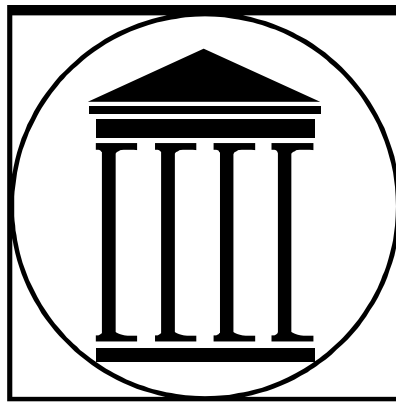


# Homeward Bound 2007-2008: Current Issues in Construction Law

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**Homeward Bound 2007-2008:  
Current Issues in Construction Law**

Thursday, February 7, 2008  
The Inn at St. John's, Plymouth

**Seminar Schedule**

**Moderator:**

Lawrence M. Dudek  
Miller, Canfield, Paddock and Stone, PLC  
Detroit

**Faculty:**

Ronald P. Strote  
May, Simpson & Strote PC  
Bloomfield Hills

James R. Case  
Kerr, Russell & Weber, PLC  
Detroit

Michael T. Lynch  
Principal/Corporate Counsel  
Harley Ellis Devereaux  
Southfield

John M. Sier  
Kitch, Drutchas, Wagner Valitutti & Sherbrook  
Detroit

2:00 p.m. – 2:45 p.m.

**Proving the Defect or Design Error and Omission Claim**

- Importance of the Spearin Doctrine
- Role of the plans and specifications
- Role of shop drawings, RFIs, and other submittals
- What is the burden of proof on the claimant to show design error?
- Performing due diligence on the claim.
- The “standard of care” defense and the non-negligent error or omission.
- Is a certain amount of design error acceptable?
- What is the “betterment” defense?

2:45 p.m. – 3:20 p.m.

### **Proving the Delay Claim**

- What is the delay claim?
- What is acceleration?
- What is constructive acceleration?
- Use of a schedule to establish a delay claim
- The “no damages for delay” clause

3:20 p.m. – 3:30 p.m.

### **Questions and Answers**

3:30 p.m. – 3:45 p.m.

### **Break**

3:45 p.m. – 4:00 p.m.

### **Damage Remedies**

- Discrete costs
- Modified total cost
- Total cost
- Cost of repair and economic waste rule
- Difference in value as measure

4:00 p.m. – 4:15 p.m.

### **Using Insurance Coverage to Fund Defense and Settlement Costs**

- CGL coverage
- E & O coverage
- Builder’s risk coverage
- Completed operations

4:15 p.m. – 4:30 p.m.

### **The Roles of Experts in Construction Litigation**

- When do you need an expert?
- What type of expert do you need?
- How to find a qualifying expert
- Consulting expert or testifying expert
- Sample retention letter
- Managing the costs of an expert

4:30 p.m. – 4:45 p.m.

### **Use of Mediation and Arbitration to Resolve Disputes**

- What rules apply to mediation
- The role of the mediator
- Techniques used by mediators to settle a case
- When is a case required and ready to be mediated?
- When is arbitration the preferred remedy?
- Who are the necessary parties, and what about the surety?
- What rules apply to arbitration
- How the arbitrator gets paid
- Arbitration and court resolution compared
- When is litigation the preferred mechanism of dispute resolution?

4:45 p.m. – 5:00 p.m.

### **Questions and Answers**

**Adjourn**

# Homeward Bound 2007-2008: Current Issues in Construction Law

Thursday, February 7, 2008  
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## **Seminar Handbook**

Cosponsored by:

The Real Property Law Section of the State Bar of Michigan

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# Homeward Bound 2007-2008: Current Issues in Construction Law

Thursday, February 07, 2008

The Inn at St. John's, Plymouth

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### Homeward Bound 2007-2008: Current Issues in Construction Law



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James R. Case practices primarily in the areas of construction law, design professional malpractice, fidelity and surety law, and commercial law. He routinely represents contractors, design professionals, owners, and sureties. Mr. Case also serves as an arbitrator and mediator in commercial and construction matters. He is a member of the Detroit Metropolitan and American Bar Associations; the State Bar of Michigan; the Surety Claims Institute; the National Bond Claims Association; and International Association of Defense Counsel.



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Lawrence M. Dudek practices in the area of commercial litigation. He also represents financial services institutions and secured and unsecured creditors in connection with all aspects of commercial collections, foreclosures and workouts involving real estate and personal property, including out-of-court workouts, federal bankruptcy, and state court litigation proceedings. He is a member of the Litigation Section of the American Bar Association, the Real Property Law Section of the State Bar of Michigan, and the Oakland County Bar Association. Mr. Dudek lectures for ICLE and has published articles in the Michigan Real Property Review.

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John M. Sier practices in the areas of dispute avoidance and resolution of commercial and construction contract issues. He is the chairperson of Kitch Drutchas Wagner Valitutti & Sherbrook's commercial litigation group. Mr. Sier has experience in analyzing legal aspects of various project delivery methods including drafting construction contracts as well as assisting in dispute resolution and project completion. He also sits on the Panel of Construction Neutrals for the American Arbitration Association and has presided over several arbitrations. Mr. Sier holds the designation of construction document technologist (CDT) from the Construction Specifications Institute. He has published articles on construction and commercial issues and has presented seminars on construction and real estate related issues. Mr. Sier is also a past president of the Catholic Lawyers Society.

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# Homeward Bound 2007-2008: Current Issues in Construction Law

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**7. Use of Mediation and Arbitration to Resolve Disputes** *(continued)*

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## **Proving the Defect or Design Error and Omission Claim**

by

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# Proving the Defect or Design Error and Omission Claim

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## **I. Overview**

The subject matter of “design errors and omissions” is an area that is frequently misunderstood. The mere existence of “defects” or “errors and omissions” in plans and specifications prepared by a design professional, i.e., the architect or engineer, do not automatically create a basis of legal liability in event that construction costs for a project increase as a consequence of these conditions. Whether the design professional is or is not legally responsible for increased construction costs is dependent upon whether the claimant or injured party, i.e., the project owner or a contractor, can establish the requisite elements of a claim for professional negligence or breach of contract by the design professional.

In order to understand the proper bases for asserting a successful claim against a design professional for “defects” or “errors or omissions” in plans and specifications, a careful consideration of the nature of the professional duty of the architect or engineer must be undertaken. A careful and complete analysis of the architect’s or engineer’s professional services contract must also be performed. This paper will explore these issues and examine how the common law and contractual duties of the design professional must be analyzed in common construction project scenarios in determining how and under what circumstances the design professional may have legal liability to others.

## **II. Common Law Duties - The Professional Standard of Care**

The rights, responsibilities and duties of the design professional with respect to all commonly recognized project delivery methods arise from two sources: the common law and contract. The common law or so-called “tort” duty of the design professional is defined by case law in the State of Michigan and relates to the responsibility of the design professional to comply with the professional standard of care. The common law standard

of care applies in the absence of a statement of the standard of performance in a contract for professional services.

So what is the common law duty of the design professional? When a claim is made against a design professional, what measure or standard does the law apply to determine the validity of the claim?

Insofar as a registered architect or professional engineer is in fact a **professional**, the conduct of the architect or engineer, in any give circumstance, must necessarily be measured by the performance of the typical architect or engineer. Traditional concepts of “ordinary care” or “ordinary negligence” do not apply in analyzing the legal duty owed by the design professional.

The common law concerning the required standard of care of the design professional in the State of Michigan is clear. The law provides that the design professional is obligated to do what the ordinary architect or engineer of ordinary skill, learning and ability would do, or would not do, under the same or similar circumstances. A failure to comply with this standard of care constitutes “malpractice” or “professional negligence.” Unless the design professional undertakes a special contractual obligation, the law implies no warranty or guarantee in connection with the professional services provided by the architect or engineer.

The legal liability of design professionals is entirely consistent with the nature of the liability imposed on other state licensed professionals, such as doctors, dentists, accountants and lawyers. So long as the design professional complies with the applicable standard of care, that is, what the ordinary architect or engineer of ordinary learning, skill or ability would do, or would not do, under the same or similar circumstances, the design professional has complied with his or her legal obligations. Note that the design professional is not legally obligated to provide the **best quality service**, but rather **average quality service**.

These legal concepts are not new, but are well grounded in Michigan law. The application of the law of professional negligence to architects was first recognized by the Michigan Supreme Court in the now seasoned case of *Chapel v Clark*, 117 Mich 638 (1898). Later cases applying the law of professional negligence to design professionals include *Bayne v Everham*, 197 Mich 181 (1917), *Ambassador Baptist Church v Seabreeze Heating & Cooling Co*, 28 Mich App 424 (1970) and *Borman’s, Inc v Lake State Development Co*, 60 Mich App 175 (1975), as well as numerous other cases.

The most succinct statement of the law is found in the Michigan Model Civil Jury Instructions approved by the Michigan Supreme Court and commonly used throughout the state in jury trials. Jury instructions are read by the trial judge at the conclusion of the case to instruct the jury as to the relevant law that the jury must apply in deciding the disputed factual issues involved in the case. Included within the Model Civil Jury Instructions is the approved definition of “professional negligence” or “malpractice”.

*Michigan Model Civil Jury Instruction 30.01*, applied in a case involving an architect, reads as follows:

**When I use the words “professional negligence” or “malpractice” with respect to the defendant’s conduct, I mean the failure to do something which an architect of ordinary learning, judgment or skill in this community would do, or the doing of**

**something which an architect of ordinary learning, judgment or skill would not do, under the same or similar circumstances you find to exist in this case.**

**It is for you [the jury] to decide, based upon the evidence, what the ordinary architect of ordinary learning, judgment or skill would do or would not do under the same or similar circumstances.**

Note that the qualifier “ordinary” is used no less than four times in this instruction. Given that fact that “perfect” performance by the design professional is not legally required and cannot be realistically expected, the parties need to consider this factor in evaluating the performance of the design professional on any given project.

### **III. Contractual Duties of the Design Professional**

It is well settled that the usual common law duties of the design professional can be modified by contract. The duty to perform in accordance with usual and customary professional standards, as explained above, applies where no specific standard of performance is stated or defined in the contract for professional services. For example, **AIA Document B141-1997, Standard Form of Agreement Between Owner and Architect**, states in its Subparagraph 1.2.3.2 that **“The Architect’s services shall be performed as expeditiously as is consistent with professional skill and care and the orderly progress of the Project.”** Under this language, the common law standard of care would apply, i.e., the architect would simply have the obligation in performing its services to do what the ordinary architect of ordinary learning, skill and ability would do in performing services under similar circumstances.

Some professional services agreements redefine the standard of performance. If a professional services agreement states that the design professional will perform all services “in accordance with the highest professional standards” (whatever those may be), the common law standard of “ordinary performance” may no longer apply. Similarly, if a contract provides that the design professional will prepare construction documents that are “free of any errors or omissions” and that are “complete, fully coordinated and account for all details of construction necessary for a completed Project”, then the design professional may be operating under a much higher standard of performance, with all of the associated liabilities. Such contract language can potentially eliminate any “usual and customary standard of care” defenses that the design professional would otherwise have, in the event that a claim arising under the contract is asserted against the design professional.

The common law standard of care, in and of itself, does not define the duties of the design professional with respect to all claims and change order issues that may arise. Certainly, the professional standard of care would obligate the design professional to prepare reasonably complete construction documents, consistent with the owner’s program requirements. The degree of accuracy of the design documents can be described in the professional services agreement, which can also address the issue of allocation of responsibility for additional costs as discussed in further detail below.

Application of the common law standard of care does not apply simply to change order issues, but to all aspects of the design professional’s involvement in the project. How the standard is to be applied depends on the circumstances surrounding the project and the nature of the undertaking by the design professional. As will be discussed in some detail, the duty of the design professional to prepare detailed “bid quality” construction

documents may be lessened in a design-build project, depending upon the level of detail required by the design-builder.

The critical lesson is that the owner or a design-builder and design professional need to exercise the appropriate cautions and good sense in defining the standard of performance in any design services contract. (The same principles apply in any project delivery method.) The key is to protect the availability of the professional liability insurance, in the event that a claim is made against the design professional arising out of the contractual relationship. The typical professional liability insurance policy covers the design professional for liabilities arising from professional negligence, i.e., a failure to comply with the applicable professional standard of care, as discussed in detail above. These policies do not insure contractual obligations as such and expressly exclude from coverage liabilities arising from contractual warranties or guarantees.

Contractual provisions that create potentially uninsurable liabilities come in different shapes and sizes, but exemplar language would include the following:

1. “The Design Professional will perform all services required hereunder in accordance with the highest professional standards.”
2. “The Construction Documents shall be complete and unambiguous and shall be fully adequate to provide for all construction necessary for the completion of the Project.”
3. “The Design Professional shall indemnify, defend and hold the Design Builder and Owner harmless from any and all claims, liabilities, losses, costs and expenses that may arise as a result of the performance of services by the Design Professional under the terms of this Agreement.”
4. “The Design Professional shall be responsible for compliance with all applicable laws, rules, regulations and orders of any governmental agency having jurisdiction over the Project and shall prepare a design for the Project consistent with all applicable legal requirements.”

#### **IV. Nature of Legal Duty Owed to Third Parties**

Construction projects invariably involve multiple contractual relationships. Even in a relatively simple and traditional “design-bid-build” form of project, the owner retains a design professional to prepare plans and specifications and then enters into a separate contract with a general contractor to provide for construction. In such an arrangement, there is no contractual privity between the design professional and contractor, even though those parties will co-exist and certainly cooperate with each other in providing services necessary to obtain the common objective—a successful completion of the project. Even in the absence of a direct contractual relationship, the design professional will rely on the contractor to provide proper construction services and the contractor will rely on the design professional to provide a proper and constructible design via the plans and specifications that the designer delivered to the owner.

Under these circumstances, what legal duty, if any, does the design professional owe to the contractor? Keep in mind that in the simple arrangement described above, the contractor will be relying on plans and specifications prepared by the design professional, even though the design professional owes its contractual duties only to the owner. If

“defects” or “errors and omissions” are contained in the design documents and the process of correcting these problems is borne by the contractor, does the contractor have a direct right of action against the designer, even in the absence of privity of contract?

In *Bacco Construction Co v American Colloid Co*, 148 Mich App 397 (1986), the court held that the absence of privity of contract was not a bar to the contractor maintaining a direct negligence action against the design professional to recover costs incurred by the contractor purportedly arising from mistakes and errors in plans furnished by the engineer. The rationale for this holding is that it is foreseeable to the design professional at the time plans and specifications are prepared that a third party, i.e., the contractor separately retained by the owner, will be relying on those plans and specifications in the performance of its separate contract obligations to the owner. Hence, the design professional was found to owe a common law duty to the contractor, who was allowed to maintain a negligence-based action against the design professional.

However, in a relatively recent non-construction claim case, the continued viability of the court’s holding in *Bacco Construction* may be open to question. In *Fultz v Union-Commerce Associates*, 470 Mich 460 (2004), the Supreme Court held that a defendant’s failure to perform contractual obligations properly did not give rise to a negligence claim by a third party arguably injured by such improper performance. In the *Fultz* case, the plaintiff was injured when she slipped and fell in a snow covered parking lot which had not been recently salted or plowed. The defendant snow removal service had contracted with the premises owner to salt the lot and remove snow and failed to properly perform its contract prior to plaintiff’s accident. Plaintiff relied on the existence of the contract and the defendant’s failure to perform in asserting a negligence claim against the defendant snow removal contractor. The Supreme Court reversed the decision of the Court of Appeals, which found that plaintiff had a viable negligence claim based on the contract, and held that the existence of the contract did not give rise to a common law duty on the part of the contractor as to the plaintiff, a third party not involved in the contract.

## **V. Multiple Bid Packages and Fast Track Scheduling**

The use of multiple bid packages, also known as “fast track” scheduling, is not a new concept, but does present unique challenges to the design professional. This accelerated method of project delivery differs from the typical “design-bid-build” delivery method due to the overlapping of the design and construction elements of the project. The “design-bid-build” method follows a paced and logical method of completing a project. Under this method, the planning, design and construction phases all occur in a sequential manner. Budgeting and programming occur first, followed by the development of a complete set of construction documents, following the usual schematic design, design development and construction documents phases of design. Once a complete set of construction documents is developed, the project is then advertised for bids or a general contract is negotiated and the construction phase is then completed. This simple method of project delivery, will still commonly used, is time consuming.

Use of multiple bid packages, or “fast tracking the job”, compresses the overall time schedule by allowing for the overlap of the design and construction phases of the project. Within the confines of the overall project budget, the design of early construction elements of the project, such as site development, foundations, structure and the building envelope, proceed first with one or more “bid packages” being released for these initial components.

Construction work on these elements begins, while design of the balance of the project proceeds. As further design work is completed, additional bid packages or construction drawing issues are released. The advantage is that the total project development time is compressed and the project is completed much faster than the more traditional design-bid-build delivery method would allow.

Under the fast track method of project delivery, adherence to the design schedule and meeting milestone dates is critical for the design professional. An owner “fast tracks” a job with the expectation of obtaining the financial benefits of an earlier completion. Unexcused delays by the design professional in adhering to the design schedule can have major financial impacts.

Accordingly, the following general guidelines should be observed by the owner and the design professional in planning and executing any fast track project:

1. Establishing the fast track method at the earliest stage of the project is essential. If a project is to proceed on a fast track basis, all parties should have this understanding from day one. Since the decision to “go fast track” is typically owner driven, the owner needs to make this decision and commitment at the earliest possible time.
2. Establish realistic and achievable milestone dates for the completion of the individual bid packages or construction issues to be prepared.
3. Clearly define the number of bid packages to be issued and the content of each package.
4. Establish a realistic budget contingency to deal with changes in design that will inevitably occur due to the nature of the delivery method. Since design documents will be prepared and issued on what amounts to a “piecemeal” basis, all design will not be fully coordinated until the completion of the project. A certain degree of redesign and rework will be necessary as later bid packages are completed. Accordingly, there will be contingency costs which the owner should be prepared to absorb. Compressing design time does not reduce design cost.
5. All parties must commit to adherence to the overall project schedule. The owner must be prepared to make timely decisions and advance contingency costs by way of change orders to keep the project on track.

## **VI. Contractor’s Submittals and Shop Drawing Review - Potential Schedule Impacts**

The contract documents control the time within which the design professional must review and respond to contractor submittals and shop drawings. Contracts typically provide that the design professional must act with reasonable promptness to conform to the project schedule. For example, **AIA Document A201-1997, General Conditions of the Contract for Construction**, Subparagraph 4.2.7, states, in pertinent part:

**The Architect will review and approve or take other appropriate action upon the Contractor’s submittals such as Shop Drawings, Product Data and Samples, but only for the limited purpose of checking for conformance with information given and the design concept expressed in the Contract Documents. The Architect’s action will be**

**taken with such reasonable promptness as to cause no delay in the Work or in the activities of the Owner, Contractor or separate contractors, while allowing sufficient time in the Architect's professional judgment to permit adequate review.**

The specific time within which the design professional must turn around its review of contractor submittals is typically stated elsewhere in the contract documents, e.g., the supplementary conditions to the construction contract or the technical specifications, or in the professional services agreement itself. The time period for review varies, depending on the size and complexity of the project, but usually runs between 10 and 15 business days. Time periods of 5 days or shorter are unusual.

Negative impacts to a project schedule can occur in various ways, if the parties fail to adhere to the allotted time periods for the review and processing of contractor submittals. Delays in contractor submittal processing can be caused by the contractor, subcontractors and/or the design professional. The impact on the critical path must be considered.

In preparing a project critical path schedule, all parties should have a clear understanding of the time periods allowed and required for the preparation, review and approval of contractor submittals. The contractor and its subcontractors must take into account the review time required by the design professional in allocating time for this process in the overall project schedule. Clearly, the design professional must pay careful attention to compliance with the review schedule for construction items on the critical path.

## **VII. Contractor Requests for Information - Potential Schedule Impacts**

Contractor requests for information (RFIs) arise on virtually every project. Typically, the contractor is seeking further direction or clarification regarding the technical requirements stated in the design documents. The design professional's duties with respect to responding to RFIs should be spelled out in the contract documents.

For example, **AIA Document A201-1997, General Conditions of the Contract for Construction**, states in Subparagraph 4.2.11:

**The Architect will interpret and decide matters concerning performance under, and the requirements of, the Contract Documents on written request of either the Owner or Contractor. The Architect's response to such requests will be made in writing within any time limits agreed upon or otherwise with reasonable promptness. If no agreement is made concerning the time within which interpretations required of the Architect shall be furnished in compliance with this Paragraph 4.2, then delay shall not be recognized on account of failure by the Architect to furnish such interpretations until 15 days after written request is made for them.**

Similarly, **AIA Document B141-1997, Standard Form of Agreement Between Owner and Architect**, states in Subparagraph 2.6.1.5:

**The Architect shall review properly prepared, timely requests by the Contractor for additional information about the Contract Documents. A properly prepared request for additional information about the Contract Documents shall be in a form prepared or approved by the Architect and shall include a detailed written statement that indicates the specific Drawings or Specifications in need of clarification and the nature of the clarification requested.**

Note that neither one of these standard contract provisions actually spells out the time within which the design professional is obligated to respond and this should be covered elsewhere in the contract documents or in the professional services agreement. Typical contractual response times run between 5 to 10 working days, depending upon the nature and complexity of the project.

The number of RFIs generated on a project and the timeliness of the design professional's response are often sources of controversy, especially when disputed delay claims are involved. A real delay by the design professional in responding to a legitimate RFI can negatively impact a project schedule, if the delay affects a critical path task. On the other hand, tardy submission of RFIs to the design professional or the submission of needless RFIs where the information sought is clearly discernable from the design documents themselves, also can delay performance and generate costly inefficiencies.

Since RFI processing often involves after the fact "finger pointing" between the contractor and the design professional, it is advisable for all parties to keep detailed RFI logs during the course of the project. A log that is contemporaneously maintained should detail dates of receipt and response for each RFI and a summary description of the information involved. All RFIs should be sequentially numbered. Depending upon the communications method used, the actual times of transmission and receipt of RFIs should be noted.

The design professional should always be alert when it receives large blocks or a group of RFIs at the same time. If a contractor is submitting RFIs in groups or "batches" all at the same time, the design professional should take particular note of the time and date of receipt, since the contractor may have been accumulating RFIs from various subcontractors over time and there may be a potential that delay claims could be involved.

## **Proving the Delay Claim**

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# Proving the Delay Claim

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|   |     |
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## I. Analyzing Schedule Delays

### A. Several Possible Causes for Delays

1. Contract language may allocate risk and responsibility for delays.
2. Responsibility usually follows control.
  - a. Owner delays-typically compensable
    - i. Unexpected subsurface conditions. *Andrew Capatano Co. v. City of New York*, 116 Misc. 2d 163, 455 N.Y.S.2d 144 (1980); *Metro. Sewerage Commn. v. R.W. Constr., Inc.*, 72 Wis. 2d 365, 241 N.W.2d 371 (1976).<sup>1</sup>
    - ii. Owner interference. *L.L. Hall Constr. Co. v. U.S.*, 177 Ct. Cl. 870, 379 F.2d 559 (1966); *John E. Green Plumbing & Heating Co., Inc. v. Turner Constr. Co.*, 500 F. Supp. 910 (E.D. Mich. 1980) (*Claim against General Contractor for interference not barred by no-damage-or-delay clause*); *In re Roberts Constr., Co.*, 172 Neb. 819, 111 N.W.2d 767 (1961)<sup>2</sup>, see also: *Siefford v. Hous. Auth. of the City of Humboldt*, 192 Neb. 643, 223 N.W.2d. 816 (1974); *Parson Constr. Co. v. State*, 180 Neb. 839, 146 N.W.2d 211 (1966)<sup>3</sup>; *Hallet Construction Co. v. Iowa State Hwy. Commn.*, 261 Iowa 290, 154 N.W.2d 71 (1967)<sup>4</sup>; *Cunning-*

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1. Held that a contractor that encountered an artesian water condition which materially differed from conditions shown in the drawing and indicated in specifications entitled contractor to receive equitable adjustment in the contract price, with any deficiencies by the contractor in pre-bid planning and post-award performance going to the element of damages.

2. Stated that a “contractor has the right to recover damages resulting from delay caused by a breach of contract by the other party. Thus, where there is a breach of contract by the owner or the other party, and the breach of contract results in delay in the work of the contractor, and the delay in the work causes damage to the contractor, the contractor has a right of recovery in the absence of a ‘no damage clause’ or other provision to the contrary in the contract and even though the contract contains a provision for extension of time.”

3. A contractor is entitled to recover damages resulting from delay caused by a breach of contract by the other party

4. Held that specific “no damage” clause in a contract will not be enforced where delay is the result of fraud or active interference

*ham Bros, Inc. v. City of Waterloo*, 254 Iowa 659, 117 N.W.2d 46 (1962)<sup>5</sup>; *Peter Kiewit Sons' Co. v. Iowa S. Utilities Co.*, 355 F. Supp. 376 (S.D. Iowa 1973)<sup>6</sup>.

- iii. Delayed approvals. *G. Bliudzius Contracts, Inc.*, ASBCA No. 37707, 90-2 BCA ¶ 22, 835 (1990).
- b. Contractor delays
  - i. Supplier deliveries or subcontractor performance. *Cascade Elec. Co.*, ASBCA No. 28674, 84-1 BCA ¶ 17, 210 (1984); *Eugene Iovine, Inc.* GSBBCA No. 6680, 84-1 BCA ¶ 17,168 (1984).
  - ii. Defective contract performance. *Fortec Constructors v. U.S.* 760 F.2d 1288 (Fed. Cir. 1985); *Able Elec. Co. v. Vacanti & Randazzo Constr. Co.*, 324 N.W.2d 667 (1982)<sup>7</sup>.
  - iii. Foreseeable or known risks included in contract. *U.S. v. Brooks-Callaway Co.*, 318 U.S. 120, 63 S. Ct. 474 (1943).
- c. Excusable delays outside of the control of owner or Contractor.
  - i. May allow additional time but not more money.
  - ii. Contractor must show:
    - (1) Delaying event beyond control of Contractor.
    - (2) Not due to fault or negligence of Contractor. *W. Wright, Inc. v. Korshoj Corp.*, 197 Neb. 692, 250 N.W.2d 894 (1977)<sup>8</sup>; *Southern Fireproofing Co. v. R.F. Ball Constr. Co., Inc.*, 334 F.2d 122 (8th Cir. 1964)<sup>9</sup>.
    - (3) Not foreseeable. *Elder James W. Thompson, HUD* BCA No. 81-592-C23, 86-3 BCA, ¶ 19, 072 (1986); *D. Federico Co. v. New Bedford Redev. Auth.*, 723 F.2d 122 (1st Cir. 1983); *Prestex, Inc. v. U.S.*, 3 Cl. Ct. 373 (1983); *Fru-Con Constr. Corp. v. U.S.*, 44 Fed. Cl. 298 (1999)<sup>10</sup>.

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5. Held that the “no damage clause” in the contract was valid, but would be strictly construed....”no damage clause” will not be enforced where delay is result of fraud or active interference upon part of one who seeks benefits thereof, or is of such duration to justify contractor in abandoning project.

6. The court held that the general contractor had failed to prove that there was no “active interference” with its work in violation of the construction contract which would entitle it to recover additional compensation as against either the owner or the engineering contractor.

7. Held that the jury instruction that the “general contractor was solely responsible for coordinating time schedules established for project and that his failure to do so could be considered sufficient breach so as to entitle subcontractor to sue to recover damages was correct”.

8. Held that in the absence of contractual commitment, the general contractor was not liable to the subcontractor for damages flowing from delays incurred by the subcontractor not caused by the general contractor.

9. Subcontractor sued a general contractor for delay damages caused by unanticipated sub-surface conditions at the project site. The subcontractor could not recover because the delay was not the fault of the general contractor.

## Proving the Delay Claim

- d. Examples of excusable delays
  - i. Unusually severe or abnormal weather. *All-State Constr. Inc.*, ASBCA No. 50513 (9/22/04); *Essential Constr. Co.*, ASBCA No. 18491, 78-1 BCA ¶ 13, 314 (1978); 48 § C.F.R. 52.249-14<sup>11</sup>.
  - ii. Acts of God. *Duble v. Canadian Pac. S.S. Co.*, 49 F.2d 291 (E.D.N.Y. 1930); *Beavers Constr. Co.*, AGBCA No. 83-125-1, 84-1 BCA ¶ 17, 067 (1983); *City of McCook v. McAdams*, 76 Neb. 1, 106 N.W. 988 (1906)<sup>12</sup>; 48 C.F.R. § 52.249-14.
  - iii. Strikes and Labor Disputes. *Otis Elevator Co.* VACAB No. 1157, 76-1 BCA ¶ 738 (1976); 48 C.F.R. § 52.249-14.
  - iv. Sovereign Acts. *D.D. Montague*, ASBCA No. 11837, 67-1 BCA ¶ 6217 (1967); *Schmoll v. U.S.*, 91 Ct. Cl. 1 (1940)<sup>13</sup>.

## B. Float

1. Float is a concept usually claimed by both sides.
2. Float sharing clauses in contracts typically used to partially absolve owners. *Santa Fe Inc.*, VABCA No. 2168, 87-3 BCA ¶ 20104 (1987); *Gulf Contracting, Inc.*, ASBCA No. 30195, 89-2 BCA ¶ 21, 812 (1989); *Rob Glo, Inc.*, ¶ 23, 357 (1991); *But see, Montgomery—Ross—Fisher, Inc.*, PSBCA No. 1096, 84-2 BCA ¶ 17, 492 (1984).
3. Float typically presumed to “belong” to the project and not for exclusive use of either party. This derives from typical holding that no time extension warranted unless delay extends overall completion date. Callahan & Holmes, *Construction Schedules* (3d ed. 2004) Lexis Nexis.

## C. Schedule Analysis

1. Some overall considerations
  - a. Certain common standards:
    - i. Schedule must start with baseline including realistic durations and logic.
    - ii. Schedule must account for resource availability.

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10. An excusable delay must result from an event for which a government contractor bears no fault or responsibility and which was not foreseeable.

11. Enumerates certain excusable delays for which a contractor is not liable.

12. Explains an act of God as “events and accidents which proceed from natural causes and cannot be anticipated and guarded against or resisted, such as unprecedented storms or freshets, lightning, earthquake, and so forth.”

13. Where a contractor is prevented [by the government] from executing his contract according to its terms, he is relieved from the obligations of the contract [as to time of completion] and from paying liquidated damages.”

- iii. Schedule updates must be accurate and adjusted for as-built conditions.
- iv. Logic can be changed or modified but must be careful to avoid concealing self-critical planning errors.
- b. Contractor requirements for time extension.
  - i. Establish extent of delay.
  - ii. Establish harm resulting from delay.
  - iii. Establish causal link between wrongful acts or events and delay. *Essex Electro Engrs., Inc. v. Danzig*, 224 F.3d 1283 (Fed. Cir. 2000); *P.R. Burke Corp. v. U.S.*, 277 F.3d 1346 (Fed. Cir. 2002); *E.C. Nolan Co., Inc. v. State*, 58 Mich. App. 294, 227 N.W.2d 323 (1975); *Walter Toebe & Co v. Dept. of State Hwys.*, 144 Mich. App. 21, 373 N.W.2d 233 (1985); *In re Yeager Bridge & Culvert Co.*, 150 Mich. App 386, 389 N.W.2d 99 (1986); *Kit-San-Azusa, J.V. v. U.S.*, 32 Fed. Cl. 647, 656 (1995)<sup>14</sup>, *Triax-Pacific v. Stone*, 958 F.2d 351, 354 (Fed. Cir. 1992)<sup>15</sup>; *Wilner v. U.S.*, 24 F.3d 1397, 1401 (Fed. Cir. 1994)<sup>16</sup>; 48 C.F.R. § 52.212-12(b) (1994), 48 C.F.R. § 52.242-14b (2004)<sup>17</sup>.
- c. Schedule Analysis must reflect actual events before and after delay. *Fortec Constructors v. U.S.*, 8 Ct. Cl. 490 (1985); *Melka Marine, Inc. v. U.S.*, 187 F.3d 1370 (Fed. Cir. 1999).
- d. Selection of expert and methodologies subject to decision maker's "gate-keeping" function. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579, 113 S. Ct. 2786 (1993); *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 119 S. Ct. 1167 (1999).
- e. Nonexclusive checklist for trier of fact to assess reliability of expert opinions:
  - i. Whether expert's technique or theory has been tested—can the theory be challenged in some objective sense or is it simply a subjective conclusory approach that cannot reasonably be assessed for reliability.

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14. The court may deny an equitable adjustment if the contractor fails to prove that, but for the government delay the contract work would have been completed on time.

15. The general rule is that the government must have been "the sole proximate cause of the contractor's additional loss, and the contractor would not have been delayed for any other reason during the period."

16. When an equitable adjustment is being sought for government-caused delay, "the contractor has the burden of proving the extent of the delay, that the delay was proximately caused by the government action, and that the delay harmed the contractor."

17. The "sole proximate cause" concept can be found in the text of the Suspension of Work Clause in the C.F.R. which states: However, no adjustment shall be made under this clause for any suspension, delay, or interruption to the extent that performance would have been so suspended, delayed, or interrupted by any other cause, including the fault or negligence of the Contractor, or for which an equitable adjustment is provided for or excluded under any other term or condition of this contract.

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- ii. Whether the technique or theory has been subjected to peer review and publication.
  - iii. The known or potential rate of error of the technique or theory when applied.
  - iv. The existence and maintenance of standards and controls.
  - v. Whether the technique or theory has been generally accepted in the relevant community.
2. Various techniques have been used to identify and quantify delay.
- a. Bar chart
    - i. linear and simple.
    - ii. Not a realistic option since it provides no causation analysis. *Al Johnson Constr. Co. v. U.S.*, 854 F.2d 467 (Fed. Cir. 1988).
  - b. Total time
    - i. Also very simple and assumes the following:
      - (1) Original bid and schedule was reasonable and realistic.
      - (2) Contractor's performance was at least as efficient as the bid.
      - (3) All delays were solely caused by owner.
    - ii. Very limited application and generally not accepted on complex projects. *Morganti Natl., Inc. v. U.S.*, 49 Fed. Cl. 110 (2001); *F.H. McGraw & Co. v. U.S.*, 131 Ct. Cl. 501, 130 F. Supp. 394 (1955).
  - c. Impacted As—Planned
    - i. Imposes owner delays on the as-planned Critical Path method schedule, and then calculates a revised completion date. *Haney v. U.S.*, 230 Ct. Cl. 148, 676 F.2d 584 (1982)(defines "critical path").
    - ii. Several weaknesses:
      - (1) Requires very simple schedule with limited activities.
      - (2) Requires accurate, realistic as-planned schedule and assumes appropriate logic.
      - (3) Entirely theoretical since it does not derive from as-built schedule or conditions of project including mitigation.
    - iii. Typically rejected due to theoretical and speculative approach. *Titan Pacific Constr. Corp. v. U.S.*, 17 Ct. Cl. 630 (1989).
  - d. Collapsed As-Built
    - i. Creates as-built schedule, then removes (Collapses) periods of delay categorized by source or cause. Collapsed schedule then reveals presumed completion date but for delays.
    - ii. Characteristics:
      - (1) Requires accurate as built information.
      - (2) Requires clear identification of delay.

- (3) Can conceal effect of delays, concurrent delays, resequencing and mitigation.
  - (4) Recreation of critical path may not reflect actual logic.
  - (5) Subjective assessments and applications of schedule logic.
  - (6) Assumes original as planned durations were reasonable.
  - (7) Collapses may ignore physical, resource or seasonal constraints.
  - (8) Does not accommodate float on various subcritical paths.
  - (9) Assume pacing by contractor not allowed.
  - (10) Requires application of personal judgment of several decision points.
- iii. This method has been accepted under certain conditions. *Fischbach & Moore Intl. Corp., ASBCA No.18, 146, 77-1-BCA ¶ 12, 300 (1976); John Murphy Constr. Co., AGBCA No. 418, 79-1 BCA ¶ 13, 836 (1979).*
  - iv. This method has also been rejected when applied improperly. *Youngdale & Sons Constr. Co., Inc. v. U.S., 27 Fed. Cl. 516 (1993).*
- e. Window or Time Impact Analysis
- i. Assess schedule status for a particular period (usually one month) and identify critical path. Then modify as-planned schedule going forward to incorporate time impact which may or may not cause an extension base on location of critical path. Subsequent analyses start by updating the schedule status.
  - ii. Characteristics:
    - (1) Only identifies impact of activities occurring during the window period, not the entire project.
    - (2) Requires accurate progress information.
    - (3) Requires accurate and complete as-planned schedule and assumes appropriate durations, activities and logic.
    - (4) As the logic of original plan is changed, there is a greater degree of subjectivity or speculation introduced.
    - (5) Allows prospective calculation of delay.
  - iii. Can be accepted if applied appropriately. *Morganti Natl., Inc. v. U.S., 49 Fed. Cl. 110 (2001); PCL Constr. Services v. U.S., 47 Fed Cl 745 (2000); Gulf Contracting, Inc. v. U.S., 23 Ct. Cl. 525 (1991).*
  - iv. May be rejected if applied incorrectly. *Cogefar-Impresit U.S.A., Inc., DOT BCA No. 2721, 97-2 BCA ¶ 29, 188 (1997).*

## D. Concurrent Delays

1. Difficult to identify and define both in concept and application.
2. Essentially, periods of delay during which both parties bear responsibility.

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3. Historically, concurrent delay would excuse liquidation damages under rule against apportionment. *U.S. v. United Engr. & Const. Co.*, 234 U.S. 236, 34 S. Ct. 843 (1914).
4. Modern view (Michigan) is to apportion delays based on causation. *PCL Constr. Services, Inc. v. U.S.* 53 Fed. Cl. 479 (2002); *Giffels & Vallet, Inc. v. Edw. C. Levy Co.* 337 Mich 177, 58 N.W.2d 899 (1953), *Robinson v. U.S.*, 261 U.S. 486, 43 S. Ct. 420 (1922); *Kaltoft v. H. Nielsen*, 252 Iowa 249, 106 N.W.2d. 597 (1960); *CJP Contractors, Inc. v. U.S.*, 44 Fed. Cl. 298 (1999); *Lauria Bros. & Co. v. U.S.*, 177 Ct. Cl. 676 (1996); *T. Brown Constructors, Inc. v. Peña*, 132 F.3d 724, 734 (Fed. Cir. 1997).
5. Delays to activities with float may not be considered concurrent since those delays do not affect the critical path. *Fischbach & Moore Intl. Corp. v. U.S.*, 223 Ct. Cl. 119, 617 F.2d 223 (1980).
6. Failure to account for concurrent delays may be fatal to claim. *Manuel Bros., Inc. v. U.S.*, 55 Fed Cl 8 (2002); *Blinderman Constr. Co. v. U.S.*, 695 F. 2d 552, 559 (Fed. Cir. 1982).

## **II. Analyzing Schedule Acceleration**

### **A. Types of Acceleration**

1. Directed:
  - a. Contractor ordered to perform same scope of work in shorter time period.
  - b. Typically not due to project conditions, more likely incentives or earlier revenue streams.
  - c. Ordinarily compensable. *Continental Consolidated Corp. v. United States*, 17 CCF, ¶ 81, 137 (1972).
2. Voluntary:
  - a. Contractor unilaterally decides to perform greater work in compressed time period.
  - b. Typically, to make up lost time for contractor delays or to complete ahead of schedule.
  - c. Not ordinarily compensable.
3. Constructive:
  - a. Elements
    - i. Occurrence of an excusable delay.
    - ii. Request by Contractor for an extension of time.
    - iii. Denial of requested extension.
    - iv. Order to accelerate. *Thompson v. Valley Corp.*, 3 Neb. App. 459, 528 N.W.2d 352 (1995).

- v. Actual acceleration that results in additional costs. *Siefford v. Hous. Auth. of the City of Humboldt*, 192 Neb. 643, 223 N.W.2d 816 (1974); *U.S. v. Rice*, 317 U.S. 61, 63 S. Ct. 120 (1942); *H.E. Crook Co. v. U.S.*, 270 U.S. 4, 46 S. Ct. 184(1926); *Omaha Public Power. Dist. v. Darin & Armstrong, Inc.*, 205 Neb. 484, 288 N.W.2d 467 (1980); *Utley-James, Inc. GSBCA No. 5370, 85-1 BCA ¶ 17, 816 (1984)*; *Norair Engr. Corp. v. U.S.* 229 Ct. Cl 160, 666 F.2d 546 (1981); *Comm'l Contractors Equip. Inc. ASBCA No. 52932, 03-2 BCA ¶ 32, 381 (2003)*. *Phoenix Contractors, Inc. v. General Motors Corp.* 135 Mich. App. 787, 355 N.W.2d (1984),
- b. Entitlement to an extension of the schedule because of a compensable or excusable delay is essential.
- c. Acceleration due to concurrent delays may not be compensable. *Kingston Bituminous Prod., ASBCA Nos. 9964 & 10902, 67-2 BCA ¶ 6638 (1967)*.

## **B. Effects of Acceleration**

- 1. Examples:
  - a. Increased manpower.
  - b. Overtime/multiple shifts.
  - c. Overlapping or stacking of trades.
  - d. Additional equipment.
- 2. May not necessarily increase costs, but multiple methods of measuring.

## **C. Measuring Affect of Acceleration and Other Schedule Variables Such as Weather, Project Mismanagement, Subcontractor-Related Problems, etc...)**

- 1. Trade stacking: crowded work areas U.S. Army Corps of Engineers, Modification Impact Evaluation Guide: "Crowding occurs when more workers are placed in a given area than can function effectively."
  - a. Assumes original manpower was optimum
  - b. Not known if study based on empirical data.
- 2. Increased manpower: overmanning. National Electrical Contractors Association, "Manual of Labor Units"
  - a. Estimating guide.
  - b. Specific to electrical contractors.
- 3. Changed work and change orders; Leonard Study (Charles A. Leonard, "The Effects of Change Orders on Productivity") suggests a correlation between loss of labor productivity and the percent of change order hours to total contract hours.

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- a. Limited sample size over various types and sizes of projects.
- b. Assumes contract hours were optimum.
4. Learning Curve and other Impacts; Mechanical Contractors Association (“Estimating Manual”) rates various factors that affect labor productivity:
  - a. Not based on empirical data
  - b. Subjective survey and application
  - c. Using industry guides without verification of actual efficiency losses can be fatal to claim *Capital Elect. Co. GSBICA No. 5316, 83-2 CBA ¶ 16, 548 (1983)*.
  - d. There must be some reasonable and accepted methodology for calculating inefficiency. *John E. Green Plumbing & Heating Co., Inc. v. Turner Constr. Co., 742 F.2d 965 (6th Cir. 1984)*; *Nebraska Plastics, Inc. v. Holland Colors Americas, Inc., U.S. Dist. LEXIS 5317 (2004)*; *Natkin & Co. v. R.F. Ball Constr. Co., Inc., 255 Iowa 1156, 123 N.W.2d 415 (1963)*.
  - e. Must look at weather and project characteristics as well (i.e., height of building).
5. Measured Mile analysis compares the unit productivity rate for a defined scope of work in an unimpacted period with the unit productivity rate of an accelerated or impacted period. *Internat’l Terminal Oper. Co., ASBCA No. 18118, 75-2 BCA ¶ 11, 470 (1975)*.
  - a. Preferred and most cited method, but requires proper application. *E.C. Ernst, Inc. v. Koopers Co., 476 F. Supp. 729 (W.D. Pa. 1979)*; *Natkin & Co. v. George A. Fuller Co., 347 F. Supp. 17 (8th Cir. 1980)*; *U.S. Industries, Inc. v. Blake Constr. Co., Inc., 671 F.2d 539 (D.C. Cir. 1982)*; *ASBCA No. 89-148-1, 92-2 BCA (CCH) ¶ 24,931 (1992)*; *Clark Concrete Contractors, Inc. v. Gen. Services Admin., GSBICA No. 14340, 99-1 BCA (CCH) ¶ 30,280 (1999)*.
  - b. Relies on performance data.
  - c. Project specific.
  - d. Must be some cataclysmic event.
  - e. Activities must be nearly identical.
  - f. Generally duration of periods compared must be the same *U.S. Ind. v. Blake Constr. Co. 671 F.2d 539 (D.C. Cir 1982)*.
  - g. Recent court decision has broadened the Measured Mile calculation to include comparison of similar work activities and least impacted periods versus impacted periods. *P.J. Dick Corp., VABCA No. 6080, (2001)*; *Clark Concrete Contractors, Inc. GSABCA, 99-1 BCA, 3028*
  - h. May be impossible to perform.
6. Baseline Analysis (alternative to Measured Mile) is the best productivity that the contractor was able to achieve on the project being analyzed. WPL Publishing

Co. Inc., Construction Claims Advisor, Tips, Techniques and Tutorials, the Baseline Analysis by H. Randolph Thomas, Vol. 3, Issue 6, 2005.

- a. Relies on performance data.
  - b. Project specific.
  - c. Does not require any cataclysmic event.
  - d. Not necessary that the reporting periods in the baseline subset are continuous.
7. Earned Value Analysis is used when there is insufficient information concerning physical units work installed on project.
- a. Contractor's estimate or payment applications are used to determine labor hours expended. Once a unit of work can be established it is compared to the actual hours expended during the impacted period. Stumpf, George, R. editor, AACEI Professional Practice Guide to Earned Value, AACEI Morgantown, WV, 1999; Donald J., Earned Value Programs for DOE Projects, Cost Engineering, Vol. 42, No. 3, February 2000.
  - b. Project specific.
  - c. Relies on money expended or budgeted.
8. Work Sampling Method is "an application of random sampling techniques to the study of work activities so that the proportions of time devoted to different elements of work can be estimated with a given degree of statistical information." American Institute of Industrial Engineers, American National Standard Z-94.11, Industrial Engineering Terminology 11-20 (1989).
- a. Expert draws comparisons of productivity before and after impacted period.
  - b. Relies on performance data.
  - c. Project specific.
9. Comparable Work Study (Two methods)
- a. Not project specific.
  - b. First method is to compare an estimate of the productivity lost on the impacted portion of the project with a similar activity that was not impacted on the same project.
  - c. Second method is to compare the productivity of similar work by another contractor whose work was not impacted with that of the work of the contractor during impacted period. *Robert McMullan & Sons, Inc., ASBCA No. 19,929, 76-2 BCA (CCH) ¶ 12,072 (1976).*
  - d. This method is difficult because all activities may be impacted and hard to define "similar work".
10. Comparable Project Study compares the productivity of the work in dispute with similar work in another project.
- a. Not project specific.

**D. Bottom Line**

1. Establish causation through schedule analysis.
2. Calculate impact on time and productivity in a manner that passes the Daubert/  
Kumho test. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579, 113 S. Ct. 2786 (1993); *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 119 S. Ct. 1167 (1999)

## **Questions and Answers**

## **Damage Remedies**

by

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# Damage Remedies

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## **I. Introduction**

This paper discusses several of the damage remedies available for a breach of a construction contract or delay. The topics include:

- liquidated damages
- no damage for delay clauses
- pay when paid clauses
- the Spearin doctrine
- home office overhead damages
- bid-related damages
- attorney fees and interest
- limitations on damage remedies

## **II. Liquidated Damages**

Liquidated damages provisions provide for a pre-determined remedy for a breach of contract or delay in the performance of the contractual obligations. They are an increasingly popular tool to avoid the complexities and unpredictability of proving damages in litigation. "When it is difficult to determine the actual damages which would be suffered under such circumstances and where the determination of the actual damages for a breach are uncertain in their nature, difficult to ascertain, or impossible to estimate with certainty by any pecuniary standard, the courts permit the parties to ascertain the damages for them-

selves and to provide in the contract the amount of damages which will be paid for the breach.” *Solomon v. Dep’t of State Highways and Transp.*, 131 Mich. App 479, 483–484 (1984), citing *Jaquith v Hudson*, 5 Mich. 123 (1858).

Liquidated damages provisions, however, must be reasonable in relation to the possible injuries the party could suffer. *Moore v. County of St. Clair*, 120 Mich. App 335, 340 (1982). In other words, the liquidated damages provision must act as a means of compensation for loss due to the breach rather than as a penalty. The use of the term “penalty” or “forfeit” does not per se make a liquidated damages provision void. Rather, “it will still be held to be stipulated damages, if, from the whole contract, the subject matter, and situation of the parties, it can be gathered that such was their intention.” *Id.* at 341. Likewise, a contract that uses the terms “stipulated” or “liquidated” will not necessarily make a liquidated damages clause valid. If the court determines that the effect of the clause is a penalty, the substance governs over the procedure and the clause will be unenforceable as a penalty.

To determine the reasonableness and validity of the liquidated damages provision, courts look to the intention of the parties when the contract was formed, not at the time of the breach or enforcement of the contract. *Solomon* at 484. This prospective outlook forces parties to negotiate with each other and formulate a reasonable liquidated damages provision at the time of contracting. Whether or not the liquidated damages provision is enforceable or not is a question of law. *Id.*

There are exceptions to recovery on a liquidated damages clause. If the party seeking to enforce the liquidated damages provision is at all responsible for causing delay in the completion, that party may only recover its actual damages and is not entitled to recover on the liquidated damages provision. *Grand Rapids Asphalt Paving Co. v. Wyoming*, 29 Mich. App. 474 (1971). The general Michigan rule is that liquidated damages provisions are either all or nothing. However, there is authority for the proposition that when the court is able to determine how many days of the total period of delay are attributable solely to the party resisting enforcement of the liquidated damage provision, the court will enforce the provision with respect to those days. *In re Construction Diversification, Inc.*, 36 B.R. 434 (E.D. Mich. 1983).

### III. No Damage for Delay Clauses

No damage for delay clauses are becoming increasingly popular in construction contracts. These clauses generally disallow a party from recovering based on the other party’s delay. In Michigan, a no damage for delay clause is generally enforceable. *Phoenix Contractors, Inc. v. General Motors Corp.*, 135 Mich. App. 787, 792 (1984). A typical no damage for delay clause will expressly deny actual damages for any delay caused by the owner, other subcontractors, or natural impediments such as floods, fire, or other causes outside the control of the owner.

There are four generally recognized exceptions, however, to the enforceability of no damage for delay clauses in Michigan. These exceptions include situations where the delay (1) was of a kind not contemplated by the parties, (2) amounted to an abandonment of the contract, (3) was caused by bad faith on the part of the contracting authority, or (4) was caused by the active interference of the other contracting party. *Phoenix Contractors* at 792.

Only delays reasonably contemplated by the parties will be enforced. When a contractor signs a no damage for delay clause, courts will imply a prospective, reasonably foreseeable test. *Walter Toebe & Co. v. Dep't of State Highways*, 144 Mich. App. 21 (1985). Otherwise, contractors would bear the burden of potential lengthy or indefinite delays. These delays could inevitably cost the contractor more than it earned from the project. Therefore, in the interest of policy and fairness, contractors are only subject to reasonably foreseeable delays in the construction process.

Delays that amount to an abandonment of the contract will not be enforced. When work performed in connection with a project so greatly exceeds that called for in the contract, courts often hold that the contract itself has been abandoned. *See C. Norman Peterson Co. v. Container Corp. of Am.*, 172 Cal. App. 3d 628 (1985). Once the court rules that the parties have abandoned the contract, either expressly or impliedly, the terms in the contract relating to changes or delays are no longer binding and the contractor may be entitled to recovery for its actual damages. *Dault v. Schulte*, 31 Mich. App. 698 (1971).

Delays caused by the bad faith of the party seeking enforcement of the clause will not be enforced. To constitute bad faith, there generally must be some active interference by the party seeking enforcement that reasonably interferes with the contractor's compliance with the construction contract. *Phoenix Contractors* at 793–794. Passive interference or unintentional acts are not sufficient.

Delays caused by active interference of the party seeking enforcement of the clause will not be enforced. "To find 'active interference' the jury must find that defendant committed some affirmative wilful act in bad faith which unreasonably interfered with plaintiff's compliance with the contract." *Phoenix Contractors* at 794. The courts are unwilling to let a malicious owner benefit from its own intentional wrongdoing when the contractor is attempting to comply with the contract.

Because no damage for delay clauses may yield harsh results, no damage for delay clauses are strictly construed. *John E. Green Plumbing & Heating Co. v. Turner Constr. Co.*, 742 F.2d 965, 966 (1984). Courts will enforce the no damage for delay clause, but will only enforce the clause to the extent that the clause specifically mentions the type of delay that occurs. Courts are unwilling to expand the scope of the no damage for delay clause. Additionally, arguments of waiver, estoppel, or first to breach may also be possible methods by which to avoid the no damage for delay clause.

#### IV. Pay When Paid Clauses

Pay when paid clauses are becoming increasingly popular in construction projects involving general contractors. These clauses are important to the unpaid subcontractor seeking payment from the general contractor. If the court upholds the pay when paid clause, the subcontractor will not be paid until the general contractor receives payment.

If the pay when paid clause in a contract is not worded to be an express condition precedent to the contractor's obligation to pay the subcontractor, the majority of courts have ruled that the clause postpones the obligation to pay the subcontractor for a reasonable time after the work has been completed. *Thos. J. Dyer Co. v. Bishop International Engineering Co.*, 303 F.2d 655 (6th Cir. 1962) (this case is not interpreting Michigan law).

Where the language of the subcontract clearly indicates that payment to the contractor is a condition precedent to the contractor's duty to pay the subcontractor, such language

will be honored by the courts. *Christman Co. v. Anthony S. Brown Dev. Co.*, 210 Mich. App. 416 (1995). Such clauses containing condition precedent language are sometimes referred to as pay-if-paid clauses to differentiate them from the ones into which may be read a reasonable time element. Unless the contract expressly limits the condition precedent to a “reasonable time,” the pay when paid clause will be fully enforced to preclude payment to the subcontractor until the contractor is paid, if ever. *Id.*

Thus, pay when paid clauses are strictly construed. If they are ambiguous as to time or scope, the courts may insert a reasonable time into the contract. However, if the pay when paid clause is clear and unambiguous regarding its scope, the courts will enforce the clause as written. In that case, the subcontractor will be precluded from receiving payment until the contractor is paid. Furthermore, any unambiguous time restrictions will be enforced unless the contract expressly limits the time period to a reasonable time.

## V. Spearin Doctrine

The Spearin doctrine is a judicially created mechanism to protect contractors. The Spearin doctrine provides that a contractor who follows an owner’s defective specifications or plans will not be liable for the resulting loss or damage. *United States v. Spearin*, 248 U.S. 132 (1918). There are two central implied warranties developed under Spearin: (1) the plans and specifications are accurate and (2) the plans and specifications are appropriate for their intended use.

In *Spearin*, the court held that the contractor was not liable for damages to the sewer system when the contractor followed the plans and specifications of the owner. The contractor contracted to build a dry-dock for the U.S. Government. The government provided the plans and specifications for the movement of a section of the sewer system. A year after the contractor moved the sewer as specified, but before the completion of the dry-dock, the sewer flooded and burst. The flooding caused damage to the area where the dry-dock was to be located. Because the contractor followed the government’s plan and specifications for the movement of the sewer system, and the government failed to provide for the dam, the government breached its implied warranty to the contractor. *Id.*

The Spearin doctrine has been used not only as a shield against liability, but also as a sword for contractors to recover damages from the owner, based on the implied warranty. See *Valentini v. City of Adrian*, 347 Mich. 530 (1956); *Hersey Gravel Co. v. State Highway Dep’t*, 305 Mich. 333 (1943). However, the Spearin doctrine does not apply to the plans and specifications of a registered design professional. See *Chapel v. Clark*, 117 Mich. 638 (1898).

## VI. Home Office Overhead Damages

The Eichleay Formula came about in 1960 as part of the Armed Services Board of Contract Appeals Decision in *Eichleay Corp.*, 60-2 BCA (CCH) 2688 (1960), *aff’d on rehearing*, 61-1 BCA (CCH) 2894 (1960). The Eichleay Formula determines the contractor’s or subcontractor’s extended home office overhead damages. Extended home office overhead costs are those overhead costs of the company which are incurred after the date on which a particular project should have been completed. To be recoverable, there must exist a compensable delay in connection with the project itself. Once this delay is established, courts have recognized the contractor’s or subcontractor’s right to recover a certain percentage of the costs incurred in connection with operating the business as a whole.

*Damage Remedies*

Because of the difficulty in allocating the fixed home office overhead costs to a particular project, but recognizing the contractor's right to compensation, the Board adopted the following formula for allocating such expenses:

- |   |   |  |
|---|---|--|
| (1) <u>Total Contract Billings</u><br>Total Contract Billings for<br>Actual Contract Period | x Total Office Overhead<br>For Actual Contract Period | = Home Office<br>Allocable To<br>Contract              |
| (2) <u>Allocable Home Office<br/>Overhead</u><br>Actual Days of Contract<br>Performance     | =   | Daily Home Office<br>Overhead Allocable<br>to Contract |
| (3) Daily Home Office<br>Overhead Allocable to<br>Contract                                  | x Number of Days of Delay                             | = Extended Home<br>Office Overhead<br>Damages          |

The basic assumption integral to the recovery of extended home office overhead is that the contractor or subcontractor has some right to expect to recover a certain percentage of his fixed home office costs in connection with each project. If there is a delay in completing the project, the contractor or subcontractor should recover the continuing fixed costs that rise in proportion to the increase in time to complete the project. For example, for each additional day of delay, there are increased costs associated with salary, rent, insurance, etc. Because these costs accumulate for each day of delay, the contractor or subcontractor should recover a portion of those increased costs.

The original Eichleay Formula has been approved by at least one court. In *Capital Elec. Co. v. U.S.*, the United States Court of Appeals for the Federal Circuit held that a contractor was entitled to recover damages for extended overhead and ruled that the Eichleay formula (as depicted above) was the appropriate formula to measure the damages for extended overhead. *Capital Elec.*, 729 F.2d 743 (Fed. Cir. 1984). While recognizing that the formula is not a precise measure of overhead damages, the *Capital* court nonetheless relied on it. Other courts disfavor the Eichleay formula in determining home office overhead damages and restrict it to limited circumstances. See *P.J. Dick, Inc. v. Principi*, 324 F.3d 1364 (Fed. Cir. 2003).

**VII. Contractor's Recovery of Costs Not Contemplated  
by Its Bid Due to a Mistake**

Where a contractor discovers a mistake in its bid after performance has begun which increases its cost of performance, its legal remedy to recover those costs is through an action for reformation of the contract on the grounds of mutual mistake or fraud. However, a court of equity cannot reform the contract to provide for the excess costs unless the mistake is common and mutual to both parties. *Blue Water Excavating Co. v. State Highway Comm'r.*, 4 Mich. App. 266 (1966).

Even where the defendant owner is aware of the possibility of the contractor's mistake, the owner's failure to call the mistake to the attention of the contractor will not constitute fraud sufficient to justify reformation of the contract:

The defendant was not required to act for the protection of the plaintiff's interest. The city's interest was conflicting and the parties were bargaining for a price. It is the plaintiff contractor which submits the bid, wins and signs the contract at the amount given therein for the work to be done, which risks any resultant loss. The city is entitled to the bargain obtained in accepting the lowest bid. It is under no obligation to examine the bids to ascertain errors and to inform bidders thereof. The city's interest is to obtain and accept the lowest bid from a contractor financially responsible and otherwise competent. The city's obligation is to itself and the public interest to save money by getting low bids, and where the above conditions are met the immediate obligation is at an end. *Id.* at 274.

It should be noted that the decision in *Blue Water, supra*, was based, at least in part, upon the court's concern for policy considerations in the context of a contract with a public entity. In reaching its decision the court stated:

The effect of this decision is a reaffirmation of the rationale and its manifestation in holdings involving public contracts which, in keeping with considerations of public policy, denies relief to successful low bidders on unambiguous, written, competitive bidding contracts after performance has begun, where the mistake for which relief is sought is attributable solely to the plaintiff contractor. *Id.* at 277-78.

Where the following circumstances are present, a court may grant rescission of a contract based upon a bid containing a substantial error:

Where the mistake is of so fundamental a character that the minds of the parties have never, in fact, met, or where an unconscionable advantage has been gained, by mere mistake or misapprehension; and there was no gross negligence on the part of the plaintiff, either in falling into the error or in not sooner claiming redress; and no intervening rights have accrued; and the parties may still be placed in *statu quo*; equity will interfere, in its discretion, to prevent intolerable injustice. *Kutsche v. Ford*, 222 Mich. 442, 449 (1923).

### **VIII. Damages for Wrongful Rejection of a Low Bid**

For a Federal Project, a contractor which has been wrongfully denied a federal government contract following the bidding process generally has no cause of action against the government for lost profits or other damages. See, generally, *Highway Paving Co. v. Hausman*, 171 F. Supp. 768 (E.D. Pa. 1959). In *Highway Paving*, however, the Court held that the aggrieved bidder had stated a cause of action against the government officials who awarded the contract for malicious interference with the plaintiff's right to secure a contract.

Under The Competition in Contracting Act, 31 U.S.C. § 3553, a bidder which has been wrongfully denied a federal government contract may be able to recover costs incurred in prosecuting a protest including attorney fees and/or bid proposal and preparation costs.

Likewise, in a bid protest case, the United States Court of Claims can award protest costs and bid and proposal preparation costs. *Sterlingwear of Boston, Inc. v. United States*, 11 Cl. Ct. 517 (1987). See also *McCarty Corp. v. United States*, 204 Cl. Ct. 768 (1974). The Court does have the authority to award costs and attorney fees. *Essex Electro Engineers, Inc. v. United States*, 4 Cl. Ct. 463 (1984). The Court of Claims, however, will not award lost profits. *Space Age Engineering, Inc. v. United States*, 2 Cl. Ct. 741 (1983).

For a State Project, when a governmental entity wrongfully refuses to accept a low bid, other than any administrative remedies which may be available, the injured contractor does not appear to have a remedy for damages or otherwise. Once the contract has been awarded and performed, the injured contractor has no right to recover damages from the state entity resulting from the loss of the contract. The Michigan Supreme Court has held that the State's duty to award the contract to the low bidder runs to the citizens of the state and not to the contractor. *Talbot Pav. Co. v. City of Detroit*, 109 Mich. 657 (1896). Likewise, The United States District Court for the Eastern District of Michigan held that not only is an aggrieved bidder not entitled to damages from the governmental entity, the bidder also has no standing to enjoin award of the contract. *Malan Constr. Corp. v. Board of County Road Comm'rs*, 187 F. Supp. 937 (E.D. Mich 1960). Bid protests may still be made by creative lawyers by bringing the suit in the name of certain taxpayers, but the chances of success of such efforts are uncertain.

In terms of subcontractors, a subcontractor has no enforceable rights against a contractor who has used the subcontractor's bid in formulating a bid to the owner and then refused to issue a subcontract absent something more than a simple request for a bid. *Premier Electrical Constr. Co. v. Miller-Davis Co.*, 422 F.2d 1132 (7th Cir. 1970), *cert. den.*, 400 U.S. 828 (1970). However, when a contractor uses the subcontractor's bid and then notifies the subcontractor confirming that it has the job, but then subsequently employs another subcontractor to perform the work, a breach of contract occurs. In *Soave Constr. Co. v. Lind Asphalt Paving Co.*, 56 Mich. App. 202 (1974), the Court of Appeals, addressing the damage issue only under the above circumstances, held that the subcontractor was entitled to recover lost profits and overhead in the form of wages for employees idled by the loss of work associated with the project.

## **IX. Attorney Fees and Interest**

Attorney fees may be recoverable in construction lien cases. M.C.L.S. § 570.1118 provides:

The court may allow reasonable attorneys' fees to a lien claimant who is the prevailing party. The court also may allow reasonable attorneys' fees to a prevailing defendant if the court determines the lien claimant's action to enforce a construction lien under this section was vexatious. Attorneys' fees allowed under this section shall not be paid from the homeowner construction lien recovery fund created under part 2.

The award of attorney fees to either the plaintiff or defendant is discretionary and the court may award attorney fees whether or not attorney fees are provided for in the contract.

Attorney fees are generally not awarded in bond cases under M.C.L.S. § 129.201 *et seq.* unless the contract expressly provided for attorney fees. *Hub Elec. Co. v. Gust Constr. Co.*, 585 F.2d 183 (6th Cir. 1978). "Contractual provisions for payment of reasonable attorney fees are generally valid. Such fees must be measured by the fair value of the ser-

vices rendered.” *Sentry Ins. A Mut. Co. v. Lardner Elevator Co.*, 153 Mich. App. 317 (1986). Like bond cases, attorney fees in Miller Act cases under 40 U.S.C.S. § 3133 (former 40 U.S.C.S. § 270a *et seq.*) are not generally awarded absent a provision to the contrary. *F. D. Rich Co. v. U. S.*, 417 U.S. 116, 94 S. Ct. 2157 (1974).

In *Erb Lumber Co. v. Homeowner Constr. Lien Recovery Fund*, 206 Mich. App. 716 (1994), the court held that since recovery of interest was expressly stated in the contract, the terms of the contract should govern. The court ruled that the interest was considered part of the cost under the contract. However, where the contract is silent or expressly provides for no interest upon damages, the result is uncertain. In *Smalley v. Gearing*, 121 Mich. 190 (1899), the court held that the lien claimant was entitled to interest. While this case has not been overruled, there are several cases that question the validity of the ruling. The uncertainty stems from the lack of statutory authority as the construction lien act is silent on the subject of interest.

## X. Limitation of Damage and Remedy Provisions

Limitation and exclusion of various types of damages are common in the contracts of construction material suppliers and are facilitated by the provisions of the Uniform Commercial Code as adopted by the State of Michigan as well as by Michigan case law.

The agreement itself can limit or alter the measure of damages and can limit the buyer’s remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods. M.C.L.S. § 440.2719(1)(a). The comments to this section caution that there must be at least a fair remedy available for the limitation to be valid. If there is not at least a “fair quantum” of remedy available so as to be unconscionable, the court will strike the clause as if it never existed.

Consequential damages can also be limited or excluded unless the limitations or exclusions would be unconscionable. M.C.L.S. § 440.2719(3). The comments to this section state that such terms are merely an allocation of unknown or undeterminable risks. The seller is always free to disclaim warranties under the applicable sections of the Uniform Commercial Code.

In general, the exclusion of certain remedies and the limitation of damages allowed by a contract for the purchase and sale of construction materials is valid unless the remedy provided by the contract fails of its essential purpose. The remedy which is provided for will not fail of its essential purpose under the code unless “unanticipated circumstances cause the seller to be unable to provide the buyer with the remedy to which the parties agreed.” *Price Bros. Co. v. Charles J. Rogers Constr. Co.*, 104 Mich. App. 369, 374 (1981). Thus, “even if the contracted for remedy is, in fact, no remedy at all, it has not necessarily failed of its essential purpose.” *Id.* at 374.

Under certain circumstances, however, the limitation or exclusion of remedy and damage provisions of a contract may themselves be unconscionable and, if so found, will be unenforceable. This will occur only when the provisions, or the contract as a whole, are found to be both “substantively” and “procedurally” unconscionable. *Northwest Acceptance Corp. v. Almont Gravel, Inc.*, 162 Mich. App. 294, 302–303 (1987).

# **Using Insurance Coverage to Fund Defense and Settlement Costs**

by

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# Using Insurance Coverage to Fund Defense and Settlement Costs

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## **I. Types of Policy Coverage**

### **A. Commercial General Liability (CGL) Coverage**

#### **1. In General.**

The standard form of CGL policy includes the usual policy declarations setting forth the insured’s name and address, the type of business it is, the form of coverage applicable, the limits of coverage for the different coverages, the annual premium and the policy term. Another section of the policy sets forth common policy conditions, including such obligations of the insured as providing notice in the event of claim and cooperating with the insurer in the defense of a claim. There are different forms of a CGL Policy that have been developed and placed in use over the years. It will be important to review the entire policy anytime there is a coverage issue.

The CGL Policy contains an insuring agreement that identifies the scope of coverage as well as exclusions from coverage (and exceptions to certain of the exclusions). The purpose of the exclusions is to narrow the scope of coverage that would otherwise be available under the insuring agreement. The policy may also include endorsements that operate to modify the scope of coverage available.

Most CGL policies are on an occurrence basis. A policy written on an occurrence basis provides coverage for all injuries and damages that occur during the policy period. Thus, claims can be made many years after the policy period has expired. Furthermore, if the damages occurred over multiple years a number of policies may provide coverage.

#### **2. Insuring clause of the Policy.**

The CGL Policy typically provides a broad grant of insurance coverage providing that the insurer will pay “those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies.... This insurance applies to ‘bodily injury’ and ‘property damage’ only if ... [such] is caused by an ‘occurrence’ that takes place in the

‘coverage territory’ and [t]he ‘bodily injury’ or ‘property damage’ occurs during the policy period.”

Key terms in the insuring agreement include “bodily injury”, “property damage” and “occurrence.”

**Property damage** is typically defined in CGL policies as “physical injury to or destruction of tangible property” or the “loss of use of tangible property.” If the only damages claimed are consequential, such as lost profits, no coverage can be afforded. However, coverage will be provided for consequential damages if there was also damage to tangible property. *Dimambro-Northend Associates v. United Construction, Inc.*, 154 Mich App 306, 397 NW2d 547 (1986), *affirmed on appeal*, 428 Mich 893, 1987 Mich LEXIS 7782 (1987).

Examples of “property damage” in decided cases include the following:

- Removal and replacement of a concrete floor in which a defective radiant tube was placed, *Bundy Tubing Co. v Royal Indemnity Co.*, 298 F.2d 151 (6th Cir. 1962).
- Damage to the interior of a building due to a leaky roof, *Calvert Ins. Co. v. Herbert Roofing & Insulation Co.*, 807 F. Supp. 435 (E.D. Mich. 1992).
- Damage to a mobile home as result of structural defects, *Radenbaugh v Farm Bureau Gen. Ins. Co.*, 240 Mich. App. 134; 610 N.W.2d 272 (2000).
- Fire damage to a tunnel under construction and construction equipment. *Diamambro-Northend Assoc. v United Constr., Inc.*, 154 Mich. App. 306; 397 N.W.2d 547 (1986), *affirmed on appeal*, 428 Mich. 893, 1987 Mich. LEXIS 7782 (1987).

An **occurrence** is that which is typically thought of as an “accident” An occurrence is typically defined in the policy as “an event or series of events that result, during the policy period, in property damages neither expected nor intended from the standpoint of the insured.”

“[W]hether something is an ‘accident’ within the meaning of the standard liability policy depends in part upon whether the resulting damage is unforeseen and unexpected *by the person injured or affected thereby.*” *Calvert Ins. Co. v. Herbert Roofing & Insulation Co.*, 807 F. Supp. 435 (E.D. Mich. 1992).

### 3. **Exclusions to policy coverage.**

When a claimed loss falls within the scope of the insuring agreement, it is not covered if it also falls within one or more of the policy **exclusions**. *Fresard v Michigan Millers Mut. Ins. Co.*, 97 Mich. App. 584, 296 N.W.2d 112 (1980), *affirmed on appeal*, 414 Mich. 686, 327 N.W.2d 286 (1982).

Typical exclusions include:

- Expected or Intended.

The policy will typically exclude coverage for conduct of the insured which was expected or intended to cause damage. Conduct of the insured that is intentional, such as fraud or intentional misrepresentation, will not be

covered under the policy; negligent conduct will be. *Western Casualty & Surety Group v. Coloma Twp.*, 140 Mich. App. 516, 364 N.W.2d 367 (1985).

- **Named Insured's Work.**

A CGL policy provision will often exclude "property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof or out of materials, parts, or equipment furnished in connection therewith." If, for example, a contractor builds an office building and the roof later collapses, coverage is not available for the cost of repairing the collapsed roof because the damage is property damage to the work performed by the insured contractor or on behalf of the named insured.

*Hawkeye-Securing Ins. Co. v. Vector Const. Co.*, 185 Mich. App. 369, 460 N.W.2d 329 (1990). On the other hand, coverage should exist for the defense and payment of a claim by the owner whose office furniture was damaged as a result of the roof collapse. *Calvert Ins. Co. v. Herbert Roofing & Insulation Co.*, 807 F. Supp. 435 (E.D. Mich. 1992).

- **Faulty workmanship.**

The CGL policy may exclude coverage for the cost of "restoration or repair or replacement of which has been made or is necessary by reason of faulty workmanship thereon by or on behalf of the insured."

"Where a contractor's workmanship is faulty, this faulty workmanship exclusion unambiguously excludes coverage as to damage to the particular part of property with regard to which the workmanship was faulty. But it does not exclude coverage as to damages to property other than the particular part of the property with regard to which the workmanship was faulty." *Underwriters at Interest vs. SCI Steelcon*, 905 F. Supp. 441 (W.D. Mich. 1995)

- **Contractually Assumed Liability**

As a general rule indemnity agreements included in the insured's contracts are excluded unless specific endorsement obtained. Insurance is not intended to guarantee contractual performance but to provide protection against risk.

- **Owned Property.**

The CGL Policy will exclude coverage for property owned by, rented by, loaned to insured, or otherwise in the insured's custody or care.

- **Pollution.**

#### **4. Exceptions to Exclusions.**

After setting forth various exclusions the GCL Policy will set forth exceptions to the exclusions. If the matter alleged falls within the scope of an exception to the exclusion, there will be coverage under the policy.

For example, an exception to the contractual liability exclusion provides coverage where the liability of the insured arises out a "warranty of fitness or quality of the named insured's products or a warranty that work performed by or on behalf

of the named insured will be done in a workmanlike manner.” An exception to the named insured’s products exclusions provides coverage for active malfunctioning.

In *Fresard v Michigan Millers Mut. Ins. Co.*, 97 Mich. App. 584, 296 N.W.2d 112 (1980), *affirmed on appeal*, 414 Mich. 686, 327 N.W.2d 286 (1982), the decision of the court of appeals was affirmed by an equally divided supreme court, which held that coverage was provided to a builder under a CGL policy. In this case, the building had installed a drainage system for a house that was unsuitable for the abnormal soil conditions. As a result, the foundation deteriorated, the floors collapsed, and the walls caved in. The insurer argued that each of three different exclusions barred coverage. These included the contractual liability exclusion, the named insured’s products exclusion, and the named insured’s work exclusion. The court held that the loss did not fall within the exclusions or that, if it did, the exceptions to the exclusions brought the loss within coverage.

#### 5. **Defense Costs.**

The amount expended in defense of a claim covered by a CGL policy does not reduce the amount of coverage limit payable under the policy.

### **B. Builder’s Risk Coverage**

1. Covers construction work and items to be incorporated into the construction work during the period of construction. Often there will be three year completed operations coverage.
2. Excludes faulty design and workmanship, but includes damage caused by such workmanship or design.
3. Business interruption option covers interruption caused by damage to or direct physical loss of the covered property.

### **C. Professional Liability Coverage**

1. A professional liability policy (also referred to as an Error and Omissions or E&O Policy) may provide coverage for the failure of project professionals to provide services consistent with the applicable standard of care. E&O coverage may exist in favor of the architect, engineer, construction managers, technical consultant and other/or other professional service providers.
2. Most professional liability policies are issued on a “claims made” basis. A policy written on a claims made basis only covers claims made between the beginning date of the policy period (or an earlier, retroactive date) and the termination date of the policy period. *Stine v Continental Casualty Co.*, 419 Mich. 89, 349 N.W.2d 127 (1984).
3. A provision known as a “tail” can be added to a claims-made policy to extend the period of time within which a claim may be reported and covered. There are two types of tails. A *basic* tail permits the insured to give notice to the insurer within a certain period after the policy has expired. After this notice has been given, the claimant has additional time to file a formal claim. A *supplemental* tail covers

claims received and made after the basic tail has expired. *See Drutchas & Perry, Claims-Made Insurance: A Primer of Benefits and Pitfalls*, 67 Mich. BJ 127 (1988) for a more detailed discussion.

4. Professional liability policies typically only require a “loss” to trigger coverage. The loss need not be property damage or physical injury but may include losses incurred by delay or loss of functionality, as well as physical damage.
5. The amount of insurance coverage available is affected by insurance company’s expenditures for defending the insureds are depleted by defense costs. The amount of policy funds available are depleted by defense costs.
6. The amount of coverage maintained by many professionals in the construction industry is often not adequate to provide full coverage for larger claims. Due to the inherent nature of a personal services firm and its lack of tangible assets, the firm may determine that it is not willing to absorb the cost of significant E&O coverage. For some smaller firms, such as minority business enterprises, the cost of E&O coverage may be prohibitive.
7. On larger projects there may be a **project specific policy** to provide coverage. Such a policy may provide coverage for all professionals involved in providing services with respect to the construction of the project. For example coverage may be afforded to the owner’s project manager, the construction manager, architects, engineers and other consultant’s providing professional services to the project.
8. A project specific policy will typically provide the first level of coverage for any claims. The various design professionals may also be required to provide their own E&O coverage which will typically provide a second level of recovery in the event that the project specific policy is inadequate to fund payment of fees and any settlement or judgment.

#### **D. Other Types of Coverages Which May Be Available**

1. **Environmental Coverage** may be available. This coverage will be triggered when cost overruns are incurred above a specified amount (“attachment point”). The coverage does not cover third parties.
2. **Pollution Legal Liability Coverage** covers third party liability claims and some limited first party cleanup. There is a great deal of variety in the policy forms.
3. **Contractor’s Pollution Liability Coverage** is operation specific, covers both third party liability claims and first party cleanup and requires extensive underwriting.

#### **E. Delayed Completion and Force Majeure Insurance**

Delayed Completion and force majeure coverage may exist for losses not traditionally covered under CGL policies.

#### **F. Inherent Defect Insurance**

Inherent defect coverage may exist for damage to structures caused by faulty design.

### **G. Subcontractor Performance Insurance**

Subcontractor Performance insurance is an insurance product attempting to compete with Payment & Performance surety bonds. This is a relatively new product with an incomplete claims history.

### **H. Design/Build Coverage**

If the delivery mechanism is a design build contract, there may be design/build coverage of claims against the contractor/design-builder for professional liability type claims.

## **II. OCIP/CCIP/DCIP Wrap Up” Coverage**

An Owner Controlled Insurance Program (OCIP), Contractor Controlled Insurance Program (CCIP) or Developer Controlled Insurance Program (DCIP) will provide coverage to all or various of the project participants. The advantages of this single source of coverage includes the ability to negotiate cost of coverage for all entities at once, control over risk management, fewer suits between participants in the project, faster and fewer cost to claims resolution, and insurance coverage not otherwise available.

There are statutory limitations on using OCIPs or CCIPs in Public Works Projects.

## **III. Practice Pointers**

- A. Getting Certificates and Policies Before a Problem Arises.
- B. Understand What Is Available from All Participants.
- C. Obtain discovery of all existing policies early in case.
- D. Compliance with notice requirements/ Notice-Prejudice Rule
- E. Defense cost voluntarily incurred.
- F. A good resource tool for understanding insurance coverage issues is *CGL/Builder’s Risk Monograph* (American Bar Association. Torts Trial & Insurance Practice Section. 2004)

# **The Roles of Experts in Construction Litigation**

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# The Roles of Experts in Construction Litigation

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## **I. Requirement and Role of Expert Witness**

- A. The uses of an expert witness in a construction case might include testimony about any one or more of the following:
1. Delays in the critical path of the scheduling of the work;
  2. Subsurface conditions;
  3. Defects in Construction;
  4. Defects in Design;
  5. Damages suffered by the contractor in the form of additional general conditions, field office and home office overhead;
  6. Cost Accounting Issues, such as analysis of job cost reports;
  7. Damages for cost of repair or reconstruction;
  8. Difference in value between structure as built compared to value structure would have had if construction had not deviated from plans and specifications.
- B. A commercial construction case can be highly complex and require a wide variety of experts to testify, such as schedulers, architects, engineers, construction costing accountants, cost estimators, contractors and forensic professionals.
- C. If the claim involves a breach of the duty of care, an expert will likely be required to establish the applicable standard of care and breach of the duty of care. An expert will be required to establish that the party claimed liable departed from the standard of care and the consequences of the departure from the standard of care. The key testimony to be provided by the expert includes the following:
1. “What is the standard of care which the professional (construction manager, architect, engineer, etc) was required to comply with?”
  2. How is the standard of care established?

3. Are there applicable standards which apply to create the standard of care?
  4. Did the professional comply with the applicable standard of care?
  5. What were the consequences of the failure of the professional to comply with the applicable standard of care?
- D. The standard of care may be established by statute, common law or the terms and conditions of the contract documents. For example, the contract documents may impose an obligation upon a design professional to adhere to a particular level of care, which may differ from that which might exist under common law.
- E. Federal Rule of Evidence 702 requires that the expert possess specialized knowledge, skill, experience, training or education which will assist the trier of fact to understand the evidence or determine factual issues.
- F. The need for a variety of consultants and professionals to assist in pursuing and defending construction claims can result in very substantial cost and expense to the client. The attorney will want to put in place a mechanism and procedure to maximize the effective use of the experts and to manage the costs of the expert testimony.
- G. In order to effectively manage the case and the costs of the case the attorney should consider the following.
1. Enter into a written retention agreement with the expert.
  2. Manage the nature of the data and other information transmitted to the expert.
  3. Have a clear understanding of the nature of information which should be communicated verbally and that information which should be communicated in written form.

## **II. The Retention Agreement**

- A. The key points to consider including in a retention letter include the following:
1. Identify who is retaining the expert. In most instances the lawyer will want to retain the expert, as opposed to the client. Retention by the lawyer may provide a greater level of protection from discovery of the expert's work product than retention by the client.
  2. Define the scope of the services and work to be undertaken by the expert. Identify the expert as an independent contractor.
  3. State the method of compensation of the expert. This may consist of a fixed fee or payment based upon an hourly rate. A contingent fee agreement may not be used with a testifying expert. A schedule of the hourly fees to be charged by types of professionals and staff in the expert's firm can be attached to the retention letter.
  4. Identify any key deadlines for deliverables, including the dates for any preliminary or final expert witness reports.

5. Define responsibility for payment of the expert's fees and costs. It is permissible for the lawyer to retain the expert but require the expert to look to the client for payment. The client should sign off any agreement to be responsible for direct payment to the expert.
6. If there is any concern about the ability or willingness of the client to pay for the expert services, the expert should be encouraged to seek a retainer commensurate with the anticipated fees of the engagement.
7. Define the nature of the information to be included in the expert's billings. Many experts will only include in their billings a very general description of the work performed, the identity of the service provider, and the hourly rate. You should consider that the billings of the testifying expert may be subject to discovery. This may require consideration of the competing considerations of the need for adequate disclosure of the work performed to approve payment versus the possibility that the billings will be subject to discovery.
8. Consider the need for a budget of fees and costs with a number not to exceed without further direction.
9. Confirm that the expert does not have any material conflicts of interest and include a requirement that the expert advise of any conflicts which might arise at a later date. It is important to recognize that experts and consultants are not governed by the strict conflict of interest rules which apply to a lawyer.
10. Consider the need for the expert to have insurance coverages. If the expert will be conducting any type of destructive testing or entering upon premises you may want to verify that the expert has adequate CGL policy coverage and it may be appropriate to obtain an indemnity with respect to any damages suffered by a third party as a result of any property damage or personal injury arising out of the activities of the expert.

### **III. Providing Data and Other Information to the Expert**

- A. In order to make effective use of the expert it is important to confer with the expert in order to determine the nature of the documents, data and other information which the expert will be required to review in order to provide a professional opinion.
- B. Construction cases are often document intensive. There may be thousands (or hundreds of thousands) of pages of documents. These include the following:
  1. The contract documents, including the construction contract, any construction management agreement, the general terms and conditions of the contract for construction, any supplementary terms and conditions, the plans and specifications, and addenda.
  2. Documents related to changes in the scope of the work such as requests for change orders, change orders, and supporting documentation, change order logs

3. Payment applications, certificates of completion, waivers and supporting documents;
  4. CPM Schedules (typically in electronic format, such as Primavera).
  5. Requests for information (RFIs) and similar documents seeking clarification of the work and RFI logs
  6. Meeting minutes of meetings involving the owner, contractor or construction manager, trades and design professionals;
  7. Inspection and testing reports.
  8. Correspondence and electronic communications.
- C. In managing the case it will be important to implement a cost, efficient document management system. This can be accomplished through scanning and OCR imaging of the documents and creation of a database with the use of a numbering system. The identifier can be used to identify the source of the document. Use of a database will permit counsel to maintain a good record of the source of documents and to keep a record of the documents which have been supplied to opposing parties. There may be a cost saving achieved through an agreement to create a common data base for use of all the parties.
- D. Documents can be provided to the expert in electronic format. However, recognizing that any data or documents provided to a testifying expert are potentially subject to discovery it is important to make certain that a privilege review has been conducted and necessary redaction made as to privileged information, prior to supplying such documents to the expert

#### **IV. Consulting Experts and Testifying Experts**

- A. A consulting experts is used to assist in the development of the claim or defense but will not be called to testify in the case.
- B. There are significant limitations upon an opponent's ability to discover the identity, existence and work product of a consulting expert. Federal Rule of Civil Procedure 26(b)(4) allows discovery of a non-testifying expert only upon a showing of exceptional circumstances under which it is impracticable for the party seeking discovery to obtain facts or opinion on the same subject by other means. Since in most instances the other party will be able to obtain its own expert, such discovery will not be permitted.
- C. The non-testifying expert can be used to identify areas where it would be helpful for the testifying expert to focus and to assist counsel in identifying strong points and weak points in the case. In order to maximize the ability to preserve the privilege associated with the non-testifying expert it would be helpful for the non-testifying expert to avoid direct communications with a testifying expert.

- D. Counsel will need to be extremely careful in communicating with the testifying expert as any such communications may become subject to discovery unless determined to be subject to work product protection.
- E. In order to minimize required disclosures it may be to the benefit of all counsel in a case to agree upon limitations upon the nature of the discovery that can be obtained from the expert and to maximize protection of each counsel's respective work product privilege.

## **V. The Expert Report**

- A. In most instances counsel will likely want to obtain a written report which sets forth the opinions to which the expert will testify and the facts and supporting material upon which the opinion is based.
- B. Under the Federal Rules of Civil Procedure an expert report is required under Rule 26(a)(2)(B). The report must contain:
  - 1. A complete statement of all opinions the witness will express and the basis and reasons for them.
  - 2. The data or other information considered by the witness in forming the opinions.
  - 3. Any exhibits that will be used to summarize or support them.
  - 4. The witness's qualification, including a list of all publications authored in the previous 10 years.
  - 5. A list of all other cases in which, during the previous 4 years, the witness has testified as an expert at trial or by deposition.
  - 6. A statement of the compensation to be paid for the study and testimony in the case.
- C. Many complex construction cases will be subject to arbitration, typically under the Construction Industry Arbitration Rules of the AAA. In such cases the parties often reach an agreement with the assistance of the arbitrator as to the nature and scope of discovery to be provided with respect to experts. In the context of an arbitration it would not be unusual to limit discovery to exchange of expert reports with examination of the expert to await the arbitration hearing.
- D. Many complex construction cases involving a battle of the experts and highly technical issues. In some instances the arbitrator(s) may suggest or be agreeable to use of a procedure which allows the experts to testify and to exchange in a dialogue with each other and the arbitrators. This can be a very effective means of resolving the dispute and should be considered. The willingness to use such a procedure will depend upon counsel's assessment of the presentation and other skills and strengths of the expert.

# **Use of Mediation and Arbitration to Resolve Disputes**

by

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# Use of Mediation and Arbitration to Resolve Disputes

## Alternative Dispute Resolution: Current Issues

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|                        |     |
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### **I. Introduction**

Emphasis on alternate dispute resolution:

Mediation, case evaluation, arbitration, mini-trials, dispute resolution boards; early neutral evaluation, initial decision maker (AIA provides architect is initial decision maker; note time limits in contract for demand for arbitration post architect decision). and variants as set forth below.

Expectations and issues of the parties, attorneys and the mediator or arbitrator.

Confidentiality, disclosures (initial and continuing), conflicts, ethics (role of the mediator, amounts, conveying information); unauthorized practice of law;

Disclosures in all cases regardless of ADR technique.

### **II. Mediation**

Can be at any time during a project, pre or post completion.

A. Factors influencing agreement to mediate and outcome.

1. Knowledge of the facts, costs and risk in litigation and assessing those factors as objectively as possible.
2. Desire to avoid risk, costs and time;
3. Expectations of the process (both of the eventual outcome and what is expected of the mediator);
4. Risk aversion, break even, cost analysis.
5. Mandated by court; required by contract as condition precedent to arbitration or mediation.

B. Types of mediation.

1. Traditional single mediator;

2. Collaborative mediation. Multiple mediators with differing areas expertise, typically one mediator with technical expertise;
  3. Meditative-arbitration. The term is used 2 different ways.
    - a. Initially mediate and then arbitrate with same person if mediation fails. Using same person requires a knowing, informed waiver of the conflict arising as the mediator/arbitrator has discussed settlement numbers.
    - b. Agreement to mediate provides that the mediation settlement can be incorporated into a binding arbitration award.
  4. Early neutral evaluation.

Presentation to a neutral, pre or early in the litigation, with the neutral evaluating the case. Non-binding.
- C. Rules:
1. Confidentiality of the discussions. MRE 2.403.
  2. Confidentiality of the mediator.
  3. Good faith. Many contracts require mediation as a condition precedent to arbitration or litigation. Requires meeting of parties. Is condition satisfied if one side refuses to participate?
- D. Drafting Considerations.
1. Locale and which parties must be present.
  2. Time limits, nature of presentation.
  3. Number of mediators (specialties).
  4. Submission and exchange of summaries and exhibits.
  5. Submission of confidential settlement figure and terms.
  6. Allocation of costs.
- E. Ethics
1. What not to expect: deception, misstatements; for example: Have x authority but tell them y; what did they tell you; what do you think it will take when the mediator has been told a number.
- F. Time for mediation
1. During course of project.
  2. Pre-litigation....saves costs.
  3. Post document exchange. Greater knowledge.
  4. Post discovery: costs have been incurred, greatest knowledge; potential that costs incurred preclude settlement.
- G. Techniques.
1. Recognize cathartic nature of any proceeding where a party gets to express their position.

2. Depends on nature of case, agreement of parties.
    - a. stress/assess risk aversion, expectations of the outcome, break even, cost, collectibility.
    - b. Baseball mediation:, parties agree on everything except number, range agreed upon, mediator decide.
    - c. Mediator requested to put number/evaluate.
    - d. Binding mediation/settlement entered as an enforceable arbitration award.
    - e. Meditative arbitration.
- H. Parties.
1. Decision makers must be present.
  2. Governmental and publicly traded companies; must be formally approved.
  3. Insurers/sureties. Must be aware of coverage issues. For example, liability policy typically covers only damage to property because of defective work, not the correction of the defective work.
- I. Settlement agreement.
1. Who is responsible for drafting?
  2. Enforceability.
  3. Outside approval by board of directors or governing body.

### **III. Arbitration**

Statutory or common law. MCL 600.5001, *et seq.*, MCR 3.602. Statutory arbitration provides that judgment may be entered on the award. Reference to rules, eg. Construction Industry Arbitration Rules of the American Arbitration Association is sufficient as the rules provide for entry of judgment on the award. 60 Mich. App. 221, 230 N.W.2d 556. An agreement to arbitrate under common law arbitration may be revoked at any time prior to award.

- A. Advantages—Disadvantages.
1. By contract, so can tailor to own needs and perspective.
  2. Knowledgeable panel.
  3. Faster/more scheduling control.
  4. Scope of award. Rules allow entry of award providing for relief beyond scope of a Court's authority.
  5. Limited appeal.
  6. Cannot by statute be used to determine title to real property.
  7. Can be as costly and time consuming as traditional litigation.

- B. Rules/conduct of the arbitration.
  - 1. No *ex parte* communications.
  - 2. Arbitrator must apply the law and contract.
  - 3. By contract, specify rules and scope of the arbitration, which defines the arbitrator's authority.
    - a. Oath of neutrality/selection and number of arbitrators.
      - i. Single arbitrator.
      - ii. Each party selects an arbitrator with the third neutral being selected by the party appointed.

Without an oath of neutrality a party appointed arbitrator can communicate with the party who appointed the arbitrator.
      - iii. Selected per rules of association administering the arbitration.
- C. Location for hearings; time limits on hearings, examination of witnesses. (Chess clock arbitration, specify time limits for examination of witnesses or presentation of entire case by each party.).
- D. Scope of discovery; depositions allowed, number of depositions, time limit on depositions, exchange of documents.
- E. Allocation of fees and costs; award of fees and costs.
- F. Joinder and consolidation; multiple parties and claims for complete resolution.
- G. Rules of evidence.
- H. Choice of law.
- I. Confidentiality. Arbitrator and mediator must maintain confidentiality. Parties are not bound to confidentiality.
- J. Form of award.
  - 1. Monetary amount only.
  - 2. Reasoned award.
  - 3. Findings and conclusions.
  - 4. High low agreement where the parties agree, without the knowledge of the arbitrator, that the award cannot be less than or greater than an agreed upon amount.
- K. Post award.
  - 1. American Arbitration Association rules provide that post award a decision may only be modified to correct clerical or computational errors.
  - 2. Enforceability of award against third parties; indemnity actions.
  - 3. Enforcement/vacature. MCR 3.602.

*Use of Mediation and Arbitration to Resolve Disputes*

- a. Move to vacate within 21 days; except where corruption, fraud, or other undue means is alleged, 21 days after the grounds are known or should have been known.
- b. Confirm award within 1 year.
  - i. Grounds
    - (a) Corruption, fraud, or other undue means.
    - (b) There was evident partiality by an arbitrator appointed as a neutral, corruption of an arbitrator, or misconduct prejudicing a party's rights.
    - (c) The arbitrator exceeded his or her powers.
    - (d) The arbitrator refused to postpone the hearing on a showing of sufficient cause, refused to hear evidence material to the controversy, or otherwise conducted the hearing to prejudice substantially a party's rights.