with the faulty design specifications, recovery on the implied warranty is precluded); *see also Travelers Cas. & Sur. of Am. v. United States*, 74 Fed. Cl. 75, 89–90 (2006) ("[T]he contractor must fully comply with and follow the design specifications, although faulty, to enjoy the protections of the implied warranty"). In *Al Johnson*, the court reasoned the "strong policy" in restricting the implied warranty to those who have complied fully with the specifications "would not be served by allowing the implied warranty to run to one who has not done what he contracted to do and fails to satisfactorily explain why not." 854 F.2d at 470. *See, e.g.*, *Alpert v. Commonwealth*, 357 Mass. 306, 320, 258 N.E.2d 755 (1970)(where the contractor does not rely in good faith on the designer's plans and specifications, the contractor is responsible for the increased costs arising from design defects); *see also Jonovich Companies, Inc. v. City of Coolidge*, 2011 WL 5137180 (Ariz.App.2011)(where contractor deviated from city's specifications, *Spearin* rule does not apply); *Gulf Western Precision Engineering Co. v. United States*, 211 Ct. Cl. 207, 218, 543 F.2d 125, 130–31 (1976)(contractor could not recover extra costs that directly and proximately resulted from the contractor's substituting its own fabrication techniques for those suggested by the Government).

D. Disclaiming the Implied Warranty of Adequate Design: Avoidance of or Challenges to Liability.

There is some confusion as to whether an owner's implied warranty of adequate design can be disclaimed. There are two separate questions: (1) whether the implied warranty can be legally disclaimed at all; and (2) if so, what specific language is sufficient to disclaim the warranty? In *Spearin*, the Supreme Court suggested that a general non-specific disclaimer would be ineffective to disclaim the implied warranty of adequate design. There is a significant body of law in both federal and state courts rejecting attempts by owners to disclaim the implied warranty with general or generic disclaimers. *Spearin*, 248 U.S. at 137 ("general disclaimers

requiring the contractor to check plans and determine project requirements do not overcome the implied warranty, and thus do not shift the risk of design flaws to contractors who follow the specifications"); accord *White v. Edsall Constr. Co.*, 296 F.3d 1081, 1085 (Fed.Cir.2002)("Only express and specific disclaimers suffice to overcome the implied warranty that accompanies design specifications"). Generally, owners have more success disclaiming the implied warranty through the use of specific disclaimers.

Subtle language can transfer the entire risk for defective designs from the owner/designer to the general contractor. Bidding contractors, and their sureties, need to be aware that any language suggesting that a design may not be adequate for the item to function for its intended purpose may shift the entire risk of that design, including the costs to make the item function as intended, to the bidder.

Such was the unfortunate case for KiSKA Construction Corp., which was forced to expend double its lump-sum bid award to remedy a design defect that led to large-scale worksite flooding. *KiSKA Constr. Corp. v. Washington Metro. Area Transit Auth.*, 321 F.3d 1151 (D.C. Cir. 2003). The contractor's loss of approximately $43 million turned on the seemingly innocuous phrase "additional dewatering wells may be required." The United States Court of Appeals for the District of Columbia Circuit found that this language sufficiently disclaimed the designed dewatering wells' ability to dewater the site to the level required by the contract. Aware of this clause, the court felt the bidding general contractor should have incorporated the risk of these design inadequacies into the bid price, and the contractor was forced to bear the costs of remedying the design deficiency.

The KiSKA case is even more troubling given that the owner likely included the disclaimer because it suspected its design was inadequate. American Subcontractors Association, Inc., *Design Risk: Disclaimers of Plans and Information* 3-4 (2008). The owner's engineer had twice reported that no number of dewatering wells would be sufficient to prevent the job-site flooding. The engineer's third report then suggested that 300 dewatering wells might be sufficient. Ultimately, the city's design called for 62 dewatering wells, which they knew would be a vastly inadequate number to dewater the site. It is possible that this disclaimer was included to transfer the risk of deficient design to the bidder, and that plan ultimately worked to save the city $43 million.

Fortunately, there are certain explicit requirements before a court will conclude that a design disclaimer transferred the risk of any design failure. For example, in a decision cited previously, *Edsall Constr. Co.*, the court refused to find that the owner disclaimed the design because the contract language did not "clearly alert the contractor that the design may contain substantive flaws requiring correction and approval before bidding." *Edsall Constr. Co.*, 296 F.3d at 1086. The alleged disclaimer read:

> Canopy door details, arrangements, loads, attachments, supports, brackets, hardware, etc. must be verified by the contractor prior to bidding. Any conditions that will require changes from the plans must be communicated to the architect

> for his approval prior to bidding and all cost of those changes be included in the bid price.

Whereas the contract in *KiSKA* specifically stated that the design was possibly insufficient to prevent flooding, the language in *Edsall* was too generalized for the court to find that the design risk had shifted away from the designer. The language merely required the contractor to verify the door's general characteristics to ensure adequacy, but did not suggest the door would not work for its purpose.

Similarly, in *S & M Constructors, Inc. v. Columbus*, 70 Ohio St. 2d 69, 24 O.O.3d 145, 434 N.E.2d 1349 (1982), the contractor agreed that it would make no claim against the city even if the subsurface conditions reported prior to bidding differed materially from actual conditions encountered during the project. The Ohio Supreme Court held the "no claim" provision was unambiguous and enforceable in the absence of a showing of fraud or bad faith on the part of the city. The Court observed that the *Spearin* doctrine does not invalidate an express contractual provision: "Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered." *S & M* at 75 (quoting *Spearin*, 248 U.S. at 136).

A design disclaimer that is narrowly tailored and specific to a particular facet of a project requires that a contractor understands the adequacy of that design and the potential costs if it proves defective. However, bidding contractors, and their sureties, can take some solace that if an alleged disclaimer's language does not suggest that the item as designed may not work for its intended purpose, the bidder will likely not bear the design risk. If language, however subtle, suggests an attempt to disclaim any piece of a design warranty, bidding contractors should be on high alert as to that term specifically, and should inquire with the designer to gather more information on why the language was included.

E. Notice Issues

Although the content and formulation of disclaimer language may affect the application of the *Spearin* doctrine, the requirement of notice, or lack thereof, can also affect the contractor's right to rely on the *Spearin* doctrine. First, most public contracts contain language requiring the contractor to review the plans and specifications and to provide notice to the owner of any obvious errors, omissions, or discrepancies. *See, e.g., PCL Const. Servs., Inc. v. U.S.*, 47 Fed. Cl. 745, 786 (2000)(if a problem is "obvious or actually perceived by contractor," contractor must provide notice, prior to contract award, to allow owner to correct the problem); *John F. Miller Co. v. George Fichera Constr. Corp.*, 7 Mass. App. 494, 499, 388 N.E.2d 1201 (1979)(contractor presented with obvious omission, inconsistency, or discrepancy should take steps, by way of his own investigation, or by putting questions to the owner to bridge gaps in the documents); *see also Travelers Cas. & Sur. of Am. v. United States*, 74 Fed. Cl. 75, 94 (2006)(contractor cannot rely on the *Spearin* implied warranty, if it fails to inquire about a patent ambiguity); c.f. *Richardson Elec. Co., Inc. v. Peter Francese & Son, Inc.*, 21 Mass. App. 47, 52, 484 N.E.2d 108, 111 (1985)(contractor that examines specifications "reasonably

conscientiously" and misses requirement that is out of sequence or ineptly expressed entitled to recover under implied warranty from issuer of the specifications).

F. *Spearin* Doctrine Under Recent Attack.

In *Dugan & Meyers Constr. Co. Inc. v. Ohio Dep't of Admin. Servs.*, 113 Ohio St. 3d 226 (2007), the court severely limited the ability of contractors to rely on the adequacy of drawings and specifications for public projects.

Dugan & Meyers was the lead contractor for the construction of a project for Ohio State University. Dugan & Meyers' performance was adversely affected by errors and omissions in the drawings and specifications provided by the University. The project schedule was impacted due to the numerous requests for information, field directives, and changes.

Dugan & Meyers submitted a claim to the University for $3.4 million in costs incurred as a result of the cumulative impact of the numerous changes required by the incomplete drawings. Dugan & Meyers' claim was based on an application of the *Spearin* doctrine. The trial court agreed with Dugan & Meyers and awarded it damages. The appellate court reversed, however, holding that *Spearin* did not support a claim of cumulative impact.

The Ohio Supreme Court affirmed the appellate court. In doing so, the court limited the application of the *Spearin* doctrine in Ohio to claims involving "affirmative indications of job site conditions," such as subsurface conditions. In contrast, the Dugan & Meyers claim was one for "*delay* in completion of a construction project due to plan changes." The court, therefore, held that it would "decline the opportunity to extend the *Spearin* Doctrine from job-site-condition cases to cases involving delay due to plan changes."

The court further held that "[absent] a showing of fraud or bad faith," the "no damages for delay" provision in Dugan & Meyers' contract expressly barred any claim for delay damages, including cumulative impact damages. In addition, the court affirmed the appellate court's conclusion that Dugan & Meyers failed to provide sufficient evidence that the problems with the plans were so extensive as to render "the owner-furnished plans *unbuildable or otherwise wholly inadequate to accomplish the purpose of the contract*." (emphasis added). The court noted that the project was completed by a new contractor, which seemed to suggest that the plans and specifications were therefore adequate and buildable.

The extent of this decision's impact is not known at this time. In fact, in a very recent decision, the Missouri Court of Appeals rejected the *Dugan* approach noting "[a]lthough there are no Missouri cases that address the use of *Spearin* claims in our State, the spirit of the standard articulated in *Dugan* appears inconsistent with principles established by Missouri courts." *Penzel Constr. Co., Inc. v. Jackson R-2 Sch. Dist.*, --- S.W.3d ---, 2017 WL 582663, at *9 (Mo. Ct. App. Feb. 14, 2017), *reh'g and/or transfer denied* (Apr. 10, 2017). The court provided the following "pro-contractor" manifesto:

> Effectively, the *Spearin* Doctrine places the risk of loss stemming from defective plans and specifications on the owner who renders the plans to the contractor. This is equitable. The owner in a construction contract is better positioned to

> assess the accuracy and adequacy of the project's plans and specifications; therefore, it is better positioned to prevent losses from ever occurring. Owners typically have unrestricted access to the construction site, and they communicate directly with their own subcontractors who create the designs for a project. Shifting the burden to ensure the adequacy of the plans and specifications to the general contractor would also have a negative economic impact. Encumbering general contractors with the responsibility of verifying the accuracy and suitability of the plans would often cause needless delay due to the duplicative nature of the work. General contractors would presumably incur more costs, in turn increasing costs for the government owners in the grand majority of cases, as the contractors would likely need to employ their own engineers and/or architects to reliably review the proposed plans. Even contractors who have their bids rejected would incur costs, as they would need to have the proposed plans examined before submitting a sensible bid. Placing the burden on contractors to ensure the adequacy of an owner's plans would reduce the efficiency of the industry, which is especially damaging to societal interests when government owners inevitably fund a portion of these increased costs. Furthermore, to hold a contractor or subcontractor liable for performing work in the exact manner agreed upon, while offering the faulting party a reprieve, is incongruent with contract principles and general notions of fairness.

Penzel Constr. Co., 2017 WL 582663, at *9 (internal citations omitted).

At the very least, contractors should not presume that they will be able to recover the full cost of impacts caused by defective plans and specifications. Moreover, it may require contractors to approach the change order process in a very different manner. What is clear, however, is that contractors performing public projects may need to reexamine the way in which they review, plan, and perform projects.

In another matter, in June 2006, King County awarded VPFK (Vinci Construction Grands Projects, Parsons RCI, Frontier-Kemper) the Brightwater Project tunneling work contract. The County specified which boring machine (the Slurry Tunnel Boring Machine “STBM” method) was to be utilized in performing the work. During performance, VPFK’s progress was substantially slower than anticipated because the County-specified STBM method was not suitable for the work to be performed under the soil conditions encountered. The STBM ultimately failed and VPFK’s performance was behind schedule.

The County sued VPFK for default. VPFK cross-claimed asserting the County’s plans and specifications were defective, which breached the owner’s implied warranty (the *Spearin* doctrine). The trial court granted summary judgment to the County dismissing VPFK’s claim that the County breached the implied warranty of plans and specifications.

While there were numerous issues involved in the appeal, the principal issue addressed the trial court’s summary dismissal of VPFK’s differing site conditions claim as to the frequency of transitions between soil types, as well as its defective specification claim relating to the County’s specification of the STBM for the Project. The effect of the trial court’s early dismissal was that some of the VPFK’s largest claims were not considered by the jury.

The Washington State Court of Appeals affirmed the trial court's decision, holding that because "there was no evidence that a machine other than the STBM could effectively accomplish the task of boring the site specific tunnel drives," the owner's implied warranty did not apply. *King Cty. v. Vinci Const. Grands Projets*, 191 Wash. App. 142, 173, 364 P.3d 784, 800 (2015). Additionally, both the trial court and Court of Appeals cited VPFK's preference for the STBM method as grounds for the finding that there was no evidence to support VPFK's breach of implied warranty claim. *Id.*

The Court of Appeals also upheld a massive $155,831,471.00 jury verdict in favor of the County against VPFK and its multiple sureties, as well prevailing party attorney fees and costs totaling $14,720,387.19. The verdict was the result of a nearly three-month trial and represents one of the largest awards, if not the largest award, in a construction dispute in Washington State. The Washington State Supreme Court recently upheld the award of attorney fees against the sureties, in part, because the sureties adopted the "entirety of VPFK's defenses against breach." *King Cty. v. Vinci Constr. Grands Projets/Parsons RCI/Frontier-Kemper, JV,* 188 Wn. 2d 618 (2017). The Supreme Court did not address the *Spearin* doctrine issues.

The Court of Appeals' decision results from a very narrow reading and application of the implied warranty. As the Court of Appeals applied the *Spearin* Doctrine, a contractor will not be entitled to the owner's warranty if it agrees the owner's specification will work. This decision may alter the landscape of construction contracting and impede the cost-effective procurement of public works construction projects in the State of Washington and elsewhere.

First, as to the Court of Appeal's holding that "there was no evidence that a machine other than the STBM could effectively accomplish the task of boring the site specific tunnel drives," the requirement that the contractor establish the existence of a viable alternative to the specified method in order to establish a breach of implied warranty claim directly contradicts the *Spearin* doctrine. The central tenant of the doctrine is that the plans and specifications as provided by the owner are warranted as accurate. The existence of a viable alternative to this specified method has no bearing on whether the specified method would result in success. Being required to prove otherwise is inconsistent with this established warranty.

Second, as the Court of Appeals applied the *Spearin* doctrine, a contractor will not be entitled to the owner's warranty if it agrees the owner's specification will work—a scenario which could occur countless times in the case of latent defects. If that were true, then the only time the warranty could be available would be in cases where the specifications contain a patent defect about which the contractor inquires. Whether the contractor prefers the owner's specified method has no bearing on the existence or extent of the owner's implied warranty.

Third, contractors are required to follow the owner-provided plans and specifications in competitive bidding. Contractors become financially accountable if they veer from the contract drawings and specifications. It is, therefore, inconsistent to also hold contractors responsible for the results when they adhere to the plans and specifications, another effect of this holding. Moreover, the Court of Appeals' decision undermines the policy purposes behind competitive bidding and, therefore, diminishes its effects. If contractors cannot rely upon the implied

warranty, they will be required to second-guess the accuracy of the plans and specifications at bid time. Contractors will deem it necessary to increase their bid price or otherwise place contingencies in their bids to protect against the risk of unknown errors and omissions. This will, in turn, increase the cost of construction to project owners and taxpayers.

The *Spearin* doctrine, as traditionally applied, is grounded in policy and common law principles that parties should be responsible for their own acts and for conditions uniquely within their control. Such control-based risk allocation incentivizes all parties to work efficiently, reducing overall project costs, and saving taxpayer money. Abandoning this longstanding doctrine and notion of common sense, as was done in the Court of Appeals' decision, may result in gross inequities and inefficiencies in the construction industry to the detriment of the taxpayers of Washington State and other jurisdictions.

Similarly, in a recent Fifth Circuit decision of *Dallas/Ft. Worth International Airport v. INet Airport Systems*, 819 F.3d 245 (2016), the court, despite holding the implied warranty existed, did not grant the contractor summary judgment on claims involving admitted plan deficiencies, since factual issues existed regarding the contractor's cooperation and participation in the solution to the defects.

The owner entered into a contract with INet to install certain air handling units to heat and cool passenger boarding bridges and aircraft. The plans for the project included detailed drawings, the precise rooftop units and parts to be used, as well as approved manufacturer's and performance requirements. The contractor was obligated to install the rooftop units, which were required to use an ethylene glycol water supplied by the owner.

An issue arose when the contractor expressed concern that the rooftop units specified in the plans might not function properly with the ethylene glycol mixture supplied by the owner's existing piping system because the rooftop units might freeze. The contractor and owner never came to an agreement as to how to proceed. When the contractor failed to meet the substantial completion deadline, the owner did not issue payment on the construction contract and engaged another contractor to complete the project. The contractor sued and moved for summary judgment.

The contract's general conditions required that the contractor:

- Inspect the plans and specifications and bring up discrepancies during the bidding process;

- Otherwise assume full responsibility for the compatibility of equipment and parts; and

- Fill in details necessary to complete the work as specified. The contractor assumed "sole responsibility" for the compliance of the contract documents and "full responsibility for satisfactory operation of all component parts of the mechanical system to assure compatibility of all equipment and performance of the integrated systems in accordance with the requirements of the specifications."

The contract allowed the contractor to submit potential errors or discrepancies to the owner and obtain approval for changes in the design. The court emphasized that the contract provided for the parties to "agree upon how to adjust for the change," and emphasized that the contractor had "duties that required [the contractor] to cooperate in finding a solution to any defects."

The trial court determined that the case turned on which party first breached the contract and concluded that the contract placed the risk of defects in the design and specifications on the owner, that the owner had admitted the designs and specifications were defective, and that the owner, therefore, breached the contract by failing to acknowledge the defects and issue appropriate change orders. As a result, the District Court granted the contractor summary judgment and awarded damages and attorney's fees to the contractor in the amount of $1.3 million. The owner appealed.

The Fifth Circuit found that there was no dispute that the plans and specifications were defective, but, focused on which party was responsible under the contract for the defective plans and specifications and the contract requirements for each party once the contractor alerted the owner to a defect that would prevent its performance.

The Fifth Circuit disagreed with the trial court, and while holding that the owner was partially responsible for the risk of the defective plans and specifications, the contract allocated some of the duties to the contractor as well. Those duties included requiring that the contractor cooperate in finding a solution to the defects. The contract required that both parties participate in resolving defects. The court held that there was a material issue of fact as to whether the contractor had, in fact, lived up to its obligation to participate in the change remedy. Therefore, the court denied summary judgment and remanded the case for breach of contract claims to proceed to the trial court.

Ultimately, although the implied warranty of the plans and specifications is well-settled law in most states, the warranty can be disclaimed or modified by contract. In the *INet* matter, the contract language specifically indicated that the contractor had full responsibility for the satisfactory operation of all the component parts of the mechanical system to ensure compatibility of all equipment and performance of the integrated systems in accordance with the requirements of the specifications. The *INet* court held that contract language can override the warranty of the adequacy of the owner's design. In fact, in *Al Johnson Const. Co. v. United States*, the Federal Circuit noted this issue when it posited "[t]he original *Spearin* case was a breach case, but provisions within contracts for contract relief were not yet in use when the *Spearin* contract was awarded. It might be assumed today that the facts of that case would now be dealt with as a constructive change order and compensable within the contract changes article, and therefore not now a breach." *Id.* 854 F.2d at 468–69. In short, specific contract language disclaiming the implied warranty or the completeness of the plans or specifications can be the key to whether the *Spearin* doctrine applies or not.

G. Burden of Proof

As noted previously, to invoke the implied warranty of adequate plans and specifications, the contractor must demonstrate that the contract documents were defective. The contractor need not demonstrate that the design falls below some professional standard, which is generally a higher burden; instead, the contractor must only establish a breach of the implied warranty. *See, e.g., Neal & Co., Inc. v. United States*, 36 Fed. Cl. 600, 628 (1996)("While the contractor has the burden of proving that the detailed requirements of the specifications are defective, 'the actions of the Government during performance of the contract may demonstrate such defects'"), *aff'd*, 121 F.3d 683 (Fed. Cir. 1997).

The contractor's burden does not end with a showing of defective plans. The contractor is also required to demonstrate that it followed the defective plans to its detriment. *See, e.g., Franklin Pavkov Const. Co. v. Roche*, 279 F.3d 989, 995 (Fed. Cir. 2002)(recovery for defective specifications requires proof that the defective specifications increased costs); *Fru-Con Const. Corp. v. United States*, 42 Fed. Cl. 94, 96 (1998)(contractor, in addition to demonstrating that the subject specifications do not permit meaningful discretion, must also show that the defective specifications are the cause of the injury); *PCL Const. Servs.*, 47 Fed. Cl. at 786 (even if latent ambiguity not perceived by contractor, contractor can prevail only if it can prove that at the time it bid the contract it actually interpreted the provision at issue in the manner it asserts, citing *Fruin–Colnon Corp. v. United States*, 912 F.2d 1426, 1430–32 (Fed.Cir.1990); *Lear Siegler Mgmt. Servs. Corp. v. United States*, 867 F.2d 600, 603 (Fed.Cir.1989).

Occasionally, a contractor may be faced with plans and/or specifications that are not in essence defective but, combined with conditions or knowledge known by the government and not relayed to the contractor, result in a constructive change. Under the constructive change doctrine, the government is liable for additional work caused by a constructive change to the contract. *See Aydin Corp. v. Widnall*, 61 F.3d 1571, 1577 (Fed.Cir.1995)(citing *J.B. Williams Co. v. United States*, 196 Ct.Cl. 491, 450 F.2d 1379, 1394 (1971))("Where it requires a constructive change in a contract, the Government must fairly compensate the contractor for the costs of the change"). Defective specifications is just one category of constructive change, which also includes "misrepresentation and nondisclosure of superior knowledge," as well as "disputes over contract interpretation during performance," "Government interference or failure to cooperate," and "acceleration." *See, e.g., Metric Const. Co., Inc. v. United States*, 80 Fed. Cl. 178, 185 (2008) (citing *Miller Elevator Co. v. United States*, 30 Fed.Cl. 662, 678 (1994)).

In the federal contracting realm, "[i]n order for a contractor to prevail on a claim of misrepresentation, the contractor must show that the Government made an erroneous representation of a material fact that the contractor honestly and reasonably relied on to the contractor's detriment." *T. Brown Constructors, Inc. v. Pena*, 132 F.3d 724, 729 (Fed.Cir.1997); *see Roseburg Lumber Co. v. Madigan*, 978 F.2d 660, 667 (Fed.Cir.1992); *Summit Timber Co. v. United States*, 230 Ct. Cl. 434, 677 F.2d 852, 857 (1982); *Morrison–Knudsen Co. v. United States*, 170 Ct. Cl. 712, 719, 345 F.2d 535, 543 (1965); Restatement (Second) of Contracts § 164 cmt. a (1979). Moreover, as the United States Court of Claims has explained:

> In misrepresentation, the wrong consists of misleading the contractor by a knowingly or negligently untrue representation of fact or a failure to disclose

> where a duty requires disclosure. . . . Some degree of Government culpability—either untruth or such error as is the legal equivalent—must, however, be shown, and the plaintiff's burden of proof is not satisfied merely by proof of a variation between the subsurface conditions as stated in the contact and as encountered.

Foster Constr. C.A. v. United States, 193 Ct. Cl. 587, 602, 435 F.2d 873, 880–81 (1970) (citations omitted).

In the state/municipal contracting realm, federal authorities may be persuasive. However, in California, "[i]t is the general rule that by failing to impart its knowledge of difficulties to be encountered in a project, the owner will be liable for misrepresentation if the contractor is unable to perform according to the contract provisions." *City of Salinas v. Souza & McCue Constr. Co.*, 66 Cal.2d 217, 222, 57 Cal.Rptr. 337, 424 P.2d 921 (1967). In *Los Angeles Unified Sch. Dist. v. Great Am. Ins. Co.*, 49 Cal. 4th 739, 749, 234 P.3d 490, 495 (2010), the California Supreme Court cited its decision in *Warner Constr. Corp. v. City of Los Angeles*, 2 Cal.3d at 294, noting "at least three instances" in which a contractor may have a cause of action against a public entity for nondisclosure of material facts: "(1) the [public entity] makes representations but does not disclose facts which materially qualify the facts disclosed, or which render [the] disclosure likely to mislead; (2) the facts are known or accessible only to [the public entity], and [the public entity] knows they are not known to or reasonably discoverable by the [contractor]; (3) the [public entity] actively conceals discovery from the [contractor]." "Although we affirmed a judgment against the city after finding all three instances to be present, we viewed each instance as an independent basis for liability." *Great American*, 49 Cal. 4th at 749.

H. Lessons and Take-Aways for Sureties.

While the practical application of the *Spearin* doctrine to sureties is mostly self-explanatory, owners have become more sophisticated in their use of contractual disclaimers to shift the risk of deficient design and/or plans to contractors and their sureties. Given this, sureties should be aware, if not already, of the inherent risk of contracting with sophisticated owners. In addition, sureties must be prepared to challenge the enforceability of design disclaimers in litigation and look for other sources of recovery in the event the principal and the bond are exposed to significant loss resulting from design deficiencies.

Although these are topics for another day, contractors and their sureties may be able to successfully recover for unanticipated conditions that differ from those stated in the plans and specifications despite broad exculpatory clauses denying owner liability for express or implied representations of the condition. In *Bignold*, the Washington Supreme Court found:

> Construing [changed conditions clauses], courts have generally allowed recovery for additional costs when the condition complained of could not reasonably have been anticipated by either party to the contract . . . . [a]nd *this is true despite admonitory or exculpatory clauses such as those requiring the contractor to carefully examine the site.*

65 Wn.2d 817, 821–22, 399 P.2d 611 (1965) (citations omitted)(emphasis added). Indeed, an owner's attempt "to give with one hand [in the DSC clause] what it takes away with the other" in purported disclaimer clauses limiting the contractor's right to rely is a common owner argument. *See* 4 Bruner & O'Connor § 14:54 at 1086. "It is well settled that such broad admonitory and exculpatory clauses do not restrict the application of the changed-conditions clause." *Metropolitan Sewerage Comm'n*, 241 N.W.2d 371, 382 (Wis. 1976)(citing *Woodcrest Construction*, 408 F.2d 406 (Ct. Cl. 1969); *United Contractors et al. v. United States*, 368 F.2d 585, 598, 177 Ct. Cl. 151, 165-166 (1966)). This is because:

> To allow such provisions to cancel out the changed-conditions clauses would destroy the whole equitable-adjustment procedure which the [owner] has agreed to [in the DSC clause] when materially different conditions are encountered.

Metropolitan Sewerage Comm'n 241 N.W.2d at 383. As such, contractors and their sureties may be able to successfully mitigate the impact of broad disclaimers by reliance on other contract clauses, such as "differing site conditions" clauses.

In addition to reliance upon changed conditions clauses, contractors and their sureties may be able to mitigate exposure and/or loss by filing claims against the owner's design professionals who provide engineering and design services and/or insurance carriers whose policies may provide coverage for damages resulting from unanticipated conditions. The *Spearin* doctrine provides just one category of potential avoidance of and challenge to liability, as well as affirmative recovery for the surety.

SESSION 7

DESIGN AND PERFORMANCE SPECIFICATIONS UNDER THE *SPEARIN* DOCTRINE

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Design and Performance Specifications under the *Spearin* Doctrine

By Jamie Lacy, Greg Smith, Gina Shearer, Bryce Holzer, and John Anderson

Project specifications can play an important role in determining whether a contractor and potentially its surety have liability, or a right to recovery, arising out of construction defects. Under the *Spearin* doctrine, the owner warrants the sufficiency of the specifications given to the contractor[1], which can relieve the contractor of responsibility for defects in construction if the contractor strictly follows the owner-provided design specifications.[2] The owner's responsibility to provide sufficient specifications "is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work."[3] Although *Spearin* may sound like a free pass for contractors to argue inadequate design, the doctrine has its limits. Significantly, the implied warranty does not extend to performance specifications. Only design specifications that are so substantially deficient or unworkable as to constitute a breach of the contract will give rise to a claim by the contractor.[4] And, the contractor must investigate the subject matter of the design specifications if it believes or should believe that the design defective.[5] Moreover, the contractor has the burden of proving the breach of the implied warranty.[6] This paper examines the differences between a design specification and a performance specification in light of the *Spearin* doctrine, the significance of the distinction, and discusses cases illustrating how courts have distinguished and analyzed these two types of specifications.

I.
Design Specifications vs. Performance Specifications: How Are They Defined?

There are two main types of specifications: design (or "method," "prescriptive" or "material-methods") and performance (or "performance-based," "performance-related," "warranty" or "end-result").[7] "Design specifications dictate the 'how' governing a contractor's tasks, in contrast to performance specifications, which concern the 'what' that is to be done."[8] A contract may contain both design specifications and performance specifications.[9] In fact, it may be crucial to analyze each contract work item separately, as some may be governed by design

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[1] *United States v. Spearin*, 248 U.S. 132 (1918); *see* JUSTIN SWEET & MARK M. SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENG'G & THE CONSTR. PROCESS 399, 492-97 (Nelson 2004).
[2] *Travelers Cas. & Sur. of Am. v. United States*, 74 Fed. Cl. 75, 89 (2006).
[3] *Spearin*, 248 U.S. at 136.
[4] *Id.* (internal quotations omitted).
[5] *See id*. at 94; *Miller v. Guy H. James Constr. Co*., 653 P.2d 221, 224 (Okla. Civ. App. 1982).
[6] *Hercules Inc. v. United States*, 24 F.2d 188, 197 (Fed. Cir. 1994).
[7] *See* SWEET & SCHNEIER, *supra* note 1, at 399. Note that "purchase" specifications—those that specify a certain material or product or manufacturer to use—are a sub-set of design specifications. *See id.*
[8] *Travelers*, 74 Fed. Cl. at 89.
[9] *Id.*

specifications while others are governed by performance specifications.[10] Whether a specification is a design or performance specification is a mixed question of fact and law.[11]

II.
Why Is the Distinction Significant?

Today, the modern approach to *Spearin* often assigns responsibility for a defective construction issue according to whether the specification prescribing the construction is a performance or a design specification. This distinction may have a significant impact on the duties and responsibilities of a contractor or completing surety. While the distinction between the two is sometimes clear based on the language of the specification that is not always the case. Confronted with a completed system on a construction project that is defective, the owner and the contractor (and/or the surety) may take significantly different positions with respect to whether the particular specifications for all or a portion of the system at issue were design specifications, performance specifications, or a combination of both. The outcome of such an inquiry can have a major financial impact on the parties.

Under a design specification, the architect-engineer and owner are responsible for the performance requirements, as long as the contractor performs the work according to the specification.[12] That is, if the contractor follows the instruction of the design specification, but the desired performance requirements are not met, then the architect-engineer and owner must devise another solution. In this situation, the contractor would be entitled to payment for his original performance, as well as payment for any additional work needed to implement any changes made by the owner because the desired performance requirements were not met.

The architect-engineer and owner may eliminate a portion of their potential liability through a performance specification. Under a performance specification, the contractor is responsible for design, engineering, and meeting the performance requirements. Such a "performance warranty … requires the contractor to correct defects if the product does not perform to some desired quality level."[13] While this gives the contractor more freedom in its means and methods, i.e. how the performance requirements will be met,[14] the contractor is also liable if its performance does not meet the requirements specified.

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[10] *Aleutian Constructors v. United States*, 24 Cl. Ct. 372, 379 (1991) (holding that "a Spearin warranty [did] not arise with respect to [an] element of the contract").
[11] *Caddell Constr. Co. v. United States*, 78 Fed. Cl. 406, 411 (2007).
[12] *See See* SWEET & SCHNEIER, *supra* note 1, at 399.
[13] U.S. DEP'T OF TRANSP., FED. HIGHWAY ADMIN., Performance Specifications Strategic Roadmap: A Vision for the Future, at http://www.fhwa.dot.gov/construction/pssr0402.cfm.
[14] Some have postulated that "[b]y being less prescriptive, performance specifications could create an environment that encourages innovation." *Id.*

In reality, the responsibilities of the contractor and the owner may be unclear, as specifications are often a hybrid of design and performance, dictating certain aspects of the work while also giving the contractor some freedom to choose its means and methods. When allocating liability, "the nature and degree of contractor involvement in the specification process [may also] define which party should be held to warrant … a specification."[15]

The importance of the distinction between design and performance specifications is that the contractor or its surety may be able to avoid liability for the contractor's failure to deliver a product that performs according to specification where design specifications were utilized and the contractor performed in a workmanlike manner. For example, where a surety defending an action on a subcontract performance bond convinced a trial court that "[t]he equipment specified in the plans and specifications, or the substantial equivalent thereof, and all … other equipment necessary to furnish and complete the air conditioning system described in the plans and specifications were installed in a workmanlike manner in the places indicated therein," the surety was not liable when the air conditioning system did not perform as specified by the owner because the plans and specifications had been prepared by the owners' architect and not by the subcontractor.[16] Furthermore, even though the subcontract contained a "guarantee" that the air conditioning system would perform as desired, the court construed such "guarantee" as being a promise by the subcontractor "not that the system as designed was adequate to produce the results desired by the owner but that the subcontractor's work pursuant to the plans and specifications would be done as effectively as possible to achieve those desired results."[17] Similarly, a contractor's guaranty extended to his work only, despite a specification providing that a cellar was "to be made perfectly water-tight and guaranteed," because the specification directed how the work should be done and "[i]t was not as though [the contractor] was left to [his] own judgment."[18]

In short, if the specification is determined to be a design specification and the system does not operate as intended because of an inappropriate design, the responsibility to correct the system should fall on the owner. On the other hand, if it is determined that the specification at issue is a performance specification, the responsibility to correct a non-performing system may fall on the contractor. Thus, whether a particular specification is determined to be a design specification or a performance specification may have a significant impact on the duties and responsibilities of a contractor or completing surety.

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[15] *Johns-Manville v. United States*, 13 Cl. Ct. 72, 120 (1987); *see also Fruin-Colnon Corp. v. Niagara Frontier Transp. Auth*., 585 N.Y.S.2d 248, 253 (N.Y. App. Div. 1992).
[16] *Kurland v. United Pac. Ins. Co*., 59 Cal. Rptr. 258, 260-61 (Ct. App. 1967); *see also Clark v. Fowler*, 363 P.2d 812, 815 (Wash. 1961).
[17] *Kurland*, 59 Cal. Rptr. at 262.
[18] *Bush v. Jones*, 144 F. 942, 943 (3d Cir. 1906).

III.
Design and Performance Specifications Are Generally Determined by the Level of Discretion reflected in the Specification.

In distinguishing between design and performance specifications, the relevant inquiry often concerns the quality and quantity of the obligations that the specifications impose.[19] Or, as one court put it, "[i]t is the obligations imposed by the specification which determine the extent to which it is 'performance' or 'design,' not the other way around."[20] A federal court described the analysis as follows:

> At the crux of [the] distinction [between design and performance specifications] is the degree to which the contractor … is free "to exercise his ingenuity in achieving [the] objective or standard of performance, [and] selecting the means" to do so. When the contractor is left no discretion or choice in the materials to be used, the specification (or portion of it) is design-type. The specification is no less a design specification when, although a particular material or composition is not required expressly, it is apparent that only one material or a certain composition will enable the product to meet the performance standards expressed in the specification. By contrast, the very same performance standard can be construed as a performance specification if the manufacturer remains free to exercise its ingenuity in meeting the standard because more than one material or composition will suffice.[21]

The Court of Federal Claims noted "the distinction between design specifications and performance specifications is not absolute and [. . .] courts should understand that it is the obligation imposed by the specification which determines the extent to which it is a 'performance' or 'design,' not the other way around."[22] Thus, simply calling a specification a "performance specification" or a "design specification" will not end the analysis. Rather, an assessment must be made of the amount of discretion placed upon the contractor in performing the work.[23]

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[19] *Travelers*, 74 Fed. Cl. at 89.
[20] *Blake Constr. Co. v. United States*, 987 F.2d 743, 746 (Fed. Cir. 1993).
[21] *Johns-Manville Corp. v. United States*, 13 Cl. Ct. 72, 131 (Ct. 1987), vacated on other grounds, 855 F.2d 1571 (Fed. Cir. 1988) (quoting *J.L. Simmons Co. v. United States*, 412 F.2d 1360, 1362 (Ct. Cl. 1969) (per curiam)).
[22] *Fru-Con Constr. Corp. v. United States*, 42 Fed. Cl. 94, 96 (Fed. Cl. 1998), citing *Blake*, 987 F.2d at 746 and *Zinger Constr. Co. v. United States*, 807 F.2d 979, 981 (Fed. Cir. 1986) (explaining that labels "performance" or "design" do not independently create, limit or relieve contractor's obligations, but, rather, that contract should be viewed in its entirety).
[23] *Id.*, citing *Blake*, 987 F.2d at 746; *see*, D'Alosio, The Design Responsibility and Liability of Government Contracts, 22 Pub. Con. L.J. 515, 568 (1993) ("liability follows design responsibility").

Metric Co. v. United States[24] provides a good example of the type of analysis undertaken by a court in determining whether the specification is "design" or "performance."[25] The project at issue involved the repair and construction of roadways and an airfield for the Navy on San Nicholas Island off the coast of California. Metric was awarded the "Repair Airfield" contract, which required Metric to make improvements and repairs to the Navy's airfield runway. The plans and specifications for this were prepared by the Navy, which administered the projects.[26]

During the course of construction, the Navy issued a contract modification directing Metric to "demol[ish] . . . all existing concrete arresting gear material and replac[e] with new compacted base material, asphalt, pour new concrete pads with new steel beams embedded in the concrete, and install a three foot wide asphalt patch between the existing asphalt and the new concrete pads."[27] Work commenced and problems were encountered.

The plans called for a 3'-0 wide AC Patch between the existing asphalt runway and the newly placed arresting-gear concrete. The specifications included size requirements for the aggregate used in the asphalt mix. Metric notified the government during the change-order negotiations that because the plans called for a three foot wide patch, the asphalt could not be laid with an asphalt paving machine as set forth in the specifications and instead had to be hand placed.[28] At one end of one runway, Metric placed the three-foot asphalt patch for the 30-end using the hand-placement methods set forth under the specifications and using the mix specified by the contract. The government rejected the asphalt patch and directed Metric to remove and replace it, on the ground that excessive aggregate was exposed. Metris disagreed but proposed to seal the exposed aggregate with a product known as TopGuard, which had been used on other areas of the project. The government eventually relented, and allowed Metric to use TopGuard on the exposed aggregate. Yet, the result remained unacceptable to the Navy.[29]

Issues also arose related to the elevation of the new asphalt patches on the runways, with the Navy not allowing any deviation between the new asphalt and existing concrete. Metric removed and replaced the three-foot asphalt patch for the 30-end on three occasions. Metric stopped using hand-placement methods and brought in a cold planer and removed the rejected asphalt and an adjacent portion of the runway to a width sufficient to allow use of a paving machine.[30]

Metric thereafter asserted six claims, including one arising out of the asphalt and rail work on the contract. With respect to the asphalt claims, as part of its case Metric asserted that it

[24] 81 Fed. Cl. 804 (Fed. Cl. 2008).
[25] *Id.* at n.28.
[26] *Id.* at 808.
[27] *Id.* at 812.
[28] *Id.* at 813.
[29] *Id.*
[30] *Id.*

performed all work in accordance with the change order and drawing, that the government breached its warranty of constructability, and that placed responsibility for Metric's increased costs on the government.[31] The Court, however, sided with the government, finding that *Spearin* was inapplicable, stating "here, the airfield contract provides that hand-placement was allowed but not that it was necessary or the only means of accomplishing the work on the arresting gear. These contract terms are not design specifications because they allowed Metric discretion to choose the means of performance."[32] Thus, because Metric had the option of determining how it would proceed with this aspect of the work, it had to bear the burden of its increased costs in performing.[33]

Fruin-Colnon Corp. v. Niagara Frontier Transp. Auth. involved a contract for the excavation and construction of twin subway tunnels, each approximately two miles long, as part of the Buffalo light rail rapid transit system.[34] In this case, the contractor claimed extra costs for grouting that was required to achieve the required watertightness of the twin subway tunnels. The Niagara Frontier Transportation Authority argued that the specification requiring the constructed tunnels to be "watertight" was a performance specification and that, therefore, the contractor's additional costs in achieving that standard were not compensable. The watertightness clause in the contract specified the end objective (e.g., watertightness) and the standards for measuring compliance with that objective but did not establish the means or the methods of achieving watertightness.[35]

However, the court stated that while the watertightness clause looked like a performance specification, in reviewing the contract as a whole, and evaluating how much control the contractor had to achieve watertightness, the court concluded that the contract established complex and exacting design standards and specifications that truly made it a design specification.[36] These standards included requirements that the contractor construct an unreinforced, cast-in-place, concrete liner of precise dimension and use prescribed concrete types and mix; the standards also specified how the concrete was to be placed, cured, protected, and finished. The contractor was given no discretion to deviate from those specifications, whether for the purpose of waterproofing or otherwise.[37] The court further stated that, for example, the contractor had no discretion to install an impermeable outer liner to resist the hydrostatic pressure that was expected to exist following completion of construction. The contract also specified that waterproofing would be accomplished by means of fissure grouting, with detailed specifications governing how to perform the fissure grouting.[38]

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[31] *Id.* at 824-25.
[32] *Id.* at n.28.
[33] *Id.* at 826.
[34] 180 A.D.2d 222, 224 (N.Y. App. Div. 1992).
[35] *Id.* at 230.
[36] *Id.*
[37] *Id.*
[38] *Id.*

Other contractual provisions also guided the court's determination that the contract, as a whole, constituted a design specification. The contract explicitly provided that all measures necessary for achieving the degree of watertightness, including remedial treatments, would be paid for at the contract unit prices.[39] The court concluded that it was unlikely that the owner would have agreed to pay the contractor on a unit-price basis if the contractor had actually assumed a performance responsibility to achieve watertightness. Even the warranty clause did not provide that the contractor would remedy water leaks at its own expense.[40]

As the foregoing cases illustrate, design specifications explicitly state how the contract is to be performed and permit no deviations while performance specifications specify the results to be obtained and leave it to the contractor to determine how to achieve those results.[41] Thus, the level of discretion that exists within a given specification is the key to courts' analysis of the difference between design and performance specifications. As one court held, "discretion serves as the touchstone for assessing the extent of implied warrant and intended liability."[42] Although the design versus performance distinction is easily applied when it involves small, less complicated contracts, difficulties frequently emerge given that many specifications may combine elements of both. While the common component in most post-*Spearin* cases revolves around the level of discretion that exists within a given specification, courts have expanded the analysis in cases where there is a blend of both types of specifications.

IV.
The Degree of Specificity can Help Distinguish Between a Design versus a Performance Specification.

Although the level of discretion, rather than the level of specificity itself, is critical to the characterization of a specification, specificity or lack thereof can certainly help in making the distinction. For instance, a design specification identifies in detail the materials and/or methods that the contractor should use to perform the work described. Design specifications typically "state precise measurements, tolerances, materials, construction methods, sequences, quality control, [and/or] inspection requirements."[43] "In other words, where the specifications are described in precise detail and permit the contractor no discretion, they are 'design.'"[44] Hence, drawings relating to construction of concrete aprons at ends of concrete storm drain piping constituted design specifications, where such specifications provided detailed instructions regarding the aprons; gave exact dimensions of the footprint occupied by the aprons; specified the thickness of the aprons; and provided the type of concrete and wire mesh to be used in

[39] *Id.* at 231.
[40] *Id.*
[41] *A.G. Cullen Constr., Inc. v. State Sys. Of Higher Educ.*, 898 A.2d 1145, 1157 (2005) (citing *George Sollitt Constr. Co. v. Unites States*, 64 Fed. Cl. 229, 296-97 (2005)).
[42] *Connors Bros. Constr. Co., Inc. v. United States*, 65 Fed. Cl. 657, 685 (2005).
[43] *See* SWEET & SCHNEIER, *supra* note 1, at 399; *accord Travelers*, 74 Fed. Cl. at 89.
[44] *Travelers*, 74 Fed. Cl. at 89.

constructing the aprons.[45] Design specifications may also be identified where "the final product is described in terms of component materials, dimensions, tolerances, weights, and required construction methodology—equipment type, size, speed, etc."[46] However, the mere fact that a specification cannot be followed precisely does not, in and of itself, indicate that it is performance and not design.[47]

In contrast, a performance specification states merely the performance characteristics required; such specification does not attempt to detail for the contractor how the performance characteristics should be met. "Performance characteristics may include items such as pavement smoothness or strength, bridge deck cracking or corrosion, chip seal stone retention, embankment slope stability, etc."[48] "[W]here the specifications set forth simply an objective or standard and leave the means of attaining that end to the contractor, they are 'performance.'"[49] Thus, where an owner had allowed a contractor to use his "own judgment, experience and knowhow [sic]" in manufacturing a product, such specification was a performance specification and the contractor, consequently, had to "assume responsibility for the means and methods selected to achieve the end result."[50] Similarly, the language of a specification was sufficient to support the trial court's determination that the specification was a performance specification where such language set forth only minimum standards "not constitut[ing] explicit instructions as to how the [work] was to be designed."[51]

Conner Bros. Constr. Co., Inc. v. United States[52] involved a contract involving certain above-ceiling work as part of a hospital renovation. The contractor, Connor Bros., and its subcontractor, Phenix, encountered conditions in the above-ceiling spaces that interfered with their ability to view the existing systems prior to bidding the work and that were different from those represented in the contract specifications and drawings. As such, Connor Bros. and Phenix claimed they were entitled to additional costs due to the defective drawings and changed conditions. The court disagreed, explaining that the portion of the contract dealing with the duct work was clearly a performance specification because the drawing showed the layout of the ductwork along with a requirement that the system was to be made operable.[53] The Court noted that the lack of detail indicated a performance specification because the contract drawings were silent as to how the duct components would be reattached, therefore giving discretion to the contractor.[54]

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[45] *Id.* at 103.
[46] FED. HIGHWAY ADMIN., *supra* note 13.
[47] *Blake Constr.*, 987 F.2d at 746.
[48] FED. HIGHWAY ADMIN., *supra* note 13.
[49] *Travelers*, 74 Fed. Cl. at 89.
[50] *Penguin Indus., Inc. v. United States*, 530 F.2d 934, 937 (Ct. Cl. 1976).
[51] *S&D Mech. Contractors, Inc. v. Enting Water Conditioning Sys., Inc.*, 593 N.E.2d 354, 358 (Ohio Ct. App. 1991).
[52] *Id.*
[53] *Id.* at 685-86.
[54] *Id.*

Likewise, in *Wilson Construction, Inc.*,[55] a road construction contract required the contractor to process cleared trees through a chipping machine and distribute the resulting chips onto roadway embankments. The relevant specification merely instructed the contractor to accomplish this objective; it provided no guidance as to the type of chipping machinery or processes to be used by the contractor for this purpose.[56] After encountering difficulties in chipping the material with its machinery, the contractor claimed that the government's chipping specification was defective and would produce unacceptable performance. Rejecting this argument, the board held that the chipping requirements fell within the performance category of specifications and therefore imported no implied warranty.[57] Thus, because "the chipping requirement was [stated] in general terms," "the design characteristics of this specification [were] not precise enough to give rise to an implied warranty that chipping was feasible."[58]

In *Santa Fe Engineers, Inc.*,[59] the project drawings and specifications for the construction of a hospital and support facilities did not indicate the exact location of duct openings in the floor slabs. The Armed Services Board of Contract Appeals concluded that the duct chase and slab penetration drawings were performance specifications because no dimensions were given, nor was the structural steel framing needed to support the concrete surrounding the non-dimensioned openings shown.[60]

A. The Identification of a Product or Manufacturer Does Not Necessarily Create a Design Specification.

Specifying a certain product or manufacturer is not dispositive of whether a specification is design or performance and does not create a design specification in and of itself. This is especially true when a specification permits substitution of a product with an approved equal. In *A.G. Cullen Constr., Inc. v. State Sys. Of Higher Educ.*,[61] project specifications for the removal and replacement of windows at a university identified two manufacturers and allowed the use of other manufacturer's windows as long as the windows complied with the required specifications.[62] One of the two manufacturers identified in the specifications was unable to provide windows that satisfied the project specifications. The contractor contended that by listing distributers in the specifications, the University had impliedly warranted that they could produce the required windows and, because that was not the case, the specifications were

[55] AGBCA No. 89-178-1, 92-2 BCA P24, 798 (1992).
[56] *Id.*
[57] *Id.*
[58] *Id.* at 717.
[59] *Appeal of Santa Fe Engineers, Inc.*, ASBCA No. 24469, 92-1 BCA 24,665 (1991), *aff'd by Santa Fe Engineers, Inc. v. Kelso*, 19 F.3d 39 (Fed. Cir. 1994).
[60] *Id.*
[61] 898 A.2d 1145 (Pa. Cmwlth. 2005).
[62] *Id.* at 1152.

defective.[63] The court disagreed and held that the "mere identification of a product or manufacturer does not create a design specification..." and that when "a government agency identifies a particular product or manufacturer by name, but permits substitution of an 'approved equal,' such a specification is 'performance' in nature and, as a result, carries no implied warranty."[64] Accordingly, the specifications were held to be performance specifications.

The court in *W.G. Yates & Sons Constr. Co. v. United States*[65] came to a similar conclusion. The project specifications in *Yates* mentioned three manufacturers that would be acceptable, but also allowed the use of "an approved equal."[66] The subcontractor obtained quotes from Appleton, a distributor for one of the three manufacturers. Months into the project, Appleton informed the subcontractor that the product was a custom model and no longer made.[67] The contractor and subcontractor on the project contended that listing Appleton as an approved manufacturer was a defective specification when it turned out that the system needed was no longer in production. The Court determined that the specifications did not require or warrant Appleton's products since the use of the brand names in the specifications was followed by the phrase, "or approved equal."[68] Like in *A.G. Cullen*, the court interpreted the option to use a non-listed manufacturer as creating sufficient discretion to categorize the specification as a performance specification and not a design defect.

B. Detailing How the Work is to be Performed Does Not Automatically Create a Design Specification.

A contract can provide some details and directions concerning the performance of work without it necessarily being deemed a design specification.[69] *PCL Constr. Servs. Inc. v. United States* involved the construction of a visitor center and parking structure at the Hoover Dam.[70] The contractor, PCL, claimed that the government was legally obligated to present the bidders, in the solicitation, with a design that achieved a certain level of coordination and completeness, that the government's designed failed to achieve this level of completeness, and that the design was severely defective, and, therefore, that the government was liable for breaching the implied warranty that if the specifications are complied with, satisfactory performance will result.[71] PCL's contract explicitly noted that the design intent would be further developed, adjusted, and/or completed during construction.[72] In analyzing the *Spearin* doctrine, the court emphasized

[63] *Id.* at 1156.
[64] *Id.* at 1157 (citing *W.G. Yates & Sons Constr. Co. v. United States*, 53 Fed. Cl. 83 (2002)).
[65] 53 Fed. Cl. 83 (2002).
[66] *Id.* at 85.
[67] *Id.* at 84.
[68] *Id.* at 86.
[69] *See PCL Constr. Servs. Inc. v. United States*, 47 Fed. Cl. 745 (2000).
[70] *Id.*
[71] *Id.* at 794.
[72] *Id.*at 796.

that contractors are typically granted at least some discretion even when specifications are largely of the "design variety." The court noted that the labels of design and performance are merely labels, and that "[t]he fact the specifications provided some details concerning how the work was to be performed does not convert what would otherwise be a performance specification into a design specification."[73] The court held that where a specification does not tell a contractor how to perform a specific task that part of the specification can be a performance specification even if the rest of the specifications are design specifications.[74] Thus, PCL was required to do some design work itself and use discretion as well as "engineering efforts."[75]

V.
Limitations to the Application of the Spearin Doctrine.

A. Contractors Cannot Ignore Patently Defective Specifications.

In addition to evaluating the level of discretion in a specification, courts may also examine the level of independent verification afforded to a contractor. Where a contract calls for potential bidders to inspect a project and/or attend pre bid meetings and the contractor does not investigate properly, or at all, and later attempts to argue that the specifications were defective, courts have found that the specifications to be performance specifications.

The implied warranty of the *Spearin* doctrine does not eliminate the contractor's duty to investigate or inquire about a patent ambiguity, inconsistency, or mistake when the contractor recognizes, or should have recognized, an error in the specifications or plans.[76] Although this duty requires contractors to clarify patent ambiguities, it does not require them to ferret out hidden or subtle errors in the specifications.[77] If a contractor enters into a contract aware of the fact defective specifications exist, it is not entitled to recover on a claim based on those defective specifications.[78]

B. Inspection Clauses May Be Indicative of a Performance Specification.

In reaching its conclusion in *Conner Bros.*, *supra*, the Court of Federal Claims focused on the contract terms calling for Conner Brothers' inspection of the project. The contract contained a number of clauses related to the inspection of the site, including site visit, site investigation, and omissions and differing site conditions clauses (i.e., the contractor assumes

[73] *Id.* (citations omitted)
[74] *Id.*
[75] *Id.* at 798.
[76] *Blount Bros. Constr. Co. v. United States*, 346 F.2d 962, 972-73 (Ct. Cl. 1965).
[77] *White v. Edsall Constr. Co.*, 296 F.3d 1081, 1085 (Fed. Cir. 2002).
[78] *Johnson Controls, Inc. v. United States*, 671 F.2d 1312, 1320 (Ct. Cl. 1982).

responsibility for all omissions in the specifications).[79] The court believed that these types of clauses were indicative of performance specifications, not design, and if it was a design contract then the contractor should have recognized any perceived deficiencies.

C. Express Disclaimers May Shift the Risk of Design Flaws to Those Who Follow the Specifications.

General disclaimers requiring the contractor to check plans, examine the site, determine project requirements, and assume responsibility for the work do not overcome the implied warranty and, thus, do not shift the risk of design flaws to contractors who follow the specifications.[80] However, express and specific disclaimers suffice to overcome the implied warranty.[81] In *White v. Edsall Constr. Co.*, the drawing provided to the contractor contained a disclaimer requiring verification by the contractor prior to bidding of the canopy door details, arrangements, loads, supports, brackets and hardware.[82] While the disclaimer did require verification by the contractor, the court found that it did not clearly alert the contractor to the possibility that the design may contain substantive flaws requiring correction and approval prior to bidding.[83] Because the disclaimer did not obligate the contractor to determine whether the design would work for its intended purpose, the contractor was not responsible for the consequences of design defects.[84] The court determined that the U.S. Army could have drafted a contract and specifications that shifted the risk of design defects, but the general disclaimer at issue was not specific enough to shift such risk.[85]

VI.
Conclusion

Spearin provides that if the government furnishes specifications for the production or construction of an end product and the proper application of those specifications does not result in a satisfactory end product, the contractor will be compensated for its efforts to produce the end product, notwithstanding the unsatisfactory results. Over the last century the *Spearin* doctrine has been examined, expanded to both public and private projects, and clarified though the lens of whether specifications are "design" or "performance." Design specifications explicitly state how the contract is to be performed and permit no deviations while performance specifications specify the results to be obtained and leave it to the contractor to determine how to achieve those results. Generally, because the *Spearin* doctrine is only applicable when dealing with design specifications, it is important to be able to distinguish design and performance specifications.

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[79] *Connors Bros.*, 65 Fed. Cl. at 669.
[80] *Al Johnson Constr. Co. v. United States*, 854 F.2d 467, 468 (Fed. Cir. 1988).
[81] *White*, 296 F.3d at 1085.
[82] *Id.* at 1083.
[83] *Id.* at 1086.
[84] *Id.*
[85] *Id.*

While design specifications present an opportunity for the contractor and its surety, performance specifications carry a risk. Recognizing these considerations, the contractor and the surety can evaluate the construction contract with a critical eye at the beginning of the contracting process, enabling each party to anticipate, and potentially mitigate, potential sources of risk.

SESSION 8

ADOPTION OF *SPEARIN* AT STATE AND FEDERAL LEVELS: A 100 YEAR SYNOPSIS

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Adoption of *Spearin* at State and Federal Levels: A 100 Year Synopsis

By: Amy M. Bernadas, Todd R. Braggins, James R. Case, and Wayne D. Lambert

INTRODUCTION

This paper will highlight the adoption and status of the *Spearin* Doctrine at state and federal levels in the 100 years since the United States Supreme Court's landmark decision in 1918. While not a complete recitation of law in every state and federal circuit, this paper is intended to provide the starting point in key states and federal circuits for practitioners and company representatives to begin an analysis of fact and law when presented with *Spearin* issues.

Alabama

While not always specifically citing *Spearin*, Alabama courts have adopted *Spearin* concepts. For example, in *AL Society for Crippled Children & Adults, Inc. v. Still Constr. Co., Inc.*,[1] the contractor, Still, brought action against the owner to enforce a mechanic's lien arising out of a construction contract. Specifically, the owner withheld payment of retainage and amounts due to Still for the replacement of windows which Still argued had been installed per the contract's specifications. The Court of Civil Appeals held that the evidence on the issue of whether the owner or contractor should bear the cost for replacement of the stationary windows with operable windows, supported judgment in favor of contractor, who installed the windows as indicated in its shop drawing submitted to and approved by the owner's architect.

Arizona

The Arizona Supreme Court has long recognized the validity and application of the *Spearin* Doctrine. In *Kubby v. Crescent Steel*[2], the Supreme Court held that the installer of a metal roof, despite roof leakage, was not liable to the owner where the specification provided by the owner did not clearly require flashing and caulking. "A contractor who undertakes to perform a contract in accordance with plans and specifications furnished by the contractee is not liable for damages due to defects in the plans, but he must perform the work in a workmanlike manner and without negligence."[3]

Arkansas

Arkansas courts have long followed *Spearin* principles beginning with *Pine Bluff Hotel Co. v. Monk & Ritchie*[4]. In that case, the Arkansas Supreme Court upheld the use of a particular jury instruction objected to by the owner concerning liability for the cost of rebuilding a retaining wall. The owner argued that the instruction should have been drafted based on the rule

that if the contractor follows the plan and specifications, which prove defective and cause the building or the improvement to fall before completion, the loss is upon the contractor and not upon the owner. The court disagreed finding that the cases cited by the owner were clearly against the weight of authority on the subject.

California

Spearin principles are well established law in California. In two key California decisions, *Souza & McCue Constr. Co. v. Superior Court of San Benito County* and *Warner Constr. Corp. v. L.A.*, the California Supreme Court effectively adopted the principles underlying the *Spearin* doctrine.[5] *Souza* concerned a public contract for the construction of a sewer.[6] The California Supreme Court granted a writ of mandate filed by the contractor, Souza, for leave to amend its pleadings to include a claim against the owner for failure to inform Souza of unstable soil conditions which contradicted statements in the specifications to the contrary.[7] In support ofits decision, citing to *Spearin*, the court found that the furnishing of misleading plans and specifications by the public body constituted a breach of an implied warranty of their correctness.[8] In *Warner*, a general contractor who entered into a contract with the City of Los Angeles encountered unforeseen difficulties not disclosed in the design documents supplied by the City.[9] The City refused to execute a change order, and the contractor performed the extra work associated with the unforeseen conditions. The contractor sued the City for misrepresentation and breach of the implied warranty of the correctness of the plans and specifications.[10] The California Supreme Court, citing to *Souza*, found that the general contractor was entitled to damages based on the City's breach of the implied warranty.[11]

Colorado

The *Spearin* concept was first recognized in Colorado in *Klipfel v. Neill*.[12] *Klipfel* concerned a contract to construct two water stock tanks. Finding in favor of the contractor, on appeal, the court found that the evidence supported a finding that the contractor substantially complied with the construction contract and that specifications of the United States Department of Agriculture Soil Conservation Service had been met as required, but were themselves deficient, thereby causing a leak in one tank. Although not directly citing to *Spearin* in support, the court held that the contractor who had substantially complied with the project's specifications, did not extend a warranty of fitness for a particular purpose to the owner and could not be held responsible for the consequences of a deficiency in the specifications.

Connecticut

In *Tompkins v. Bridgeport,*[13] the Supreme Court of Connecticut acknowledged the principles of the *Spearin* doctrine without citing *Spearin* in a case that was decided but 5 years after *Spearin.* The court stated that an owner will have to indemnify its contractor against

damages and costs incurred by the contractor for building a project according to the terms of the contract and without fault on the part of the contractor. The court further stated that a contractor is bound to cover its own costs in defending against the owner's claims of contractor negligence. Although the contractor may be able to recover from the owner the costs for its defense of claims of negligence, the contractor "*must first clear their own skirts . . .*"

Delaware

In *Ridley Investment Company v. Croll*,[14] the court ruled in favor of Croll by finding that "the great weight of authority supports the proposition . . . that a contractor is not liable for any damage occasioned by a defect in plans and specifications furnished by the owner if he performs his work without neglect and in a workmanlike manner." *Croll* involved a private development contract in which the Ridley Investment Company contracted with Croll to construct four post office buildings in accordance with plans furnished to Croll by Ridley. Soft soils were discovered in the course of excavation. Per the request of Croll, Ridley agreed to pay for pilings along the exterior walls. When Croll then further recommended additional pilings under the floor slab itself, Ridley refused and directed Croll to proceed with construction as planned. Damages for the subsequent settling of the floor were held not to be Croll's responsibility.

District of Columbia

In *Baber v. Baessell*,[15] the court held, in citing *Spearin*, that there was no basis to find a contractor liable for defects due to faulty plans or specifications if the contractor has been hired to follow them and has done so, unless he has in some manner warranted them. Baber contracted with Baessell to build a private home. Baber furnished Baessell the plans. Upon completion of the home, Baber complained, among other things, that the roof was defectively built, that it did not have the correct or proper pitch to provide for necessary and adequate drainage, and that the roof leaked. Baber paid for corrections to the roof and sued Baessell to get his money back. In ruling in favor of Baessell, the court found there was no evidence that the roof as built by Baessell was not built strictly in accordance with the plans and specifications. Furthermore, the court found that although there was evidence of unsuitable materials and design, it found that the plans and the specifications called for the unsuitable materials and design.

Florida

The Fifth Circuit Court of Appeals applied Florida law in *Bradford Builders Inc. v. Sears Roebuck & Co.*[16] in following *Spearin* and held that where a contractor is bound to build a project according to plans and specifications given to it by the owner, the contractor will not be responsible for damages resulting from defects in the plans and the specifications. The court further found that this principle is not overcome by general clauses requiring the contractor to

visit the site before bidding, familiarize itself with the plans and to inform itself of the general requirements of the work before contracting.

Georgia

The Georgia Supreme Court first recognized the *Spearin* Doctrine in *Decatur County v. Praytor, Howton & Wood Contracting Co.*[17] In this case, the contractor rescinded its contract with the county for construction of bridges when it discovered that it would need to install bridges much lower than what was indicated by the specifications provided by the county. Citing *Spearin*, the court explained that normally a contractor can recover damages for errors in the plans and specifications provided by the owner. The court, however, held that the county was not liable for the changes in this case because its contract with the contractor expressly disclaimed its implied warranty as to the adequacy of the plans and specifications.

Illinois

Illinois has long followed the *Spearin* Doctrine. In *W.H. Lyman Const. Co. v. Village of Gurnee,*[18] a contractor sued a village and engineering firm, which drafted plans and specifications for bids on a sewer project, for breach of implied warranty of accuracy and sufficiency of the plans and specifications. The court cited *Spearin* and a progeny of Illinois cases and explained that it is "established that a contractor who builds according to plans and specifications furnished to him and performs the job in a good and workmanlike manner is protected and such contractor will not be responsible for the consequences of defects in such plans and specifications."[19] *Id.* at 37.

Indiana

Indiana follows doctrine consistent with the *Spearin* Doctrine. In *Millner v. Mumby*,[20] a homeowner brought suit for breach of contract against a contractor that poured concrete walls for his house that turned out to be defective. The homeowner had provided the plans and specifications for the project. The court explained that "virtually every American jurisdiction that has considered the issue has held that a contractor who builds a structure according to plans and specifications supplied by the building owner is not to be held liable if the plans and specifications prove defective." The court explained that the same rule should be applied in Indiana and held that the contractor was not liable.

Iowa

The *Spearin* concept has long been followed in Iowa. Specifically, in 1885 in *Holland v. Union Cty*.[21], litigation arose concerning the defective design for a bridge. Both parties agreed the design was unsuitable, but the parties differed as to who was responsible for it. The contractor contended that Union County required the contractor to use old material in the design,

and he recommended a different design which would increase the cost of the bridge. According to the contractor, Union County was very desirous of using the old material, and indisposed to entertain any plan which would exclude it. The Iowa Supreme Court upheld the decision of the lower court that there was sufficient evidence to justify the jury in rendering a verdict for the contractor on the ground that Union County was responsible for the design.

Kansas

Kansas has implicitly adopted the *Spearin* Doctrine. In *Heman Const. Co. v. Mason*,[22] specifications for the construction of a public building were provided by a state architect. The contractor completed the project but did not properly lay the cement floors. The court quoted *Spearin* for the principle that when a contractor builds in accordance with plans and specifications provided by an owner, the contractor cannot be held liable for defects in those plans and specifications. The court, however, ultimately held that the contractor could not benefit from the *Spearin* doctrine because it did not build in accordance with the plans and specifications

Kentucky

The Court of Appeals of *Kentucky in Culbertson v. Ashland Cement & Constr. Co*[23] reversed the decision of the lower court in favor of a contractor and against the owner of an apartment building on his counterclaim for defective concrete work performed by the contractor. The court's reversal was due, in part, to the instructions submitted to the jury. More specifically, the court found that the lower court submitted to the jury the question of whether the work was done in accordance with the contract and the specifications made part of it, without construing the contract for them or telling them what facts they were to find, which amounted to a submission to the jury of the law and the facts of the case. At trial, the contractor had argued that the deficiencies in the concrete resulted from the lack of expansion joints, and that expansion joints were not provided for in the plans and specifications. Applying *Spearin* concepts, the court instructed that if a second trial is conducted and similar evidence is offered, the lower court must instruct the jury that expansion joints were not required by the specifications, and that the contractor is not liable for any defect in the work resulting from the want of expansion joints.

Louisiana

The *Spearin* concept has long been followed in Louisiana. Specifically, the *Spearin* opinion was cited by the Louisiana Supreme Court in *Louisiana Shipbuilding Co. v. Bing Dampskibsaktieselskab*[24], in support of its holding that the builder was not at fault for defects in ships it built since it had followed the owner's specifications. Decades later, La. R.S. 9:2771 was enacted to provide for the statutory non-liability of a contractor for destruction or deterioration of work performed according to supplied plans and specifications and which is not subject to waiver by the contractor.[25] La. R.S. 9:2771 demonstrates the legislative intent to offer

a strong protection to a contractor who relies on plans and specifications submitted to him by the owner or its representative.[26] This protection is not absolute, however. In *New Orleans Unity Society of Practical Christianity v. Standard Roofing Co.*,[27] the Louisiana Fourth Circuit Court of Appeal held that the statute did not insulate a contractor from liability on his guaranty to the owner for a ten year roof warranty. Likewise, in third party tort actions, Louisiana courts have held that a contractor may not blindly rely on plans and specifications furnished to the contractor, and could be held liable to third parties if the contractor had reason to believe that compliance with specifications or plans would create a hazardous situation.[28] Most recently, in *LASHIP, LLC v. Terrebonne Port Commission*,[29] the United States Fifth Circuit Court of Appeal, citing to La. R.S. 9:2771 upheld the trial court's judgment that a subcontractor did not negligently fail to warn the contractor of design defects in columns installed under a contract to build a ship building facility as the contractor was unable to point to specific evidence that the subcontractor had a "justifiable reason" to believe its adherence to the plans would create a hazardous condition.[30]

Maine

The Supreme Court of Maine has consistently applied the S*pearin* Doctrine, beginning with the 1981 decision in *Marine Colloids, Inc. M.D. Hardy, Inc*.[31] Thereafter, citing S*pearin*, the Supreme Court held that "Ordinarily, a contractor who completes a construction project in a workmanlike manner and in strict compliance with plans furnished by the owner will not be held liable for damages resulting from defects in the owner's specifications."[32]

Maryland

The *Reinhart Construction Company v. Baltimore*[33] case involved an issue that arose not during construction of the project but during the five-year warranty period after completion. The contract in *Reinhart* required that "all work to be done under this contract must be guaranteed and kept in repair by the contractor of a period of five years from the date of" acceptance, including all maintenance and repairs necessary to keep the work in a "first-class condition." The failures in the paving work installed by Reinhart were found to be caused by the materials specified by the owner's architect, not a result of defective workmanship on Reinhart's part. In citing *Spearin*, the court held that where a contract prescribes certain materials to be used by the contractor, the contract will not be construed to impose liability on the contractor when the materials it was required to use do not meet the demands thereafter made upon them. The court further held that a general contractor guaranty of good condition during a warranty period does not obligate the contractor to liability for mistakes or miscalculations in the architect's plans.

Massachusetts

Although Massachusetts addressed issues similar to those in the *Spearin* case for years, the Massachusetts case that most clearly espouses the *Spearin* doctrine is *Alpert v. Commonwealth.*[34] In this case, Alpert was the bankruptcy trustee who took over the claim of the contractor who had sued the Commonwealth of Massachusetts for costs incurred as a result of defective plans and specifications on a highway project. In this case, the Commonwealth had provided a Notice to Contractors that all information necessary to build the project was contained in the plans and specifications. It turns out that the Commonwealth had much more information (or superior knowledge) regarding subsurface conditions than which was included in the contract documents. The court found that it "is well established that where one party furnished plans and specifications for a contractor to follow in a construction job, and the contractor in good faith relies thereon, the party furnishing such plans impliedly warrants their sufficiency for the purpose intended."[35]

Michigan

Michigan has adopted the *Spearin* Doctrine. In *L.W. Kinnear, Inc. v. City of Lincoln Park*,[36] the contractor entered into a contract with the defendant city for the construction of 15,000 feet of lateral trunk line sewer. The contractor plaintiff claimed it was owed more than the original contract price because defendants changed the method of construction of the sewer to a more expensive method than was contemplated in the plans and specifications. Citing *Spearin*, the plaintiff argued that "since defendants designated in the contract the type and design of the sewer, they thereby warranted the type and design as being adequate and suitable for the proposed use under the existing conditions, and, if . . . the collapse of the sewer resulted 'from the design, type and specifications' of the sewer, then the loss must be borne by defendants. The Michigan Supreme Court stated that "[i]f plaintiff is right as to the facts, we think he is right as to the law." The court therefore ordered a new trial, reversing the trial court, which had prohibited the plaintiff from recovering any extra costs associated with the method of construction being different from the plans and specifications.

Minnesota

Minnesota has explicitly adopted the *Spearin* doctrine. In *McCree & Co. v. State*,[37] the plaintiff contractor sued for breach of warranty and to recover payments withheld by the state in connection with a contract for the improvement of certain highways. The construction was delayed due to unforeseen wet and plastic soil conditions. The plaintiff took the position that the methods and specifications prescribed by the contract and provided by the state represented and warranted that the subsoil was capable of being compacted as specified and directed. Citing *Spearin*, the court explained that "[i]t is generally held and this by the great weight of authority that the act of the owner in furnishing the plans and specifications amounts to a warranty of their

fitness and that, where one party furnishes specifications and plans for a contractor to follow in a construction job, he thereby impliedly warrants their sufficiency for the purposes implicit therein and whether the builder has been damaged in proceeding with the work in reliance on such an implied warranty or whether he was damaged in relying on the warranty in making his bid, he may recover."

Mississippi

In *Havard v. Board of Supervisors*,[38] the court ruled in favor of the contractor, Havard, by holding that the:

> general rule is that a construction contractor who has followed plans and specifications furnished by the owner, architect, or engineer, and which have proved to be defective or insufficient, will not be responsible to the owner for loss or damages which result after the work has been completed, solely from the defective plans and specifications, in the absence of any negligence on the part of the contractor or any express warranty by him as to the plans and specifications being free from defects.

In *Havard*, the School District hired Havard to construct classrooms and a gymnasium according to plans and specifications prepared by the School District's architect. After the project was complete, but during the one-year warranty period, the gym floor buckled due to moisture and water intrusion. Havard attempted some repairs but discontinued before remedying the problem because it claimed that it had fully performed the contract. The School District hired another contractor to perform remedial work and sued Havard to recoup its costs.

Missouri

After nearly 100 years, the courts of Missouri finally adopted the *Spearin* Doctrine in the recent decision in *Penzel Constr. Co., Inc. v Jackson R-2 School Dist*rict.[39] In *Penze*l, the court recognized that the *Spearin* Doctrine had not been expressly accepted or rejected in Missouri, but went on to conclude that "After examining *Spearin* and Missouri precedent, we believe S*pearin* claims are acceptable vehicles for bringing causes of actions based on deficient plans and specifications in construction projects involving a governmental entity-owner."[40]

Nevada

The Nevada Supreme Court has long recognized the S*pearin* principle that where a contractor follows the plans and specifications furnished by the owner and its architect, it will not be responsible to the owner for any loss or damages which results solely from insufficient plans or specifications in the absence of any negligence on the part of the contractor or any express warranty by him as to their being sufficient or free from defect.[41] More recently, the Nevada Supreme Court specifically cited *Spearin* as potential defense to a rebar subcontractor.[42]

New Jersey

In a case decided six months before *Spearin*, the court in *Drummond v. Hughes*[43] found that had the contractor followed the plans and specifications provided to it by the owner's architect, it would not be found financially responsible for damages resulting from a faulty design. In *Drummond*, the contractor decided to modify the architect's design because it felt that the materials and work called for in the plans and specifications were defective. The court stated that a "good and workmanlike job is a job properly executed; whether the result is what it should be depends on the plans and specifications."

New Mexico

The *Spearin* concept was recognized by the New Mexico Supreme Court in the 1952 decision, *Staley v. New*.[44] In *Staley*, the court affirmed the trial court's finding that the owner could not recover against the general contractor because the owner's representative had furnished the plans and specifications for the owner's heating system and the contractor and its subcontractor had performed the work in a workmanlike manner and in accordance with those plans and specifications.

New York

New York courts have long followed *Spearin* principles, the best example of which is the *Fruin-Colnon Corp v. Niagara Frontier Transp. Authority*[45] decision. In *Fruin-Colnon*, the intermediate appellate court, citing *Spearin*, considered the issue of whether the contractor, which had followed the design specifications in building a tunnel, was entitled to additional compensation for the correction of leakage. The court answered affirmatively, finding that since the contract did not create a performance specification, the contractor was not responsible for making the tunnels watertight at its own expense. The court provided further guidance: "Under a performance specification, only an objective or standard of performance is set forth, and the contractor is free to choose the materials, methods and design necessary to meet objective or standard of performance…. That is in contrast to a design specification, where the owner specifies the design, materials and methods and impliedly warrants their feasibility and sufficiency."[46] The court also added that whether a provision is a design or performance specification depends on the language of the contract, as well as factors such as the nature and degree of the contractor's involvement in the specification process and the degree to which the contractor is allowed to exercise discretion in carrying out its contract performance.[47]

North Carolina

The *Spearin* doctrine has been faithfully followed in North Carolina courts since at least the 1981 decision in *Burke Co. Public School Bd. of Education v. Juno Construction Cor*p.[48] As

one North Carolina state court found, "[i]t is simply unfair to bar recovery to contractors who are misled by inaccurate plans and submit bids lower than they might otherwise have submitted."[49]

Ohio

The Ohio Supreme Court recognized Ohio's acceptance of the *Spearin* doctrine in *Dugan & Meyers Constr. Co., Inc. v. Ohio Dept. of Adm. Servs.*[50] *Dugan* concerned a contract for the construction of three buildings at Ohio State University. The plaintiff contractor sued to recover an amount that had been withheld based on a liquidated damages clause for a delay in the completion of the project. The plaintiff claimed that the delay was caused in large part by the fact that the plans for the project provided by the state were inaccurate and incomplete, causing them to be changed several times, and that the state was therefore liable for the delays under the *Spearin* doctrine. The Court explained that "Ohio courts have recognized that the '*Spearin* doctrine holds that, in cases involving government contracts, the government impliedly warrants the accuracy of its affirmative indications regarding job site conditions.'"[51] The Court, however, rejected plaintiff's argument, declining to extend the doctrine to damages flowing from delay in completion of a project due to plan changes.

Oklahoma

Applying *Spearin*, the Supreme Court of Oklahoma in *Oklahoma City v. Derr*[52] upheld a judgment in favor of a contractor who entered into a contract with the city of Oklahoma City for the construction of a sewer system. The court held that a contractor will not be relieved from the performance of a municipal contract, because he meets a situation incidental to the performance of the contract that was not anticipated by him, although such unexpected situations may add extra expense in completing the work. However, a different rule applies where the contractor must build and complete a structure according to the plans and specifications by the owner. The contractor will not be required to bear extra expense resulting from the performance of the contract on account of defects in the plans and specifications prepared and submitted by the owner.

Pennsylvania

In a case that pre-dated *Spearin* by some twenty years, the Supreme Court of Pennsylvania decided in *Filbert v. Philadelphia*[53] that a contractor is not to be held liable for defects in a project if it builds the project in accordance with the plans and specifications it was bound to follow. In this case, the City of Philadelphia claimed that the reservoir that Filbert built was to be leak-free. In fact, one of the project specifications included language requiring the contractor to perform "*all work necessary to make a complete and perfect reservoir, ready for use.*" However, the court found that this language had to be read in context with the other parts of the agreement that detailed the specific work that Filbert was to perform and that this language

did not indicate an intention on the part of the City that contractors were to be responsible for the result if there was no default on their part.

In *Canuso v. City of Philadelphia*,[54] the contractor was found not to be liable for the costs associated with the failure of work that was the subject of its own design. Per the contract, Canuso submitted a design for temporary work that was needed to support bridge arches in the construction of a highway bridge. The court ruled in favor of Canuso who sued the City to recoup the costs it incurred in fixing the temporary work failure because the City's engineers nonetheless retained complete control and approval over the project's plans and specifications and a contractor, even a specialist, who builds according to the Owner's plans will not be responsible for the sufficiency of the work.

South Carolina

Spearin principles are followed in South Carolina. In the 1951 case *Hill v. Polar Pantries*, the South Carolina Supreme Court upheld a jury verdict of breach of contract in favor of an owner against a designer of the plans and specifications for a frozen food lock facility.[55] The owner contended that its frozen food locker became unusable after cracks emerged in the floor and walls and that the defects resulted from insufficient plans and specifications for which Polar Pantries was liable.[56] In support of its decision to uphold the jury's verdict, the court found that if a party furnishes specifications and plans for a contractor to follow in a construction job, he thereby impliedly warrants their sufficiency for the purpose in view.[57]

South Dakota

While not specifically citing *Spearin*, the Supreme Court of South Dakota has adopted the *Spearin* concepts: "[A] construction contractor who has followed plans or specifications furnished by the contractee, his architect, or engineer, and which have proved to be defective or insufficient, will not be responsible to the contractee for loss or damage which results… solely from the defective or insufficient plans or specifications, in the absence of any negligence on the contractor's part, or any express warranty by him as to their being sufficient of free from defects."[58]

Tennessee

In dicta, Tennessee implicitly accepted the application of the *Spearin* doctrine in *Brown Bros., Inc. v. Metropolitan Government of Nashville and Davidson County*.[59] In *Brown Bros*, the City of Nashville advertised bids for a contract to extend a road, and with its advertisement it provided estimates for the types of excavation that would be necessary. In submitting a bid, the plaintiff contractor relied on the excavation estimates provided by Nashville. When the estimates were found to be incorrect, costing the plaintiff extra money in excavation costs, the plaintiff

relied on the *Spearin* doctrine and sued to offset those costs. The court acknowledged the "formidable" body of law consistent with the *Spearin* doctrine in other jurisdictions and in so doing seemed to accept the doctrine itself. However, the court rejected the plaintiff's contention that the *Spearin* doctrine made Nashville liable for its excavation estimates, explaining that "[w]e are unpersuaded, however, that the *Spearin* Doctrine is as broad as the appellant represents it to be, or that it is applicable to the facts of this case." The court ultimately held that the *Spearin* doctrine did not apply to shift liability for estimates to the government for providing the estimates.

Texas

In 1907, the Texas Supreme Court, rejecting *Spearin* concepts, held in *Lonergan v. San Antonio Loan & Trust Co.*[60] that a contractor bore the risk and liability of a building collapse that was the result of defective design documents. *Lonergan* has never been expressly overruled, and the Texas Supreme Court has not specifically addressed the question since 1907. The *Lonergan* decision has been followed by multiple Texas courts. For example, in *McDaniel v. City of Beaumont,*[61] a contractor for a high school building sued for additional costs arising out of correction of plaster work because of inaccurate specifications. Citing to *Lonergan,* the *McDaniel* court agreed that an owner does not warrant the sufficiency of the plans and specifications for a project.[62] Similarly, in *Emerald Forest Util. District v. Simonsen Constr. Co.,*[63] on appeal, the court held that the trial court's judgment in favor of the contractor was contrary to *Lonergan.* Although the jury found at trial that the sewer line at issue failed because of deficient design, the appellate court stated that the controlling issue is whether the owner warranted the sufficiency of the design of the sewer system and, citing *Lonergan*, found that there was no justification for imposing on the owner a legal duty to insure the sufficiency of the specifications.[64] Further, in *City of San Antonio v. Forgy*,[65] at issue was whether an owner breached a duty of good faith and fair dealing by failing to inform its contractor that city engineers had recalculated the ability of casings specified in the contract to withstand anticipated pressures. In reaching its decision, the court assumed that the contractor had a right to rely on the sufficiency of the plans the owner prepared, but stated in dicta that the owner's failure to warn and the contractor's failure to make a determination on his own behalf pertained more to the law of negligence than a breach of trust under the contract.[66] The court ultimately held that there was no duty of good faith and fair dealing imposed on the owner.[67]

Notably, a parallel line of cases exists in Texas that follows the *Spearin* doctrine. The divergence from *Lonergan* began with *Newell v. Mosley*.[68] In *Newell*, a contractor was sued by an owner when he refused to proceed with construction of a house because of alleged deficiencies in the plans and specifications for the project which would have added an additional $1,500.00 to the cost of construction. The court found the contract was based on a mutual mistake of material fact and rescinded the contract.[69] The court then addressed the owner's argument that the contractor's duty to determine whether the house could fit on the lot precluded

the contractor's right of rescission.[70] The court found that the contractor "acted on [the owner's] implied warranty that the plans and specifications were sufficient for the purpose in view."[71] *T*he court determined that the "plans submitted by [the owner] constituted a positive assertion that the house could be constructed on the lot. Consequently, [the owner] made a representation upon which [the contractor] had a right to rely without an investigation."[72] In *City of Baytown v. Bayshore Constructors, Inc.*[73], the First Court of Civil Appeals in Houston held that an owner's failure to provide correct or adequate plans and specifications constituted a breach of the contract, entitling the contractor to recover his resulting damages.[74] Thereafter, the court reaffirmed its decision in *Bayshore Constructors in Turner, Collie & Braden, Inc. v. Brookhollow, Inc.*[75] In doing so, the court acknowledged *Lonergan*, but refused to follow it.[76]

In 2005, the United States Fifth Circuit Court of Appeal in *Interstate Contracting Corp, v. City of Dallas*[77] overturned a jury verdict in favor of a contractor and against an owner on issues of breach of contract and breach of implied warranty. In the case, the court discussed the history of *Lonergan* and its progeny, as well as the parallel line of cases that support the *Spearin* doctrine.[78] In its analysis, the court criticized the holding in *Bayshore Constructors* stating that "the court's rationale in *Bayshore Constructors* was flawed because the contracts in the cases it relied on expressly required the owner to provide adequate plans.[79] In support of its opinion, the Fifth Circuit held that the Texas Supreme Court would follow the *Lonergan* rule and found that the risk of defective plans and specifications was assumed by the contractor due to the fact that there was no express language in the contract that shifted the risk to the owner.[80]

Virginia

The S*pearin* Doctrine has been the law in Virginia since the Virginia Supreme Court's 1919 decision in *Adams v. Tri-City Amusement Co.*, where the contractor was found not responsible for the collapse of basement walls, which collapse was determined to be attributable to the architect's failure to design the walls with sufficient strength to stand on low and wet ground.[81] Note that a S*pearin* defense was recently rejected a lower court, which strictly enforced the contract provisions requiring the contractor to notify the engineer of any errors, omissions, conflicts, and discrepancies in the plans prior to proceeding with the work.[82]

Washington

In *Huetter v. Warehouse & Realty Co.*,[83] a case that pre-dates the *Spearin* decision by four years, the Washington Supreme Court found in favor of the contractor that performed work in accordance with plans and specifications furnished to it by the owner, absent an express warranty incorporated into its contract. In *Huetter*, the contractor actually abandoned the project because of the defective plans and sued successfully to obtain the full value of the work that it had installed before its abandonment.

Washington courts tend to cite to the principles of the *Spearin* doctrine without citing the *Spearin* case. For instance, in *Kenney v. Abraham*,[84] the court noted that the rule has long been settled in multiple American jurisdictions that a construction contractor who has followed the plans and specifications provided to it by its customer will not be held responsible to that customer for damages that result from defective or insufficient design in the absence of any negligence on the contractor's part. In this case, however, the court found the contractor negligent in failing to adhere to the plans and specifications and held the contractor liable for damages resulting from its negligence.[85]

Wisconsin

Wisconsin explicitly adopted the *Spearin* doctrine in *Thomsen-Abbott Const. Co. v. City of Wausau*.[86] In *Thomsen-Abbott*, the plaintiff contractor sued the City of Wausau over a public building contract to recover the extra cost of "de-watering" the building site made necessary by the City's change in the concrete footing plans so as to place most of the footings considerably below the ground water table. Citing *Spearin*, the court explained that "[i]n situations like this a contractor bidding on a public work project has the right to rely on the express representations contained in the plans even in the presence of a contract clause similar to the one in the instant contract, which places a duty of investigation upon the contractor." The court, however, held that the contractor had accounted for the costs of de-watering in its bid and was therefore not entitled to recover extra costs.

Wyoming

The Wyoming Supreme Court has recognized the application of S*pearin* principles in a 2008 decision involving a dispute over installation of water and sewer mains: "… a contractor is not responsible for defects in the owner's plans and specifications in the absence of some negligence on the contractor's part…."[87]

Federal Courts

The following federal jurisdictions have addressed the *Spearin* doctrine. Please note that the Federal Circuit decisions referenced herein are intended to identify only whether a particular Circuit Court has addressed the *Spearin* Doctrine. Practitioners are advised to also review *Spearin* treatment in court decisions from the state in which the issue arises.

Second Circuit

The Second Circuit addressed the *Spearin* doctrine in *Montrose Contracting Co. v. Westchester County*.[88] In *Montrose*, the contractor sued Westchester County in connection with a contract to build a sewer tunnel. The contractor argued that it was entitled to damages because

more of the tunnel required compressed air than the plans and specifications indicated. Citing *Spearin*, the court explained that "[w]here one party furnishes specifications and plans for a contractor to follow in a construction job, he thereby impliedly warrants their sufficiency for the purpose in view." The court further explained that "[w]hether the builder was damaged in proceeding with the work in reliance on this implied warranty, as in the cases supra, or whether he was damaged in relying on the warranty in making his bid, as he did here, he may recover." The court therefore held that the contractor could recover for the damages incurred from the errant specifications.

Third Circuit

The Third Circuit addressed the *Spearin* doctrine in *Passaic Valley Sewerage Com'rs v. Tierney*.[89] In *Passaic Valley*, the contractor sued under a contract dealing with the construction of a new sewer system. Complications in the project arose when the methods in the specifications for keeping the pipes water tight were failing. Citing *Spearin*, the court explained that it is a "well-settled rule that, if a contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications." The court therefore held that the contractor was entitled to damages caused by the problematic specifications provided by the owner.

Fifth Circuit

The Fifth Circuit addressed the *Spearin* doctrine in *Bradford Builders, Inc. v. Sears, Roebuck & Co*.[90] While not the main issue at bar, *Bradford Builders* involved a peripheral dispute regarding liability for specifications involving the placement of a fence line in relation to electrical lines, and the court invoked the *Spearin* doctrine, stating that "if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications." The court further explained that "this responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work."

Sixth Circuit

The Sixth Circuit addressed the *Spearin* doctrine in *U.S. for Use and Benefit of Carter v. Ross Corp*.[91] In *Carter*, the contractor sued after incurring extra costs associated with unanticipated handling and re-handling of debris on an excavation project. The court first noted that there is a broad general rule that "one who has contracted to perform specific work for a stated price will not be entitled to extra compensation because he encounters difficulties that have not been provided against in the contract." However, the court then cited *Spearin*, noting

that the aforementioned general rule is seldom followed, and the court went on to hold that the contractor was entitled to recover for these added expenses.

Seventh Circuit

The Seventh Circuit addressed the *Spearin* doctrine in *Premier Electric Const. Co. v. U.S.*[92] In *Premier Electric*, the contractor sued under a contract for the construction of an approach light system at an airport, arguing that it was entitled to recovery under the *Spearin* doctrine because an access road became inaccessible during the project. While the court acknowledged the validity of the *Spearin* doctrine, the court held that the doctrine did not apply in the contractor's case because the inaccessibility of the road was not a problem with the plans or specifications and was, instead, simply an unforeseen circumstance.

Eighth Circuit

The Eighth Circuit addressed the *Spearin* doctrine in *Centex Const. Co. v James*.[93] In *Centex*, the contractor sought rescission of a contract with the City of New Orleans for the construction of a sewer when the contractor discovered that it was required to excavate, on average, two feet deeper than expected. Citing *Spearin*, the court explained that "[i]t is well settled where one party furnishes plans and specifications for a contractor to follow in a construction job, he impliedly warrants their sufficiency for the purpose in view." Finding that the specifications misrepresented the "ground line," the court held in favor of the contractor and rescinded the contract.

Ninth Circuit

The Ninth Circuit address the *Spearin* doctrine in *Phoenix Tempe Stone Co. v. Dewaard*.[94] In *Phoenix Tempe Stone*, the contractor sought damages when the construction of a bridge required more excavation than the plans and specifications indicated due to the rock elevation being miscalculated. The trial court found that the plans and specifications were incorrect about the depth of the bedrock and granted judgment in favor of the contractor. Citing *Spearin*, the Ninth Circuit affirmed the trial court, explaining that it was not the contractor's responsibility to discover that the depth of the bedrock in the plans and specifications was incorrect.

Tenth Circuit

The Tenth Circuit addressed the *Spearin* doctrine in *Miller v. City of Broken Arrow Oklahoma*.[95] The contractor contracted with the City of Broken Arrow for the construction of a sewer line to be built in accordance with plans and specifications provided by an engineering firm retained by the City. The contractor stopped construction after the job was 93% complete

when it determined that the methods for stabilizing muddy areas provided in the plans and specifications was inadequate. Citing *Spearin*, the court held in favor of the contractor, explaining that "a contractor is entitled to rely on an owner's plans and specifications and that the contractor is not thereafter liable to the owner for loss or damage which results solely from the insufficient or defective plans is in accord with numerous court decisions."

Eleventh Circuit

The Eleventh Circuit addressed the *Spearin* doctrine in *Otis Elevator Co. v. WG Yates & Sons Const. Co*.[96] In *Otis Elevator*, there was an ambiguity as to the size of the steps in specifications for the construction of an escalator. The subcontractor that bid on the project failed to clarify the ambiguity in the specification prior to bidding, even though it was aware at the time that the ambiguity existed. While the court applied the *Spearin* doctrine, it held that the subcontractor was obligated to "bring to the Government's attention major discrepancies or errors" detected in the specification or drawings. The court therefore held that the subcontractor's failure to ask for clarification meant that it bore the risk that the general contractor would adopt a different, reasonable interpretation of the ambiguous specifications.

D.C. Circuit

The D.C. Circuit addressed the *Spearin* doctrine in *Baber v. Baessell*.[97] In *Baber*, a lawsuit arose over the construction of a building, in part because the roof was leaky. However, the court found that the contractor built the roof in accordance with the plans and specifications provided by the owner. Citing *Spearin*, the court held in favor of the contractor, explaining that "[t]here is no liability for defects due to faulty plans or specifications if the builder has been hired to follow them and has done so."

Federal Circuit

The Federal Circuit has addressed the *Spearin* doctrine on many occasions and has developed the doctrine over many years. Cases applying *Spearin* over the decades illustrate that the doctrine is alive and well in the Federal Circuit.[98]

United States Court of Claims

Given that *Spearin* was originally decided by the United States Court of Claims and affirmed by the Supreme Court of the United States, it is no surprise that the Court of Claims has also faithfully applied *Spearin* over the years.[99]

[1] 309 So. 2d 102 (Civ. App. 1975).
[2] 466 P.2d 753 (Ariz. 1970).
[3] *Id. See also*, *Chaney Bldg. Co. v. City of Tucson*, 716 P.2d 28 (Ariz. 1986); *Willamette Crushing Co. v. State*, 932 P.2d 1350 (Ariz. Ct. App. 1997)(*Spearin* applies only to design specifications, not performance specifications).
[4] 183 S.W. 761, 763 (1916); see also, *Graham Const. Co. v. Earl*, 208 S.W.3d 106, 109–10 (2005).
[5] See *Souza & McCue Const. Co. v. Superior Court of San Benito Cty.*, 370 P.2d 338 (1962); *Warner Constr. Corp. v. City of Los Angeles*, 466 P.2d 996 (1970).
[6] *Souza*, 370 P.2d at 339.
[7] *Id.*
[8] *Id.* at 340.
[9] *Warner*, 456 P.2d at 996-997.
[10] *Id.* at 997.
[11] *Id*. at 1001.
[12] 494 P.2d 115, 117 (1972); see also, *BRW, Inc. v. Dufficy & Sons, Inc.*, 99 P.3d 66, 73 (Colo. 2004).
[13] 94 Conn. 450, 123 A. 135 (Conn. 1923).
[14] 192 A.2d 925 (Del. 1963).
[15] 85 F.2d 725 (DCA DC 1936).
[16] 270 F.2d 649 (5th Cir. 1959).
[17] 165 Ga. 742 (1928).
[18] 84 Ill.App.3d 28 (1980).
[19] *Id*. at 37.
[20] 599 N.E.2d 627 (1992).
[21] 68 Iowa 56, 25 N.W. 927, 929 (1885); see also, *Midwest Dredging Co. v. McAninch Corp.*, 424 N.W.2d 216 (Iowa 1988).
[22] 112 Kan. 648 (1923).
[23] 144 Ky. 614, 139 S.W. 792, 794 (1911).
[24] 158 La. 548, 104 So. 364 (1925).
[25] La. Stat. Ann. § 9:2771.
[26] *Harbor Const. Co. v. Bd. of Sup'rs of Louisiana State Univ. & Agr. Mech. Coll.*, 2010-1663 (La. App. 4 Cir. 5/12/11), 69 So. 3d 498, 504.
[27] 224 So.2d 60 (La.App. 4th Cir.1969).
[28] *See, Morgan v. Lafourche Recreation Dist. No. 5*, 01–1191 (La.App. 1 Cir. 6/21/02), 822 So.2d 716; *Cormier v. Honiron Corp.*, 00–446 (La.App. 3 Cir. 9/27/00), 771 So.2d 193; *Van Alton v. Fisk Elec., Inc.*, 531 So.2d 1175 (La.App. 4th Cir.1988).
[29] 680 F. App'x 317 (5th Cir. 2017).
[30] *Id.* at 321-322.
[31] 433 A.2d 402 (Me. 1981).
[32] *Paine v. Spottswoode*, 612 A.2d 235 (Me. 1992).
[33] 157 MD. 420, 146 A. 577 (Md. 1929). See also *Gaybis v. Palm*, 201 Md. 78,85, 93 A.2d 269 (Md. 1952) (contractor does not warrant the sufficiency of plans and specifications given to it by the owner, only the skill and care with which he performs his work and the soundness of the materials used therein.); *Dewey Jordan, Inc. v. Maryland-National Capital Park and Planning Commission*, 258 Md. 490, 265 A.2d 892 (1970); *Dillon Properties, Inc. v. Minmar Builders, Inc*., 257 Md. 274, 262 A.2d 740 (1970).
[34] 357 Mass. 306 (1970).
[35] The *Alpert* case cited *M.L. Shalloo v. Ricciardi & Sons Construction, Inc*., 348 Mass. 682 (1965) for the general rule cited in the *Alpert* case. Interestingly, more than four decades earlier, Massachusetts took a different approach in *N.J. Magnam v. Fuller*, 222 Mass. 530, 111 N.E. 399 (1916) ("When one enters into a contract with a builder to erect a structure in accordance with plans and specifications, . . . there is no implied warranty or agreement on the part of the owner, . . . that the work can be done according to the plans and specifications, or that, if so done, if [sic] will be safe. It is the duty of one, who proposes to enter into a building contract to examine the contract, plans and specifications, and to determine whether it is possible to do the work before entering into the engagement, or to insist upon some stipulation covering that matter.")
[36] 260 Mich. 250 (1932).
[37] 253 Minn. 295 (1958).
[38] 220 Miss. 359, 70 So. 2d 875 (Miss. 1954).

[39] No. ED103878 (Mo. Ct. App. Feb. 14, 2017).
[40] *Id*. at p.7.
[41] *Home Furniture, Inc. v. Brunzell Construction Co*., 440 P.2d 398 (Nev. 1968).
[42] *Halcrow, Inc. v. District Court*, 302 P.2d 1148 (Nev. 2013).
[43] 91 N.J.L. 563, 104 A. 137 (1918).
[44] 250 P.2d 893 (N.M. 1952); *see also, Vinnell Corp. v. State, 512 P.2d 71 (N.M. 1973).*
[45] 585 N.Y.S.2d 248 (4th Dept. 1992); *see also, CGM Construction, Inc. v. Sydor*, 42 N.Y.S.3d 407 (3rd Dept. 2016).
[46] *Fruin-Colnon, supra*, 585 N.Y.S.2d at 253.
[47] *Id.*
[48] 273 S.E.2d 504 (N.C. Ct. App. 1981).
[49] *Battle Ridge Companies v. North Carolina Dept. of Transportation*, 587 S.E.2d 426 (N.C. Ct. App. 2003).
[50] 113 Ohio St.3d 226 (2007).
[51] *Id.* (quoting *Sherman R. Smoot Co. v. Ohio Dept. of Adm. Servs*., 136 Ohio App.3d 166, 176 (2000).
[52] 1925 OK 159, 109 Okla. 192, 235 P. 218, 221; see also, *Woods v. Amulco Prod.*, 1951 OK 190, 205 Okla. 34, 235 P.2d 273.
[53] 181 Pa. 530, 37 A. 545 (Pa. 1897).
[54] 326 Pa. 302, 192 A. 133 (Pa. 1937).
[55] *Hill v. Polar Pantries*, 64 S.E.2d 885 (1951).
[56] *Id.* at 886.
[57] *Id.* at 888.
[58] *Reif v. Smith*, 319 N.W.2d 815 (S.D. 1982); *see also, Bunkers v. Jacobson*, 653 N.W.2d 732 (S.D. 2002).
[59] 877 S.W.2d 745 (1993).
[60] 104 S.W.1061 (Tex. 1907).
[61] 92 S.W.2d 552 (Tex. Civ. App.—Beaumont 1936, no writ).
[62] *Id.* at p. 561.
[63] 679 S.W.2d 51 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.).
[64] *Id*. at p. 53.
[65] 769 S.W.2d 293 (Tex. App.—San Antonio 1989, writ denied).
[66] *Id*. at p. 297.
[67] *Id*. at p. 298.
[68] 469 S.W.2d 481 (Tex. Civ. App.—Tyler 1971, writ ref'd n.r.e.)
[69] *Id.* at 482–83.
[70] *Id.* at 483.
[71] *Id.*
[72] *Id.*
[73] 615 S.W.2d 792 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).
[74] *Id.* at p. 793.
[75] 624 S.W.2d 203 (Tex. Civ. App.— Houston [1st Dist.] 1980, writ ref'd n.r.e.).
[76] *Id.* at p. 207.
[77] 407 F.3d 708 (5th Cir. 2005); see also, *Dallas/Fort Worth Int'l Airport Bd. v. INet Airport Sys., Inc*., 819 F.3d 245, 250 (5th Cir.), reh'g denied, 821 F.3d 643 (5th Cir. 2016); see also, *Harris Const. Co. LTD. v. GGP-Bridgeland, L.P.*, No. CIVA H-07-3468, 2010 WL 1945734 (S.D. Tex. May 12, 2010).
[78] *Id.* at p. 716-720.
[79] *Id.* at p. 718.
[80] *Id.* at p. 720-723.
[81] 98 S.E. 647, 648 (Va. 1919); *see also, Chantilly Constr. Corp. v. Commonwealth*, 369 S.E.2d 438 (Va. Ct. App. 1988).
[82] *Modern Cont'l South v. Fairfax County Water Auth*., 72 Va. Cir. 268, 2006 WL 3775938 (Fairfax Cir. Ct. 2006).
[83] 81 Wash. 331, 142 P. 675 (Wash. 1914).
[84] 191 Wash. 167, 90 P.2d 713 (Wash. 1939) citing 88 A.L.R. 798.
[85] See also *Clark v. Fowler*, 363 P.2d 812 (Wash. 1961); *Teufel v. Wienir*, 68 Wash. 2d 31, 411 P.2d 151 (Wash. 1966).
[86] 9 Wis.2d 225 (1960)
[87] *Three Way, Inc. v Burton Enterprises, Inc*., 177 P.3d 219 (Wyo. 2008).
[88] 80 F.2d 41 (2d Cir. 1936).

[89] 1 F.2d 304 (3d Cir. 1924).
[90] 270 F.2d 649 (5th Cir. 1959).
[91] 385 F.2d 564 (6th Cir. 1967).
[92] 473 F.2d 1372 (7th Cir. 1973).
[93] 374 F.2d 921 (8th Cir. 1967).
[94] 20 F.2d 757 (9th Cir. 1927).
[95] 660 F.2d 450 (10th Cir. 1981).
[96] 589 Fed. App'x 953 (11th Cir. 2014).
[97] 66 App. D.C. 226 (D.C. Cir. 1936).
[98] *See, e.g., USA Petroleum Corp. v. U.S.*, 821 F.2d 622 (Fed. Cir. 1987); *Al Johnson Const. Co. v. United* States, 854 F.2d 467 (Fed. Cir. 1988); Hardwick *Brothers Co. II v. United States*, 168 F.3d 1322 (1998); *Lakeshore Engineering Services, Inc. v. United States*, 748 F.3d 1341 (2014).
[99] *See, e.g., J.L. Simmons Co. v. United States*, 412 F.2d 1360 (Ct. Cl. 1969); *Ordinance Research, Inc. v. United States*, 609 F.2d 462 (Ct. Cl. 1979).

SESSION 9

IMPACT OF DELIVERY METHODS

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THE IMPACT OF ALTERNATIVE DELIVERY METHODS ON SPEARIN'S IMPLIED WARRANTY OF THE PLANS & SPECIFICATIONS[1]

I. Introduction

Since the seminal case of *U.S. v. Spearin,*[2] the United States' most prominent project delivery method of "design-bid-build" has been challenged by alternative delivery methods, including turnkey, integrated project delivery, design-build, CM at Risk, and numerous variations of these methods. These delivery methods often combine both design and construction obligations on the contractor, or promote partnering or a sharing in the risks involved in designing a project, which stretch the basic premise of *Spearin: the Owner's implied warranty of the design*. Courts are now being faced with addressing if, and how, the *Spearin* Doctrine applies to projects that are built through alternative delivery methods. This paper briefly describes the history of project delivery methods, describes some of the most popular delivery methods being utilized across the United States today, and discusses how courts' address contractual risk assignment under the various delivery methods considering the significant impact of *Spearin's* implied warranty of the plans and specifications.

II. History and Project Delivery Methods in The U.S. Today

A "project delivery method" is "a comprehensive process including planning, design and construction required to execute and complete a building facility or other type of project."[3] For over 4000 years construction has been a pinnacle achievement of mankind.[4]

> Throughout history, "construction" was a single elemental term of reference for the entire architectural, engineering and building process under the responsible direction of an individual "master builder," who typically designed the project and then hired artisans to construct the work. … Only within the past century did the architectural profession cede to contractors the responsibility for on-sight management of the building process.[5]

Today, numerous construction delivery methods are used.

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[2] / 248 U.S. 132 (1918).
[3] / https://www.dbia.org/resource-center/Documents/what_is_design_build_primer.pdf
[4] / See also 1 Philip l. Bruner & Patrick J. O'Connor, BRUNER & O'CONNOR ON CONSTRUCTION LAW § 1:1 (Thompson Reuters 2016) [hereinafter BRUNER & O'CONNOR].
[5] / 1 Bruner & O'Connor §1:1, Fn. 1.

For instance, while the majority of projects are delivered using the "traditional" "design-bid-build" ("DBB") method, there are numerous other delivery methods, including: (i) design-negotiate-build, (ii) design-GMP-build, (iii) engineer-procure-construct, (iv) turnkey, (v) build-operate-transfer, (vi) build-own-operate, (vii) program management, (viii) construction management at risk, (ix) design-bid-multi-prime, (x) design-build, (xi) integrated project delivery, and (xii) various hybrids to these approaches.[6] Contractually, the distinction between these delivery methods varies drastically. However, as relevant to this paper, we focus on design-bid-build ("DBB"), Construction Management at Risk ("CMAR"), and Design-build ("DB").

Nearly 100 years ago, Spearin was decided in the context of the traditional design-bid-build ("DBB") delivery model. In DBB, the owner first retains a design professional who is responsible for providing detailed plans and specifications, known in the industry as "construction documents." Contractors then provide pricing, whether through competitive bids, a cost-plus, or negotiated basis, but the key component is that the pricing is based upon the contractor being obligated contractually to strictly comply with and building according to the detailed plans and specifications provided by the Owner's designers. In what is known as the "Spearin Doctrine," Courts have long held that an owner who provides detailed plans and specifications to the general contractor and requires the contractor to follow them impliedly warrants the adequacy and completeness of the plans and specifications to the contractor. *United States v. Spearin* (1918) 248 U.S. 132, 136-137. The *Spearin Doctrine* has been recognized in nearly every state in the union.[7]

In establishing the *Spearin Doctrine* nearly a century ago, the United States Supreme Court recognized that the contractor cannot be responsible for defects in the owner's plans and specifications:

> [I]f the contractor is bound to build according to the plans and specifications supplied by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. This implied warranty is not overcome by the general clauses requiring the contractor to examine the site, to check up the plans, and to assume responsibility for the work until completion and acceptance.[8]

[6] / See generally, 2 BRUNER & O'CONNOR §§6:1 – 6:18.
[7] / See, e.g., *Souza & McCue Constr. Co. v. Superior Court* (1962) 57 Cal.2d 508, 510-511; *Howard Contracting Inc. v. G.A. MacDonald Constr. Co.*, (1998) 71 Cal.App.4th 38; *McConnell v. Corona City Water Co.* (1906) 149 Cal.60, 64; *Penzel Constr. Co. v. Jackson R-2 Sch. Dist.*, 2017 Mo. App. LEXIS 493 (2017)(adopting *Spearin* as law in Missouri).
[8] / *Spearin,* 248 U.S. at 136.

Additionally, some states, like California, recognize that the implied warranty pursuant to the *Spearin Doctrine* can also be a basis for recovery where the owner directs extra work due to defects in the plans and specifications under certain circumstances.[9]

The basis for the decision in *Spearin* was the holding from the U.S. Supreme Court, that in the context of a DBB project, the owner *impliedly warrants* to the contractor the adequacy of the plans and specifications. This allows the contractor to submit its lowest price and be paid for additional work necessitated by an error or omission in the plans and specifications. The responsibility for payment of the additional costs caused by defective plans and specifications usually rests with the owner. Much of the case law in the United States is based on interpreting contracts involved in the DBB delivery method, where the Owner has furnished detailed design documents and required the contractor to comply with the design documents. Unfortunately for owners, an owner typically will not be able to recover such costs from the architect or engineer, who provided the plans and specifications, since design professionals do not warrant the adequacy of their work product to the owner, but only agree to perform in accordance with the applicable "standard of care."[10] This is often referred to as the *Spearin* Gap.[11] Owners caught between the design professional and contractor, more often than not, object to paying for these extra costs and much litigation has resulted.

III. DBB Derivative Contracting Methods and *Spearin*

A. "Multi-Prime" Delivery Method

There are multiple derivatives of the DBB delivery method. For instance, an owner may undertake to break up the construction by design disciplines or "trades," and contract with multiple contractors according to the trade involved. These "multi-prime" method is typically utilized in both the public and private sector when the owner employs experienced internal staff capable of managing the project.[12] Proponents of multi-prime tout perceived advantage, including lower markup by general contractors, avoidance of bid-shopping and bid-peddling, and the potential ability to save time by letting

[9] / *See*, *Los Angeles Unified School District v. Great American Ins. Co.* (2010) 49 Cal.4th 739).
[10] / *See, e.g., City of Mounds View v. Walijarvi*, 263 N.W.2d 420 (Minn. 1978).
[11] / *See, e.g., Pittman Constr. v. City of New Orleans*, 178 So.2d 312 (La. Ct. App. 4th Cir. 1965); *L.K. Comstock & Co. v. United Engineers & Constructors Inc.*, 880 F.2d 219, 226 n.7, 14 Fed. R. Serv. 3d 348 (9th Cir. 1989).
[12] / *See, generally,* 2 BRUNER & O'CONNOR §6:14.

certain trades as designs are completed.[13] However, under this approach, no single contractor is responsible for the overall project costs, completion or success, and the owner is also exposed to direct claims of multiple contractors.[14] Moreover, management of multiple contractors, including day to day scheduling and coordination is the responsibility of the owner or the design professional.[15] As in the DBB delivery model, in the multi-prime contract approach, generally the owner impliedly warrants to the contractor the adequacy of the plans and specifications where *Spearin* applies.[16]

B. Construction Manager At-Risk

The Construction Manager At-Risk ("CMAR") delivery method is becoming more and more popular as many states enact statutes that allow public entities to deliver construction project using CMAR. Typically, a CMAR provides preconstruction services to the owner such as project feasibility, design review and comment, and budgetary and constructability review of the design professional's developmental and for construction plans and specifications.[17] In situations where the CMAR plays a significant role in development of the plans and specifications, and was paid for consulting services while doing so, questions may arise as to whether a CMAR claim a reasonable reliance on the owner's implied warranty of the plans and specifications.

In *Coghlin Electrical Contractors v. Gilbane Building Company,*[18] the Supreme Judicial Court of Massachusetts addressed the issue of whether a CMAR assumed design liability to a subcontractor for defects in the plans and specifications. The state of Massachusetts, undertook the design and construction of a new psychiatric facility and contracted with a design professional to prepare the plans and specifications. After the design was partially complete, the state contracted with Gilbane Building Company to act as the CMAR. Under the CMAR contract, Gilbane would provide typical CM pre-construction services, including making recommendations on design alternatives, modifications and

[13] / Id.
[14] / *See, generally,* 2 BRUNER & O'CONNOR §6:14.
[15] / *See, e.g., Apac-Georgia v. DOT*, 472 S.E.2d 97, 221 Ga.App. 604 (Ct. App. 1996).
[16] / *See, e.g., Schenkel & Shultz, Inc. v. Herman F. Fox & Assoc., P.C.*, 636 S.E.2d 835, 180 N.C.App. 257 (Ct. App. 2006).
[17] / *See, generally,* 2 BRUNER & O'CONNOR §6:13.
[18] 36 N.E.3d 505 (Mass. 2015).

value engineering followed by undertaking the construction of the project under a cost plus with a guaranteed maximum price. Gilbane subcontracted with Coghlin for electrical work, which complained that design errors and omissions increased its labor hours by almost 50%. Coghlin submitted a request for equitable adjustment to Gilbane and the owner, but the failure to resolve the dispute resulted in Coghlin filing suit against Gilbane. Gilbane, in turn, filed a third-party action against the state. Relying on the *Spearin* Doctrine, Gilbane argued that the state warranted the adequacy of the plans and specifications and, because of defects in the plans and specifications, the contractor was entitled to an equitable adjustment.

The lower court, did not agree with Gilbane and held that an owner does not provide an implied warranty of the adequacy of the plans and specifications under the CMAR delivery method. The court reasoned that the role of the CMAR was so different than the role of a traditional general contractor and because of Gilbane's involvement in the design process, the Spearin Doctrine was not applicable. The case went on appeal to the Supreme Judicial Court of Massachusetts, the highest court in the state. Reviewing the lower court's ruling that no implied warranty of design is found in a CMAR contract, the Supreme Judicial Court reached a different conclusion. The Supreme Judicial Court's decision to overturn the dismissal of the case was focused on the fact that the CMAR did not have control of and responsibility for the design.

Although the CMAR consulted in the design phase to some degree, the court reasoned that the owner and its designer ultimately controlled the design and did not have an obligation to accept the CMAR's input regarding design-related matters. Accordingly, the Supreme Judicial Court concluded that the CMAR's participation in the design phase, but not as the designer, did not warrant shifting the risk of a defective design from the owner and its third-party designer. Even though the Court found the implied warranty of design applicable to CMAR contracts, it has raised new issues as to how courts will determine when damages for a defective design are recoverable by the contractor. The court stated that the CMAR may recover damages caused by the breach of the design warranty only if it proves that its reliance on the defective plans and specifications was reasonable and in good faith. Finding the CMAR's reliance on the design reasonable, the court then reasoned that the fact finder should consider the CMAR's level of participation in the design phase and the extent to which the contract delegates design

responsibility to the CMAR. The greater the CMAR's design responsibilities, the more difficult it will be for the CMAR to establish that its reliance on the defective design was both reasonable and in good faith.

What seems apparent is that the greater the CMAR's design responsibilities in the contract, the greater the CMAR's burden will be to show that its reliance on the defective design was both reasonable and in good faith. To avoid responsibility and potential liability, the CMAR's pre-construction services contract should specifically identify the CMAR's role in the design process, limit or qualify its responsibility or control over the design, and identify who has the responsibilities as to the warranty of the adequacy of the design of the plans and specifications. Owners would like this risk to be shifted to the contractor, so if contractors and sureties are not willing to accept design responsibility, the contractor must closely review the contract and strike provisions attempting to do just that. The Contractor may also attempt to add provisions in the contract specifically placing the warranty of the plans and specifications as a responsibility of the owner.

IV. Project Delivery Methods Where Design is Delegated to the Constructor

Given the basic premise of Spearin where the Owner furnishes the design and requires the contractor to strictly adhere to the design documents, one might wonder how the courts address contracts where design is delegated to the contractor. This delegation can occur (and often does) even in DBB contract under "performance specifications." Performance specifications are specifications that direct the contractor to design and construct a component or product of work to meet certain goals or standards on quality and function.[19]

A. Performance Specifications

The basic rule for performance specifications is that the owner does not impliedly warrant the design, because the contractor is charged with furnishing the design for such work.[20] The key to this determination is whether the contractor is truly free to use its discretion and ingenuity in furnishing a design for the work. Where the contractor is constricted by significant owner requirements or

[19] / See, e.g., 3 BRUNER & O'CONNOR §9:87; *Aleutian Constructors v. U.S.*, 24 Cl. Ct. 372, 378, 37 Cont. Cas. Fed. (CCH) ¶76478 (Fed. Cir. 1993).
[20] / *See, PCL Constr. Servs. Inc. v. U.S.*, 47 Fed. Cl. 745 (2000); *Fru-Con Constr. Corp. v. U.S.*, 42 Fed. Cl. 94.

constraints, the contractor may be able demonstrate that the "performance specifications" are actually design specifications over which the contractor had no control over the ultimate design. Bruner & O'Connor summarize the doctrine in mixed performance and design specifications like this:

> For over 60 years, as between the owner and contractor, the party in "control" of the detailed design impliedly warrants to the noncontrolling party the adequacy of the design. The characterization of plans and specifications as "design" or "performance" is critical to the allocation of risk for inadequate or defective design under "design" specifications.[21]

This often leads to arguments between the contractor and owner as to which party was charged with control over the design of the system or component. For instance, in *PCL Constr. Servs. v. U.S.*, the court observed: "portions of PCL's contract at issue were performance specifications, or a mix of design and performance specifications, but not exclusively design specifications, which carry with them an implied actionable warranty."[22] Accordingly, careful scrutiny must be made to determine whether the implied warranty will be in-play when disputes over the work based on design occurs.

B. Design-Build

Unlike the traditional delivery method of DBB, the contractor in a design-build project is generally (in theory) responsible for both design and construction of the project for the owner based upon the owner's goals and parameters for the project.[23] Even in the truest form, the contractor will inevitably develop its design based upon some degree of owner-supplied information, such as design criteria, angering reports or conceptual drawings.[24] In most such instances, the contractor is responsible contractually for designing and constructing the work, and in such cases courts have found there is no implied warranty of the plans and specifications by the owner and "*Spearin* will be categorically unavailable to the design-build contractor."[25]

However, "design-build contracts are often quite lengthy and complex," and "do not lend themselves to rudimentary classifications.[26] One author noted:

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[21] / 3 BRUNER & O'CONNOR §9:88.
[22] / *PCL v. U.S.*, supra, 47 Fed. Cl. at 796.
[23] / See, e.g., Kishwaukee Comm. Health Servs. Ctr. V. Hospital Bldg. & Equip't Co., 638 F.Supp. 1492 (N.D. Ill. 1986);
[24] / See,
[25] See, Jason A. Lien and Justin Rose, 37 Construction Lawyer, No. 3 (Summer 2017), at 6.
[26] Lien and Rose, 37 Construction Lawyer, No. 3, at 9.

> [T]he liability question in the ever-expanding world of design-build contracts is a bit more nuanced … With careful contract drafting that properly utilizes performance specifications, design-build owners can drastically limit their own liability, rendering *Spearin* effectively null. [In particular,] [g]iven the high degree of control that an owner has in drafting the initial contract or RFP, prudently drafted design-build contracts that include only performance specifications, or that disclaim the owner's liability with sufficiently exacting language, may effectively nullify *Spearin.*[27]

Especially in the context of design-build, sometimes the contract may not be clear on design responsibility. This has led to a few contrasting decisions on relatively similar circumstances.

In *Fluor Intercontinental, Inc. v. Department of State,*[28] the Department of State ("USDS") issued a request for proposals on a fixed price design build contract for several buildings and a perimeter wall for an embassy complex in Kazakhstan. In the RFP, the USDS provided a set of design drawings and specifications that was to be adapted by the contractor. The RFP stated that the drawings were included for the sole purpose of illustrating the design intent of the owner. The USDS also provided a site utilization plan and an engineering feasibility study. The RFP, however, did require the contractor to perform its own engineering. The RFP contained a disclaimer that the contractor remained solely responsible and liable for design sufficiency and should not depend of reports provided by USDS as part of the contract documents. Additionally, the contractor was responsible for adapting the construction drawings based upon the unique conditions of the site and other local and regional factors, based upon analyses performed by the contractor.

The *Fluor* contract was for $63,057,022. During various design and construction review stages, Fluor provided documents to the USDS who had an opportunity to review them with technical representatives and provide comments to the contractor. Throughout the project, Fluor encountered various conditions at the site that it claimed caused additional costs and delays. Fluor sought more than $15 million in an additional compensation. The Civilian Board of Contract Appeals held that, in a design-build contract, the risk of developing a design, and the consequence of miscalculating the resources available for constructing the design, fell solely with Fluor. Fluor assumed the risk that its plan for construction would work and changes to the plan based upon the conditions at the project site were Fluor's own issues. The Fluor decision allowed the owner to avoid all responsibility because of its use of

[27] Lien & Rose, 37 Constr. Lawyer, No. 3, at 8-9.
[28] *Fluor Intercontinental, Inc. v. Dept. of State*, CBCA 490, et al. (Mar. 28, 2012)

the design-build delivery method, along with contractual disclaimers concerning information on which the contractor was entitled to rely.

On the other hand, in *Armour & Co. v. Scott*, 360 F.Supp. 319 (W.D. Pa. 1972), *aff'd*, 480 F.2d 611 (3d Cir. 1973), the court found that the owner's active and extensive involvement in the design of the electrical and mechanical systems negated any risk-shifting set forth in the performance specifications. Also, *in P.J. Dick, Inc. v. Gen'l Servs. Admin.*,[29] the contract started with a performance specification but during the submittal and review stage, the government required control joints in specific locations in concrete. Thus, the Board found that the government impliedly warranted the concrete's control joints would be sufficient to prevent extensive cracking.

A significant discussion of *Spearin* in the context of design-build contracts also occurs in the case of *White v. Edsall Construction Co.*, 296 F.3d 1081 (Fed. Cir. 2002). In *White v. Edsall*, the Army required the contractor to utilize a specific door design for a design-build helicopter storage facility as part of its contract requirements. The Army argued that the contract's disclaimer clearly and plainly requiring the contractor to "verify" the design before bidding, including verifying supports, attachments, and loads, which shifted the responsibility for the door design to the contractor. The Court held that the disclaimer was "general" in nature because it did not alert the contractor the actual door design may have had substantive flaws needing correction and approval. While the contractor bore the risk to check the accuracy of the physical details, the court found the language did not require the contractor to confirm the adequacy of the design. Thus, the court found the Army warranted the adequacy of the design and was responsible for the consequences of the design defect, and the general disclaimer did not obligate the contractor to analyze the design to determine whether it would work for its intended purpose.

In sum, while the general rule applicable to design-build contracts is that the owner provides no implied warranty of the design, which the contractor is furnishing as part of its obligation, the general rule has exceptions. The exceptions follow the control and role of the owner in the specific work which is the subject to the disputed deficiency. Further, in several decisions, clear and careful drafting may absolve the owner of *Spearin* liability even where the owner is not fully delegating design. The authors note that cases are relatively sparing in on this issue in the context of design-build contracts, and over

[29] / 1994 GSBCA LEXIS 207, GSBCA Nos. 11697, 12132, 94-3 BCA ¶26,981

time the authors expect the degree of control approach will dictate who bears responsibility for *Spearin's* implied warranty.

C. "Integrated" and Other "Alternative" Delivery Methods

In response to perceived "fragmentation" and poor productivity in the construction industry, a few owners have embraced "lean" concepts and collaborative agreements for construction known as "integrated project delivery,"[30] or "IPD." The main concept behind IPD is "to align the commercial interests of the major project participants and govern the delivery process as a collective enterprise."[31] The goal of the IPD agreement is to eliminate traditional focus on risk transfer, and instead emphasize the relational aspects of the team charged with delivering the project.[32]

The IPD agreement is

> a relational contract … [that is] signed by the architect, the construction manager/general contractor (CM/GC) and owner … describ[ing] how they [are] to relate throughout the life of the project. …[¶]
>
> The [IPD agreement] seeks to create a system of shared risk, with the goal of reducing overall project risk, rather than just shifting it. In part, this goal is supported by investing significant efforts in up-front collaboration, with the owner funding early involvement of the project team … The CM/GC is compensated on a cost-plus fee basis with either a guaranteed maximum price (GMP) or an estimated maximum price (EMP). An EMP operates as a pain and gain sharing threshold, but limits the potential losses to the IPD team at their collective profit, keeping with the owner the risk of more significant cost overruns. [¶]
>
> [Instead of] separate contingency amounts for design issues and construction issues[, t]he [IPD agreement] combines these contingencies into one IPD team contingency.[33]

The core group of team members sets criteria and decides how the project contingency will be shared, which IPD advocates contend enhances productivity, and reduces project duration, cost and injuries.[34]

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[30] / See, generally, 2 BRUNER & O'CONNOR ON CONSTRUCTION LAW §§6:18.10 – 6:18.90; R. Mauck, W. Lichtig, D. Christian and J. Darrington, *Integrated Project Delivery: Different Outcomes, Different Rules*, (2009 Victor O. Schinnerer & Company, Inc.), an unpublished paper originally presented at the McDonough Holland & Allen PC 48th Annual Meeting of Invited Attorneys, and presented at the 26th Annual Legal Retreat, 2009 Associated General Contractors of California – Legal Advisory Committee.

[31] / R. Mauck, W. Lichtig, D. Christian and J. Darrington, *Integrated Project Delivery: Different Outcomes, Different Rules*, supra note 107, at 5.

[32] / Id.

[33] / Id., at 14-15.

[34] / See, generally, 2 BRUNER & O'CONNOR ON CONSTRUCTION LAW §§6:18.10 – 6:18.90; R. Mauck, W. Lichtig, D. Christian and J. Darrington, *Integrated Project Delivery*, supra note 107; D. MacNeel, *The Truth About Lean Construction*, Constructor Magazine (2011, July/Aug) (AGC of America, McGraw Hill Construction).

IPD can be pursued through collaborative agreements, design assist agreements, or single purpose entities.[35] The process is still relatively new, and case law is relatively little.

In the context of integrated project delivery, one could posit that *Spearin* has no place. Yet, undoubtedly, even the most collaborative owners will – at times – exercise control over designs by insisting upon certain components and systems be included. In those instances, if the result anticipated is not achieved and the owner seeks to hold the contractor responsible for the defect, one would expect *Spearin's* implied warranty to apply.

V. Conclusion

Spearin and control are deeply intertwined, regardless of project delivery method. Conceptually, design-build and "collaborative" methods should not result in Spearin's application. But in those instances where the owner dictates or controls certain designs, the doctrine may apply. Thus, a careful analysis must be made into the facts of each situation, regardless of the delivery method.

[35] / See, e.g., AIA B195, A195 and A295; C195 and exhibits; B. Cooper, Managing Director, Gallagher Construction Services, San Francisco, *Insuring & Bonding Projects Using Integrated Project Delivery*, a presentation for AGC California in 2009.

SESSION 10

IMPACT OF THE ECONOMIC LOSS RULE

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PEARLMAN 2017

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Impact of the Economic Loss Rule

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PEARLMAN 2017

1. Introduction

The economic loss rule ("ELR") provides that a cause of action for negligence is not available when the only loss or damage is to the subject matter of the contract. It arises from the English common law opinion of *Hadley v. Baxendale* (1854) 9. Exch. 341 which distinguished tort from contract damages. In determining whether to apply the rule, the court assesses whether the cause of action is in contract or tort, and when the loss is only the economic loss to the subject matter or the contract itself, the action stands in contract alone. The ELR is a rule of contract law.

While the ELR developed as an offshoot of products liability law, its utility in the construction context is obvious. Construction work is performed pursuant to contracts. Construction claims involving construction failures, including defective workmanship, are prosecuted under various theories, including breach of contract, breach of warranty, and negligence. Again, where the defective workmanship is performed on the work contracted for under the construction contract, the possibility of an economic loss defense exists, particularly where no damage to third-party property has occurred.

In construction litigation, motions for summary judgment based on the economic loss rule are commonplace, and are sometimes granted, thus eliminating the negligence cause of action, a tort cause of action giving rise to more remote damages that are not recoverable under a breach of contract theory.

Therefore the *Spearin* doctrine, a contractor or surety would use the ELR to avoid liability for losses or damages outside of the contact itself, and as to the contract itself, shield itself from any liability due to the defects in the plans and specifications. A contractor or surety could use *Spearin* and the ELR to pursue third-parties.

2. ELR and *Spearin* as a Shield

The modern approach to *Spearin* assigns responsibility for a defective construction according to whether the specification prescribing the construction is a performance or a design specification. *PCL Constr. Servs., Inc., v. United States*, 47 Fed. Cl. 745 (2000). Because a contractor can invoke the *Spearin* doctrine only when it builds a system according to a design specification, it is important to understand the difference between the two. It is important for contractors to be able to spot performance specifications because of the increased risk the contactor assumes when building according to a performance standard.

Performance specifications set forth an objective or general standard that is supposed to be achieved, and the contractor is "expected to exercise his ingenuity in achieving that objective or standard of performance, selecting the means and assuming a corresponding for the selection. *Blake Constr. Co. v. United States*, 987 F.2d 743, 745 (Fed. Cir. 1993). Performance specifications specify the results to be obtained and leave it to the contractor to determine the best way to achieve the desired results. Therefore, the contractor not only warrants that the system will be constructed as planned, but also that it will perform as intended. The *Spearin* shield is probably not available, but invoking the ELR should be, and the damages limited to those available for breach of contract only.

Design specifications precisely state how the work is to be performed. Design specifications describe in detail the materials to be used and the manner in which the work is to be executed. There is no flexibility allowed to a contractor's approach and, as one court put it, the contractor is "required to follow [these specifications] as one would a road map." *Id.* The contractor does not warrant that the system will perform in any certain way.

The level of discretion that exists within a given specification is the key to courts' analysis of the difference between design and performance specifications. "Discretion serves as the touchstone for assessing the extent of implied warranty and intended liability." *Conner Bros. Constr. Co., Inc., v. United States*, 65 Fed. Cl. 657, 685 (2005). However, difficulties frequently emerge when determining whether a specification is a design or a performance, given that many specifications may combine elements of both.

A contractor that is claiming that a particular specification is design rather than performance must establish that the specification does not allow any kind of meaningful discretion in how the work is performed and, further, that the defective specification is the cause of the injury. *Id*. In other words, the contractor has to prove that he or she followed the design precisely and thoroughly and that any deviation was a result of the design itself, not the contractor's work product.

Identifying the use of a certain manufacturer or a product is not dispositive of whether a specification is design or performance, especially when a specification permits substitution of a product with an approved equal. Simply naming a specific product or manufacturer does not create a design specification in and of itself. *W.G. Yates & Sons Constr. Co. v. United States,* 53 Fed. Cl. 83 (Fed. Cl. 2002); *Fla. Bd. Of Regents v. Mycon Corp.,* 651 So. 2d 149 (Fla. Dist. Ct. App. 1995).

One way to determine whether a specification is a performance specification is to determine the "result to be obtained" from the work. For instance, if the work calls for all the windows in a building to be replaced and nothing further, then it is likely a performance specification. However, if the specification and plan call for certain windows to be replaced in a certain location of the building and for the replacement of the windows to be completed in accordance with a certain procedure and/or product, then the specification could be labeled a design specification. *A. G. Cullen Constr., Inc. v. State Sys. Of Higher Educ.,* 898 A.2d 1145 (Pa. Commw. Ct. 2006). The decree of discretion rather than specificity itself is what helps determine what the specifications designation is.

The aforementioned analysis cannot always protect a contractor in large, sophisticated projects. Owners may use disclaimers buried in the contract documents that deny all responsibility for the design. In *Kiska v. Washington* (2003) 321 F.2d 1151, a Washington D.C. Metro subway construction project was bid on by the plaintiff for a flat fee of $43,000,000.00. Unfortunately, a dewatering system designed by the owner was ineffective to reduce the water level for the *tunneling* needed, and a new, much more expensive one had to be used. Because the contact stated the contractor should be prepared to deal with the groundwater issues and additional wells (systems) may be needed, the Court of Appeal upheld the jury verdict that the plaintiff, contractor had assumed responsibility for any deficiencies in the dewatering system. *Kiska* sustained a big loss on the cost overruns.

Plaintiffs may attempt to circumvent the ELR and pursue tort damages based upon negligent misrepresentation. The California Supreme Court has held that the economic loss rule does not bar a parallel tort claim where (1) a defendant makes "affirmative misrepresentations on which a plaintiff "relies": and (2) those misrepresentations "expose a plaintiff to liability for personal damages independent of the plaintiff's economic loss." *Robinson Helicopter Co. v. Dana Corp.* (2004), 34 Cal.4th 979, 993. The guiding principle is that "[a] breach of contract remedy assumes that the parties to a contract can negotiate the risk of loss occasioned by a breach …[but] a party to a contract cannot rationally calculate the possibility that the other party will deliberately misrepresent terms critical to that contract." *Id*. at 992-93. 22 Cal.Rptr.3d 352, 102 P.3d 268.

To state a claim for negligent misrepresentation under California law, a plaintiff must allege: (1) misrepresentation of a past or existing material fact; (2) without reasonable ground for believing it to be true; (3) with intent to induce another's reliance on the fact misrepresented; (4) justifiable reliance on the misrepresentation; and (5) resulting damage. *Apollo Capital Fund, LLC v. Roth Capital Partners, LLC,* (2007) 158 Cal.App.4th 226, 243, 70 Cal.Rptr.3d 1999 (2007). "In contrast to fraud, negligent misrepresentation does not require knowledge of falsity." *Id.* Instead, "[a] person who makes false statements, honestly believing that they are true, may still be liable for

negligent misrepresentation if he or she has no reasonable grounds for such belief." *Id* (international quotations omitted). But negligent misrepresentations is still considered "a species of the tort of deceit." *Biley v Arthur Young & Co.,* (1992) 3 Cal.4th 370, 407; *see also* Cal. Civ. Code §1710(2).

This claim is not easy to plead and harder to prove. But it is available.

3. ELR and *Spearin* as a Sword

There will be instances where a contractor or his surety may wish to pursue third-parties for indemnity on losses sustained. Using *Spearin* to protect itself, the contractor and/or surety may attempt to pursue said third-parties on such tort and equitable claims. However, issues such as privity of contract arise that can be considerable obstacles.

An interesting case applying the economic loss rule in the construction context is *CBI NA-CON, Inc. v. UOP*, 961 S.W.2d 336 (Tex. App - 1997). In that case, UOP, an engineering firm entered into a contract with the owner Fina for the design of a fluid catalytic cracking unit for an oil refinery. Fina then entered into a contract with Chicago Bridge & Iron (CBI) to build the unit at Fina's facility. Fina filed suit against contractor CBI for negligence. CBI filed a third-party claim for contribution against UOP.

The court held that CBI could maintain a contribution claim against UOP only if they were both joint tortfeasors, so that the court was required to determine whether or not Fina could maintain a negligence action against UOP. In doing so, it applied the economic loss rule and found that the only damages being claimed by CBI were economic damages which were the subject matter of the contract between Fina and UOP. Therefore, Fina's only cause of action was in contract and not in tort. Finally, since CBI was not a party to that contract, it had no right to sue UOP for contribution under Texas law.

An exception to the economic loss rule exists where the conduct of the wrongdoer causes damage to property other than the subject matter of the work itself. That exception was applied by the court in *Thomson v. Espey Houston & Assoc., Inc.*, 899 S.W.2d 415 (Tex App - 1995). In that case, the court

upheld an apartment complex owner's cause of action for negligence against an engineer in the face of an ELR defense.

Unlike the typical construction relationship, the engineer had been hired by the contractor and *not* the owner, and as a result, the owner had no direct contractual relationship with the engineer. The engineer's negligence in designing the drain system and testing the soil quality were alleged to have caused damage to other parts of the apartment complex. This resulted in cracking walls, doors that would not fit properly, mildew standing water, shifting, and formation of water pools that blocked the street and spilled into adjacent property.

The court held that because of the defective design, there was damage to property *beyond* the subject matter of the contract so that a viable negligence cause of action was stated as to the property damage. At the same time, the court upheld the engineer's economic loss defense as applied to the owner's cause of action against the engineer for negligent approval of draw requests since it did not go beyond the subject matter of the contract to perform those services.

Another example of application of the ELR is *Alcan Aluminum Corp. v. BASF Corp.* 133 F. Supp. 2d 482 (N.D. Tex 2001). Alcan manufactured panels that were used for gas station fascia in sunrooms. Alcan sprayed foam urethane into its panels to create a rigid core. That foam was manufactured by BASF, and complaints were received after panels developed bubbles and deformed. As a result, Alcan sued BASF for the cost of making good on its warranties issued for the panels, including allegations of negligent misrepresentation and professional negligence.

The court ruled that the negligence claims were barred by the ELR, since Alcan did not suffer personal injury or property damage. Due to the fact that BASF's foam was only a component part of the entire panel, the court considered the issue of whether the claim involved damage to the other property as well to avoid the application of the economic loss rule. The court concluded that damage to a product as a whole caused by a defective

component assembled by the buyer constituted an economic loss, rather than damage to the other property, so that the negligence claims were barred.

4. ELR, *Spearin*, and Insurance Coverage Issues

Insurers will frequently state the position that once the ELR has eliminated the negligence cause of action, the insurer no longer owes a duty to defend and indemnify an insured contractor as to the remaining breach of contract cause of action. This position is sometimes based on the notion that a CGI policy provides coverage only for tort damages and not breach of contract. The ELR has even been offered up in support of the argument that damage to a project arising out of the insured contractor's defective work is an economic loss due to the applicability of the ELR.

In the case of a general contractor or homebuilder, an entire project may constitute the "subject matter" of the contract with the owner. Therefore, application of the ELR dictates that since damage to the subject matter of the contract is economic loss, and it cannot be property damage covered under the CGL policy.

It is obvious "physical injury to tangible property" can occur in a construction project which is the subject matter of the contract between the insured contractor and the owner. For example, consider a home that is subject to water infiltration due to defective installation of the windows and exterior cladding. Water infiltrates the home and causes damage to the interior finishes, rotting of the wooden structural members, and mold, requiring that the home be torn down and rebuilt.

Obviously, there has been "physical injury to tangible property," the home, but at the same time, that home is the subject matter of the contract between the homebuilder and the homeowner. At that point, there has clearly been an "occurrence" of "property damage" as those terms are defined in the policy, and to determine the scope of the insurance coverage for the loss, policy's property damage exclusions must be examined. If the homebuilder constructed the home through subcontractors, there is likely a considerable amount of insurance coverage available.

In *Jacob v. Russo Builders*, 592 N.W.2d 271 (1998), one court fitted the operation of the property damage exclusions into existing principles of law, including the ELR. There, the owners of a newly built home sued the general contractor, the masonry subcontractor, and the subcontractor's CGL insurer for damage arising out of the mason's failure to install the masonry with adequate mortar, resulting in massive leakage of water into the home.

The court denied coverage for the cost of replacing the masonry itself base on the exclusion in the insured mason's policy as to the completed operations hazard, denying coverage for work performed by the named insured arising out of the work or any portion of the work. Nevertheless, the court upheld coverage for relocation costs, temporary repairs, interior repairs, and loss of use and enjoyment of the home, none of which constituted work performed by the named insured. The court bolstered its conclusion with an ELR analysis, holding that the cost of replacing the masonry itself constituted economic loss flowing from the mason's breach of its subcontract, while the other damages constituted property damage and loss of use damages not barred under that rule.

The particular policy before the court in *Jacob v. Russo* fitted neatly into an ELR analysis since the insured was a masonry subcontractor. Thus, the named insured's work was limited to the masonry work performed and the policy did not exclude coverage for damage to the work of other trades. It is unclear what the court's analysis would have been had it been called on to apply the ELR rationale to the general contractor's coverage, including the exception for subcontractors' work. Under those circumstances, the court may well have impermissibly regarded the entire home as the subject matter of the contract and all damage to be an economic loss. As pointed out above, this type of analysis would appear to run contrary to the policy language.

This type of situation occurred in *Wausau Tile, Inc., v. County Concrete Corp.*, 593 N.W.2d 445 (1999). The manufacturer of concrete paving blocks brought an action against a cement supplier and an CGL insurer under theories of breach of warranty, breach of contract, negligence, indemnification, contribution, and strict liability arising out of the property damage and

personal injury caused by expansive pavers. The expansion was caused by a defective additive in the pavers.

The court held that the manufacturer's claim against the supplier was for purely economic loss since the manufacturer was not the real party-in-interest with respect to personal injury and property damage claims of purchasers of allegedly defective paving blocks. This ruling was based on the economic loss rule.

As to CGL coverage for the supplier, the court held that since the negligence and strict liability claims against the supplier were barred by the ELR, its insurer likewise had no duty to defend it against those claims. It should be noted that the court dealt with coverage under the supplier's CGL policy in a cursory fashion, stating that, "it is undisputed that the breach of contract or warranty is not a covered 'occurrence' under the Traveler's policy." *Id*. at 460.

Apparently, the parties stipulated that there was no occurrence resulting from the breach of contract or the issue was overlooked. For whatever reason, it was not argued by the insured that the focus should have been on the occurrence of property damage and personal injury, as defined in the policy, and not the label of the cause of action.

However, in *Commercial Union Ins. Co. v. Roxborough Village Joint Venture*, 944 F.Supp. 827 (D Colo. 1996), the court soundly rejected the economic loss analysis in that case. Pulte, the homebuilder, sued Roxborough, the developer, due to its negligent installation and maintenance of utilities and misrepresentation and concealment of conditions making the land unsuitable for construction. Roxborough raised the ELR as a defense to Pulte's claim. In refusing to apply the ELR, the court held that while the rule prevents recovery in tort where the duty breached is a contractual duty and the harm incurred is the failure of the purpose of the contract, the rule is not absolute, and its application is limited to cases involving economic loss only. As to the allegations of Pulte against Roxborough, the court held that the claims involved allegations of intentional misconduct on the part of Roxborough and breaches of duties of care independent of contractual obligations. Therefore, the ELR did not apply.

As far as the reliance by Commercial Union, the insurer, on the ELR, the court stated as follows:

> I find the use of rule in the insurance context troublesome generally and specifically questions its applicability in this case. As an initial matter, Commercial Union's argument that it owed Roxborough no indemnification duty under the Policies because Pulte's claims against Roxborough settled sounded in contract, rather than tort, is a novel one.
>
> Commerical Union cites no case in which an insurer invoked the rule in this manner and I find no reasoned basis for doing so.

The court added as follows:

> In essence, Commercial Union argues application of the ELR to "protect" the contractual relationship between Pulte and Roxborough. Citing *Adventure*, Commercial Union argues that a characterization of Pulte's claims in the underlying case as sounding in tort will "undermine" the Pulte-Roxborough relationship and "frustrate" the ability of commercial entities like them to allocate the risk of pecuniary loss [Citation to Pulte's brief omitted.] Commercial Union's use of the ELR in this manner is strained and self-serving.

As the Roxborough court observed, the applicability of an economic loss rule analysis to coverage under a CGL policy for defective work impermissibly mixes liability and coverage concepts. Quite predictably, this "strained and self-serving analysis" invites the parties, and the courts, to ignore the remainder of the policy, i.e., the property damage exclusions, where the complete coverage analysis is intended to be played out. That analysis may result in potential coverage for property damage arising out of defective work.

5. Conclusion

The ELR and the *Spearin doctrine* are very much alive and well in both federal and state courts. The contractor and the surety as defendants should always raise the *Spearin* doctrine and the ELR as defenses, first to absolve the contractor of any liability outside of not following the plans and designs of third-party entities such as the owners or design professionals, and then to limit any damages to those in contact and not in tort. The contractor and the surety can then use the *Spearin* doctrine to pursue those third-parties whose negligent design or other conduct caused economic losses to said contractor. As a practical matter, the tort of negligent misrepresentation will probably not be allowed to supplement the ELR when either (1) the parties are in privity of contract with each other or (2) the remedies for the consequences of another party's failure of contractual performance are governed by the parties' own contracts with the owner. Finally, the contractor/surety should always try to be creative in invoking coverage from an underlying CGL insurance carrier for the contractor by asserting that an act or occurrence may have occurred that caused actual physical damage to a third-party.

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SESSION 11

CHANGES IN DISCOVERY RULES: THE INSURERS' ROLES & RESPONSIBILITIES

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The Insurers' Roles & Responsibilities

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Discovery is the bane of modern federal litigation.

- Judge Posner, *Rosetto v. Pabst Brewing Co.*, 217 F.3d 539 (7th Cir. 2000).

I. Discovery Wars

Discovery gone wrong is the kryptonite to a legal action. Unfortunately, few lawyers do discovery right. Poorly managed discovery drives up costs, wastes time, and can drive litigants, lawyers, and judges mad. Discovery fights slowdown or stop litigation, and lead to (otherwise avoidable) judicial intervention. With the proliferation of electronic documents and the evolution of the discovery rules, sanctions and judicial reprimands are on the rise. But with the right strategies, common pitfalls can be avoided, costs can be kept reasonable, and we can move toward the ideal of doing discovery right. For instance, one such strategy is the use of computer-assisted review. This is often referred to as predictive coding or technology assisted review. Courts have begun to acknowledge "[p]redictive coding has emerged as a far more accurate means of producing responsive ESI in discovery." *Progressive Cas. Ins. Co. v. Delaney*, 2014 WL 3563467 at * 8 (D. Nev. July 18, 2014). "Studies show it is far more accurate than human review or keyword searches, which have their own limitations." *Id.*

The goal of discovery is to seek the truth, so that disputes may be decided by what facts reveal, not by what facts are concealed. By encouraging full discovery of issues and facts before trial, parties are able to assess their respective positions, thereby facilitating settlement of disputes. *Nancarrow v. Whitmer*, 463 S.W.3d 243 (Tex. App.—Waco 2015). The Federal Rules of Civil Procedure (and most state rules) have been revised and modernized to meet this mission.

This modernization of the rules is relatively recent. Despite several updates, the Federal Rules of Civil Procedure (FRCP) remained largely limited to paper until 2006. Evidence, on the other hand, had gone electronic and onto hand drives of computers and handheld devices. To synchronize the legal system to the realities of the digital age, electronic discovery (e-discovery) amendments to the FRCP were enacted on December 1, 2006. Put simply, changes to the FRCP mean that almost all discovery now involves e-discovery.

A year later, the FRCP were completely rewritten, under the leadership of *Legal Writing in Plain English* author Bryan Garner, for the avowed purpose of making them easier to understand. Confusion continued, and another revision to the rules went into effect December 1, 2015. Rule #1 now makes explicit what was perhaps previously implicit: all parties – not just the judge – must secure the just, speedy, and inexpensive determination of every action and proceeding. FED.R.CIV.P. 1. To achieve this goal, discovery must be "proportional" to the needs of the case. FED.R.CIV.P. 26. Objections to discovery must be specific and transparent (no more avoiding discovery with obscure objections), and documents must be produced at a specific time (not simply that they will be made available sometime in the future) FED.R.CIV.P. 34.
Three additional changes meant to speed up litigation include:

1. Service of process must now occur within 90 days instead of 120 days (Rule 4);

2. The judge issues a scheduling order within 90 days instead of 120 days (Rule 16); and

3. A litigant can now deliver document requests before the initial meeting (Rule 26).

All of these amendments are aimed at doing discovery right, by minimizing potentially exorbitant costs of e-discovery; removing methods of discovery misuse and abuse; and guiding litigants in properly obtaining evidence. If the rules are read and put into practice, payment bond claims that appeared unsettleable can become settleable.

II. Technology Assisted Review (TAR): The Superior Tool for Voluminous ESI

In conjunction with the newly explicit requirements of Rule 1, technology-assisted review (TAR), also known as predictive coding or computer-assisted review, is a new tool in the mission to make responding to discovery requests more efficient and accurate. When responding to requests for document production, parties can often find themselves spending an immense amount of time (and money) manually sorting through titanic volumes of information to identify responsive documents. In cases requiring review of large repositories of ESI, technology provides a more efficient, accurate, and legally acceptable way of carrying out this process. *See Tinto v. Vale*, 306 F.R.D. 125, 127 (S.D.N.Y. 2015).

Faster, Cheaper, and More Accurate

Rather than billing clients for associates and law clerks to spend hundreds of hours manually sifting through mountains of documents, TAR enables a computer to take care of this work in a fraction of the time (at a fraction of the cost). TAR involves analysis by both

people and technology. *Moore v. Publicis Groupe*, 287 F.R.D. 182, 189 (S.D.N.Y. 2012). The process initially requires manual review of a relatively small sample of the total ESI search pool. These documents then serve as a seed set that informs the computer's algorithm. Essentially, the computer learns what to look for during its portion of the review by analyzing the seed set. Moreover, as the computer reviews the rest of the ESI, attorneys periodically evaluate the computer's results, which in turn further refines the TAR algorithm. The end result is a demonstrated cost savings that often amounts to the cost of TAR equaling only 2% of exhaustive manual review costs in similar circumstances. *Id.* (citing the Text Retrieval Conference study by Maura R. Grossman and Gordon V. Cormack, published in 2011). Thus, the responding party can often produce TAR results that satisfy a production request in less time and at less expense than manual review.

In addition to relieving parties from the potentially crushing expense of manual review, TAR is also at least as accurate, if not more so, in identifying responsive ESI. *Moore*, 287 F.R.D. at 190 (pointing to a 2010 empirical study by Herbert L. Roitblatt, et al., showing computer categorization of documents to be at least as accurate as manual review). This fact has apparently impressed TAR's utility upon the courts. While some lawyers continue to mistakenly believe that exhaustive manual review is the gold standard, several courts recognize that TAR is gaining acceptance and even being promoted as the more accurate method of ESI review. *Tinto*, 306 F.R.D. at 127; *Malone v. Kantner Ingredients, Inc.*, No. 4:12CV3190, 2015 WL 1470334, *3 n. 7 (D. Neb. Mar. 31, 2015).

Add to this the fact that the process includes periodic quality assurance checks to improve the accuracy of the results, and it is evident that, compared with other methods, TAR is faster, cheaper, and more accurate in conducting review for responsive ESI. In short, TAR is *better* than the alternative options for ESI review. *Moore*, F.R.D. at 192; *Hyles*, 2016 WL 4077114, at *2; *see Duffy v. Lawrence Mem'l Hosp.*, No. 2:14-cv-2256-SAC-TJJ, 2017 WL 1277808, at *3 (D. Kan. Mar. 3, 2017). Thus, although some erroneously believe exhaustive manual review to be the preeminent method for production review, TAR has demonstrated that it is—as courts have so recognized—the superior method for conducting voluminous ESI review.

Limitations: Practical Incompatibilities and the Responding Party's Discretion

TAR is an excellent tool for discovery involving large amounts of ESI, but it is not without limitations. Some practical limits of TAR derive from limitations inherent in the underlying technology. While TAR is very useful for reviewing searchable text-based documents, it is not proficient for searching through image, video, or audio files, nor for reviewing files that are mostly made up of numbers (e.g., spreadsheets). Similarly, where the number of documents in the review pool is relatively small, it is often more cost effective to

conduct manual review or use another method that requires less effort to set up. Also, the costs of motion practice will increase where the parties cannot agree on specific TAR protocols.

Moreover, TAR is an option that *may* be implemented at the discretion of the responding party and cannot be compelled by the party making the discovery request. This is premised on the idea that the responding party is considered to be in the best position to determine how to search for and produce responsive documents. *See In re Viagra Prods. Liab. Litig.*, No. 16-md-02691-RS (SK), 2016 WL 7336411, at *1 (N.D. Cal. Oct. 14, 2016). Thus, even in circumstances where TAR is cheaper, more efficient, and superior to other review techniques, courts will not grant a requesting party's motion to compel a responding party's use of TAR when the latter would prefer to use another legally acceptable method of document review. *Hyles v. New York City*, No. 10 Civ. 3119 (AT)(AJP), 2016 WL 4077114, at *1 (S.D.N.Y. Aug. 1, 2016); *Tinto*, 306 F.R.D. at 127 n. 1 (S.D.N.Y. 2015); Dynamo Holdings LP v. Comm'r of Internal Revenue, 143 T.C. 183, 188–189 (2014); *see also Webb v. Exxon Mobil Corp.*, 856 F.3d 1150, 1160 (8th Cir. 2017) (failing to overturn the lower court's denial of the requesting party's motion to compel the responding to use TAR). However, there is at least some judicial speculation that this rule may change at some point in the future. "There may come a time when TAR is so widely used that it might be unreasonable for a party to decline to use TAR. We are not there yet." *Hyles*, 2016 WL 4077114, at *4. Accordingly, arguments for compulsion will likely persist and may one day even prove successful.

III. Proportionality: The New Defensive Weapon

Lawyers spend a great deal of their time shoveling smoke.

- Justice Oliver Wendell Holmes, Jr.

There is a scene in the hit AMC show *Better Call Saul* where white-shoe lawyers bully their not-so-wealthy litigation opponents with boxes and boxes of discovery requests. Saul Goodman, the frustrated sole practitioner, remarks that this abusive discovery tactic will make litigation too expensive for his clients, each of whom has a relatively small claim.

Unfortunately, this driving-up-the-costs strategy has been employed in innumerable real cases. Generations of lawyers have labored under the misimpression that the scope of discovery is so broad that anything "reasonably calculated to lead the discovery of admissible evidence" is fair game – regardless of costs, and regardless of the size of the discovery in relation to the dollar amount of the case. This led to a widespread problem of litigation and discovery costs substantially exceeding the value of the case.

Overview of New Rule 26(b)(1): Adding Proportionality, Ending "Reasonably Calculated"

In order to limit ever-increasing discovery costs, the Advisory Committee made wholesale changes to Rule 26(b)(1), which defines the scope of discovery. The new Rule 26(b)(1) limits discovery to that which is "proportional to the needs of the case," and provides five illustrative factors for courts to consider:

1. the amount in controversy;
2. the parties' relative access to relevant information;
3. the parties' resources;
4. the importance of the discovery in resolving the issues; and
5. whether the burden or expense of the proposed discovery outweighs its likely benefit.
6.

FED.R.CIV.P. 26(b)(1) (2015).

Proportionality determinations are to be made on a case-by-case basis using the above listed factors, and "no single factor is designed to outweigh the other factors in determining whether the discovery sought is proportional." *Bell v. Reading Hosp*., 2016 WL 162991, *2 (E.D. Pa. 2016).

Another notable change to Rule 26(b)(1) is to eliminate the phrase "reasonably calculated to lead to the discovery of admissible evidence." The Rules Committee tried without success to revise that sentence in previous proposed amendments, and has written committee notes making clear that it does not establish a bedrock definition for the scope of discovery. Nevertheless, many practitioners and courts stick to the notion that a litigant can obtain discovery of virtually anything that's "reasonably calculated" to lead to something helpful in the case. Accordingly, the Advisory Committee eliminated this language in order to emphasize that discovery should not be permitted beyond the defined scope. *April 10-11, 2014 Report of Advisory Civil Rules*, pgs. 86-8. This amendment bolsters the "proportionality" requirement of permissible discovery.

What is disproportionate?

The late venerable Professor Arthur Miller, reporting to a committee in 1983, described disproportionate discovery with this example:

In a $10,000 damage case, spending $50,000 on discovery is disproportionate.

Arthur R. Miller, FED. JUDICIAL CTR., AUGUST 1983 AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE: PROMOTING EFFECTIVE CASE MANAGEMENT AND LAWYER RESPONSIBILITY 32 (1984). Miller's discovery-cost hypothetical is closely in line with the average costs incurred in federal cases – an estimated $35,000.

For every federal case in which any type of discovery is involved, estimated average costs incurred for discovery exceed $35,000 (http://logikcull.com/blog/estimating-the-total-cost-of-u-s-ediscovery/). This figure includes both civil and criminal cases. In criminal

cases, discovery costs are, on average, 1/10th as expensive as civil cases. Therefore, it is safe to estimate the average discovery costs in federal cases to exceed the $50,000 hypothetical posed by Miller.

Thus, if civil litigants in federal court find themselves fighting over $10,000, but anticipate an "average" amount of discovery costs, the issue of disproportionality should be explored, including a careful analysis of the five factors in Rule 26(b).

How are proportionality concerns raised? Who has the burden of proof?

Until late last year, there were few weapons a litigant could use to shield off disproportionate discovery. But now, the responding party can bring into issue the proportionality of the discovery, and it is likely a judge today would agree with Professor Miller: if the discovery costs will substantially exceed the amount in controversy, then the discovery request is impermissible, as it is outside the scope of permissible discovery (given the proportionality test).

The new proportionality rules have been enforced by federal courts, thereby limiting the scope of discovery requests. *Griffith v. Landry's*, 2016 WL 2961528 (M.D. Fla. May 23, 2016). Under the new scheme, proportionality is not a limit; rather, it defines the scope of what is permissible under the Rules. For instance, in *In re Bard IVC Filters*, patients brought a products liability action against Bard, a medical device manufacturer. *In re Bard IVC Filters Prods. Liab. Litig.,* 317 F.R.D. 562, 563 (D. Ariz. 2016). The patients sought discovery of ESI held by Bard's foreign subsidiaries regarding communications with foreign regulators. *Id*. Following the relevancy analysis, the court turned to determine proportionality by addressing two of several factors: (1) the importance of the discovery in resolving the issues; and (2) relative access to the relevant information. *Id.* at 566. The Defendants argued the burden and expense of the proposed discovery greatly outweighed the benefit because Bard had entities in 18 different countries. *Id*. The plaintiffs sought communications between each of these entities and their respective foreign regulatory authorities over the last 13 years. *Id*. The court was not persuaded such an expansive request was proportional to the needs of the case and concluded the Defendants need not search the ESI of foreign Bard entities for communications with foreign regulators. *Id*.

The question of who has which burdens of proof on the issue of proportionality remains a point of contention amongst scholars. Hon. Craig B. Shaffer, *The "Burdens" of Applying Proportionality*, 16 Sedona Conf. J. 55 (2012). Even though the proportionality requirement is meant to impose "collective responsibility [on the court and the parties] to consider the proportionality of all discovery," the early trend in the courts appears to be placing the burden on the responding party to explain why a discovery request is outside the scope of the Rules. *In re Bard*, at 564. The amendments were not intended to permit the

opposing party to refuse discovery simply by making a boilerplate objection that it is "not proportional." FED. R. CIV. P. 26 Adv. Comm. Note to 2015 Amendment. Instead, the responding party must demonstrate why the discovery requests are disproportional when taking into account some or all of the factors enumerated in Rule 26(b)(1) (i.e. the amount in controversy; the parties' relative access to relevant information; the parties' resources; the importance of the discovery in resolving the issues; and whether the burden or expense of the proposed discovery outweighs its likely benefit.).

Thus, Judge Horan of the Northern District of Texas recently put the burden on the responding party to demonstrate disproportionality, i.e. that the requested discovery does not fall within Rule 26(b)(1)'s scope of proper discovery. *Carr v. State Farm Mutual Automobile Ins. Co.*, 312 F.R.D. 459, 464-66 (N.D. Tex. 2015). Likewise, a Special Master (appointed by the court to help resolve discovery disputes during complex litigation) determined that Boeing's proportionality objections were without merit where Boeing emphasized the burden of discovery "but failed to demonstrate how such a burden deviates from the proportionality required by Rule 26(b)(1)." *Ala. Aircraft Indus. v. Boeing Co.*, 2016 WL 562916, *3 (N.D. Ala. 2016), *accepted and adopted*, 2016 WL 557253, *1 (N.D. Ala. 2016). If Boeing had attempted to demonstrate why the discovery requests were disproportionate, it may have had a difficult time meeting the "amount in controversy" factor, as AAI is suing Boeing for over $100 million. Nevertheless, as discussed above, the dollar amount of the case is only one of the five "proportionality" factors. And, as no single factor is designed to outweigh the other factors, Boeing – had it done more than make a blanket objection – would have had the opportunity to convince the court that some or all of the other four factors demonstrate disproportionality.

Therefore, in seeking a motion for protective order against seemingly disproportionate discovery, the party resisting discovery will likely have the burden of proving disproportionality, using the five factors in Rule 26(b)(1). Nevertheless, the requesting party should be able to explain the ways in which the underlying information bears on the issues as that party understands them. Although the resisting party will likely have the burden of proof, the requesting party must still comply with Rule 26(b)(1)'s proportionality limits on discovery requests; is subject to Rule 26(g)(1)'s certification requirement (e.g. the discovery request is not being used for an improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation); and faces Rule 26(g)(3) sanctions if a certification violates the rule without substantial justification. *Heller v. City of Dallas*, 303 F.R.D. 466, 475–77, 493–95 (N.D.Tex.2014).

Putting proportionality into practice.

This new mindset means closer cooperation with opposing counsel and taking advantage of the increasing willingness of the federal courts post-amendment to engage early on discovery issues. "[T]he revised rule places a shared responsibility on all the parties to consider the factors bearing on proportionality before propounding discovery requests, issuing responses and objections, or raising discovery disputes before the courts." *Salazar v. McDonald's Corp.*, No. 14-CV-02096-RS (MEJ), 2016 WL 736213, at *2 (N.D. Cal. Feb. 25, 2016). Frank conversations with opposing counsel about the discovery sought and burdens of providing it can inspire creative solutions that benefit both sides. The ability of the court to keep discovery focused through discovery conferences and pre-motion hearings also adds tremendous value. *See Siriano v. Goodman Mfg. Co., L.P.*, No. 2:14-CV-1131, 2015 WL 8259548, at *5 (S.D. Ohio Dec. 9, 2015) (directing the parties "to engage in further cooperative dialogue in an effort to come to an agreement regarding proportional discovery" and scheduling discovery conference to discuss phased discovery). The 2015 amendment, after all, obligates all of the parties to consider the proportionality factors in making discovery requests, responses, or objections. *Dao v. Liberty Life Assurance Co. of Boston,* 2016 WL 796095, at *3 (N.D.Cal.2016).

While it is still too early to tell which directions courts will head in as to the various issues the stem from the proportionality rule, a handful of cases have suggested that the amended Rule 26(b) narrows the scope of discovery, in part to address the "explosion of information that has been exacerbated by the advent of e-discovery." *XTO Energy v. ATD, LLC*, 2016 WL 1730171, *17 (D. N.M. 2016). Another decision has similarly referred to "Rule 26(b)(1)'s narrowing of the scope of discovery." *Davita HealthCare Partners, Inc. v. United States*, 125 Fed.Cl. 394, 398 n. 3 (2016). Other courts, however, view the 2015 amendments not as creating new standards, but rather as a means to exhort judges to exercise their preexisting control over discovery more exactingly. *Robertson v. People Magazine*, 2015 WL 9077111, *2 (S.D.N.Y. 2015). Accordingly, litigants should remain up-to-date with proportionality case decisions in their jurisdiction to determine whether any courts are interpreting the Rule amendments as narrowing the scope of permissible discovery.

Proportionality is still a very new concept, by understanding the rule and how it is to be enforced, parties have a new defensive weapon to overbroad, overly burdensome, and disproportionate discovery requests. The increased prominence given to the concept of proportionality and the new mindset this fosters has the potential to greatly streamline the discovery process. By focusing on proportionality issues at the outset of litigation, being prepared to make specific and supportable objections, cooperating with opposing counsel, and making use of the courts, defense counsel can make the most of this potential.

IV. Requests for Production and the New Ban on Boilerplate Objections

Requests for production are primarily governed by Federal Rule of Civil Procedure 34, and are subject to related Rules, including the new proportionality rule, as discussed above. A party may generally serve on any other party a request to produce documents, including electronically stored information. The request must describe with reasonable particularity each item or category of items to be inspected; must specify a reasonable time, place, and manner for the inspection and related acts; and may specify the form in which electronically stored information is to be produced. FED.R.CIV.P. 34 (a)-(b).

The responding party generally has 30 days to respond, and must produce the documents or things within the time specified in the request or another reasonable time specified in the response. *Id.* at (b)(2). The recent amendments emphasize that any objections to discovery must be specific and transparent (not boilerplate or made without elaboration), and the responding party has the duty to specify the exact time it will produce the documents. FED.R.CIV.P. 34. The Rules do, however, permit rolling production, provided that the responding party specifies reasonable start and end dates in its written response. The responding party must also say whether documents are actually being withheld based on objections.

In a suit over an intra-family dispute regarding the management of a joint venture, one court determined plaintiff's responses to defendant's Requests for Production were "deficient." *NOA, LLC v. Khoury*, 2016 WL 4444770 at *1 (E.D.N.C. Aug. 23, 2016). The plaintiff's answered a number of requests with the following phrase: "'[a]ny and all documents in the possession, custody or control of the Plaintiff/Counter-Defendant that is responsive to this Request will be made available for inspection and/or copying at a mutually agreed date and time.'" *Id.* at *5. The court determined this was a "boiler-plate response" which "lacked [] the substance required by Rule 34." *Id.* The crux of the issue with this response was that plaintiff offered no "specific time, place, and manner" thereby providing an incomplete answer. *Id*. at *6. The court awarded monetary sanctions as punishment for the boilerplate responses. *Id.*

As stated in the rule, the documents must be produced in the requested format, or if a request does not specify a form for producing ESI, a party must produce it in one of two ways:

1. in a form or forms in which it is ordinarily maintained; or
2. in a reasonably usable form or forms.
3.

Id. at (b)(2)(E). There have been numerous discovery fights over form of production, including what constitutes "reasonably usable."

For example, the issue in *Johnson v. RLI Insurance*, was "whether the documents that have been produced by RLI in paper or .pdf format satisfied Federal Rule of Civil Procedure 34(b)(2)(E)'s requirements that electronically stored information be produced 'as they are kept in the usual course of business' and 'in a form or forms in which [the information] is ordinarily maintained or in a reasonably usable form or forms.'" *Johnson v. RLI Ins. Co*., 2015 WL 5125639 *4 (D. Alaska Aug. 31, 2015). The plaintiff sought to have responsive documents provided in native format with accompanying metadata. *Id*. The defendant asserted, "the documents in paper or .pdf form that it had [] already provided were [] reasonably usable and no further production should [have been] required." *Id*. After an extensive analysis on persuasive authority, the advisory committee note to Rule 34(b), and the Sedona Conference, the court determined the following as key factors to consider: (1) what metadata is ordinarily maintained; (2) the relevance of the metadata; (3) the importance of reasonably accessible metadata to facilitating the parties' review, production, and use of the information; (4) whether there was a showing additional facts of real value would be found within the metadata; and (5) whether the volume of produced data was so large that metadata was necessary to manage the production of the documents. *Id.* Ultimately, the court determined requests for documents from 2005 to present, over 3,690 insurance policy claim files, and the unreasonable burden of navigating applicable privileges and statutory protections of such documents outweighed relevant information that might be derived from the metadata responses to these discovery requests. *Id,* at *6. The court therefore refused to compel RLI to respond to Johnson's requests for production for metadata and held the paper or .pdf formats already produced sufficed. *Id.*

Although e-discovery scholars' opinions on form of production vary, it is widely recommended that, in general, requesting parties should specify that production shall be in "native format." "Native format' refers to the file format which the application (e.g. Outlook) works with during creation, edition, or publication of a file. In other words, e-mail files should generally be produced in their original format, not in PDF, TIFF, or printed on paper and shipped in Bankers' Boxes. Courts have recently reaffirmed that producing e-mails in PDF form generally does not comply with the revised Federal Rules of Civil Procedure. *Mitchell v. Reliable Security*, 2016 WL 3093040 (N.D. Ga. 2016). Receiving native format ESI generally helps keep costs down, can be fundamental in efficiently and effectively reviewing documents, and contains more details (e.g. metadata) than flat files, such as paper. Subject to any relevant ethical rules, viewing the metadata of discovery received may unveil spoliation (i.e. showing a document was altered), may provide leads to other potentially important witnesses (e.g. comments to a Word Document made by a third party), and could provide other helpful evidence in developing your theory of the case.

V. Depositions

Depositions in federal court are generally governed by Rule 30. A party may depose any person (generally without needing prior approval of the court), including a party witness, a non-party witness, or a corporate representative of a party. Court approval is generally needed when the deposition would result in more than 10 depositions being taken by any side in the case; when the deponent has already been deposed; or when the party is seeking to take a deposition before the time specific in Rule 26(d). A party who wants to depose a person by oral questions must give reasonable written notice to every other party. The notice must state the time and place of the deposition and, if known, the deponent's name and address.

In 1970, Rule 30(b)(6) was added, for the primary purpose of ending the practice of "bandying," whereby organizations would produce deposition witness after deposition witness, each disclaiming knowledge of facts that, obviously, someone in the organization had to know. Fed.R.Civ.P. 30(b)(6) *advisory committee's notes, subdivision b* (1970).

30(b)(6) depositions, known as "corporate representative depositions," can be a very powerful tool when the opposing party is a corporation. 30(b)(6) depositions require the corporate-party to designate a representative or a group of representatives to testify about information "known or reasonably available to the organization." FED.R.CIV.P. 30(b)(6). Compare the 30(b)(6) requirement of the corporate representative to affirmatively acquire the knowledge of the corporation with the general rule of regular fact witnesses, who are not obligated to do anything to prepare for the deposition. In fact, it would probably not be much of a stretch to say that many litigators prepare their clients, if they are being deposed in an individual capacity, to get comfortable with the Holy Trinity of deposition responses: "Yes – no – I don't know."

Rule 30(b)(6) does not permit such tactics. Instead, an organization must prepare and produce a witness knowledgeable about the issues in the case (as set forth in the corporate representative deposition notice), regardless of how little knowledge the corporate representative has in her individual capacity. In short, the corporate representative must do her homework before the deposition, must investigate what the corporation knows and has reasonable access to knowing, and must be well-prepared to thoroughly answer questions related to the topics set forth in the deposition notice.

The corporation representative can be almost anyone. Pursuant to the Rule, the noticed corporation must provide "one or more" officers, directors, agents, employees, or "other persons" (which may include former employees, experts, etc.) who consent to testify on its behalf in response to matters known or reasonably available to the corporation. Once selected, such corporate representative(s) shall be designated as to each area of inquiry via written response to the 30(b)(6) notice.

VI. Spoliation

Spoliation of evidence happens when a document or information that is required for discovery is destroyed or altered significantly. If a person negligently or intentionally withholds or destroys potentially relevant information, that party may be liable for sanctions for such misconduct. Importantly, the duty to preserve potentially relevant evidence is generally triggered as soon as litigation is "reasonably anticipated" (which is often before a lawsuit is filed). *Micron Tech., Inc. v. Rambus Inc.*, 645 F.3d 1311, 1320 (Fed. Cir. 2011).

The consequences for spoliation have historically been widely variable. In jurisdictions where the intentional act of altering or destroying evidence is criminal by statute, it may result in fines and incarceration. In some jurisdictions, courts have held that proceedings possibly altered by spoliation warrant a "spoliation inference" – the fact-finder can infer that the lost or altered evidence would have been beneficial to the non-spoliating party.

The use of a spoliation inference may be warranted depending on the circumstances, but not all cases of spoliation warrant this serious response by the court. In a 2013 case before the Texas Supreme Court named *Brookshire Brothers Ltd. v. Aldridge*, a man named Jerry Aldridge went into one of Brookshire Brothers' supermarkets, and after a few minutes in the store, slipped and fell. He went to a doctor approximately 90 minutes later, and returned to the store five days after the accident to complain of back injuries caused by the fall. The supermarket chain's security department only kept what it felt was the relevant part of that store's surveillance video consisting of just before to a few minutes after Mr. Aldridge slipped and fell. When he first filed suit against Brookshire Brothers without an attorney, Mr. Aldridge was able to get video evidence consisting of the 30 seconds before he slipped and fell, plus the next seven minutes. He attempted to obtain more of the store's video surveillance footage, but was refused. When he hired an attorney, the attorney was also unable to obtain footage from before or after the event (which might have been useful to prove negligence based on how long the spill was on the floor, or on the seriousness of Mr. Aldridge's injury). The store's surveillance system automatically writes over previously recorded video after 30 days, unless saved separately. Brookshire Brothers did not keep any additional footage from before or after the accident. The trial court judge found that the store's refusal to provide the additional video footage constituted spoliation, and gave the jury a "spoliation inference instruction". The jury was instructed that they may find the failure by the store to retain (and subsequently provide to the other party) the additional footage may be considered an attempt to hide evidence that Brookshire Brothers' management knew would be damaging to their case. The jury returned a verdict for Mr. Aldridge in excess of $1 million. The Texas Twelfth District Court of Appeals upheld the verdict and the spoliation inference instruction. The Texas Supreme Court reversed, order-

ing a new trial, stating that it was abuse of discretion by the trial court to issue a spoliation inference instruction in this case, that the court should have imposed a different corrective measure on Brookshire Brothers (a less severe sanction), and that a spoliation inference instruction to the jury is only warranted in egregious cases of destruction of relevant evidence.

Until late last year, the consequences of spoliation under the federal rules were widely variable, due in part to lack of express guidance on remedies for spoliation and the wide discretion afforded to district court judges. Before the 2015 revisions, Rule 37(e) afforded a "safe harbor" for "failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." The Discovery Subcommittee reviewed the cases discussing Rule 37(e), however, and found that it has had very limited impact.

As recently revised, Rule 37(e) now explicitly defines when spoliation has occurred and what remedies a court may order to correct it. The rule lists three requirements for spoliation: (1) the "electronically stored information" at issue "should have been preserved in the anticipation or conduct of litigation"; (2) that information "is lost because a party failed to take reasonable steps to preserve it" and (3) "it cannot be restored or replaced through additional discovery." If these requirements are satisfied, and if another party is prejudiced by the loss, under Rule 37(e)(1) the court "may order measures no greater than necessary to cure the prejudice." Prejudice was proven in *Sec. Alarm Fin. Enterprises, L.P. v. Alarm Prot. Tech., LLC*, when two home security companies were engaged in a suit regarding the illegal poachment of customers and alleged defaming. *Sec. Alarm Fin. Enterprises, L.P. v. Alarm Prot. Tech., LLC,* 2016 WL 7115911 at *1 (D. Alaska Dec. 6, 2016). The plaintiff had recorded a number of calls to its call centers. *Id.* The defendant sought discovery of those calls but it became apparent the recordings had been overwritten pursuant to the plaintiff's database overwriting process. *Id.* Notably, the plaintiff preserved "only a select few recordings that appeared [] to bolster its own case." *Id.* at *6. Rule 37(e) "authorizes two tiers of sanctions for spoliation" of electronically stored information. *Id.* at *5. The first tier allows the Court, if there has been a finding of prejudice, to order measures no greater than necessary to cure the prejudice. The plaintiff was unable to defeat the claim of Prejudice by showing that the information was available through other means. As a result, the court sanctioned the plaintiff under the first tier of the newly amended Rule.

If the party that lost the evidence "acted with the intent to deprive another party of the information's use in the litigation," more severe sanctions are available under Rule 37(e)(2), including a presumption that the lost information was unfavorable to the party, instructing the jury that it may or must apply such a presumption or even dismissing the action entirely.

Rule 37(e) and the duty to preserve evidence does not apply, however, when information is lost before litigation is "reasonably anticipated." *Micron Tech., Inc. v. Rambus Inc.*, 645 F.3d 1311, 1320 (Fed. Cir. 2011). In short, spoliation penalties generally cannot occur when the information was lost or modified before litigation was reasonably anticipated.

VII. Informal Discovery

Informal discovery, i.e. uncovering factual information obtainable without a formal request to opposing counsel or an authorization from the opposing party, is a very valuable tool as both a precursor and a supplement to formal discovery because:

1. it does not hinge on (sometimes difficult to obtain) cooperation from opposing counsel, where costly and time-consuming discovery disputes may result;

2. it can be conducted at virtually any point after the potential for litigation arises, regardless of formal discovery schedules; and

3. it could swiftly reveal key facts in your case, all with the assistance of an associate or paralegal, utilizing free or low-cost search tools (e.g. Google searches or social media).

While the rules vary from state to state, as a general rule, attorneys may access and review the public portions of a party's social-networking pages without facing ethical repercussions. Seth I. Muse, *Ethics of Using Social* Media *During Case Investigation and Discovery*, AMERICAN BAR ASSOCIATION (June 13, 2012). However, the rules become more complicated when it comes to the issue of "friending" adverse witnesses on social media. Lisa McManus, *Friending Adverse Witnesses: When Does It Cross The Line Into Unethical Conduct?*, LEXISNEXIS (2011). Some states, like California, recommend an absolute bar on "friending" both represented and unrepresented parties based on communication with represented parties, the rules of professional conduct, and the duty not to deceive. SDCBA Legal Ethics Opinion 2011-2. Other states, like New York, view that the ethical boundaries are not crossed when an attorney or investigator friends witnesses using only truthful information (e.g. no fake names). NY Committee on Professional and Judicial Ethics, Formal Opinion 2010-2.

Subject to the rules of professional conduct, informal discovery may include interviewing, meeting with witnesses, getting affidavits signed, and accessing information from public sources. Public sources include court dockets revealing the party's conduct in other lawsuits, articles, journals, news stories, annual reports, and social media content.

The general rule permitting informal discovery was applied by the Supreme Court of West Virginia, when it held that lawfully observing a represented party's activities that occur in full view of the general public is not an ethical violation. *State ex. rel State Farm Fire & Cas. Co. v. Madden*, 451 S.E.2d 721, 730 (W.Va. 1994). At least one commentator has even suggested that the informal discovery of social media websites should be formalized as an affirmative duty, as a natural extension of Model Rule of Professional Conduct 1.1 and Federal Rule of Civil Procedure 11. Agnieszka McPeak, *Social Media Snooping and its Ethical Bounds*, 46 Ariz. St. L.J. 845 (2014).

VIII. Conclusion

"Discovery is intrusive, unpleasant, time-consuming and costly. It is, like life itself, nasty and brutish. Unfortunately, it is not generally short. However, it is the inevitable concomitant of litigation and neither party is free to ignore the obligations imposed by the discovery rules."

- Judge Cole, *Flentye v. Kathrein*, 2007 WL 2903128 (N.D. Ill. 2007).

Notable authority indicates an attorney's citation to case law applying a prior version of the Federal Rules of Civil Procedure was not only inexcusable but sanctionable. *See Fulton v. Livingston Fin. LLC*, 2016 WL 3976558 (W.D. Wash. July 25, 2016). In *Fulton*, an attorney attempted to explain his erroneous reliance on the former Rule 26 by arguing the amended version "did not alter the relevance standard." *Id.* at *9. However, Rule 26(b)(1) further limits the scope of discovery to information "that is 'proportional to the needs of the case." *Id.* The attorney made no reference to the proportionality requirement or even the newly amended rule in his brief. *Id.* at *8. The court seemed to take special offense to the attorney's inability to "own [] up to his misrepresentation." *Id*. at 9. Accordingly, the court sanctioned the attorney. *Id.* Bearing this in mind, the importance of staying up to date with changes to the Federal Rules is crucial.

Understanding the new federal approach (including proportionality) can help us move away from the view that discovery is "nasty and brutish," and towards the ideal of doing discovery right. The top three points to keep in mind are:

1. Learn the new e-discovery rules and best practices, and keep up to date with the latest decisions on issues left unanswered by the recent amendments;

2. Begin your discovery plan early, revisit it often, and follow it carefully;

3. Cooperate with opposing counsel, with the court, and with witnesses in planning for discovery and in collecting, preserving, and properly producing evidence.

With these points in mind, the new federal rules provide a vehicle for keeping costs appropriate; for optimizing the discovery process; and for expediting resolution of disputes.

SESSION 12

USE OF REPTILE BRAIN TRIAL STRATEGY: THE REPTILE THEORY AND ITS APPLICABILITY TO COMMERCIAL LITIGATION

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The Reptile Theory and Its Applicability to Commercial Litigation

Mike F. Pipkin

While the "reptile theory" may be unfamiliar to many in the surety industry, to those who try cases with regularity, the reptile theory is fast becoming a trial strategy with which defense attorneys must grapple. But what exactly is it? And if reptile theory strategies are being implemented against me, what can I do to prepare for and respond to it?

This article will discuss four primary topics:

- What the reptile theory is;
- What it looks like in its typical application;
- What it can and does look like in the commercial litigation setting; and
- How to respond to it—during discovery, with trial advocacy skills, and with case law.

What is the Reptile Theory?

The reptile theory is a trial advocacy technique first used by plaintiffs' attorneys to convince jurors that "they are the only thing that stands between a defendant's actions and complete anarchy."[1] It sprung from a book (and related seminars) by David Ball (a trial consultant) and Don Keenan (a plaintiff's personal injury attorney) entitled "Reptile: The 2009 Manual of the Plaintiff's Revolution." The book's premise is that "[w]hen the Reptile sees a survival danger, even a small one, she protects her genes by impelling the jury to protect himself and the community. . . . The greater the perceived danger to you and your offspring, the more firmly the reptile controls you."[2] Based upon this premise, Ball and Keenan urge followers of the reptile theory's concepts to posture the case so as to put jurors in the position of protecting themselves, their loved ones, and their community.[3]

However, the theory itself is nothing new. Rather, it is a repackaging of demagoguery, appealing to an audience's (here, a jury's) emotions, especially fear and anger. Indeed, Aristotle

[1] "Just What Is the "Reptile" and How Do I Combat Against It?", Mike H. Bassett and Sadie A. Horner, FOR THE DEFENSE 36 (March 2017).

[2] David Ball and Don Keenan, "Reptile: The 2009 Manual of the Plaintiff's Revolution", 8 (2009) (hereinafter "Reptile").

[3] The premise that there is such a thing as an evolutionary "reptilian" portion of the human brain is scientifically unsupported. Ben Thomas, "Revenge of the Lizard Brain," Guest Blog, Scientific American (Sept. 7, 2012).

once said: “The Emotions are all those feelings that so change men as to affect their judgements, and that are also attended by pain and pleasure. Such are anger, pity, fear and the like, with their opposites.”[4]

Plaintiffs’ lawyers who utilize reptile theory methodology seek to get the jurors’ brains into survival mode. They hope that the jury sees themselves as the only ones who can prevent and/or rectify harm and injury. Ball and Keenan write further: “No man is an island. So, when something threatens the community, it threatens all of us and our children. That motivates us into being ‘guardians’ of the community.”

What Does the Reptile Theory Look Like in its Typical Application?

Given that the genesis of the reptile theory arose of an alignment of a plaintiff’s attorney and a trial consultant, it should be expected that the typical utilization of the theory arises in personal injury cases, catastrophic or not, and products liability cases. In those cases, plaintiffs’ lawyers try to convince jurors that they are the ones that can protect the community, ensure safety, and make the world safer for everyone.[5]

For instance, plaintiffs’ attorneys skilled in the reptile theory will work to take a simple, relatively uncomplicated fact situation giving rise to an injury, and turn it into a scenario where the defendant is endangering the entire community, with the jury being the only entity that can prevent dangerous and reckless conduct in the future. At the conclusion of the evidence, the attorney will try to “try to empower the jury so that the jurors think that a large jury award (and ‘fair compensation’) is the only thing that will diminish danger within the community.”[6]

Applied to a trucking case, for example, the plaintiffs’ lawyer will set out the theme in general terms, such as “No company should be allowed to endanger the public needlessly.” Then, they apply the general theme with more specificity: “Trucking companies should not overschedule their drivers just to make more money.” Finally, they will tie the two themes together, arguing that the community is endangered when these defendants overscheduled their drivers in order to profit.”

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[4] *See also* A. Greely, “A Brief Primer on the Reptile Theory of Trial Strategy: Plaintiff Psychology and the Defense Response” at 1-2 (ABA 2015 Section of Litigation Annual Conference).

[5] “Just What Is the “Reptile” and How Do I Combat Against It?”, Mike H. Bassett and Sadie A. Horner, FOR THE DEFENSE 36 (March 2017).

[6] *Id.* at 37.

What Can the Reptile Theory Look Like in Commercial Litigation?

So, why should surety and fidelity litigators care about the reptile theory? To answer that question, at least from the perspective of the author, the following is the background of a financial institution bond case litigated through trial, how the plaintiff's trial strategies bore trace elements of the reptile theory, and the implications of those strategies on the client's exposure.

The facts of the underlying claim for loss were very complicated, arising from allegedly fraudulent behavior perpetrated by an attorney/title agent in purported cahoots with a Ponzi scheme artist. Under the retainer agreement with the insured (a title insurance company), the attorney's duties were to examine titles; issue title insurance commitments, policies, and endorsements on forms underwritten by the insured; and collect title insurance premiums. The insured later discovered and alleged that the attorney had acted fraudulently in facilitating at least twenty-eight real estate closings, wrongfully obtained loans, misappropriated escrow funds, and failed to remit premium funds collected on behalf of the insured. The plaintiff (an insurance company itself) paid claims submitted by real property owners with titles clouded by mortgages with forged signatures. After submitting an initial proof of loss, followed by multiple supplements, the insurer began and continued its investigation, including pre-suit depositions. When it apparently became dissatisfied with the pace of the inquiry into the claim, the insured sued on the bond seeking coverage for losses arising out of the allegedly dishonest actions of an attorney retained by the insured.

After discovery and the resolution of certain dispositive motions (which eliminated certain elements of the insured's claims), the parties went to trial before a jury on the causes of action on which factual issues were ripe.[7] Notwithstanding the complexity of the underlying fact pattern, at trial, the plaintiff's case presentation revolved around a simple theme:

- The plaintiff paid a large amount of money as a premium for issuance of the financial institution bond (along with a large deductible);
- The plaintiff submitted a claim on the bond, arising from losses it suffered which it believed to be covered by the bond; and
- The insurance company denied its responsibilities and failed to pay a valid claim.

This simple, and simplistic, theme was woven through opening statements, presented through direct examination testimony, was used repetitively during cross examination of hostile

[7] Other dispositive motions were pending before the court on which there were no fact issues for jury determination, including certain defenses made the basis of the insurer's denial of the overall claim.

witnesses, and was summarized along with a plea for substantial damages during closing argument.

In response, and despite being somewhat hamstrung by an inability to refer to pending dispositive motions, the insurer entered into evidence a robust and thorough defense supporting its various affirmative defenses to the insurer's claims. Nevertheless, following more than a week of trial testimony and boxes of exhibits, the jury returned a punitive verdict in favor of the plaintiff following only four hours of deliberations.

During the "post-game analysis," it became clear that the plaintiff's case presentation strategy arguably bore foundations from the reptile theory. Specifically, notwithstanding the fact that insurance companies occupied both sides of the docket, Plaintiff's counsel positioned its client as a "victim" of the insurer's "bad faith" claims handling practices, taking advantage of the limitations on the insurer's trial presentation resulting from pending dispositive motions that did not require fact issues to be resolved. Then, after establishing its client as a "victim," Plaintiff's counsel cast aspersions on the motives of the insurer with respect to the handling of the claim, again leveraging the jury's lack of knowledge of pending dispositive motions that were critical to the insurer's defense and claim handling strategy. Finally, Plaintiff's counsel tied the simplistic themes together, arguing that substantial damages should be awarded because of the insurer's conduct. [8]

Legal Limits on Improper Argument

Demagoguery works in many arenas. Fortunately, many cases have established that appeals to the jurors' passions are improper.[9] One form of the prohibition on appeals to juror passion is barring counsel from asking the jurors to put themselves in a party's place and to ask themselves how they individually would want to be treated or what compensation they would

[8] Within seconds of the jury's departure from the courtroom, the Court threw out half of the verdict as unsupported by the evidence, and asked for briefing two other jury questions, demonstrating an inclination to overrule the jury with respect to another one-quarter of the verdict (facts not captured by a lurid Law360 article published within hours of the jury's verdict.

No judgment was ever entered on the jury's verdict, as the parties were urged strongly to resolve the claims before the Court ruled on the pending pre- and post-trial dispositive motions. The matter was resolved on confidential terms.

[9] *E.g.*, *Minneapolis, St. P. & S. S. M. Ry. Co. v. Moquin*, 283 U.S. 520, 521 (1931) ("In actions under the federal statute no verdict can be permitted to stand which is found to be in any degree the result of appeals to passion and prejudice. Obviously such means may be quite as effective to beget a wholly wrong verdict as to produce an excessive one."); *Soloria v. Atchison, Topeka & Santa Fe Ry. Co.*, 224 f.2d 544, 547 (10th Cir. 1955) ("strong appeals in the course of argument to sympathy, or appeals to passion, racial, religious, social, class, or business prejudice lie beyond the permissive range of propriety"); *Stone v. Foster*, 106 Cal. App. 3d 334, 355 (Cal. Ct. App. 1980) ("attempts to appeal to the prejudice, passions or sympathy of the jury are misconduct.").

view as appropriate had they suffered the same injuries, otherwise known as the "Golden Rule" argument.[10] The bar on "Golden Rule" arguments is nearly universal. Indeed, Ball and Keenan's book contains an appendix of cases from nearly every jurisdiction recognizing the Golden Rule.[11] Nevertheless, the underlying premise of the reptile theory is to suggest that the jurors put themselves in the plaintiff's place and take the necessary steps to protect themselves and the community via a punitive verdict.

There is some debate whether the "Golden Rule" prohibition extends to liability determinations or is limited to appeals as to damages. [12] Notwithstanding the Reptile book's

[10] "Limiting Reptile Argument, By Appeal and Otherwise," unattributed and unpublished paper presented by Martin J. Kravitz, Steven C. Pasarow, Robert A. Olson, and Patrick E. Stockalper at the Annual Meeting of the Federation of Defense & Corporate Counsel (Charleston, South Carolina, March 8, 2017). *See e.g., Granfield v. CSX Transp., Inc.*, 597 F.3d 474, 491 (1st Cir. 2010) (a "Golden Rule" argument is "universally condemned because it encourages the jury to depart from neutrality and to decide the case on the basis of personal interest and bias rather than on evidence"); *Arnold v. E. Air Lines, Inc.*, 681 F.2d 186, 199 (4th Cir. 1982) ("The Golden Rule and sympathy appeals are . . . obviously improper arguments . . .. Having no legal relevance to any of the real issues, they were per se objectionable . . .."); *Loose v. Offshore Navigation, Inc.*, 670 F.2d 493, 496 (5th Cir. 1982) (a "Golden Rule" argument encourages the jury to depart from neutrality and to decide the case on the basis of personal interest and bias rather than on the evidence"); *Caudle v. District of Columbia*, 707 F.3d 354, 359-60 (D.C. Cir. 2013); *DuBois v. Grant*, 835 P.2d 14, 16 (Nev. 1992) (banned golden rule argument is the impermissible suggestion that the jurors trade places with the victim; *Boyd v. Pernicano*, 385 P.2d 342, 343 (Nev. 1963) (improper to ask the jurors to place themselves in the shoes of the victim because such argument interferes with the objectivity of the jury); *Seffert v. Los Angeles Transit Lines*, 56 Cal.2d 498, 511-12 (1961), Traynor, J. dissenting ("No rational being would change places with the injured man for an amount of gold that would fill the room of the court, *yet no lawyer would contend that such is the legal measure of damages*.") (emphasis added); *Horn v. Atchison, Topeka & Santa Fe Ry. Co.*, 61 Cal. 2d 602, 609 (1964) ("it was improper to appeal to the jurors to fix damages as if they or a loved one were the injured party"); *Collins v. Union Pacific Railway Co.*, 207 Cal.App.4th 867, 883-84 (2012) ("A 'golden rule' argument is one where counsel asks the jury to place itself in the victim's shoes and award such damages as they would charge to undergo equivalent pain and suffering" and is prohibited as an improper appeal to passion); *Loth v. Truck-A-Way Corp*. 60 Cal. App. 4th 757, 765 (1998) ("The appeal to a juror to exercise his subjective judgment rather than an impartial judgment predicated on the evidence cannot be condoned. It tends to denigrate the jurors' oath to well and truly try the issue and render a true verdict according to the evidence. Moreover it in effect asks each juror to become a personal partisan advocate for the injured party, rather than an unbiased and unprejudiced weigher of the evidence. Finally, it may tend to induce each juror to consider a higher figure than he otherwise might to avoid being considered self-abasing." (citations omitted)).

[11] Reptile at 267-326.

[12] Compare, *e.g., Cordova v. City of Albuquerque* 816 F.3d 645 (10th Cir. 2016) (although "Golden Rule" argument improper on damages issue, proper when argued on issue of ultimate liability to ask jurors to put themselves in officers' shoes accused of unreasonable use of deadly force); *Shultz v. Rice*, 809 F.2d 643, 652 (10th Cir. 1986) (permitting defense argument that jurors place themselves in defendant physician's shoes with choices he faced); *Stokes v. Delcambre*, 710 F.2d 1120, 1128 (5th Cir. 1983) ("It is not improper when urged on the issue of ultimate liability"; not improper to ask jurors to put themselves into jailed plaintiff's shoes as to why he did not seek help from deputies in face of assault by other inmates); *Lopez v. Langer*, 114 Idaho 873, 879 (1988) ("Golden Rule" arguments prohibited as to damages; but "where such arguments merely appeal, in a moderate manner, to the jury's common sense by asking them to ascertain the reasonableness of a defendant's actions (or a plaintiff's actions) in the context of the case, they will be permitted.") *with Caudle v. D.C.*, 707 F.3d 354, 359-60 (D.C. Cir. 2013) (collecting cases going both ways; "Golden Rule" prohibition applies to both liability and damages; improper to ask jurors to put themselves in discrimination plaintiffs' shoes); *Edwards v. City of Philadelphia* 860 F.2d 568, 574 fn. 6 (3rd Cir. 1988).

attempt to narrow its scope, the prohibition on appeals to jurors' self-interest are not limited strictly to direct or explicit appeals that jurors put themselves in a party's shoes. Thus, more generally, appeals to jurors' self-interest—the fundamental Reptile premise—are improper.[13] In fact, some of the most-used Reptile attempts to avoid the "Golden Rule" prohibition fall within precedent addressing improper argument. Counsel cannot ask a jury to "put yourself in the plaintiff's shoes."[14] Likewise, the "newspaper ad" ploy, asking the jury to think how much a newspaper advertisement or, today, a Craigslist posting, would have to offer for someone to agree to endure what the plaintiff had to endure, is improper.[15]

Another Reptile favorite is the request that the jurors act as the "conscience of the community." The fundamental premise that the jurors are charged with the responsibility for protecting the community can certainly lead to improper argument.[16] Similarly, it is improper to urge the jury to "send a message" or "to preserve the rights not just of [these] plaintiffs but of everyone."[17]

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[13] *See, e.g., Allstate Ins. Co. v. James*, 845 F.2d 315, 318-19 (11th Cir. 1988) (defense argument that jurors' policy premiums might be affected); *Roy v. Employers Mut. Cas. Co.*, 368 F.2d 902, 904-05 (5th Cir. 1966) (same); *Cassim v. Allstate Ins. Co.*, 33 Cal. 4th 780, 796 (2004) ("An attorney's appeal in closing argument to the jurors' self-interest is improper and thus is misconduct because such arguments tend to undermine the jury's impartiality"); *Brokopp v. Ford Motor Co.*, 71 Cal. App. 3d 841, 861 (Cal Ct. App. 1977) (plaintiff's claim that defendant, rather than public healthcare [Veterans Administration] should pay to treat plaintiff's injuries improperly appealed to self-interest).

[14] *Loose v. Offshore Navigation, Inc.*, 670 F.2d 493, 496-97 (5th Cir. 1982); *Woods v. Burlington N. R. Co.*, 768 F.2d 1287, 1292 (11th Cir. 1985), *rev'd*, 480 U.S. 1 (1987).

[15] *Collins, supra*, 207 Cal.App.4th at 883.

[16] *See, e.g., Blue Grass Shows, Inc. v. Collins*, 614 So.2d 626, 627, *quoting Westbrook v. General Tire and Rubber Co.*, 754 F.2d 1233, 1238-39 (5th Cir. 1985) ("you are conscience of community" argument improper); *Norman v. Gloria Farms, Inc.*, 668 So. 2d 1016, 1021 (Fla. Dist. Ct. App. 1996) (defense argument that verdict would put an end to local culture and hold jurors to community ridicule); *Regalado v. Callaghan*, 3 Cal. App. 5th 582, 598-99, 207 Cal. Rptr. 3d 712, 725-26 (Ct. App. 2016) ("in our view the remarks from Regalado's counsel telling the jury that its verdict had an impact on the community and that it was acting to keep the community safe were improper"); *United States v. Rogers*, 556 F.3d 1130, 1143 (10th Cir. 2009) ("Prosecutors are not permitted to incite the passions of a jury by suggesting they can act as the community conscience to society's problems"); *Gilster v. Primebank*, 747 F.3d 1007, 1011 (8th Cir. 2014); (Counsel's closing rebuttal argument "giving" to the jury "the power and responsibility for correcting injustices" akin to prosecutor's improper plea that jury act as conscience of community); *Fyffe v. Massachusetts Bay Transp. Auth.*, 86 Mass. App. Ct. 457, 466-475, *review denied*, 470 Mass. 1105 (2014) ("conscience of community"/"guardians of the safety of all of the moms, all of the dads, and all of the children, and all of the grandparents that ride in these trains" so prejudicial as to not be cured by later instruction); *but see Freeman v. Blue Ridge Paper Prod., Inc.*, 229 S.W.3d 694, 712 (Tenn. Ct. App. 2007) ("An appeal to the jury to act as the community's conscience is not necessarily improper argument").

[17] *See, e.g., Caudle, supra*, 707 F.3d at 361 (preserve rights of everyone); *Nishihama v. City & County of San Francisco*, 93 Cal.App.4th 298, 305 (2001) ("any suggestion that the jury should 'send a message' by inflating its award of damages . . . would be improper where, as here, punitive damages may not be awarded"); *Gielow v. Strickland*, 185 Ga. App. 85, 86 (1987) (argument to punish defendant for wrongdoing).

Often underlying a Reptile presentation is an attempt to demonize the defendant and its counsel. This subtext supports a narrative that the defendant (and its counsel) pose an ongoing danger to the jurors (and the community by implication) that must be stopped. Again, this sort of argument is improper.[18]

Finally, a related method is the psychological tactic of "anchoring," where counsel presents to prospective jurors on voir dire a large potential damages amount in hopes of preconditioning them to a large result, even as a "discounted" or compromise sum. This strategy may be prohibited, depending on the jurisdiction, and certainly dependent on the role counsel plays during jury selection.

Preservation of Error and Appellate Relief

The guidelines set forth above should act to prevent much of the trial advocacy techniques that the Reptile authors advocate. Nevertheless, if the issue makes its way to the appellate level, correcting error can be difficult, because of (1) error preservation and (2) prejudice.

Preservation

"'Generally, to preserve for appeal an instance of misconduct of counsel in the presence of the jury, an objection must have been lodged at trial.' In addition to objecting, a litigant faced with opposing counsel's misconduct must also 'move for a mistrial or seek a curative admonition' unless the misconduct is so persistent that an admonition would be inadequate to cure the resulting prejudice. This is so because '[o]ne of the primary purposes of admonition at the beginning of an improper course of argument is to avoid repetition of the remarks and thus obviate the necessity of a new trial.' . . . However, the 'absence of a request for a curative admonition does not forfeit the issue for appeal if 'the court immediately overrules an objection

[18] *See, e.g., Cassim, supra*, 33 Cal.4th at 796 ("Nor may counsel properly make personally insulting or derogatory remarks directed at opposing counsel or impugn counsel's motives or character"); *Las Palmas Associates v. Las Palmas Center Associates*, 235 Cal.App.3d 1220, 1246 (1991) ("Personal attacks on opposing parties and their attorneys, whether outright or by insinuation, constitute misconduct. . . . Such behavior only serves to inflame the passions and prejudice of the jury, distracting them from fulfilling their solemn oath to render a verdict based solely on the evidence admitted at trial"); *DeJesus, supra*, 116 Nev. at 819 (counsel impermissibly asked jurors to "send a message" to law firms that try to prevent injured persons from recovering ("that's what the power brokers of this world do to people like you"); *Kaas v. Atlas Chemical Co.*, 623 So.2d 525 (Fla. App. 1993) ("Other states have also held that improper comments made by counsel which accused a medical expert of perjury and accused opposing counsel of committing a fraud upon the court, caused a proceeding to be, 'not in any meaningful sense a trial at all but a thoroughly unseemly name calling contest, reflecting a personal vendetta between a lawyer and an expert witness, in which the jury was essentially asked to choose between the combatants.'").

to alleged prosecutorial misconduct [and as a consequence] the defendant has no opportunity to make such a request.'"[19] This is the general rule throughout the country.[20]

Mere objection is not sufficient either. The objection must be timely. One recent California appellate decision, although expressly finding a "Reptile" argument—telling "the jury that its verdict had an impact on the community and that it was acting to keep the community safe"—was improper, held that an objection at a break in plaintiff's counsel's still uncompleted closing argument came too late.[21] And, "[i]n addition to objecting, a litigant faced with opposing counsel's misconduct must either 'move for a mistrial or seek a curative admonition'" unless an admonition would have been inadequate under the circumstances.[22] Thus, where a curative admonition is given, it is often the case that counsel will have to move for a mistrial to preserve the issue for appellate review.[23] Indeed, some jurisdictions may even require a motion for new trial in order to preserve the issue for appellate review.[24]

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[19] *Cassim v. Allstate Ins. Co.*, 33 Cal. 4th 780, 794,95 (2004); *see also Horn v. Atchison, Topeka & Santa Fe Ry. Co.*, 61 Cal. 2d 602, 609-10 (1964) (The sum result of counsel's remarks was such as to create an atmosphere of bias and prejudice which manifestly was calculated to deprive defendant of a fair trial. Certainly such conduct cannot be condoned. However we are persuaded to the conclusion that defendant has waived its right to complain by its failure to make timely objections, and the instant judgment should not be reversed.").

[20] *See, e.g., DeJesus, supra*, 7 P.3d at 462 ("Generally, a failure to object to attorney misconduct precludes review"); *Millen v. Miller*, 308 A.2d 115 (Pa. 1973) ("An indispensable element to finding such comment to have constituted reversible error is the requirement that opposing counsel make a prompt and specific objection on such grounds to give the trial court the opportunity to caution the jury to disregard the comments"); *Paragon Family Rest. v. Bartolini*, 799 N.E.2d 1048, 1957 (Ind. 2003) (no review of closing argument without objection); *Burns v. Prudential Sec., Inc.*, 167 Ohio App. 3d 809, 860 (2006) ("comments to the jury about the 'close-knit community' and the plaintiffs being the jurors' 'friends and neighbors,'" defense "counsel did not object to these classifications. '[T]he failure to object to misconduct of counsel at the time it occurs constitutes a waiver of the right to object on review of the case.'").

[21] *Regalado, supra*, 3 Cal. App. 5th at 598-99, 207 Cal. Rptr. 3d at 725-26; *But see People v. Jasso*, 211 Cal.App.4th 1354, 1364 & fn. 5 (2012) ("Defense counsel's objection, though not immediate, was timely, because it came in time for the trial court to cure any harm made by the remarks.").

[22] *Cassim* at 795; *see also Smith v. Haugland*, 762 N.W.2d 890, 898, 900 (Iowa 2009) (plaintiff argued to the jury that "your decision will make a statement to this community and all the many, many patients who have this benign [medical condition] problem"; trial court sustained objection, but defense did not ask for curative instruction or timely ask for a mistrial; plaintiff reiterated statement once more; held on appeal: No abuse of discretion in not granting a new trial).

[23] *See Seabury-Peterson v. Jhamb*, 15 A.3d 746, 751 (Me. 2011) (trial court did not abuse discretion in giving curative instruction and denying mistrial).

[24] *See Sauter v. Wasemiller*, 389 N.W.2d 200, 202 (Minn. 1986).

Prejudice

Even if the misconduct is objected to in a timely manner, appellate reversals are rare. "The question is whether counsel's misconduct so permeated the trial as to lead to the conclusion the jury was necessarily influenced by passion and prejudice in reaching its verdict."[25] Significantly, the test most often applied by appellate courts to these cases, holds that the use of a "Golden Rule" argument is rendered harmless either by an immediate curative instruction.[26] Or, appellate courts hold that a complete final instruction to the jury concerning its proper role in the determination of liability and damages issues can cure the harm.[27] Thus, counsel faced with improper argument is in a quandary. If counsel does not ask for an admonition or curative instruction, the error may be waived, at least in all but the most extreme cases. However, if counsel does ask and the court agrees, the appellate may find any prejudice cured.

Moreover, even if an objection is lodged and requests for an admonition and curative instruction are made, appellate courts still appear to be reluctant to find prejudice.[28] Reversals are rare, but they do happen, usually in cases involving multiple examples of misconduct or counsel disregarding specific trial court directives.[29] The trial court's exercise of discretion to grant a

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[25] *Cooper v. Firestone Tire & Rubber Co.*, 945 F.2d 1103, 1107 (9th Cir. 1991) (although directed verdict striking punitive damages claim, counsel urged jury to inflict punishment on defendants and characterized a low verdict as a "hunting license" for defendants).

[26] *See, e.g., Shultz v. Rice*, 809 F.2d 643, 652 (10th Cir. 1986) (potential for prejudice adequately cured where, immediately following objection to use of "Golden Rule" argument, the court "sufficiently admonished the jury to weigh [the offending attorney's] argument against the whole of the evidence and the law presented them").

[27] *See, e.g., Joan W. v. City of Chicago*, 771 F.2d at 1023 ('[a]though the judge did overrule the City's objection to the Golden Rule argument and did not give a limiting instruction, we have noted that any prejudice can often be cured simply by a general instruction that properly informs the jury on the law of damages"); *Spray-Rite*, 684 F.2d at 1246 (harmless error where "the jury was properly instructed concerning the law it should apply in determining liability and damages"); *Edwards v. City of Philadelphia*, 860 F.2d 568, 574-75 (3rd Cir. 1988); *Brown v. Parker Drilling Offshore Corp.*, 410 F.3d 166, 180 (5th Cir. 2005) (no prejudice where objection sustained and some admonition given);

[28] *See, e.g., U.S. v. Reynolds*, 534 Fed.Appx. 347 (6th Cir. 2013) ("But the misconduct was not flagrant. The statements were isolated. They 'did not mislead the jury because it did not marshal them to punish all the drug dealers in their community by convicting [the defendant]; rather, the comment accurately identified [the defendant] as [a] drug dealer[ ]' who dealt with a Mexican cartel."); *United States v. Wettstain*, 618 F.3d 577, 589-90 (6th Cir. 2010) ("There is no evidence that the prosecutor intentionally sought to mislead or prejudice the jury. We do not find that the prosecutor's statements 'seriously affect[ed] the fairness, integrity, or public reputation of the judicial proceedings").

[29] *See, e.g., Whitehead, supra*, 163 F.3d at 278 (multiple misconduct, no objection); *Loose v. Offshore Navigation, Inc., supra*, 670 F.2d at 496 (objection made and overruled); *Grosjean v. Imperial Palace, Inc.*, 125 Nev. 349, 369 (2009) (objected to and unobjected to misconduct including "Golden Rule" and "send a message" arguments [while counsel was crying] required a new trial on punitive damages).

new trial is reviewed more favorably than asking the appellate court to reverse for misconduct for the first time.[30]

How to Respond to the Reptile Theory

Pre-Trial—Witness Preparation for Depositions

A primer on preparing a designated corporate representative or claim handler for a deposition is beyond the scope of this paper. Nevertheless, when preparing a corporate witness for deposition, the attorney must now anticipate the possibility that reptile theory case strategies will include deposition questioning designed to eventually undercut and impeach the witness's credibility and testimony at trial. As a result, some of the more common recommendations suggested to witnesses may not prepare them completely to anticipate deposition questions intended to advance a reptile theory approach.

For instance, typical recommendations made to witnesses preparing for testimony include:

- **Just Answer the Question**—This advice is very good, and is certainly viable in a vacuum. However, if the witness is not aware that the questioner is trying to lay traps for future use, the answers, while truthful and responsive, may create difficulties later in the case.

- **Avoid Thinking Out Loud**—This advice is excellent, yet almost unavoidable, especially by witnesses who do not testify often, yet want to appear cooperative during a deposition.

- **Keep Your Answers Brief and Succinct**—Again, excellent advice. However, while a "yes" or "no" answer is certainly brief and succinct, and often truthful and responsive, the witness's failure to qualify the response appropriately can lead to greater problems later in the case.

Again, the above recommendations, among others, remain excellent advice. However, any advice to witness preparation must now also include discussions on how to identify seemingly innocuous questions, the short answers to which may help the plaintiff lay the predicate for a reptile theory argument. For instance:

[30] *See, e.g.*, *Baptist Mem'l Hosp., Inc. v. Bell*, 384 So.2d 145, 146 (Fla. 1980) (affirming trial court grant of new trial based on "Golden Rule" argument where objection sustained and curative instruction given and subsequent arguably excessive damages); *Lance, Inc. v. Ramanauskas*, 731 So.2d 1204, 1216 (Ala. 1999) (remittitur, rather than new trial, can be proper remedy for improper argument).

- "Parties to contracts should honor their commitments, shouldn't they?"
- "Insurance companies that issue policies or bonds expect claims at some point, don't they?"
- "You would agree with me that a surety claims handler should investigate and respond to claims promptly, wouldn't you?"
- "Valid claims should be paid promptly, should then not?"
- "There is no good reason not to pay a valid claim, correct?"

While these simple, inoffensive questions may often lend themselves to concise answers, when the subject matter of the underlying lawsuit is complicated and contested, the witness must be prepared to articulate the reasons while the answers are not as simple as the question suggests. If handled successfully, the answers will not be as able to be taken out of context or used for impeachment purposes later in the case.

Motions in Limine

Once at the trial court level, and given the limited prospects for appellate recourse discussed *supra*, the motion in limine can help educate the trial court as to likely tactics and their impropriety. In those jurisdictions with binding precedent prohibiting Golden Rule or "conscience of the community" arguments, the motion in limine should stress and explain the similarities between such arguments and reptile theory arguments.

Voir Dire

In addition to briefing a judge on the case law that prohibits the use of the reptile theory during trial, attorneys should also be ready during the trial to do all that they can to identify and stop a plaintiff's attorney's efforts to get the jurors to ignore the evidence and take steps to protect the plaintiff and the community. During voir dire, the plaintiff's lawyer will likely explore the juror's experiences with insurance claims of all types, *e.g.*, homeowners and automobile liability policies, priming the jury for the idea that his client has a similarly simple claim.

In response, the defense attorney must be prepared to tell his client's story—not just once, but repeatedly. Jury research indicates jurors learn and retain information by being told stories. While the defenses may be technical and relatively arcane, they must be designed into stories that can be told simply. To the extent a case is not about liability, but is rather just focused on damages, the time for the jury to hear that is at the outset. The honesty will be appreciated and, at that point, the jurors will understand quickly that the reason that they have to

spend their time as jurors is that somebody does not want to settle. Then, if the defense has established its credibility before the jurors, it is possible that the jurors will believe that the reason the case has not settled is because the plaintiff is overreaching in its demands.

Opening Statements

While the plaintiff's counsel will seek to establish its simple themes and begin to attack, the defense must be prepared to counter with its own story. Explain to the jury the processes that the client went through during its investigation. Talk about what that investigation revealed, and how those facts applied to what the claim handler was considering.

Remember, the plaintiff's attorney will try to create an image of the surety or insurance company as focused on nothing more than collecting premiums and denying responsibility when receiving claims. It is the defense attorney's responsibility to tell a story, that the client acted reasonably based on the facts learned during the investigation, and that some outrageous jury award is not within the definition of "fair and reasonable compensation."

Witness Testimony

Returning to the topic of witness preparation, thought-out responses to the questions listed above will help the jurors understand that the claim handler is not an unthinking automaton, but rather is doing a thorough job investigating and evaluating the claim. At its most basic level, the reptile theory wants the jury to believe that every decision is simple, not complex, removing the concept of "reasonableness." The defense attorney's responsibility is to ensure that the jury is continually reminded that every decision has multiple factors that weigh in, and that the jurors are to decide if the client responded to the claim with reasonableness under the circumstance.

So, what does that mean with respect to overall trial preparation? It will require consistent preparation of all witnesses, including mock depositions or mock examinations where the witnesses are subjected to expected questions. The day before, or the morning of, the deposition will simply not allow enough time for thorough preparation.

Trial Briefs and Pocket Briefs

Motions in limine can be supplemented and expanded upon by a comprehensive trial brief that addresses reptile theory issues. In addition, pocket briefs during trial at critical junctures, *e.g.*, before expert testimony and before closing argument, can remind the trial court of the appropriate standards for conducting examination and for argument. In addition to reminding the trial court of applicable standards, such briefs provide a written record that objection to

improper argument was made and provide a foundation for succinct objections during closing argument.

Conclusion

While the reptile theory will be more prevalent in personal injury and products liability cases, savvy plaintiff's lawyers are always looking for an advantage when it comes to jury trials. The reptile theory appeals to the simplest instincts of humanity. In response, the defense attorney must be ready to respond with its own narrative and story, presenting the defense with simplicity at every opportunity. Defense counsel must also be ready to explain, again with simplicity, that reasonable steps taken during an investigation is what is required, not perfection.

Combating the reptile theory in a commercial case starts with the answer, and proceeds from that point on. When discovery begins, the responses and witness preparation must reflect the reality that the opponent is preparing traps for future use, both in dispositive motions and during trial. Thorough preparation will allow the defense counsel to respond at every level during the life of the case.

SESSION 13

ETHICAL ISSUES IN USE OF CLOUD FOR EXCHANGE AND STORAGE OF DOCUMENTS

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PEARLMAN 2017

September 7-8, 2017

Columbia Winery | Woodinville, WA

ETHICAL ISSUES ARISING FROM THE USE OF THE CLOUD FOR EXCHANGE AND STORAGE OF DOCUMENTS

Pearlman Association Annual Meeting
September 8, 2017

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I've looked at clouds from both sides now,

From up and down and still somehow,

It's clouds illusions I recall,

I really don't know clouds at all.

Joni Mitchell*, Both Sides Now* (1967)

This short paper is intended as a guide to fundamental concepts and resources for company representatives, consultants and counsel. The material in the paper will be discussed and amplified in the presentation to be given by the presenters at the conference on September 8, 2017. The paper will be supplemented by handouts furnished at the presentation.

What is the Cloud?

According to a 2016 American Bar Association survey, a startling 10% of attorneys do not know whether or not they are utilizing the "cloud" in their practice. The inescapable assumption is that most attorneys do not really know what the term "the cloud" refers to. And that knowledge gap is likely shared by a significant number of their surety company clients, if not some of their consultants as well. In the simplest sense, the "cloud" is just another term for the "internet." "Cloud storage," "cloud computing" and similar terms all refer to gaining access to programs, data and services by accessing them through the internet rather than by switching on a computer in your own premises and accessing what is on its hard drive and connected servers.

Accordingly, when data or information is transmitted from one party to another over the internet, it is leaving the equipment and electronic storage devices that are controlled by the sender, entering systems owned and controlled by others that are in the "cloud," and eventually being delivered or made accessible to an intended recipient (who may or may not receive it and store it on a locally controlled hard drive device). The intermediate step in which the information is stored on and perhaps viewed on systems other than those locally controlled or owned by the sender and recipient is the "cloud" portion of the transmission. The most frequent "cloud" usage is the daily use of email, which has become so commonplace that users generally give little thought to how many systems, owned and/or controlled by how many different enterprises, an email may be housed on while it makes its journey from sender to recipient.

When a company uses "cloud computing" or "cloud storage" for all or part of its operations, it means that it is accessing data and the programs being used to manipulate that data via the internet, with the actual programs and data being housed on another company's equipment and systems.[1] Corporate entities and law firms are increasingly seeking the many advantages and efficiencies offered by "cloud computing" for various segments of their operations. Among the many potential efficiencies are reduced hard

[1] According to the Pennsylvania Bar Association Committee on Legal Ethics And Professional Responsibility Formal Opinion 2011-200, "while there are many technical ways to describe cloud computing, perhaps the best description is that cloud computing is merely 'a fancy way of saying stuff's not on your computer.'"

and soft costs of maintaining and updating software and systems, reduced needs for large volume data storage hardware on premises and increased options for off-premises back-up solutions available.

But where confidential, proprietary, privileged or otherwise sensitive information is involved, using the "cloud" to transmit, store or manipulate the data comes with a set of security and (at least for attorneys) ethical concerns that were never presented by the 20th century paper universe in which a client handed an attorney or consultant a file that was kept in the attorney or consultant's own locked office in his or her own locked file cabinet.

Security Concerns

Clients, consultants and counsel are well-advised to take advantage of appropriate security features when transmitting sensitive information using the cloud. In *Harleysville Ins. Co. v. Holding Funeral Home*, 2017 U.S. Dist. LEXIS 18714 (W.D. Va. February 9, 2017), an insurance company transmitted its complete claim file, including allegedly privileged and work product material, to its own counsel using the cloud facility "Box" but without any password or other security functions and without an expiration date being tagged to the downloadable link. Opposing counsel found the web address for the link that had been provided to the insurer's counsel within the insurer's formal document production and used it to access all of the transmitted data. The Court held that all applicable privileges and exemptions from discovery had been waived by the unprotected cloud transmission from the client insurer to its own counsel, stating that the transmission amounted to "the cyber equivalent of leaving its claims file on a bench in the public square and telling its counsel where they could find it." The case and appropriate precautions that might be taken when using such cloud transmission facilities as "Box" and "DropBox" will be discussed in the presentation.

Ethical Concerns

The increasing prevalence of usage of the "cloud" by law firms to store and transmit privileged information has led to the issuance a new wave of opinions and guidelines both by the American Bar Association and by separate state bar associations. The guidance to counsel provided varies both in technical content and in the degree of clarity of the burden placed upon the attorney utilizing cloud facilities. However, in general the guidance provided requires various degrees of due diligence by counsel in assuring that reasonable steps are being taken by the cloud service vendors utilized by counsel to keep the information in question confidential and protected from unauthorized

access and/or destruction. Both the ABA and many state bar associations have issued guidance on the ethical concerns in the form of formal opinions, which will be discussed as part of the presentation.

ABA Position. The ABA Standing Committee on Ethics and Professional Responsibility recently issued a formal opinion on the subject of cloud usage by attorneys. ABA Formal Opinion 477r - Issued May 11, 2017 (revised May 22, 2017). "Securing communication of protected client information."

> "A lawyer generally may transmit information relating to the representation of a client over the internet without violating the Model Rules of Professional Conduct where the lawyer has undertaken reasonable efforts to prevent inadvertent or unauthorized access to information relating to the representation. However, a lawyer may be required to take special security precautions to protect against the inadvertent or unauthorized disclosure of client information when required by an agreement with the client or by law, or when the nature of the information requires a higher degree of security."

(see
https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/aba_formal_opinion_477.authcheckdam.pdf
for text of entire ABA formal opinion)

Other ABA resources that are relevant to the issue:

ABA Model Rules of Professional Conduct Rule 1.1 – Amended in 2012 to include as part of required attorney "competence" keeping abreast of "the benefits and risks associates with relevant technology." Similar requirements have been adopted by many states.

ABA Model Rules of Professional Conduct 1.6(c) – "A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client."

State Positions. Over the years, as cloud usage has increased, state ethics opinions have been issued on the subject. The opinions range from setting forth recommendations for attorneys to follow to reasonably safeguard confidential information to potentially creating "best practices" standards or affirmative ethical obligations. The opinions of the particular relevant state must be reviewed, and the the ABA maintains a website on which all such opinions have been gathered (20 states at most recent report) with jump links to the particular opinions of interest, which can be found at: tinyurl.com/pmh5z2g.

Four states whose opinions give a reasonable survey of the field will be discussed as part of the presentation.

Suggested Practical Precautions – While these will be further discussed in the presentation, a few suggestions are as follows:

For company representatives:

a. Inquire of your outside counsel and consultants as to whether they are storing your company's confidential information in the "cloud" and what privacy and security precautions they have in place;
b. Give counsel and consultants advance notice before transmitting sensitive, confidential or privileged information to them electronically, and consider agreeing on security precautions prior to the transmission where warranted;
c. Maintain sufficient security precautions when transferring information electronically to either a consultant or retained counsel, and consider additional security protection if you believe that the communication is covered by "privilege" or "work-product" protection and/or that the information is particularly sensitive (*i.e.*, confidential, proprietary, etc.);
d. Become familiar with and utilize the security functions available from the vendor when using large file transfer facilities such as "Box," "DropBox" or the like;
e. Become familiar with encryption functions that may be available within your company's existing systems and that might be used when transferring information electronically to your consultants or counsel;
f. Consider treating all transmissions of data to or from a consultant, or a representative of the principal or indemnitors, as though the material were sensitive, potentially privileged and had to be kept confidential, even if no litigation is then pending and no counsel has yet been retained.

For counsel (and consultants):

a. Review your state ethical opinions and any legislative requirements before entering into cloud storage and computing solutions, especially if you intend to store or manipulate any confidential client information on your cloud platforms;

b. Carefully vet any cloud computing vendor and carefully review its security procedures for protecting both the lawyer's and clients' data before entering into any SaaS (software as a service) or other cloud services agreement. (Particular suggested questions will be discussed as part of the presentation);
c. Consider using as few vendors as possible in your cloud solutions in order to reduce the number of potential vulnerabilities to cyber attack on your data (and that of your clients);
d. Carefully review all SaaS (software as a service) and other agreements involved in your cloud computing solutions to confirm the privacy and security precautions and obligations of the vendors;
e. Become familiar with and utilize the security functions available from the facility vendor when using large file transfer facilities such as "Box," "DropBox" or the like;
f. Consider encrypting especially sensitive files locally before uploading them to the cloud;
g. Find out where your data is being hosted, and whether it is kept at all times within the United States.

<u>For consultants</u>:

a. In addition to "b" through "g" above, consider treating all transmissions of data to or from the insurance company client, principal or indemnitor as though the material were highly sensitive, potentially privileged and had to be kept confidential, even if no litigation is then pending and no counsel has yet been retained.

The themes and information listed will be further amplified during the presentations.